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Managers do the daftest things

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But how can they be stopped?

IN THE film "12 Angry Men", released in 1957, Henry Fonda turns in a remarkable performance as a juror convinced of the innocence of a teenager accused of killing his own father. His 11 fellow jurors are equally convinced of the defendant's guilt. Mr Fonda's character battles to prevent the others from leaping to a hasty verdict—and wins them round, one by one.

Business needs more people like "juror number eight". Mr Fonda's character has the courage to question the rationale for important decisions—even if that means swimming against the tide. Poor decisions in risk management and a host of other areas have helped plunge many of the world's largest banks and other financial outfits into a seemingly bottomless abyss.

Financial firms are not the only ones that have made mistakes. So, too, have business giants such as Yahoo!, which rejected a $40 billion takeover offer from Microsoft in February 2008, only to see its share price plunge. The woes of GM and Chrysler, which have been forced to grovel for government handouts, are evidence not just of the scale of the downturn but of the decisions in the upper echelons of the two American car giants.

All of this will come as no surprise to the authors of a new book called "Think Again", which argues that even the cleverest business leaders slip up in crucial choices. Its authors—Sydney Finkelstein of the Tuck School of Business, and Jo Whitehead and Andrew Campbell of Ashridge Business School—point out that decision-making in business is often far from the rational, data-driven exercise that companies pretend it is. In fact, a decision is susceptible to a whole range of psychological biases that can trip up even experienced executives.

One of these biases is to assume that past experience is relevant today, even when the circumstances are different. For instance, Richard Fuld, the former boss of Lehman Brothers, steered the American investment bank through the choppy market during the collapse and bail-out of Long-Term Capital Management, a hedge fund, back in 1998. When credit markets seized up last year, Mr Fuld appeared slow to grasp the extent of the crisis. Perhaps this was in part because his experience at piloting Lehman through that earlier storm had lulled him into a false sense of where the crisis was leading. Ultimately Lehman failed, with earth-shattering consequences.

Another psychological bias is "pre-judgment". This happens when managers let a strongly held belief blind them to arguments against it. The authors cite the example of Boots, a British pharmacy chain, which expanded into health-care services such as dentistry and chiropody around ten years ago. Some analysts and Boots board members were sceptical, but Steve Russell had concluded it was the way of the future before he took over as chief executive in 2000. In the end, the move flopped because Boots did not have sufficient know-how to manage the activities in-house. His strategy in tatters, Mr Russell departed in 2004.

Managers can make daft decisions for a host of other reasons too—including close friendships with colleagues and pure self-interest in hoped-for bonuses and other rewards. So how can companies try to stop these biases from causing calamities?

Messrs Finkelstein, Whitehead and Campbell suggest several safeguards. One is to seek out as much data from different sources as possible to ensure that managers weigh all sides of an argument. BP, a British oil giant, sometimes hires two law firms to get contrasting views on important decisions such as a potential acquisition.

Another safeguard is to encourage internal debate before a decision, perhaps by formally asking an individual or a team to play devil's advocate. GE, an American conglomerate with a financial arm that has been battered by the credit crisis, recently announced that it would encourage more "naysayers" to take part in its planning and operating meetings, in order to stimulate debate. A third safeguard is to monitor the progress of decisions so that errors can be spotted fast—though this does nothing to prevent a bad decision in the first place.

Even with such safeguards, an imperial chief executive surrounded by yes men might neuter the checks—perhaps by undermining devil's advocates. So boards of directors need a further line of defence. Hence, using their own resources and outside consultants if necessary, they should conduct their own reviews of important decisions.

The book's authors say that an independent chairman is essential if such oversight is to work. They warn that firms are asking for trouble if they have a single person as chairman and chief executive—as at Marks & Spencer (M&S), a big British retailer. Some M&S shareholders who have been lobbying to reverse Sir Stuart Rose's appointment to both seats would no doubt agree with that. Better to have a handful of angry executives than an army of angry shareholders.