

Knowing our biases

Mark Salway says optimism is key in the charity sector, but a bit of pessimistic thinking never hurt.

TRY TO CATCH a coin falling through water and you may well miss it on your first attempt. After learning and watching how it flicks backwards and forwards, you may well catch it second or third time round. It's difficult because of the water's distorting effect on your vision and the seemingly random effect of the water on the falling coin.

Making decisions in the charity sector is similar – your best guess is often distorted by your conscious and unconscious biases, sometimes buffeted by external forces. Not only do we have to manage decisions about risk and reward, but do so also with emotional and sometimes highly personal choices. Take, for example, humanitarian response during a war, and it is difficult to make objective decisions when the consequence of any decision could be profound.

A positive outlook

Charities are by nature optimistic and want to help create a better world. Optimism can be a positive force which can create energy to drive social change, and we should celebrate this. However, optimism in a hard contractual budget could be a disaster, as charities find themselves dipping into precious reserves to make up any shortfall.

This bias has a name: "Optimism bias". In the finance world, this is held up as the tendency to over-promise delivery and under-budget our projects.

I have found that optimism bias is endemic in the charity sector. However, we are not alone. The government *Green Book* (looking at investment appraisal in central

government) highlights a study across a wide range of projects that identified project cost and works having an optimism bias of 17 per cent, while for capital projects this rose to 47 per cent. It urged government departments to think about this and price it into their work.

“Many charities believe they can grow with minimal investment in overheads”

My recent work with several international charities has shown that indicatively we have an optimism bias of 15-20 per cent in our work. Taking into account not just the financials but also project outcomes and outputs, that is 15-20 per cent more stress on budgets and 15-20 per cent more concern about project deliverables which we have to manage during implementation just because of our optimism when we started planning. The commercial sector is very good at driving this out of their business and taking on risk without being over-optimistic, and we must get better too.

Looking ahead

So coming back from summer holidays, many of you will be moving into budget cycles. How much do you over-promise and under-budget in your charities? And how do you start to address this inherent bias?

One approach is to ensure that both operations and finance staff sign off proposals and budgets, and work together armed with the understanding of optimism bias. You may, for example, want to write this

as a separate line into your project proposals or annual budgets. You could then reduce this budget line where you are certain, or increase time and costs against budget lines where you are not.

Optimism bias also changes with the complexity of projects, how far the work is taking place in the future and the risk of the project. How often have you nailed your figures and said with 100 per cent accuracy what the budget figure will be at the end of the year, when the reality is that it could be a broad range?

Being part of the Cass Business School, I talk to many charities and get to see their business plans. Many are now making optimistic decisions about their financial position and overhead levels. Specifically, they believe that they can continue to grow and develop their organisations with minimal investment in overheads. Many charities are not able to scale up even if they wanted to, because they now lack the infrastructure to do so. A little pessimism could help here.

A final piece of research is brilliant for accountants and finance staff. It argues that the make-up or composition of the group or individuals making the decision has a large part to play on optimism. They cite, for example: "If all of the group were entrepreneurs, they are much more likely to take risk-taking decisions than if the group comprised wholly of accountants". So crack out your inner entrepreneur and think differently... ■



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