

The Root Causes of Anticipation Failures

In this briefing memo, we will review the root causes of failures to anticipate threats to a company's strategy and survival. Along with assessment and adaptation failures, anticipation failures are one of the three main causes of strategic risk governance breakdowns. In our next memo, we will look at what companies and boards can do to avoid anticipation failures.

First, what is strategic risk governance? Let's look at the underlying concepts.

- Strategy is a causal theory of how to use limited resources to achieve critical goals in the face of ignorance and uncertainty.
- As we use the term, strategic risk is the potentially negative effect of uncertainty on critical outcomes.
- And governance is the system of rules, practices, and processes by which a company is directed and controlled to achieve its goals.

Governing strategic risk is one of the most important functions a company's board performs.

There are four main causes of anticipation failure.

The first is the complex nature of the environment in which most companies operate. Complex systems are characterized by multiple linkages between causes and effects, many of which involve non-linearity and time delays. Moreover, many of the players in such systems are constantly adapting their behavior in response to feedback about its results and observations about what others are doing. And in today's densely interconnected world, those feedback loops operate faster and with more information than ever before in human history. As a result of these factors, today's competitive environment is characterized by hidden tipping points, sudden regime changes, and a rising number of so-called black (or grey) swans and tail events.

The behavior of complex systems is extremely difficult to accurately predict, and the challenge increases exponentially as the time horizon lengthens.

The second cause of anticipation failure lies in our evolutionary past, and how we are wired to perceive the world around us.

Having spent so much of our human existence in a world without writing or maths, we naturally use stories rather than formal models to make sense of our uncertain world, including the fundamental cognitive processes of explanation and prediction. Stories are powerful because they have both rational and emotional content; while that makes them easy to remember, it also makes them very resistant to change. The old saying that it takes twice as much evidence to change an opinion than it does to form one is, if anything, an understatement. When a company's environment is rapidly changing, this can easily cause failure to anticipate new threats.

But it gets worse. To avoid cognitive dissonance, we naturally tend to look for and put more weight on information that is consistent with, and reinforces, our existing stories. As Daniel Kahneman has noted, "familiarity breeds blindness with inferior information."

Neuroscience researchers have also found that our brains asymmetrically update our memories, with too little weight given to negative experiences, which in turn creates a natural bias towards over-optimism. Researchers have also found that our tendency towards overconfidence has deep evolutionary roots as a signaling mechanism in the competition to attract resources and mates.

In sum, at the individual level, many of our basic cognitive processes are potential sources of anticipation failure.

Group dynamics are the third source of these breakdowns, especially our natural tendency to conform to the views of our peers, particularly in situations where uncertainty is high. This produces a tendency towards groupthink, which inhibits the airing of dissenting views and new information that does not cohere with the group's preferred story.

Organizational factors give rise to a fourth source of anticipation failure, via the tendency to recruit and promote people who have similar views, and the increasing desire (particularly as a company grows) to avoid errors of commission (e.g., false alarms), even though that makes errors of omission (e.g., missed alarms) more likely.

When you look at all the forces involved, it is easy to see why anticipation failures have tended to be the rule, not the exception throughout history. In our next briefing memo, we'll review what companies and boards can do to improve their chance of avoiding them.

Next up: How to overcome the root causes of anticipation failure.

For more information about how Britten Coyne Partners can help your organization manage and govern strategic risk, please contact us:

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