

## FOG COLORED GLASSES: BIAS AND OVERCONFIDENCE IN BUSINESS DECISIONS

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A psychic can reinterpret or disavow a crystal ball. Forecasters and strategists aren't so lucky. They must predict sales, costs, stock prices, market response, competitors' actions, and more, always under uncertainty. People make decisions based on those predictions, and the decision-makers remember the quality of the predictions.

We often ask, how do we get better crystal balls? But the problem isn't only that crystal balls are foggy. Perhaps the fog is on our glasses.

### IT'S CLEAR

As I prepared for a business war game, I attended a workshop at a major advertising agency. The workshop was designed to help my client develop possible themes for its marketing.

During the workshop, the agency displayed several ads and asked the client's managers to rate them. The managers unanimously rated one ad as having excellent clarity – unanimously except for one person. The facilitator asked the dissenter why he thought the ad wasn't clear. The dissenter proceeded to demolish the ad thoroughly: this is vague, that is hazy, an ambiguity here, an innuendo there. When he was done, the rest of us were stunned that we'd ever thought the ad was clear.

By contrasting their beliefs in the workshop, the client didn't just avoid an advertising blunder. They did something deeper, something humans usually don't do: they agreed to challenge their thinking.

### BELIEVING IS BELIEVING

We humans seek and retain facts consistent with our beliefs. (Psychologists call that *confirmation bias*.)

We discredit or avoid facts that conflict with our beliefs. When's the last time you bought and read a book by an author with whose views you expected to disagree? (I don't do it either.) Yet the truth is that some of what we accept as truth is not true.

I've seen really smart strategists arrive at my business war games being sure of the right answer, and leave being sure of a different right answer. (That's not because of me. That's because of what they've discovered for themselves.) I've seen my own strategy simulations demolish my beliefs about competitive strategy and help me find better ones (Chussil 2008). What is it about business war games and simulations that, like the advertising workshop, help people see different solutions?

To answer that question, let's talk for a moment about the accuracy of our beliefs.

### CALIBRATION

"Calibration" refers to the match between confidence and accuracy.

Weather forecasters are well-calibrated: when they say there's a 70% chance of precipitation, 70% of the time it precipitates. They are well-calibrated partly because they have good data for feedback on their predictions and partly because they base their predictions on sound, verified principles.

In other fields (including business), feedback is less frequent and data are more ambiguous. Principles are less sound and more contentious. It's hard to calibrate well. So what can we do?

According to Scott Plous, "The most effective way to improve calibration seems to be very simple: *Stop to consider reasons why your judgment might be wrong.*" (Plous)

Experiments show that generating reasons that support a preferred answer does not reduce overconfidence. Generating reasons that *oppose* the preferred answer *does* reduce overconfidence.

When you are appropriately confident in an answer, you are more likely to make wise decisions. With your fog-colored glasses removed, you can see into the crystal ball more clearly.

Generating valuable opposing reasons means challenging what we believe is clear, obvious, and profoundly true. Say our profit forecast assumes 5% sales growth. Here are some directions those challenges might go. (Note that challenging a belief doesn't assume the belief is wrong. It merely says the belief matters and therefore it's worth testing.)

- That 5% sales-growth assumption comes from extrapolating trend lines into the future. Our market is changing. Will the past predict the future?
- Our competitors have announced their growth plans, and they say their new products will trash ours. We're going to be in a real battle to get *any* growth.
- Analysts say the market is going to be flat this year. For us to grow at 5% in a flat market, our competitors will have to lose market share. They're as hungry for growth as we are.
- That sales-growth number is what the finance department wants us to get. That doesn't mean it's possible. Does the sales department think they can deliver?
- Our profit forecasts don't take price into account. We might have to cut prices to grow sales at 5%, and if we do, then profits aren't going to hit the target.

We can challenge our thinking and get a better look at the crystal ball by creating a marketplace of ideas. There are various ways to do so.

## A MARKETPLACE OF IDEAS

A monopoly of ideas is to decisions what a monopoly of products is to purchases: a lousy selection from a complacent supplier. A marketplace of ideas implies

competition and an active search for alternatives; that is, opposing reasons.

### ***Embrace disagreement before making decisions.***

Alfred P. Sloan, Jr., the legendary president of General Motors almost a century ago and who presided over GM's monumental growth, captured it well. "I take it we are all in complete agreement on the subject here. Then I propose we postpone further discussion of this matter until our next meeting, to give ourselves time to develop disagreement and perhaps gain some understanding of what the decision is all about." (*Harvard Business School Alumni Bulletin*.)

***Look outside your industry.*** You can get ideas from what others have done. Imagine what Steve Jobs, Elizabeth Warren, Sir Richard Branson, Meg Whitman, or James Cameron would do if they ran your company... or one of your competitors'.

***Ask strange questions.*** What would happen if we didn't take this action? What could we do if we had more resources? What could we do that would make customers happy to pay a premium price? What would happen if we go down this road and we get half, or double, of what we expected? Imagine we're looking back five years from now; what would we say we did right and wrong?

***Role-play, simulate, and war-game.*** The world looks different through your competitors' eyes. Take a look by role-playing and war-gaming them. Those techniques generate great opposing reasons because your own really smart people do their best to cause your virtual defeat. Test ideas by simulating them. I've seen Fortune 500 companies get very surprised.

***Emphasize cause and effect.*** Avoid accounting-based models or trend-line predictions, because they reflect unrealistic views of how the future comes to be. Things happen for reason, and if those causal things change (or if you make them change), then you can "change" the future.

To make better competitive-strategy predictions and decisions — you know, the kind that can make or break your business — challenge your thinking, look for opposing reasons, deregulate your company's marketplace of ideas. Why not?

## REFERENCES

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