WHELAN PARTNERS CONSULTING

Decision making is perhaps the most critical skill that a leader or business owner must possess. Fundamentally decision making is *the job* of a leader. Whether it's allocating resources, hiring or firing, dealing with unexpected events, or setting a vision or direction for the organization, a leader's decision making will influence and often determine the outcome. And yet, developing decision making aptitude is woefully limited in most leadership development and training. Like anything, decision making is a skill that must be cultivated.

The decision-making apparatus that we are imbued with is notoriously limited. While our brains are amazing machines, capable of performing hundreds of times the number of operations per second of the world's fastest super computers, it wasn't specifically designed for long term financial decision making. That's why, despite the brain's significant power, we can end up in a situation where the average American between 55 and 64 only has around $105,000 saved for retirement. We all know that someday we won't be able to work. We also know that the only way to be prepared for retirement is to save and invest significant amounts of our income, and yet we don't.

The field of behavioral finance seeks to identify why we make these kinds of errors. What's been found is that the brain takes short cuts to solve complex problems, particularly when it comes to abstract ideas like money or time. So, while intellectually we know we should save money, instinctually it's not natural and requires intentional decision making. What makes it really challenging is that while these issues are potentially easy to sort out intellectually, they can still be very hard to overcome emotionally, as ultimately you are fighting against yourself.

The first step to better decision making is to understand what kinds of errors you are likely to make. Recognizing those errors, you can begin to identify them in yourself and in your team. It's always easier to recognize someone else's biases than it is to recognize them in yourself, so including others in the conversation can make it easier to identify your own errors.

There are three categories of decision-making errors. They are belief perseverance, information processing and emotional. There is some overlap and one decision can be affected by several of these errors. Ultimately, the point in recognizing the ways we can make errors can help us short circuit them and get back into more intentional decision making.

Belief perseverance errors come from the theory that our minds experience stress when faced with information that contradicts previously held beliefs. In order to combat that stress the brain may take a shortcut, by either ignoring or rejecting that information. For example, many professional services are facing increased competition from technology and automated services. So, while some professionals are proactively addressing the issue by finding ways to cut costs and automate processes, others simply push back and say things like "that won't affect us", or "we run a different kind of business." Unfortunately, those owners who ignore the threat are much more likely to be adversely affected by it.

While the brain can do amazing things, it has its limitations. The brain works around those limitations by taking other shortcuts, that can make us feel like we have greater certainty than we do. These are information processing errors. A great example of this is how difficult it is for us to intuit probabilities. In 2016 popular political statistician Nate Silver predicted Hillary Clinton had a 71.4% chance of winning by the time the election rolled around. Obviously, she did not win and the immediate reaction, indeed the seemingly natural reaction was to assume Nate Silver had been incorrect. However, something that has a greater than 25% chance of occurring can reasonably occur. In fact, if you sit down at a blackjack table, the odds of being dealt a blackjack are slightly less 5%, but that doesn't stop players from risking their money and reasonably hoping that they will see one. So, in one instance, something occurring when it had a 28% chance of succeeding seems to violate our expectations while something occurring with an only 5% probability of succeeding meets our expectations, and actually validates the risk we were willing to take to get it.

Finally, we have emotional errors. These occur when emotions take over our decision making. Most commonly in business you can see things like irrational exuberance, or irrational loss-aversion. Irrational exuberance occurs when a decision maker gets so excited about an idea that he or she fails to fully investigate it and executes it out of that excitement. On the other end of the spectrum you have loss aversion, where a leader is so afraid of loss, that he or she avoids even reasonable risks.

Recognizing an error in yours or a partner's decision making doesn't mean that a decision is incorrect, it simply means that further, fact based investigation is required. You may find that while you were initially avoiding an idea because of an irrational loss aversion, further investigation yields the same conclusion, that is, that the decision is too risky. The best way to use an understanding of these errors is to identify when you might be subject to them and find ways to reduce the effect they have on your ultimate conclusions.