

CFM QUARTERLY JANUARY 2026

PART A : ARTICLE

DEBIASING THE CORPORATION

Prasanna Chandra

Corporate decision making is often contaminated by a variety of biases. McKinsey consultants Tim Koller, Dan Lovallo, and Olivier Sibony have written extensively about these biases. They and others have offered a number of useful suggestions for combating these biases. Here are the more important of these suggestions.

1. Combine inside view with outside view
2. Be objective about budgets
3. Resist the allure of glamour projects
4. See strategy alternatives in the momentum case
5. Check sunk cost fallacy with contingency planning
6. Counter groupthink with premortem
7. Know when to kill a project
8. Get both sides of the story
9. Avoid snap judgements
10. Build a momentum case
11. Guard against competitor neglect
12. Lift your head from the sand
13. Don't steer your strategy by the wrong star
14. Check reverse financial engineering

1. Combine Inside View with Outside View

The appraisal of strategy and projects is often biased on account of overconfidence, confirmation bias, illusion of control, representativeness bias, availability bias, anchoring, herding, affect heuristic, groupthink, and sunk cost fallacy.

To deal with biased appraisal of strategy and projects, combine inside view (which is very appealing) with outside view (which is rational).

The inside view looks at a problem by focusing on the specific task, drawing on information that is close at hand, and making predictions based on that narrow and unique set of inputs, which include anecdotal evidence and wrong perceptions.

It's natural to be drawn to the inside view. It's usually concrete and filled with engaging detail we can use to craft a story about what is going on.

The outside view is typically abstract, bare, and doesn't lend itself so readily to storytelling. Yet it is essential to consider the outside view as an antidote to the bias-inducing inside view.

2. Be Objective about Budgets

Companies are slow to shift resources between and among business units. An extensive McKinsey study found that each year the proportion of company's capital expenditures in each business unit was highly correlated to the previous year's proportion.

Such stickiness is due to anchoring. It is a psychological phenomenon in which a number, however irrelevant it may be, influences the judgement of people. Daniel Kahneman and Amos Tversky carried out a famous experiment called the "Wheel of Fortune" experiment in 1974 to demonstrate the phenomenon of anchoring. Participants in this experiment were shown the number generated by the Wheel of Fortune and then asked what percentage of African nations were members of the U.N. The answers given by them were influenced by the random number thrown up by the Wheel of Fortune, although it had no relevance whatsoever to the questions asked.

Thanks to anchoring, budgeting in most organisations tends to be an incremental exercise. Despite extensive discussions, next year's targets are not likely to be very different from the ones business units proposed at the beginning of the budget process.

What is the remedy? Since an anchor is such a powerful influence, another anchor is required to overcome it. To see how it works suppose that you are entrusted with the task of setting your company's sales targets for different regions. Instead of beginning with the previous year's targets, you can as Tim Koller, Dan Lavallo, and Oliver Sibony suggest take the following steps to reanchor yourself.

Step 1: Identify key fact – based non-historical criteria for setting sales targets. This might include factors like market growth over a period of time, the company's present market share, and the number of sales representatives in the company relative to competitors.

Step 2: Build and calibrate a forecasting model based on these criteria You can perform regression analysis using the variables identified in Step 1 as independent variables to explain historical sales.

Step 3 Use the model as a second anchor. The model can be used to forecast the sales for the following year. The output of the model can be used as a second anchor to change the dynamics of the target- setting discussion.

According to Koller, Lavallo, and Sibony, “Variations of this reanchoring approach can be used in any target- setting or resource- allocation process where you want to challenge the status quo. It focuses debate where debate is really needed and helps reduce the inertia that anchoring induces.”

3. Resist the Allure of ‘Glamour’ Projects

Suppose you are the manager in a telecommunications company, and you have a choice to make between overseeing the systematic repair of cell towers and managing the company’s launch of a next- generation smartphone. Most likely you will choose the opportunity of leading the launch of a new generation smart phone (a glamorous project) rather than overseeing the repair of cell towers and other equipment (a mundane project).

In most organisations, glamorous projects attract undue attention and investment commitment whereas mundane projects (like a maintenance project) tend to be neglected and receive inadequate investment.

This happens for three reasons. First, sexy new projects are inherently more exciting than routine maintenance projects. Second, as far as the existing projects are concerned, the only news is usually bad news – products are taken over by competing brands or equipment’s needs to be replaced entailing significant costs. Third, many companies have separate funding committees for new projects and maintenance projects. When funds are limited, as they often are, new projects get priority, even though both types of projects can contribute significant value.

What is the remedy? One oil and gas company realised that maintenance was getting short shrift vis- a- vis extraction. To redress this situation, it assigned two executives who were members of the extraction committee to be members of the maintenance committee as well. This ensured that maintenance projects received the resources and attention they justified. This approach can be applied to most companies in capital – intensive industries such as power, telecommunications, and chemicals where committees that examine capital expenditures are distinct from those that review operating expenditures. As Inskandar Aminov, Aaron De Smet, and Dan Lavallo put it “By creating overlapping committees, which convene regularly and give voting rights to members from different parts of the organizations, companies can overcome bureaucracy, break down siloes, and in many cases, reduce unnecessary overhead.”

4. See Strategy Alternatives in the Momentum Case

One way to incorporate the outside view is to construct a momentum case along with the base- case and other scenarios. A momentum case represents what could happen if a company takes no, or limited, strategic view. As Tim Koller, Dan Lavallo, and

Werner Rehm put it, "A momentum case is an objective assessment of industry growth and competitive dynamics. It is built using external variables such as market share, competitor's reactions, pricing or margin drops, and changes in cost structure." A momentum case helps in setting more realistic performance targets, reveals the potential negative consequences if the company takes only limited or no strategic action, and suggests investments necessary to just to keep the current business going.

5. Check Sunk Cost Fallacy with Contingency Planning

Traditional economics assumes that while making a decision, people ignore past costs and consider only the present and future costs and benefits associated with that decision. In reality, however, people routinely consider historical costs when making decisions about the future. Such behaviour is called the **sunk-cost effect**. It may be viewed as a tendency to continue an endeavour, once an investment of money, time, or effort has been made.

To mitigate sunk cost fallacy, **contingency planning** must be done. In contingency planning, future possibilities are envisaged and the actions to be taken in these possibilities are predetermined and put down explicitly on a contingent road map. The whole idea of a contingent road map is to pre- identify the actions to be taken under various scenarios. The actions, of course, will include the abandonment option. This helps in overcoming sunk cost fallacy and endowment effect.

6. Counter Groupthink with Premortem

Groupthink occurs because a desire for conformity leads to collective confirmation bias and group members are reluctant to share information or challenge proposals made by others.

According to Hersh Shefrin groupthink can be checked by:

- Asking group members to refrain from stating their positions at the beginning of the discussion.
- Explicitly encouraging debate, disagreement, and information sharing.
- Designating one member of the group to be a devil's advocate for each major proposal.
- Regularly inviting outside experts to attend meetings, with the charge that they challenge the group to refrain from meek conformism.

Using Premortem People prefer harmony over conflict. This leads to social biases like groupthink and sunflower management. Group think involves striving for consensus at the expense of a realistic evaluation of alternatives. Sunflower management is the tendency for groups to align with the opinions of their leaders.

Thanks to these social biases, people do not express their reservations candidly and forcefully. They do not want to disrupt harmony by trying to surface potential

problems. As a result, an objective and balanced appraisal of decision alternatives is compromised.

How can people be encouraged to express contrary views freely? Psychologist Gary Klein suggests the use of the premortem technique. It is a sneaky way to get to motivate people to serve as a devil's advocate without encountering resistance. If a project turns sour, some lessons will be learned about why the project failed and what went wrong as in the case of a medical postmortem. Why don't we invert the process? Before the project starts, someone should say, "We have a crystal ball that can predict the future. Our crystal ball says that the project has failed. It has been a fiasco. Now everyone should take few minutes and write down all the reasons why he thinks the project failed." This will encourage people to think of insightful reasons why this project might fail. There will be an interesting competition among people to come up with potential problems that others many have overlooked. The entire dynamics would change. Instead of avoiding things that might disrupt harmony, people will try to surface potential problems.

Daniel Kahneman regards premortem as a great idea. He says "My guess is that, in general, doing a premortem on a plan that is about to be adopted won't cause it to be abandoned. But it will probably be tweaked in ways that everybody will recognise as beneficial. So the premortem is a low-cost, high-pay off kind of thing."

7. Know When to Kill a Project

Several studies have shown that business leaders are disinclined to kill projects. Companies and individuals that have a successful track record find it harder to terminate projects because they have an ingrained belief they can make every project a success, as long as people work hard enough. They believe more in the person sponsoring the project than in the inherent merits of the project. This belief is compounded by sunk cost fallacy this means that managers who are evaluating projects assign greater weightage to the costs incurred in the past compared to costs to come.

To counter these tendencies, companies must designate a full – time "project killer", a person who has a deep technical knowledge of the technology and business aspects of the industry, to prevent project creep. As Tim Koller, J. Andr'e de Barros Teixeira and Dan Lovallo put it, "Companies absolutely need to invest in new ideas. They must be entrepreneurial and imaginative. But they also need to adopt mechanisms that take some of the emotion out of their resource – allocation decisions."

8. Get Both Sides of a Story

In most meetings, people rarely speak until the leader has spoken. Further, they feel more comfortable in endorsing rather than challenging, the leader. This is called the

“sunflower bias.” Compounding this bias is the tendency of leaders to hammer their ideas, even in face of negative information.

One way to mitigate these biases is to assign two independent groups or individuals (a red team and a blue team) the task of representing opposite sides on a decision being evaluated. The teams present their arguments in a mutually agreed-upon format and time frame. After that the decision makers voice their opinions. Warren Buffett sometimes uses this approach. When considering his biggest acquisitions, he generally hires two investment advisers one to argue in favour of the deal and the other to argue against it. Buffett listens to arguments from both sides before taking the final decisions. The advisers are compensated on the basis of the final decision.

9. Avoid Snap Judgements

Important choices, personal and professional, are often subject to **halo effect** which is the human tendency to make specific inferences on the basis of a general impression. Thus, when a company is doing well financially, observers conclude that it has an innovative strategy, a visionary CEO, a motivated workforce a vibrant culture, superb customer orientation, and so on. When a company’s performance falls, people are quick to infer that it has a flawed strategy, a confused CEO, a complacent workforce, a stifling culture, an apathy toward customers, and so on.

Our desire for excessive coherence (or the need to fit complicated ideas into simple mental frames) prompts us to draw conclusions faster than we should.

To mitigate the effect of halo effect in business decisions, executives should first acknowledge their intuitions and then take a minute to ask themselves. “If I set aside my first impressions, what judgement would I make? “This s like a blind taste test, in which the consumers can say what they really think without the strong glow of a brand’s halo.

10. Build a Momentum Case

Executives tend to be overly optimistic about their existing projects and seek to maintain the status quo. They rely on their own perceptions of the market and use internal data to build forecasts and set use internal data to build forecast and set strategy. They rely on what researchers call the “inside view.” They fail to ask hard questions about market dynamics and competitive behaviour or what the researchers call the “outside view.”

One way to inject the outside view into strategy discussions is to **build a momentum case** to be considered alongside a base case and other forecasting scenarios. According to Tim Koller, Dan Lovallo, and Werner Rahm, “A momentum case s an objective assessment of industry growth and competitive dynamics. It’s built using external variables, such as market share, competitor’ reactions, pricing or margin

drops, and changes in cost structure.” A momentum case can help in setting more realistic performance targets, pointing out gaps in product portfolios, suggesting investments necessary to keep the current business going, and revealing possible negative consequences, if the company takes only limited or no strategic actions.

11. Guard Against Competitor Neglect

Given the interdependent nature of strategic decisions, companies usually pay a steep price when they fail to anticipate the actions and reactions of competitors. The neglect of competitors is a manifestation of the **inside view**, in which decision makers are guided by their own data and subjective perceptions than by external factors and objective, statistical view.

An effective hedge against competitor neglect can be war games these are exercised in military to determine how well they are likely to perform given the responses of opponents. Such exercises enable business leaders to assess how well potential strategies are likely to perform given potential responses of competitors.

As Tim Koller, Heigh Courtney, and Davod Lovallo put it, “War games can take many forms and encompass many technologies- from simple to sophisticated- but the one constant should be a debriefing session, conducted within and across teams to capture lessons and reformulate strategies and processes as necessary.”

12. Lift Your Head from the Sand

Research suggests that in a group setting many members may ignore the information presented to them or interpret it in such a way that potentially troubling implications may be glossed over. Such a cognitive bias is called the “ostrich effect,” meaning that people figuratively put their heads in the sand and avoid unpleasant information.

One way to counteract **ostrich effect** in business conversations is to employ a **readout process**. According to McKinsey consultant Eileen Kelly Rinaudo, there are typically five steps in a readout process.

1. Syndicate an agenda early
2. Designate a scribe
3. Capture critical points for each items of the agenda
4. Share the critical points with full group
5. Get verbal confirmation from all members

As Rinaudo says, “Plainspoken and practical, the readout process imposes accountability on everyone in the room and can reduce the risk of misinterpretation during business meetings.”

13. Don't Steer Your Strategy by the Wrong Star

Business leaders often rely on analogies. However, if the analogy is weak or similar to the issue at hand in a very superficial way, there is a real risk of anchoring themselves to misleading solutions.

How can business leaders avoid superficial or “false” analogies? One way is to engage in **similarity mapping**. This exercise should be conducted by a dedicated team that prompts business leaders to identify structural similarities between the apparently similar problem from another context (the source problem) and the actual problem the company faces (the target problem). By doing so, business leaders can determine the conditions that must be satisfied for the analogy to make sense in the new context and then fine tune the proposed solution.

14. Check Reverse Financial Engineering

Most organisations use reasonably well-defined quantitative indicators (such as IRR being more than 20 percent or accounting rate of return being more than 25 percent) for approving or rejecting project proposals. Since a project sponsor is keen to get his project included in the capital budget, he is likely to massage the numbers and dress up his project proposal to satisfy the organisational norms. It is fairly easy to do so, by merely tweaking some assumption or the other. In most cases there are 8 to 10 assumptions (such as market size, market share, selling price, raw material cost, project life, growth trajectory, and so on) underpinning the financial projections. Often, the desired financial numbers can be obtained by modifying a few of these assumptions by just 1 to 3 percent. Thanks to informational asymmetry – project sponsors often know much more than project approvers – the project approvers may not be able to detect the nature of financial manipulation.

Is there some way by which such financial manipulation can be checked. Rita Gunter McGrath and Ian MacMillan have suggested a process they call **discovery-driven planning** that has the potential of improving the quality of analysis. Discovery-driven planning reverses the sequence of the steps in the stage-gate process. Its logic is fairly simple. Since the project sponsors know how good the numbers should be to get the project approved, why go through the farce of making and revising assumptions to get the desired set of numbers? Instead, start with the minimal acceptable revenue, income, and cash flow statement and then ask “what assumptions must be fulfilled to get these numbers.” The project sponsor is expected to develop an assumptions checklist – a list of assumptions that must be valid for the project to succeed. McGrath and MacMillan refer to this as the “reverse income statement.” If a critical assumption is not proved to be valid, the project sponsor must modify its strategy until all the underlying assumptions are valid. If no set of plausible assumptions supports the numbers, the project is rejected.

How is discovery driven planning better than the traditional method of project planning? The traditional method focuses the spotlight on financial projections, while obfuscating the assumptions. But there is no need to shine the spotlight on the numbers as the desirability of attractive numbers has never been questioned. By contrast, discovery-driven planning focuses the spotlight on the assumptions that reflect the key uncertainties, a place where senior managers need illumination.

Championing the cause of discovery-driven planning, Christensen et.al argue in a January 2008 HBR article: "Today, processes like discovery-driven planning are more commonly used in entrepreneurial settings than in the large corporations that desperately need them. We hope that by recounting the strengths of one such system, we'll persuade established corporations to reassess how they make decisions about investment projects."

PART B : SNIPPETS

Dual- Beta Model

Roy D. Henriksson and Robert C. Merton proposed a dual- beta model in 1981, a model which has an up beta and a down beta. As the names suggest, the up beta measures the beta of the financial asset on days when the market rises and the down beta measures the beta of the financial asset on days when the market falls.

In a research paper titled "Reduction in Cost of Capital in Indian market," Gautham Kanthaswamy and Prasanna Tantri of ISB looked at the phenomenon of dual- beta and found that there has been a reduction in the sensitivity of the Indian market to the movement of global markets, especially on the downside, in the time period after demonetisation. They examined data from January 1, 2000 onwards and used January 1, 2017 as a point of division. With respect to the MSCI World Index, in the post demonetisation period, the up beta of the Indian market (NIFTY 50) increased by 0.02 while the down beta decreased by 0.25.

While the authors do not get into the reasons for a decline in India's down beta, the recent structural changes in the economy and consequent increase in the flow of domestic funds into the equity market may explain the phenomenon.

The reduction in the down beta could lower the cost of capital for Indian companies. However, a lot will depend on what happens over the medium to long- term.

Radical Uncertainty

While mathematical tools like probability, variance, regression to the mean and fat tails provide some help in grappling with and the future, they are inadequate and even misleading.

As Nassim Taleb said relying on the bell- shaped curve leads to the notion of the world being a 'Mediocristan.' In reality, the world is what he calls 'Extremistan' as it is shaped by wild, unpredictable, and powerful events. In Taleb's world, "history does not crawl, it jumps."

In a similar vein, Nobel laureate Kenneth Arrow commented, "Our knowledge of the way things work, in society or nature, comes with trailing clouds of vagueness. Vast ills have followed a belief of uncertainty." Arrow warned that mathematically driven risk management approach to investing can be self- destructive.

As investment sage Peter Bernstein said, "The recognition of risk management as a practical art rests on a simple cliché with the most profound consequences: when the world was created, nobody remembered to include certainty." He added, " We are never certain, we are always ignorant to some degree. Much of the information we have is either incorrect or incomplete."

The Hedgehog and the Fox

In his popular essay, "The Hedgehog and the Fox: An Essay on Tolstoy's View of History," Sir Isaiah Berlin classified writers and thinkers into two categories: hedgehogs and foxes.

Hedgehogs view the world through the lens of a single defining idea. They rely only on one big idea or one grand theory, no matter what the logical consequences of doing so are. Foxes, on the other hand, are skeptical of a single idea or grand theory. Instead, they stitch together a collection of ideas and draw on a wide variety of experiences before making a decision. The fox is perhaps the perfect mascot for the College of Liberal Arts Investing.

PART C : WIT AND WISDOM

Humour

Wedding Present

A couple got a 235- piece after dinner set as wedding present. What was it?
A box of tooth picks.

Dentist

A Texan Oilman went to the dentist. After examining him, the dentist said, "You are fine. There is no need for drilling." The oilman said , "Please drill. It is lucky for me."

Wise Saws

1. Silence, along with modesty, is a great aid to conversation. :
Montaigne.
2. It is possible to own too much. A man with one watch knows what
time it is; a man with two watches is never sure.