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Don't Let Anchoring Bias Weigh Down Your Judgment

by Helen Lee Bouygues

August 30, 2022



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Summary. Even expert decision makers who should know better can fall into the trap of anchoring. That's the cognitive bias where our minds assign too much weight to information that is easily accessible but unfortunately irrelevant. Anchoring can prove costly in... [more](#)

It happens just about every time I go to a restaurant with my daughter. I open the menu and scan the options. Then I glance at the children's menu. Oftentimes, the menu is pretty similar, with the same pasta and tomato sauce. But the items on the children's menu are usually less expensive, and I'll think to myself: *Wow, good deal.*

If I think again for a moment, though, the deal isn't really a deal. After all, I estimated the cost of the pasta based on the adult menu, not the actual cost of making some bow-tie noodles and serving them with a red-tinted sauce.



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My faulty reasoning is the product of anchoring, a cognitive bias that can undermine our critical thinking. According to researchers, anchoring is when people rely on irrelevant but easily accessible facts to make judgments. Our minds give too much weight to initial impressions or numbers that influence — our subsequent thoughts. In my case, the prices on the adult menu shaped — or anchored — my judgment about the value of the items on the children's menu.

In the 1970s, psychologists Amos Tversky and Daniel Kahneman showed the power of the anchoring effect. In a landmark study, the researchers found that spinning a wheel of fortune in front of participants and anchoring them with random numbers influenced their answers to simple questions, like “what is the percentage of United Nation countries in Africa?”

Studies show that anchoring effects persist no matter how weak the connection between the anchor and the actual decision. One study found that “estimates of an athlete's performance were influenced by the number on his jersey.” In other words, people thought that an athlete with a higher jersey number was better than an athlete with a lower number, all else being equal.

Anchoring affects all kinds of decisions, even those made by experts who should know better. In particular, a recent study shows that anchoring is far more prevalent in the financial world than previously believed, with substantial anchoring effects influencing performance in the stock market. Led by a team at Ghent University, the study showed that investors valued firms more highly if the firms had higher stock prices. This occurred even after controlling for factors like the number of stocks available and other issues of corporate governance.

So, if two companies have the same financial profile except Company X has fewer shares at a higher price than Company Y, then Company X's shares will sell better over the long run than Company Y's. Why? Because the stock price — the anchor — enhances the company's perceived value.

While anchoring can lead to serious and costly mistakes, there are also ways to use the [bias](#) to your advantage. Here are three strategies that can help make sure that your thinking is clear and well-grounded — but not anchored.

Don't Let Anchors Drag You Down

Anchoring is everywhere in the retailing world. It's a way to make customers feel like they're getting a good deal. One of my favorites is big box stores that will offer huge "discounts" off grossly inflated "original" prices that have little to do with the item's actual value.

So, for instance, I'll see a low-budget couch "originally" priced at \$800 that has been marked down to \$200 to make the couch seem like a great deal. Companies will often perform such "markdowns," even though there's no reason that the couch should have been priced at \$800 in the first place.

There are ways out of anchoring. The first step is gaining clarity around the data. When we are clearer about the evidence, we are less likely to get hoodwinked. When it comes to a big decision, for instance, I often write down all the factors involved. Writing down the information helps me evaluate its reliability and eliminate anchors that aren't relevant.

Talking through decisions can serve the same purpose. I find that when I seek out the advice of my friends and peers and force myself to be explicit about my reasoning, it can help expose an anchor.

The key questions to answer are: What information am I using to make this decision or judgment? Is it accurate and relevant? Am I weighing its importance correctly?

If you find yourself lacking good evidence, then it's a sign that you might be engaging in anchoring. It's also a sign that you need to do more research, which brings us to our next takeaway.

Do Your Research to Escape Bias

I once consulted for Shark, a French company that creates high-end motorcycle helmets. The firm was considering whether or not to move its production line from Portugal to Thailand. At first glance, it seemed like the move would make good business sense. After all, production costs are generally lower in Thailand.

But my team realized that there was an anchoring problem. The team at Shark had considered the cost for production of a standardized helmet, but the company's product offering was typically customized helmets. In other words, Shark's team had relied on the production cost of one type of helmet rather than the cost of customizing each helmet.

So we brought in a group with stopwatches to figure out the exact production cost for different categories of helmets. The results showed that it was actually better to keep over 70% of the production in Portugal.

Anchoring to the tune of what happened at Shark is always the result of lack of information or misinformation. Too often, the human brain gets fixed on outdated or irrelevant information and fails to see things clearly.

This is why for budgets I often recommend [zero-based budgeting](#), which forces firms to evaluate costs with a fresh eye. As part of a zero-based budget process, the firm has to clear away from previous budgets and justify all recurring expenses anew. This process forces businesses to leave their anchors behind and thus find new opportunities for savings and growth. This is particularly relevant with current supply chain issues and inflation.

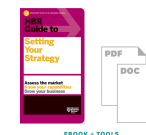
It may not always be possible to bring in outside help, but you can always do more research. If you suspect a number or piece of information may be an anchor, try to refute or confirm it by researching other sources. Gather opinions from colleagues who haven't yet been exposed to the anchor. Interview experts who can inform you about the anchor's relevance, or lack thereof.

Use Anchors to Your Advantage

My friend Alex Clavel, the Head of Corporate Strategy at Softbank, recognizes the usefulness of anchoring in negotiations. He encourages his team “to use anchoring proactively to convince other parties at the negotiating table that somehow our ‘anchor’ should be the basis of discussions.” If it's successful, this kind of anchoring can “keep the discussion on your terms as much as possible,” making a favorable outcome more likely.

Conversely, it is vital to resist this kind of anchoring when the other side attempts to deploy it. Alex tells me that he recently worked to eliminate the anchor of a counterparty whose company's valuation had dwindled due to diligence issues. The counterparty still insisted on referring to the \$500 million initial valuation in negotiations. But Alex reminded them that the number was no longer relevant and could no longer serve as a basis for negotiations.

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Similarly, I'll sometimes use anchors to shift a negotiation in my favor. For example, during a negotiation session, I may begin by talking about a part of the contract that's already been settled in my opponents' favor. With this "win" in the forefront of their minds, my opponents may be more likely to make concessions once we move on to unsettled matters. As Cecile Ferrie-Davies, a Managing Director at Pimco, argues, "anchoring can more often influence the context of a transaction than the specific analysis."

In the end, the phenomenon of anchoring shows that while we think of ourselves as rational and logical beings, extraneous details can have an outsized influence on our reasoning. The best solution is a mix of vigilance and humility and [improving critical thinking skills](#). Otherwise, you might be a victim of anchoring, dragged down by your bias, whether you notice it or not.



Helen Lee Bouygues is the president of the Paris-based [Reboot Foundation](#). A former partner at McKinsey & Company, she has served as interim CEO, CFO, or COO for more than one dozen companies.



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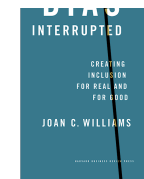


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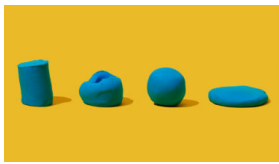


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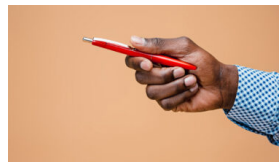
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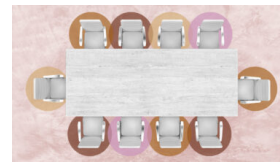
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