Rendering a Powerful Tool Flaccid:

The Misuse of Premortems on Wall Street

Gary Klein
MacroCognition LLC
gary@macrocognition.com

Paul D. Sonkin
Teachers College, Columbia University
pds30@tc.columbia.edu

Paul Johnson
Columbia Business School
pj27@columbia.edu

This Draft: February 2019

Abstract

The premortem is an easy-to-use method for risk identification that has become increasingly popular within the investment community, as well as in other domains. The premortem often surfaces important, and sometimes path-critical, issues that go unnoticed. Also, the premortem increases candor and trust within teams putting it into practice. Two Economic Nobel prize winners (Kahneman and Thaler) have advocated for its use. However, too often the premortem has been applied improperly, reducing its benefits. We use a case study to identify five common mistakes and describe ways to correct them. We also present a step-by-step guide to conducting a premortem.

Introduction

The premortem, which can be used in a wide variety of settings, is a novel way to not only identify potential risks, but also to critique plans. Yet too often on Wall Street, the premortem gets implemented incorrectly, robbing it of its full potential. The authors cringe whenever they hear money managers and capital allocators describe how they perform premortems. Nonetheless, the method must indeed be robust if professional investors still see it as useful even though they are butchering it.

We describe in this essay how the premortem came into existence, why it works so well (when implemented correctly), and how to correct some of the most common mistakes we have observed Wall Street experts make when implementing the method. To properly frame and describe the process, we first tell a brief story that will provide an analog for readers to map the correct steps of the premortem to.

A case study of Sherman McCoy and Consolidated Fuzz

It was a crisp June morning when Sherman McCoy walked briskly through the entrance to the glass-walled conference room with a picturesque view of Central Park. McCoy was excited about his latest investment idea – Consolidated Fuzz. Assembled around the table were a half-dozen senior and junior analysts, all of whom look like they came from central casting – a mix of men and women, each impeccably dressed and well-bred, all with Ivy League credentials and strapping good looks. The group had spent weeks researching Consolidated Fuzz, performing channel-checks, interviewing past employees, and consulting with industry experts. The analysts identified a catalyst and believed they had both an informational and analytical edge. The team was confident the investment opportunity they had identified would be an easy double in the next 18 months, with, what they believed, a minimal amount of risk.

Sherman was so excited about the idea that he remained standing, pacing back and forth with nervous energy, as he addressed the team about the final steps in their investment process. He reminded the group, "We will need to accumulate our position quickly, because everyone will pile-in and push-up the price after we file our 13D." Despite his obvious enthusiasm for the idea and high conviction in the research his team had completed, Sherman's tone became more serious as he stated, "I just want to make sure we have done a proper premortem before finishing our process." Pausing for effect, he then asked, "What can go wrong?" Sherman leaned forward, his palms on the conference room table, as he challenged the group, "Come'on. Go."

Bennett Marco, a partner and the most senior member of the group, responded first, "After a calm hurricane season last year, reinsurance rates have softened, which might affect their insurance group." Sherman looked around to see who else wanted to speak. Eugenie Chaney, a junior analyst, jumped in, her voice a little tentative, "They have had some issues with their European operations and I'm concerned that the new guy they brought in won't be able to implement the cost-cutting measures he has outlined." George Stroud, a seasoned analyst, took control of the discussion as he raised four potential problems, one after another, in rapid succession, while the rest of the group relaxed, relieved not to feel pressure to contribute to the debate. The discussion continued for about an hour and every concern that was raised was dissected and addressed. Raymond Shaw, a newly minted Columbia JD/MBA, remained silent through the entire meeting but thought to himself, "The recent legislation introduced in a House bill *might* affect their insurance group if enacted," but dismissed the concern because he felt "the chances of that are remote."

Finally, Sherman blurted out, somewhat impatiently as the meeting had taken longer than he had planned, "What are we left with? Nuclear war?" Marco responded, half-jokingly, "All

bets are off at that point, …but other than that, we are good." Sherman announced, to no one in particular, "Go tell Chunjin to start buying stock."

Two weeks later, Sherman's firm filed a 13D showing ownership of 9.9% in Consolidated Fuzz. The stock jumped 10% on the news, which surprised no one in the firm, least of all Sherman. By the end of the year, Consolidated Fuzz's stock price had increased by more than 50% from the firm's initial purchase and had become its largest position. Just after 4:00PM on December 31, Sherman looked at the price of Consolidated Fuzz and thought about the hundreds of millions of incentive fees he had just earned. He smiled broadly, and then whispered, "It doesn't get better than this."

And it didn't. A few weeks later, a competitor of Consolidated Fuzz named Amalgamated Lint announced that they were party to an investigation by the US Department of Justice (DOJ) into sales practices within their insurance division. The investigation had uncovered widespread fraud with the Company's accounting practices. Within a few short months, on a snowy Tuesday morning in early March, Amalgamated Lint declared that it was filing for bankruptcy protection. That following Sunday, Senator John Iselin and Thomas Jordan, sponsors of the Iselin-Jordan Insurance Reform Act, appeared on 60-Minutes and explained why their proposed bill would have prevented the collapse of Amalgamated.

Consolidated Fuzz's stock price declined sharply during the months of the Amalgamated Lint scandal and returned to McCoy's original purchase price. As a show of confidence, Sherman bought additional shares, increasing his ownership to 14.9% of Consolidated Fuzz's stock. In early July, the Iselin-Jordan Insurance Reform Act passed and went into law. A few weeks later, in the first week of August, Consolidated Fuzz held their quarterly call with analysts to announce their second quarter results. The company's earnings had declined sharply from the

prior year's results and management informed investors that the newly-passed Iselin-Jordan

Insurance Reform Act would significantly curtail their insurance operations going forward. The

stock declined 35% the next day in response to the disappointing financial results and had, by

then, lost 80 percent of its value since the first of the year. McCoy faced staggering losses in the

position, which he had no hope of recovering.

What went so horribly wrong with the investment process? Had the team not done a

premortem to prevent this type of outcome? Upon reflection, the group had never heard from

Raymond Shaw about the proposed legislation. While Shaw was aware of the problem, he never

mentioned it during the premortem, even though it had the potential to severely impact

Consolidated Fuzz's insurance operations. Had the premortem failed or was there something else

going on in this situation?

What exactly is a premortem?

Before we discuss what went wrong with McCoy's investment, we will first define a

premortem. A premortem is simply a method for identifying potential flaws in a plan. It works

by having the team imagine that the plan has failed and identify the reasons for its assumed

failure. A premortem enables problem finding and encourages candor between team members.

One of the great features of a premortem is that it is conducted *before* the plan is launched.

Therefore, any weaknesses it identifies can be addressed before the plan is implemented. When

used correctly, a premortem reduces the risk of a plan's *actual* failure.

How is a premortem conducted?

Step 1: The team members become familiar with the plan (or in this case the investment)

before the premortem meeting. Sometimes the premortem is used at the end of a kickoff meeting

for a new project, after the project plan has been presented.

Step 2: The group gathers to conduct the premortem. The person facilitating the meeting, who is often, but not necessarily, the project leader, tells the team members to imagine that a crystal ball shows that this plan has failed, catastrophically, at some point in the future, perhaps six months or a year from the time of the meeting. There is no doubt in the outcome because the crystal ball never lies – the plan has been an unmitigated disaster.

Step 3: The team members work individually at their seats to write down all the reasons they can think of to explain why the plan failed. If the facilitator is also the project leader, he or she also writes down reasons for the fiasco. This step has a time limit — usually two minutes — because it is critical for the team to act promptly, without delay. The facilitator should call-out the remaining time as the process progresses to maintain the sense of urgency.

Step 4: If the facilitator is the project lead, he or she is the first person to state a reason why the project failed. The facilitator then asks each group member to state just one of the reasons they believe why the plan failed and records all responses into a consolidated list, usually on a white board or display easel. Every member of the team *must* submit a reason the plan failed (one not already stated), and all individuals are limited to a single reason (per round). It is important that everyone participates and that the facilitator does not let any individual dominate the discussion. The facilitator repeats the process for each round of the premortem. The session usually requires two rounds to elicit all the unique responses from each team member, but rarely a third round.

Step 5: The team examines the list on the board and discusses the merits and implications of each item listed.

Step 6: Next, the facilitator asks each person to work individually to write down what actions he or she can take to reduce or avoid the problems listed during Step 4. Once again, there should be a time-limit to this step, also usually two minutes, to keep the process moving rapidly.

Step 7: The facilitator quickly surveys each person to have them describe the action(s) he or she has identified in Step 6, and someone writes the actions on the board for the team to see.

Step 8: The facilitator uses the information uncovered from the premortem to revisit the original plan to make it stronger, conduct further research into the plan's viability, or potentially abort the plan entirely. When done correctly, the premortem harnesses the team's creativity to identify weaknesses or blind-spots in the plan (or investment thesis).

One way to think of a premortem is to use the metaphor of a solar eclipse. The moon occludes the sun and allows observers to see the sun's corona. Similarly, a premortem lets the team see aspects of the plan that are ordinarily hidden because of the intensity of the team leader's commitment to the plan and the pressure for team harmony.

Five conditions that make premortems effective:

1. **Problem reframing.** The goal of the premortem is to allow the group to identify weaknesses, poor assumptions or hidden risks associated with a plan or an idea. Research shows that it is easier to find reasons for why something *has* happened as opposed to developing different scenarios for things that *might* happen. (Mitchell, Russo, & Pennington, 1989) The premortems leverages this insight by forcing individuals to explain *why* the plan failed rather than attempting to speculate about weaknesses in the plan in a disengaged fashion. Once the team members have shifted their mindset to accept that the plan has failed, the premortem allows them to become creative in identifying the cause of the plan's failure and uncover its flaws and weaknesses.

2. **A cognitively diverse crowd or group.** The wider the group's expertise and experience, the wider will be the range of suggested causes of the plan's failure. Research shows that individuals with similar backgrounds in expertise and knowledge produce similar ideas. (Nijstad, Diehl, & Stroebe, 2010). Since the premortem's goal is to expose the widest possible sources of the plan's (potential) failure, a more cognitively diverse group may produce a more comprehensive list of potential problems.

3. **Psychological safety.** By design, the premortem requires that every group member provide valid and important criticisms, and the process should acknowledge team members for identifying the most insightful potential problems that had not been previously identified. To get the most out of a premortem, the facilitator needs to create an environment that eliminates or reduces social pressures present in "normal" group dynamics, which is referred to as creating "psychological safety." Creating psychological safety is a critical aspect of the premortem and one of its key differentiators when compared to other approaches used to identify a plan's inherent weaknesses. For instance, in most critiquing sessions, fear stifles ideation. When team members worry that they may be offending or look stupid in front of other members of the team, especially the project leader, they will be reluctant to participate and present any "controversial" ideas. Experience shows that group members will be reticent in their participation if they fear that there may be repercussions to their comments. On the other hand, openness to ideas unfreezes the analytical process, prevents confirmation bias, and reduces concurrence seeking. (Johnson, Johnson, & Smith, 2000) Achieving these goals requires that the Project Leader go first and is why it is critical that he or she set an example of candor. It

is not enough for Project Leaders to announce that everyone should be honest and speak their minds, they must lead by example in voicing a realistic criticism of the plan to set the tone for the dialogue.

4. **Group "equality."** It is critically important to have "equal" participation from each team member. To achieve this goal, all group members need to feel that the premortem is a democratic process where everyone's contribution is considered equally, without individual bias or hierarchical structure. Even junior members of the team should be valued. Their contribution is important because they bring fresh eyes and a different perspective to the exercise, one not tainted by being a long-standing group member. On the other extreme, individual contribution will be suppressed if any individual interrupts, criticizes, or tries to dominants the discussion. Studies have shown that group interaction can actually inhibit rather than stimulate creative idea generation if the process is not handled in a democratic fashion. (Nijstad, Stroebe, & Lodewijkx, 2003)

5. **Sense of urgency.** It is critical that the premortem follow a rapid pace to avoid paralysis that often comes from too much group discussion and superficial analysis. It is important for the team to understand that the process has a finite time limit, which forces individuals to work quickly when generating their ideas and the meeting to remain focused on the plan during the team discussions.

Where did the premortem idea come from?

Gary Klein developed the premortem in the late 1980s to help his company perform more effective kickoff meetings. Klein wanted to encourage the assembled team to produce a more insightful review of the plan they were getting ready to enact. After using the premortem for

about a decade, Klein described the process in his book *The Power of Intuition* (Klein, 2004)

and then in a short article, *Performing a Project Premortem,* published in the Harvard Business

Review (Klein, 2007).

The premortem method has become surprisingly popular. It has been used by wildland

firefighters, military planners, psychotherapists, power generation plant managers, corporate

managers and executives. And most recently, Wall Street investment firms.

Daniel Kahneman, a Nobel laureate, mentioned the premortem method at the end of a

talk he gave at Davos and heard the CEO of a major international corporation mutter, "It was

worth coming to Davos just for this!" (Kahneman, 2011 p. 264). Richard Thaler, another Nobel

laureate, identified the premortem as his example of an unappreciated concept everyone should

know (2018). "Many companies that were once household names and now no longer exist might

still be thriving if they had conducted a premortem, with the question being: 'It's three years

from now and we're on the verge of bankruptcy. How did this happen?'" (Thaler, 2018 p. 190)

How does a premortem differ from other critiquing methods?

There are other critiquing methods, such as appointing a *devil's advocate*, assigning a *red

team* (Hoffman, 2017), using a *murder board*, and conducting *risk assessment and failure

analys*es. Each approach has its merits, and limitations. Researchers Nemeth, Brown and Rogers

(2001) found that devil's advocates did not improve the quality of group solutions. Interestingly,

they found that the process actually increased the group's support for the orthodox opinions. The

researchers reasoned that the results were probably because the devil's advocate was seen as

enacting a role rather than voicing authentic dissent. Red teams and murder boards take time and

energy to assemble and gain familiarity with the plan. Risk assessment and failure analyses

generate quantitative estimates but only for the factors that are already known — they are not designed to uncover novel threats.

Veinott, Klein and Wiggins conducted a formal study of the impact of premortems when compared to traditional critiques (e.g., "Does anyone see any problems with this plan?") and systematic listing of pro/con issues. The researchers assumed that the participants in their study were overconfident in the potential success of their plan and wanted to measure how the different methods reduced that (over-) confidence. The researchers found that the traditional, simple critique had no effect on reducing the team's confidence in their plan. The listing of pro/con issues and the premortem both reduced confidence levels, and the premortem method generated significantly lower plan confidence ratings than either of the two other methods. (Veinott, Klein, & Wiggins, 2010)

What rendered the premortem process ineffective in the Sherman McCoy story?

As simple as the premortem method is, there are numerous examples of well-intended teams performing the process improperly by leaving out important, but nuanced factors, resulting in a sub-optimal outcome, as we detailed in the opening story.

Although McCoy believed he was performing a premortem on Consolidated Fuzz with his team, he wasn't. He violated many of the essential steps required for a successful premortem. The story illustrates some of the most common mistakes we have observed:

Mistake 1: *Asking the group, "What can go wrong?"*. McCoy started the premortem by asking, "What can go wrong?" He should have framed the discussion as peering into the future with the crystal ball and seeing with certainty that the plan was an unmitigated disaster. McCoy failed to establish the right mindset at the very beginning of the meeting.

This approach is probably the most common mistake we see. Unfortunately, it blunts the impact of the premortem. Although, well-intentioned, the question, "What can go wrong?" is just too passive. It doesn't push the group into making creative and important discoveries. The essence of the premortem is the firm assertion at the beginning that the plan <u>has</u> gone horribly wrong. It has failed. No equivocation. The reframing is critical in shifting the group's mindset.

Mistake 2: *Allowing a slow, overly contemplative pace.* Looking back at the description of the session: "The discussion continues for about an hour and … every concern that is raised is dissected and addressed.'" This description gives the impression of an academic seminar, not the fast-paced lightning rounds necessary to making a premortem a success.

We have found that a slow pace allows individuals time to edit and second-guess their initial thoughts and saps the group's energy. Instead, the premortem process requires a brisk pace. By allowing group members only a few minutes to write down everything that comes to mind forces greater response spontaneity. The exercise continues even if some of the group members haven't finished assembling their list.

Mistake 3: *Asking for volunteers.* Asking for volunteers tells everyone that they can lay back and not participate, and often allows the most vocal group members to dominate the discussion. That atmosphere is not ideal for the process to be effective. Instead, everyone must participate and share their ideas. The typical way to ensure contribution is to go around the room, having each person state the item at the top of their list. An even better way is to call on people semi-randomly to keep participants "on their toes." Everyone is

forced to participate in the process this way, which increases dramatically the group's ideation.

Looking back at our story, McCoy leaned back to see who would start the discussion, with Bennett Marco speaking-up first. Eugenie Chaney chimed in next. No one was put on the spot and the more passive team members were allowed to sit back and not participate fully in the process. In fact, Raymond Shaw, the newly minted Columbia JD/MBA, kept silent through the entire meeting, even though he had critical information about recent legislation introduced in a House bill that might affect the Company's insurance group if enacted.

Mistake 4: *Having one of the group participants initiate the process.* To be successful, the process must start with the team leader or the plan's primary champion offering a reason why the project failed. If the leader's contribution is flippant or trivial, then he or she will have indicated to the team that they don't have to take the process seriously. Even worse, this type of response shows that the team leader is not being truly self-reflective or candid regarding their own idea. The premortem demands honesty and candor, starting with the team leader setting the tone.

McCoy was content to let Bennett Marco speak first — but Sherman should have been the one to start. He needed to demonstrate that he was invested in the premortem exercise and took it seriously.

Mistake 5: *Letting team members present more than one item from their list or dominating the discussion before moving to the next group member.* This mistake is

exactly what happened when George Stroud presented all of the items on his list while the rest of the group slipped further into a relaxed and passive state.

By not limiting everyone to contribute only one idea per round (assuming there are multiple rounds) can allow one of the team members, usually a high-ranking individual, to hog the spotlight and dominate the discussion. This mistake also sends a signal to the rest of the team that their ideas are not valuable or their contribution is not important. The facilitator needs to stop that person, no matter how high-ranking, from dominating the discussion and remind the group that the process allows for only one contribution per individual (per round). If the group is small or there is enough time, the facilitator can go around the room a second time, or even a third, so that everyone's full list of ideas is presented. In practice, individual team members will state ideas from another person's list, so it is rarely necessary to conduct a third round. However, because individuals often want recognition for their ideas, the facilitator should ask after each idea is expressed, "Who else had that idea on their list?" An individual may explain that he or she had a variant of the idea, and it is okay to write that elaboration on the board. Otherwise, the facilitator merely needs to tally the hands to see how common the idea was.

What does the premortem get you?

The primary benefit of a premortem is to identify inherent weaknesses in a plan or investment thesis *before* it is implemented. premortems usually surface potential problems that had not occurred (or were not identified) to other members of the team, especially to the team leader.

A secondary benefit is that a premortem reduces overconfidence. There is ample evidence that most planners, team leaders, and teams in general, are overconfident. The premortem challenges the team's hubris by acknowledging that things can (and will) go horribly wrong. However, it is important to note that the premortem can be a problem itself as it may foster a defeatist attitude. That is why Step 6 is important because it encourages the team members to identify ways that the team can address potential potholes, weaknesses, and traps in the plan.

Third, the premortem fosters a culture of candor, which is usually its most important benefit. A premortem encourages openness and psychological safety for authentic dissenters, which is counter to the way most organizations operate. Ideally, team members can voice their concerns and be respected for their contribution rather than attacked for their criticism. And, they should be admired for being thoughtful, creative, and insightful in doing so.

That kind of culture can make a big difference in the way the team works together. It tells the team members that there is no stigma to raising concerns, no accusations of disloyalty, no sidelining of critics, and no adversarial stance, at least during the premortem session. Hopefully, that spirit will spill over into the group's cooperation and other activities in the organization.

While many organizations might balk at adding new steps to their evaluation process, groups that use a premortem as part of their investment or planning process often experience an emotional shift. After running through a few of these sessions, an organization will become uneasy if someone suggests moving forward with a plan without performing a premortem. It's like the way older drivers used to resent the inconvenience of fastening a seat belt versus the sense of vulnerability most drivers feel today if they start driving without buckling-up. People can drive perfectly well without wearing a seat belt — it only matters when they are involved in

a collision. A premortem functions the same way, it is a small extra step which can save your life, but only if "worn" properly.

Bibliography

Hoffman, B. G. (2017). *Red Teaming: How Your Business Can Conquer the Competition by Challenging Everything*. New York: Crown Business.

Johnson, D. W., Johnson, R. T., & Smith, K. A. (2000). Constructive Controversy. *Change*, (January / February), 28–37.

Kahneman, D. (2011). *Thinking, Fast and Slow*. New York: Farrar, Straus and Giroux.

Klein, G. (2004). *The Power of Intuition: How to Use Your Gut Feelings to Make Better Decisions at Work*. Crown Business.

Klein, G. (2007). Performing a Project Premortem. *Harvard Business Review*, *85*(9), 18–19.

Mitchell, D. J., Russo, E. J., & Pennington, N. (1989). Back to the future: Temporal perspective in the explanation of events. *Journal of Behavioral Decision Making*, *2*(1), 25–38.

Nijstad, B. A., Diehl, M., & Stroebe, W. (2010). Cognitive Stimulation and Interference in Idea-Generating Groups. *Group Creativity: Innovation through Collaboration*, (1), 137–159.

Nijstad, B. A., Stroebe, W., & Lodewijkx, H. F. M. (2003). Production blocking and idea generation: Does blocking interfere with cognitive processes? *Journal of Experimental Social Psychology*, *39*(6), 531–548.

Thaler, R. H. (2018). The Premortem. In J. Brockman (Ed.), *This Idea Is Brilliant: Lost, Overlooked, and Underappreciated Scientific Concepts Everyone Should Know* (pp. 189–190). Harper Perennial.

Veinott, B., Klein, G. A., & Wiggins, S. (2010). Evaluating the Effectiveness of the PreMortem Technique on Plan Confidence. *Proceedings of the 7th International Conference on Information Systems for Crisis Response and Management*, (May), 1–9.