

Managing irrationality

Business management suggests the best decisions are based on a series of logical actions that result in a successful outcome. However, companies often operate in an irrational environment and this factor needs proper management, says **Leandro Herrero**



Every time the hunting party of a certain Indian tribe prepares to go on an expedition, the same ritual occurs. One of the elders gathers the men and ceremoniously burns small pieces of wood. People dance, the hunters get ready, and the elder indicates the way to go. The shape of the ashes, after a few mixes and movements in a flat container, shows the elder the direction the hunters should take: north, south, east, up the mountain, down the valley, etc. This is a community where hunting is a major part of the way of life. This tribe is not only good at using hunting tools but it is also very successful in its various escapades. Coming back with 'food' is the norm. The key to the tribe's success is in those ashes. The ashes determine where the hunters go. Not terribly scientific by our standards, but, this is not the point. The point is how the whole thing works.

There is an unwritten principle behind this type of irrationality leading to success. The logical and rational thing for a hunting group to do is to go back to the place where they found the animals last time. If animals abound east of the camp and down in the forest, why on earth would anybody want to go west and up the hills? If you were a management

consultant to these Indians you would surely recommend that they repeat what has proven to be a successful process and develop expertise. Maybe, dare I say, you would tell them that they should create a core competence around that standard process. Notwithstanding the catatonic expression on the face of tribe's Chief Ash-Reader when explaining these terms to him, the advice itself would be wrong – you would be advising rationality when irrationality is what feeds them. Indeed, if the hunting party went to the same place every time and each trip was successful, the result would be that the area is progressively depleted of animals. The ashes introduce a random strategy which, by forcing the pack to go in several directions without much repetition, makes them bound to find animals without depleting the hunting areas. The irrational ashes have a rational logic after all.

Modern times and different scenarios

An army battalion is on a full survival exercise in the Alps. As such, conditions are deliberately harsh, the whole idea being to test ways to survive with little or no support. Everything goes well until the weather changes suddenly and heavy snow and storms flood the place. The drill is no longer a drill – it's pure reality testing. The soldiers didn't anticipate this. The group's situation gets progressively more dangerous. Some people reach freezing thresholds. Something serious must be done



but they are a bit paralysed in deciding what to do. Activity is better than the alternative so they know that they must walk. The question is which direction should they take? Suddenly one of the soldiers comes up with a map that was hidden in his kit. He was probably not supposed to have it but, quite frankly, they are not in the business of debating discipline now. The map is more than welcome. It takes them a few seconds to figure out the route they must follow to get back to the base. The map clearly shows them the straight path along the valley, over that hill, across the river, eventually reaching the base. And so they move on. A few hours later, exhausted but alive, they reach base camp. It was great to have a map whether they were supposed to have it or not. They celebrate over hot drinks. Once settled, they have a chance to look at the map again with some calm. It was a map of the Pyrenees!

Both stories are true. In both cases action was induced and inaction prevented; in both cases the outcome was the result of a successful adaptation to the prevailing conditions. The Indians went in the direction indicated by the ashes and statistically increased their chances of finding animals. The soldiers in the Alps were saved by the existence of a (wrong) map that made them move on. The Indians' irrational behaviour (for us) and irrational method (for us), which is for them 'rational', actually saved them. The soldiers' rational behaviour (for us and for them), based on a rational method (for us and for them), saved them, even if it was based upon completely wrong information.

Daily life provides us with continuous examples of these combinations: wrong assumptions leading to ultimate success, right information leading to total failure, irrational thinking that delivers the goods, rational behaviour that destroys something, and so on. We have a tremendous ability to go along with post-hoc fallacies, that is, B follows A, so A causes B. Good planning precedes project success, so success occurs because of the planning. Good training increases sales, so therefore, sales are the result of the training effort. A new leader's arrival coincides with a turnaround in the business – good news, the turnaround is due to the leader we have just hired.

Post-hoc fallacies are an incredibly good anxiolytic for the brain, better than taking tranquilisers. They tell us that our actions make sense and that the world around us is rational, ergo, manageable by us rational people. A closer look at the reality could perhaps tell us a different story. For example, that the project's success was not the result of extraordinary planning but because of the heroic actions of a few people; that the increased sales were not due to the outstanding training of the sales force but to the pathetic performance of a key competitor; that the business turnaround had nothing to do with the new leader but with the measures put in place by the old one who was fired before he could see the benefits of them, etc.

Despite our tendency to believe that the world around us is rational, we are a live

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production machinery of irrational actions. We may find the Indians esoteric but we ourselves may also be seen as such by other observers. We have this need to declare rationality as the norm, otherwise there would be no parameters by which to judge or any logic to follow. The whole discipline of economics is based upon the assumption of rationality. Given the option, that is, given knowledge of alternatives and outcomes, people will opt for a rational behaviour that maximises utility. This is the foundation of all economics. In plain English, we expect people to behave rationally and mainly in their own interests, whether it's a personal or group interest. The whole architecture of economics is of course flawed because the assumption is no longer sustainable. This is why the branch of behavioural economics exists : to study these irrational inconsistencies of people or markets that can't be understood from the mother principle of the discipline.

So, are we all Indians playing with ashes and deciding where to go, or soldiers making it back to base despite wrong maps? Are we surrounded by unpredictable chaos despite our determination to see logic and order? Well, the answer is a bit of everything. What strikes me is how much of our business life (processes, decisions, 'logic') is based upon assumptions of rationality when, just out of the window we could see a rather different world. Let me give you an example. A company providing data serves a customer by delivering huge amounts of market information. That information, it's assumed, will be the basis for good resource allocation decisions, which in turn, it's assumed, will lead to success. This formula has worked for donkeys' years. But the whole logic algorithm is often flawed. The existence of available and ready-to-use information is unfortunately no guarantee of good decision-making. Managers make good decisions with lousy information and bad decisions with excellent information. The logic also assumes that people who receive such information will actually use it, which is a hell of an assumption. Very often the assumed route of the information flow within the company is totally theoretical, as a good knowledge-flow mapping exercise would perhaps show. Finally, it's also assumed that managers, in general, will act rationally in assessing the information, and that they will make the consequent and consistent resource allocation decisions, and that these will lead to a particular, say, market share increase. Again, there is an incredible amount of rain-making in this thought

process, but we want to believe that this is how it works.

Managing irrationality is a forgotten core competence, to use the jargon. It's not about throwing in the towel and declaring that there is madness out there and, therefore, anything is possible. Rather, it is about (1) being aware that we are very irrational animals provided with a fairly rational thinking tool inside our heads and (2) that one has to challenge the apparent lines of rationality, scratch the surface and try to find those assumptions that have the consistency of cream cakes. It is also about (3) not dismissing the role of irrationality itself, what I call the 'remember-the-hunters' warning, because it may contain some good adaptative solutions that rationality itself may lack. It's also about (4) not mistaking irrationality for emotionality. Many people believe that the opposite of rational is emotional. And in business terms 'emotional' almost always has a negative connotation. If we say of a leader that he is not a good one because he sometimes acts very emotionally, we are really saying that we expect rationality and emotional detachment from him. 'Emotionally' literally means here 'not good for business'. But the true opposite to rationality is irrationality, while the true opposite to emotional is unemotional. You can be rational and emotional (our brain is this way all the time) and also irrational and emotional etc.

In general, business management doesn't even have the equivalent of behavioural economics. The Society for the Advance of Behavioural Economics (SABE) states that it "welcomes the use of psychology, sociology, history, political science, biology, and other disciplines to assist in furthering our understanding of economic choice." There is no such equivalent in business management. I would be just happy with a tenth of it! We all, apparently, make rational decisions in business based on rational data. We hunt in the same area where we hunted before which gave us that 3.4 % increased market share, with the same repeated process. And it's all ISO9000. We need some pieces of wood and a  box of matches.

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