

Black Swans in HR

Nassim Nicholas Taleb's *The Black Swan* is a practical book about epistemology and statistics. It is also very funny. The central part of the argument is that some phenomena fit in what he calls Mediocristan and others in Extremistan. Mediocristan is the realm of normal distributions, standard deviations and occasional outliers which can be safely ignored. Extremistan is the much more intractable world where the distribution of outcomes does not follow a normal distribution and outliers are of very large magnitude.

A familiar example of Extremistan is the book publishing industry. The average sales of a book are small; so small that if the industry were in Mediocristan it would be bankrupt. However, some outliers like the Harry Potters series sell a gazillion copies. It's the outliers that matter.

You might believe that sales of Harry Potter were several standard deviations from the mean. But sadly you would be dangerously even disastrously wrong. Therein lies the problem that prompted Taleb to write *The Black Swan*.

Standard deviation is a statistical term relevant to normal distributions. It is meaningless in the distributions found in Extremistan. When we use models from Mediocristan to try to understand Extremistan we are setting ourselves up for trouble: just ask the banks (or the taxpayers who are bailing them out.)

While we can do the math for Mediocristan, the math for Extremistan can be intractable. You might think that any model is better than no model but again you'd be sadly and dangerously wrong. If you stepped out of the train station in Kuala Lumpur then using the only map you had, one of New York City, would be worse than useless. (Yes, I know Weick quotes Holub's strange map story to the contrary, but the point stands).

To land without any map is disconcerting; but you are far better off knowing you don't know than thinking you do—this is another one of Taleb's main points.

Black Swans and The Fourth Quadrant

Taleb advises that we not worry about being stupid if the consequences are small. So if we think of a simple two-by-two matrix, we are ok in the quadrants of Mediocristan: Small Consequences and Extremistan: Small Consequences. We are also ok in the quadrant of Mediocristan: Large Consequences since we understand that domain. Where we must be fearful is in the Fourth Quadrant

of Extremistan: Large Consequences where large, unpredictable events shape outcomes over the long term.

Taleb's Four Quadrants

	Small Consequences*	Large Consequences
Mediocristan	Quadrant 1 safe	Quadrant 2 (sort of) safe
Extremistan	Quadrant 3 safe	Quadrant 4 Black Swan domain

* Taleb's actual table refers to simple and complex payoffs rather than small and large consequences but that more technically correct concept is not needed for my purposes.

A Black Swan is simply one of those large events that was completely unanticipated. A Black Swan could be good or bad but the management issue is more often about protecting yourself from unanticipated disaster than hoping for something miraculous (the film industry and R&D being exceptions).

Relevance to Human Resources

Luckily, HR rarely operates in the Fourth Quadrant. Unlike bankers, we don't have the power to bring down an economy. Unlike petroleum engineers, we lack the opportunity to destroy giant ecosystems. However, there are implications for HR and I've teased out a few. They may lack the drama of the stock market but they are important in our own lives.

- **Project Plans**

In your experience do HR projects go badly wrong because the planning was poor or because something completely unexpected comes out of the blue like a merger, a change of senior leadership or a sudden collapse in the organization's fortunes?

The “out of the blue” events don't fit into our Mediocristan based planning model; and it's normal to believe that the resulting project failure was not our fault. However, if you've been around for a while you'll know that outlandish “once-in-a-thousand years” events seem to happen every few years and hence should not be such a surprise.

The implication is this: if you are undertaking a very important project, one where failure is very costly, you should be prepared for a totally unanticipated disastrous event. Being prepared for what cannot be anticipated is what life is all about. How do you do this? First you try to redesign the project, such as breaking it into small stages, so that the failure of a stage reduces the overall effect on the project. This preparation takes you out of the Fourth Quadrant. Another is to have

a fallback position. Finally, don't be too efficient, some redundancies (e.g. extra staff on a project) can make you more resilient.

- **Talent Management for Critical Positions**

For most jobs, performance either follows a vaguely normal distribution or the impact of outliers is not important. However, there are some jobs in the organization where the right person could save the company and the wrong one could sink it. C-level jobs fit into this category but there may also be technical jobs that have similar leverage. Do you use the same talent management processes for Extremistan positions as you do for Mediocristan positions? You shouldn't.

- **Hiring for Jobs where Risk Decisions Are Made**

One subset of Critical Positions is those where the person can make important decisions about risk. They are the ones who decide if a set of derivatives is a wise investment or what kind of safety plans you need when drilling a hole in the ocean. These people should have a strong intuitive sense of Extremistan. When hiring for these positions you can judge their understanding of Extremistan by asking "Sometimes, really crazy things happen out-of-the-blue that lead to disaster. What do you think about that?"

The response "Well, that's just life, but these things are very rare." is not a good answer. If they say "Don't worry, I know how to model risk" it is even a worse answer. What you want is to see a certain fearful look in the person's eyes as they talk about 'not putting all the eggs in one basket'. It's not that you don't want people to take risks; it's just that you don't want them blindly discounting the possibility of very large, unanticipated events.

- **Watching out for Psychopaths**

The normal bad employee only does normal damage, but the successful psychopath will rise to a senior level where they can reap untold destruction. You may think your existing recruiting processes screen out psychopaths. This is probably not true. Psychopaths often are wonderful interviewers who are charming, articulate and give hiring managers exactly the right answers. If you hire charming, articulate people who give the right answers then you are at risk of hiring someone who in themselves could be an extreme event. In hiring, err on the side of screening out this kind of risk because just one bad hire of this magnitude will undo the positive impact of 1000 good hires.

I haven't exhausted the implications and I'd be interested to hear your insights as to the implications of Taleb's work to HR.

Positive Black Swans

As in the case of Harry Potter, there are positive Black Swans as well as negative ones. When you are looking for a job yourself then you are seeking positive Black Swans. What is the chance the man sitting next to you on the bus can get you a good job? It's impossible to know what the chance is, beyond that it's very small. But the cost of asking is small and the unanticipated outcome could be very large, so job seekers should pursue these sorts of positive Black Swans. You could never guess that the man on the bus is actually the CEO of a large firm or the cousin of the Sultan of Brunei or a mail clerk who always checks the job postings in his firm. You don't need to guess, you just invest very little in the hope of a big return by talking to them about your job hunt.

This sort of thinking applies to a style of life where you invest small amounts in the off-chance that there might be a large positive outcome. You ask the cook in the cafeteria how they would approach a particularly tricky change management issue. You bring in lots of interns just in case one proves to be a superstar. You try lots of little, inexpensive experiments knowing that if just one turns out well, it could be huge for the organization.

A Personal Black Swan

My own personal Black Swan took place in London. My buddy Nick comes along one day and says "Hey, let's go to the Brixton Academy to see The Smiths." The fact that he didn't have tickets and the concert had been sold out far in advance failed to affect his calculations. Knowing the mission was doomed I nonetheless hopped in the car and we headed down from Kilburn. It would have been wiser just to get tickets for the next show, but this was not an age of wisdom. We had just reached the venue when Nick spotted two kids who had been refused entry because they were underage. They were willing to sell their tickets—and for cost! Nick prudently turned down that offer on the grounds that the backup band had already started (not only had we failed to buy tickets in advance, we had failed to arrive on time). The lads relented and sold us the tickets at less than face value. We saw The Smiths that night. It was their last concert.

The Black Swan is available on Amazon (www.amazon.com/Black-Swan-Improbable-Robustness-Fragility/dp/081297381X)

David Creelman writes and speaks on human capital management (www.creelmanresearch.com)