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Don't follow the herd

Decision makers have often been found to copy or mimic the decisions of others

Presented by



Peter Tingling, Professor, Simon Fraser University Business School, Financial Post



ROBERTO SCHMIDT/AFP/Getty Images)

Making the right decisions has long been the hallmark of superior performance - and never more important than now. Indeed, good decision making is as equally relevant to developing a solution for the current economic crisis as it is to the NHL draft. How we make decisions is not only the essence of management, but our ability to make good decisions is often the only difference between success and failure.

Although we know that decision making can be chaotic, opportunistic and intuitive, it is a rare and perhaps brave manager who does not apply formal and rational analysis when making decisions. The real message of Malcolm Gladwell's *Blink* is not that intuition is useful in the detection of art forgeries, but that it is usually the result of years of judgment and largely inadequate for complex financial decisions. Smart managers do not use intuition as a replacement for analysis but as a complement to approaches based upon intelligence-design-choice where rationally analytic methods are used to assess alternatives.

Commonly taught in business schools, sophisticated models and advanced analytics such as Subjective Expected Utility, Value at Risk, Risk Adjusted Return on Capital and modern portfolio theory are the essential decision tools of most managers.

However, decision makers are not simply economic automatons or "lightning-fast calculators" who plug data into computers. Before committing to a course of action, managers frequently consider the decisions made by others and weigh how their own decisions will be perceived. Most particularly among heavily regulated industries or where signalling behaviour can be easily observed, decision makers have often been found to copy or mimic the decisions of others and create a herd of common choice even if the outcome is wrong. The adage that bankers make lemmings look like free thinkers has a great deal of currency in financial circles.

But how pervasive is this phenomenon and, perhaps more important, do managers knowingly make decisions that they believe to be against their own judgment? During a multi-year research project into decision making, I led a study to investigate these very questions. A national sample of hundreds of senior executives and managers were given an analysis of two options and asked to choose between them. Not surprisingly, the overwhelming majority, 91%, selected the one that traditional analysis

indicated was the "better" choice. However, when informed that someone else had already selected the demonstrably inferior choice, the proportion of managers selecting the "better" option dropped to 73%. Furthermore, if told that the person who had selected the inferior choice had a reputation for high performance, the proportion of decision makers selecting the "better" option dropped to 63%.

There are a number of implications to this study. The first is that managers do not always do what we expect. When asked why 9% of the decision makers ignored the traditional analysis and selected what was clearly an inferior choice, the most common refrain was they thought that they would show some leadership by being different and that the two choices were so similar that the difference was negligible. This is of course very close to the operating world of most senior executives. As U.S. president John F. Kennedy noted during the Cuban missile crisis, at the point of executive decision the obviously poor options have usually been excluded from the array of choice and all of the alternatives have about the same degree of viability.

A second implication is that while managers can usually be counted upon to make decisions that are supported by analytic evidence, they are very comfortable, perhaps too comfortable, with ignoring facts and conforming to the decisions of others even if they believe them to be suboptimal. As economist John Maynard Keynes observed during the last economic crisis: "Worldly wisdom teaches that it is better for reputation to fail conventionally than to succeed unconventionally."

What does this mean for managers? Mimicry is not necessarily bad. Certain environments benefit (or suffer, depending upon your perspective) from what economists refer to as network effects where herding or common choices lead to greater benefits. A common and frequently cited example is the VHS/Beta format war of the early 1980s, where it was wise to copy others who bought VHS players even if you believed Beta was better.

Mimicry, however, is not valid in all strategies or markets and managers need to think carefully before blindly following others, especially if their own analysis suggests otherwise. Imitation may be a valid process when deciding between restaurants or movies, but there are much greater risks when choosing strategy. As recent events have underscored, even influential organizations make bad decisions and the reputations of Lehman Brothers, Merrill Lynch and Washington Mutual are now in tatters.

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- Peter Tingling holds a PhD in Organizational and Technological Decision Making. He teaches Financial Risk Management and Sustainability in the Faculty of Business Administration at Simon Fraser University and is the CEO of Octothorpe Software Corp.

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