What We Should Talk About When We Talk About Risk

Strategy, impact, and learning (SIL) team in collaboration with Ian David Moss | May 2019

Introduction

Whether you're in the for-profit or the nonprofit world, we all seem to be talking about risk. No one wants to "play it safe" or "hedge their bets." Instead, we're launching moonshots and embracing failure. The problems we face are so big and complex, the thinking goes, that the only way to tackle them is to put everything on the line and fully commit. But this "risk is good" mantra glosses over the fact that some risky decisions are just bad decisions.

So how should philanthropic organizations leverage risk in a more sophisticated way to achieve the kind of change we seek? The first step may be to acknowledge that much of our most consequential decision making happens in information-poor and ambiguous contexts, and risk taking is simply a strategy for managing this uncertainty. After all, when we describe a decision as "risky," what we are actually saying is, "I am not sure what will happen if we decide to do X."

The idea for this paper began with a conversation at Democracy Fund about how we, as a foundation, could take more and better risks. As we got further into this work, however, we realized that the conversation about risk was really rooted in the nature of decision making itself — in particular, what it means to make a good decision in a low-information/high-uncertainty context.

This document lays out the philosophical foundations of the approach we intend to take and what we think it means broadly for Democracy Fund's work. We hope that by looking at risk taking through a broader lens of decision making, we can open up the conversation both internally and externally about what it means to be an organization that takes smart risks. This approach also provides an opportunity to look more critically at all of our internal processes to see whether they support good decision-making habits and how we might refine these processes to better leverage and mitigate risk to maximize our impact. In the coming months, we'll be taking a deeper look at these processes — from the decisions we make about the systems we work in and what strategies will lead to the impact we hope to see, to what investments we make, to how we use evaluation and learning to assess and revisit those decisions, and everything in between.

Why we should care about decisions

Our personal and professional lives revolve around the dilemmas we face and how we resolve them. Despite their importance, we are barely conscious of most decisions we make. Our brains are programmed to make decisions intuitively whenever possible, drawing upon our past experience and pattern-matching skills to arrive at sound judgments. Indeed, the advantages of intuitive decision making are significant. Intuition is lightning-fast, feels natural, enjoys wide social acceptance, and yields "good enough" judgments in many contexts.

Researchers have demonstrated, however, that for intuition to be reliable, it requires "training" — i.e., lots of previous experience tackling similar problems, with prompt and accurate feedback on those past efforts. (Think of the decision about when and how much to press the brake pedal when a red light comes into view.) Without that training in place, intuition can fall prey to numerous errors in judgment, such as:

- **Confirmation bias**: the tendency to discount information that challenges our existing worldview;
- **Availability heuristic**: the tendency to give too much weight to information that is easily obtained or remembered; and
- **Planning fallacy**: the tendency to underestimate the time and resources required to complete projects.[i]

Most of our decisions either benefit from well-trained intuition or carry low enough stakes that a little bias doesn't matter. But the most important decisions we make in life rarely meet either criterion. They can include philanthropic leaders' decisions about what mission to select, which strategies to adopt, and what grant opportunities to fund. Such decisions have significant consequences for philanthropic leaders and their organizations and arguably have even more impact on grant recipients, beneficiaries, and the world at large. It is therefore not just a responsibility but a moral imperative for philanthropists to ensure that all such decisions are made thoughtfully. Certainly, many philanthropies have processes in place to vet decision making: Grants are subject to financial and legal review, strategies are vetted by a board, and so on. But these processes, often built on embedded assumptions about which decisions are most important, are vulnerable to bias and errors in judgement. Building good decision-making skills requires that we think more holistically about how, when, and where we make decisions and look at all decisions as an opportunity to override our instincts and combat bias in our decision making.

Philanthropy and complexity

One reason why intuition may not be reliable in philanthropy is that foundations, governments, impact investors, and donors typically operate in highly complex environments.

"Complex" in this sense is a technical term drawing on a wide range of scholarly work rooted in disciplines ranging from evolutionary biology to economics to computer science.[ii] While there is no universally accepted definition of the concept, scientists generally agree that complexity arises from tightly interwoven, interdependent relationships between different components within a system. Virtually any group of people, therefore, constitutes a complex system, which in turn means that the vast majority of philanthropic institutions design and implement programming in a complex systems environment as well.

Complex systems defy easy comprehension. Simply by coordinating their actions, system participants can cause a surprisingly stable order to emerge with no central planning at all. Small changes to a system can have wildly disproportionate effects or no effect at all. Moreover, complex systems are constantly evolving and changing in response to both internal and external stimuli. All of this means that a confident understanding of a complex system — e.g., weather formations or traffic patterns — can only come from enormous quantities of relevant and reliable data. In the absence of such data, philanthropic leaders and managers must learn to live with significant uncertainty about the eventual impact of their actions.

Confronting the unknown

Embracing humility about what is knowable in the face of complexity — what some philosophers call "epistemic humility" or "epistemic modesty" — can be challenging for philanthropic professionals who, in many cases, bring deep expertise and longstanding experience to their programmatic roles. High-stakes decision making in a complex philanthropic environment requires a reframing of the meaning of "expert," from someone who has all the answers to someone who knows how to ask the right questions.[iii] Importantly, reframing what it means to be an "expert" is not a straightforward endeavor. It can require significant changes in organizational culture, from the very pragmatic (e.g., How can we facilitate meetings to encourage meaningful questions?) to the more philosophical (e.g., How can we more explicitly value different kinds of expertise?).

Central to this posture is a willingness to change one's mind in response to new information. This is not the same as abdicating forceful opinions entirely — many such opinions are strongly held for good reason. Rather, a critical thinker is willing to entertain the *possibility* of being wrong, even in situations when it does not seem very *likely*. Even more important, expert critical thinkers are able to articulate in concrete terms what it would take to shift their perspective on an issue relevant to a decision at hand. Regularly practicing such thought experiments promotes a discipline (and when practiced together, a culture) of detachment from one's opinions, which, in addition to leading to more accurate judgments, reduces the stress and embarrassment that might otherwise come with having to admit a mistake. This discipline can also make decision making more inclusive and equitable: By reframing our understanding of expertise, we can make room for more diverse perspectives and ensure that our decisions account for a greater variety of viewpoints and experiences.

The promise and purpose of information

Keeping in mind the limits of our knowledge, it's nevertheless important to remember that just because we don't know much *for sure* doesn't mean we don't know anything *at all*.

Uncertainty exists on a continuum. A crucial skill for combating bias is learning to think *probabilistically* — i.e., to assign concrete probabilities to claims about the world rather than relying on vague language such as "could," "likely," and "distinct possibility." When it comes to uncertainties that center on numbers, such as setting budget figures for the coming year, we have the opposite problem: We tend to use point estimates (a single number) rather than consider the full range of possibilities within a well-defined confidence interval.

Developing these skills can be accomplished through mathematical exercises, but the real point here is philosophical. The purpose of information is to *reduce uncertainty* about things that matter. This is true even in complex systems, which most scientists agree become easier to comprehend with more and better information. We may never understand complex systems completely, but the more we can say about a system's components, the relations of those components to one another, and the system's capacity for change, the more accurate our judgments will be and the less uncertainty we'll have to account for. And the less information we currently have about a system, the more helpful new information will be.[iv]

The challenge here is to develop a common understanding of how we talk about uncertainty and what it means to make decisions in less certain contexts. It's no coincidence that organizations with an "expert" culture also value decisiveness, even in highly uncertain contexts. After all, there's a sense of security that comes from having experts tell us, in unequivocal terms, what the "right" decision is in a highly ambiguous context. But being honest and straightforward about our confidence in a decision, based on available information, can help us make better decisions in the long run. Doing so helps make the thinking around decision making more visible — a key habit for building a culture of learning[v] — and determines whether/how we can gather additional information to increase our confidence in a decision.

Consulting the oracle

Decisions are predictions. Whenever we make a decision, we are implicitly or explicitly comparing the expected outcomes of one path forward to the expected outcomes of one or more alternatives. The more (justifiably) confident we can be in those predictions, the more likely we are to realize our preferred outcomes. As a result, skill at telling the future is an essential component of smart decision making.

Philanthropic professionals have no guarantee, of course, that their predictions will turn out to be correct. But thanks to recent advances in the science of forecasting, in particular those by Philip Tetlock and the Good Judgment Project, there is now an empirical basis for improving forecasting performance in an organizational context.[vi] For many high-stakes decisions, it is likely

that even slightly more accurate forecasts would easily justify the comparatively small amount of time and expense necessary to realize that improvement.

Indeed, one can argue that forecasting is even more central to decision making than research, data, or evaluation. While all knowledge assets are potentially useful in a decision-making process, knowledge can only tell a manager what is true about the past and the present, whereas decisions are always about the future. Thus, knowledge is only as valuable to a decision as the relevance and accuracy of the predictions made possible by that knowledge. This is particularly relevant when considering the role of research, evaluation, and learning in decision making. Increasingly, we talk about evaluations in terms of their "utilization" and research by its "policy relevance" — essentially, the degree to which research and evaluation are used to inform decisions. But this expectation can set up something of a trap for using evaluation and research. There are real limits to the use of knowledge gleaned from research and evaluations for forecasting future events. However, acknowledging those limitations can reinforce a tendency to ignore such evidence when it doesn't conform with our own beliefs and biases — a bad decision-making habit. A better strategy might reframe research and evaluation evidence as a tool for reducing uncertainty and checking biases, but which must be combined with good forecasting skills to contribute to better decisions.

Forecasting in complex environments

Making the kinds of predictions associated with high-stakes philanthropic decisions is far from straightforward. Foreseeing impactful events is hard enough in the context of a relatively controlled environment. In complex systems, however, this type of forecasting becomes very challenging.

For one thing, we don't always have good information about the complex systems in which we operate. In addition, complex systems are continually evolving and sometimes experience dramatic upheaval, which means we can't be sure that the information relevant today will still apply in the future. In extreme scenarios, complex systems can fall prey to the "butterfly effect," or the idea that a small change in one part of the system can trigger a chain reaction that results in a major disruption to the status quo. These unlikely but extremely impactful events, sometimes referred to as "black swans," pose both conceptual and practical difficulties for the probability-based forecasting methods mentioned earlier.[vii]

The key point here is that not all complex systems are created equal. Some exhibit relatively consistent behavior despite their complexity, making predictions easier even if we don't fully understand how the systems work. Some are highly visible and transparent, offering possibilities for useful data analysis that likewise can inform smart investments. And some have neither characteristic, posing something of a mystery to philanthropists trying to make change within them. In those contexts, it may be best to eschew proactive strategies entirely in favor of responding as quickly as possible to emerging threats and opportunities. Wise decision makers are able to differentiate between these scenarios and know — keeping epistemic humility in mind — when the information available is "good enough." After all, the pursuit of certainty can itself be a barrier to making clear, timely decisions.

A better way to think about risk

So how does this thinking around strategic decision making relate to risk? At its core, risk management involves two basic problems: predicting the likelihood of impactful events and planning what to do in the event they occur. As you can see, this is just decision making by another name. And there's no reason it can't or shouldn't be as strategic as our approach to philanthropic decision making more generally.

Risk management is usually considered a function of operations or other support functions within an organization. But risk is a multifaceted phenomenon that bridges functional silos, including grantmaking strategy. Rather than establish blanket rules aimed at minimizing downside risk in all situations, a better solution would be to approach situations on a case-by-case basis. That will open up space to convene professionals from across the organization to assess the likelihood that a particular decision

would lead to consequences — both positive and negative — on finances, legal exposure, programmatic impact, reputation, and more. As with other advice in this paper, the degree of effort invested in a process should be calibrated to what's at stake: If there's not that much to lose or gain either way, there's no need to belabor the decision. But if the consequences are significant, then risk analysis and planning should definitely be part of the decision-making process.

Conclusions: Making smart decisions every day

Based on the ideas explored in this paper, Democracy Fund has a few takeaways for making better decisions — and in so doing, improving our ability to leverage risk in pursuit of our goals.

1) Look at current decision-making processes critically: Some decisions are subject to more review and oversight than others, but such scrutiny is based on assumptions about which decisions are most important or "risky." These review/oversight processes may not actually support better decision making and may create unnecessary burdens to making smart, timely decisions. We need to explore the rationale and assumptions behind these processes with a fresh eye and revise them as necessary.

2) Reconsider what we mean by "expertise": We are still big believers in the importance of expertise, but it's time for us to consider how we can better leverage different perspectives and better questions to mitigate bias and encourage creative problem solving. This might mean bringing in different types of expertise and casting a wider net around what we define as "expert" when it comes to decision making. We could also think about how we ask experts to "show up" in the decision-making process, offering the kind of questions/feedback we think leads to better decisions.

3) Reflect on how exactly our evidence and learning practice contributes to decision making: As discussed previously, there are real limitations on our ability to use evidence to increase certainty in complex contexts. But navigating complex systems means that we often need to revisit or refine decisions, particularly as new information comes to light. Doubling down on an "adaptive management" approach can help us use evidence and learning as a frame for managing uncertainty. In this way, the collection of evidence and learning actually becomes something of a risk-mitigation strategy.

4) Be more explicit about the uncertainty we face: Navigating uncertainty is the central challenge of any manager and all the more so for philanthropic leaders. There is no foolproof way to make perfect decisions every time. What we can do is openly acknowledge how uncertainty might affect the quality of our decisions. This means getting more explicit about estimating probabilities of potential outcomes when making major decisions and building organizational fluency around probabilistic thinking.

5) Don't overthink it: The approaches to strategic decision making discussed here include some inherent tensions. Be careful about your decisions, but don't fall prey to indecision! Try to understand the system, but don't expect too much from evaluation! Forecasting is central, but predicting some things is too hard, so don't try! What we should take away from this paper is that effective decision making requires balancing all of these considerations, not in a fuzzy haphazard way but in a very precise way. We need to match strategies, techniques, and thinking styles to the particular situations and contexts where they make the most sense. This paper is not making one recommendation to act a certain way; it's making a recommendation to invest in learning a discipline that will allow wise, flexible responses to a wide range of situations. After all, regardless of the sophistication of our decision-making processes and norms, "getting it right" in the complex conditions in which we work will be an elusive goal. But this is exactly what makes social-sector work so exciting and important. We cannot let our fear of making a bad decision lead to indecision — and inaction.

Endnotes

[i] Many books written for the popular press provide an overview of these and other cognitive biases and how they relate to intuition, but perhaps the most comprehensive is Daniel Kahneman, *Thinking, Fast and Slow,* Farrar, Straus & Giroux, New York, NY, 2011, Print.

[ii] Melanie Mitchell, "How Can the Study of Complexity Transform Our Understanding of the World?" *Big Questions Online*, January 20, 2014, https://www.bigquestionsonline.com/2014/01/20/how-can-study-complexity-transform-our-understanding-world/

[iii] Center for Evaluation Innovation, "Embedding Learning into the Way We Work," PowerPoint created for the American Evaluation Association National Conference on October 31, 2018, Cleveland, OH.

[iv] Douglas W. Hubbard, *How to Measure Anything: Finding the Value of "Intangibles" in Business*, Wiley, Hoboken, NJ, 2014, Print.

[v] Julia Coffman, *5-A-Day: Learning by Force of Habit*, Blog, *Medium,* June 20, 2018, Accessed May 14, 2019. Available at https://medium.com/@jcoffman/5-a-day-learning-by-force-of-habit-6c890260acbf.

[vi] Philip Tetlock and Dan Gardner, *Superforecasting,* Crown, New York, NY, 2015, Print.

[vii] Nassim Nicholas Taleb, *The Black Swan: The Impact of the Highly Improbable,* Random House, New York, NY, 2007, Print.