Predictable Surprises

Chapter 1

What is a Predictable Surprise? A Preview

Were the earth-shattering events of September 11, 2001, predictable, or were they a surprise? What about the collapse of Enron in bankruptcy and scandal? We argue that they were both predictable and a surprise – they were predictable surprises. Predictable surprises happen regularly in organizations, private as well as public. We define a predictable surprise as an event or set of events that take an organization by surprise, despite leaders’ prior awareness of the information necessary to anticipate the events and their consequences. We believe one of the main responsibilities of leadership is to identify and avoid predictable surprises.

Predictable surprises occur regularly across organizations; the September 11 tragedy and the fall of Enron are simply dramatic recent examples. Most leaders recognize growing systemic weaknesses in their organizations that have the potential to flash into a major crisis over time. Visionary and courageous leaders avoid tragedies by both anticipating and taking steps to mitigate the damage of such threats. But far too many leaders are predictably surprised. The United States’ lack of preparedness for a terrorist attack using airliners rendered the nation terribly, and avoidably, vulnerable. Likewise, unwillingness on the part of U.S. leaders to deal with well-recognized weaknesses in the financial oversight of companies set the stage for Enron’s collapse.

Consider the weaknesses in the U.S. aviation security system that led the terrorists to decide to use airplanes as weapons. The federal government knew that militant Islamic terrorists
were willing to become martyrs for their cause, and that their hatred and aggression toward the United States increased throughout the 1990s. Terrorists bombed the World Trade Center in 1993. In 1994, terrorists hijacked an Air France airplane and made an aborted attempt to turn the airplane into a missile aimed at the Eiffel Tower. In 1995, the U.S. government learned of a failed Islamic terrorist plot to simultaneously hijack eleven U.S. commercial airplanes over the Pacific Ocean, then crash a light plane filled with explosives into CIA headquarters. Meanwhile, dozens of federal reports and Vice President Al Gore's special commission on aviation security provided comprehensive evidence that the U.S. aviation system was full of holes. Any frequent flyer knew how simple it was to board an airplane with items, such as small knives, that could be used as weapons.

When you put the pieces together, the threat of a predictable surprise emerges. Did the U.S. government know that four airplanes would be used to attack New York and Washington? No. Did the government know that both World Trade towers would fall? No. But U.S. government agencies and officials had all of the data they needed to know that dangerous deficiencies in airline security existed – ones that could be exploited in a variety of ways, thereby requiring urgent attention. The use of commercial airplanes as weapons on September 11 was therefore a predictable surprise. While advance knowledge of the terrorists’ plans could have headed off the attacks, the U.S. intelligence community is only partially responsible for failing to “connect the dots.” More broadly, it is the responsibility of the federal government to ensure that our skies are safe and secure. As was made clear on 9/11, our leaders failed miserably in this regard.

What about the collapse of Enron? Was it foreseeable and preventable? Immediately following the energy giant’s bankruptcy, the firm’s auditor, Arthur Andersen, faced intense
scrutiny. How could Andersen have vouched for the financial health of a company that had been concealing billions of dollars in debt from its shareholders? Facing investigation for its role in the scandal, Andersen threw what some observers described as a “shredding party” of documents from its Enron audit; ultimately, the firm was found guilty of obstruction of justice and ceased its audits of public companies.

At the heart of the Enron debacle is a conflict of interest that experts, including one of the authors of this book, have been warning about for years. In 2000, a number of researchers testified before the Securities and Exchange Commission (SEC) that the rapid growth of the Big 5 accounting firms’ consulting divisions throughout the 1990s had made impartial financial audits impossible. With the firms relying on consulting work for much of their income, they found themselves in the compromised position of seeking the approval of the very companies whose books they were expected to judge without bias. The dramatic rise in fraud cases investigated by the SEC—up 41 percent from 1998-2001—was one sign of the potential for a dramatic predictable surprise. Separation of the Big 5 firms’ auditing and consulting functions, many advised, was needed to head off disaster. But, faced with vociferous opposition from Congress and from the auditing industry, including Arthur Andersen CEO Joseph Berardino, the SEC backed down. The predictable result: the collapse of Enron and Arthur Andersen, the loss of thousands of employees’ jobs and retirement savings, and a stain on U.S. financial markets.

**Characteristics of Predictable Surprises**

In the aftermath of any significant crisis, legions of Monday morning quarterbacks inevitably assert that the people in charge should have predicted the disaster. But true surprises really do happen, surprises for which no one should be blamed. Other surprises occur that
responsible leaders envisioned, yet deemed too unlikely and too costly to prepare for. When leaders have recognized potential threats, carried out thorough cost-benefit analyses, and decided that action is unwarranted, we do not criticize them on the basis of hindsight. But often, given the information that was potentially available, a responsible leader should have anticipated a surprise and worked to prevent it. For this reason, we distinguish *unavoidable* surprises from *predictable* surprises. As opposed to an unavoidable surprise, a predictable surprise arises when leaders unquestionably had all the data and insight they needed to recognize the potential, even the inevitability of a crisis, but failed to respond with effective preventative action. In this book, we offer a multidisciplinary look at why predictable surprises are so common within organizations. We consider the cognitive, organizational, and political roots in a manner that can be generalized to most organizations.

How can leaders identify a predictable surprise while there is still time to act? We offer six characteristics of predictable surprises, each of which can be found in the September 11 tragedy and the Enron scandal.

First, a shared trait of predictable surprises is that leaders knew a problem existed and that the problem would not solve itself. In many cases, such festering problems have been talked about in board meetings, executive sessions, Congress, the Oval Office, and written about in the press. While leaders may have had differences of opinion about the urgency of the problem, the weight of evidence supported the need for action. As we will document, the administrations of George H.W. Bush, Bill Clinton, and George W. Bush all knew that aviation security and financial oversight of companies were deficient. These leaders were aware of a growing threat, but failed to mobilize and respond accordingly.
Second, predictable surprises can be expected when organizational members recognize that a problem is getting worse over time. Some problems solve themselves; for example, the human body and the natural environment are robust, and have strong abilities to cure themselves. But when scientific evidence (economic, biological, or other) suggests that a problem will not solve itself, and will probably continue to escalate, a predictable surprise is likely. Although report after report told U.S. leaders that the nation aviation security system was worsening by the day, while our enemies’ power to take advantage of such weaknesses mounted, little was done. Similarly, the weight of evidence presented to the SEC in 2000 made it clear that auditors’ lack of independence was a growing problem that could lead to disaster, yet the commission failed to enact real reform. Predictable surprises are not “bolts from the blue” that come without warning. Unlike avoidable surprises, they are not failures of recognition, but failures of response.

A third feature of predictable surprises is that fixing the problem would incur significant costs in the present, while the benefits of action would be delayed. As we will argue in Chapter 4, individuals, organizations, and governments have a strong tendency to discount the future. It is counterintuitive to spend scarce resources now to prevent an ambiguous harm from occurring in the future. New security and oversight systems aimed at fixing the aviation security and financial oversight systems in the 1990s would have required expensive direct costs from the federal government and from corporations. The benefits of preventative action would have simply been a reduction in the likelihood and magnitude of events such as the September 11 attack and the bankruptcy of Enron. Leaders and citizens alike would have observed no tangible return from their investment of time and money.

A fourth characteristic is related to the previous one: addressing predictable surprises typically requires incurring a certain cost, while the reward is avoiding some cost that is
uncertain, but likely to be much larger. Thus, leaders know that they can expect little credit for preventing them. Measures aimed at avoiding predictable surprises require costs that constituencies will notice, yet politicians will not be recognized and rewarded for the disasters they help to avert. For this reason, they have little motivation to work to prevent predictable surprises, and therefore may choose instead to cross their fingers and hope for the best. Consider the electrical power system. We don’t end each day thanking the power company for keeping our lights on. But if there is a protracted outage, even if it’s due to necessary repairs, there will be hell to pay. Fixing aviation security before September 11 would have slightly increased travel delays and the cost of flying. But because the U.S. public could not envision the predictable surprise of failing to fix the problem, aviation security remained a low priority for politicians – including those who had been warned for years by reliable sources about the potential for a catastrophe on the scale of September 11. Nor did many U.S. citizens pay attention to the issue of auditor independence prior to the collapse of Enron. The most pressing social and economic problems are often also the most onerous and thankless tasks, because most citizens have not yet even recognized them. Wise leaders will recognize this odiousness as a feature of predictable surprises and work to educate their constituencies about the need for significant and immediate action.

A fifth characteristic is that decision-makers, organizations, and nations often fail to prepare for predictable surprises because of the natural human tendency to maintain the status quo. Above and beyond concerns about the cost and time requirements of change, when a system still functions and there is no crisis to catalyze action, we will keep doing things the way we have always done them. Acting to avoid a predictable surprise requires a decision to act against this bias and to change the status quo. By contrast, most organizations change
incrementally, preferring short-term fixes to long-term solutions. To avoid predictable surprises, leaders must make the case for change and eliminate the status quo as an option. Thus, while some token efforts to improve airport security and to address auditor conflicts of interest were made in the 1990s, reforms fell woefully short of meeting the challenges. We accepted too many features of outdated, ineffective systems.

An unfortunate sixth characteristic of predictable surprises is that a small vocal minority benefits from inaction, and is motivated to subvert the actions of leaders for their own private benefit. That is, while society is often desperate for its leaders to take decisive action on an issue, special-interest groups that benefit from the status quo will fight hard to block reform. As we will document in Chapter 2, to prevent well-specified and much needed improvements in security from being implemented, the airlines manipulated governmental decision-making via lobbying and campaign donations. The airlines’ political action suggested that they were far more concerned with reducing their short-term expenses than with ensuring the safety of their passengers. Notably, they were the first in line for government assistance in the aftermath of September 11. Similarly, in 2000, as we describe in Chapter 3, auditing firms had little trouble persuading Congress and the SEC that they were capable of providing unbiased audits of the same corporations they depended on for consulting profits. The collapse of Enron a year later made it clear that the Big 5 firms, including Arthur Andersen, did not deserve their remarkable ability to distort government policy. Politicians and government regulators have been too easily swayed by the arguments of these special-interest groups.

Collectively, these six characteristics of predictable surprises provide a useful set of signals that danger is present. Ignored, these characteristics lead to tragedy. With sound
leadership, disaster can be avoided. This book aims to guide decision-makers toward action to prevent future predictable surprises.

**Prototypes of Predictable Surprises**

We expect that our introduction of 9/11 and Enron both made you curious about the predictability of these events, but also have you wondering if these data is really there to make this accusation.

Chapters 2 and 3 offer an overview of events relevant to the predictable surprises of the September 11 attacks and the Enron collapse. We believe that these data will eliminate any doubt about their predictability. But our goal is not to provide a comprehensive history of either set of events, but to illustrate a pervasive leadership oversight – the failure to avoid predictable surprises. The notion of predictable surprises is a diagnostic concept, not just a post-hoc explanation of recent tragedies. Predictable surprises can and should be anticipated, rather than merely identified in hindsight, as the costs of prevention are far lower than the costs incurred in the aftermath of disaster. The U.S. government could not have predicted the specifics of these events, but should have better anticipated and prepared for a broad variety of catastrophes.Interestingly, organizations will achieve the greatest success if they adopt blanket measures to prepare for a spectrum of disasters, rather than addressing potential surprises one at a time. The accounting reforms that emerged after the downfall of Arthur Andersen were extremely narrow, focusing on specific flaws of Andersen’s audit of Enron rather than treating these flaws as symptoms of a major systemic problem. These tentative reforms are unlikely to prevent future crises.
While we personally did not advocate the need for greater airline security before September 11, the first draft of the Gore Commission on airline security report, written in 1996, contains all of the details that U.S. leaders needed to identify and prepare for this predictable surprise (see Chapter 2). In the case of auditor independence, Max H. Bazerman, one of the authors of this book, was part of the effort to persuade the U.S. government to take action before a predictable surprise erupted. Bazerman co-wrote and published a 1997 paper entitled "The Impossibility of Auditor Independence" and testified before the Securities and Exchange Commission (SEC) in 2000 that true auditor independence cannot occur within the current U.S. financial system (see Chapter 3).¹

Why Don't We Act on Predictable Surprises?

By now, we trust that you are thinking about the predictable surprises in your own organization. Why is it so common for executives to fail to act on predictable surprises?

In Part 2 of the book, we provide a multidisciplinary look at why predictable surprises are so common within organizations. We will consider the cognitive, organizational, and political causes of predictable surprises in a manner that can be generalized to most organizations.

Chapter 4 will focus on the cognitive reasons that we ignore the threat of predictable surprises. We will argue that people tend to hold positive illusions that lead us to interpret events in an egocentric manner and undervalue risks. In addition, people tend to overly discount the future, reducing our willingness to invest now to prevent some disaster that may be quite distant and vague. People also tend to try to maintain the status quo, creating a barrier to the dramatic changes that are needed to address predictable surprises. Finally, most of us are more willing to run the risk of incurring a large but small-probability loss in the future rather than accepting a
smaller, sure loss now. We don't want to invest in preventing a problem that we have not experienced and cannot imagine with great specificity. Thus, far too often, we only address problems after we have experienced significant harm.

Moving to the level of the organization, Chapter 5 argues that for an organization to avoid predictable surprises, it must efficiently and effectively take a number of steps: scan the environment for information regarding threats, integrate that information from multiple sources, respond in a timely manner, observe the results of the response, and incorporate lessons learned into the "institutional memory" of the organization. Organizations often err by failing to follow these critical processes. This may be because organizational "silos" impede integration of information, or because individual incentives encourage people to behave in ways that damage the collective. Regardless, organizations are rendered vulnerable to being predictably surprised.

Finally, at the political level, Chapter 6 shows that there are often a small number of individuals and organizations that are highly skilled at corrupting the political system for their own benefit. The failure of the United States to enact meaningful campaign finance reform for so many years, for example, created an election environment of legal corruption; even with the recent ban on soft-money donations created by the 2002 passing of the McCain-Feingold campaign finance reform, it remains far too easy for special interests to influence the political process and help predictable surprises come to pass. Meanwhile, a politician’s larger constituency will remain focused on the costs of action to prevent predictable surprises, while ignoring future benefits – which will often follow the leader's term of office. As a result, small groups that are intensely activated around an issue will hold sway over a much larger polity that does not have strong feelings on the issue. When a predictable surprise occurs, politicians and journalists tend to focus on a small number of evildoers, rather than exploring systemic flaws
that create incentives for abuse. Too often the tyranny of the minority, fortified by conviction, clout, and cash, keeps us from preventing predictable surprises.

**Diagnosing and Preventing Predictable Surprises**

Hindsight may be 20/20, but in Part 3, we show that leaders can prescriptively employ the concept of the predictable surprise to avoid future disasters. The key lies in establishing robust systems for recognizing, prioritizing, and mobilizing to prevent predictable surprises.

Chapter 7 focuses on how leaders can enhance their ability to recognize emerging threats. Drawing on stories such as the mistakes of the U.S. intelligence community prior to the 9/11 terrorist attacks, the failed merger of General Electric and Honeywell, and the crippling difficulties faced by Monsanto in its attempt to sell genetically modified food in Europe, the chapter explores the factors that contribute to recognition failures. We provide leaders with specific tools, including measurement system redesign, intelligence network building, scenario planning, and disciplined post-problem learning, to enhance their abilities to recognize looming trouble.

Chapter 8 explores how leaders can more effectively prioritize actions to prevent predictable surprises. To help leaders overcome barriers to effective prioritization, including noise, competing priorities, diverse cognitive biases, and perverse incentives in organizations, we supply a powerful set of tools to strengthen prioritization. These include structured dialogue processes, rigorous decision analysis, and incentive-systems redesign.

Finally, Chapter 9 examines how leaders can better mobilize support for tackling predictable surprises. Even if they recognize and prioritize action to address looming problems, leaders may be stymied by organizational inertia and active opposition from special-interest
groups. While the courage to tackle tough problems is a prerequisite for success in mobilizing to prevent predictable surprises, it is not sufficient. Leaders can use techniques such as persuasive communication, strategic coalition-building, structured problem-solving, and crisis-response techniques to accelerate mobilization.

**Some Specific Predictable Surprises that Demand Attention**

In our concluding chapter, we identify some of the most important predictable surprises currently facing society. We will argue that predictable surprises can be expected due to the failure of our leaders to effectively address industry reliance on government subsidies, global warming, campaign finance reform, auditor conflict of interest, ignoring future financial obligations, the aging of populations and the impact on economies, at an industry-specific level, the potential of airlines’ frequent flyer programs to lead to disaster, and the frequent vague contracts that are so often written between firms. This treatment will allow readers to consider predictable surprises that can be effectively mitigated.

While the vision to identify predictable surprises may be rare, the courage do something about them is rarer still. We define courage as a willingness to act against one’s own and others’ short-term interests to avoid heavy long-term costs, as well as the capacity to persuade other influential parties of the need for action. The Clinton/Gore administration had the vision to recognize the need for radical improvement in airline security in the late 1990s. Unfortunately, it lacked the courage to act. Similarly, Arthur Levitt, the head of the SEC in 2000, had the vision to focus on the lack auditor independence in the accounting world, but lacked the courage, as well as the clout, to stand up to special-interest groups to the extent necessary to avoid the predictable surprise of the Enron collapse. We will provide leaders with tested approaches to
persuading influential constituencies to abandon the status quo. In doing so, we will hone leaders’ ability to prevent predictable surprises from damaging their organizations.

If our efforts are somewhat successful, we will convince you that September 11 and Enron were predictable surprises. If we reach a greater level of success, you will finish the book believing that a conceptual structure exists for identifying predictable surprises. If we achieve the highest level of success to which we aspire, when you finish this book you will have identified predictable surprises in your organization and will begin to implement strategies to effectively respond to these threats.

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