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Delusions of Success

Dan Lovallo and Daniel Kahneman must be commended for their clear identification of causes and cures to the planning fallacy ("Delusions of Success: How Optimism Undermines Executives' Decisions," July 2003). Their look at overoptimism, anchoring, competitor neglect, and the outside view in forecasting is highly useful to executives and forecasters. But Lovallo and Kahneman underrate one source of bias in forecasting – the deliberate "cooking" of forecasts to get ventures started. My colleagues and I call this the Machiavelli factor.

The authors mention the organizational pressures forecasters face to exaggerate potential business results. But adjusting forecasts because of such pressures can hardly be called optimism or a fallacy; deliberate deception is a more accurate term. Consequently, Lovallo and Kahneman's analysis of the planning fallacy seems valid mainly when political pressures are insignificant. When organizational pressures are significant, both the causes and cures for rosy forecasts will be different from those described by the authors.

In our study of bias in cost and demand forecasting in capital-investment transport projects, my colleagues and I found strong evidence of heavy political pressures on executives to make rosy forecasts – and minor penalties for having made such forecasts. Indeed, during the 70 years covered by our study, forecasters consistently made errors of the same size and frequency, resulting in repeated cost overruns and demand failures. Urban rail investments, for instance, had average cost overruns of 45% in constant prices, and actual patronage was 50% lower on average than forecasted. Comparing our data with data for other types of investments, we found the same pattern. Forecasts for public works projects are not fundamentally different from those for, say, private dot-com IPOs in this respect.

Overoptimism, as depicted by Lovallo and Kahneman, would be an important and credible explanation for this phenomenon if estimates were produced by inexperienced forecasters. But given that humans can, and do, learn from experience, it seems unlikely that forecasters would continue to make the same mistakes decade after decade. It seems even more unlikely that whole professions of specialized forecasters, often called in from outside the organization as Lovallo and Kahneman recommend, would collectively be subject to such a bias and would not learn over time. Such learning would help to reduce, if not eliminate, overoptimism. Then cost and demand estimates would become more accurate over time. But our data clearly show this has not happened.

We tested our data against four different explanations for bias in forecasting – technical, economic, psychological, and political – and found that political explanations fit the data best.

If executives are indeed deliberately cooking their estimates because of organizational pressure to do so, they will have little incentive to accept the outside view.

Bent Flyvbjerg
Professor of Planning
Department of Development and Planning
Aalborg University
Denmark