

Teresa Almeida

Grace Lordan

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How behavioural science can help firms navigate the 'new normal'

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As businesses try to adapt to the 'new normal', the temptation is to rely on past experience to make big decisions. Teresa Almeida and Grace Lordan (LSE) warn that they need to adopt different, scenario-based approaches, and listen to a wide range of voices in their organisation – not just 'people like us'.

The “new normal” is now ingrained in the discourse surrounding COVID-19. As we lift our heads and find our feet, the phrase expresses the certainty we crave as we navigate towards the future. Behavioural science can help this effort – not by somehow revealing the right choices to make, but by recognising that at times of uncertainty, how

we approach decision-making changes. We rely more on heuristics and biases which affect how we assess risk, and perceive costs and benefits.

When we face unexpected challenges, it is natural to rely on the familiar and to devise solutions based on past experience. In a very timely book, *Radical Uncertainty*, which was published earlier this year, John Kay and Mervyn King analyse how the probabilistic analysis core to business and economic models can engender a false sense of security when the outcome is unknowable. Drawing on economics, statistics, anthropology and other fields, they argue that models that aim to maximise expected utility and return are best suited for “small worlds” where past experience can be used to make strategic and economic decisions – but not where the future is unpredictable or uncertain. And our way out of this pandemic is both unpredictable and uncertain, particularly when it comes to damage to the economy.

Fridtjof Nansen, a Norwegian explorer and Nobel Peace prize winner, was a polar hero. In the late 19th century, he observed the sea currents over the Polar Sea towards Greenland and developed the idea that the ice floes drifted across the polar area towards the North Pole, a point no human had ever reached. To test this theory, he **organised an expedition and designed and built a ship, the *Fram***, which could withstand the pressure of becoming frozen in the ice. The expedition departed in June 1893, and the ship held, enduring temperatures of -50C.



A model of the Fram in an Oslo museum. Photo: [gig4791](#) via a [CC-BY-NC-SA 2.0 licence](#)

Early into the second year of being locked in the ice, Nansen's calculations showed they were not in fact drifting towards the pole, and at times were further south than the original departure point. When faced with a choice of returning home having failed to achieve his goal or carrying on, he convened his crew and decided to attempt to reach the pole on skis. He took only one other person and limited provisions, leaving the rest of the crew on the *Fram*. They spent weeks travelling by foot on the ice. But unknown to them, conditions were pushing the ice south faster than they were able to travel. They ran out of supplies and were forced to turn back south having reached the 86°N and failing to reach the pole. Their return journey was even more perilous: without supplies and skis, the two explorers spent another winter on the ice. To survive they created an improvised dug-out where they hid for months before eventually encountering another explorer on a desolate island, which **saved their lives**.

The expedition enabled many important scientific advances regarding polar currents, and Nansen's inventions inspired further voyages north. However, it is also an example of how, when faced with the unknown, people rely on heuristics such as overconfidence and sunk cost bias and underestimate the current situation. It was impossible for Nansen

to know he was relying on an incomplete map and that his own calculations were incorrect. But his decision to carry on shows the mistakes humans make when using incomplete information. In behavioural science this is known as “**narrow framing**” – a tendency to see each decision without considering the overall context. In decisions involving risk, this can lead to an overfocus on short-term losses or, as was the case of Nansen, failing to see the big picture and the overall risk in his venture.

A recent **CFO pulse check survey** conducted by BCG shows that most Chief Financial Officers have adapted to the COVID-19 lockdown and are in broad agreement on the type of actions to take in the medium term. Devising an initial plan with the help of currently available data is of course important. But managers should not ignore long-term planning. Failing to do so can lead to miscalculation. Like Nansen, it is hard to predict what will happen when we reach uncharted territory, and relying on imperfect models can give undue weight to the confidence we place in our predictions. Instead, firms need to be able to cope rather than optimise, and avoid assuming that static processes and solutions built for now will still be flexible when we get new information.

In a recent **panel** on the lessons from behavioural science for the pandemic, Paul Dolan discussed how in the face of fresh evidence and ambiguous information, individual beliefs and the stories and solutions we communicate will need reframing. However, this may be a slow process unless businesses and policymakers actively plan different scenarios based on potential evidence, so as to overcome the desire for a consistent narrative.

A scenario-based approach can help policy makers and businesses remain agile amid noisy signals. Scenarios which explore the key sources of uncertainty and evaluate their potential implications can improve resilience. The psychologist Gary Klein coined the term *premortem*, where teams come together to suggest reasons why a

strategy might fail, finding weaknesses and identifying risks. The ability of leaders to do this relies in part on individual differences and past experiences. However, group dynamics also play an important part. Diverse groups can act as a positive force, but their success depends on being able to have a breadth of views in the room, sharing unique information. When Nansen convened the crew of the *Fram*, no one spoke out against the plan to ski to the pole. His confidence and the crew's desire to conform may have led to *groupthink*. Similarly, an **analysis** of a global data set of more than 1,000 CEOs and CFOs shows that along with Net Present Value ranking, timing of cash flows and financial constraints, capital is allocated within firms based on "gut feel" and the personal reputation of senior management. This leads to confirmation bias and the halo effect creeping into decision-making. To reassess the landscape and find the best plan of action, firms need to extract and analyse information from silos in the organisation.

Now, more than ever, we need diverse perspectives around the table, with leaders encouraging dissent. Collective intelligence improves a group's capacity to deal with uncertainty, but the value is not in the average or maximum knowledge of group members. Instead, group performance is **correlated with equality in who gets to speak, and the diverse make-up of teams**. At the same time, uncertainty leads to emotional responses and reliance on what is familiar, which erodes some of the gains of diversity. In a **study** of labour force data during recessions, Grace Lordan, director of the LSE's **Inclusion Initiative**, found that discrimination and inequality in wage and employment widens during recessions, with the worsening of labour market outcomes concentrated among high-skilled workers. We can learn from the impact of the 2008 financial crisis and take action to get inclusion right. The **Virtual Inclusion in the City report** analyses obstacles faced by the City of London's leaders, posing solutions grounded in behavioural science. For instance, firms can audit decisions about labour force changes.

They can also avoid making performance assessments which are more likely to be based on unconscious biases.

John Maynard Keynes emphasised the role of psychology in economics. He argued that individual beliefs and expectations influence decision-making regarding estimates of the future, which in turn impact the market. Leaders are now being asked to chart a course to safety in an imperfectly defined context. In these situations, it is hard to calculate relative probabilities to optimise decision-making. Narratives allow us to interpret present experience and to transmit collective knowledge. They are a **powerful mechanism** for maintaining stability or promoting change in organisations. But collective knowledge only arises when leaders embrace diversity of thought and look beyond those “who look like me”. Dealing with uncertainty requires embracing rather than fearing a communicative spirit of trial and error. The “new normal” is in fact a new territory, which like Nansen’s North Pole, is still uncharted. Listen to your crew, and keep the flexibility to recalculate the route along the way.

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This post represents the views of the authors and not those of the COVID-19 blog, nor LSE.

About the author



Teresa Almeida

Teresa Almeida is an MSc student in behavioural science at LSE. She has run B2B campaigns across some of the largest enterprise businesses in the area of information and communication technology.



Grace Lordan

Dr Grace Lordan is an Associate Professor in Behavioural Science at the London School of Economics

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