Q&A on good decision-making and “the psychology of risk”

Interviewer: Gareth Byatt – Principal Consultant, Risk Insight Consulting
Interviewee: Hans Læssøe – Principal Consultant, AKTUS

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Hans,

Thank you for taking the time to provide your thoughts on “the psychology of risk”, and how good risk management helps to inform good decision-making. There is lots to discuss in this field, and I know that you are an active writer, thinker and reviewer in this space.

Gareth: You have written a book recently, Prepare to Dare, which I think people will find very interesting to read.

Can you tell us a little about the book, what you hope people can obtain from it and how you tackle the topic of “the psychology of risk and decision-making”?

Hans: Thank you for inviting me. The book is based on the experiences I have collected through a decade of strategic risk management – and talking to a lot of people in different industries about this.

I have two main focus areas in the book:

First, risk management is NOT complicated beyond any other management you do already – and it adds the most value when it is embedded into the processes and discussions through which you make decisions for the company – from strategy to operations. Simply trying to mitigate risks taken after decisions have been made is inadequate and expensive.

Secondly, I wish to transform the thinking from one of “risk management” to one of “intelligent risk taking” – hence the book’s title. The world is moving faster and faster – and to be competitive, you must make better decisions, faster than before. Intelligent risk taking is an important part in your toolbox for this.

Too many decisions, in any organisation, are taken based on opaque information, or lack of it, and are driven by personal biases and ambitions, often in a political atmosphere where there is no right and wrong. This makes decision making difficult – and therefore, good tools and techniques are needed to support good decision making.
Gareth: Thanks for that, Hans.
Building on from this point, we read a lot nowadays about how everything in the world is interconnected in an increasingly complex ecosystem, and how organisations, large and small, may struggle to unravel and understand true insights into the uncertainties they face.
I wondered what your views are on the “interconnectivity of risks” in a complex world and what it means for decision-making.

Hans: The world is surely becoming more and more complex – and it changes at an ever-increasing speed. However, as you and I wrote in an article a short while ago, this is a condition we all share, and therefore it is important that you stop whining about it – but rather, act on it from a positive mindset, to leverage these conditions.

We have to remember that, in parallel to the interconnectivity of the world, we get better and better data and opportunities to see what is happening – and we need to spend the time to look at the data available to us. 100 years ago, companies were generally local and produced goods and services in the country where they sold and used suppliers from the neighbourhood. Today, midsized companies are global and reap the benefits of a world of suppliers and partners and customers.

Even smaller organisations have international suppliers, and almost all companies have a website that enables international trade. This may add to complexities – but it also adds to lots of opportunities. Where would Apple be today if they had only ever operated in California?

This makes decision making harder. The days of an executive having more knowledge and insights than his team by default, and hence being able to make the right decision unsupported by others, are long gone – despite what some executives may still perhaps think.

Decision-makers have teams of specialists who are able to disseminate the vast quantities of information and provide relevant and competent decision support. We have to remember that most of the information we get is irrelevant to the decision we are addressing at present, so we really need to focus on “what matters”. How we look at and perceive risk helps us to do this.

Gareth: As we think through and understand uncertainty, we need to be mindful of our cognitive biases. We can obtain good data, but if we let our biases control our decisions, we won’t make the best use of the data available to us.
There is a wealth of material – research, articles, opinions – about unconscious biases and how they impact how we make decisions (this old McKinsey article on the subject still resonates with me). For example, do we pay enough attention to good quality data or do we “trust our gut” too often?
Do you think we are currently finding the right balance between being data-led and using our intuition, and are we doing the right things to de-bias our decision-making?

Hans: In many cases, we do have good data to base decisions on. Naturally, the more operational / short-term the decision is, the more precise the data will be, and the more scientifically correct can we make the right decision. Whilst these day-to-
day decisions are important, they do not always have large impacts (though some do).

The decisions with big impacts are the strategic, long-term decisions which are about how to be effective in a future and a market that we know will change. This is where “gut-feeling” plays an important part, and also where organisational politics comes in and can blur the picture.

Having said this, I do think that politics is natural and not a bad thing executed by politicians. A political decision is one where we may agree on the current situation and status. We may share some image of the desired future status – but as there are multiple roads “from here to there”, all of which have risks and opportunities and all of which may be effective – we will most likely not agree on the best way to meet our target, and therefore we need to define a shared compromise on the road ahead.

This is where data can be used and interpreted, if it exists – and hence, where biases, beliefs and gut feelings come in and become important … to the extent the latest Nobel Prize winner in Finance, Richard Thaler is not a financial expert but looking at human biases and how decisions are made – sometimes despite knowing better.

When we rely too much on gut feel, we may make bad decisions – and end up using a lot of resources risk managing and adjusting to make up for, what was a bad decision in the first place. BP at Deep Water Horizon as well as Tepco running the Fukushima nuclear power plant both designed their safety systems at a lower level than what was known to be called for … and had to pay dearly to remedy the subsequent disaster. Volkswagen implemented what was to be a temporary fix to an environmental demand … and ended up with a scandal.

Gareth: Your point about “gut feel” is an interesting one, Hans. I spoke with the cognitive psychologist Gary Klein recently, and he told me that we should never trust our gut. What he said was: “Wonderful as it is, our intuition can mislead us. We have to consciously examine our intuitions to see if they make sense.”
So, I think your view is aligned with Gary’s.

Hans: I think so. I firmly believe that decision makers should be supported with the relevant insights available to make better decisions. I also believe that risk management professional are well suited to be involved in this supporting process as the risk management process are designed to drive focus on what is important and what can be left out.

At the end of the day – I do NOT believe in decision making which contradicts your gut feeling. I do not think an executive can drive the execution of a decision if he / she feels it is wrong – regardless of how they describe why they feel that way.

Gareth: I’d like to move onto a connected point that I see as important for the Risk profession: how well do we help people to see insights? I know this is something that you are a keen advocate of, and that you write about.
I have followed the work of cognitive psychologist, Gary Klein, for some time. Gary has written a lot (in books, research papers, and articles for the Harvard Business Review and other publications) about how people think and make decisions. I was interested to read his research into the ways that people see insights. Gary talks about how we could see more insights if we spend less time on reducing errors, and more time being curious, seeing connections, spotting contradictions and coincidences, and recognising when we are faced with “creative desperation” (meaning that we have an urgent problem to solve).

Do you think we spend enough time focusing on insights, or too much time looking at and reacting to things we already know about? Or is the focus about right, most of the time?

**Hans:** Naturally, when a problem or a challenging situation is staring you in the face, you tend to focus on the problem and ignore anything else.

Such problems can catch senior people in the public and private sector unaware. In many cases, others in their organisation can handle the situation if they are given the chance. If senior people are caught unawares by them and they find themselves on the backfoot, they have to ask why that is the case. Have they and their teams not spent enough time thinking about and preparing for possible events and situations?

I would love to see an executive or a politician delegating problems and challenging situations to people at the right level of the organisation to handle them.

That said – the world is luckily not ruled/governed by attention to mishaps. For much of the time, our attention is focused on looking ahead.

However – any decision has a range of potential outcomes, and the awareness of this and the size of these ranges still leaves plenty of room for improvement. This is where Risk professionals can use their expertise to raise the awareness and drive that decisions are well informed.

**Gareth:** I’d like to talk now about culture, and the impact it has on how people take and manage risk in their everyday activities. I wondered if you could describe what you see as a positive culture and how it can make a significant impact on how people take and manage risk. Incidentally, I have been reading an interesting book, *The Culture Code* by Daniel Coyle recently on this subject.

**Hans:** First of all, every organisation has a culture of some sort. Some shared image of “how we do things here” and what constitutes good and bad. This emerges out of shared stories, and anecdotes as well as what is being punished and what is rewarded – what make a hero, and what makes a villain.

* Cultures can be formed and built deliberately by management, and in fact I believe it is probably the most important responsibility of management. Richard Branson of Virgin describes it this way “Take care of your people, and they will take care of your customers.”
There are important culture aspects around risk taking. Some companies describe themselves as entrepreneurial and will be ready and willing to pursue any opportunity they see, even if they know that several of these endeavours will fail. Others are focused on “doing it right the first time”, and spend significant resources validating every move they make. Such companies rarely lose, but they also rarely win “big”. Increasingly, such companies may miss out on opportunities for being too slow to respond.

To me – a good culture is one where risks are taken deliberately and intelligently. This is a culture where three basic questions of risk management are embedded in every decision made:

1. What can happen (good or bad)
2. How important is that (impact and likelihood)
3. What do we do about it (if anything)

It is also a culture which, in respect to the increased dynamics of the world, people focus on the following:

- Know how much risk they are prepared to take, and how much of that they have taken already
- Deliberately scout for opportunities in the periphery of their current business
- Define which strategies and actions to take, and manage the risks taken as part of good decision making
- Promote taking risks, when it is done intelligently … even if / when the result is not successful
- Criticise risk taking without proper preparation … even when this leads to success

This is the reason for my book title “Prepare to Dare”. You have to dare in order to win, and you have to prepare in order to make winning more than sheer luck. Remember, in a dynamic world business development is like walking up a down-escalator. If you stand still, you move in the wrong direction (you go backwards).

I mean, anyone can buy a lottery ticket, but as chances of winning are extremely slim the winner of the gazillion dollars has not made a more intelligent decision than the millions of losers.

Gareth: What should we be doing to help young professionals be good at taking and managing risk?

Hans: We should expand their training and development. A lot of risk management is a technical skill-set which I am not abandoning. I would teach three topics:

- Strategic thinking and planning
- Business leadership … how decisions are made
- Human biases and the impact on decision making

With these supporting skills, I would ask risk managers and young professionals to poke into the current decision making processes, be it resource allocation, project management, sales & operation planning, budgeting or the like – and examine how these processes are executed, and how (if at all) risks and opportunities –
uncertainties in general, are taken into account … and what can the I as risk manager apply my skills to raise the bar on decision making.

There is one further approach I would advocate using: Monte Carlo simulation. Working with a plethora of more or less interlinked risks and opportunities is far too complicated to put into any one formula. To deal with this, use Monte Carlo simulation in an intuitive and empirical approach, much helped by tools on a PC, which enable us to model decisions and the potential outcomes … and pinpoint the real key risks and opportunities. The approach is half a century old, and still not used by most risk managers – it is almost embarrassing.

Gareth: Is there anything else related to this discussion about decision-making and the psychology of risk, Hans, that we haven’t covered and which you would like to raise?

Hans: The whole element of human biases is a key element. As I mentioned earlier, Richard Thaler just won the Nobel Prize on working with how psychology and biases influence decision making. Understanding this to a reasonable level is a great lever for a risk manager to use, for example whenever a decision process “goes astray” based on some bias.

Understanding bias will help risk managers improve the quality of decisions made in the company, and, whilst still being in a supporting role, they can have significant influence on the decisions being made and hence the success of their organisation. At some point in time, executives will notice – and the risk manager will be a highly respected part of decision making.

Some 100 years ago, this was the position of the finance specialist. We don’t have 100 years to embed risk management into everyday practice … but given the speed of change, we should be there in less than a decade. I predict, that those who are not, will wither and die in the highly competitive business landscape of 2025.

That said – I am NOT advocating dropping the use of traditional risk management methodologies. They will work well as process quality enhances, and may be embedded in the ISO 9000 standard, which has gradually evolved into a Total Quality Management approach.

Gareth: Lastly, I’d like to finish by asking if you are following any particular thought leaders on risk management at the moment, whose work people reading this interview may find of interest.

Hans: My focus is strategic risk management, and hence I look at three persons and lines of thought, which I find inspiring and worthwhile.

One is Klaus Schwab and the 4th Industrial Revolution which for one is described in a book but is also a material on the website of the World Economic Forum. I believe this book is a must read for almost anyone in business leadership and strategic or risk management.
The other is the **Gapminder Foundation**, which was created by the late **Hans Rosling**, a Swedish professor in world health. The analyses and findings they have made and are making provide a very different perspective of the world than what is portrayed in the press. It also indicates that our biased image of the world is founded at a very young age, and ignores any developments made over the past decades.

A third is **Alexei Sidorenko** of risk academy. He is – deliberately – provocative but drives a lot of the thinking behind changing from reactive and compliance-based risk management towards proactive intelligent risk taking. He has published hundreds of YouTube videos and articles – and gives good inspiration, even when you opt not to use some of it. Alex is also very much into the human bias issue.

**Gareth:** Thank you very much for your time, Hans.

**Hans:** Thank you – it was a pleasure.