

The management seer in crisis: managing optimism bias

The beginning of an end

As I looked at my reflection from the shiny mirror hanging at the corner in the room, I could see the Drucker in me. I smiled as I sat at the corner of the bed, flipped the pages of practice of management, and began to meticulously memorize again today's decision for tomorrow's results ¹. "Once again, events have proven the Drucker's idea of management ageless. Perhaps it's time to look away from the tradition of basing decisions on economic forecasts and focus on inventing the future" I thought to myself as I fell back to the bed. It has been a long night of fantasizing for me. The last thing I can remember was that a client phoned me saying he had heard about me. "Can you please come over to the office by 12 noon?" He asked. "That's fine by me", I replied.

When I arrived, He had arranged two executive chairs, he set them six feet apart facing each other. We both greeted from distance, after which he asked if I cared for a glass of water. "Yes, I do", I replied. "Cold or Hot", He asked? Cold I replied as I clutched my suit and took a deep breath, I knew that my rise or fall as a management consultant was dependent on this moment. A few minutes later, he gave me a glass of water and a list of financial documents. His smile slowly faded away as he began to narrate his tale of ordeals.

"We have reached a cross road", He said. "We are over 50% below our 2020 revenue forecast, we have had to lay-off several workers because we could no longer pay the bills. The whole thing just feels like a rock came crashing down on our head. I do not understand why the government had to shut down the economy. For crying out loud, we had hardly recovered from the economic recession when the pandemic struck. The whole lockdown thing kept us hemmed in the double squeeze of dying from hunger or disease ²".

Every now and then, I looked at him straight into his eyes and then I look at the report, as I juxtaposed it with the end of year outcome. It never ceased to move me all the while he was talking, his look of despair, his facial gesture of disappointment and his tone of frustration.

For a moment, he folded his hands and stared at me. "2020", he said, shaking his head. "It was a struggle". His voice broke – down as did his heart as he stared firmly at me. You could see it, hidden behind his shallow smile was a countenance of sorrow and disappointment. "it was the year that we had to scramble and we still do. How suddenly can prosperity become peril?" He looked at me expecting an answer.

"Within a twinkling of an eye", I replied, as I gave him a smile, interrupted him and began to speak:

"There have been as many plagues as wars in history, yet always plagues and wars take people equally by surprise". Albert Camus-the plague ³.

¹ Peter Drucker: The practice of Management.

² ILO BRIEF: COVID-19 crisis and the informal economy. Immediate Responses and Policy Changes.

³ Albert Camus: The Plague.

We have always had epidemics, I said, after quoting Albert Camus. “COVID-19 is not an accident or random event it only flared up because globalization have made the world a global village; It’s the new world we have created for ourselves.” I was merely paraphrasing an idea I had memorized that morning from the article Frank M. Snowden, Epidemics and Society: From the black death to the present ⁴.

“The world we live in today is more intertwined than ever before. National boundary is just an illusion. We saw the signs of an impending doom, but we never prepared for the storm. Long before the pandemic, we have always had HIV and AIDS to contend with, an epidemic which started from one part of the globe and travelled through the vehicle of globalization. from Africa in 1960, it touched down at Haiti and from Haiti to the Caribbean’s, from the Caribbean to New York in the 1970’s and then to San Francisco, It has now travelled all over the globe ⁵. Did we really learn anything from EVD (Ebola Virus Disease) which took-off from the Demographic Republic of Congo in 1976, and travelled all the countries in the continent of Africa. by 2014, it had arrived the U.S and SPAIN. How many managers are prepared for the next pandemic-climate change? we have seen how devastating the impact could be in other countries, over and over again we have read the warnings of an impending global warming. But have we incorporated strategies that will make the transition easy when it does happen? do we even bother asking ourselves these key questions in planning or are we stock in the myopic economic indicators of Inflation rates, interest rate and GDP. How well will the business survive had there been a shut-down of the global economy during HIV and AIDS? If for Any reason, there is a global warming in the future that ravages the world economy, how can we manage the crisis? at the beginning of a year, we focus all of our attention on the rosy economic forecasts and lose touch with reality. We do not attach a note to our yearly plan stating clearly how we plan to transit should there be a climate change, disease or war that makes our traditional way of doing things unworkable. There are many factors that may not appear in economic realities, yet they do pose greater threats to business survival in the short and long-term than some other economic variables we consider. Many Forward-thinking Managers who survived in the pandemic had long ago asked the “what if question”. We all saw the signs, but only a few prepared for the storm.”

The room was getting warm, and I was almost dehydrated, so sipped a few drops of water and decided to ease the tension by telling him a success story. A story I followed during the crisis

⁴ Peter I. Rose: Frank M. Snowden, Epidemics and Society: From the black death to the present

⁵ History.com Editors: History of AIDS.

and one I knew that could bring home what I call *The Missing factors in Managerial planning*. Some of these factors are included in what Drucker calls the Bedrock factors ⁶.

Success Story

“Thinking globally and acting locally allows us to have a global strategy and global mindset and at the same time, consider local events and be as close to our clients and employees as possible in the pandemic”Paolo Morelli

The above quote were the exact words of Paolo Morelli, the CEO of PM Holding, one of the managers I observed during the pandemic that was prepared for the storm. The Pandemic definitely was not much of a surprise to those managers who had always asked the *“what if”* kind of questions in their planning. Despite the crisis posed by the pandemic, there are a few managers who showed courage in the crisis. One major thing that is common among all managers that performed well in the pandemic was the fact that they saw it common and had all along prepared for a *Worst-Case Scenario*.

The organization was one the few that saw the pandemic coming. In the last 5 years, the organization have been building a structure that allowed the workers to work from home. As at the time the pandemic struck in March, the transition to remote working was smooth because majority of the workers were already used to remote working. During the Crisis, the organization was focused on its value of safety of the team and business continuity ⁷.

The organization maintained its value of trust, innovation and communication. When the Organization noticed just how threatening the crisis could be on the business, a risk management team was set up to carryout operational and commercial risk analysis. The operational risk management team focused on managing the risk associated with the clients and employees while the commercial risk management team focused on avoiding a loss in market share for the organization. During the pandemic, the organization switched to remote auditing. The flexible nature of the organization enabled it to flourish in the crisis.

Managing Tomorrow: the Danger of Optimism Bias

“An economist is an expert who will know tomorrow why the things he predicted yesterday didn’t happen today”Laurence Peter.

No business is in isolation, every business is a unit of a larger system, This is why every business must have a plan and budget at the beginning of every year. I am however, not pleased with the high emphasis placed on financial indicators(and the neglect of non-financial factors) in making business projections. If we ever learnt anything in the crisis, it is that economic indicators do not tell the whole story about the future. Its underlying assumption that Natural and Artificial Disaster will always remain unchanged or constant is an over-simplification. Many managers innocently fall prey to such bias in planning when they rely solely on economic indicators.

⁶ Peter Drucker: The practice of Management.

⁷ seQure: Navigating Business in Times of COVID-19: Interview with Paolo Morelli.

There is an optimistic bias in economic projections that every other thing will remain equal (Ceteris-Paribus). This bias is considered necessary for simplicity because there are a thousand reasons why ceteris may never be paribus. As Ulrich Witt puts it: *“it may be useless to explain all causes of changes, because some of them lies outside the domain proper of respective evolutionary theory. In the case of economics for example, such factors are: weather condition, Natural disaster, war and political upheavals”*. These economic projections on which most managers base decisions have never been more unreliable as it was in the 2020 crisis. How do we explain that in 2019, the world output for 2020 was projected to rise from 2.9 to 3.3, and by the end of the year, the actual was -3.5. Most businesses that assumed every other thing will remain equal by basing decisions on economic factors alone were caught up in the bandwagon effect and put out of balance in the crisis.

This Optimistic Bias is also evident in the business cycle of Schumpeter who suggested that an economy will always tend towards equilibrium, as if it is automatic and there is just one business cycle. I have always had my doubts about the predictive power of the common-sense business cycle theory; a theory which was criticized by Drucker. According to Drucker, the business cycle is a result of too many cyclical movements that it can only be analysed in retrospect ⁸. There are several factors that may disrupt the business cycle and prevent it from reaching equilibrium in the long-run. Some of these factors may not have appeared as economic realities and hence are ignored to the detriment of several businesses. As David Wallace-Wells puts it: *“.... even within the post-industrial nations of the wealthy west, where economic indicators such as unemployment rate and GDP growth circulate as though they contain the whole meaning of life in them, figures like these are a little bit hard to fathom; we have become so used to economic stability and reliable growth that the entire spectrum of conceivability stretches from contractions of about 15%....”* ⁹.

Am I against being optimistic? No. Am I against the use of economic indicators in business planning and profit forecasting? of course, am not. Being optimistic is important for motivating the employees to achieve better performances. I am not against being optimistic in planning and decision-making process. What I am not impressed with is the over-optimism that plagues many managers such that they become myopic and give less attention to the environmental and non-financial exogenous factors happening around them.

Innovating your New Normal

“Smell the cheese often, so you know when it is getting old¹⁰” Dr Spencer Johnson

This is a rare wisdom for the over optimistic manager who believes in the fallacy that all thing will remain equal and fail to have a holistic view in planning for tomorrow. The days that are coming will require a manager to think beyond just selling existing products to developing new ones. The

⁸ Drucker: practice of management

⁹ David Wallace-Wells: The Uninhabitable Earth: Life After Warming

¹⁰ Dr. Spencer Johnson: Who Moved My Cheese?

key difference between a competent and an incompetent manager is their ability to handle Change. The old idea that things will remain the same is out of style as competent managers are discovering more reliable ways of delivering value to clients. As Drucker notes “If you want something new, you have to stop doing something old.” The market equilibrium disruption caused by Innovation is one of the reasons why all things will never remain equal in our world today. If there is anything we have learnt from the crisis, it is that technologically advanced firms who always adopted new innovative techniques and methods were less affected by external economic shocks.

The game is changing and those who are too rigid to incorporate changes will fade away. In the 21st century, we have moved from market exploitation to market creation. The use of pricing competitive strategy to gain market share is going out of style. More important is the use of innovative ideas to create new products or services that will cause industrial disequilibrium and gain more market share for the firm. Every competent manager needs to not just have an Innovation or Technology department, but must himself be technologically inclined. This is the manager Drucker describes as the manager of tomorrow ¹¹. According to Drucker, the traditional way of doing things in an organization will always kick against new possibilities ¹².

“Finally,” I said, as I took the last drop of water, cleared my throat and was rounding-off.

I could hear mum laughing in the living room. I woke up, I must have fallen asleep, it has been a fantasy all along. I sat up on the bed and sighed. “maybe I have got some optimistic bias in me too” I thought to myself as I fell back to the bed, tossed and turned from one end to the other searching for sleep, but the pleasure of sleep had left me. It was then I began to ponder on the following questions: is it time for the next generation? Are they experienced enough or are they too naive?

I began to reminisce a few cases in the past when the younger generation stepped up to the challenge and proved their mettle in a crisis.

From Crisis: a new manager is born

“The biggest problem is not to let people accept new ideas, but to let them forget the old ones” -----John Maynard Keynes.

Centralization vs Decentralization:

There is no other story worth telling than the story of Ford Motor Company, how that the company was at the verge of a collapse because of its attempt to do without managers after world war II, had it not been for the timely intervention by his *grandson*, there would be no Ford today. Far more than just the importance of decentralization, the story shows us that after every major crisis, old ideas become unworkable and a new generation of young minds have always had to come up with new ideas; one different from the old generation. The belief that the younger generation are often inexperienced is a fallacy as history has proven that the younger generation are more likely to adapt and be in touch with the changing world than the older generation. The Old Henry Ford was

¹¹ Peter Drucker: the practice of management

¹² Peter Drucker: Managing in Turbulent Times

operating a centralized system and assumed that things will remain as they were. An idea which became obsolete after the world war, but an idea the old Henry Ford was unwilling to let go. His grandson adopted a decentralized system that saved the company from an impending collapse. Decentralization involves building an organizational structure that gets the subordinates involved in the decision-making process. The chief executive in every business (except perhaps the very smallest) cannot properly be organized as the job of one man ¹³, It must be the job of a team of several men acting together. A manager of the 21st century will need to manage the process, not the people.

Ceteris Paribus vs Change:

Although I am not against the use of economic indicators for making forecasts for the business. The younger generation have learnt by experience that all things will never be equal. Economic indicators are flooded with optimistic bias and do not reflect worst case scenarios. The Old manager is stiffer to change because He was never exposed to a fast-paced technological world, one where there are no impossibilities. They often assume that all other things will always be equal, the younger generation assumes the opposite. The quicker we come to terms that there will always be fluctuations, the sooner we begin to prepare and become dissatisfied with the norm.

“Finally,” I said to myself as I walked up to the shinning mirror hanging at the corner of the wall. “Nobody knows tomorrow, the best we can do is manage tomorrow by inventing it rather than trying to predict it”. Managing tomorrow is a skill that is learned from experience and training, It requires mixing optimistic scientific predictions with threatening non-financial factors as well as “gut-feelings” and intuition to find a balance. Economic forecasts should be taken with a “pinch of salt” in business planning and decision making. Business planning going forward will have to consider several *what-if* questions cutting across not just economic indicators, but other environmental and non-financial factors that may not have expressed themselves in economic realities. The best way to manage tomorrow is to be innovative and get ready today for the *worst-case scenario*. This can only be achieved when managers free themselves from the shackles of optimistic bias in try to predict the future using economic indicators. As Drucker rightly said “trying to predict the future is like trying to drive down a country road at Night with no lights while looking out the back window.”

¹³ Peter Drucker: the practice of management

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