Decision-Making

Introduction

There is a tremendous amount of available information about the decision-making process, the steps involved in making a decision, the implications of choices, and which processes for decision-making are the most effective. However, it is difficult to say with complete certainty how good decisions are made and which processes are the most effective overall or within one particular organization.

In this reading, we will look at the results of a survey conducted by McKinsey & Company about how companies make their decisions. The survey included questions about human resources, financial implications, material resources, internal politics, and outcomes. The survey was conducted in November of 2008 among companies in a wide range of industries. McKinsey received 2,327 responses from business executives throughout the world, in various corporate positions, which were used in the tabulation and analysis of the report. In 2009, McKinsey & Company produced an article about the survey's results, titled "How Companies Make Good Decisions: McKinsey Global Survey Results," in *McKinsey Quarterly.* The information in this reading is based on this article and the survey results.

Scope of Decisions

As mentioned above, the survey covered a wide range of departmental decisions, such as financial growth, human resource needs, and increasing productivity. However, most of the decisions addressed in the survey came about as a result of CEO involvement or an executive board rather than by employees in lower level positions.

Interestingly, many decisions came about as a result of factors that were not part of the organizations' annual planning processes. 52% of decisions made were a result of external factors or those that were typically not part of the planning process. Of these companies, however, 23% of decisions were made as a result of an urgent need or an unforeseen situation; 9% of respondents stated that decisions were made outside of the annual planning process, because the organizations do not have a planning process; 3% of respondents stated that decisions made were due to the need to spend funds before the end of their budgeting cycle. Only 30% of decisions made overall were a result of annual planning activities. (Note: Percentages do not add up to 100% due to the exclusion of those who responded with *other* or *don't know*.)

Results of the survey also showed that 2/3 of the decisions focused on met or exceeded financial growth and cost savings expectations. Also, a majority of respondents indicated that the results of their decisions also exceeded their expectations for the speed with which decisions were carried out, the cost of implementation, and anticipated market share gains.

The types of decisions made by companies who responded to the survey included the following areas:

- Product, service, or geographic expansion 34%
- General organizational changes 21%
- Investment in current products, services, or geographic areas 15%
- New infrastructures 12%
- Mergers and acquisitions 11%
- Maintaining the current infrastructure 5%

(Note: Percentages do not add up to 100% due to the exclusion of those who responded with *other*.)

When looking at the overall goal of any specific corporate decision, 78% of respondents said that revenue growth was the major determining factor. When the question related to human resource needs, 57% of respondents said that improved efficiency and productivity were important factors in their decisions.

Factors for Good Decision-Making

<u>Accountability</u>

Survey results emphasized the importance of group discussion before making an important decision. McKinsey found that companies where the same person is responsible for initiating and giving approval for decisions have shown the poorest financial results. Additionally, companies that make decisions without the benefit of a strategic plan are two times more likely to experience unsatisfactory results. Over 20% of those companies had revenues that were 75% below expectations. In both of these cases, the survey implies that decision-making procedures and responsibilities are being neglected in these organizations.

On the positive side, the survey shows several areas where decision-making has been successful in increasing revenues and lowering costs. In cases where the responsibility for implementation of a decision was clear and where that person was involved in the decision-making process, results exceeded expectations. For 51% of decisions that exceeded expectations, 73% of responding companies said that there was clarity as to who was responsible for implementing a decision; 64% of respondents said that the person implementing the decision also participated in the decision-making process.

These results clearly indicate the importance of a collaborative effort in the decision making process and how the lack of effective procedures can have serious financial implications.

Analysis

The survey also illustrated the importance of analyzing several factors that included detailed financial models, past corporate experiences, risk of a project combined with the risks of other corporate projects, and overall financial risk models.

Survey results indicated that creating a detailed financial model ranked as the most important factor in the decision-making process as it related to results of the decision. When a detailed financial model was developed, expected revenues performed 53% above expectations; profitability was 51% above expectations, and speed of completion exceeded 51% of expectations.

Additionally, the inclusion of similar outside situations in the decision-making process enabled the organizations to experience positive outcomes in profitability and growth.

When decision makers considered comparable situations from their past experiences in their decision-making process, expected revenue increases performed 48% above expectations; profitability was 47% above expectations; and speed of completion exceeded expectations by 48%.

In examining risk compared to other corporate projects as part of the decision-making process, expected revenue increases exceeded expectations by 42%; expected profitability exceeded expectations by 45%; and completion speed exceeded expectations by 38%.

Finally, when decision-makers considered the analysis of an overall financial risk model, expected revenues exceeded expectations by 41%; expected profitability exceeded expectations by 42%; and expected completion speed exceeded expectations by 41%.

Decision Discussions

The survey asked respondents about the various discussions that were essential to their decision-making processes. One of the topics discussed by decision-makers was the issue of who would participate in the decision-making process. Including workers based on their skills and experiences was believed to increase the likelihood of a positive outcome. According to the survey, when experienced employees were involved in a decision, revenue increases exceeded expectations by 59%; profitability exceeded expectations by 61%; and speed of completion exceeded expectations by 63%.

Additionally, when the decision-making process was transparent to all participants, positive results were seen. Transparency resulted in revenue increases that exceeded expectations by 58%; profitability exceeded expectations by 57%; and speed of completion exceeded expectations by 54%.

Finally, when decision makers discussed how their decision would complement all of the decisions made by the organization, expected revenues exceeded expectations by 52%; profitability exceeded expectations by 51%; and completion speed exceeded expectations by 58%.

These statistics indicate that inclusion, transparency, and corporate strategy are important factors in the decision-making process.

Politics

While not part of a formal strategic plan, politics can typically have some impact on corporate decision-making. Survey respondents indicated that decisions focusing on the benefits to a specific unit or division, rather than to the entire organization, showed below expected results.

On the other hand, when corporate leaders participate in informal arrangements with each other, good decisions may result. For example, when executives work across departments or divisions and make exchanges of information in support of other projects, the original project in question tends to be completed sooner than expected.

Survey respondents indicated that CEOs generally play a big part in initiating decisions that are the most successful as well as least successful. The implication of this finding is that CEOs may be willing to take greater risks than other employees. For this reason, it is even more important that decisions are arrived at through a comprehensive examination of those projects, with group discussion and collaboration, to ensure that the right decision is made for the right reasons.

Conclusion

The survey indicates that top management should establish a good decision-making process that includes thorough analysis, collaborative discussion, and strategic planning. Procedures should include:

- the development of financial risk models;
- the examination of past decisions;
- the evaluation of participant skills and experiences;
- transparency; and
- prioritized corporate goals.

Summary:

- McKinsey & Company conducted a 2008 survey to evaluate how companies make their decisions and published the results of the survey in 2009. They received 2,327 responses.
- The majority of decisions are made at the highest corporate level.
- Most decisions were the result of factors that were not included in corporate plans.
- Research results indicated that a majority of decisions made exceeded expectations.
- Decisions in the survey included the areas of product, service or geographic expansion; general organizational changes; investment in current products, services or geographic areas; new infrastructures; and mergers and acquisitions.
- The most important criterion for evaluating the success of a decision is the level of revenue growth.
- The study indicated that the most important factors for making good decisions are accountability and the importance of identifying those responsible for implementing a decision; developing a financial risk model; having transparent and collaborative discussions; and using corporate politics for the company's overall benefit.

Reference:

McKinsey & Company. 2009. *McKinsey Quarterly*. "How Companies Make Good Decisions: McKinsey Global Survey Results."