ORGANIZATIONAL BEHAVIOR AND HUMAN RESOURCE MANAGEMENT

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lesson 01

a short introduction to human decision making

COMMON MISCONCEPTIONS

I AM RATIONAL

NOT REALLY (SORRY!!)

WE ARE LESS RATIONAL THAN WE THINK

BUT THIS IS NOT ALWAYS A BAD THING

A "GOOD" DECISION HAS TO BE PERFECTLY "RATIONAL"

PERFECT RATIONALITY IS A GOOD THING, BUT IN PRACTICE IS RARELY (IF EVER) ACHIEVABLE

THE PERFECT RATIONALITY MODEL PROVIDES GENERAL GUIDELINES, BUT HUMAN DECISION MAKING IS QUITE DIFFERENT

ALL THAT MATTERS IS INTELLIGENCE, INFORMATION, EXPERIENCE

THESE ARE NECESSARY BUT NOT SUFFICIENT ELEMENTS

HISTORY IS FULL OF VERY INTELLIGENT, WELL INFORMED, EXPERIENCED PEOPLE WHO MADE VERY BAD DECISIONS

THERE'S A FOURTH "INGREDIENT" WHICH IS ESSENTIAL TO BECOME GOOD DECISION MAKERS

THERE IS ONE FORMULA FOR OPTIMAL DECISIONS
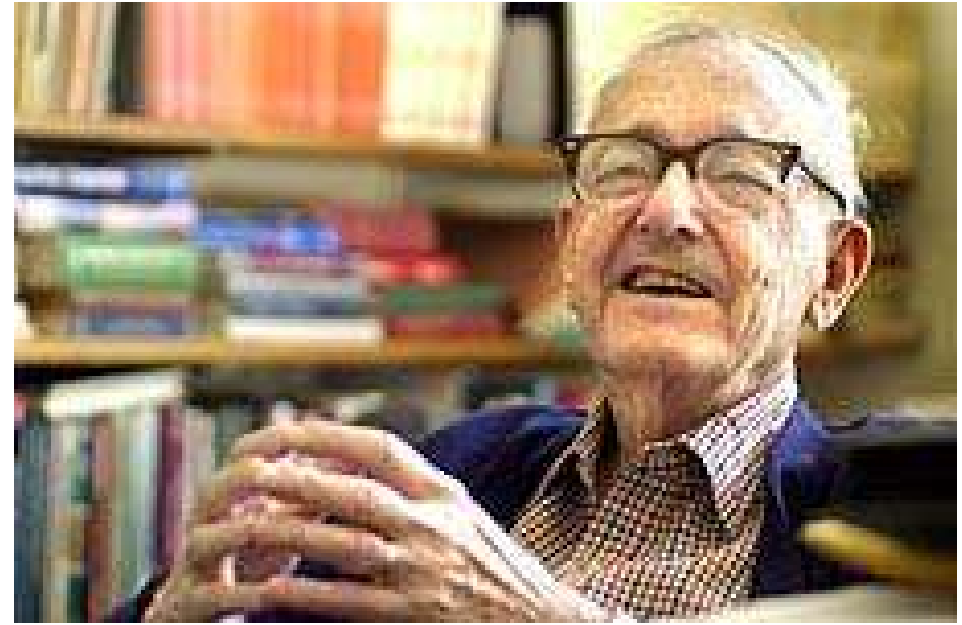
NOT IN THE REAL WORLD

HOWEVER, THERE ARE PRACTICAL WAYS THROUGH WHICH WE CAN IMPROVE OUR ABILITY TO MAKE GOOD DECISIONS

GOOD DECISION MAKING IS CONTEXT-INDEPENDENT

NOT AT ALL

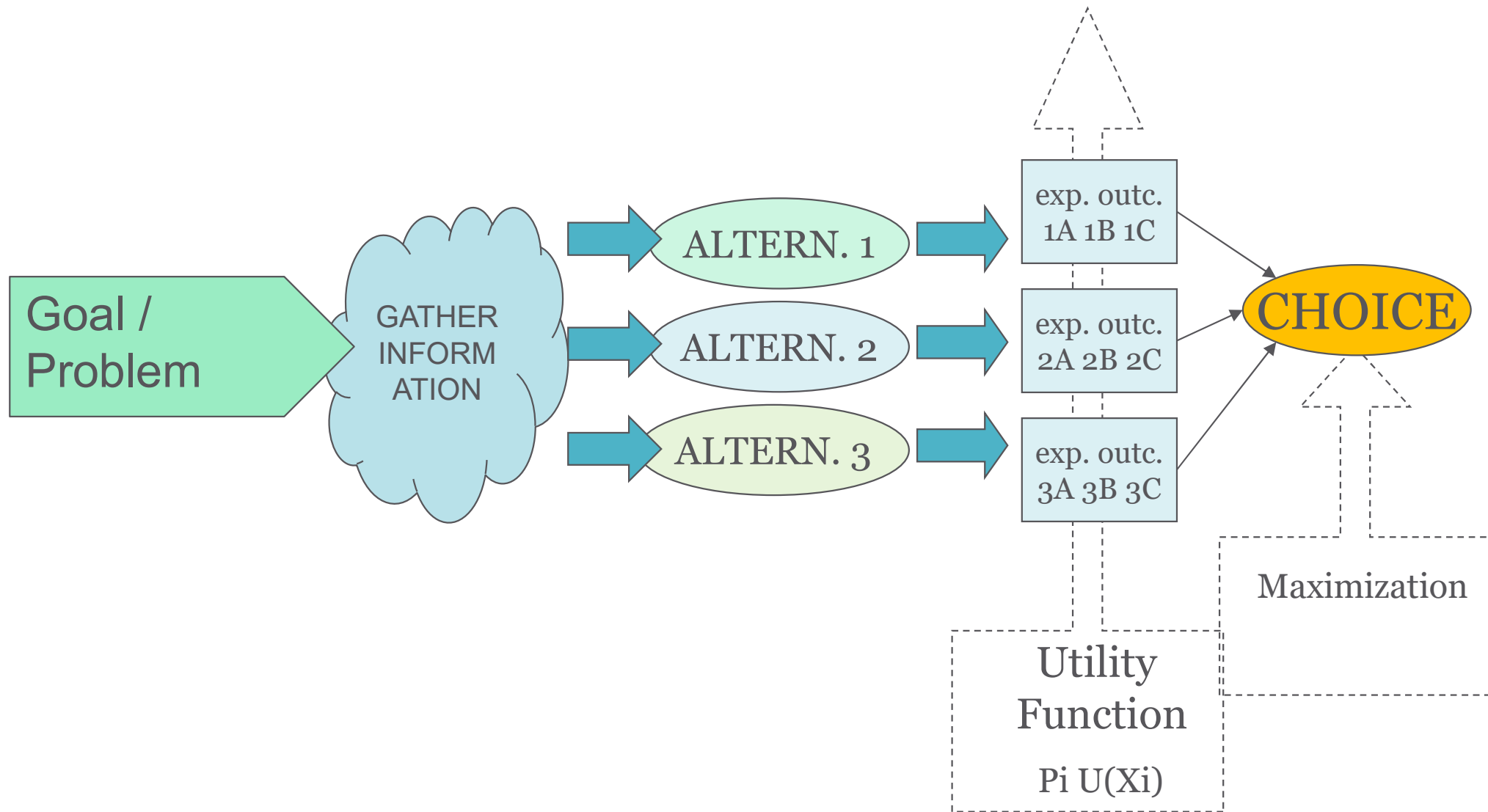CONTEXT MATTERS A LOT, IN MANY DIFFERENT WAYS

WHY IT IS IMPORTANT

Herbert Simon (Nobel in Economics, 1978)

«to manage is to decide»

An simplified version of the «classic» model of rational decision making

Goal / Problem → GATHER INFORMATION → ALTERN. 1 → exp. outc. 1A 1B 1C → CHOICE

ALTERN. 2 → exp. outc. 2A 2B 2C

ALTERN. 3 → exp. outc. 3A 3B 3C

Utility Function

Pi U(Xi)

Maximization

Expected Utility

- *Decision making as expected utility maximization*
  - U x P
- What game do you prefer to play?

  - A. Earn 4 euros every time you find a hearts card from a deck of poker cards

  - B. Earn 3 euros every time you find a red card from a deck of poker cards

Human (real) vs Perfect (abstract) decision making

In order to understand **human** decision making in organizational or individual situations, the classic rational model is not always a very useful guidance

Not even, sometimes, in very simple decisions

This is especially true when decisions are complex

please notice: almost all decisions that are important in our life are, indeed, quite complex

So, what's the problem with classic rationality?

- STRENGTHS:
  - It does provide general guidelines about what a good decision making process by an «abstract rational» actor should look like
  - in other words: **we should try to** set clear goals, to collect relevant information, to identify options, to imagine and evaluate consequences, to think about preferences
  - we also should try to follow fundamental logic / statistical principles
    - for example, if A > B and B > C, we must conclude that A > C

- PROBLEMS:
  - rational models rarely describe accurately how we think and decide in the real world
  - its effectiveness relies on very stringent, often unrealistic assumptions and constraints

WE NEED SPECIFIC KNOWLEDGE ABOUT *HUMAN* DECISION MAKING

From «abstract» rationality to «human» rationality

- If we want to understand HUMAN decision making, we need to consider:
- we have limited time, energy, resources
  - both individually and collectively
- we often have conflicting, unclear goals
- we often have incomplete, inaccurate information
- we often use intuitive, implicit processes within our decision making process
- we need to balance effectiveness and efficiency
- we make decisions within a context, and the influence of context is extremely significant

Is it about «skill» or «luck»?

skill ←——————————————————→ luck

MORE EXAMPLES?

The variable boundary between skill and luck

«skill»

1. to be experienced about the decision domain
2. to have personal qualities
3. to utilize a **good «process»**, that is
   - being able to acquire and evaluate pertinent, accurate and complete information
   - knowing effective decision making technique
   - being able to adapt those techniques to one's specific context
   - **to know yourself**, your strengths, your weaknesses, your implicit intuitutions and thought processes
   - being able to **delegate**
   - being able to manage **group** decision making processes

«luck»

1. anything that does not depend on the process that we utilize:
   - what we could not predict
   - what we could not know
   - what we could not control

   - what we could have predicted, and we didn't
   - what we could have known or controlled, and we neglected

A little exercise

1. You decide to invest resources (time, people, money, reputation etc) in a project. After the end of the project, you realize that the final outcome is below expectations, or even negative overall. Was it a GOOD or a BAD decision to invest in such project?

2. You decide to invest resources (time, people, money, reputation etc) in a project. After the end of the project, you realize that the final outcome is above expectations, or even excellent. Was it a GOOD or a BAD decision to invest in such project?

HOW DO YOU THINK THAT THE VAST MAJORITY OF PEOPLE WOULD RESPOND?

WAY TOO OFTEN, WE ASSOCIATE THE JUDGMENT ON THE DECISION (as a PROCESS, or METHOD to decide) TO ITS OUTCOME

In the example above, I gave you NO INFORMATION AT ALL about the quality of the decision process

A crucial trap to avoid: the «OUTCOME BIAS»

IN REALITY

OUTCOME

	POSITIVE	NEGATIVE
GOOD	deserved success	bad luck
BAD	good luck	deserved failure

QUALITY of the DECISION PROCESS

A crucial trap to avoid: the «OUTCOME BIAS»

WHAT WE THINK

OUTCOME

	POSITIVE	NEGATIVE
GOOD	deserved success	deserved failure (or, sometimes, bad luck)
BAD	deserved success	deserved failure (or sometimes, bad luck)

QUALITY of the DECISION PROCESS

Mistakes to avoid and approach to embrace

OUTCOME

	POSITIVE	NEGATIVE
GOOD	**ERROR**: I used a good process, so no need to examine or change it **CORRECT APPROACH**: Even though everything went well, I can still learn about how to improve my process	**ERROR**: I used a bad process, so I need to change it **CORRECT APPROACH**: I need to understand that the bad outcome was due to bad luck and how an even better process can decrease the influence of luck
BAD	**ERROR**: I used a good process, so no need to examine or change it **CORRECT APPROACH**: by examining the process, I understand that I just was lucky, so I can improve it. Next time I might not be so lucky!	**ERROR**: I was unlucky, so no need to examine and change my process **CORRECT APPROACH**: : by examining the process, I understand that it was not jst bad luck, but I need to improve the process!

QUALITY of the DECISION PROCESS

OUTCOME BIAS

- TO BLINDLY ASSOCIATE A GOOD OUTCOME TO A GOOD PROCESS, and a BAD OUTCOME TO A BAD PROCESS

- TO EXAGGERATE THE RELEVANCE OF LUCK WHEN THE OUTCOME IS NEGATIVE

- TO EXAGGERATE THE RELEVANCE OF SKILL WHEN THE OUTCOME IS POSITIVE

- (notice: sometimes we do the opposite when we evaluate other people's decisions, especially people that we don't like)
  - «she got a great result; she just got lucky»
  - «she got a bad result; she's incompetent»

- Instead, we need to examine critically our decision making process regardless of the outcome, because in all circumstances there may be opportunities for improvement!
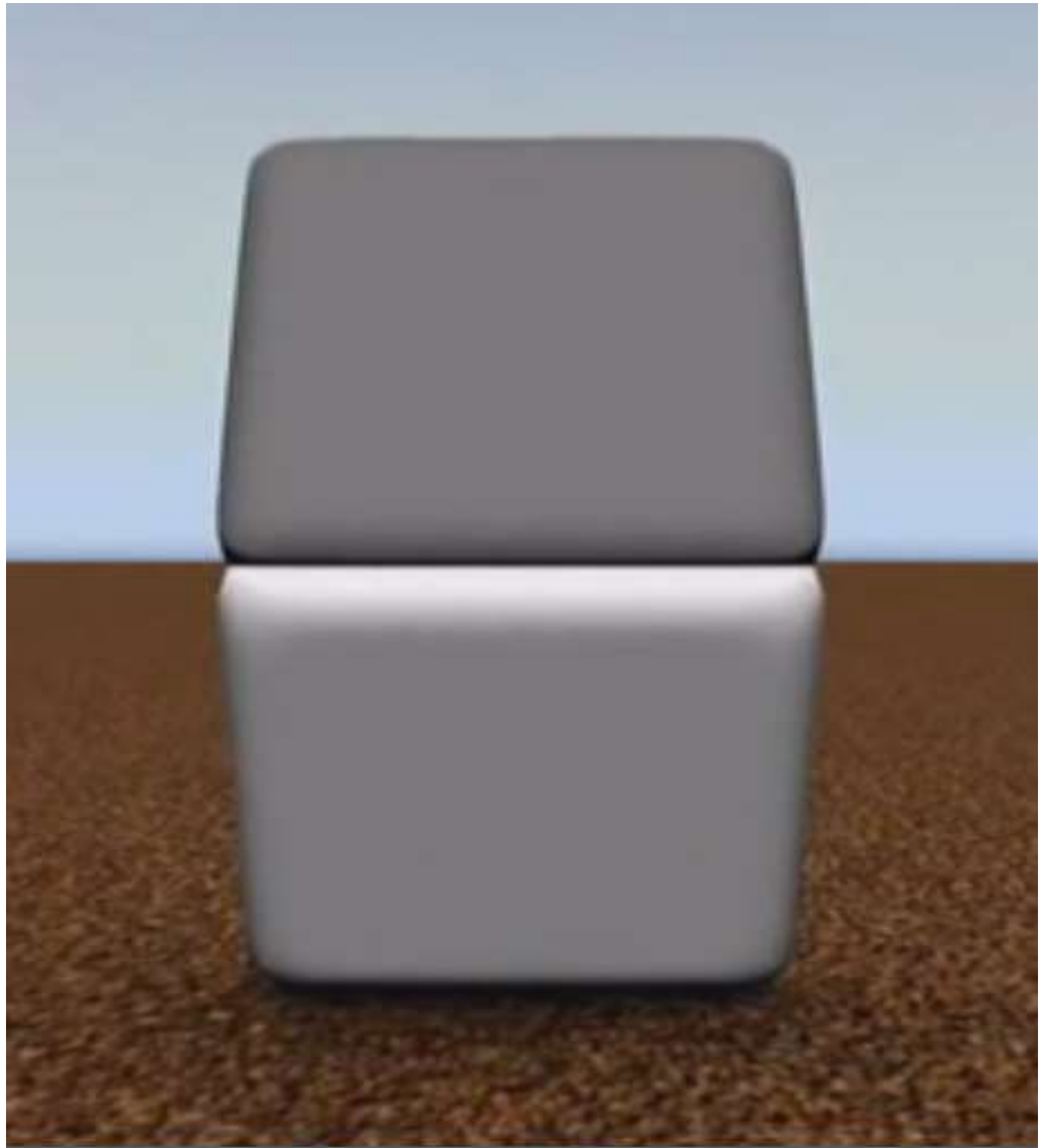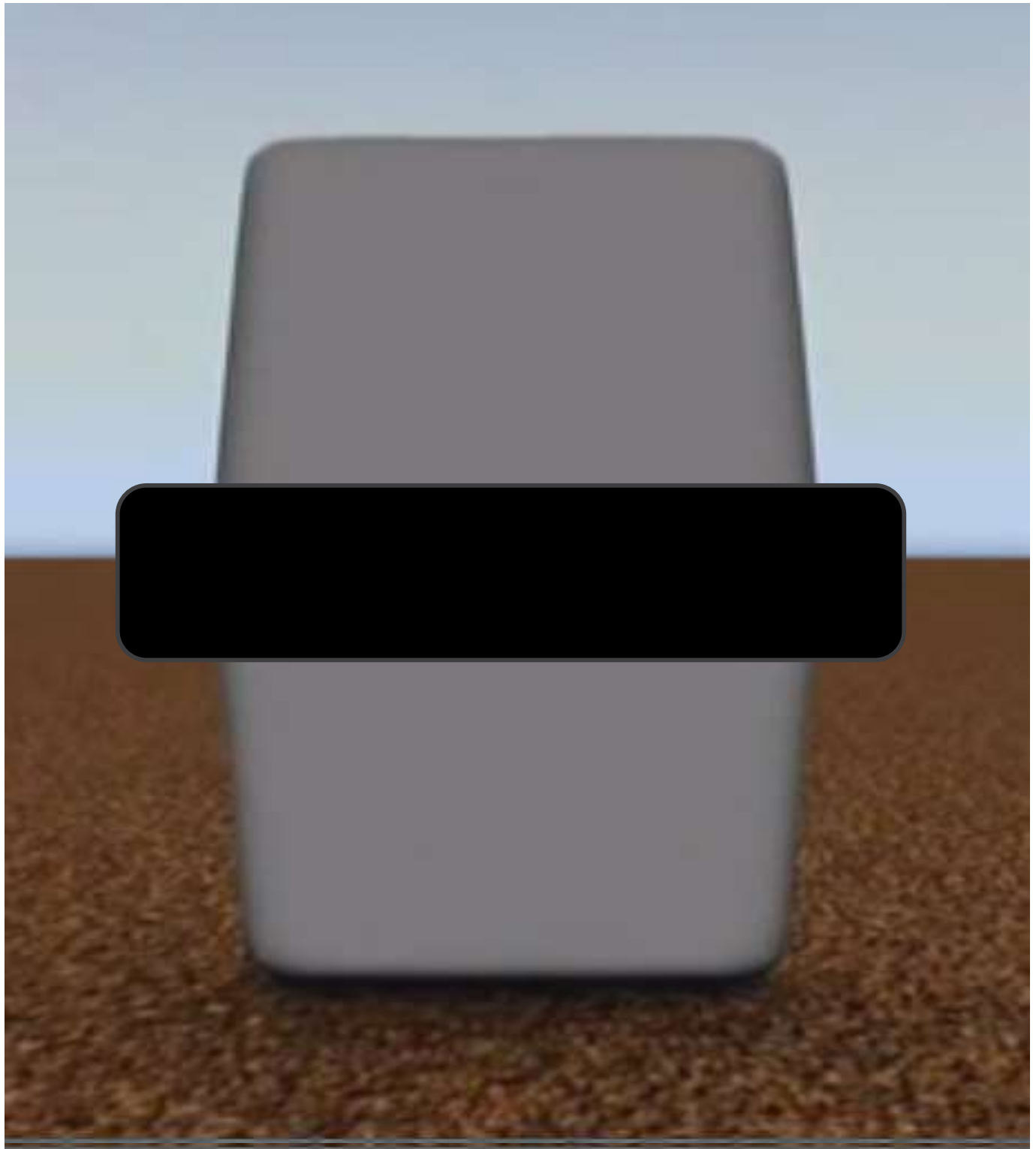
What does it mean that «context is very relevant» in order to understand human decision making?

Let's see a few examples

The relevance of «context»

Do you trust your eyes?

A USEFUL ANALOGY (from Thaler and Sunstein)

- Carol is the manager of an elementary school in a big city
- She realized that the way foods are laid out on the buffet greatly influences children's choices

- Carol's options (among many others)
  - 1. TO MAXIMISE CHILDREN'S WELL BEING
  - 2. TO MAXIMISE CHILDREN'S HAPPINESS
  - 3. TO MAXIMISE THE FINANCIAL RESULTS FOR THE SCHOOL
  - .... (many others)

But, she doesn't really want to influence the children's food choices. After all, this is not her job. She doesn't want such responsibility.

What could she do? Is she really able to make sure that the children's choice are not influenced by the food layout?

- **ANY order in the buffet will influence the childrens' choices**
- The difference is that:
  - in some cases, she can use her knowledge about the childrens' behavior to achieve some goals (maximise their health, the financial results etc)
    - *please notice: what goals are worth pursuing is a completely different matter, outside of our perimeter of interest in this course*
  - in other cases (e.g., random order) she does not pursue any goal

WHO IS CAROL?

WHO ARE THE CHILDREN?

- **CAROL IS:**
  - a team leader
    - and the children are the team members
  - a manager
    - and the children are the employees, the customers
  - a city mayor, or a prime minister
    - and the children are the citizens

CAROL IS ANYBODY THAT CREATE OR INFLUENCE THE CONTEXT IN WHICH OTHERS MAKE DECISIONS

(regardless of hierarchical position: a collaborator may indeed influence the context of his / her boss' decision)

CAROL is also the «PRESENT YOU» and the child is the «FUTURE YOU», because YOU CREATE THE CONTEXT IN WHICH YOU WILL MAKE DECISIONS IN THE FUTURE

THE RELEVANCE OF CONTEXT AND CHOICE ARCHITECTURE

So, the «CONTEXT» in which we make decisions is very important, because

- often it will have a significant influence in our choices

- often we are not aware of such influence

- often a small difference in the context may have significant behavioral effects and consequences

- the example of affordances for physical objects (Gibson, 1979)

affordances, stove and knobs
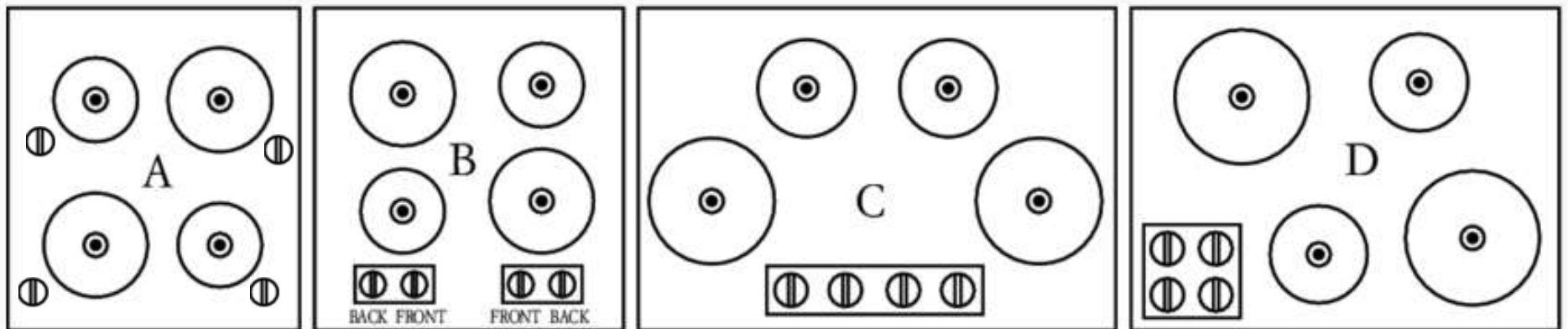
WHAT KIND OF «DECISION CONTEXT» ARE WE TALKING ABOUT?

- Information we have / receive / search
  - the way information is collected, communicated
  - the way the problem is presented, described
- social interactions
  - the relationship with colleagues, collaborators, leaders, customers etc
- culture and norms (at the organizational and social level)
  - rules, procedures, incentives, symbols, traditions etc.
  - including rules and procedure for making decisions that are accepted and utilized in the organization
- the physical layout / environment of work
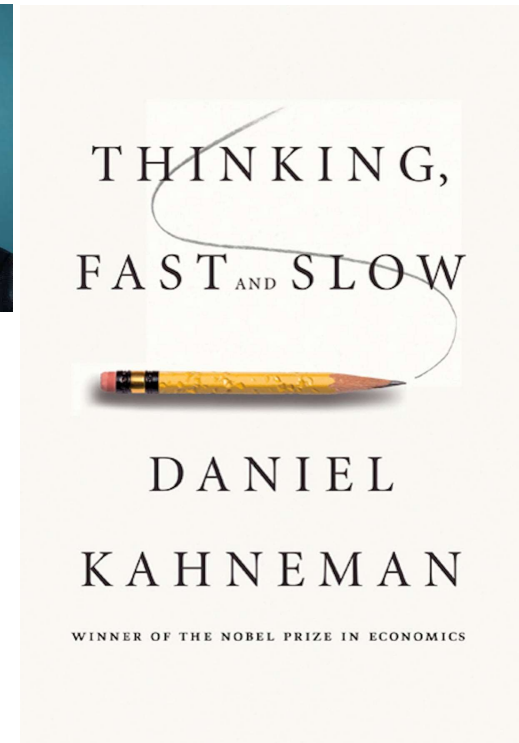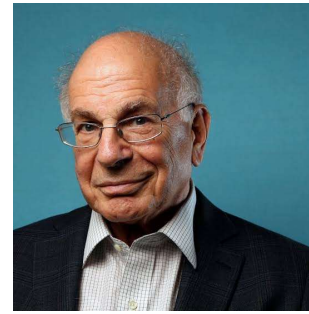 - spaces, buildings, lights, colors etc

Behavioral Sciences and the debate about «Paternalism»
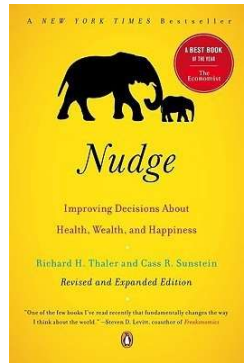
- The «Nudge» approach (Thaler, Sunstein) aims at creating a «decision environment» (choice architecture) for people so that they will be «nudged» to make better decisions (in their own interests) while, at the same time, remaining free to choose whatever they want

- Thaler and Sunstein call this approach «Libertarian Paternalism»

  – it may sound like an oxymoron (a self-contradicting term)

  – why paternalistic? why libertarian?

- Is this a good thing or a bad thing?

- What are the alternatives?

- First, let's see what the nudging approach is and what it is based on

A crucial distinction: thinking fast and slow

- SYSTEM «2»
  - Based on logic and rationality
  - Conscious, explicit
  - Slow

- SYSTEM «1»
  - Based on intuitions, hunches, gut feelings
  - Unconscious, implicit, context-dependent
  - Fast

- These two modalities always cohexist, to some extent
- However, one can be more influential than the other, depending on the situation
- We tend to underestimate the relevance of system 1; it is implicit and unconscious, so we don't control it, thus we tend to neglect its relevance

System 1 nudges examples

https://www.caranddriver.com/features/a25378462/road-design-for-safer-driving/

Predicted accidents and fatalities

|	Benchmark	Shock nudge	Optical nudge	Noise nudge
Accidents	50,000	43,300	37,800	40,200
Fatalities	2,560	2,217	1,935	2,058
		-13%	-24%	-20%
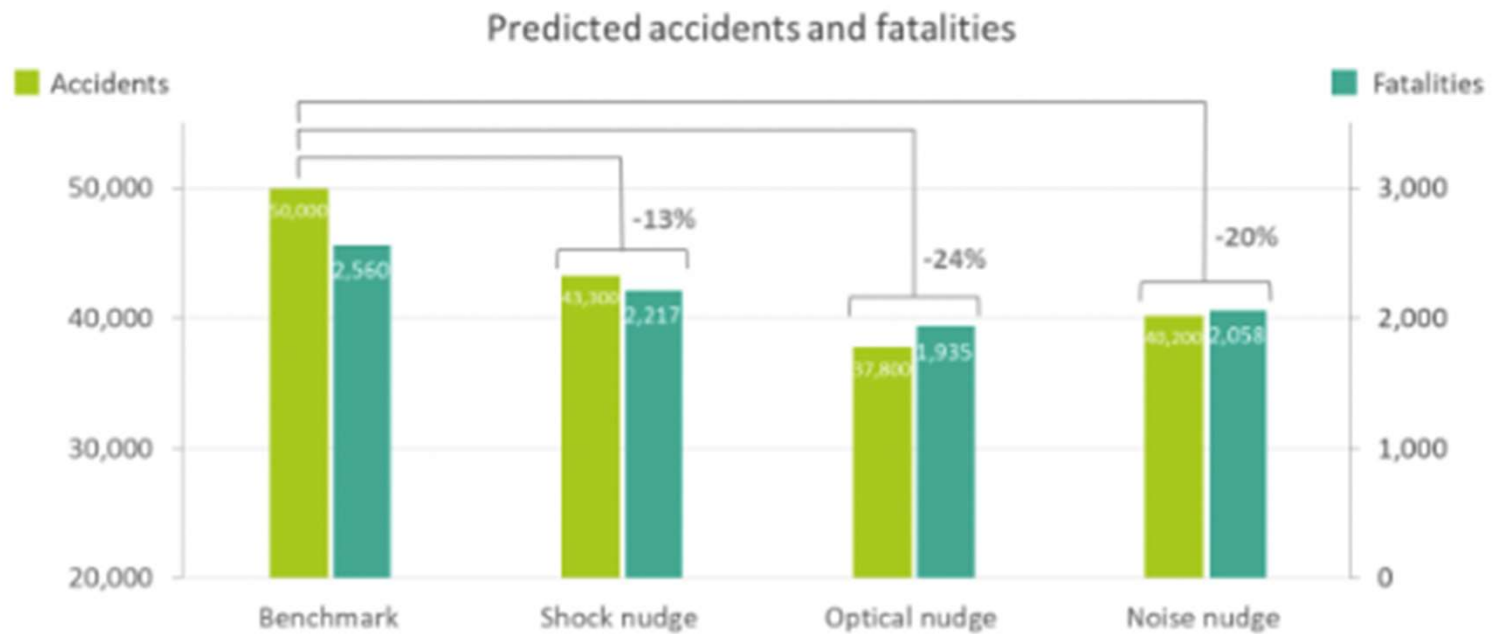
System 2 nudges examples

Pure system 2

Nutrition Facts

8 servings per container

Serving size   2/3 cup (55g)

Amount per 2/3 cup

Calories   230

% Daily Value*

QUICK FACTS:

12%	**Total Fat** 8g	
12%	**Total Carbs** 37g	
	Sugars 1g	
	Protein 3g	

AVOID TOO MUCH:

5%	Saturated Fat 1g
	Trans Fat 0g
0%	**Cholesterol** 0mg
7%	**Sodium** 160mg
	Added Sugars 0g

GET ENOUGH:

14%	Fiber 4g
10%	Vitamin D 2mcg
20%	Calcium 260mg
45%	Iron 8mg
5%	Potassium 235mg

* Footnote on Daily Values (DV) and calorie reference to be inserted here.

a combination of S1 and S2

Per serving

Fat	22.4g
Saturates	4.5g
Sugars	2.0g
Salt	2.65g

■ HIGH ■ MEDIUM ■ LOW
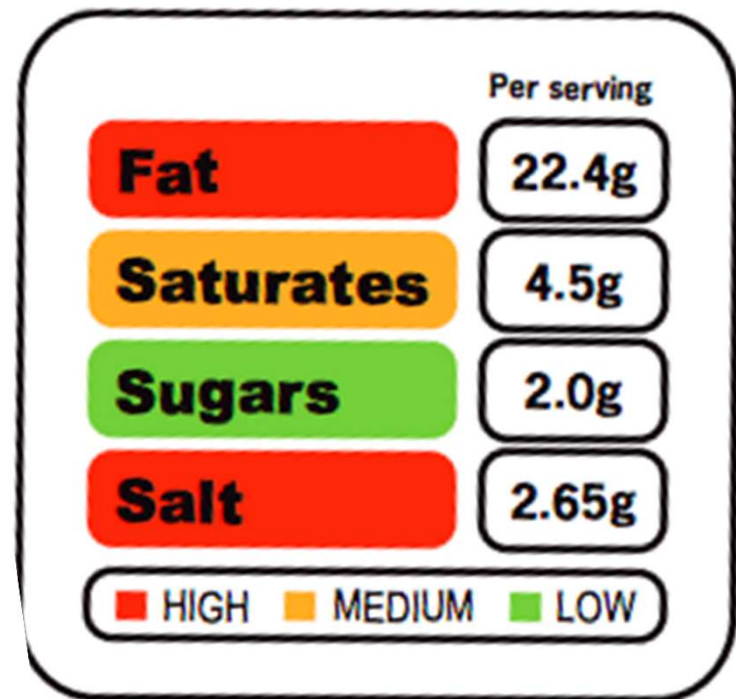
Other examples
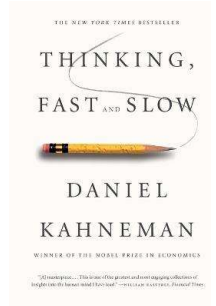
- **«System 1 nudging»: the focus is on the behavior and on leveraging our intuitive (unconscious) processes**
  - » the «Save More Tomorrow» program utilizes well known psychological phenomena like time discounting bias, status quo bias etc
  - » Some critics believe that this approach is not so «libertarian» because it has a direct influence on the outcome of people's decisions

- **«System 2 nudging»: the focus is on improving the people's ability to make better conscious decisions, through**
  - » better / simplified information
  - » better / simplified decision mechanisms
  - » warnings, reminders, feedbacks etc
  - » This is obviously a better approach in «philosophical» terms (decreasing the **direct** influence on the outcomes of people's decisions and behaviors and preserving a deeper sense of choice «freedom»)
  - » However, system 2 approaches are usually not as effective and / or as easy to implement as the more «implicit nudges»

What alternatives do we have?

- Knowledge about people's behavior and how they make choices is just a «tool», just an «instrument»
  - Like any instrument, it can be used for good or bad purposes
  - There is nothing intrinsically positive or negative in such knowledge. it is just a matter of how it is used
- And … what is the alternative? Could we design contexts that have NO INFLUENCE whatsoever on people's behavior?
  - it is very difficult, very often it is quite impossible (Carol has to put the foods somewhere …)
  - the alternative to such knowledge is simply … ignorance
  - ignorance leads to designing policies and contexts without knowing what are their behavioral consequences, and such policies may have negative / uninteded effects because context in which behaviors happen is ignored
  - policies can be much more effective if we know what kind of context will increase / decrease their effectiveness

- **EFFECTIVENESS IS ALWAYS CONTEXT-DEPENDENT**
  - what works in one context may not work in another
  - this is **not a weakness** (as it may appear), **but an intrinsic feature of the approach and the fundamental basis of its effectiveness**
  - the nudging approach, by definition, is **an intervention that changes the context (the «choice architecture») in order to change behavior**. Thus, it requires a specific evaluation on the nature of the context and «customized» changes to the context itself

- **LONG TERM EFFECTIVENESS**
  - Data are still not fully conclusive, but we can say that long term effectiveness is more likely if
    - New habits and automatic behaviors are created (System 1)
    - New knowledge, competence, awareness is created (System 2)
  - Thus, nudging can generate and crystallize learning process of various kinds, and when this happens, the positive effects can be sustained in the long term
  - Many examples around the world (more on this later)

OUR LEARNING PATH ON DECISION MAKING

Defining problems and goals

01

02 Collecting and considering information

Generating ideas and judgements

03

04 Evaluating and choosing options