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How to Minimize Your Biases When Making Decisions

by Robert F. Wolf | 11:00 AM September 24, 2012

"There is always an easy solution to every human problem — neat, plausible, and wrong." Little did he know it when he penned (http://www.bartleby.com/73/1736.html) these words, but journalist H.L. Mencken (http://en.wikipedia.org/wiki/H._L._Mencken) was tapping into the very core of behavioral decision making and the need to understand and compensate for it.

Every day, senior managers are tasked with making very significant strategic decisions for their companies, which usually require support by teams of internal and external experts and a heavy dose of research. Theoretically, knowledge-based decision making underpins every successful organization. But, as Plato pointed out, "Human behavior flows from three main sources: desire, emotion, and knowledge." First-hand experience and best sellers like Daniel Kahneman's *Thinking, Fast and Slow* (http://www.amazon.com/Thinking-Fast-Slow-Daniel-Kahneman/dp/0374275637) have confirmed an even broader range of behavioral vulnerabilities and vagaries in our abilities to make decisions as human beings.

For those of us tasked with modeling the risk/reward potential of various business opportunities, the need to address these influential, often subconscious factors in the modeling process is compelling. In the enterprise risk management (ERM) arena, in particular, it is mandatory that incisive analysis of decision options means taking rigorous steps to challenge not only the scenarios we develop, but also their underlying assumptions.

From what we have learned from behavioral economists, we — as actuaries in the enterprise risk management space — outlined some of the most prevalent biases that creep into all kinds of risk/reward decision making — personal as well as professional. By acknowledging and shedding light on these sources of distortion we can strengthen the relevance and reliability of our decision-making strategies and assessment of potential risk manifesting from these decisions. We not only have to consider our own human biases, but also those of our audience, our team, and our competitors.

(Click on the chart to view full-sized version.)

Decision Bias	Distortion
Anchoring	• We tend to be influenced by numbers, even invalid ones, and we don't adjust away from them as we should • Numbers affect our decisions , even when we should ignore them • Our questions prime our attention for certain information, ignoring or omitting contradictory data
Framing	• How a situation is presented to you affects your decision. *Generally our pain of losing is more powerful than our pleasure of winning, hence we really are risk averse to gains and risk seeking to avoid further loss.*
Availability heuristic	• Vivid, easily imagined, but uncommon events are highly weighted in our brains • Recent events get weighted disproportionately higher than past events
Confirmation bias	• Our initial decisions become self-fulfilling prophecies *We seek out evidence that confirms our initial decisions, ignoring information against them*
Commitment escalation	• Making decisions and committing resources doesn't necessarily guarantee a reward, and may produce a loss • It's difficult to accept sunk costs
Hindsight bias	• Once we know something, we can't remember when we did not know it • This challenges our ability to learn from past failures

(http://blogs.hbr.org/cs/assets_c/2012/09/decisionbias-2337.html)

Minimizing the impact of these biases is crucial. They can sneak into any risk/reward management scenario we develop, unless we exercise considerable rigor at every stage of the process from assumption right through to the presentation of alternative scenarios and their attendant considerations. To address the kinds of biases outlined briefly here, we must challenge our decision making process by realizing that we both influence and are influenced by the format of the

information. The above heuristics have served us well as human beings when we were employed in work such as tilling the land. They do, however, open us up for biased risk/reward decision-making when applied to today's knowledge-based work. To minimize their impact, we must:

- Search relentlessly for potentially relevant or new disconfirming evidence
- Accept the "Chief Contrarian" as part of the team
- Seek diverse outside opinion to counter our overconfidence
- Reward the process and refrain from penalizing errors when the intentions and efforts are sound
- Reframe or flip the problem on its head to see if we are viewing the situation in either a positive or negative framework
- Redefine the problem from here on out and ignore the old problem to avoid escalation of unnecessary commitment
- Develop systemic review processes that leave you a committed "out" possibility when trying to "cut the losses"
- Avoid the potential for escalation or further emotional investment in faulty decisions engendered by premature "public" commitment.

Throughout the process, it's crucial to recognize that most risk does not manifest itself from some exogenous contingent event, but rather is driven by the behaviors and decisions of people. It is only by exercising the intellectual rigor to challenge our current views of the future and long-lived underlying assumptions that we gain the means to manage the real risks that face our enterprises. I have addressed the "individual" element here. I am strong supporter that it doesn't end here. I encourage all to read the post (http://blogs.hbr.org/cs/2012/06/whats_your_risk_attitude_and_h.html) by David Ingram and Mike Thompson who address that it is not only our behaviors as "individuals" that are relelevant, but also and perhaps rather, how we make risk/reward decision-making in groups.