Deloitte.

Decisions that matter — and how to make them better

Bad decisions are made in organizations every day, with countless ways to miss the mark. Whether it's squishy goals, competing interests, bad assumptions, not enough time, insufficient information, or simply not enough talent, there are plenty of corners that can be cut, and we all do it.

On some level, making bad decisions is unavoidable. No one can always be right. But leading companies tend to make fewer bad decisions, especially when it comes to those that can drive or destroy significant value — decisions that matter.

Decision making is a distributed function involving lots of different people throughout the organizational hierarchy. But two individuals in particular often have specific responsibilities for helping their organizations get better at making decisions: Chief financial officers (CFOs) and chief information officers (CIOs). This paper looks at opportunities where these two leaders can collaborate to drive more effective decision-making throughout their organizations. But first, we'll take a quick look at why people make suboptimal decisions in the first place.

The dynamics of decision-making

Over the past few decades, the science of decision-making — behavioral economics — has uncovered the many mechanisms of human frailties that contribute to bad decision making. Drawing on insights from neurology, psychology, economics, and beyond, they've painted a humbling picture: We're all just people, and people don't always act rationally (see Figure 1). And when you add in the complexity of postdigital disruption — the deluge of data enabled by social, mobile, and cloud technologies — all bets are off. Decision making is more complicated than ever, there's too much information to process, and sometimes leaders just have to go with gut instincts — or so they think.

Efforts to improve the quality of decisions should begin with a clear view of the biases that can disrupt effective decision-making. These biases occur at the individual, group, and organizational levels.

Individual level. These behavioral biases are the result of deep psychological dimensions that lead to predictable patterns of poor judgment. They include such blind spots as framing biases, anchoring, and overconfidence.

Group level. Pitfalls at the group level usually involve a lack of clarity around decision rights. Specifically, teams often move forward on important decisions without explicit agreement on the *who, what,* and *how* of decision-making.

Organization level. At this level, decision effectiveness becomes a matter of execution. A transparent approach to communicating and implementing decisions is important.

Within and across each of these levels, all sorts of biases and blind spots have the potential to disrupt effective decisions. They are often revealed when people are asked to assess information, develop estimates, or make assumptions.

Figure 1: How classical and behavioral economists view decision-making

Classical Economics	Behavioral Economics
• Individuals maximize their utility from a stable set of preferences • Assumes consistent, rational behavior	• Individuals are assumed to have bounded rationality, meaning that people have limited time and capacity to weigh all the relevant benefits and costs of a decision • Decision making is less than fully rational — people are prone to make predictable and avoidable mistakes

Cascading biases: Framing, anchoring, and overconfidence

Individuals often start the decision-making process anchored to the initial information provided, without considering the fact that such information may actually prove irrelevant in the long run. To further complicate matters, information is almost always framed by implicit biases. Even the most objective data — financial information, for example — arrives fully framed as the truth, in many cases ignoring a mountain of other information that could be made available. Starting from this initial anchor, individuals begin to adjust their estimates and assumptions (see Figure 2). They stop adjusting when they become uncertain, which occurs as their adjustments get farther and farther away from the anchor point. This leads teams to favor information that is consistent with the anchor and the initial framing, rather than looking for information that might create more uncertainty. People are rarely aware of the anchor and its effect on their decisions. And they are almost always more confident about their choices than is warranted.

Figure 2: Capital investment decision process

	Identify need and define scope	Determine the baseline	Evaluate the business case	Establish governance and risk models	Allocate resources	Execute
Individual biases	Framing	Anchoring				
Group biases		Anchoring	Overconfidence	Unclear decision rights		Overconfidence
Organization biases			Decisionfatigue		Sunk-costfallacy	

Decision quality: Point of impact for CFOs and CIOs

If it's true that organizations can develop the capabilities to make better decisions where they count the most, where does it make sense to get started? What should CFOs be doing? How can CIOs help? How can these two leaders work together to drive more value for the organization?

A recent Deloitte CFO Signals™ survey shows that CFOs say their executive teams struggle most with decisions that typically involve high uncertainty and financial cost. In the study, 58% of CFOs cited investment decisions related to organic growth, such as product pricing and distribution, as ones their company's executive teams find most challenging[1].

Though every organization is different, it is possi ble to construct a working list of typical decisions that matter across organizations. In most cases, the decisions are a) those where people can act more wisely with the right decision-making infrastructure in place, and b) that are important enough to seriously impact value creation (see Figure 3).

The list below barely scratches the surface of decisions that matter. And while CFOs and CIOs aren't personally responsible in every one of these areas, their roles significantly influence on those who are.

Figure 3: A sampling of decisions that matter

Decision category	Decisions that matter
Capital projects	Which investments should we make in new capital projects?
	How should capital be allocated across asset classes or capital outlays?
	Which projects should we retire from our portfolio?
Technology strategy and investments	Which investments should we make in new IT projects?
	What technology investments should be made across the organization?
Enterprise planning	What is the appropriate budget for an enterprise over a given time horizon?
	Which strategic plans do we need to have in place to achieve our goals?
Pricing	What is the most effective pricing strategy relative to our competitors?
	When should we modify our pricing strategy to respond to changes in our competitive environment?
Supply chain	Which strategies and practices should be in place for moving the right product to the right place at the right time?
	What are the most effective direct and indirect sourcing and procurement strategies for reaching our goals and satisfying customers?
	How can we improve sales and operations planning while achieving supply chain flexibility?
Organizational strategies	What are the vision, mission, and values of our organization?
	Which operating model is best for our organization?
	What is our talent management strategy?

As used in this document, "Deloitte" means Deloitte LLP and its subsidiaries. Please see www.deloitte.com/us/about for a detailed description of the legal structure of Deloitte LLP and its subsidiaries. Certain services may not be available to attest clients under the rules and regulations of public accounting.

The CFO as catalyst

Despite scores of books on the subject, many organizations haven't given adequate recognition to the influence of behavioral economics on corporate decision-making. And even among those that have, results have been spotty. Part of what's missing is continuity and discipline, which is where a structured process for decision-making can work wonders. But process alone isn't enough. You may have your very best people and processes in place, but blinds spots and biases can still take a toll when it comes to decisions that matter. CFOs, aided by CIOs, are in a position to drive needed improvements.

Heads of state rely on advisors to inform their most important decisions. The world's most accomplished athletes rely on coaches to see things about their performance that they can't see for themselves, and may not want to see. But in business, seeking insights from others when making big decisions is often viewed as a sign of weakness. Bold confidence tends to be rewarded more than careful deliberation, even when the confidence proves to have been misplaced. Look into the fast-paced frenzy of mergers and acquisitions, where half of all transactions fail to produce the expected value.[2] Other areas of corporate decision making suffer from similar biases, though they may not grab the spotlight the way big transactions do. Regardless, almost any decision that matters can be undermined by common human biases, group dynamics, and organizational blind spots. A CFO's perspective and insight can help mitigate those risks (see Figure 4).

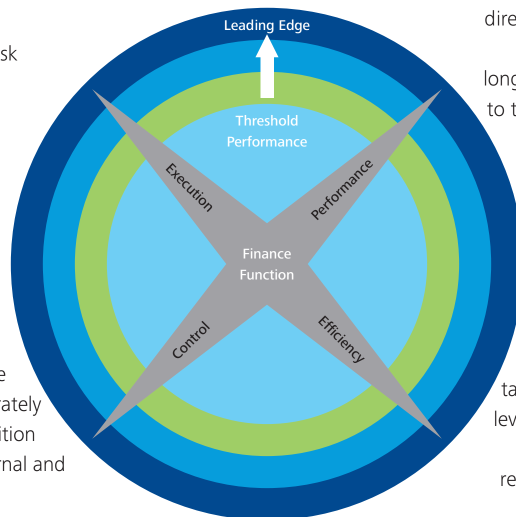
Figure 4: Four Faces of the CFO

Catalyst

Catalyze behaviors across the organization to execute strategic and financial objectives while at the same time creating a risk intelligent culture

Strategist

Provide financial leadership in determining strategic business direction, M&A, financing, capital markets, and longer term strategies vital to the future performance of the company



Steward

Protect and preserve the critical assets of the organization and accurately report on financial position and operations to internal and external stakeholders

Operator

Balance capabilities, talent, costs, and service levels to fulfill the finance organization's core responsibilities efficiently

In most organizations today, CFOs must master the complex act of balancing work in four critical roles: steward, strategist, operator, and catalyst. It is in the last role — as catalysts — that CFOs have the opportunity to lift the overall performance of their organizations to create more value through better decisions. The fit is both natural and compelling.

Instinctive objectivity. Like anyone, CFOs have biases. Yet because of their roles and formal responsibilities, they bring an inherent objectivity to business. They are independent from many strategic business decisions, even as they support those decisions with analytics insights and data.

Central to performance management. CFOs are responsible for understanding past, present, and future performance. They are in the know on what's happening, since finance organizations are capable of drawing connections between business decisions and results. They are tasked with driving an organization-wide understanding of performance drivers.

Masters of tradeoffs. Understanding and evaluating tradeoffs is an important part of making better decisions. And it's an activity in which CFOs often excel, because weighing costs and benefits is routine in the finance organization. So is the job of maximizing returns while minimizing risks. If you really want to understand how tradeoffs work, just ask a CFO.

It's not unusual to see CFOs already filling similar roles. Many of our CFO clients are often referred to as voices of reason in their organizations — depended on by colleagues as both sounding boards and discussion partners. But acting as a catalyst for smarter decision-making in other parts of the business demands more. It requires understanding the influence of behavioral biases in decision making.

The illusion of validity

If you're a CFO reading this piece, there's a good chance your personal blind spots and biases are already kicking in. Confident in your own objectivity and analytical abilities, you may have already decided that improving how your organization makes decisions isn't a priority for you right now. You may even believe that your organization is significantly better than average, and that the cost of a few bad decisions is one you can live with. You're a busy person, after all, and you're good at what you do.

Such is the bias of overconfidence, one of the darkest of blind spots uncovered by behavioral economists such as Daniel Kahneman.

The confidence we experience as we make a judgment is not a reasoned evaluation of the probability that it is right. Confidence is a feeling, one determined mostly by the coherence of the story and by the ease with which it comes to mind, even when the evidence for the story is sparse and unreliable. The bias toward coherence favors overconfidence. An individual who expresses high confidence probably has a good story, which may or may not be true.[3]

Even in the face of such confidence, some CFOs will see the wisdom of improving the quality of the decisions they and their organizations make. For these brave souls, the road ahead may involve some uncomfortable introspection. Because they bring their own biases to every decision they face. Plus, their biases are backed by the considerable weight of the CFO title, which can be an intimidating presence to colleagues at every level of the organization.

That said, there are three broad areas of focus for organizations that want to upgrade the quality of their decision-making approaches and weed out biases that undermine value:

1. **Sharpen.** Get smart about the most common mistakes organizations make when it comes to decision-making — with a specific focus on your own organization's performance, biases, and culture.

2. **Shape.** Revisit your organization's framework for making decisions with an eye toward applying it broadly and deeply across the enterprise. This will eventually require instituting a shared language that addresses the most common biases and blind spots in your organization. Be sure to shape the framework so that it's relevant for decisions made by individuals (reflecting personal biases), groups (reflecting the need for decision rights), and the broader organization (where analytics and execution come into play).

3. **Show.** Lead by example using the framework and language in everyday decisions. This will include training and enlisting your own personal decision advisor — a partner you can count on to shine a bright light on your own individual biases and blind spots.

The CIO connection

For CFOs, one collaboration in particular stands out for its potential to improve the quality of decisions. Many have found a willing partner in the Chief Information Officer (CIO) — a person who can bring several specific, powerful capabilities to the table.

While CFOs have access to a wide range of information at the heart of the business, that doesn't mean they have everything they need. Just like anyone, CFOs don't know what they don't know. But when the CFO isn't operating with the right information, the whole business can suffer. That's where the CIO comes into play. Not only do CIOs traffic in the currency of data every day, they typically bring a completely different way of thinking about that information. For CFOs itching to eliminate their blind spots, CIOs can be instrumental.

Big data

As business leaders try to crack the code on big data, the tools and skills at the CIO's disposal have begun to take on new relevance. Whether the challenge is to simply capture these immense and complex data sets, or to analyze and visualize the underlying data in new ways, CIOs can be instrumental. When it comes to making smarter, more informed decisions, big data represents a potential windfall — but only if you know what to do with it.

Information visualization

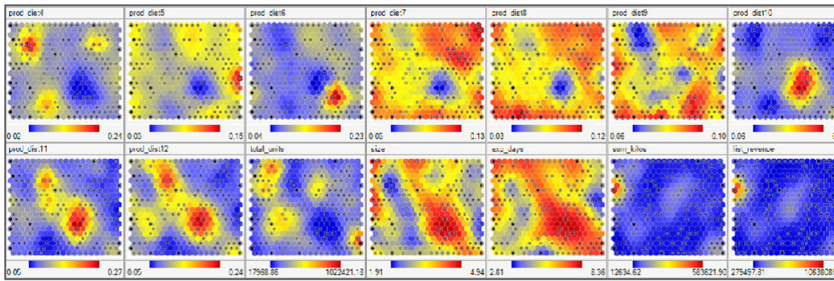
Information visualization is another area where CIOs can bring a lot of value. As organizations push decision-making information out to the broader workforce, they need to improve how that information is presented. CIOs are at the forefront of visualization and user experience. To get an idea of the impact that better visualization could have on CFO-supported decision-making, consider the example of heat maps — a "Doppler radar" view of business issues that allow decision makers to make complex associations using a series of simple, intuitive maps (see Figure 5).

Predictive analytics

The practice of business analytics is moving quickly from hindsight to insight to foresight — the ability to better predict what will likely happen in the future, using a mix of current and historical data, as well as information from external sources. While this is certainly not only a technological challenge, technology has a big role to play, and most CIOs have already dipped their toes into the waters of analytics, if not taken a deep dive.

For CFOs looking to improve the quality of decision making in their organizations, there are plenty of peers who can help. But there may be no better door to knock on first than the one that says "CIO."

Figure 5: A "Doppler radar" view of business issues



Source: Deloitte Consulting LLP Analysis 2011

In this heat map visualization, a financial services firm has created a view of the characteristics of customers who consistently delivered profitable loans. By grouping the customers into profit-based segments, the company identified other variables that were strongly correlated to profitability — not just demographic information, but also details such as the origination amount, interest rate paid, dealer markup, and more.

A call to excellence

As consultants working with organizations across all industries and sectors around the world, we see the costs of poor business decision-making every day. Even organizations with leaders who know better often fail to avoid some of the most basic errors. *Our conclusion? Individuals and groups tasked with making decisions are often not able to self-correct for their biases.* Even when talented teams of individuals work together to take on a complex decision, the whole is not always greater than the sum of the parts.

Many organizations understand they need to improve the quality of decisions that matter. Whether they are actually able to do anything about it is largely in the hands of two people: The CFO and the CIO.

Authors

Steven Ehrenhalt
Global Finance Transformation Leader, Deloitte Consulting LLP
hehrenhalt@deloitte.com

Rich Penkoski
Principal, Deloitte Consulting LLP
rpenkoski@deloitte.com

Laura Bede
Senior Manager, Deloitte Touche Tohmatsu Limited
lbede@deloitte.com

---

[1] Deloitte LLP CFO Signals™ Survey: 2012 Q3 Results, see www.deloitte.com/us/cfosignals2012Q3

[2] Bloor Research, Nov. 2007; Deloitte 2000: ("Solving the Merger Mystery, Maximizing the Payoff of Mergers & Acquisitions), etc. There are numerous studies that support the statement above. "Fewer than 30% of merging companies improve shareholder value five years after the acquisitions have been completed" - "Does M&A Pay?" Robert F. Bruner, Chapter 3, Applied Mergers & Acquisitions, John Wiley & Sons, 2004

[3] "Don't blink: The hazards of confidence," Daniel Kahneman, New York Times, October 2011

This publication contains general information only and is based on the experiences and research of Deloitte practitioners. Deloitte is not, by means of this publication, rendering business, financial, investment, or other professional advice or services. This publication is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor. Deloitte, its affiliates, and related entities shall not be responsible for any loss sustained by any person who relies on this publication.

Copyright © 2012 Deloitte Development LLC. All rights reserved.
Member of Deloitte Touche Tohmatsu Limited