THE BOARD MINDSET™

The vital attribute of exceptional boards

HOW TO AVOID STRATEGIC MISTAKES

If your business is on the wrong road, the amount of operational control you exert will make little difference. Sometimes being on the wrong road is the result of a calculated risk and the best a leader can do is pull the plug, and quickly. The "fail fast, cheap and often" advice is astute, even if difficult to follow.

James Lam, an independent director and expert on risk, says that 60% of risk is strategic, 30% operational and just 10% financial. Yet many leaders put resources in reverse of this order. The more concrete nature of operations can make a decision in this area seem more obvious.

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Strategic decisions are different. The very nature of strategy is about making choices that determine the nature and direction of an organization. The uncertainty that surrounds strategic decisions is often uncomfortable. Since most leaders are in the mold of appearing confident and are rewarded for doing so, they tend to dismiss their emotional reactions as irrelevant. In so doing, they also quash their instincts to investigate when concerned or to challenge peers' opinions, especially when a leadership team agrees and is charged up.

Lam and I agree that the single largest cause of strategic error is cognitive bias, though most people are sure it doesn't apply to them. This is especially true in the world of deals where some aspects of the lead up are interesting, a bit glamorous and even thrilling. I have likened it to courting where everyone is on their best behavior and only after the marriage do the parties come to really understand each other.

Andrew Hill, Associate Editor and Management Editor at Financial Times writes, "Is there a love more certain, more blind, or more doomed than that of two CEOs bent on doing a deal?" He goes on to discuss what he calls, "Cringeworthy corporate bromances" and wonders about the overflowing confidence displayed by the leaders of SunTrust and BB&T following the announcement of their merger.

It is fascinating how much a positive relationship between top leaders interferes with rigorous thinking and just as interesting to note how much hyperbole is tolerated by bystanders. The AOL-Time Warner deal is famous for both the enthusiasm with which it was executed and the tremendous losses it racked up in the ensuing years. More recently, the shocking loss of value of General Electric, formerly thought to be a 'can't lose' investment, has been chalked up to a succession of bad deals.

If the size of the company, experience of leaders, and enthusiastic investors do not provide protection from strategic errors, what does? Awareness of cognitive bias, the role of emotion and acceptance that both will exert influence.

The most common biases and how to spot them:

Over-Confidence

The honest-to-goodness awareness, on the part of leaders, that arrogance is a risk factor. What does it look like? When leaders think and talk like this:

- "I've done this before, I've got it."
- "This deal can't fail."
- "This is a perfect match."
- "Our cultures are a fit."
- "The management teams are great, everyone stays."
- "Nothing will change."

Denial of Self-Interest

Understanding the personal rewards of a deal and, alternatively, the personal costs of not doing a deal.

- Do leaders need to get their ticket punched?
- Are there backroom deals that must be fulfilled?
- Does a leader's personal situation improve if a deal goes through?
- Will some groups be disappointed if the deal doesn't proceed?

Blind Trust

What concerns do you have that either you or others dismiss out of hand, especially if questions are met with resistance?

- Are others reassuring but don't provide much other than a pacifier?
- How are customers going to be impacted?
- What are the relationships with suppliers like and how will they change?
- Do you avoid inquiry because the other party acts insulted when questioned?

All strategic decisions involve cognitive bias. The greatest risk is to those who think they are above it all. The least risk is to those who recognize that risk is reduced by asking questions, of others and oneself.