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CFO Insights
Making decisions that matter

Bad decisions are made in organizations every day. Whether it's squishy goals, competing interests, bad assumptions, not enough time, insufficient information, or simply not enough talent, there are countless ways to miss the mark.

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.

How do they do that? Those organizations understand that decision making is a distributed function involving lots of different people throughout the organizational hierarchy. But they also recognize that there are two executives with the knowledge to help their organizations improve decision making: chief financial officers (CFOs) and chief information officers (CIOs). In this issue of *CFO Insights*, we will look at opportunities for these two leaders to collaborate and drive more effective decision-making throughout their organizations, as well as the barriers they face in making good decisions in the first place.

The dynamics of decision-making

Over the past few decades, the science of decision-making – behavioral economics – has uncovered many mechanisms of human frailties that can contribute to bad decision making. Drawing on insights from neurology, psychology, economics, and beyond, behavioral economists paint a humbling picture: We are all just people, and people do not always act rationally (see Figure 1). And when you add in the complexity of post-digital disruption – the deluge of data enabled by social, mobile, and cloud technologies – the decisions that matter may become more complicated than ever.

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

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

Improving the quality of decisions, therefore, should begin with an understanding of the biases inherent in 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 can lead to predictable patterns of poor judgment. They include such blind spots as framing biases 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.

Decision quality: Point of impact for CFOs and CIOs

Of course, many decisions that matter involve all three. To implement an effective pricing strategy, for example, requires assessing information from a multitude of competitors. To set appropriate targets for future hiring requires developing adequate estimates for growth. And making new capital investments depends on making assumptions about timing, markets, and the cost of capital. Yet, while every organization is different, it is possible to construct a working list of typical decisions that matter across organizations and see where input from both CFOs and CIOs could thwart potential biases and blind spots.

The following list of decisions that matter is only a partial one, but includes decisions a) where people can act more wisely with an effective decision-making infrastructure in place, and b) are important enough to seriously impact value creation (see Figure 2). And while CFOs and CIOs are not personally responsible in every area, their roles can significantly influence those who are.

Figure 2: 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 preferred for our organization?
	What is our talent management strategy?

The CFO as catalyst

To positively influence decision making, however, CFOs and CIOs should be well versed in the nuances of behavioral economics. Having structured processes in place is not enough to determine good decisions. Even with your most knowledgeable people and leading processes, blinds spots and biases can still negatively affect decisions that matter.

Part of the problem is that in business seeking insights from others on 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.[1] The truth is, though, that almost any decision that matters can be undermined by common human biases, group dynamics, and organizational blind spots.

A CFO's perspective and insight, in particular, can help mitigate those risks. In fact, in their roles as catalysts,[2] CFOs have the opportunity to lift overall performance and create value through better decisions. The role can be bolstered by the following attributes:

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. Moreover, they are tasked with driving an organization-wide understanding of performance drivers. And since finance organizations are capable of drawing connections between business decisions and results, CFOs are well positioned to distinguish which decisions produce results.

Masters of tradeoffs. Understanding and evaluating tradeoffs is an important part of making effective decisions. It is also an activity in which CFOs often excel, because weighing costs and benefits is routine in the finance organization, as is the job of increasing returns while reducing risks. If you really want to understand how tradeoffs work, ask a CFO.

The illusion of validity

Acting as a catalyst for smarter decision-making throughout the business, however, starts with a CFO understanding his or her own biases. As CFO, though, there is a good chance those personal blind spots and biases have already kicked in. Confident in their own objectivity and analytical abilities, some CFOs may have already decided that improving how their organization makes decisions is not an immediate priority. They may even believe that their organization is significantly better than average, and that they can live with the cost of a few bad decisions.

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

"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]

Still, even CFOs confident enough to improve decision making will bring their own biases to every decision. Moreover, 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. But by focusing on the following three areas, CFOs can start to weed out biases that undermine value:

1. **Sharpen.** Get smart about the most common mistakes organizations make regarding decision-making – with a specific focus on your own organization's performance, biases, and culture. For a CFO, that means listening to those involved in the process and actually understanding how they think and execute. Then, armed with their insights, CFOs can pinpoint areas of potential weakness and create targeted contingency plans to keep decisions on track.

2. **Shape.** Revisit your organization's framework for making decisions with an eye toward applying it broadly and deeply across the enterprise. Decisions should not be confined to business units, for example, when the issues they address extend cross functionally. This may eventually require instituting a shared language that addresses the most common biases and blind spots in your organization. In addition, 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 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. As your advisor, this wingman can remind you not to be completely wedded to the numbers in the decision-making process. You may want to be precise in making a decision, but relying on only the numbers can turn out to be the precisely wrong approach.

The CIO connection

Many CFOs have found a willing partner in the CIO – a person who can bring several specific, powerful capabilities to the table. Central to those capabilities is the ability to identify and deliver the right data at the right time to run the business. 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, particularly in the following areas:

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.

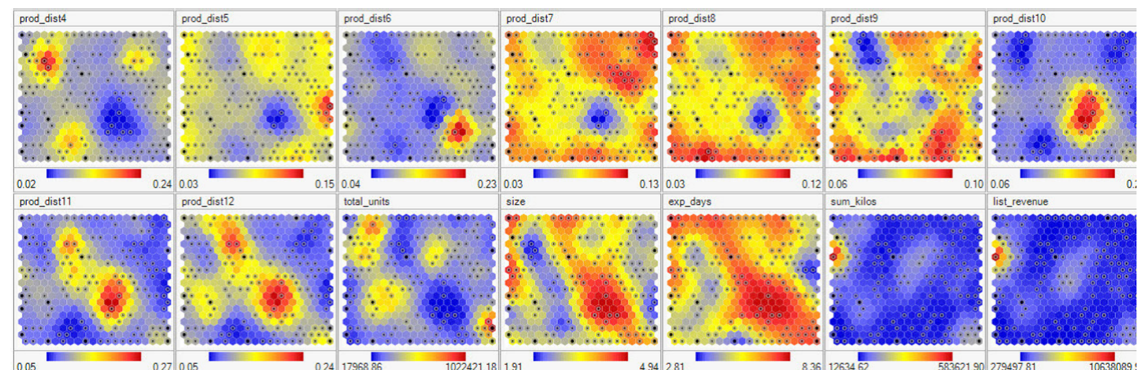
Information visualization

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 should 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 3).

Predictive analytics

The practice of business analytics is moving quickly from hindsight to insight to foresight – particularly the ability to predict what will likely happen, 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 CIOs are important partners to the CFO in effectively leveraging data management and business-intelligence techniques for fact-based and predictive decision-making.

Figure 3: 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

The cost of poor business decision-making affects companies every day. Even organizations with leaders who know better often fail to avoid some of the most basic errors. Moreover, individuals and groups tasked with making decisions are sometimes simply not able to self-correct for their biases.

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."

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Endnotes

[1] 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

[2] "Four Faces of the CFO," Deloitte U.S. CFO Program http://www.deloitte.com/view/en_US/us/Insights/browse-by-role/Chief-Financial-Officer-CFO/Four-Faces-of-the-CFO-Chief-Financial-Officer/index.ht

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

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