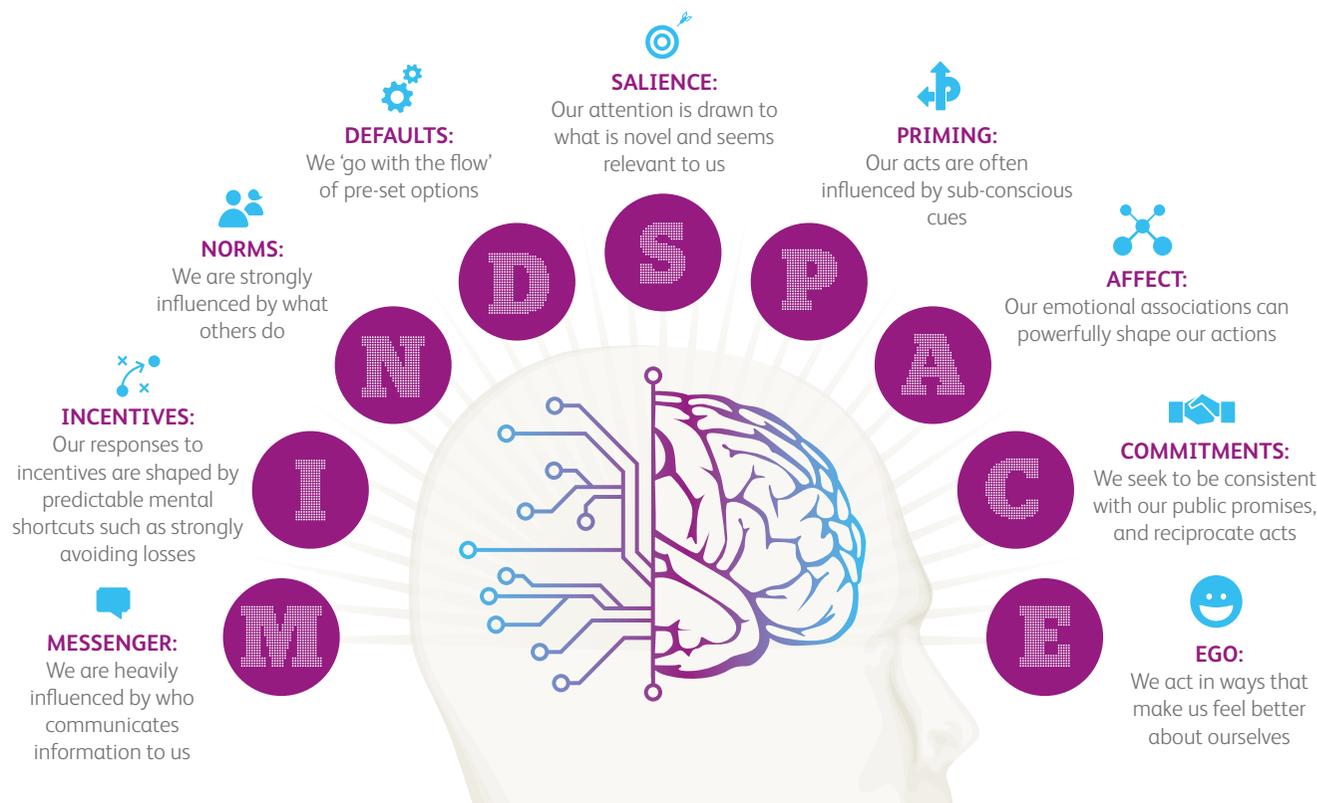# BearingPoint® Institute

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IN 30 SECONDS

- A leader decision-making scholar, Professor Ivo Vlaev, makes the case for taking a behavioural approach to corporate strategic decision-making

- Strategic decisions make or break companies; yet most business leaders would admit that the quality of their strategic decisions is far from faultless

- To optimise your business outcomes, you are best off adopting a behavioural approach that joins a real-world understanding of complex human behaviours with data-driven modelling

- MINDSPACE is an easy, practical checklist, drawn from behavioural economics, that businesses can use to influence behaviours

How behaviours impact your corporate decision-making

It is no secret that the science of decision-making has been deeply impacted by behavioural principles in recent years. We spoke with Professor Ivo Vlaev about the mainstreaming of behavioural economics and why corporate strategists should embrace its powerful insights.

The MINDSPACE framework for behaviour change assembles the nine most robust effects that influence our behaviour

SALIENCE: Our attention is drawn to what is novel and seems relevant to us

DEFAULTS: We 'go with the flow' of pre-set options

PRIMING: Our acts are often influenced by sub-conscious cues

NORMS: We are strongly influenced by what others do

AFFECT: Our emotional associations can powerfully shape our actions

INCENTIVES: Our responses to incentives are shaped by predictable mental shortcuts such as strongly avoiding losses

COMMITMENTS: We seek to be consistent with our public promises, and reciprocate acts

MESSENGER: We are heavily influenced by who communicates information to us

EGO: We act in ways that make us feel better about ourselves

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*Businesses are fundamentally
institutions or machines for
decision-making*

Economic models assume that everyone behaves perfectly rationally. A bit like robots - which, if you hadn't checked the news lately, are moving into workplaces, by stealth, and climbing up the corporate ladder.

But humans aren't robots, and they don't act programmatically. So when the standard decision-making models are applied to corporations, the results are often dismal.

Behavioural economists, like Professor Ivo Vlaev from Warwick University, focus not on robots but on humans in all their misbehaving, irrational glory. They mine the latest insights on what we know about human psychology, including social, cognitive and emotional factors, and use that to explain human decision-making. And over the past decade, this fairly marginal field has moved to the forefront, triumphing in academic circles, in the press and, increasingly, in policy and business spheres.

Professor Vlaev, a leading thinker in behavioural economics, has been working closely with corporates to help them improve their decision-making.

In this conversation he shares his views on how digital is transforming strategic decision-making. And he explains why business leaders need to consider the underlying dynamics behind the way

Behavioural economics tells us how to fix human biases if we can and, if we can't, it tells us what to do about it

humans think to bring forth successful outcomes. With these fundamentals unpacked, Vlaev then introduces a novel framework that arms leaders with practical tools and methodologies to influence behaviours for smarter business outcomes.

BearingPoint Institute (BEI): What's wrong with current approaches to business decision-making?

Ivo Vlaev: Businesses are fundamentally institutions, machines for decision-making, where every second there are hundreds and thousands of decisions made by various interrelated individuals.

Decades of research show that managers do not always act as rational decision-makers, as standard economic models assume, and the resulting biases can lead to costly errors.

BEI: So, what to do?

Ivo Vlaev: Behavioural economics is the descriptive science of human decision-making. This is in contrast to the

normative science of decision-making – how humans should make decisions - which is called economics and statistics.

The big question is: are cognitive biases fixable? (See the MINDSPACE checklist.) Behavioural economics can answer this question as it tells us how to fix human biases if we can and, if we can't, it tells us what to do about it.

BEI: How are biases typically 'fixed' in business contexts?

Ivo Vlaev: Conventional approaches to eliminating biases focus on 'changing minds'. That is, influencing the way people think through more information and better incentives.

Typically, this involves training people to recognise biases, to help them think more logically and rationally, leading to better outcomes.

The implication is that decisions require de-biasing. This is because effective decisions are seen as more likely when managers act without bias.

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BEI: What are the problems with the de-biasing approach?

Ivo Vlaev: Well, evidence suggests that the de-biasing approach is insufficient for effective strategising because it only deals with our conscious, slower analytical half. But our automatic, emotional, subconscious half also plays a role in decision-making.

Even irrelevant stimuli can significantly influence decisions, such as the impact of sunny or cloudy weather on which applicants for a job receive offers.

Importantly, our conscious, slower thinking often fails to correct for the problems created by our automatic, intuitive mode of thinking because decision-makers are unaware of how it influences their decisions. (See 'Dual Process Model of Behaviour'.)

In cases where decision-makers do recognise these biases, they do not sufficiently adjust using the slower, more deliberate mode of thinking. In other words, even when steps are taken to de-bias managers' decisions, the results may be suboptimal.

The MINDSPACE framework is a practical behavioural economics checklist to help decision-makers design the decision environment to promote better outcomes

DUAL PROCESS MODEL OF BEHAVIOUR: SYSTEM 1 & SYSTEM 2 THINKING

Consciousness involves different kinds of thinking. Psychologists including two recent Nobel laureates, have proposed two main thought processes that are commonly referred to as 'System 1' and 'System 2'.

System 1

System 1 is the mind's automatic, fast, intuitive approach to thinking. Here, the mind processes information quickly, and is heavily influenced by context, past experience and biology.

Intuitive thought processes are often regarded as irrational when in fact they may be highly practical and logical in specific domains.

Examples: routine conversations, detecting hostility in a voice, answer to 2 + 2 = ?

System 2

System 2 is the mind's slower, conscious, more deliberate mode of thinking. Here, reason dominates and the mind is actively focused on tackling a demanding cognitive task.

System 2 thinking may produce poor and even irrational results, just as they may lead to favourable outcomes.

Examples: solving a complicated math problem, parking in a narrow car space, filling out a tax form, maintaining a faster walking speed than is natural for you.

Source: Daniel Kahneman, *Thinking, Fast and Slow*, New York: Farrar, Straus and Giroux, 2011

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BEI: So how does behavioural economics help with biases?

Ivo Vlaev: Behavioural economics aims to introduce strategies for managing these faster, intuitive biases by 'changing contexts' – that is, the environment within which people act - as opposed to 'changing minds'.

Instead of trying to correct our intuitive, automatic thinking, we seek to reframe the problem of de-biasing into a problem in which we actually try to engage different automatic processes.

The MINDSPACE framework (see infographic at the beginning), for example, is a practical behavioural economics toolkit that can help with 'strategising with biases'. This means engineering the decision context to direct managers' intuition towards better outcomes. It can also address how to take advantage of competitor biases.

In general, whereas conventional de-biasing aims to make existing decision-making strategies more accurate, behavioural economics seeks to reframe the decision so that different automatic/emotional decision-making strategies may be recruited.

The same errors that make us stumble can also be used to make better choices.

MINDSPACE

Which decision biases are sabotaging your organisation's best-laid plans?

Derived from the MINDSPACE framework[1], the BearingPoint Institute has devised a checklist to help you identify the most common biases that can stand in the way of strategic decision-making.

Multiple techniques exist to change behaviours within organisations by either activating biases or neutralising them. Before deploying these techniques, however, it's necessary to first **identify which biases are in play.**

ASK YOURSELF:

M MESSENGER

Q: Is the decision influenced heavily by the people who provide the information, even if they are not stakeholders?

A: Consider whether the credibility of the person delivering the information is having an influence.

I INCENTIVES

Q: Are you drawn towards the 'easy answer', such as quick wins or lower-risk options?

A: Decisions are embedded within certain contexts. Think about how the 'solutions' are being framed. Through what lens are you viewing the problem? To unravel this, seek alternatives ways of tackling the problem.

N NORMS

Q: Is the chosen option seen as non-controversial, for example is it in line with what others are doing?

A: Challenge whether you are taking the decision to align with your peers, or because you're concerned about appearances.

D DEFAULTS

Q: Has the decision fallen back on the default option when considering broader options, particularly if time/money has already been spent?

A: This is the seductive pull of sunk costs, the bait of easy options. Ward off laziness and think through the best course of action: it will pay dividends in the long run.

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- Interview

- Dual Process Model of Behaviour: System 1 & System 2 thinking

- MINDSPACE Checklist for Decision Biases

- About the interviewee

- TEST: Assess the quality of your strategic decisions

BEI: Can you give an example of a behavioural economics technique used in a business context?

Ivo Vlaev: Let's take Salience [representing the 'S' in MINDSPACE].

Consider the problem of hiring 'top talent'. Stereotype is a 'salient' cue and can work as a useful shorthand for identifying talent – the candidates who fit the stereotype are inferred to be more competent.

So, it has been observed that elite law firms in the UK may be over-represented by graduates from Oxbridge. One possible reason is that Oxbridge degrees are so salient that CVs with this cue are more likely to be considered further in the hiring processes.

But the use of this salient cue can be suboptimal. Graduates from other schools may be better than some Oxbridge graduates, but law firms cannot uncover these 'false negatives' unless they hire against the stereotype.

There will be more behavioural insight teams within organisations in the future, in the same way there are accounting and legal teams within organisations today

S SALIENCE

Q: Are you drawn towards a particular option that is being flagged as new or relevant, for example in the media or by suppliers?

A: Ignore your favoured option for the moment, and develop the neglected options. In doing so, use different benchmarks, models and sources. Then compare. The objective here is to understand the basis of your decision.

P PRIMING

Q: Are you swayed by the way the scene was set early in the process, for example meeting those impacted by the decision?

A: Priming is often subliminal, so it may be hard to recognise. Take a sceptical look at the language, imagery, and other 'staging effects' that are in play in the lead-up to the selection of a decision. Question whether you are responding to these external stimuli.

A AFFECT

Q: Did the emotions of decision-makers play a part in the decision-making?

A: Remove yourself from the high temper of the moment. Revisit this issue once feelings have subsided and look at the problem again taking an outside view.

C COMMITMENTS

Q: Was the decision steered towards keeping promises or commitments (for example, to senior management) or to customers?

A: Imagine breaking your promises and commitments, and develop another story to justify a different approach.

E EGO

Q: Was the decision guided by how decision-makers felt they would look?

A: Think about the motive behind the decision. Do you think you are gravitating towards a particular decision for self-serving reasons because it strengthens a positive and consistent self-image of yourself? Test this by asking others how they would make the decision.

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There will be more Chief Behavioural Officer roles created

BEI: Do you have a real-world example?

Ivo Vlaev: Yes, this is what a leading law firm Clifford Chance tried to do. They adopted a 'CV blind' policy to break the Oxbridge recruitment bias[2].

By engineering the hiring context this way, the firm has managed to find many hidden gems where their competitors were not searching – that is, in the under-exploited pool of graduates from non-elite universities.

BEI: What's another example of a behavioural economics technique?

Ivo Vlaev: Another category of behavioural cues is Priming [representing the 'P' in MINDSPACE].

Primes can be words - for example, one feels more powerful and confident when asked to describe an experience in which one person has power over others; sights - for example, larger size food containers make people eat more; smells - for example, the scent of all-purpose cleaner makes people more likely to keep their table clean.

We are not aware of how our preferences and decisions are shaped by these primes. Our actions may seem unpredictable and non-rational, but in fact they are often influenced by many subconscious cues.

In the future, behavioural economics testing will be able to scale-up by using big data

Knowledge about priming can help strategists influence others – or at least avoid being taken advantage of by others.

For example, research shows that the colour of the cover of business proposals (a presumably irrelevant prime) can influence evaluation outcomes systematically: blue enhances the acceptance rate whilst red reduces it.

BEI: Where is the new frontier of behavioural economics research?

Ivo Vlaev: First, there'll be more field experiments to test behavioural economics assumptions in the real world.

It's not sufficient to test those assumptions based on interviews, etc. You need to conduct randomised trials without the participants being aware they are part of the experiment. In business, it's fairly easy and inexpensive because the structures are already in place: you only need to tweak certain environmental features to see the effect on recipients.

The second big innovation will be big data.

Increasingly, we can take a big scale approach to testing behavioural hypotheses by utilising big data from hundreds and thousands of individuals using digital devices – for example, digital wearables – to actually track their movements, decisions, and behaviours. Typically, most experiments are smaller in scale and come from lab research.

Third, there will be more behavioural insight teams within organisations in the future, in the same way there are accounting and legal teams within organisations today.

This is already happening, but in many cases the policies generated by these teams aren't implemented in practice. I think not only will there be more Chief Behavioural Officer roles created, I believe that they will be accorded higher status so they will be more empowered to improve decision-making. ●

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  Checklist for Decision Biases

- About the interviewee

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  of your strategic decisions

ABOUT THE INTERVIEWEE

Professor Ivo Vlaev
Professor of Behavioural Science at Warwick University
Ivo Vlaev is Professor of Behavioural Science at Warwick University and Visiting Professor of the Faculty of Medicine at Imperial College London. Ivo received a DPhil (PhD) in Experimental Psychology from the University of Oxford. His research is to advance understanding of human decision-making (behavioral economics) and behaviour change. It is a convergence of psychology, neuroscience and economics, which achieves results that none of the disciplines can achieve by themselves.

Key research interests are human decision-making in various domains (social, financial, medical). Specific research topics are risk attitudes, consumer psychology, behavioural finance, cooperation, well-being. Ivo is also a co-author of the UK Cabinet Office MINDSPACE report, advising local and national policymakers on how to effectively use behavioural insights in their policy setting.

Ivo.Vlaev@wbs.ac.uk

Project team

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ASSESS THE QUALITY OF YOUR STRATEGIC DECISIONS

Organisations are the sum of the decisions they make. Yet just how helpful and advanced are the tools, data, behaviours and processes that organisations use to make quality decisions?

Take this quick test to evaluate your organisation's strategic decision-making capabilities by circling the letter next to the statement you agree with most fully. Then read how we rate your answers and the actions we recommend you to take.

1 We monitor our strategic decision-making process and evaluate progress:

A   systematically and collaboratively, with a clear and accepted process in place

B   flexibly, accommodating the time commitments of key stakeholders

C   in a semi-structured manner, when we have resources available

D   on an ad hoc basis with a few key people involved, and strategic decisions are discharged quickly

2 We review feedback and make modifications to our decision processes:

A   on a formal basis over the complete cycle, drawing insights through ongoing iteration

B   in fairly frequent cycles, in an organised fashion to close the gap between principle and practice

C   as the need arises, adapting to reflect the prevailing view

D   informally as we are close to the process, making changes where necessary as we go

3 We address barriers in the decision process:

A   using a holistic, proactive approach with a view to overcoming behavioural biases and organisational impediments

B   in an informed manner when challenges and opportunities arise in the business

C   at the point at which we need to step in to keep the decision on track

D   we feel uncomfortable imposing barriers to the decision process

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4 We find that generally the data needed to make strategic decisions is:

A   comprehensive, relevant, available and fully utilised

B   of high quality, and made accessible with good tools

C   unavailable or incomplete in places, but with a strong awareness of its importance

D   not there, as the company excels more in working with people and utilising qualitative methods

5 In making strategic decisions, we leverage digital technologies (for example, analytics, automated tools) and skill sets:

A   to transform the business: digital is integrated company-wide to promote more intelligent decision-making

B   with particular emphasis on certain areas of the business, although plans are afoot to extend these capabilities

C   where necessary, but recognise the need for non-digital tools as well

D   not at all: we don't require these capabilities for our business

6 Strategic decision-making authority is assigned to decision-makers:

A   at board-level, with empowered and answerable executives

B   with solid managerial experience, a far-reaching remit, who report to the board

C   accountable for certain big-ticket projects, and where decisions can be quantified (for example, sales revenue)

D   at the local level, linked to local priorities, in which everyone is empowered

7 We select the right course of action because we have:

A   clear objectives, sound data, the input of all stakeholders, sustained by a holistic process

B   managers with drive who know what they're doing, and able to carry people to the finishing line

C   a deep understanding of our business and market

D   people we trust to work independently at a local level

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Add up your scores. If you have a majority of:

As Your organisation has formal processes in place, and displays excellent behaviours and smart metrics to enable quality decision-making. You've done your homework by developing feedback loops for continuous learning that is also buttressed by high quality data and digital tools. Yet whilst due diligence is prioritised, there's a risk that accuracy comes at the expense of timely decision-making, and agility is muted by formality. For even better outcomes, consider how to build greater agility and efficiency into your decisions, perhaps by empowering people more.

Bs Your organisation strikes a good balance between formal and informal processes. As a group, you're attuned to the techniques to raise the quality of your strategic decisions. Further benefits would flow if you take the next step in embedding more sustainable decision processes and practices; and lift your digital competency to even greater heights.

Cs Your organisation has an eye toward developing a good decision-making culture; and your processes and practices are more informal than formal. Whilst this enables flexibility and may be supportive of growth, the flipside is you may be courting a level of risk that is higher than it needs to be, relying too much on the expertise and instincts of a few decision-makers. More attention toward formalising your processes and practices might be helpful, in addition to harnessing more data and throwing the net wide to solicit the input of diverse stakeholders.

Ds Your organisation favours informal processes to govern strategic decision-making. This enables you to move with speed and fluidity at the local level, and affords an ability to respond to the specificities of context. However, should things go awry, there are no solid mechanisms of recourse built into your decision processes. Missing, too, is full oversight of your critical decisions. You would likely do well to begin the journey of embedding more digital tools and feedback loops, acting more collaboratively, and building a robust risk management strategy into your decision-making processes.

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About the BearingPoint Institute

At the BearingPoint Institute, our ambition goes beyond traditional 'thought leadership'. We aim to contribute original ideas to the science of business management whilst equipping decision makers with practical advice gained in the field and through our research projects.

www.bearingpointinstitute.com

About BearingPoint

BearingPoint consultants understand that the world of business changes constantly and that the resulting complexities demand intelligent and adaptive solutions. Our clients, whether in commercial or financial industries or in government, experience real results when they work with us. We combine industry, operational and technology skills with relevant proprietary and other assets in order to tailor solutions for each client's individual challenges. This adaptive approach is at the heart of our culture and has led to long-standing relationships with many of the world's leading companies and organizations. Our global consulting network more than 10,000 people serves clients in over 75 countries and engages with them for measurable results and long-lasting success.

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