Book Review

The Logic of Failure: Recognizing and Avoiding Error in Complex Situations

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Not that long ago I was reading *The Wall Street Journal* and came across an interview with Michael Creighton, the author of very popular works of fiction – *Jurassic Park*, *Prey*, etc. What some people don't know is that Mr. Creighton bases much of his fictional work on academic studies of scientific and psychological importance. Interwoven within nearly all of Mr. Creighton's work is very useful information of specific relevance to financial counselors and planners – that is, the process of human thinking and acting. So, it was with great interest that I read the interview. In a sidebar to the article was a list of recommended books from Mr. Creighton. I immediately went online and purchased all of the recommended books. It was in this way that I came across Dietrich Dorner's book titled *The Logic of Failure: Recognizing and Avoiding Error in Complex Situations*.

This 222-page book left me wondering why I had not come across Dr. Dorner's work previously. The book was published in 1989 – almost 20 years ago. I am most grateful to Mr. Creighton for turning me on to this important work. And, like Mr. Creighton, I encourage all financial counselors and planners and those interested in researching personal finance topics to read the book. Dr. Dorner's work has significantly impacted the way I view the process of financial planning and the way in which I teach financial planning at the undergraduate and graduate levels.

Given this strong endorsement, readers may wonder how a book titled *The Logic of Failure* could possibly have anything to do with the day-to-day activities of financial counselors and planners. This question will certainly come to mind when a reader opens the book to the first chapter and finds a detailed description of experiments designed to assess how people make decisions that have immediate and long-lasting implications. The experiments deal with resource choices of an African tribe and the management of a mythical English town. Nothing in the chapter, or in the book for that matter, has anything to do directly with financial planning, financial services, or consulting others on personal finance topics. So, one may ask, why is this an important book for financial counselors and planners to read?

The answer is that Dr. Dorner explains why people have difficulty in achieving goals and objectives, difficulty managing time, difficulty in evaluating exponentially developing processes, and difficulty in assessing side effects and long-term consequences of implemented actions. Dr. Dorner provides useful insights into how systems actually work and why planners most often fail when dealing with complex systems.

Dr. Dorner writes in a refreshingly simple and straightforward manner. Although the book is based on experimental psychological research, the details of each experiment are written in an accessible manner. In fact, Ph.D.-types will probably be searching the endnotes for more detailed references. One learns that a personal finance life, if seen as a complex system, requires financial counselors and planners to deal with complexity, dynamic change, intransparency, and internal exchanges based on changes in personal factors. For novice planners, in particular, this is sometimes a radical idea.

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Here is an example of what I mean. One summer I taught a graduate level personal finance case studies course. For their final project, students were required to write a targeted financial plan for a client. The client was a recently divorced woman who had found that she had hit an income ceiling in her job. She had an opportunity to return to school to earn more income, which would allow her to save more for her retirement. Another choice was to remain in her current job and make do the best she could. Students needed to work through relatively simple present value calculations of income streams, document changes in cash flow and net worth, and calculate different tax scenarios. These were all easy steps to take when helping the client. The class was split almost equally between men and women.

What is interesting is that all of the women, but none of the men, recommended that the client return to school. I asked myself how could this happen? After all, I reasoned, every student needed to do the same calculations, and, in theory, they must have arrived at the same financial conclusion. In fact, most did. The main difference between the men and the women in the class can be attributed to one factor. The men tended to base their recommendation on preconceived single-step heuristics, while the women tended to see the client's life as a system.

The men fell into logic traps that made it difficult for them to see the client's life as a complex system. Going back to school was not only a financially astute action, obtaining a college degree added to the client's psychic income and human capital. For the men in the class, these intangible benefits must not have weighed as much in the final calculation as they did for the women. Furthermore, the men tended to seize upon one or two pieces of information and base all other recommendations on these facts, regardless of how implementing the recommendations would impact other factors in the client's life – just as Dr. Dorner predicted. For instance, one male student recommended that the client sell her house, even though the client had previously made it very clear that this was not an option. Another male student asked the client to reduce her contributions to her church, even though the client said she would not do this.

I am now requiring all of my undergraduate and graduate students who are in their final case studies course to read the Dorner book. The book's concepts are used to develop discussions about the process of financial planning and the use of systems theory as a planning tool. One way I do this is to have students physically draw models showing what will happen if a client increases contributions to a 401(k) plan. Students draw a basic system with links and feedback loops showing what this one simple action can do to change other variables within a client's financial life. It is during these moments that students see that within a system any change will, by default, impact other areas of a client's financial plan. Using the Dorner book as our basis for discussion, students also come to realize that for many clients financial goals often contradict each other.

Learning how to rank goals and work through internal system conflicts is useful for most students. Students ultimately learn that whether or not the intended outcomes of actions outweigh unforeseen or unanticipated outcomes is a driving factor of success for a financial consultant. Only after students fully appreciate the system's aspect of financial planning do we jump into solving individual cases.

In summary, I strongly encourage a perusal of Dietrich Dorner's book on the logic of failure. Even though novice financial planners will discover the lessons of the book to be extremely useful, I am sure that experienced planners and counselors will also find insights into the way current planning processes can be improved. For those teaching personal finance theory or case study courses, this book should be considered as a supplemental reading component of the course. Financial counseling and planning, not only as a process, but as a tool for dealing with complex systems is a refreshing way to look at what most financial advisers do on a daily basis. Enjoy this book!