The psychology of managerial capital allocation

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Preface

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Abstract

Capital allocation decisions are critical for large organisations. Management research mainly considers such decisions from an organisational perspective, largely overlooking potential psychological influences. Therefore, this thesis investigated cognitive processes that affect capital allocation decisions. Three studies examined how participants integrated multiple kinds of cues when making their decisions. Each study presented participants with both statistical information and non-numerical semantic information. In each study, participants had the opportunity to leverage a statistical concept that arguably should be the sole basis of the decision. The first study showed participants sequential risky choices without intermittent feedback. Participants could have combined the risk across decisions to reduce the overall potential loss. However, they struggled to do this, unless it was depicted visually. The second study asked participants to allocate a budget across a set of business projects. Participants could have used the variance associated with the provided forecast estimates to choose which metrics to use for the allocation. However, they only appropriately used this information when it was expressed verbally, and did not when it was expressed numerically. In the third study, participants saw projects with conflicting statistical and anecdotal evidence. The anecdotes were either similar or dissimilar to the target project. Participants could have clarified the conflicting evidence by using provided information about the distribution from which the anecdote was sampled. However, they ignored this information. Despite this, participants moderated their use of the anecdote by its similarity to the target project. These results show that people's capital allocation decisions are bounded by a limited understanding of certain statistical concepts, but that they are capable of more nuanced choice when properly scaffolded.

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Executive: A man who can make quick decisions and is sometimes right.

—Elbert Hubbard (1914, p. 52)

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Introduction

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Much of modern life depends on large organisations. General Electric (GE) makes the engines that power our aircrafts, Johnson & Johnson makes our shampoo, and Google allows us to search the internet. The areas of our lives that are less affected by such private firms depend on public sector organisations such as public hospitals, schools, and police. The justification for the existence of organisations of this size is that the particular combination of individual divisions, alongside a corporate management, will lead to better performance for each of the divisions than they would have been able to generate individually. In other words, the assumption is that such organisations create a synergy—the quality of the whole will be greater than the sum of its parts.

Multi-divisional organisations are typically organised in a hierarchical structure, with a corporate management team and subsidiary divisions. Each division can be made up of several business units. For instance, some of GE's divisions include GE Aviation and GE Healthcare. Similarly, in the public sector, a hospital system may operate through multiple individual hospitals in different regions.

Such organisations therefore need to make capital allocation decisions. That is, given a limited amount of financial resources, how best to invest in the multiple divisions? Equally? Pick a winner? What metric should be used to compare across divisions? Capital allocation is a critical process to the operation and development of multi-divisional organisations.

The products and services that arise from organisations are necessarily a result of the work of many people. In GE, for instance, the factories that generate aircraft engines need to be staffed by production line workers, accountants are needed for bookkeeping, and software engineers are needed to design and maintain the production systems. Despite this, many important strategic decisions ultimately come from a very small number of people. The decisions that the CEO or other lower level executives make can have large consequences on the life of the company.

It is often assumed that a few people having a lot of decision-making power is for the best. Managers of large organisations often appear to be bold and effective decision-makers. It appears that their position of power and wealth was necessarily arrived at through high competence and rational decision-making, suggesting that the organisation is in good hands. However, there are three reasons why it may be concerning that much of an organisation's future—and by extension often many more components of the economy—depends on the decisions of a few individual. First, the role of survivorship bias in obtaining the manager's role is unclear, because the number of managers that used the same management strategy and failed is unknown. Second, decades of work have shown that people's decision-making is often fallible and that job experience does not always alleviate this fallibility. Third, managers of large organisations often face uncertain environments, which increases the likelihood of managers facing psychological biases.

1. Introduction

There are many examples of companies that suffered due to such biases. Overconfidence and confirmation bias likely played a part in Blockbuster's famous refusal of an offer to buy Netflix in 2000 (Meissner et al., 2015). Roxburgh (2003) identified how Equitable Life Assurance Society unnecessarily anchored on previous interest rate performance and was unprepared when rates changed. In an example of the sunk-cost fallacy, the London Stock Exchange continued investing in an automated-settlement system even when it no longer remained profitable. The Bank of England needed to step in and stop the project. Overconfidence in market entry is also a common issue, illustrated by EMI's introduction into the medical-diagnostics market with the CT scanner (Camerer & Lovallo, 1999; Horn et al., 2005). By underestimating the competition and overestimating their own capabilities they eventually incurred losses and exited the market.

One class of biases has not been well studied: capital allocation biases. While some previous work investigating these biases exists (e.g., Bardolet et al., 2011), many questions still remain unanswered. This is a rather large hole in the literature because capital allocation decisions are at the centre of executive and lower level managers' roles. When making capital allocation decisions, there are elements of the decision-making environment that can be deceiving for managers. This thesis examines how the framing of a series of business projects affects people's decisions about those projects. Specifically, the same set of projects, presented in aggregate form, is much more likely to be accepted. Further, sometimes people are distracted by extraneous semantic information, such as the relative similarity of the options.

The results of the thesis show that although people in general make sensible decisions, they fail to moderate them appropriately when presented with critical information. Specifically, information about metric variance is ignored even when other metrics are available. Further, people seem to appropriately use statistical and anecdotal information based on relevance to the situation at hand, but ignore information about the sampling of the anecdote. Not appropriately using these kinds of statistical concepts has important financial consequences, discussed below. In short, people overall tend to make sound decisions, but fail to appropriately moderate them in situations that have more subtle (but consequential) statistical implications.

All the experiments in the thesis use laypeople, except for one experiment. However, past work generally shows the same biases in managers and laypeople (with some showing more bias, e.g., Haigh & List, 2005). Further, upcoming studies will directly test managers to determine any potential expertise effects.

Section 1.1 will explain how the capital allocation process functions in hierarchical organisations and why it is necessary to analyse such a process with a psychological approach. Section 1.2 reviews the literature on decision-making biases and how these may apply to capital allocation decisions. Section 1.3 will then summarise the rest of the thesis chapters.

1.1 Capital allocation in hierarchical organisations

The purpose of a multi-divisional organisation is to generate more value than any of the individual divisions combined. The whole should be greater than the sum of its parts. Previous work suggests that this is achieved due to factors such as reduced transaction costs (Coase, 1937; Liebeskind, 2000; Teece, 1980, 1982; Williamson, 1981), shared resources (Barney, 1991; Wernerfelt, 1984), increased competitive advantage (Porter, 1980, 1985), increased monitoring (Gertner et al., 1994), and increased synergies (Barney, 1988). The underlying logic is the same: a multi-divisional organisation will be successful if it manages its divisions using processes and resources that are shared or, better yet, are complementary.

In order to successfully manage multiple units, large organisations developed a hierarchical structure. Bower (1970) identified three levels of the typical management hierarchy: business, division, and corporate. These are equivalent to front-line (or bottom), middle, and top level managers (Noda & Bower, 1996). Early theorists suggested that the strategy for the organisation's growth is driven completely by the top managers; the rest of the organisation simply enacts their proposals. However, Mintzberg and Waters (1985) emphasised the role of an emergent strategy, in which lower level managers affect change in the organisation's strategy. Other work proposed and found evidence for an iterated process in which a strategic context may be set by top managers, but business projects advanced by lower level managers also contribute to driving the strategy of the organisation (Bower, 1970; Burgelman, 1983; Noda & Bower, 1996).

The way that capital is allocated in an organisation is very important to its growth and longevity. This process is a part of the broader process of resource allocation. A *resource* can refer to many types of assets that an organisation owns, both tangible and intangible, of which capital is only one (Wernerfelt, 1984). The capital allocation process itself is an important driver of the strategic outcomes of an organisation (Bower, 1970; Bower & Gilbert, 2005), and as a result, is an important influence on its financial performance (e.g., Arrfelt et al., 2015; Bardolet et al., 2010). Sengul et al. (2019, p. 72) describe intra-firm capital allocation as "(i) a process of determination, comparison, and selection among multiple investment alternatives, (ii) taking place across organizational levels of the firm, and (iii) influenced and constrained by the external context in which the firm is situated." In capital allocation, business-level managers typically formulate project proposals, which their division managers then evaluate. The division managers then choose the projects to send for final approval with the corporate managers. The supply of available capital is also influenced by external sources such as investors, competitors, and customers. However, this thesis focuses on the comparison and selection processes that are relevant during business project evaluation.

Managers ultimately have only limited information about the projects that they evaluate. They typically have access to descriptive information about the investment and its known properties, but also are provided with financial metrics that estimate the returns on the investment. There are many such metrics; they usually attempt to encapsulate a trade-off between predicted future gains, present losses (in the form of the capital spent to pay for the investment), and opportunity costs. Examples include Net Present Value (NPV), Internal Rate of Return (IRR), Return on Investment (ROI), Cost-Benefit (CB), and Pay-Back Period (PBP). This thesis focuses on NPV, since it is one of the most frequently used metrics for project evaluation (Graham & Harvey, 2001; Graham et al., 2015; Remer et al., 1993). NPV is the difference between the money that a project is forecasted to make and the initial investment in its development (accounting for the time value of money), as seen in Equation (1.1):

$$\mathrm{NPV} = \sum_{t=0}^{n} \frac{R_t}{(1+i)^t}, \tag{1.1}$$

where t is the time of the cash flow, i is the discount rate, R_t is the net cash flow, and n is the total number of periods. NPV is a useful metric because simply knowing that it is positive suggests that the project that it describes should be profitable. Therefore, metrics such as these have a strong influence on the decision of the manager evaluating a project.

However, there are other influences on project evaluations other than the value of the financial metrics. For instance, politics within or outside the company can lead to situations in which a decision is based on social influence or even manipulation (Garbuio & Lovallo, 2017). Such influence is not necessarily negative; it may involve qualitative feedback from, for instance, a more senior manager (Thamhain, 2014). Research has also shown that the media can have a tangible influence on managerial decision-making (Bednar et al., 2013; B. Liu & McConnell, 2013). Other sources of influence are the organisational structures and incentives that are in place both externally (Kokkinis, 2019) and internally to the organisation (Rajan et al., 2000; Ullrich & Tuttle, 2004). Such dynamics have also been the subject of economic modelling investigations (Cavagnac, 2005; Ortner et al., 2017; Reichelstein, 1997). Project proposals might also be affected by certain approval structures. For instance, managers might submit overly-optimistic project proposals if they know that the corporate team only accepts projects with a certain minimum NPV forecast.

Another potential organisational influence on capital allocation is the extent of diversification present in an organisation. A diversified organisation is one that possesses different divisions that are unrelated in some way. Penrose (1959/2009, p. 96) defined it as such:

> a firm diversifies its productive activities whenever, without entirely abandoning its old lines of product, it embarks upon the production of new products, including intermediate products, which are sufficiently different from the other products it produces to imply some significant difference in the firm's production or distribution programmes.

Previous work found that organisations that are made up of more related divisions are more successful than those that are made up of unrelated divisions (Harrison et al., 1993; Rumelt, 1974; Shelton, 1988; Wernerfelt & Montgomery, 1988). This is also true within business divisions (P. S. Davis et al., 1992). However, *more* diversified firms have also been shown to be associated with profitability (Grant & Jammine, 1988). This is usually explained by the ability for such firms to avoid risk associated with any one market. Some of the discrepancy in diversification findings has been explained to be due to the specific measures used (Lubatkin & Shrieves, 1986). It may also be because most studies used Standard Industrial Classification (SIC) codes to measure diversification (e.g., Rumelt, 1974), whereas others operationalised it using other approaches (e.g., resource-based; Harrison et al., 1993).

The advantage that related organisations have had has been explained through *synergies* (Barney, 1988). That is, an organisation with two divisions that can use their resources to better one another are better off together than separately. The 1960s saw a general rise in mergers and acquisitions from executives seeking to diversify their organisations. However, doing so simply for the sake of increasing divisions, rather than an understanding of the possible synergies, leads to the organisation actually being worth less than the sum of its parts (known as a *diversification discount*; Lang & Stulz, 1994). In fact, many organisations that acquired other businesses to diversify subsequently end up divesting them (Porter, 1987). For instance, in 2018 Australian conglomerate Wesfarmers demerged its Coles division, a successful retailer. Since then, the share price for both companies has risen by approximately 62% and 32%, respectively (Boyd, 2021).

While much of the performance of an organisation depends on influences that are external to the individual managers (e.g., organisational, political), psychological factors are often also quite consequential. For instance, on the one hand, organisational factors such as relevant support teams and approval processes may influence capital allocation depending on the extent of an organisation's extent of diversification. On the other hand, psychological factors such as ability of managers to compare between business project proposals may also impact allocation differently depending on the organisation's diversification. It is likely to be more difficult for a manager to evaluate project proposals from two dissimilar divisions that it is to evaluate those from two similar divisions. The organisational influences discussed above often assume that the manager that is making the decisions acts rationally, as per traditional economic theory. However, surveys of executives show that CEOs and CFOs often rely on non-financial factors for capital allocation decisions (Graham et al., 2015). Executives in these surveys identified manager reputation and confidence as two of the most important factors for capital allocation decisions. Further, research in psychology has shown that cognitive biases can influence such capital allocation decisions. Section 1.2 discusses such biases and the relevant implications for the thesis.

1.2 The psychology of capital allocation

Managers of large organisations are generally assumed to have a superior decision-making capability to non-managers. However, managerial decision-making involves many of the same processes that have been shown to be affected by psychological biases in the general population (Das & Teng, 1999; McCray et al., 2002; Schwenk, 1984). Further, an organisation's success ultimately depends on strategic decisions made by top level managers (Mazzolini, 1981). Therefore, despite early work attempting to analyse such decisions using a structured organisational analysis (e.g., Mintzberg et al., 1976), it is important to understand the potential influence of psychological biases on managerial decisions. Research in the field of behavioural strategy has started to do this (Powell et al., 2011).

1. Introduction

Psychological research has shown that people tend to make decisions that are inconsistent with neoclassical economic theory. For instance, Expected Utility Theory (EUT; Friedman & Savage, 1948; von Neumann et al., 1944) assumed that people have complete information when making decisions. However, both laypeople and managers of organisations are limited in the amount of information that they have and their ability to use it (Cyert et al., 1956; Simon, 1955). Such inconsistencies with economic prescription are likely to have evolutionary origins, so are sure to be adaptive in certain environments (Bettis, 2017; Gigerenzer, 2008; Haselton et al., 2009). However, there are many situations in which such inconsistency with economic theory can have bad consequences.

Research has shown many ways in which the allocation of capital in an organisation can be influenced by psychological biases. For instance, Benartzi and Thaler (2001) found that people tend to allocate their retirement fund equally between the available options, regardless of their composition. This *naive diversification* bias was also found in capital allocation for hierarchical firms (Bardolet et al., 2011). Managers allocated capital equally across the available divisions in the firm, regardless of performance. Analysis of real companies found that this behaviour is damaging to firm performance because it means that lower performing business units get subsidised by higher performing units, which are not operating at their full potential (Arrfelt et al., 2015; Bardolet et al., 2010). Subsequent studies found that business unit size also matters; capital allocation to both the smallest and largest units is disproportionate to their actual profitability levels (Bardolet et al., 2017). This was attributed to a combination of naive diversification and political power effects.

Relatedly, people tend to continue expending capital into investments that appear to be failing (Staw, 1981). This *escalating commitment* is another way that psychological biases can influence allocation in an organisation. This pattern of decision-making is likely a consequence of the sunk cost fallacy, in which people avoid "cutting their losses" even when they know that they cannot recuperate an investment (Parayre, 1995).

Managers also do not always seem to seek profit maximisation. Shapira and Shaver (2014) offered managers and MBA students two investment from a hypothetical firm: one with the same expected returns as the average of the firm's current investments and one with lower returns than the firm's average returns. However, both investments were profitable, so to maximise firm profits both should be chosen. Instead, participants were more likely to only choose the first investment. It seems that the firm's average returns served as an anchor, so participants did not want to reduce the firm's average returns, regardless of profitability.

The way that information is presented can also influence allocations. For instance, Yates et al. (1978) showed that people's evaluations are sensitive to the level of detail in the information provided. They found that people devalued descriptions of university courses more when they had less detail. This may be relevant for managers evaluating project proposals. A proposal might appear more attractive simply due to the level of detail in it, even if the level of detail does not correspond with the quality of each proposal.

Further, people tend to be over-confident in their decisions and forecasts. This has been shown in laypeople (E. J. Langer, 1975; Mannes & Moore, 2013; Puri & Robinson, 2007; Soll & Klayman, 2004), as well as in IT professionals (McKenzie et al., 2008) and managers (Barone-Adesi et al., 2013; Kahneman & Lovallo, 1993; Lovallo & Kahneman, 2003). This is important for higher-level managers that evaluate project proposals because the metrics that rely on forecast estimates may be biased by the over-confidence of the lower-level manager that created the proposal. Further, the higher-level manager evaluating the proposal may in turn be over-confident about its prospects due to factors that are unrelated to the underlying value. Overconfidence is also seen when considering the success of projects in hindsight (Bukszar & Connolly, 1988; Christensen-Szalanski & Willham, 1991). This means that it less likely that managers will be able to effectively learn from both past mistakes and successes due to the potentially erroneous belief that the outcome was anticipated.

Managers often create sensitivity analyses, estimating the worst case, best case, and most likely scenario for a forecast. However, these are likely to be anchored on past experiences that further the manager's existing beliefs. In fact, prior research has shown that people are poor at constructing subjective probability distributions (e.g., Alpert & Raiffa, 1982; Schaefer & Borcherding, 1973; Tversky & Kahneman, 1974; von Holstein, 1971). Therefore, this suggests that even if the lower-level managers that construct project proposals calibrate their forecasts so that they are not over-confident, they are still likely to provide inaccurate estimates of their degree of confidence.

The above summarises many of the currently known psychological biases related to capital allocation. This thesis focuses on three essential processes within the capital allocation process: 1. risky choice, 2. the comparison between diversified businesses, and 3. the influence of prior experience. Each of these is prone to separate biases, that are also interrelated. The subsequent subsections review the literature for these processes.

1.2.1 Risky choice

Neoclassical theories such as EUT suggest that when faced with multiple risky options people should choose the option with the highest Expected Value (EV), all else being equal. This means multiplying the value of each option by its probability and comparing the resulting values (first documented in Pascal, 1670/1999). For instance, imagine being presented with the following two choices:

A) a gamble that involves a 50% chance gaining \$200 and a 50% chance of losing \$100; or

B) gaining/losing nothing.

In option A, the EV is calculated as $200 \cdot 0.5 - 100 \cdot 0.5 = 50$. Since the EV for option A (50) is higher than the EV for option B (0), EUT would suggest that option A should be chosen.

This basic principle was extended by Bernoulli (1738/1954), who suggested that a persons' subjective value of money differs depending on their current wealth. This *diminishing marginal utility* suggests that the more money a person already has, the less value acquiring more money will have for him. For example, the experience of a rich man that finds $10 on the street is very different to the experience of a homeless man that finds $10 (Bradley, 2013). Even though $10 was gained in both cases, $10 has less value to a person that already has, for example, $1000, than for a person that initially only has $10. This principle is usually modelled as an power function (with a fractional exponent).

Prospect theory (Kahneman & Tversky, 1979; Tversky & Kahneman, 1992) challenged EUT by suggesting that people's subjective value of money does not depend on their state of wealth—it depends on a change of wealth from a reference point. This is important because people's subjective value of money is different depending if they are gaining or losing money. Specifically, losses have a stronger psychological impact than equivalent gains. This disparity is one of the most settled and consistent findings in psychology and economics, having been well-replicated (e.g, Ruggeri et al., 2020). The fact that losses loom more than equivalent gains for the vast majority of people is referred to as *loss aversion* (Kahneman & Tversky, 1979). This finding was the primary reason that Daniel Kahneman won the Nobel Prize in Economics in 2002 (Kahneman, 2003). Loss aversion has been found with small amounts of money in experimental settings (Kahneman & Tversky, 1979; Tversky & Kahneman, 1992) and with millions of dollars in corporate settings (Koller et al., 2012; Swalm, 1966). The effect has been found in young children (Harbaugh et al., 2001), the numerous disparate cultures in which it has been tested (Weber & Hsee, 1998), and even in capuchin monkeys (Chen et al., 2006). Furthermore, a neural basis for loss aversion was identified (Tom et al., 2007). Therefore, loss aversion is clearly central to human cognition and behaviour.

The function that represents the value of a prospect describes both loss aversion and diminishing marginal utility, as seen in Equation (1.2):

$$v(x) = \begin{cases} x^{\alpha} \text{ if } x \geq 0 \\ -\lambda(-x)^{\beta} \text{ if } x < 0, \end{cases} \tag{1.2}$$

where x is the possible outcome, λ represents the loss aversion coefficient, and α and β represent the diminishing marginal utility for gains and losses, respectively.

In other words, loss aversion means that losses have more impact than equivalent gains. In fact, the impact of loss aversion can be expressed even more precisely, as a measurement of the ratio of the slopes of the curve for gains and losses. This measure tells us the average amount that losses have more impact than equivalent gains. In a sequel to the original prospect theory paper, Tversky and Kahneman (1992) measured a median coefficient (λ) of 2.25 of loss aversion. This means that people respond to losses 2.25 times more than equivalent gains. Similarly, this paper measured a median exponent (representing diminishing marginal utility, α and β) of 0.88 for both gains and losses. This means that people discount money the more of it they have by a rate of $x^{0.88}$.

Figure 1.1 shows loss aversion as the function being steeper in the domain of losses than the domain of gains. It shows diminishing marginal utility by the slight curve of the function. Equivalent changes in actual wealth from the references point (x-axis) have different impacts on the changes' subjective value (y-axis). An increase in wealth ($x = 1$) brings about an equivalent increase of value ($y = 1^{0.88} = 1$). However, a decrease in the same amount of wealth ($x = -1$) brings about a decrease in value 2.25 times the value of the equivalent gain ($y = -2.25 \cdot (-(-1))^{0.88} = -2.25$).

This research is relevant to capital allocation because the project proposals that managers evaluate invariably involve an element of risk. Therefore, managers are likely to be affected by similar effects on risk that have been shown in laypeople. However, hierarchical organisations offer an even more complex situation. Lovallo et al. (2020) found that the risk profiles of lower-level managers are lower than those of the top managers. They suggest that this may be due to lower-level managers' loss aversion to accepting projects that may jeopardise their job. However, the top managers recognise that a loss in one or more business units is likely to be offset by

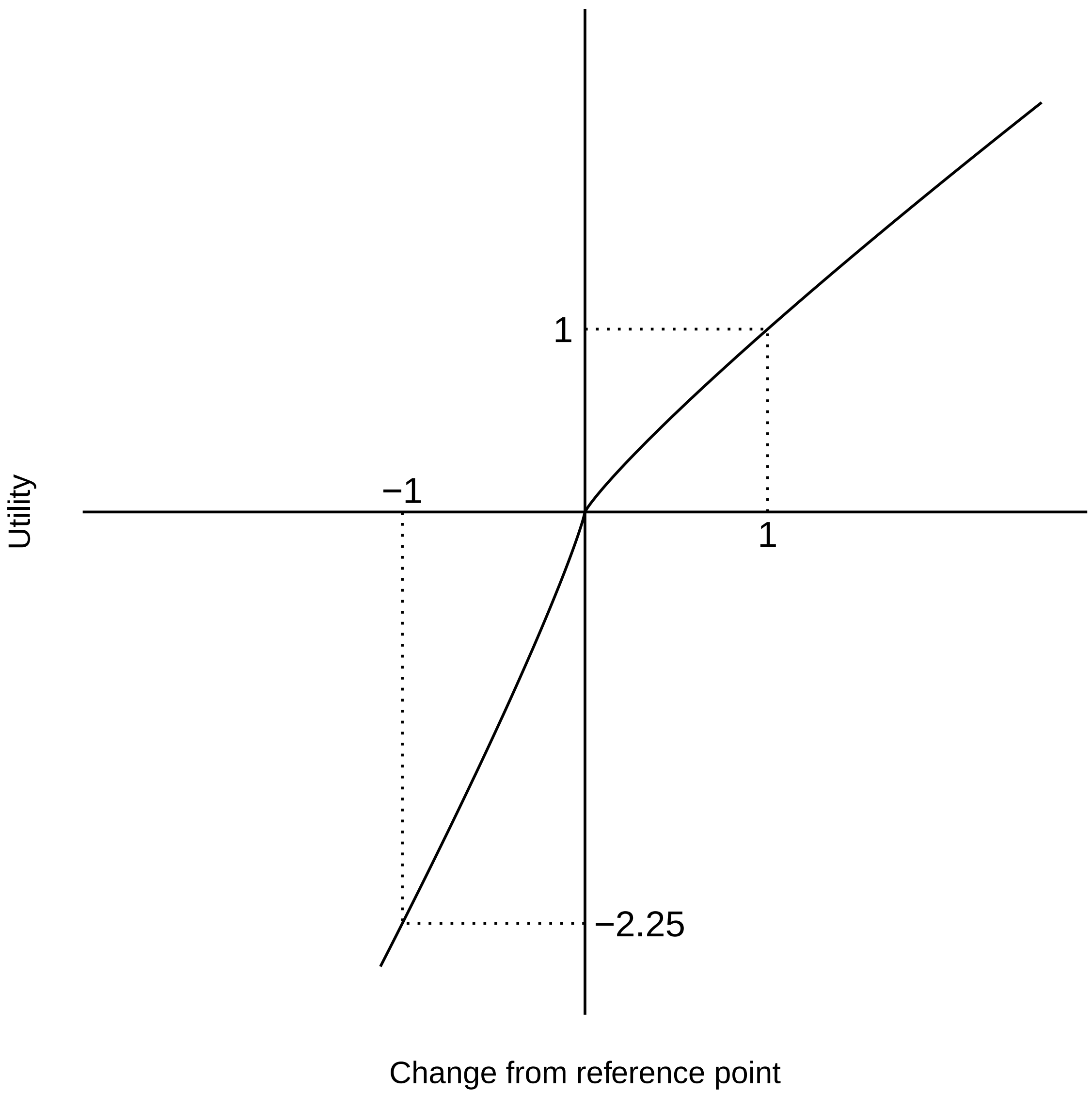

Figure 1.1: An example of the value function in prospect theory.

gains in other units. Such an inconsistency in risk profiles across the levels of an hierarchical organisation fails to take advantage of the benefits of risk aggregation, which has long been understood in external markets (Markowitz, 1952).

Lovallo et al. (2020) suggested that lower-level managers' failure to aggregate risk to the degree desired by top executives is costing companies approximately a third of the total EV of new project proposals. This is an example of a negative consequence associated with ignoring statistical concepts such as risk aggregation. It is thus critical to identify ways to support risk aggregation across organisational hierarchies. The psychological literature shows that people's risk aggregation is facilitated through various choice bracketing manipulations. However, there has been no work that investigated such situations without providing participants with feedback in between decisions; this critically limits the external validity of this work because in the real world, organisations evaluate several projects before seeing the outcomes of any one decision. The experiments presented in Chapter 2 investigate the effects of choice bracketing on risk aggregation without feedback.

1.2.2 Project similarity

When evaluating project proposals, managers are likely to be influenced by the relative similarity of the available options to each other. The extent to which this may be true is important especially since the increase firm diversification. Organisations are not only varied by the number of divisions which they possess, but also by the extent of diversification. This means that managers are likely to find themselves comparing across dissimilar types of projects.

As mentioned above, there are likely many organisational and financial reasons why the extent of diversification in an organisation would impact its performance. However, the impact of psychological factors has not been investigated. Specifically, project similarity, which is an organisational factor, is likely to affect the project comparison process, which is a psychological factor. This may then have downstream consequences on firm performance through, for instance, the kinds of financial metrics that are used and how they are evaluated. Having more similar projects to compare may mean more attributes on which to evaluate, whereas a dissimilar comparison may lead to a situation in which a manager has to rely on potentially unreliable metrics.

Structure-mapping theory (SMT; Gentner, 1983; Gentner & Markman, 1997) provides a model of comparison that psychologically distinguishes similar and dissimilar allocation tasks. SMT models comparison as a process of bringing conceptual structures into alignment which, when possible, puts shared dimensions into correspondence. Alignment both highlights when two conceptual structures share dimensions, but also highlights how the two structures differ along those shared dimensions, called *alignable differences*. For example, when comparing two oil discovery projects, all the relevant processes of planning an exploration and measuring the amount of hydrocarbons in a prospect might be identical, but the specific amount measured will be different. This is the alignable difference: a difference between the two projects that is constrained within the same conceptual structure. However, when comparing between an oil field and a refinery, there will be significantly more *non-alignable differences*, because the two domains do not share component dimensions. That is, many of the processes that exist in the exploration business unit have a significantly different dimensional structure to those in the refinery business unit, such that it will be difficult to find meaningful alignments. More non-alignable differences mean that there are less opportunities to make meaningful comparisons, and so would make predicting relative project success and ranking their priority more difficult. Chapter 4 experimentally examines business project comparisons and how project alignment affects capital allocation decisions.

When evaluating projects, managers make use of financial metrics, such as NPV. However, such metrics are reliant on forecast estimates of, for instance, future cash flows. Do managers take into account such inherent variance in their decisions? This is especially important to investigate given the above discussion. In cases of non-alignable comparison managers may rely on a potentially unreliable metric. On the other hand, in an alignable comparison, managers might have the option to moderate their choice based on the relative reliability of different metrics. It is important to remember that all such decisions are often very consequential for the manager. That is, the project could ultimately make the company money and lead to future opportunities for the manager, or potentially cause financial harm to the company (and subsequently lead to a job loss). This is another example of the way in which ignoring certain statistical concepts—here metric variance—can have negative consequences for an organisation.

Psychological research shows that laypeople are in general quite poor at using numerical variance information (Batteux et al., 2020; Galesic & Garcia-Retamero, 2010; Konold et al., 1993; Vivalt & Coville, 2021). However, it is unclear to what extent managers would be sensitive to variance information in the metrics associated with the projects that they evaluate. On the one hand, perhaps managers' financial training will allow a consideration of such variance estimates, but this might not manifest in a situation in which managers have already been shown to be prone to biases. Chapter 4 investigates whether people are as sensitive to verbally-instructed reliability information as they are to numerical reliability information.

1.2.3 Reasoning from past cases

Managers often use past events to reason and make predictions about the future (Einhorn & Hogarth, 1987). Such past events may be those that happened to the individual manager, a case from the organisation's history, or from an external source. This will especially be the case in a project evaluation scenario when a given project is hard to compare with the other projects at hand. However, managers evaluating project proposals may make inappropriate comparisons when considering the target project to other cases. For instance, when comparing a target problem to other cases, people tend to limit the size of the comparison set to a small number. This is often only a handful of cases, or even one. Doing this might mean only considering potentially irrelevant surface similarity to the current situation and not aligning the underlying causal structure. Further, this might mean not considering other similar projects.

Tversky and Kahneman (1974) discussed a number of biases that may influence such processes. The availability bias is seen when people mistake the ease of retrieval of information for its frequency. Further, research on analogical retrieval showed that people are more likely to retrieve surface similar cases than those with a relational connection (Gentner et al., 1993). As such, managers are likely to recall cases that may not be sufficiently relevant to their target situation and be overly-confident about the frequency of such cases occurring. Such a focus on a particular case might then also lead to an anchoring effect, wherein other decisions might be disproportionately seen as relevant. Tversky and Kahneman (1974) also found that people are not sensitive to properties of sample size such as the greater amount of non-representative outcomes in small samples. This means that managers are even less likely to appreciate the importance of considering a large sample of cases when drawing conclusions to a target problem. Tversky and Kahneman (1974) also note an insensitivity to predictability, in which people do not take into account the reliability of the information that they have to make a prediction. This might mean that managers may struggle to ideally weigh evidence of varying degrees of reliability.

External sources that might be used to compare to a target situation include business case studies. Considering such examples of prior business decisions or events are the way that most MBAs learn about the business world. Publications such as Forbes or Harvard Business Review publicise various businesses' successes and failures and so may create an allure to use such case studies in the decision-making process. On the other hand, managers may have access to more aggregated data about their industry from, for instance, consultancy companies. How do managers use these various types of evidence in their decision-making?

Research on this topic suggests that managers tend to prefer anecdotes over statistics, unless aided (Wainberg, 2018). This is a concern because Gavetti et al. (2005) suggests that managers often make use of case studies quite poorly. The analogy literature draws a distinction between surface similarity, in which a mapping is made between easily identifiable but potentially functionally irrelevant attributes, and relational similarity, in which the underlying mechanism is considered. Are managers sensitive to the deeper causal mechanisms that underlie the anecdotes they judge? Or are they simply influenced by surface similarity? Chapter 6 investigates the extent to which people moderate their reliance on anecdotes or aggregated data by the relevance of the anecdote to the target project during capital allocation. It also considers whether people are sensitive to information about the distribution from which the anecdote was sampled. Ignoring this statistical concept can have negative consequences for an organisation by potentially over- or under-estimating the relevance of a past case and therefore making an ill-informed investment.

1.3 Chapter overview

In sum, the potential consequences of a diversified hierarchical structure are that business projects will be considered one at a time, and if they are considered together, disparate project types will make comparisons hard. Considering projects one by one might mean that risk is not aggregated across projects and therefore value is lost. The difficultly to compare will lead to both potentially relying on unreliable metrics, and relying on improper anecdotal evidence. The thesis is that people often go half-way. They do not completely disregard the normative strategy, but also struggle to moderate their decisions when it comes to statistical concepts such as aggregation, variance, and sampling.

The previous section identified three capital allocation processes that are currently under-studied and so are important to investigate further. First, the evaluation of individual project proposals might lead to managers only considering such projects one at a time, despite the opportunity of aggregating a portfolio of such projects. The choice bracketing literature suggests that there are ways of facilitating such aggregation, but does not investigate this without providing participants inter-trial feedback. Second, in situations in which managers compare multiple projects, the structural alignment literature suggests that managers in diversified firms will struggle to allocate capital, more than those in more integrated firms. Further, these managers might not be sensitive to the variance inherent in the financial metrics they rely on. Third, a difficulty to compare across existing projects might instead mean a reliance on prior case studies from personal or external experience. Research on anecdotal bias suggests that managers might rely more on such case studies than on aggregated data, but it is unclear whether they will use anecdote relevance to moderate their decisions. Further, it is unclear if they will appropriately use information about the anecdote's sample distribution.

The rest of this thesis investigates the psychology of capital allocation decisions in three chapters that describe empirical work, two theoretical chapters, and a general discussion chapter. Chapter 2 describes two experiments that investigate the effects of choice bracketing on risk aggregation without feedback. Chapter 3 is a short theoretical chapter that discusses the difference between evaluating project proposals with inherent budget estimates and the process of allocating an existing budget top-down. Chapter 4 describes three experiments that investigate the effects of alignment and reliability type—verbal or numerical—on allocations. Chapter 5 is another short theoretical chapter that discusses the trade-offs that people make when using information to evaluate project proposal options. Chapter 6 describes two experiments that investigate the effects of anecdote similarity on the anecdotal bias. Finally, Chapter 7 discusses the theoretical and practical implications of the empirical chapters and concludes the thesis.

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Cultivate the habit of surveying and testing a prospective action before undertaking it. Before you proceed, step back and look at the big picture, lest you act rashly on raw impulse.

—Epictetus (ca. 125/1995)

2

Effect of choice bracketing on risk aggregation in repeated-play gambles with no feedback

Contents

2.1 Introduction

Investors know not to put all their eggs in one basket. Ever since work on modern portfolio theory (Markowitz, 1952), it has been clear that combining the risk of a set of individual investments reduces the overall risk of the portfolio of investments. But what about situations in which it is not clear that a set of investments fit together as a portfolio? Personal decisions such as buying a car or moving cities are typically evaluated independently, as are business decisions such as a farm investing in new cropping technology or a multi-business firm building a mine.

While these decisions are separated in time, they are often not so far apart that it is easy to learn from past outcomes (and sometimes the outcomes themselves are unclear). This is because the outcomes of large investments are often delayed. As such, the decision-maker cannot always use the knowledge of the returns of one investment when evaluating a subsequent investment. Any results that a farmer may identify from using a new technology will only become apparent after many seasons of use. Similarly, it will take many years for a multi-business firm to begin to estimate whether the output of a mine resulted in the expected return on investment. These are the decisions that this chapter investigates: sequences of large risky choices without immediate outcomes.

Risk aggregation is the combination of probability or variance information (or both) associated with certain outcomes for the purpose of understanding that information more comprehensively (Bjørnsen & Aven, 2019). However, the psychological literature suggests that this process may be difficult for people to use. Work on prospect theory (Kahneman & Tversky, 1979) suggests that people's evaluation of gambles does not conform to expected utility theory and is prone to framing effects. Specifically, people typically evaluate gambles one by one (Kahneman & Lovallo, 1993; Rabin & Weizsäcker, 2009; Tversky & Kahneman, 1981). As such, it is unlikely that people will be able to aggregate risk when they do not perceive a series of investments as a portfolio. So, what would encourage people to aggregate risk? The literature on *choice bracketing* (Read et al., 1999) shows that grouping a set of individual gambles together facilitates risk aggregation. As such, the current work provides two primary contributions. First, this work is the first to investigate the effect of choice bracketing on risk aggregation in independent gambles evaluated without immediate returns. Second, this work introduces novel choice bracketing manipulations.

The earlier work on risk aggregation essentially did the aggregating work for the participants. For example, experimenters provided participants with an outcome probability distribution, usually with an explicit indication to group the choices together, such as by asking for a single decision to be made on a set of identical gambles. Other work addressed the more realistic situation of a set of independent gambles. However, most of this work provided participants with the outcomes of their choices before the subsequent choice. In these paradigms participants experienced individual outcomes from the eventual outcome distribution of the gambles, meaning that aggregation was confounded with learning.

As mentioned above, in real-life there is usually a significant delay between the choice a person or firm makes and the outcome of that choice, and there are likely to be several interim choices in the meantime. This is especially true for business executives, who would typically have to wait months or years before beginning to understand the consequences of their decision, and even then the outcome may be unclear. However, previous work did not investigate the effect of choice bracketing on risky choice without feedback. This is surprising, since choice bracketing is exactly the kind of process that should promote aggregation in these more realistic decisions. As such, this chapter investigated new ways of encouraging participants to bracket their risky choices, but with a paradigm that involves a series of independent choices without feedback. In this way, the paradigm is more isometric with real-life risky choice.

2.1.1 Multi-play gambles

Despite the difficulties of risk aggregation, people seem to aggregate "naively" when considering multiple gambles. Samuelson (1963) told of a colleague who rejected a gamble that involved a 50% chance of gaining \$200 and a 50% of losing \$100, despite the gamble's positive Expected Value (EV). That is, $200 \cdot 0.5 - 100 \cdot 0.5 = 50$. Rejection of a positive EV gamble out of fear of the possible loss is classic loss aversion. However, the same colleague said he would accept 100 plays of the same gamble. Samuelson argued that this choice is irrational.[1] Intuitively, it is clear that over the course of 100 gambles, the positive EV wins out, and a net loss of money is extremely unlikely. Samuelson's colleague was more risk averse when making a single decision about one gamble (a *single-play* gamble), than when making a single decision about multiple (in this case 100) identical gambles (a *multi-play* gamble).[2]

Wedell and Bockenholt (1994) replicated the Samuelson (1963) anecdote experimentally with a gamble involving a potential gain of \$100 and a potential loss of \$50. Participants accepted the multi-play gamble of 100 plays more than the single-play gamble. This effect has since been replicated with different outcomes and probabilities, both with hypothetical and real money. Some participants often require fewer than 10 plays of a previously rejected gamble in order to accept it (DeKay & Kim, 2005; Keren, 1991; Montgomery & Adelbratt, 1982; Redelmeier & Tversky, 1992). Other similar studies found a multi-play effect that was in the predicted direction but not significant (Barron & Erev, 2003; Benartzi & Thaler, 1999; Klos et al., 2005; T. Langer & Weber, 2001). Further, the effect is not seen when participants do not perceive gamble outcomes as fungible (DeKay, 2011; DeKay et al., 2006; DeKay & Kim, 2005) or when choice is continuous rather than discrete (Bristow, 2011).

However, multi-play effects are likely robust, since there is also evidence that such gambles reduce a variety of cognitive biases. These include common-ratio effects (DeKay et al., 2006; Keren, 1991; Keren & Wagenaar, 1987), preference reversals (Wedell & Böckenholt, 1990), ambiguity aversion (H.-H. Liu & Colman, 2009), and the illusion of control (Koehler et al., 1994). Participants are also more

[1] Other work suggests that it is consistent with expected utility theory, once certain assumptions are added (e.g., Aloysius, 2007; Ross, 1999). However, a normative discussion is out of the scope of the present work.

[2] This chapter uses the terminology for gamble types used in Bristow (2011), and Camilleri and Newell (2013).

likely to use explicitly provided EVs in multi-play gambles (Li, 2003), show eye movements more congruent with an EV model than single-play gambles (Su et al., 2013), and judge multi-play gambles as riskier (Joag et al., 1990).

People prefer multi-play gambles that are displayed with an aggregated outcome distribution of those gambles than those without (Benartzi & Thaler, 1999; Coombs & Bowen, 1971; DeKay & Kim, 2005; Keren, 1991; Klos, 2013; T. Langer & Weber, 2001; Redelmeier & Tversky, 1992; Venkatraman et al., 2006; Webb & Shu, 2017). This is because these distributions present the probabilities of all the different possible outcomes, so very clearly show the rarity of a loss. Note that this does not seems to hold when returns are calculated as percentages, rather than fixed dollar amounts (Stutzer, 2013); and when participants do not perceive gamble outcomes as fungible (DeKay & Kim, 2005). However, when this effect is demonstrated, the multi-play gamble is usually set up such that its (binomial) outcome distribution shows a relatively low chance of losing any money and a very low chance of losing a lot of money. For instance, Figure 2.1 shows the outcome distribution of the Samuelson (1963) gamble played 10 times. Outcome distributions of this sort do the aggregating work for the participants, making the attractiveness of the multi-play gamble clearer. This work suggests that participants can comprehend and respond to aggregated risk, but that they struggle to compute the aggregation without external help.

2.1.2 Repeated-play gambles

Decisions in real life are usually sequential, and rarely identical as in the multi-play paradigm (cf. Barron & Erev, 2003). That is, people tend to be confronted with individual choices whose outcomes and outcome probabilities are different from one choice to another, and these choices occur at different points in time. In a business setting this can be seen in decisions about whether to invest in new projects; proposals and opportunities differ widely and occur at different times. Managers are not ever simply asked: “here are 10 identical investments to consider; do you want all or none of them?”

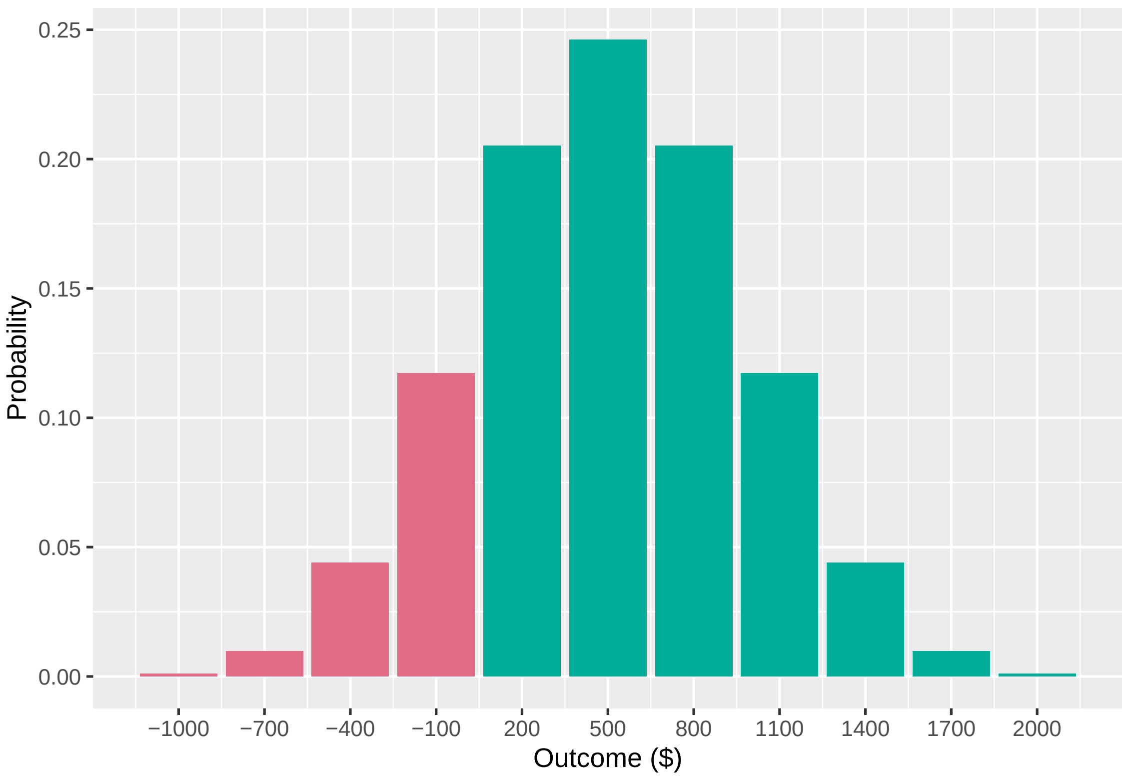


Figure 2.1: The outcome probability distribution of the Samuelson (1963) gamble (50% chance of gaining $200 and a 50% of losing $100) played 10 times.

In *repeated-play* (rather than multi-play) gamble paradigms, participants make decisions about a series of individual gambles. Research using this paradigm found that people are less risk averse both when outcomes for a series of gambles are evaluated less frequently and the subsequent decisions are made less frequently (Bellemare et al., 2005; Beshears et al., 2016; Gneezy & Potters, 1997; Thaler et al., 1997). People are also less risk averse (for positive EV gambles) when they receive feedback after each decision or are able to sample from the distribution of possible outcomes before making a choice (Barron & Erev, 2003; Camilleri & Newell, 2011, 2013; Hertwig et al., 2004; Jessup et al., 2008; Ludvig & Spetch, 2011; Wulff et al., 2018). Other work found that loss aversion is mitigated when people are explicitly instructed to consider the options as a part of a portfolio (Sokol-Hessner et al., 2012; Sokol-Hessner et al., 2009).

These studies are closer to real-life decisions than the multi-play gamble paradigm, because they involve a set of separate gamble decisions, rather than a single decision about a set of gambles. However, for the most part, the experiments used in the repeated-play gamble literature use various forms of feedback throughout the course of the experiment. That is, participants are shown the outcomes of their gambles before they make more decisions. This paradigm is known as *experience-based choice*. In *description-based choice*, on the other hand, the gamble is simply presented to the participant without any feedback, as in the multi-play gambles above. In real life, people rarely see the immediate outcomes of their risky choices, and even less so in business settings, where any return on investment often takes years to manifest.

Only a limited number of studies have used a repeated-play paradigm without feedback. For instance, Jessup et al. (2008) and Hertwig et al. (2004) investigated the effects of feedback in repeated-play gambles on the weighting of small probabilities, and had a no-feedback control condition. Other work similarly used individual description-based gambles presented sequentially (e.g., Ert & Erev, 2013; Joag et al., 1990). However, these studies did not attempt to facilitate participants' risk aggregation. Haisley et al. (2008) provided limited evidence for facilitating risk aggregation. They gave participants the opportunity to buy five (negative EV) lottery tickets, and either presented them one at a time, or together. Participants bought fewer tickets, when they considered them jointly, thereby maximising EV. However, the experimenters did not specify the outcomes and probabilities of each gamble, meaning that it is unclear if participants understood the independent lotteries as identical or non-identical. This reduces the external validity of the study, as most independent risky choice involves non-identical outcomes and probabilities. In sum, these studies were not designed to research how to facilitate risk aggregation and reduce loss aversion. This chapter is novel because its goal is to facilitate risk aggregation without the experimental artefact of immediate feedback.

2.1.3 Choice bracketing

Research in psychology and economics has identified ways of facilitating risk aggregation by encouraging people to group their choices. Specifically, people aggregate more when they consider the consequences of their choices together (broad bracketing) than when they consider them individually (narrow bracketing; Read et al., 1999). In multi-play gambles (especially when displayed with an outcome distribution), choices are inherently bracketed broadly because a single choice is made about multiple gambles. Similarly, studies that used repeated-play gambles facilitated risk-tolerance through what can in hindsight be considered broad bracketing. For instance, when Thaler et al. (1997) presented gamble outcomes less frequently, they allowed participants to consider longer time increments with a single evaluation.

Both the original Samuelson (1963) anecdote and its subsequent replications show that people do have an intuition for aggregation even without the risk being calculated exactly for them. This chapter tests whether that same intuition can be elicited and applied across sets of unique bets. What are the minimal conditions required to encourage aggregation? The multi-play gamble work suggests that participants can engage in a more intuitive form of aggregation when provided with the right contextual cues. Investigating the effects of more subtle cues will help shed light on the cognitive processes underlying choice bracketing. Of course, the effects of more subtle cues would not eliminate the utility of explicit financial education, but they will help the design of decision-making contexts to best align with such instruction.

One way of potentially facilitating risk aggregation is to highlight to participants the number of total options that are available to them. Sokol-Hessner et al. (2009) and Sokol-Hessner et al. (2012) reduced risk aversion using lengthy instructions that encouraged participants to "think like a trader." This meant considering all the repeated-play gambles as a portfolio, as opposed to considering them individually. However, this was quite a strong manipulation that is perhaps unrealistic in real world. A more subtle cue could involve simply making participants aware that they are going to be making a series of choices. If people possess an intuitive understanding of aggregation, as suggested above, then this kind of contextual cue will also facilitate aggregation.

2. Effect of choice bracketing on risk aggregation

In addition to simply informing participants that they will make a series of choices, making the choices more readily comparable may facilitate broad bracketing, and thus risk aggregation. Consider the inverse situation wherein a lack of comparability between choices may prevent broad bracketing, such as when an executive for a multi-business firm makes decisions across multiple distinct industries. Of course, the similarity of decision contexts does not change the maths of risk aggregation, but may well affect whether people do aggregate risk across decisions. DeKay and Kim (2005) found that multi-play effects are not seen when choices are not considered fungible. For instance, participants aggregated across dollar amounts, but not across patients in a medical decision. As such, people may behave similarly when considering a set of dissimilar choices if they do not consider them fungible.

There is further suggestive evidence that the similarity of a set of choices to one another will affect choice bracketing. Choices whose differences are easy to compare (alignable differences) are weighted heavier than those that are difficult to compare (Markman & Loewenstein, 2010; Markman & Medin, 1995). Increased similarity across a set of choices may both highlight the ability for those choices to be bracketed, and further facilitate risk aggregation through the comparable attributes. However, it is possible that increased similarity will facilitate risk aggregation even without a tangible benefit to the underlying calculations. That is, it is possible that simply manipulating the similarity of financially-irrelevant semantics of a choice set will make people less risk averse. If so, then this will be by virtue of an implicit risk aggregation in which the mere awareness of the possibility of a grouping of choices reduces risk aversion. It is important to investigate the effect of similarity especially because in managerial settings, executives in multi-business firms will often have to make comparisons across industries that are hard to compare. For instance, General Electric currently develops both analytic software products and jet engines for the military. They had been even more diversified previously, at one stage simultaneously developing home appliances and owning the NBC television network.

In addition to the similarity between choices, how choices are presented may affect how easily they are compared, and thus whether or not the multiple subsequent effects listed above would come to fruition. As mentioned above, Haisley et al. (2008) found a higher degree of EV maximisation when gambles were presented jointly, rather than separately. Similarly, Hsee et al. (1999) found that people's choices were affected by whether they viewed the attributes of the choices separately or jointly. Their *evaluability hypothesis* suggests that attributes that are difficult to evaluate will have a greater impact on joint presentation than separate presentation. Joint presentation is a form of broad bracketing because it forces a participant to view of all the components of a decision together. Participants may therefore be more likely to consider aggregating the risk involved in a set of choices when all those choices are in view. Joint presentation potentially reduces the working memory load otherwise needed to maintain that set of choices. As such, it is quite possible that a combination of highly similar choices, presented jointly will lead to the highest likelihood of broad bracketing, and thus risk aggregation.

Moher and Koehler (2010) replicated Gneezy and Potters (1997), but separately manipulated the number of gambles seen per trial and feedback frequency. They found that participants were less risk averse when viewing a set of three gambles per trial, than when viewing only one. However, they only found this effect with a set of identical outcomes. When outcomes were non-identical, there was no effect of presentation. However, participants were always presented with gamble outcomes for each trial, so it is unclear to what extent this influenced participants' ability to bracket broadly. In fact, when seeing gambles separately, participants were less risk averse when receiving feedback for each trial, compared to every three trials. Testing a presentation manipulation without the confound of feedback will help to clarify this effect.

2.1.4 Internal capital market investment context

Executives of large, successful firms are often viewed as fearless risk-takers who take on risky projects to generate innovation and growth. However, the available evidence suggests that executives do not view themselves that way (March & Shapira, 1987; Swalm, 1966). Executives typically evaluate multiple investments over time. Risk aggregation is sensible when investments are only partially correlated (i.e., the success of one does not influence the success of another). It is sensible to take on a set of risky investments with positive EV, where each investment has some chance of loss, because those that succeed will make up for those that failed. These benefits are well-known in stock market investment settings, thanks to Nobel laureate Harry Markowitz's work on modern portfolio theory (1952).

However, it is unclear whether the general public and even business managers use this concept, due to the extent of risk aversion in both those populations (e.g., March & Shapira, 1987; Tversky & Kahneman, 1992). In fact, executives treat risk like the rest of us; they view investments one at a time, are risk averse in the domain of gains, and are risk seeking in the domain of losses (Lovallo et al., 2020; MacCrimmon et al., 1986; Swalm, 1966). However, it is understandable why risk aggregation is foreign to most people; outside of an investment portfolio selection situation, it is unlikely for people to spontaneously group a selection of individual risky choices. Usually in life, people encounter risky choices sequentially, and so the risk of each individual choice is more salient than the aggregated risk of an arbitrary combination of choices.

Lovallo et al. (2020) show that executives treat investments within their own company in isolation. In multi-business firms, the managers of each business unit often make the investment decisions about individual projects. As such, they often do not consider the scope of their decisions in the context of the entire company. For instance, Nobel laureate Richard Thaler offered 25 division managers working for the same firm a hypothetical investment that involves a 50% chance of gaining $2 million for the company and a 50% chance of losing $1 million (1999). Only three managers said they would accept the investment. However, the CEO indicated that he would have clearly preferred managers to accept all the investments. To each middle-manager, the choice represents a risk of loss for their division and potentially their job, whereas for the CEO the entire portfolio of choices represents a worthwhile risk.

This chapter investigates risky choice in the context of business project investment internal to a company because this is a real-world context where choice bracketing is important and currently under-appreciated (Lovallo et al., 2020). The participants in these experiments were taken from a population that does not have extensive managerial experience. However, in such a population a lack of risk aggregation is most likely more common, and the variables used here are readily applicable to the financial decisions that laypeople make. For instance, one of the real-world applications of the choice bracketing literature has been to use outcome distributions and increased time horizons to encourage investment in high risk, but high EV, retirement funds (e.g., Benartzi & Thaler, 1999). Otherwise, people typically prefer low risk, low EV, funds. Further, using laypeople eliminates potential differences in prior experience with the management-based decision-context. Upcoming research will focus on managers with context-specific experience to investigate the effects of that experience.

2.2 Experiment 1

Experiment 1 investigated the effect of three choice bracketing manipulations on risky choice in hypothetical capital allocation scenarios. Previous research had low ecological validity because of the use of multi-play paradigms or feedback. In this experiment, the risky choice task was a description-based repeated-play paradigm. This means that participants had to make a choice about whether to accept a number of different hypothetical investments, but were not provided with the outcome of their choices after each decision. The variables of interest were the similarity of the choices, whether the choices were presented together or separately, and whether participants were aware of the number of choices that they would be making.

The values and probabilities of the gambles were set up such that each individual gamble, as well as the aggregation of all the gambles, would be attractive to a rational agent interested in maximising EV. As such, the key dependent measure was the proportion of risky choices participants accepted.

Previous research suggests that people will be willing to make more risky choices when explicitly told to bracket their choices (Sokol-Hessner et al., 2012; Sokol-Hessner et al., 2009). Therefore, Experiment 1 tested the following:

Hypothesis 2.1—Awareness main effect. Participants that know how many projects to expect will make more risky choices than participants that are unaware.

Further, previous work suggests that joint presentation is a form of broad bracketing (e.g., Hsee et al., 1999; Moher & Koehler, 2010). Therefore, Experiment 1 tested the following:

Hypothesis 2.2—Presentation main effect. Participants will make more risky choices when seeing projects jointly than when seeing them separately.

Similarity of options has also been shown to affect the way people bracket their choices (e.g., DeKay & Kim, 2005). Therefore, Experiment 1 tested the following:

Hypothesis 2.3—Similarity main effect. Participants that see projects from the same industry will make more risky choices than participants that see projects from different industries.

2.2.1 Method

Participants

One hundred and ninety-eight people (82 female) were recruited from the online recruitment platform Prolific. Participants were compensated at a rate of £5 an hour. The average age was 32.52 (SD = 11.42, min = 18, max = 69). Participants reported an average of 7.01 (SD = 9.1, min = 0, max = 42) years of work in a business setting, and an average of 1.7 (SD = 2.85, min = 0, max = 20) years of business education. The mean completion time was 12.04 (SD = 11.29, min = 3.1, max = 112.4) minutes. Table 2.1 shows the between-subjects condition allocation.

Table 2.1: Experiment 1 group allocation.

Similarity	Awareness	N
High	Aware	53
High	Naive	53
Low	Aware	47
Low	Naive	45
Total	-	198

Materials

Instructions Participants were told to imagine that they are executives in a large company and that they will need to decide about investing in a number of hypothetical business projects. The appendix shows these instructions in Figure A.1.

Risky investment task Participants saw 10 short descriptions of business projects, and were asked whether they would invest in that project or not. Each description included the name of the hypothetical business, the amount they forecast the project to cost, the amount the project is forecast to make, and probabilities for these forecasts. The project values were selected so that the projects appeared attractive when aggregated, and unattractive when segregated (see T. Langer & Weber, 2001). These values were different for each project, but followed a set of constraints for each project's EV and the probability of any loss given the outcome distribution of all 10 projects ($P(\text{loss}_{aggregated})$). Further, there was a constraint on the gambles' loss aversion coefficient (λ), which is a measure of people's greater sensitivity to losses compared to gains. The constraints were:

1. EV > 0;
2. $\lambda < 2.25$; and
3. $P(\text{loss}_{aggregated}) < 0.1$.

As such, each project cannot be considered to be a loss in terms of expected value, but also would not be an easy choice for investment, because of the low λ

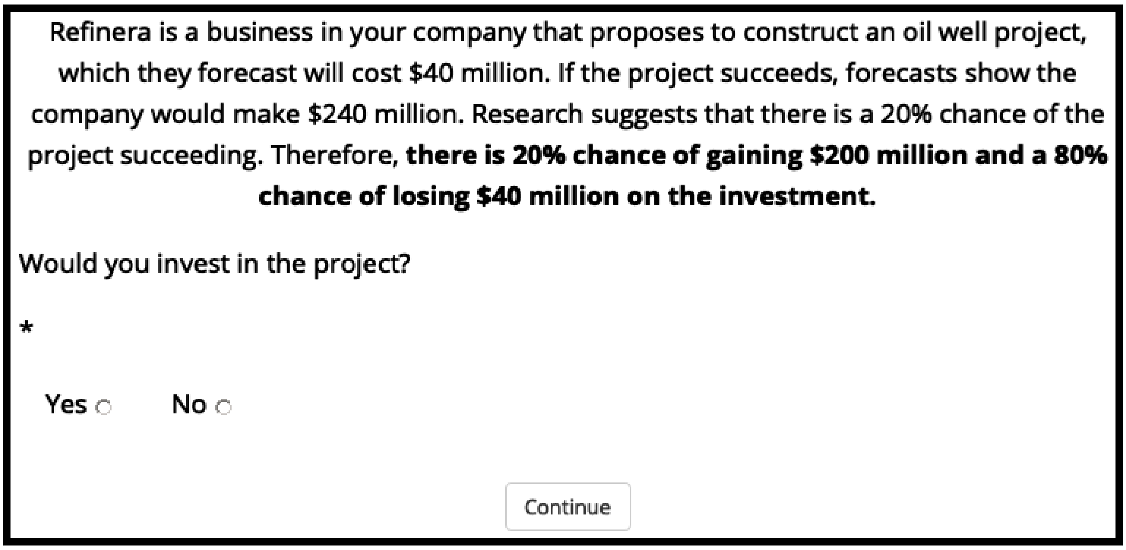


Figure 2.2: Example of a project choice display in Experiment 1. Border added for clarity.

(made to be lower than the median loss aversion coefficient calculated in Tversky & Kahneman, 1992). Further, since people are especially sensitive to loss probabilities (Kahneman & Tversky, 1979; Zeisberger, 2020), an arbitrarily low $P(\text{loss}_{aggregated})$ was chosen to make investment in the complete set of projects seem attractive. The actual probability of a loss given the outcome distribution used in the experiment was 0.09. This was calculated by summing all probabilities in the Poisson binomial distribution whose outcomes were less than zero. For comparison, $P(\text{loss}_{aggregated})$ = 0.17 for 10 plays of the Samuelson (1963) gamble. The highest probability of a loss for any single gamble ($P(\text{loss}_{single})$) was 0.80. Figure 2.2 shows an example of a description of a project in this task.

In the high similarity condition, these project descriptions were all about one type of project (in this case an oil well project) and were all from the same business. In the low similarity condition, each project was from a different industry. In the joint presentation condition, the 10 projects were all displayed on the one webpage, whereas in the separate presentation condition each was displayed on a different webpage. Participants in the aware condition saw the display shown in Figure 2.3 before their separate presentation display. Those in the naive condition simply

Figure 2.3: The display seen by those in the aware condition of Experiment 1. Border added for clarity.

proceeded without this message. The financial and probability values were identical regardless of condition, and the order of each set of 10 projects was randomised.

Although the project descriptions were succinct, and the decisions in the task were made quickly, they reflect real decisions in businesses in critical ways. Companies that consider their forecast estimates probabilistically (i.e., do not simply use the most likely estimate as the only estimate) do frame their options as likelihoods of certain monetary outcomes.

Outcome distribution decision Participants were asked if they would invest in the last 10 projects they saw and were provided with a graph of the outcome probability distribution of the 10 projects. The appendix shows this graph in Figure A.2. A coding error was discovered after collecting data. This was an error in the generation of gambles, which meant that the outcome distribution decision data could not be used. Therefore, the effect of outcome distribution will not be discussed until Experiment 2, which fixed this issue. Appendix A.1.2 presents an analysis of this data, and describes the coding error and its implications.

Follow-up gambles Participants were shown four further sets of gambles (11 total) that functioned to check participant attention and replicate the gambles from Samuelson (1963) and Redelmeier and Tversky (1992). See Appendix A.1.1 for details.

Procedure

Participants read the instructions and completed the risky investment task, first in the separate presentation condition, and then in the joint condition. They then made the outcome distribution decision and responded to the 11 follow-up gambles.

2.2.2 Results

Project choice

A three-way ANOVA was conducted to investigate the effects of similarity, awareness, and presentation on the proportion of participants' decision to invest in the 10 projects. As seen in Figure 2.4, participants invested more when they were told that there will be 10 projects, compared to when they were not told this, $F(1, 194) = 9.52$, $p = .002$, $\hat{\eta}^2_p = .047$. As seen in Figure 2.5, participants invested more when viewing the projects jointly, compared to when they viewed them separately, $F(1, 194) = 28.14$, $p < .001$, $\hat{\eta}^2_p = .127$. Although there was no main effect of similarity, $F(1, 194) = 1.63$, $p = .204$, $\hat{\eta}^2_p = .008$, the interaction between similarity and presentation was significant, $F(1, 194) = 4.31$, $p = .039$, $\hat{\eta}^2_p = .022$ (see Figure 2.6). Specifically, the presentation effect was stronger in the high similarity condition, $\Delta M = 0.07$, 95% CI $[0.04,\ 0.09]$, $t(194) = 5.29$, $p < .001$, than in the low similarity condition, $\Delta M = 0.03$, 95% CI $[0.00,\ 0.05]$, $t(194) = 2.06$, $p = .041$. These findings suggest that it is possible to facilitate risk aggregation with subtle choice bracketing manipulations.

Trial-by-trial analysis

Exploratory analyses were conducted into the possible effects of the manipulations on a trial-by trial basis. The appendix shows the data for all conditions (see Figure A.3). The key findings are in the separate presentation. As Figure 2.7 shows, in the separate condition people are more likely to accept projects over the 10 trials, but this interacts with awareness, $b = 0.04$, 95% CI $[0.01, 0.08]$, $z = 2.32$, $p = .021$. Specifically, the relationship between choice and trial is stronger in the aware condition, $b = 0.11$, 95% CI $[0.06, 0.16]$, $z = 4.54$, $p < .001$, than in the naive condition, $b = 0.03$, 95% CI $[-0.03, 0.08]$, $z = 1.01$, $p = .311$. It seems that participants that were told the total number of projects became less risk averse as the experiment proceeded, regardless of the gamble values.

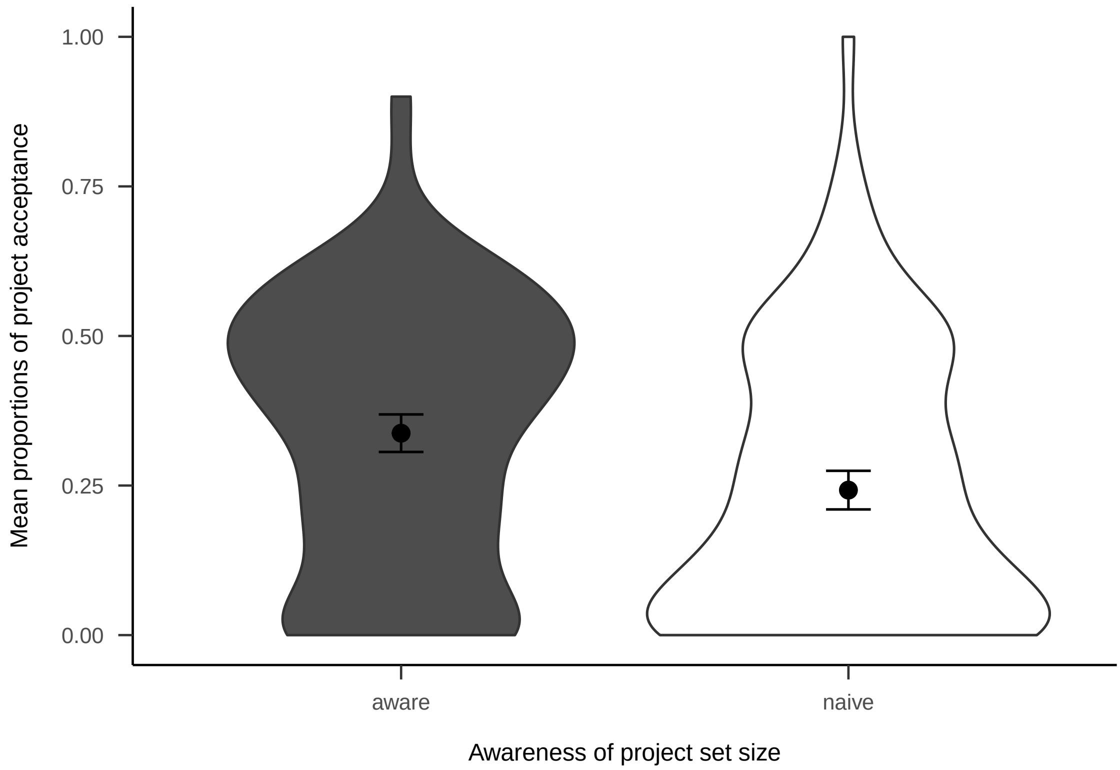


Figure 2.4: Mean proportions of decisions to invest in each set of 10 projects, by awareness conditions. Error bars represent 95% confidence intervals.

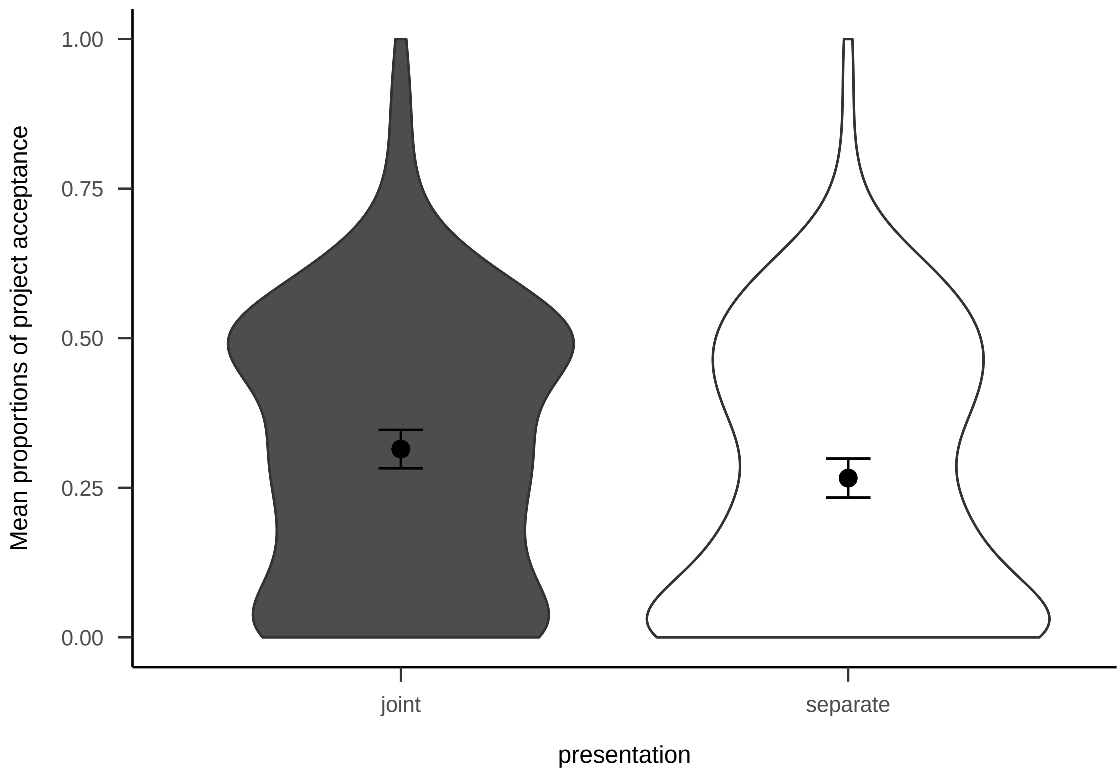


Figure 2.5: Mean proportions of decisions to invest in each set of 10 projects, by presentation conditions. Error bars represent 95% confidence intervals.

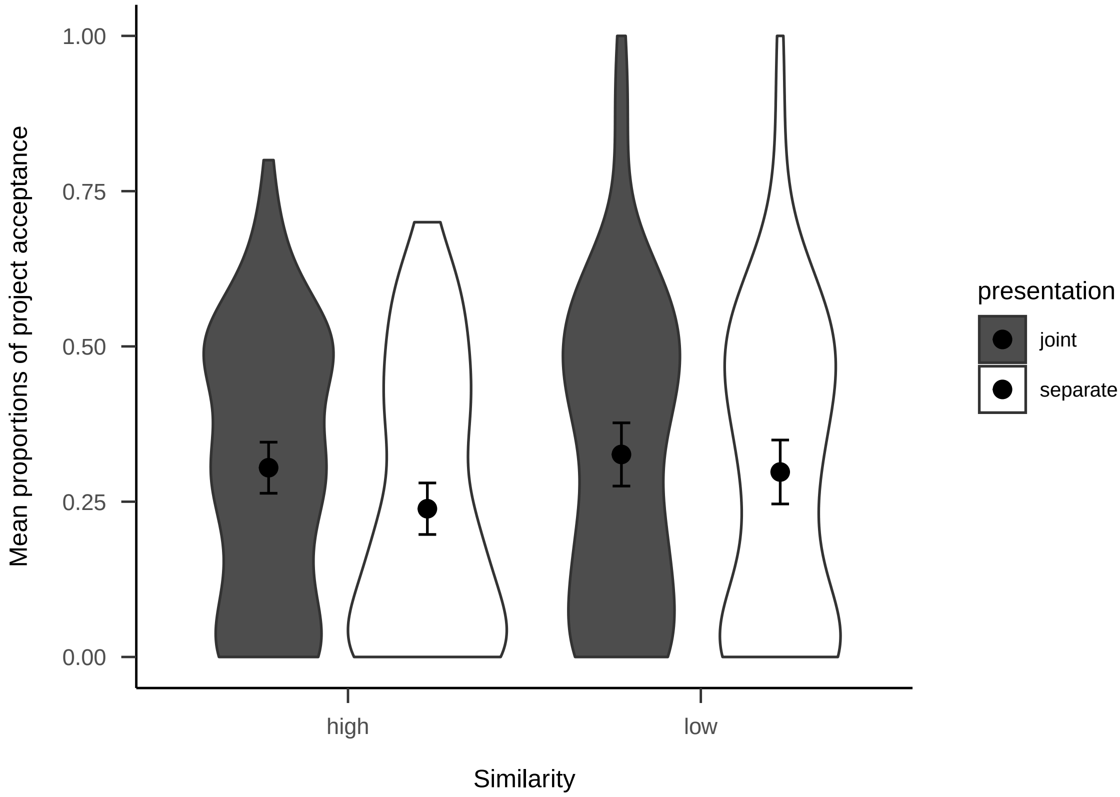


Figure 2.6: Mean proportions of decisions to invest in each set of 10 projects, by similarity and presentation conditions. Error bars represent 95% confidence intervals.

2.2.3 Discussion

Experiment 1 found evidence for most of the hypotheses. Specifically, people made more risky choices when considering those choices jointly on the same page, compared to on separate pages; and when they knew how many choices were in the set. Further, the results showed an interaction between project similarity and presentation. Exploratory analyses showed that participants' risk aversion decreased as they proceeded through the trials, but only when participants were aware of the number of projects.

Presentation effect

The presentation effect may be a result of one of two mechanisms. A mathematical aggregation explanation would mean that participants are combining the gambles into a mental representation of the probability distribution and then deciding based on the attractiveness of that distribution. A joint presentation of

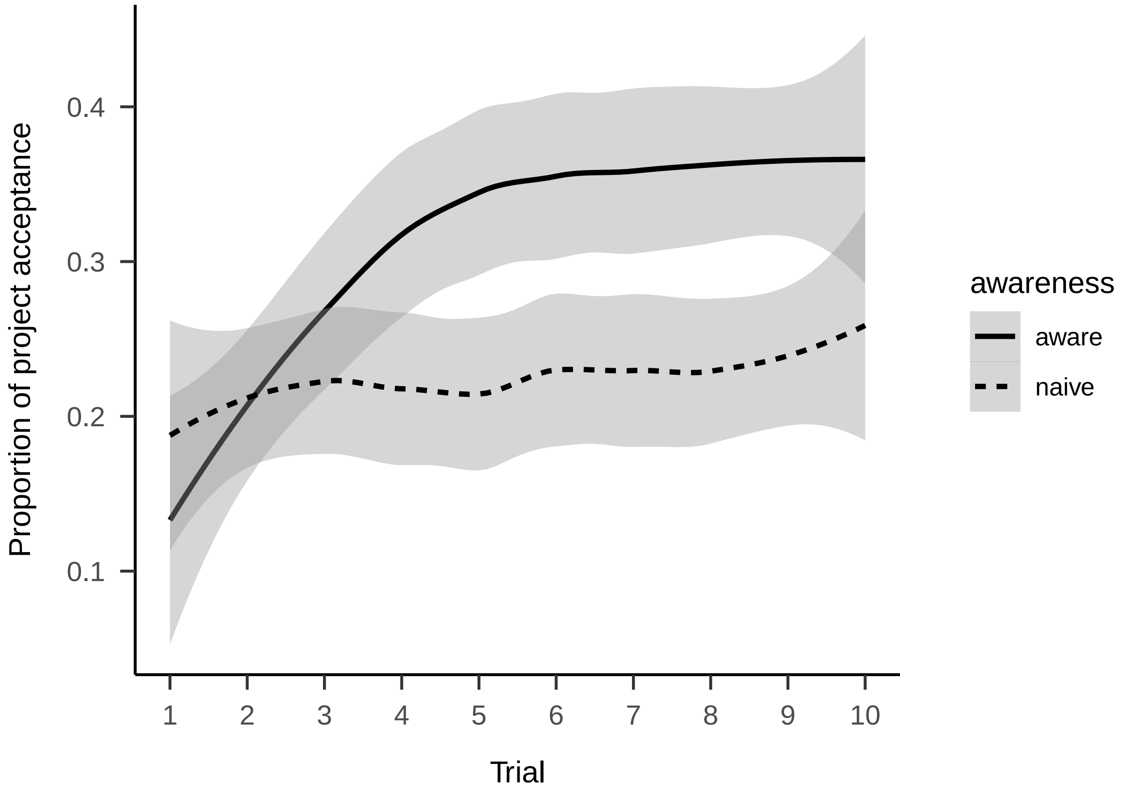


Figure 2.7: Proportion of project acceptance in the separate presentation condition, by trial, and awareness conditions. LOESS is used for smoothing over trials and the shading represents 95% confidence intervals.

choices would facilitate this combination. On the other hand, people may also be using a sort of naive aggregation process when they are encouraged to group their choices together. A naive aggregation explanation would suggest that participants in the joint condition are simply more likely to realise that a few big wins could offset a few losses. Participants could have been encouraged by the joint display to consider the set of projects together. This could then lead to the conclusion that investing in a higher number of gambles might mean that the gains of some projects will pay off the losses of the other projects.

Awareness effect

Experiment 1 found that participants that viewed the projects separately were more likely to invest in the projects as the trials went on, regardless of the actual gambles. Having an awareness of the total number of projects in the set could increase the likelihood that participants would naively aggregate. Specifically, knowing the number of total projects might increase the salience of the idea that the gains of some projects will offset the losses of others, because it reinforces a focus on the entire set. Another possibility is that participants had a certain aspiration level (Lopes, 1996) that they were attempting to reach. This might mean that they invested more as the task proceeded after realising that the gambles were not becoming significantly more favourable. Barron and Erev (2003, p. 219) specifically did not tell participants about the number of gambles they would experience to "avoid an 'end of task' effect (e.g. a change in risk attitude)." Barron and Erev (2003) provided participants with feedback, but this should not be necessary for an aspiration level explanation since participants only need to be aware of the potential for certain gains.

This result may also be due to a Gambler's fallacy effect or the law of small numbers. This effect is characterised by people's expectation of a pattern to follow the underlying distribution of the function that generates each component. For instance, someone observing the results of a coin flip that look like HTTHTTTT might anticipate that the likelihood of "heads" is higher than that of "tails," despite the actual likelihood being 50% for either. This effect occurs in sequential decision-making, so may be relevant for the repeated-play decisions in Experiment 1. Barron and Leider (2010) found that the gambler's fallacy (in a roulette prediction task) emerges when information about past outcomes was displayed sequentially, but not when it is displayed all at once. Haisley et al. (2008) found evidence for the gambler's fallacy with a repeated-play gamble paradigm. As such, it is possible that an effect such as the Gambler's fallacy can explain the effect of the awareness manipulation. That is, participants may have thought that after a few gambles that they considered risky, the last ones were more likely to materialise. Further, this would be more likely to occur for those that knew the total number of projects, because they knew when the sequence was approaching its end.

Similarity effect

Experiment 1 did not find a main effect of similarity in the individual choice data as predicted in Hypothesis 2.3. Instead, choice similarity interacted with the presentation condition. This interaction is harder to explain since it was not hypothesised. In fact, the results seem to suggest the opposite to what was originally expected. Initially, it was predicted that people would be less risk averse in the high similarity condition, due to the better ability to consider the isolated projects as a grouped set. Similarity was thought to act as a broad bracket, and therefore increase aggregation. That is, it was expected that seeing a set of similar projects would help participants aggregate risk when seeing them separately, more than when projects are dissimilar. Instead, project acceptance was actually numerically higher in the low than in the high similarity condition ($\Delta M = -0.06$, 95% CI $[-0.12,\ 0.00]$, $t(228.14) = -1.83$, $p = .068$) when projects were presented separately, averaging over awareness conditions.

There was no significant difference between similarity conditions regardless of presentation condition. However, allocations were significantly higher in the joint presentation condition than in the separate condition for both high and low similarity. The interaction seems to have been found due to the larger difference in the high similarity condition. Perhaps the ability to aggregate risk when projects are presented together is more made more salient when projects are similar.

Specifically, the interaction seems to be driven by the separate high similarity condition being lower, rather than by the joint high similarity being higher, as would have been expected. As such, participants could have been engaged in a naive *diversification*, rather than a naive aggregation. In "true" diversification, people would choose a set of projects that are partially (and ideally negatively) correlated, as per Markowitz (1952). However, in reality people that intend to diversify only seem diversify naively, meaning that they neglect co-variation when diversifying (e.g., Hedesstrom et al., 2006). Instead, they only seem to be looking for variety, rather than diversification in the strict sense. This *diversification bias* is also seen in product choices (Read & Loewenstein, 1995).

In Experiment 1, participants may have considered the high similarity condition as a sign that the set of projects may not be sufficiently "diversified." However, this explanation would also predict the joint presentation condition to be lower in the high similarity condition. So, perhaps when in the separate condition, participants were constantly thinking that they might be getting a different project in the next display, so rejected more projects because of the lack of diversification, but not realising that they would not be getting any other type of project. Those in the joint presentation, on the other hand, were able to see all ten projects, so already knew that there were no other projects in the set, and so were less likely to reject projects on the basis of the hope for different projects in the future.

Limitations

This experiment had two major limitations. First, proper counterbalancing was not used in the high alignment project domain, nor in the order of the within-subjects manipulation of presentation. As such, it is unclear what role these elements played in the results, especially in the presentation condition, in which participants always saw the separate condition first. Second, as mentioned above in Section 2.2.1, there was a mistake in the generation of the gamble values that meant that the individual gambles did not correspond with the distribution that participants saw. Both of these limitations were addressed in Experiment 2.

2.3 Experiment 2

Experiment 2 investigated the effect of presentation, awareness, and distribution on project choice. For the distribution manipulation, half of the sample saw an outcome probability distribution as in the previous literature (e.g., Redelmeier & Tversky, 1992; Webb & Shu, 2017) to determine their risk aversion when the gambles are explicitly aggregated. In contrast to most of the repeated-play choice literature, each choice was presented without subsequent feedback. Further, in contrast to Experiment 1, the distribution were displayed alongside each gamble, as opposed to only at the very end. This is an important manipulation because finding out whether it is effective will 1. add to the understanding of the conditions necessary for mathematical aggregation (beyond a mere intuitive sense of aggregation), and 2. suggest new ways to encourage aggregation in real-world applications.

In past work, participants were shown ordinary binomial distributions, since multi-play gambles are identical. However, there has not been an investigation of *non-identical* gamble distributions in this context. Doing this requires using a *Poisson* binomial distribution, which allows for multiple trials with different probabilities.

Further, Experiment 2 addressed potential order effects in Experiment 1 by manipulating all the main variables between-subjects. Manipulating presentation between-subjects, removes the potentially confounding factor of reduced risk aversion over time.

Experiment 2 again tested Hypotheses 2.1, and 2.2, from Experiment 1. Further, following the finding in Experiment 1 that participants in the aware condition seemed to become more risk-taking as the experiment progressed, Experiment 2 tested the following:

Hypothesis 2.4—Interaction of trial number and awareness. Participants will make more risky choices as the trials progress, but only when they are aware of the total number of projects in the set.

Further, multi-play gambles with outcome distributions have been shown to reduce risk aversion compared to multi-play gambles without distributions (e.g., Redelmeier & Tversky, 1992; Webb & Shu, 2017). Therefore, Experiment 2 tested the following:

Hypothesis 2.5—Distribution effect. Participants will make more risky choices when presented with an aggregated outcome distribution than when making the same decisions individually.

Table 2.2: Experiment 2 group allocation.

Awareness	Distribution	Presentation	N
Aware	Absent	Separate	40
Naive	Absent	Joint	41
Naive	Absent	Separate	41
Naive	Present	Separate	42
Total	-	-	164

2.3.1 Method

Participants

One hundred and sixty-four people (51 female) were recruited from the online recruitment platform Prolific. Participants were compensated at a rate of £5 an hour. The average age was 26.39 (SD = 8.63, min = 18, max = 72). Participants reported an average of 2.55 (SD = 5.34, min = 0, max = 43) years of work in a business setting, and an average of 1.67 (SD = 2.94, min = 0, max = 20) years of business education. The mean completion time was 6.53 (SD = 5.15, min = 1.18, max = 39.93) minutes. Table 2.2 shows the between-subjects condition allocation. Appendix A.2.1 describes the power analysis conducted to arrive at this sample size.

Materials

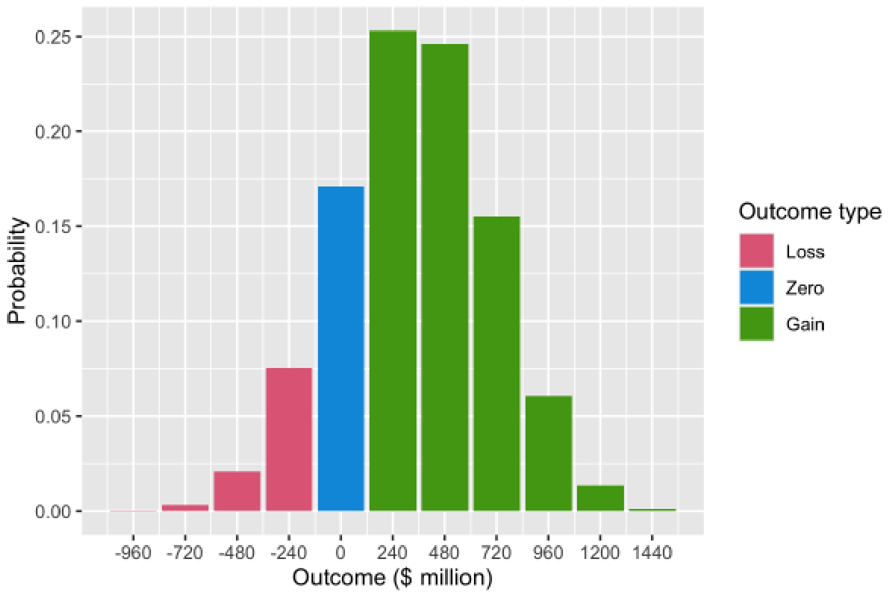
Instructions Participants were shown the same instructions as in Experiment 1 (see Section 2.2.1).

Risky investment task Participants saw a similar display to the one in Experiment 1 (see Section 2.2.1), but with new gamble values, in order to fix the mistake in the Experiment 1 gamble value calculation (detailed in the appendix Section A.1.2).

The presentation and awareness manipulations were as in Experiment 1. However, in the distribution-present condition participants saw the outcome probability distribution of all the projects alongside the description, rather than after all the projects were seen (see Figure 2.8).

Below is the probability distribution of final outcomes if all projects were chosen.

The numbers on the x-axis (labelled 'Outcome') represent the final amounts of money possible if you chose to invest in all the projects. The numbers on the y-axis (labelled 'Probability') represent the likelihoods of each of the possible outcomes. Negative final outcomes (losses) are shown in red, positive final outcomes (gains) are shown in green, and a final outcome of zero (no loss or gain) is shown in blue.



Indicate below whether you would invest in the following:

Refinera is a business in your company that proposes to construct an oil well project, which they forecast will cost $40 million. If the project succeeds, forecasts show the company would make $240 million. Research suggests that there is a 30% chance of the project succeeding. Therefore, **there is 30% chance of gaining $200 million and a 70% chance of losing $40 million on the investment.***

Yes ○

No ○

Continue

Figure 2.8: An example of a display seen by those in the separate distribution-present condition of Experiment 2.

Follow-up Participants were asked how many projects they think they saw, whether they were willing to accept all or none of the projects, and how many they would be willing to accept if they had to choose a number. Appendix A.2.1 shows these questions.

Procedure

Participants read the instructions and completed the risky investment task in their respective conditions. After seeing the individual projects, participants were then asked the three follow-up questions.

2.3.2 Results

Project investment

The project investment data were analysed as proportions of choice per participant, as in Experiment 1. Each experimental condition was compared to the same control condition (separate presentation, naive awareness, and distribution absent). Figure 2.9 shows these data. The difference between presentation conditions was not significant, d_s = 0.00, 95% CI [-0.43, 0.43], $t(80)$ = 0.00, p = 1.000. Similarly, the difference between awareness conditions was not significant, d_s = 0.15, 95% CI [-0.29, 0.58], $t(79)$ = 0.66, p = .508. However, those that that saw a distribution chose to invest significantly more (51.19%) than those that did not see a distribution (39.02%), d_s = 0.47, 95% CI [0.03, 0.90], $t(81)$ = 2.11, p = .038.

Further, as Figure 2.10 shows, it doesn't seem as if the previous awareness by trial effect was replicated.

Follow-up

The portfolio choice data from both the number and binary questions were congruent with the above, finding that those in the distribution condition were more likely to invest (see Appendix A.2.2).

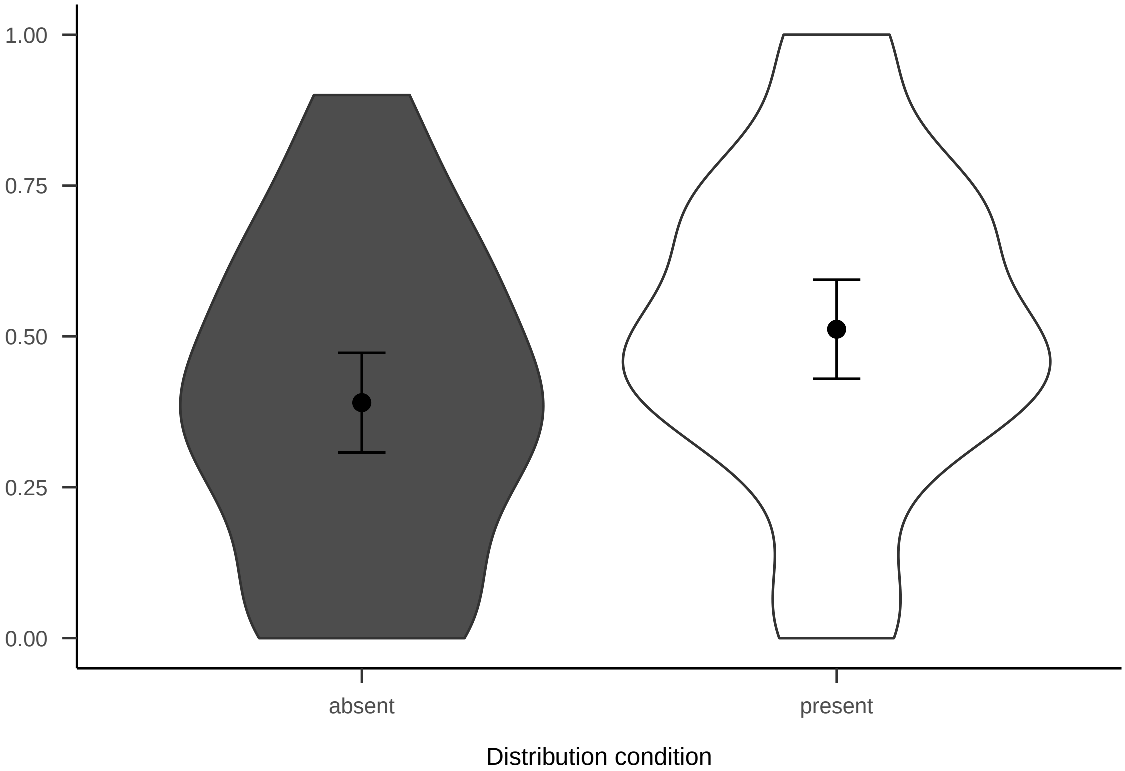


Figure 2.9: Mean proportion of project acceptance for the presentation, awareness, and distribution effects. Note, the condition on the left of each effect is the reference condition (separate presentation, naive awareness, distribution absent). As such, it is identical for the three effects. Error bars represent 95% confidence intervals.

2.3.3 Discussion

Experiment 2 found support for Hypothesis 2.5). Seeing an outcome distribution of a business project portfolio had a strong effect on participants' decision-making. Participants indicated that they would invest in more projects and were more likely to indicate that they would invest in the entire portfolio. However, the awareness and presentation effects found in Experiment 1 (see Section 2.2.2) did not replicate.

These findings provide evidence for choice bracketing. That is, people do seem to be primarily considering gambles one at a time. Further, these findings suggest that that the main bottleneck for appropriately aggregating a set of gambles is a computational one. That is, people simply cannot mentally combine the outcomes and probabilities in a way that sufficiently approximates the outcome distribution display.

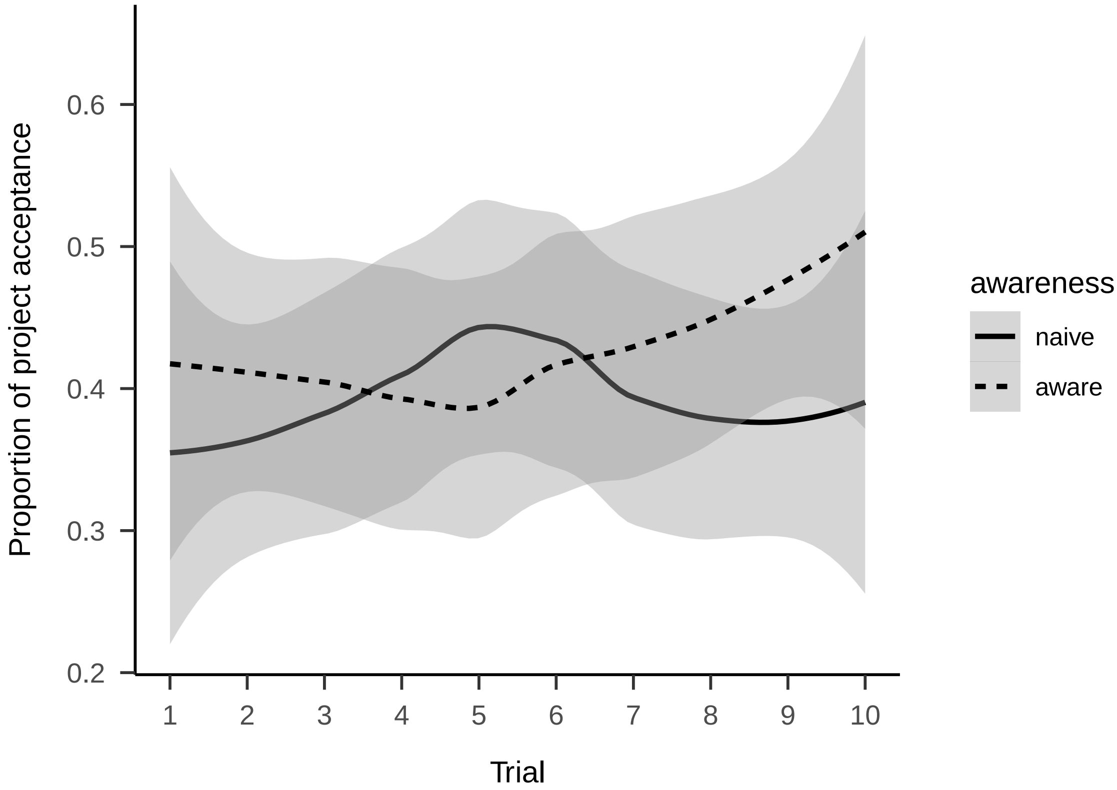


Figure 2.10: Mean project acceptance for separate presentation, distribution absent condition, by awareness and trial. LOESS is used for smoothing over trials and the shading represents 95% confidence intervals.

The lack of replication of the awareness and presentation effects provides evidence against a naive aggregation account of the distribution effect. Specifically this suggests that the distribution effect is a result of a lack of ability to mathematically combine risk, rather than naive aggregation. If some of the bottleneck was attributable to a lack of realisation that the individual gambles could be grouped together, then the effects from Experiment 1 should have replicated. Instead it seems that even when people have an opportunity to consider an entire set of risky choices together (and consider that the gains may outweigh the losses), they do not do this.

In Experiment 2, all the gambles came from the same domain. This was done to attempt to replicate the relevant effects from Experiment 1. However, there could have been something about that particular domain that led to the lack of replication. A follow-up experiment addressed this issue by presenting participants with 20 gambles from 10 different industries and still did not replicate the awareness effect (see Appendix A.4).

2.4 General discussion

This chapter found that choice bracketing facilitated risk aggregation in description-based repeated-play gambles. This paradigm has never been a target of research. Early work on risk aggregation involved multi-play gambles, which treated gambles as simultaneous and identical. However, most risky choice outside the lab involves considering multiple choices independently, as in repeated-play paradigms. Most repeated-play paradigms have involved providing participants with feedback, or allowing them to sample from outcome distributions. Large real-life investments are different, as their outcomes are not eventuated immediately (and do not allow for distribution sampling). The limited prior work using description-based repeated-play gambles did not consider the effect of choice bracketing on risk aggregation. As such, the paradigm used in this chapter allowed for the investigation of choice bracketing in a way that is more isomorphic with real-life prescriptions.

Experiment 1 found evidence for the effects of similarity, presentation, and awareness of the number of projects. Experiment 2 found evidence for the effect of an outcome distribution but did not replicate the presentation and awareness effects. Subsequent follow up experiments (reported in Appendices A.3 and A.4) again tested the similarity and awareness effects. These experiments found evidence for naive diversification (an advantage for low similarity) when considering them all projects once and did not replicate the trial-by-trial interaction from Experiment 1.

Therefore, in addition to the novelty of the paradigm itself, this chapter found that choice bracketing facilitates risk aggregation. As per Hypothesis 2.5, Experiment 2 found that showing a distribution of outcome probabilities without inter-trial feedback reduced risk aversion. Further, there was mixed evidence for Hypothesis 2.3, such that people were less risk averse when the set of projects they saw were dissimilar, but only when offered them as a portfolio (see Appendix A.3). There was only minimal evidence for Hypotheses 2.1 and 2.2, suggesting that viewing projects together and an awareness of the number of projects are not sufficient to encourage aggregation. Altogether, it seems that subtle contextual cues are often not sufficient to encourage risk aggregation and that people need risk to be is aggregated for them explicitly in order to understand the benefits of aggregation.

2.4.1 Theoretical implications

The finding that participants are less risk averse when provided with an aggregated outcome distribution is congruent with previous work (e.g., Redelmeier & Tversky, 1992). However, when distributions have been previously used, gambles were identical—as in multi-play paradigms—and used immediate feedback for repeated-play paradigms (e.g., Benartzi & Thaler, 1999). As mentioned previously, both these paradigms have limited ecological validity because usually people are faced with non-identical sequential choices and do not receive immediate feedback. This work is the first to provide evidence for this aggregation effect with non-identical gambles without feedback.

The other choice bracketing findings are less congruent with previous research. Sokol-Hessner et al. (2009) and Sokol-Hessner et al. (2012) found that encouraging participants to make decisions akin to a professional investor increased the amount of risky choices they made. The results showed that a subtler manipulation—whether or not participants were aware of the number of choices to be made—is not sufficient to encourage aggregation. Hsee et al. (1999) found that useful, but hard-to-interpret, attributes were used more when the options were presented jointly, rather than separately. In the case of these experiments, the "hard to interpret" element of the decision set was the risk of the projects. Contrary to Hsee et al. (1999), it seems that risk was not always accounted for more when projects were presented jointly, rather than separately. More study is needed to understand whether the effects that were seen in Experiment 1 but not replicated in the subsequent experiments are due to statistical chance or specific elements of the experiment.

Research on the effect of option similarity on choice (e.g., Markman & Medin, 1995) suggests that alignable differences are more important than non-alignable differences. Further, the effects of multi-play gambles and outcome distributions on risk aggregation are only seen when participants perceive the options as fungible (e.g., DeKay & Kim, 2005). As such, it was predicted that a set of investments that involve the same type of investment would be seen as more similar, and therefore be considered as fungible. Hypothesis 2.3 predicted that this would facilitate a broad bracketing, and therefore more risk aggregation.

Instead, the results showed that choice similarity did not affect individual project allocations. However, when participants were given an all-or-nothing choice for the entire set of projects, those that viewed dissimilar projects were more likely to take the entire set projects than those that viewed similar projects. This is different from the initial hypothesis, however, it may still suggest an effect of choice bracketing. That is, this effect was only found when participants were asked about the entire portfolio of projects, rather than when they had a chance to make a choice about each project. The way that the question was framed may have acted to broadly bracket the choices by forcing the choice.

A diversified portfolio is one whose investments are uncorrelated or negatively correlated. According to Portfolio Theory (Markowitz, 1952), a diversified portfolio is preferred to one that is not diversified, because it reduces the probability of a loss. When some investments have losses, others will have gains—the root of "don't keep all your eggs in one basket." Typically, questions of gamble aggregation assume that each gamble is independent. That is, the gambles are uncorrelated. As such, aggregation of a portfolio already assumes that the portfolio is somewhat diversified (or at least that the gambles aren't perfectly correlated).

In the case of the similarity effect, the choice bracketing did not seem to encourage aggregation, but instead appears to have encouraged a naive diversification (Hedesstrom et al., 2006; Read & Loewenstein, 1995). It could not have been actual diversification, because the projects did not contain correlational information. Instead, participants could have been more eager to accept the project portfolio due to the higher variability between projects (due to the similarity manipulation).

How does choice bracketing facilitate aggregation?

Much of the literature (e.g., Benartzi & Thaler, 1999) is not clear about why choice bracketing occurs. Some explain the effect of bracketing on aggregation using risk aversion (e.g., Read et al., 1999), while others refer to the increased weighting of potential losses (Webb & Shu, 2017).

Decision-from-experience *sampling* studies explain the underweighting of rare events (as opposed to the overweighting that occurs with decisions-from-description) by sampling bias and recency effects (e.g., Hertwig et al., 2004; Wulff et al., 2018). That is, they explain that people are less risk averse for positive EV gambles because when they sample from the distribution they only sample a small amount (usually approximately 20 times) so they do not experience rare events very often. Also, the latter half of the sequence of sampling is significantly more predictive than the former (recency effect). Some decision-from-experience *feedback* studies explain this effect by "choice inertia" (Camilleri & Newell, 2011). That is, "the tendency to repeat the last choice, irrespective of the obtained outcome" (p. 383). However, there is not much more elaboration beyond this. Repeated-play gambles show more underweighting than multi-play gambles. This is said to be due to a "reliance on a very small set of samples" (Camilleri & Newell, 2013, p. 64). However, this explanation does not account for repeated-play effects independently.

The experiments in this chapter shed some light about the mechanisms behind why choice bracketing may affect risk aggregation in repeated-play gambles without feedback. Two explanations were proposed: participants may realise that some gains will offset the losses, or they may need explicit aggregation. Not finding evidence for the subtle choice bracketing manipulations suggests that people do not intuitively consider that the gains of their choices may offset the potential losses. Perhaps the possibility of recouped losses would become more salient when other participants are explicitly told of this possibility, as in Sokol-Hessner et al. (2009). Their explicit instruction manipulation is introduced above as appearing unrealistically strong, but the results of this chapter suggest that people do need very explicit scaffolding in order to use risk aggregation.

2.4.2 Practical implications

This research implies some prescriptions for capital allocation decision-making. For instance, even if managers implement processes that encourage a joint evaluation of projects, this may be insufficient to encourage aggregation. Projects need to very explicitly be considered as individual components in a portfolio in order to facilitate better risk aggregation. Some companies are already implementing processes that make this more explicit (Lovallo et al., 2020). This is especially important for those that would still have to evaluate projects separately. Further, this work shows the importance of being explicit about the forecasted probabilities of project success. Doing this is necessary for the aggregation process. Even more ideal would be to forecast project success using an entire probability distribution for the different possible outcomes. However, research shows that people struggle to construct such distributions (e.g., Alpert & Raiffa, 1982; Schaefer & Borcherding, 1973; Tversky & Kahneman, 1974; von Holstein, 1971) and Chapter 4 shows that people struggle to use such variance information when making allocation decisions.

Interestingly, participants were less risk averse about a portfolio of projects when industries differed, compared to when they were all from the same industry. Simply manipulating the similarity of financially-irrelevant semantics of a set of choices affected participants' risk aversion. This has implications for managerial settings. Executives in multi-business firms often have to make capital allocation decisions that involve comparing dissimilar projects. How can an oil well exploration project be appropriately compared to an oil refinery? Or to a microchip project? Chapter 4 suggests that evaluating dissimilar business projects is more difficult to comparing similar projects. The current work suggests that managers may actually be *less* likely to realise the benefits of aggregation when they are in a less diversified company. As such, managers should complement an understanding of aggregation with that of diversification. This might help to avoid being biased by a lack of variety of projects despite a potentially high level of diversification.

2.4.3 Future research

The main novelty of the experiments in this chapter comes from increasing ecological validity of risky choice problems by removing inter-trial feedback. Future work should test even more realistic scenarios. Such studies should involve managers, ideally in multi-business firms. Investigating whether the choice bracketing findings from these experiments replicates in a sample of managers will help to determine whether these results could be applied to real-world managerial decision-making. This is especially important since Haigh and List (2005) found that professional traders show more myopic loss aversion than students. Further, the similarity, awareness, and presentation manipulations should be tested with managers since it is possible that they have a greater sense of naive aggregation and are therefore more likely to be more amenable to such manipulations. The addition of extra payment for better performance on the task might also assist in making the task more isomorphic with real-world managerial decisions. Further, in the present experiments, participants viewed the projects all in the space of one session. However, this is not completely isomorphic to real life, where managers make many other decisions that are unrelated to the large risky investments at their companies. Future research should test participants over a longer period of time (as in Beshears et al., 2016) in order to see whether the effects of the manipulations replicate in a more realistic environment.

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3
Joint evaluation of multiple projects

Chapter 2 found that people struggle to aggregate risk even when provided with choice bracketing cues that could have built on an intuitive sense of how aggregation reduces risk. The finding that people are more likely to accept many gambles at once (e.g., Samuelson, 1963; Wedell & Bockenholt, 1994), even without any aids to calculate risk, suggests that people can gain an intuition for the benefits of aggregation. Yet, in the current work, people instead considered projects one at a time and only leveraged the benefits of aggregation when given an explicit visualisation of what it entails.

This shows that it is important to change organisational policy to encourage considering business projects jointly. Doing this means that the risk can be concurrently aggregated. In real-life capital allocation scenarios, when managers evaluate projects sequentially, an aggregated distribution can also be presented using any number of projects that were considered in the recent past. This means that a strategy of project risk aggregation can be implemented at any stage in an organisation's lifespan. Relatively new ventures can implement these recommendations by waiting until a certain number of project proposals have been accrued before aggregating.

Considering projects jointly is also useful for accountability purposes. The usual incentive structure in organisations that judges each project outcome independently is likely to punish risk-taking due to its potential negative consequences and not due to the information that was available at the time of evaluation. Framing a set of projects as a portfolio means that any subsequent success or failure of one project can be traced back to the entire batch, and the performance of the whole portfolio can be evaluated.

Business projects might not always be either accepted or rejected, as in Chapter 2. Instead, top-level managers might ask for project proposals from lower-level managers, and then allocate funds from the available budget. An organisation might also have a initial "culling" phase, and a subsequent ranking phase. When initially considering a set of projects, some might be rejected according to certain rules. For instance, an NPV might not meet a certain minimum cut-off. The remaining projects in the set can then be ranked in order of priority and receive an allocation of capital from the budget.

A few potential problems arise at the point that projects are considered jointly for ranking and allocation. For instance, it might not be easy to compare between the projects in the set. As discussed in Chapter 1, diversification of business units has become very popular in large organisations. Therefore, most hierarchical organisations are likely to face difficult comparisons when deciding on how to rank and allocate capital to projects that originated in different divisions. A non-hierarchical organisation that develops one type of product may be able to simply compare across any number of intrinsic project attributes, whereas a diversified organisation is likely to have to rely on more abstract financial metrics, such as NPV. Such metrics are "abstract" because they can be applied in almost any domain.

For instance, when comparing across two oil well projects, there can be both attributes intrinsic to the project, such as the amount of hydrocarbons that are extracted per hour, and also the more abstract financial metrics. There is a potential interaction between the ease that managers have to compare across the projects and the kinds of measures that are used to make the comparison. Two similar projects, such as two oil wells can be evaluated using litres of hydrocarbons extracted per hour, whereas an oil refinery cannot. In the case that two dissimilar projects are compared, managers can use financial metrics to compare across domains. This can lead to comparable accuracy as long as the abstract metrics are as reliable as the intrinsic project features.

A concern that arises out of a reliance on such metrics is that underlying variance is not taken into account. Forecast estimates such as NPV rely on many assumptions and contain much inherent uncertainty, so managers that use them should be cautious about over-relying on them. Chapter 4 tested people's sensitivity to forecast estimate variance information. That is, will people use NPV more when the variance information suggests that it is a reliable measure, than when the information suggests that it is unreliable?

Chapter 2 manipulated project presentation and found no significant difference between when projects were considered jointly or separately. This was explained by the bounds on people's ability to intuitively aggregate. However, it was unclear what components of the projects people focused on both because they were not explicitly manipulated and because the task involved a binary choice (accept or reject). A relative allocation measure for multiple projects with systematically varied attributes would allow to determine the influence of those different attributes. Therefore, Chapter 4 considered the situation in which people are already presented with choices together and asked to evaluate the projects by allocating a hypothetical budget.

Further, Chapter 4 identified the factors that affect people's decisions independently from the potential risk of losing hypothetical money, which is a large reason for the effects in the previous chapter. Risk aversion was accounted for by making it clear that no losses are possible. This was achieved by using only positive NPVs, which implies that the project is not forecasted to lose money.

Chapter 4 also manipulated how easy the project attributes are to compare in order to identify the ways that decision-making in a diversified organisation might be different to that of a more integrated organisation. Chapter 2 manipulated similarity by either showing a set of projects from the same industry or a set from different industries. This was meant to simulate an integrated and diversified firm, respectively. This manipulation was not as strong because there were no project attributes that could be aligned or not. That is, there was nothing actually non-alignable. This may explain the equivocal similarity effect. Chapter 4 more fully manipulated alignability by having project attributes be critical to the evaluation. These project features were shown explicitly so that the difficulty of the comparison is more obvious.

It is not possible to compare apples and oranges. But it is possible to compare apples and oranges in terms of some specific attribute—to say that apples deliver twice as many calories per dollar or that oranges deliver twice as many vitamin C units per dollar.

—Robinson (1944, p. 13)

4

Project similarity bias and variance neglect in forecast metric evaluation

Contents

4.1 Introduction

One of the most important tasks that executives face is allocating capital within their company. This requires ranking different projects based on their importance and predicted success, and allocating limited capital respectively (not unlike a scientific funding agency). Ranking projects requires comparing them across a number of dimensions. For example, an executive in an oil company might have multiple proposals on his or her desk for where to explore for oil next and how to do so. Figuring out what makes one oil discovery project better than another one is relatively easy. However, consider a different scenario in which the executive has to allocate capital between an oil discovery project and an oil refinery project. The dimensions of an oil refinery project that distinguishes good from bad projects may be totally different from the dimensions of oil discovery projects that do the same. Think of a funding agency giving out fellowships and deciding between two cognitive scientists, or a cognitive scientist and a physicist. What makes a physics proposal better for the field of physics than a cognitive science proposal is for cognitive science?

Structure-mapping theory (SMT; Gentner, 1983; Gentner & Markman, 1997) provides a model of comparison that psychologically distinguishes these two kinds of allocation tasks. SMT models comparison as a process of bringing conceptual structures into alignment which, when possible, puts shared component dimensions into correspondence. Alignment both highlights when two conceptual structures share dimensions, and also highlights how the two structures differ along those shared dimensions, called *alignable differences*. For example, when comparing two oil discovery projects, all the relevant processes of planning an exploration and measuring the amount of hydrocarbons in a prospect might be identical, but the specific amount measured will be different. This is the alignable difference: a difference between the two projects that is constrained within the same conceptual structure. However, when comparing between an oil field and a refinery, there will be significantly more *non-alignable differences*, because the two domains do not share component dimensions. That is, many of the processes that exist in the exploration business unit have a significantly different dimensional structure to those in the refinery business unit, such that it will be difficult to find meaningful alignments. More non-alignable differences mean that there are less opportunities to make meaningful comparisons, and so would make predicting project success and ranking their priority more difficult. This chapter experimentally examined project comparisons and how such comparisons affect capital allocation decisions. The working hypothesis was that comparisons with more alignable differences will make project predictions more precise, and project rankings easier and more informative, than a comparison with non-alignable differences.

However, what happens when the two domains are too disparate for a decision-maker to align them, but the task demands that they be aligned? This is actually a bit of uncharted territory experimentally. The prediction is that when forced to, people will grab at any piece of information that they can and then try to infer and abstract as much as seems reasonable to ease the alignment. This is in fact what occurs very frequently in business settings. Corporate enterprises continue to embrace diversification strategies in their investments, and so constantly have to make capital allocation choices that involve very disparate domains. To overcome these difficult comparisons, executives rely on various financial measures that in theory can apply to any project or business proposal. These financial measures work well to ease the burden of the difficult comparison by abstracting away from the complexities of the individual projects, and just focus on financial information such as total costs, projected profits, etc. Initially hard-to-compare projects can therefore be more easily evaluated by comparing values on individual numerical measures.

The most common financial measure that is used by executives in order to value business project proposals is Net Present Value (NPV; Graham & Harvey, 2001; Graham et al., 2015; Remer et al., 1993). NPV is the difference between the money that a project is forecasted to make and the initial investment in its development (accounting for the time value of money), as seen in Equation (1.1).

NPV is commonly used to decide about capital allocation and investment. The simple rule is that if a project's NPV is positive, then it is financially viable, and if NPV is negative, then it is not. However, the use of NPV has been criticised, both by academics and practitioners (Fox, 2008; Willigers et al., 2017). The main criticism is that there is underlying variance within the NPV measure that is not made apparent by the final form of the measure, a single numerical value. For instance, NPV is dependent on the cash inflows that are projected for each year of the project. However, financial forecasting is known to often be inaccurate and prone to optimism bias (Lovallo & Kahneman, 2003; Puri & Robinson, 2007). Therefore, there is bound to be variation in the reliability of NPV measures as a function of the forecasting error in the cash flow calculations. The duration of the project and the discount rate are further sources of variance that are hidden by the single numerical value of NPV.

As such, the secondary goal of this research was to investigate the extent to which people are sensitive to variance information (from financial forecasting) when making capital allocation decisions. This consideration is especially important in the capital allocation situations illustrated above, in which executives need to compare between projects from disparate domains and therefore have to rely on NPV. This matters because the NPV calculated from different domains may have different underlying forecasting error, which may compromise the utility of using NPV as the basis of the comparison. Do executives sufficiently account for the inherent variance in the measure that they rely on so much? Research shows that people are good at extracting variance information when experiencing numerical sequences (Rosenbaum et al., 2020). However, people struggle to use variance information when it is represented numerically (Batteux et al., 2020; Galesic & Garcia-Retamero, 2010; Konold et al., 1993; Vivalt & Coville, 2021).

4.1.1 Experiment summary

Experiment 1 investigated the effect of alignment on the decision-making of naive participants' capital allocation to a set of fictional projects. NPV reliability was manipulated by directly stating whether it is a reliable measure because the naive participants were assumed not to have the requisite knowledge to be sensitive to reliability information otherwise. This experiment predicted that when projects are alignable, participants use NPV if they are told that it is a reliable measure, but do not use it if they are told that it is unreliable. However, when projects are not alignable, participants were predicted to use NPV regardless of the stated NPV reliable.

Experiment 2 investigated the decision-making of management students in almost the same situation as Experiment 1. The main difference was that instead of telling participants the reliability of NPV, this experiment manipulated the level of associated *numerical* NPV reliability. That is, the width of numerical ranges around an NPV. Participants were predicted to rely more on NPV in the non-alignable projects than in the alignable projects. However, this experiment predicted that there will be no effect of numerical reliability, since there is very little evidence that people are sensitive to variance information when represented numerically.

Experiment 3 again tested the alignment and reliability effects in a non-business population, but manipulated both verbal and numerical reliability in the same experiment to allow for direct comparisons. An effect of reliability was predicted in the verbal reliability condition, but not in the numerical reliability condition. Further, this experiment used project descriptions with clearer profitability indicators, and added a larger selection of business industries.

4.2 Experiment 1

Experiment 1 investigated the effects of alignment and explicit NPV reliability information on capital allocation decisions. The structural alignment literature suggests that people weigh alignable differences more heavily than non-alignable differences. It was expected that people would use NPV more than any other product attributes (because it applied to every product). However, this effect should vary with participants' perceived reliability of the value. That is, if other project dimensions were alignable, then it should be easier to adjust the use of NPV based on its reliability. However, it was predicted that in low alignment there will be a reliance on NPV, as the sole alignable difference, regardless of its stated reliability. These effects were measured by considering the linear trend of how NPV, across projects, relates to the money allocated to the projects. Critically, participants saw both NPV and other features intrinsic to each project domain, and these were inversely related. Therefore, a positive NPV amount trend indicated a reliance on NPV, whereas a negative trend indicated a reliance on the intrinsic project features. First, Experiment 1 tested the following omnibus hypothesis:

Hypothesis 4.1—Overall effect. The alignment × reliability amount × NPV amount interaction will be significant.

Initially, the specific effects were tested excluding the no NPV condition. Comparing across dissimilar projects will be difficult, so participants are expected to rely on NPV more in such a scenario than when they have other alignable attributes. Therefore, Experiment 1 tested the following:

Hypothesis 4.2—Alignment effect. The linear NPV amount trend will be higher, on average, in low alignment than in high alignment.

Participants are likely to moderate their allocations based on the provided reliability information. However, it is more likely that they will do this when they have multiple options for metrics to use than when only NPV is alignable. Therefore, Experiment 1 tested the following:

Hypothesis 4.3—Moderation of NPV reliability by alignment. The NPV amount × reliability interaction will be stronger in the high alignment than in low alignment.

More specifically, it is expected that when projects are similar, participants will rely on NPV more (positive NPV amount trend) when they are told that it is reliable and rely more on the projects' intrinsic features (negative NPV amount trend) when they are told that it is unreliable. However, when projects are dissimilar, it is expected that participants will rely solely on NPV solely, regardless of what they are told about its reliability. Therefore, Experiment 1 tested the following:

Hypothesis 4.4—NPV reliability in high alignment. In high alignment, the linear NPV amount trend will be higher in the high reliability condition than in the low reliability condition

Hypothesis 4.5—NPV reliability in low alignment. In low alignment, the linear NPV amount trend will not differ significantly between reliability conditions

A no NPV condition was used to gain a better understanding of the baseline responding to the materials without NPV. This was used to determine the extent of participants' reliance on NPV. When projects were similar, this condition was expected to be equivalent to the low reliability condition, as participants disregard NPV. When projects were dissimilar, this condition was expected to express the average participant value judgements for the project descriptions, which should result in a more or less flat NPV amount trend. Therefore, Experiment 1 tested the following:

Hypothesis 4.6—No NPV comparison in high alignment. In high alignment, the linear NPV amount trend will be higher in the high reliability condition than in the no NPV reliability condition.

Hypothesis 4.7—No NPV comparison in low alignment. In low alignment, the linear NPV amount trend in both the low and high reliability conditions will be higher than the no NPV reliability condition.

4.2.1 Method

Participants

One hundred and eighteen people (55 female) were recruited from the online recruitment platform Prolific. Participants were compensated at a rate of £5 an hour. The average age was 29.42 ($SD = 9.25$, $min = 18$, $max = 73$). Table 4.1 shows the between-subjects condition allocation. NPV amount was varied within subjects.

Materials

Instructions The instructions page explained to the participants, who did not necessarily have business experience, about the task and NPV. However, this page was also used to manipulate whether participants were told that NPV was reliable or unreliable as a financial measure. Participants in the low NPV reliability condition

Table 4.1: Experiment 1 group allocation.

Alignment	Reliability amount	N
High	High	26
High	Low	17
High	No NPV	17
Low	High	21
Low	Low	16
Low	No NPV	21
Total	-	118

were told that NPV is an unreliable metric, whereas those in the high NPV reliability condition were told that NPV is a reliable metric. Those in the no NPV condition saw instructions that did not include the NPV explanation. Critically, participants were told to invest in products with a high objective value (because a better quality product is not always better in a consumer goods market). Since participants might still not use this instruction when directly viewing the projects, Experiment 3 used projects with attributes that more inherently conveyed quality. Appendix B.1.1 shows the instructions used in Experiment 1.

Project display Participants read sets of fictional business projects for which to potentially allocate capital. The high alignment display was a table that listed various attributes for five projects (see Figure 4.1). The low alignment display presented each project as individual paragraphs that described the relevant attributes with full sentences (see Figure 4.2). In the high alignment display, all projects were of the same product type and the concrete attributes were consistent. In the low alignment display, each project was of a different product with concrete attributes relevant to that project. For both alignment conditions, each project description included an NPV.

This alignment manipulation was reinforced by visual presentation. The table format was better afforded by the high alignment condition because all the dimensions were shared. However, this confounded alignment with presentation

	Project 1	Project 2	Project 3	Project 4	Project 5
Product	Laptop	Laptop	Laptop	Laptop	Laptop
RAM (GB)	4	8	32	2	16
Hard drive (GB)	500	750	2000	250	1000
Resolution (px)	900	1080	1440	768	1200
Processor (Ghz)	2.4	3.2	3.8	1.6	3.6
NPV ($)	663	495	70	887	252

Figure 4.1: An example of a high alignment display in Experiment 1.

style. This was addressed in Experiment 3 by equating the table format across both alignment conditions.

Critically, the value of the concrete attributes were always in conflict with the NPV. For instance, Project 4 always had the lowest value for each of the concrete attributes for laptops, but always had the highest NPV. This meant that participants' allocations could be used as a proxy measure for an individual's degree of dependence on NPV.

Allocation Participants completed a capital allocation task (see Figure 4.3), adapted from Bardolet et al. (2011), in which they were asked to allocate a hypothetical yearly budget across the given five projects.

Additional measures Other measures were included apart from allocation. The stimuli and analyses for these measures are reported in Appendices B.1.1 and B.1.2, respectively. Specifically, participants were asked to forecast the future returns of the projects (see Figure B.4), rank the projects (see Figure B.5), indicate their confidence in their decisions (see Figure B.6), and justify their decisions (see Figure B.7).

PROJECT 1

This project is about developing a new shampoo. It will have a 400 mL capacity, and the patented Dandruff Reduction Factor was 17 at testing. The fragrance was optimally effective for 3 metres, and the Safety Authority gave it a 81% safety rating. The NPV is estimated to be $685.

PROJECT 2

This project is about developing a new laundry machine. The machine will have a 12-star energy rating and an 8L capacity. The maximum speed rate is 900 rpm and it will have six different cycle programs. The NPV is estimated to be $500.

PROJECT 3

This project is about developing a new mountain bike. It will have a tensile strength of 910 megapascals, and a suspension for travel of 200mm. It will have a 12-speed cassette and is guaranteed for at least three tours. The NPV is estimated to be $81.

PROJECT 4

This project is about developing a new laptop computer. It will have 2GB of RAM and a hard drive with 250GB capacity. The resolution will be 768px, and the processor speed will be 1.6 Ghz. The NPV is estimated to be $894.

PROJECT 5

This project is about developing a new backpack. It will have eight separate compartments for different types of storage, and a total capacity of 30L. The company will offer a four-year warranty, and the material is an 800-denier nylon fabric. The NPV is estimated to be $251.

Figure 4.2: An example of a low alignment display in Experiment 1. Border added for clarity.

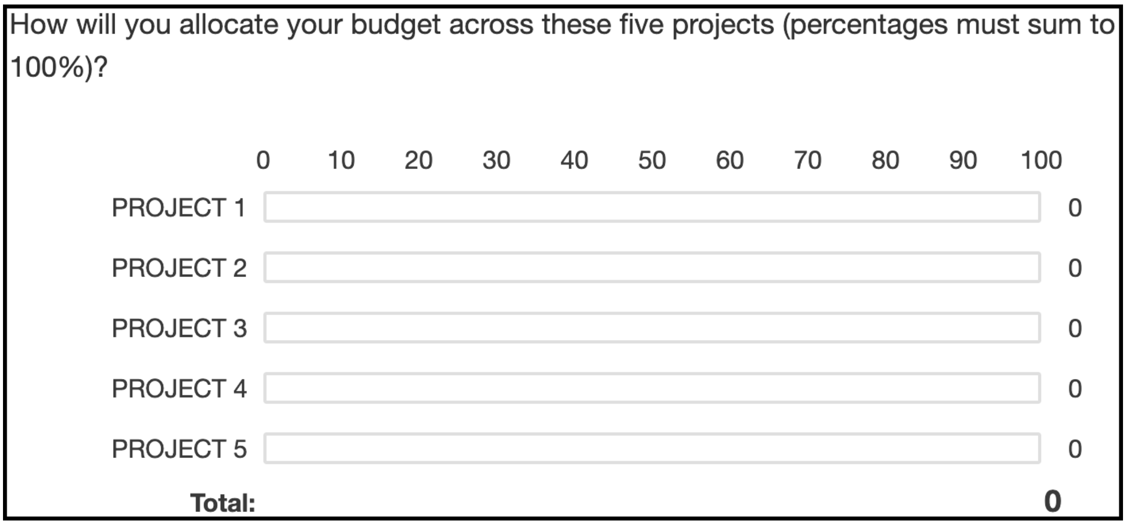

Figure 4.3: The allocation task. Border added for clarity.

Procedure

After reading the relevant instruction page, participants completed the forecasting task directly after each project display in the low alignment condition. For the high alignment condition this was done directly under all projects. Participants then ranked the projects and subsequently answered the allocation, confidence, and justification questions.

4.2.2 Results

A mixed factorial ANOVA was conducted to investigate the effects of alignment and NPV reliability on participants' allocations. As seen in Figure 4.4, the alignment × reliability amount × NPV amount interaction was significant, $F(6.57, 367.76) = 2.18$, $p = .039$, $\hat{\eta}_p^2 = .038$. The analyses excluding the no NPV condition showed the expected results. The NPV amount trend was higher in the low alignment condition than in the high alignment condition, $M = 61.70$, 95% CI [33.02, 90.37], $t(76) = 4.29$, $p < .001$, averaging over reliability amount. This shows that people relied on NPV more when projects were dissimilar than when they were similar.

Further, the NPV amount × reliability amount interaction was stronger in the high alignment condition than in the low alignment condition, $M = 67.81$, 95% CI [10.47, 125.16], $t(76) = 2.36$, $p = .021$. Specifically, in high alignment, the NPV amount trend was higher in the high reliability condition than in the low reliability condition, $M = -63.47$, 95% CI $[-100.00,\ -26.94]$, $t(112) = -3.44$, $p = .001$, whereas in low alignment, there was no significant difference between reliability conditions, $M = 4.35$, 95% CI $[-34.52,\ 43.21]$, $t(112) = 0.22$, $p = .825$. This shows that people only used the reliability information to moderate their allocations when projects were similar and not when they were dissimilar.

The comparison with the no NPV condition revealed the expected pattern. In high alignment, the linear NPV trend was only significantly lower in the no NPV condition than the high reliability condition, $M = 75.70$, 95% CI $[39.17,\ 112.24]$, $t(112) = 4.11$, $p < .001$, and not the low reliability condition, $M = 12.24$, 95% CI $[-27.94,\ 52.41]$, $t(112) = 0.60$, $p = .547$. However, in low alignment, the linear NPV trend was significantly lower in the no NPV condition than both the low reliability condition, $M = 64.63$, 95% CI $[25.76,\ 103.50]$, $t(112) = 3.29$, $p = .001$, and the high reliability condition, $M = 60.29$, 95% CI $[24.14,\ 96.43]$, $t(112) = 3.30$, $p = .001$.

The ranking, confidence, and forecast mean data were all largely congruent with the allocation findings (see Appendix B.1.2). The results also showed that forecasts of those in the low alignment condition had higher standard deviations than those in the high alignment condition (see Appendix B.1.2). However, this did not replicate in subsequent experiments (see Appendices B.5.2 and B.6.2).

4.2.3 Discussion

Experiment 1 found evidence for the effect of alignment on laypeople's decision-making in capital allocation scenarios. Specifically, when projects were comparable, people used NPV when they were told that it was reliable, but not when they were told that it was unreliable. However, they used NPV regardless of reliability when it was the only shared dimension across products.

Experiment 1 manipulated *verbal* NPV reliability. That is, participants were explicitly told whether NPV was considered to be a reliable metric or not. However, in the real-world the reliability of a metric is more commonly expressed in numerical form, such as a range around an estimate. Experiment 2 attempted to replicate the

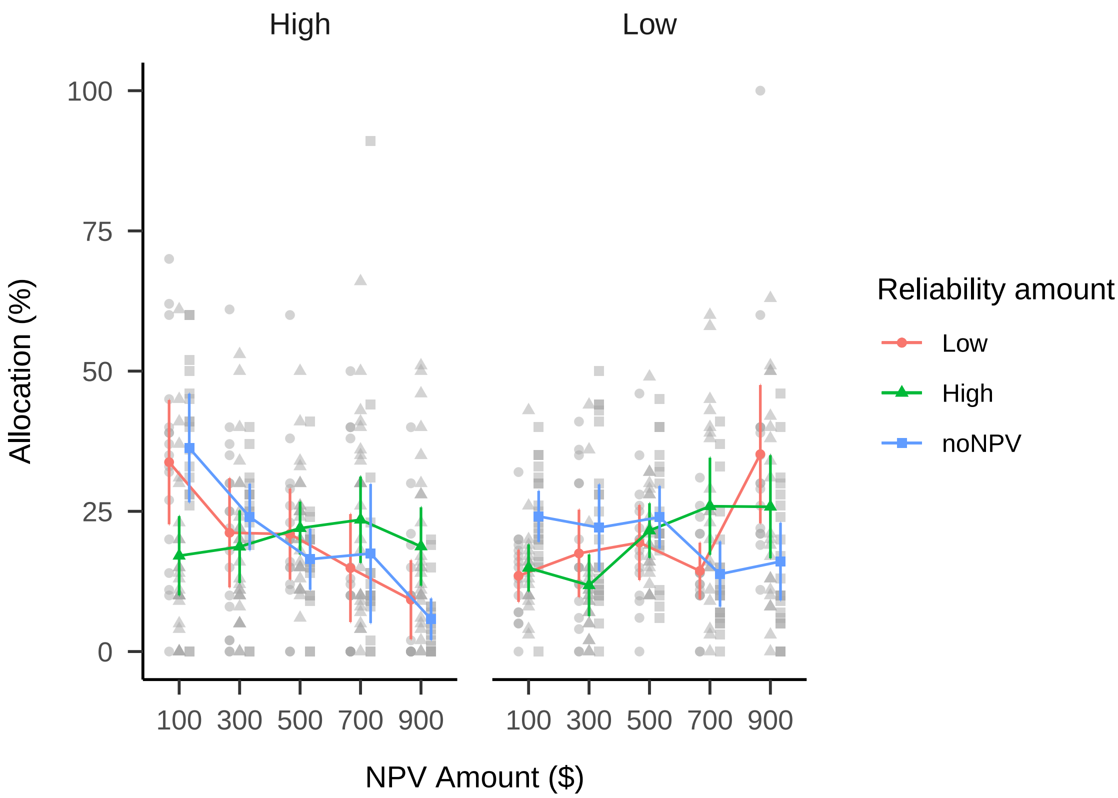

Figure 4.4: Mean allocation. Error bars represent 95% confidence intervals based on the multivariate model. Note that this mixed factorial design does not allow for using confidence intervals to make inferences by "eye" across conditions.

alignment effects, while manipulating the *numerical* NPV reliability associated with each project, rather than the verbal reliability as used in Experiment 1. Further, people with sufficient experience with financial theory and analysis might be able to successfully draw inferences from such information. Therefore, Experiment 2 used a sample of Masters of Management students, instead of the laypeople used in Experiment 1.

4.3 Experiment 2

Experiment 2 investigated the effects of alignment and numerically-expressed variance information on capital allocation decisions. In Experiment 1 the information about the variance inherent in the NPVs was communicated explicitly as the conclusion (e.g., "NPV is unreliable"). In Experiment 2, however, only the actual variance information itself was communicated without the conclusion about its reliability. Specifically, participants saw the range of predicted values (akin to a confidence interval). Therefore, while Experiment 1 manipulated *verbal* reliability, Experiment 2 manipulated *numerical* reliability. Further, Experiment 2 studied participants with more business experience than the previously used laypeople samples. This experiment tested whether the previous findings of an alignment effect will replicate with people with more business experience. The experiment also tested whether this population is sensitive to variance in forecasts.

Hypothesis 4.2 was again tested to investigate the alignment effect in the new sample. However, the other hypotheses from Experiment 1 were not tested again because Experiment 2 manipulated numerical reliability and did not include a no NPV condition. Research has shown that people are poor at reasoning with numerical variance information (Batteux et al., 2020; Galesic & Garcia-Retamero, 2010; Konold et al., 1993; Vivalt & Coville, 2021). Therefore, Experiment 2 tested the following:

Hypothesis 4.8—No effect of numerical reliability. The NPV amount × reliability amount interaction will not be significant in either alignment condition.

Experiment 2 also investigated the potential to quickly change participants' understanding, if they did not initially use numerical reliability for their allocations. Therefore, participants were presented with a short lecture on the importance of paying attention variance in financial decision-making. However, results were inconclusive, so see Appendix B.2 for a more detailed discussion. Further, Experiment 2 investigated whether participants would have a higher sense of understanding NPV than they really do (as in Long et al., 2018). These results are also reported in Appendix B.2 as they were not sufficiently relevant to this chapter.

4.3.1 Method

Participants

Fifty-four people (28 female) were recruited from a Masters of Management course at an Australian university. Age information was not recorded. Both the reliability amount conditions (low and high) and alignment conditions (low and high) were presented within subjects and the order of their presentation was counterbalanced.

Materials

Instructions Participants were shown similar instructions to Experiment 1 (see Section 4.2.1). However, here they were given more information about NPV (about the discount rate and initial investment). The appendix shows the full instructions (see Figure B.12).

NPV test Participants were presented with a short and simple test of their understanding of NPV (see Appendix B.2.1).

Project display As seen in Figures 4.5 and 4.6, the project display was as in Experiment 1, except for the addition of another set of projects that differed in semantic content. That is, the projects were about different types of products (to allow for a within-subjects manipulation). Along with the single NPV, participants saw the forecasted ranges of cash flow that were used to calculate the NPV. In the low numerical reliability condition, the ranges were ±85% around the mean (e.g., $150-$1850 if the forecast mean was $1000); whereas in the high numerical reliability condition, the ranges were ±5% around the mean (e.g., $950-$1050 if the forecast mean was $1000). Wide ranges should indicate low reliability in the measure, while narrow ranges should indicate high reliability. Between the four displays, participants were told to treat each new set of projects as independent to the other sets.

NPV knowledge ratings Participants were asked to rate the confidence of their knowledge of NPV at multiple points in the experiment. The appendix shows an example of this display (see Figure B.15).

PROJECT 1

This project is about developing a new pair of wireless earphones. They will have a frequency response of 16-40,000Hz and a sensitivity of 90 db/mW. The battery life is 8 hours and the pair will isolate noise up to 35 dB. The range of the cash inflow for the first year is $861-$10,619. The NPV is $227.27.

PROJECT 2

This project is about developing a new wrist watch. It will be water resistant up to 50m and will have one extra timing feature. The hardness of the glass face is rated 4 on the Moh scale and the strap is 10% leather. The range of the cash inflow for the first year is $966-$11,914. The NPV is $881.82.

PROJECT 3

This project is about developing a new treadmill. It will 12 training programs for different interests and abilities and 10 speed levels. It will also have two small compartments for storage and three adjustable inclination levels. The range of the cash inflow for the first year is $832.50-$10,267.50. The NPV is $81.82.

PROJECT 4

This project is about developing a new couch. It will have a guarantee for 10 years and a lightfastness level of 5. The cover's ability to resist abrasion has been tested to handle 50,000 cycles and it has a softness rating of 70%. The range of the cash inflow for the first year is $906-$11,174. The NPV is $490.91.

PROJECT 5

This project is about developing a new bottle of perfume. It will have a 100 mL capacity, and the scent will be able to last for 12 hours. The fragrance concentration will be 30%, and there will be two layers of notes to the scent. The range of the cash inflow for the first year is $925.50-$11,414.50. The NPV is $654.55.

Figure 4.5: An example of a low alignment low reliability display in Experiment 2. Border added for clarity.

	Project 1	Project 2	Project 3	Project 4	Project 5
Product	Laptop	Laptop	Laptop	Laptop	Laptop
RAM (GB)	4	8	32	2	16
Hard drive (GB)	500	750	2000	250	1000
Resolution (px)	900	1080	1440	768	1200
Processor (Ghz)	2.4	3.2	3.8	1.6	3.6
Cash inflow range for Year 1 ($)	$5,890-$6,510	$5,738-$6,342	$5,244-$5,796	$6,137-$6,783	$5,538.50-$6,121.50
NPV ($)	$636.36	$490.91	$18.18	$872.73	$300.00

Figure 4.6: An example of a high alignment high reliability display in Experiment 2.

Variance lecture Participants were shown a short lecture on the importance of paying attention to variance information, in an attempt to facilitate a subsequent increased use of the numerical reliability information in their allocations (see Appendix B.2.1 for more details and the lecture slides).

Procedure

Participants saw the instructions and NPV explanation, and completed a simple test to demonstrate their understanding of NPV. They then completed four counterbalanced capital allocation trials (equivalent to each condition combination), and subsequently saw a brief presentation about the importance of paying attention to variance in financial decision-making. Participants then completed a further two capital allocation trials of two of the trials that they saw earlier. They were shown the allocation values that they provided earlier, and were given the opportunity to change them. Participants rated their knowledge of NPV once before the NPV test, re-rated after the test, and again after the four project displays. They were then asked to rate their knowledge of NPV as they believe it had been both before and after the variance presentation.

4.3.2 Results

A within-subjects factorial ANOVA was conducted to investigate the effects of NPV amount, alignment, and numerical NPV reliability on participants' project allocations. Figure 4.7 shows these data. The alignment $\times$ reliability amount $\times$ NPV amount interaction was significant, $F(2.81, 148.75) = 3.95$, $p = .011$, $\hat{\eta}^2_p = .069$. However, this appeared to be driven by the difference between alignment conditions in the interaction between the quadratic NPV amount trend and reliability amount, $\Delta M = -42.28$, 95% CI $[-76.96,\ -7.59]$, $t(53) = -3.14$, $p = .011$, even after applying a Šidák correction. The same interaction but with the linear NPV trend was not significant, $\Delta M = -6.13$, 95% CI $[-31.50,\ 19.25]$, $t(53) = -0.62$, $p = .954$. Further, the linear NPV trend did not differ between reliability amount condition in neither the low alignment condition, $\Delta M = -3.19$, 95% CI $[-18.77,\ 12.40]$, $t(53) = -0.41$, $p = .683$, nor the high alignment condition, $\Delta M = 2.94$, 95% CI $[-12.63,\ 18.52]$, $t(53) = 0.38$, $p = .706$. However, averaging over reliability amount, the linear NPV trend was higher in the low alignment condition than in the high alignment condition, $\Delta M = 28.19$, 95% CI $[5.57,\ 50.81]$, $t(53) = 2.50$, $p = .016$. This suggests that participants relied more on NPV when projects were dissimilar than when they were similar.

The ranking data were congruent with these results, while the confidence data were less so. Further, the NPV knowledge data did not replicate the effect from Long et al. (2018, Study 1). These analyses are reported in Appendix B.2.2.

4.3.3 Discussion

Experiment 2 replicated the alignment effect found in Experiment 1 with participants with real-world business experience. That is, Hypothesis 4.2 was supported, as people relied more on NPV when faced with a set of dissimilar project than when projects were all from the same domain. Experiment 2 also found evidence for Hypothesis 4.8,

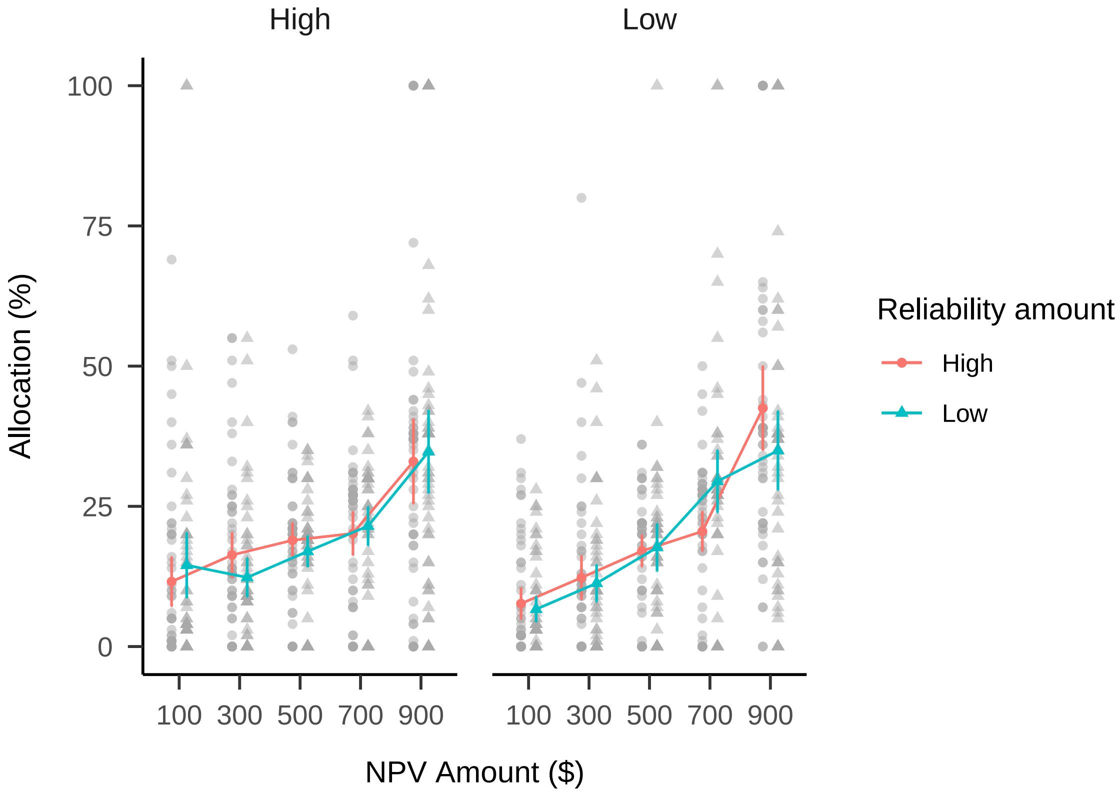

Figure 4.7: Mean allocation. Error bars represent 95% confidence intervals based on the multivariate model.

with no significant differences between the numerical reliability amount conditions. While Experiment 2 did not replicate the interaction found in Experiment 1, it should be emphasised that these are two different effects. In Experiment 1, participants were explicitly told about the reliability of the NPV measure, whereas in Experiment 2, they were provided with variance information that merely implies NPV reliability. Thus, Experiment 2 showed that business students are affected by comparability of project sets, but not by numerical NPV reliability information. Specifically, participants appeared to only focus on the NPV itself, and not on any variations in the underlying noisiness of the measure for a specific project.

However, it is unclear whether laypeople would also display this variance neglect. Further, in Experiments 1 and 2, the business projects consisted of a limited number of domains. It is unclear to what extent these specific domains influenced the results. These projects were centred around consumer products, which were originally chosen to be more easily accessible to participants without business experience. However, with these projects, individual features do not necessarily indicate a project's profitability. For instance, a laptop with a low capacity can be more profitable than a laptop with a high capacity due to the existence of consumer goods markets. Experiment 3 addressed these limitations.

Another limitation of the last two experiments was the potential presentation style confound. The two alignment conditions differed in the number of alignable differences, but also in the way that the information was presented. The information in the low alignment condition was presented in paragraphs, whereas the information in the high alignment condition was presented in tables. While it is likely that each of these data types would be presented in this way in a business setting, it is important to rule out that this manipulation did not also unnecessarily increase task difficulty. Therefore, Experiment 3 attempted to replicate this effect, while controlling for presentation style.

4.4 Experiment 3

Experiment 3 investigated the effects of alignment, reliability type, NPV amount, and reliability amount on allocations. Experiment 1 manipulated reliability amount by using *verbal* prompts. That is, participants were told explicitly whether or not NPV was reliable for a certain project industry. Experiment 2 investigated whether people were able to extract this same kind of reliability information from *numerical* prompts. That is, participants saw NPVs with either wide or narrow ranges, indicating either low or high reliability of the metric, respectively. However, Experiment 1 sampled laypeople, whereas Experiment 2 sampled a Masters of Management course. Therefore, it was not possible to compare the two reliability types (verbal and numerical) without ruling out the potential confound of population type. As such, Experiment 3 manipulated NPV amount, alignment, and reliability amount, but also added a reliability type factor. Further, presentation style was a possible confound in the alignment manipulation of the previous experiments. That is, the business projects in the high alignment condition were always displayed as a part of a table, whereas the projects in the low alignment condition were displayed in prose, as paragraphs. Experiment 3 fixed this by using the same presentation style across alignment condition.

The expected pattern of results in the verbal reliability condition of Experiment 3 was a replication of Experiment 1. For the numerical reliability condition, findings from a pilot experiment (detailed in Appendix B.8) were used for predictions. This experiment found no significant differences in a similar numerical reliability condition to the one used in Experiment 3. This was therefore expected also for the present numerical reliability condition. The appendix shows a simulation of these hypothesised effects (see Figure B.19). Therefore, as well as again testing Hypotheses 4.1, 4.2, 4.3, 4.4, and 4.5 for the verbal reliability condition, Experiment 3 tested the following:

Hypothesis 4.9—Overall effect. The alignment × reliability amount × reliability type × NPV amount interaction will be significant, such that the effects hypothesised above will be seen in the verbal reliability condition, but none of these effects will be seen in the numerical reliability condition.

4.4.1 Method

Participants

Four hundred and forty-eight people (176 female) were recruited from the online recruitment platform Prolific. Participants were compensated at a rate of £5 an hour. The average age was 41.65 (SD = 10.3, min = 29, max = 78). Participants reported an average of 6.94 (SD = 8.23, min = 0, max = 43) years of work in a business setting, and an average of 3.73 (SD = 6.27, min = 0, max = 45) years of business education. The mean completion time was 11.35 (SD = 10.79, min = 1.92, max = 183.7) minutes. Table 4.2 shows the between-subjects condition allocation. The two reliability amount conditions (low and high) were presented within subjects and the order of their presentation was randomised. As before, NPV amount was varied within subjects. Therefore, each participant saw two separate project displays. Appendix B.3.1 describes the power analysis conducted to arrive at the sample size.

Table 4.2: Experiment 3 group allocation.

Alignment	Reliability type	N
High	Explicit	112
High	Implicit	112
Low	Explicit	112
Low	Implicit	112
Total	-	448

Materials

Instructions Participants saw similar instructions to the previous experiments, with an added explanation of the NPV reliability information for each reliability type condition (see Appendix B.3.1). Further, they completed a test of basic NPV understanding. This test functioned also as an attention check as, although it was required to answer, the response should only be one of two letters.

Project display The project displays were similar to the previous experiments. Here, however, participants saw the same presentation style in both alignment conditions. Each display had a table describing the projects in the set, with ranking and allocation inputs. The project details were presented as dot points within the relevant cells of the table. Figure 4.8 shows an example of a low alignment, low verbal reliability display; and Figure 4.9 shows an example of a high alignment, high numerical reliability display.

Three elements were counterbalanced: 1. the association of reliability amount and project set (two variations), 2. the association of business name with NPV (five latin square variations), and 3. project variation (five variations per alignment condition). For high alignment, project variation meant the project type. For low alignment, this meant the intrinsic feature variant for the relevant project type. Table column order and project display order were both randomised.

Carefully read through the project descriptions below and then do the following: 1. Rank the projects between 1 (highest) and 5 (lowest) in order of investment priority in the relevant "Project Ranking" row input; and 2. Allocate each project a percentage (a number between 0 and 100) of the total budget in the relevant "Project Allocation" row input.

Relevant information	**Project 1**	**Project 2**	**Project 3**	**Project 4**	**Project 5**
Project ranking	Ranking:	Ranking:	Ranking:	Ranking:	Ranking:
Project allocation (%)	Allocation:	Allocation:	Allocation:	Allocation:	Allocation:
Business name	Pressbloom	Cweb	Pharmacore	Erectic	Railmont
Project type	national newspaper	software	pharmaceutical	high-rise construction	railway
Predicted project features	• Newspapers printed: 50,000 a day • Number of weekly advertisers: 80 • Ink that is not discarded due to impurities: 5,000L a day	• Code written: 1,000 lines a day • Security rating: 60% • Number of potential customers in first year: 3 million	• Pills pressed: 300,000 an hour • Shelf life: 20 months • Probability of symptom reduction after a week: 90%	• High-rises built: 8 a year • Probability that the builders complete construction within a month of the due date: 70% • Number of tenant expressions of interest: 100	• Railway lines built: 5 a decade • Number of seats filled by paying customers at peak hour: 2,000 • Time before the train carriages will need to be serviced: 12 years
NPV ($)	501 million. (In this industry, NPV is an **unreliable** predictor of a project's profits.)	611 million. (In this industry, NPV is an **unreliable** predictor of a project's profits.)	722 million. (In this industry, NPV is an **unreliable** predictor of a project's profits.)	806 million. (In this industry, NPV is an **unreliable** predictor of a project's profits.)	416 million. (In this industry, NPV is an **unreliable** predictor of a project's profits.)

Continue

Figure 4.8: An example of a low alignment, low verbal reliability display in Experiment 3.

Carefully read through the project descriptions below and then do the following: 1. Rank the projects between 1 (highest) and 5 (lowest) in order of investment priority in the relevant "Project Ranking" row input; and 2. Allocate each project a percentage (a number between 0 and 100) of the total budget in the relevant "Project Allocation" row input.

Relevant information	Project 1	Project 2	Project 3	Project 4	Project 5
Project ranking	Ranking:	Ranking:	Ranking:	Ranking:	Ranking:
Project allocation (%)	Allocation:	Allocation:	Allocation:	Allocation:	Allocation:
Business name	Liquid Pipeline	Enfuel	Petroyield	Refinera	Oilpier
Project type	oil well	oil well	oil well	oil well	oil well
Predicted project features	• Oil extracted: 3,400L an hour • Time the machinery lasts before requiring maintenance: 11 years • Probability of finding oil: 96%	• Oil extracted: 2,000L an hour • Time the machinery lasts before requiring maintenance: 7 years • Probability of finding oil: 90%	• Oil extracted: 3,870L an hour • Time the machinery lasts before requiring maintenance: 13 years • Probability of finding oil: 99%	• Oil extracted: 2,470L an hour • Time the machinery lasts before requiring maintenance: 8 years • Probability of finding oil: 92%	• Oil extracted: 2,940L an hour • Time the machinery lasts before requiring maintenance: 10 years • Probability of finding oil: 94%
NPV ($)	494-546 million. (Midpoint: 520.)	792-876 million. (Midpoint: 834.)	409-453 million. (Midpoint: 431.)	697-771 million. (Midpoint: 734.)	598-662 million. (Midpoint: 630.)

Continue

Figure 4.9: An example of a high alignment, high numerical reliability display in Experiment3.

Interstitial Before each project display, participants saw an "interstitial" page, whose role was to 1. introduce the next display, and 2. check the participant's attention (not required to answer, so can be skipped if the interstitial text isn't read). See Figure B.23 in the appendix for an example.

4.4.2 Results

A mixed factorial ANOVA was conducted to investigate the effects of NPV amount, alignment, NPV reliability amount, and NPV reliability type on participants' project allocations. Figure 4.10 shows these data. Only the main results are reported here, while the rest of the hypothesised allocation effects are reported in Appendix B.3.2. The predicted four-way interaction (alignment × reliability amount × NPV amount × reliability type) was not significant, $F(3.20, 1, 420.19) = 0.71$, $p = .555$, $\hat{\eta}_p^2 = .002$. However, most of the hypothesised specific effects were found.

Verbal reliability

The three-way interaction (alignment × reliability amount × NPV amount) in the verbal reliability condition was not significant, $\Delta M = 13.42$, 95% CI $[-1.27,\ 28.11]$, $t(444) = 1.80$, $p = .073$. This is most likely due to the size of the two-way interactions in each alignment condition being relatively similar, despite the expectation of no interaction in the low alignment condition (as was seen in Experiment 1). In high alignment, the interaction between the linear NPV amount trend and NPV reliability amount was significant, $\Delta M = -36.63$, 95% CI $[-47.02,\ -26.25]$, $t(444) = -6.93$, $p < .001$. Specifically, the trend was stronger in the high reliability amount condition, $\Delta M = 27.26$, 95% CI $[17.69,\ 36.83]$, $t(444) = 5.60$, $p < .001$, than in the low reliability amount condition, $\Delta M = -9.38$, 95% CI $[-18.86,\ 0.11]$, $t(444) = -1.94$, $p = .053$. This shows that, as in Experiment 1, participants moderate their allocations based on verbally-expressed NPV reliability.

Contrary to Experiment 1, the interaction between the linear NPV amount trend and NPV reliability amount was significant in low alignment, $\Delta M = -23.21$, 95% CI $[-33.60,\ -12.83]$, $t(444) = -4.39$, $p < .001$. This suggests that participants were also able to moderate their allocations based on verbal reliability in the low alignment condition. Despite the lack of a three-way interaction in the verbal reliability condition (that would have indicated a difference in the two alignment two-way interactions), the linear NPV amount trend was stronger in the low alignment condition than in the high alignment condition when averaging over reliability amount, $\Delta M = 28.97$, 95% CI $[17.68,\ 40.26]$, $t(444) = 5.04$, $p < .001$. This suggests that when NPV reliability was expressed verbally, as in Experiment 1, participants relied more on NPV when projects were dissimilar than when they were similar.

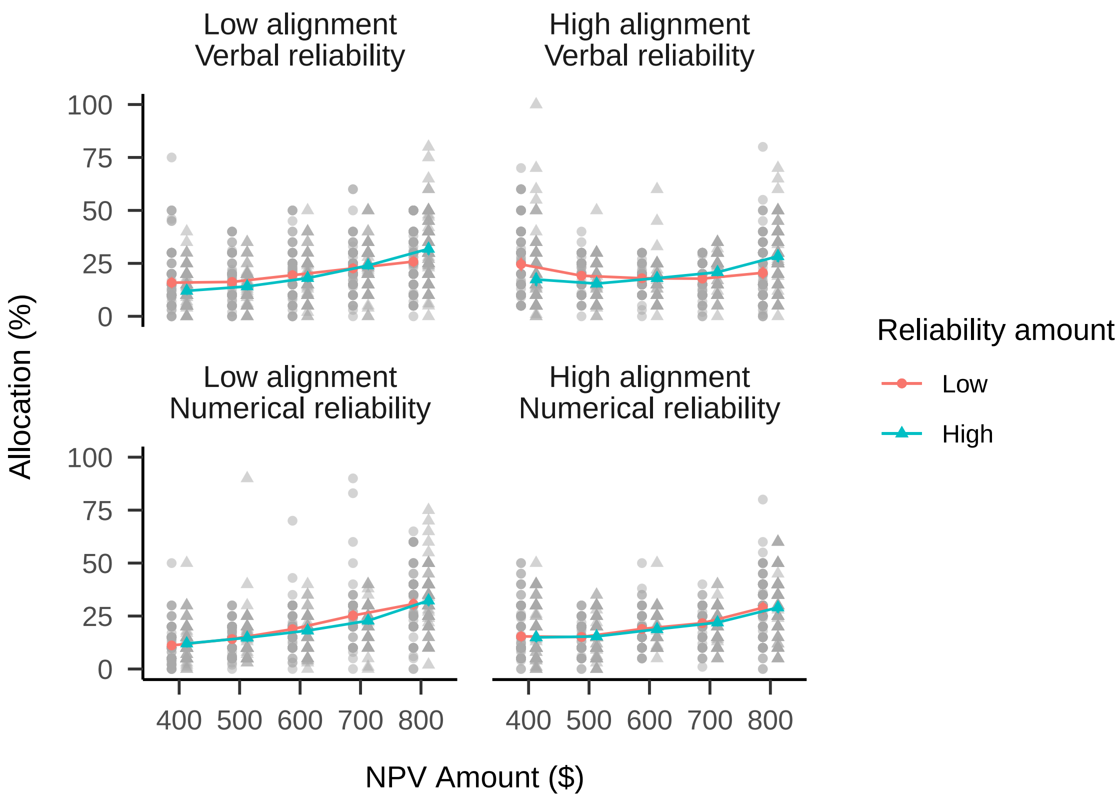

Figure 4.10: Mean project allocation for all conditions. Error bars represent 95% confidence intervals based on the multivariate model. Here, however, the intervals are so narrow that they are mostly obscured by the mean indicators in the plot.

Numerical reliability

In the numerical reliability condition, the linear NPV amount trend was not significantly "equivalent" between those in the low and high alignment conditions (averaging over reliability amount), $\Delta M = 15.19$, 95% CI $[3.90,\ 26.48]$, $t(444) = 2.64$, $p = .996$. In fact, a post-hoc comparison suggests that the low alignment trend was stronger (with Bonferroni adjustment), $\Delta M = 15.19$, 95% CI $[0.78,\ 29.60]$, $t(444) = 2.64$, $p = .034$. This is the same pattern as in the verbal reliability condition above and in Experiment 2. Further, the linear NPV trend was not significantly different between reliability amount conditions in both the low alignment condition, $\Delta M = 1.64$, 95% CI $[-11.61,\ 14.90]$, $t(444) = 0.31$, $p > .999$, and high alignment condition, $\Delta M = -1.21$, 95% CI $[-14.46,\ 12.05]$, $t(444) = -0.23$, $p > .999$. This shows that participants did not use numerical reliability to moderate their allocations.

4.4.3 Discussion

Hypotheses 4.1, 4.2, 4.3, and 4.4 were supported in the verbal reliability condition. This shows that, while overall participants prefer to use NPV as a proxy for project quality in their allocations, they still use verbal reliability information. Specifically, when projects are similar, people use NPV when they are told that it is reliable, and use alternative metrics when told that it is not reliable. However, Experiment 3 did not find evidence for Hypothesis 4.5. Instead, Experiment 3 found that even in the low alignment condition, participants still moderated their use of NPV. They still used NPV regardless of reliability condition, shown by the positive NPV amount trend in both reliability conditions. However, Experiment 3 shows that participants used NPV less when told that it was unreliable.

Further, Experiment 3 did not find support for Hypothesis 4.9 mostly likely because of the unexpected effects of NPV amount in the numerical reliability condition. The hypothesis was constructed in response to the results of a pilot study (documented in Appendix B.8) that replicated the results of Experiment 1 in the verbal reliability condition, but did not replicate the results of Experiment 2 in the numerical reliability condition. That is, when faced with numerical ranges as variance information, people did not seem to even use the midpoint in their decisions. Experiment 3, on the other hand, replicated the finding of Experiment 2 in the numerical reliability condition. Specifically, people used NPV more when projects were dissimilar, but critically, they did not use numerical range information to moderate their allocations.

4.5 General discussion

Across three experiments there were two main findings: 1. NPV is used more when options are hard to compare; and 2. people do not consider numerical variance information, despite this being important to the reliability of the NPV forecasts. These effects were consistent across both naive and experienced populations, which indicates their persistence. People make use of metrics with alignable differences when in a situation that requires comparison across disparate options. However, they do not sufficiently moderate their use of such metrics even when they have alternative attributes to use.

Experiment 1 found that when participants were told that NPV was unreliable, they did not use it in their allocation decisions, but when they were told that it was reliable they did. Experiment 2 found that people with some business experience relied on NPV more for capital allocation when the rest of the information was non-alignable, compared to when it was alignable. However, participants did not take into account the numerical reliability information when making these decisions. Experiment 3 found further evidence of these effects, within one experimental design.

Alignable differences have been shown to be important to decision making in many settings (Markman & Loewenstein, 2010; Markman & Medin, 1995). The experiments in this chapter are novel in the investigation of alignment effects in a capital allocation paradigm. Further, these experiments considered the extent to which the reliability of an alignable measure (NPV) affects the way people use it. The experiments found that this is dependent on the availability of other alignable differences in the choice set. If other alignable differences are available, then participants are willing to reduce their use of a supposedly unreliable alignable measure (and use it when told that it is reliable). However, when no other alignable differences are available, then the unreliable, but alignable, measure is used less. This was found in both Experiment 1 and 3, as well as to lesser extent in a pilot study (reported in Appendix B.4).

Financial measures such as NPV are useful because of their alignability. That is, they act as an alignable difference regardless of the inherent similarity of a set of projects. Psychologically, these measures are useful because they allow for relevant inferences (Lassaline, 1996) and because they offer an abstraction of concrete details (Doumas & Hummel, 2013). However, the theoretical account of structural alignment does not directly speak to the real-world implications when there is a need for non-alignable comparisons. NPV is a type of abstraction that allows comparison between different aspects of a company. For instance, comparing an oil field project with a refinery project might be made easier by using NPV. On the other hand, this increased alignment might actually hide important information because it does not consider the finer complexities inherent within each business unit. The forecasts use to calculate NPV are based on different indicators in each business unit, and there are likely to be differences in variance between each unit's estimates. As such, one can imagine a continuum of similarity comparisons in which usefulness of comparison increases with the level of alignability, but is moderated by the level of abstraction that is required to achieve the alignment.

The finding that people, even with some business experience, do not sufficiently consider variance information is surprising, but understandable. It is surprising because so much of financial decision making depends on considering different sources of variance (e.g., risk, volatility, and uncertainty). However, it is understandable because research from psychology and statistics education shows that statistics students and people in general have a poor ability to draw statistical inferences (e.g., Galesic & Garcia-Retamero, 2010; Konold et al., 1993). Future research should investigate the conditions under which people's sensitivity to variance information can be facilitated. For instance, it is unclear whether it is merely salience that is lacking, and that therefore visual aids could be useful, or whether further explicit explanation of the statistical inference is necessary. Pilot experiments suggest that participants still struggle to use numerical reliability information, even when given very explicit instructions (see Appendix B.7).

A possible limitation of these experiments is the use of NPV as the only financial metric. In the business world there are many metrics that serve similar functions and would be used as a tool to deal with non-alignable options, as NPV was in the current study. Therefore, future research should attempt to replicate the current findings with different financial measures.

Future research should also investigate the boundary conditions of the reliability effect. That is, people seem to be responding to explicit reliability information, but not to variance information that implies reliability. Future research should attempt to identify the minimal kind of information about variance that participants need in order to understand the relevant implications about reliability. Participants may simply not notice the variability information, or assume that it irrelevant. For instance, future research could test participants in a condition in which the variability information is more salient.

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5

Looking for alignment in past cases

Chapter 4 found that people do not sufficiently weigh the importance of numerical variance information in capital allocation. This is important for when projects are dissimilar because people might not pay attention to the variance that underlies NPV. However, there are also implications for high alignment scenarios. When projects are alignable this means that managers are likely to have a choice of using both abstract metrics as well as intrinsic project features. Managers may use a metric such as NPV, whose variance may suggest a lack of reliability, despite being able to use intrinsic projects features. They may therefore miss out on an opportunity to use different, potentially more reliable measures.

An evaluation of a non-alignable set of projects can therefore lead to many potential pitfalls. Such a situation is likely to occur in most hierarchical organisations and be more common the more the organisation is diversified. Chapter 3 discussed that a solution to managers not aggregating the risk of multiple projects is a concurrent evaluation of projects as a portfolio. However, the solution to the evaluation of dissimilar project in the case of a diversified organisation is likely to involve significantly more difficult structural changes in the organisation. For instance, this may mean divesting certain divisions of the organisation, as GE has been doing over the last few years (Scott, 2018).

Other solutions are also possible. For instance, organisations can develop a more normative use of metrics and take into account underlying uncertainty. However, this kind of change might require substantially more statistical reasoning abilities than can be expected of managers without better decision guidelines. Another solution managers may use is to look to evidence from similar projects from outside the organisation. This is useful because a diversified organisation may not have enough points of reference for a project proposal within it. Doing this both does not require substantial restructuring of the organisation as in divestment and is already an on-going practice, as opposed to aiming to facilitate managers' statistical reasoning.

Evidence from similar projects may come in the form of an individual case study from another organisation, or a research report that describes a statistical result. Case studies are especially important in managerial decision-making since they are used extensively in business school teaching materials. Therefore, managers are likely to look to case studies to inform their decisions. But would they think that a single case study is more useful than statistical data? The literature on anecdotal bias suggests that they might. Therefore, Chapter 6 considers the influence of an anecdote on project allocation when it conflicts with statistical evidence.

Previous work showed that people often do not give evidence appropriate weighting in their decisions (Griffin & Tversky, 1992). Anecdotal and statistical evidence are potentially conflicting sources of evidence, so it is important to appropriately weigh their influence when making a decision. It is possible for these sources of evidence to conflict because statistical estimates commonly refer to the mean value of a distribution, whereas individual cases may be sampled, for instance, from either tail of the distribution. This kind of comparison would give the appearance of conflicting information, especially if the distribution is skewed. In the same way that in Chapter 4 the intrinsic project features conflicted with the abstract financial metric, in Chapter 6 the description of an anecdote conflicted with the financial metrics of the target project.

Chapter 6 considered how people dealt with such conflicting information. That is, would they focus on one metric or use a trade-off? In the previous chapter, people did not seem to predominantly use one cue or another. The fact that those in the low alignment condition relied on NPV more than those in the high alignment condition means that those in the high alignment condition were still referring to the intrinsic project features to some extent. Specifically, the different measures' influence may have been integrated in a form of trade-off. However, there was no clear way of determining this, because the allocation measure was aggregated in the analysis. Chapter 6, however, set up the conditions so that it was possible to determine whether participants were using anecdotes exclusively, partially, or not at all.

We like stories, we like to summarize, and we like to simplify

—Nassim Nicholas Taleb (2007, p. 63)

6

Anecdote similarity moderates anecdotal bias in capital allocation

Contents

6.1 Introduction

A good story is often more persuasive than data. While usually harmless in daily settings, poor judgement due to a bias towards anecdotal evidence can lead to larger-scale negative consequences. Perhaps the most prominent example of such an error in judgement is the belief that a vaccine causes a certain disorder based on isolated stories, despite contradictory scientific evidence. An analogous error exists in settings such as managerial decision-making. In business, managers use analogies, usually called *case studies*, as a part of strategic decision-making. Case studies are examples of previous situations that are considered similar by the decision-maker and are used to draw inferences about a target problem. When comparing such examples with aggregated data these are called anecdotes.

Many businesses use case studies to inform their decisions, but often struggle to use them successfully (Gavetti & Rivkin, 2005). This is likely because of the high salience of companies that have ended up either very successful or very unsuccessful. That is, people are often uninterested in average outcomes, but are captivated by both positive and negative extreme outcomes. Increased salience of an anecdote may increase its influence above useful statistical data. Further, increased anecdote salience may also shift attention away from structural similarities in favour of more surface similarities. Both of these issues may explain unsuccessful use of case studies.

The first consideration when using a case study is its merit relative to available aggregated statistical data. That is, if the case study is a single data point in a set of other relevant cases, then using the statistical properties of the larger sample is more inferentially informative than using a single case from within the sample. Despite this, research has shown that people can prefer anecdotal evidence over statistical data (e.g., Freling et al., 2020; Jaramillo et al., 2019; Reinard, 1988; Shen et al., 2015).

However, if this larger sample is not available (or is ignored), then the second consideration when using a case study is the extent of its similarity to the target problem. Research on the psychology of similarity judgements distinguishes between surface and relational similarity (Gentner, 1983). The consensus of this research is that the more conceptual structures two cases share, the more useful they are in decision-making (Lassaline, 1996; Markman & Medin, 1995). As such, case studies that are similar to a target problem on a merely surface level are less useful than those that are related by shared conceptual structure.

Previous research has considered the role of similarity and analogical reasoning in business-related decision-making (e.g., Gavetti et al., 2005). Other work has investigated the impact of anecdotes in capital allocation decisions, and separately the impact of similarity on anecdotes (summarised below). However, it is unclear to what extent an anecdote's similarity to the target problem will affect the influence of anecdotes in capital allocation decisions. Further, it is unclear whether people will be sensitive to information about the distribution from which the anecdote was sampled.

6.1.1 Anecdotal bias

Anecdotal bias is the finding that anecdotal evidence sometimes influences people's beliefs more than statistical evidence. Journalists, for instance, are well aware of the power of anecdotes. An analysis of approximately 29,000 New York Times editorials showed a reliance on anecdotes to drive arguments (Al Khatib et al., 2017). While some research concluded that statistics are more persuasive than anecdotes (e.g., Allen & Preiss, 1997; Hoeken, 2001; Hornikx, 2005) and others were equivocal (Winterbottom et al., 2008), a number of studies have found evidence for anecdotal bias (e.g., Jaramillo et al., 2019; Ratcliff & Sun, 2020; Reinard, 1988; Reinhart, 2006; Shen et al., 2015). Zebregs et al. (2015) suggested that this disparity in findings might be due to statistics having an effect on beliefs and attitudes, and anecdotes affecting intention. A more recent meta-analysis of 61 studies showed that overall people find statistical evidence more persuasive than anecdotal evidence (Freling et al., 2020). However, even if statistical evidence is overall more persuasive across studies, anecdotes that add no additional information to co-presented statistics still influence judgement (Jaramillo et al., 2019). Further, the meta-analysis found that people tend to prefer anecdotal evidence over statistical data when the stakes are more emotional, medical, or relevant to the decision-maker. In business, the decisions are clearly relevant to the decision-maker.

6.1.2 Anecdotal bias in business

It is important to investigate anecdotal bias in business because of the implications this might have on managers' use of case studies. There are many cases of managers successfully using analogies from anecdotal cases, but also of failures to analogise properly (Gavetti et al., 2005; Gavetti & Rivkin, 2005). There is very little research on anecdotal bias in business, but the existing work finds clear evidence of the effect. In fact, the recent meta-analysis by Freling et al. (2020) only included the work in Wainberg et al. (2013) as one such paper.

Wainberg et al. (2013) gave a sample of managers and other professionals a choice between two audit firms, which varied in their audit deficiencies for various clients. The experiment was designed in a way that the statistical evidence favoured one firm and the anecdotal evidence favoured the other firm. Participants viewed one of five conditions. In the *anecdote only* condition, they were shown examples of firm deficiencies; whereas in the *anecdote & statistics* condition, they were shown the same as in the anecdote condition, but also saw the number of deficiencies and clients. However, participants were not explicitly provided the proportions for these values. In the *statistics only* condition, the proportions and clients without deficiencies were made explicit. The *anecdote & enhanced statistics* condition added the anecdotes to the statistics only condition. The *anecdote & enhanced statistics—judgment orientation* condition emphasised the importance of proportions and keeping absolute numbers in their relevant context.

Wainberg et al. (2013) found evidence for anecdotal bias. They measured the proportion of participants choosing the firm favoured by the statistical data. Those that saw only the anecdote chose this firm equivalently to those that saw both the anecdote and the statistics. Further, participants chose this firm less when seeing both types of information than when seeing just statistics, even when the underlying proportions were made explicit (anecdote & enhanced statistics condition). This provided evidence of anecdotal bias, as participants ignored contradictory statistical data.

Finding no difference between the anecdote & statistics condition and the anecdote only condition implies that the anecdotal bias effect is "complete." That is, this shows that the statistics displayed did not play a role in influencing choice. A "partial" effect would have been one in which the anecdote & statistics condition had been chosen more than the anecdote only condition. This would mean that statistics still played some role in influencing choice.

The other important finding in this work was that highlighting relevant statistical features and providing some explanation of statistical inference reduced the anecdotal bias. This is important because it suggests that potential psychological biases can be reduced with a re-framing of the provided information and an explanation of the relevant statistical concepts.

Wainberg (2018) conducted a similar study to Wainberg et al. (2013), but with a capital budgeting task, as opposed to a binary choice. Participants had to choose between purchasing three production-line machines for a mid-sized company that prints circuit boards. The provided statistical data suggested that Machine A was better than Machine B, which was better than Machine C. Participants were either given only this information, or were also provided with an anecdote. This anecdote was in the form of an email correspondence from a colleague from another company that recommended against Machine A (the best option). As in Wainberg et al. (2013), participants were assigned to *anecdote & statistics* and *statistics only* conditions. In the *judgment orientation I* and *judgment orientation II* conditions, participants were told to "think like a scientist" and either received an explanation of what this means, which was either short or a long, respectively. These explanations emphasised the importance of statistical inference.

Wainberg (2018) found evidence for anecdotal bias. Including a contradictory anecdote alongside statistical evidence (the anecdote & statistics condition) reduced the proportion of choosing Machine A. They also found that the addition of instructions that emphasised scientific thinking reduced this bias. Unlike Wainberg et al. (2013), Wainberg (2018) could not determine whether this was a complete or partial anecdotal bias because they did not use an anecdote only condition. Further, neither work considered the effect of the similarity of the content of the anecdote to the target problem.

6.1.3 Effect of similarity

The extent of one's reliance on an anecdote should arguably be moderated by its similarity to the target problem. Previous work has discussed the importance of weighting previous cases by their similarity to the present situation (Gilboa & Schmeidler, 1995; Lovallo et al., 2012). For instance, consider a medical treatment that with contradictory statistical and anecdotal evidence. A large-scale aggregated study found 99% efficacy of the treatment, while an individual reports on social media that they became sick as a side-effect of the treatment. On the one hand, an individual's decision of whether to use the treatment should be informed more by the aggregated data than by the anecdote. On the other hand, the individual might have reason to be concerned if the person who became sick was the individual's identical twin. The inference that the individual may therefore also need to be cautious about the treatment arises from a specific causal model based on the two cases' shared genetics.

There have been mixed results regarding the effect of anecdote similarity on the extent of anecdotal bias. Hoeken and Hustinx (2009, Study 3) found evidence for an effect of similarity on anecdotal bias with laypeople for a variety of claims. As well as manipulating whether participants received a claim supported by an anecdote or statistical evidence, they manipulated whether the anecdotal evidence was similar or dissimilar to the claim that it was supporting. They found that similar anecdotes were more persuasive than dissimilar anecdotes. Hoeken (2001) did not find evidence for an effect of similarity about a local government proposal with a student sample. Similarly, Hornikx (2018) considered the effect of similarity on anecdotal bias in local government policy decision-making. The researchers did not find an effect of similarity, or an effect of anecdotes. However, they measured persuasiveness and perhaps requiring to make more concrete decisions will be a better test for a more real-life scenario.

Apart from the need to clarify the effect of similarity on the anecdotal bias effect, it is important to clarify how such an effect might work. Research on analogical reasoning has made the distinction between simple surface similarity and deeper relational similarity (Gentner, 1983). As mentioned above, one's use of an anecdote should be moderated by the extent to which it is associated by an underlying casual mechanism or mere surface similarity. Imagine a manager of a multi-divisional company that is deciding how to allocate capital between an oil well project and a technology project. Would hearing of a recent failed oil well project at a different company influence the manager's allocation decision? If so, would it influence the decision because of the fact that the anecdote and one of the target projects are from the same industry (surface similarity)? Or would the manager look to the underlying reason of why the anecdote failed and first identify if this mechanism is relevant to the target oil project (relational similarity)? The experiments in this chapter investigate whether the anecdotal bias effect is due to causal inductive reasoning or merely the association between the valence of the anecdote and surface similarity with the target.

6.1.4 Experiment summary

Experiment 1 investigated whether anecdotal bias in a capital allocation paradigm is moderated by similarity of the anecdotes. Further, it tested whether giving extra information about statistical thinking would encourage participants to consider the statistics over the anecdote. Experiment 1 used a negative anecdote, which is an example of an unsuccessful case. This kind of anecdote has been shown to produce anecdotal bias in both medical (Jaramillo et al., 2019) and business (Wainberg, 2018) decision-making. However, Jaramillo et al. (2019) found less of a bias in positive anecdotes, which are examples of successful cases, and Wainberg (2018) did not consider these at all. Therefore, Experiment 2 attempted to replicate the effect of similarity on anecdotal bias with a positive valence anecdote. Further, Experiment 2 provided participants with information about the sample distribution of the anecdote, whereas Experiment 1 did not. This allowed for an informal test of whether people are sensitive to such information.

6.2 Experiment 1

Experiment 1 investigated the effects of similarity and anecdotal bias on capital allocation. Participants were asked to allocate a hypothetical budget between two business projects. They also saw a case study that was either similar or dissimilar to the target project (but still from the same industry). Further, participants were allocated to the same conditions as in Wainberg (2018), except that of the two judgement orientation conditions, only the *judgment orientation II* condition was used. Further, an anecdote only condition was used. For the conditions with statistical evidence, participants also saw aggregated information about the success of similar projects in the form of Net Present Value (NPV) as well as a reliability measure. One project was clearly better than the other when considering the statistical data, but the anecdotal evidence suggested the opposite.

Previous research found that people are more persuaded by negative anecdotes than by positive statistical data in capital allocation scenarios (Wainberg, 2018). While other work has shown that similar anecdotes are more persuasive than dissimilar anecdotes (Hoeken & Hustinx, 2009, Study 3), it is unclear how similarity changes the anecdotal bias effect. As such, the main question was whether anecdotal bias will be greater when the anecdote is similar than when it is dissimilar. The target project was supported by the statistics, but is inconsistent with the anecdotes. Further, Experiment 1 only used negative anecdotes. So, evidence of anecdotal bias is given when allocation in a statistics only condition is higher than allocation to an anecdote & statistics condition. Therefore, Experiment 1 tested the following:

Hypothesis 6.1—Anecdotal bias is moderated by the similarity of negative anecdotes. Allocations to the target project will be higher when only the statistics are presented and when the statistics are accompanied by a low similarity anecdote, in comparison to when the statistics are accompanied by a high similarity anecdote. In addition, allocations are predicted to not be affected by the low similarity anecdote at all. That is, the statistics only condition should not differ from the low similarity anecdote & statistics condition.

Experiment 1 predicted that that the anecdotal bias effect will be complete, as in Wainberg et al. (2013). Specifically, the participants presented with the high similarity anecdote along with the statistics will not use any statistical information. Testing the high similarity condition will allow for an equivalent test to Wainberg et al. (2013). Therefore, Experiment 1 tested the following:

Hypothesis 6.2—Effect of statistics for negative anecdotes. Participants will allocate capital equivalently to the target project when in the high similarity anecdote & statistics condition and when in the high similarity anecdote only condition without enhancing the statistics explanation.

Participants with additional information explaining the importance of "scientific thinking" and statistical data may be less affected by anecdotes, as in the *judgment orientation II* condition in Wainberg (2018), here called the *enhanced statistics condition*. Experiment 1 tests whether this effect protecting against anecdotal bias would replicate in a capital allocation scenario. Therefore, Experiment 1 tested the following:

Hypothesis 6.3—Effect of enhanced statistics for negative anecdotes. Participants will allocate more capital to the target project when in the high similarity anecdote & enhanced statistics condition than when in the high similarity anecdote & statistics condition.

6.2.1 Method

Participants

Two hundred and eighty-four people (197 female) were recruited from a Psychology undergraduate sample at The University of Sydney. Participants were

Table 6.1: Experiment 1 group allocation.

Anecdote	Alignment	N
Anecdote & statistics	High	41
Anecdote & statistics	Low	40
Anecdote only	High	41
Anecdote only	Low	40
Enhanced anecdote & statistics	High	41
Enhanced anecdote & statistics	Low	41
Statistics only	NA	40
Total	-	284

compensated with course credit. The average age was 20.84 (SD = 4.93, min = 18, max = 58). Participants reported an average of 1.68 (SD = 3.63, min = 0, max = 32) years of work in a business setting, and an average of 0.81 (SD = 1.57, min = 0, max = 12) years of business education. The mean completion time was 22.24 (SD = 97.45, min = 1.67, max = 1,101.48) minutes. Table 6.1 shows the between-subjects condition allocation. Appendix C.1.1 describes the power analysis conducted to arrive at this sample size.

Materials

Instructions All participants initially saw general instructions that explained the task. The subsequent instructions that participants saw depended on their experimental condition. Those in the anecdote only condition were told that they will see a case study of a failed project and an analysis of why it failed. Those in the statistics only condition were told that they will see NPV and reliability information as a part of the descriptions of the two focal projects. Participants were explained that these values were sourced from a study with a large sample. Those in the anecdote & statistics condition were given both of these instructions, and were also told that the information in the anecdote is subsumed in the data of the aggregated study. Those in the anecdote & enhanced statistics condition saw the same as those in the anecdote & statistics condition, but were subsequently given the explanation of scientific thinking that Wainberg (2018) used. Appendix C.1.1 shows the instructions used in Experiment 1.

Allocation task In the allocation task, participants allocated a percentage of a hypothetical budget between two projects that come from different businesses within a company. In this chapter, these two projects will be referred to as the *focal* projects. One of these projects will be referred to in this chapter as the *target* project and the other as the *comparison* project. The target project was used as a reference for the similarity manipulation. That is, the anecdote was either high or low in similarity compared to the target project. Further, the data analyses presented in Section 6.2.2 used allocations to the target project as the DV.

Participants were presented with information about each business' name, location, integration (vertical or horizontal), and organisational structure (centralised or decentralised). See Appendix C.1.1 for an explanation of these terms. Further, participants were presented with information about features of each project that they were told were available to managers before the time of investment. Participants in the anecdote only condition saw just this information (see Figure 6.1), while those in the statistics conditions saw this information along with measures of NPV and "Overall reliability rating" (see Figure 6.2). Participants entered their allocation data underneath this table, in two textboxes labelled *Project A allocation* and *Project B allocation*, respectively.

Anecdote Participants that were presented with an anecdote (those in either the anecdote only, anecdote & statistics, or anecdote & enhanced statistics conditions) saw a description of a business project and an accompanying "analysis." Figures 6.3 and 6.4 show the anecdote display for those in the high and low similarity conditions, respectively. The project description had a similar layout to that of the focal projects. That is, it contained information about the business name, location, integration, and organisational structure of the business. It also detailed several predicted features of the project. Underneath this description was a paragraph of text that participants

Target projects

Allocate your budget between the following two projects using percentage values (the two values should sum to 100):

Relevant information	**Project A**	**Project B**
Business name	Enfuel	Microxy
Investment	oil well	microchip
Location	Texas, USA	Manchester, UK
Integration	vertical	horizontal
Structure	centralised	decentralised
Predicted project features	• Oil extracted: 2200L an hour • Time the machinery lasts before requiring maintenance: 8 years • Probability of finding oil: 88% • Type of well: onshore	• Microchips produced: 4000 an hour • Usable semiconductor yield after testing: 60% • Compatible PCs in the market: 75% • Type of integrated circuit: digital

Project A allocation: ______ %

Project B allocation: ______ %

Figure 6.1: Focal project display for the anecdote only condition in Experiment 1.

Target projects

Allocate your budget between the following two projects using percentage values (the two values should sum to 100):

Relevant information	**Project A**	**Project B**
Business name	Enfuel	Microxy
Investment	oil well	microchip
Location	Texas, USA	Manchester, UK
Integration	vertical	horizontal
Structure	centralised	decentralised
Predicted project features	• Oil extracted: 2200L an hour • Time the machinery lasts before requiring maintenance: 8 years • Probability of finding oil: 88% • Type of well: onshore	• Microchips produced: 4000 an hour • Usable semiconductor yield after testing: 60% • Compatible PCs in the market: 75% • Type of integrated circuit: digital
Overall reliability rating (%)	95	87
NPV ($)	900	100

Project A allocation: %

Project B allocation: %

Figure 6.2: Focal project display for the statistics only, anecdote & statistics, and anecdote & enhanced statistics conditions in Experiment 1.

were told was an analysis of why the project failed. This text referenced each of the features in the description in order to justify the project failing.

Those in the high similarity condition saw a description of a project from a business with the same type of investment as the target project (labelled Project A). All categorical attributes were identical to those in this target project, and the numerical attributes were all made to be lower. In the analysis, the numerical attributes were explained to have failed because they were not as high as certain cut-offs. Critically, these cut-offs were made to all be higher than the relevant values in Project A. This was done to make sure that the numerical attributes in the anecdote seem more relevant to those in Project A. For instance, for Project A, oil extraction was 2200L an hour, for the anecdote it was 2000L an hour, and the cutoff was 3000L an hour. As such, a failure of the anecdote because of an insufficient oil extraction rated will seem more relevant since they both share the state of being lower than the cut-off in the analysis. Note, however, that there was uncertainty about the generalisability of these cut-off values because the participants did not receive a explicit indication of whether these values were meant to generalise to other cases.

Follow-up questions Participants that saw the anecdote were subsequently presented with follow-up questions. They were asked how similar they believe the anecdote was to the target project, how relevant it was for their allocations, and how relevant it would be for judgements about other projects of that type. Figure C.7 in the appendix shows these questions.

Procedure

Participants were introduced to the study through the general instructions and the specific instructions relevant to their condition. They were then presented with the allocation task, which included the anecdote analysis and description (for those not in the statistics condition) and the focal projects description. Those that saw an anecdote were subsequently shown the follow-up questions.

Case study

- Business details:
  - Business name: Refinera
  - Location: New Mexico, USA
  - Integration: vertical
- Investment: oil well
- Predicted project features:
  - Oil extracted: 2000L an hour
  - Time the machinery lasts before requiring maintenance: 7 years
  - Probability of finding oil: 80%
  - Type of well: onshore

Refinera struggled to establish itself in the regional market because of what scientists now know is a hydrocarbon shortage in the New Mexico area. A centralised organisational structure meant that key operational decisions were delayed with what needed to be a timely process. Being vertically integrated meant that these delays caused losses at the retail sites due to miscalculations of petrol supply. To make up for this, a post hoc analysis concluded that oil was needed to be extracted at a rate of 3000L an hour and sites have at least a 96% probability of finding oil before management approved the project. Further, machinery needed to have thought to last at least 10 years before requiring maintenance, because maintenance costs further offset the initial investment after the 7 years of development. Further, the well was quite susceptible to crude oil price changes due to it being an onshore well, and so added additional financial setbacks over the course of the project.

Figure 6.3: Anecdote display for those in the high alignment condition in Experiment 1.

6.2.2 Results

The effect of similarity on anecdotal bias

Anecdotal bias was tested by comparing the statistics only condition with both the high and the low similarity anecdote & (not enhanced) statistics conditions. Figure 6.5 shows these data. The omnibus one-way ANOVA test of these three conditions was significant, $F(2, 118) = 4.19$, $p = .018$, $\hat{\eta}_p^2 = .066$. Planned comparisons revealed that participants allocated more to the target project when seeing only statistics than when seeing the high similarity anecdote with statistics, $\Delta M = -12.31$, 95% CI $[-21.53, -3.09]$, $t(118) = -2.64$, $p = .009$; but not compared to seeing the low similarity anecdote with statistics, $\Delta M = -1.48$, 95%

Case study

- Business details:
  - Business name: Refinera
  - Location: Zhuhai, China
  - Integration: horizontal
- Investment: oil well
- Predicted project features:
  - Oil extracted: 1400L an hour
  - Time the machinery lasts before requiring maintenance: 5 years
  - Probability of finding oil: 56%
  - Type of well: offshore

Refinera struggled to establish itself in the regional market because of what scientists now know is a hydrocarbon shortage in the Zhuhai area. A decentralised organisational structure meant that communication across relevant business units was delayed with what needed to be a timely process. Being horizontally integrated meant that these delays caused losses at the other well sites due to a drain on the collective resources. To make up for this, a post hoc analysis concluded that oil was needed to be extracted at a rate of 2100L an hour and sites have at least a 67% probability of finding oil before management approved the project. Further, machinery needed to have thought to last at least 8 years before requiring maintenance, because maintenance costs further offset the initial investment after the 5 years of development. Further, the well was quite difficult to construct due to it being an offshore well, and so added additional financial setbacks over the course of the project.

Figure 6.4: Anecdote display for those in the low alignment condition in Experiment 1.

CI $[-10.75,\ 7.80]$, $t(118) = -0.31$, $p = .753$. These findings provide evidence of anecdotal bias only in the high similarity condition.

The effect of enhanced statistics

The effect of enhanced statistics was investigated by comparing the conditions in which participants saw an anecdote with statistics to the conditions in which they saw the same, but with enhanced statistics. Figure 6.6 shows these data. The two-way interaction between similarity and the two types of the anecdote & statistics condition was not significant, $M = 3.89$, 95% CI $[-8.86,\ 16.65]$, $t(238) = 0.60$, $p = .548$. Further, the main effect of anecdote & statistics condition (averaging over similarity) was also not significant, $\Delta M = -0.12$, 95% CI $[-6.50,\ 6.26]$,

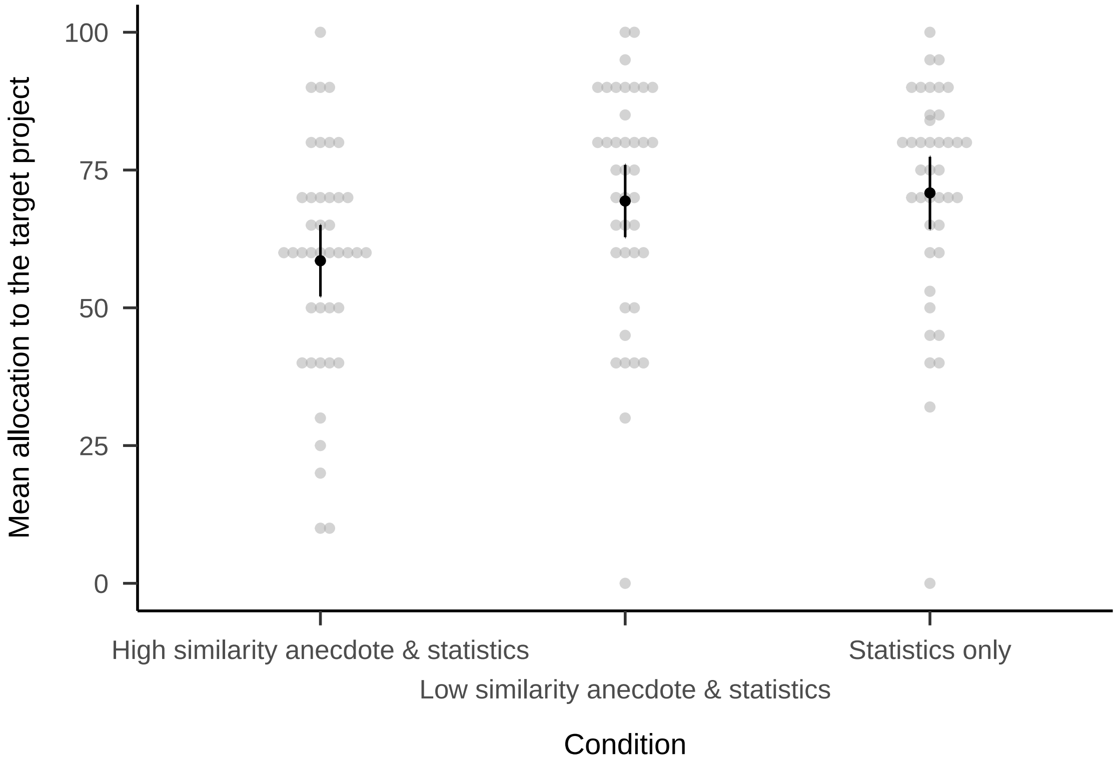

Figure 6.5: Mean allocation to the target project. Error bars represent 95% confidence intervals.

$t(238) = -0.04$, $p = .971$. This suggests that providing participants with instructions on how to think statistically is not sufficient to facilitate a focus on statistics.

The effect of statistics

A two-way ANOVA was conducted to investigate the interaction of similarity (low and high) and anecdote condition (anecdote only and statistics & anecdote, excluding the anecdote & enhanced statistics condition). Figure 6.6 shows these data. This identified the role of statistics in people's allocations. The interaction between anecdote condition and similarity (excluding the enhanced statistics condition) was significant, $M = -13.14$, 95% CI $[-25.93,\ -0.34]$, $t(238) = -2.02$, $p = .044$. Specifically, the difference between allocations when only seeing an anecdote and seeing the anecdote with statistics was greater when the anecdote was similar, $\Delta M = -21.56$, 95% CI $[-32.33,\ -10.80]$, $t(238) = -4.72$, $p < .001$; compared to when it was dissimilar, $\Delta M = -8.43$, 95% CI $[-19.32,\ 2.47]$, $t(238) = -1.82$, $p = .164$. These findings provide evidence of partial anecdotal bias in the high

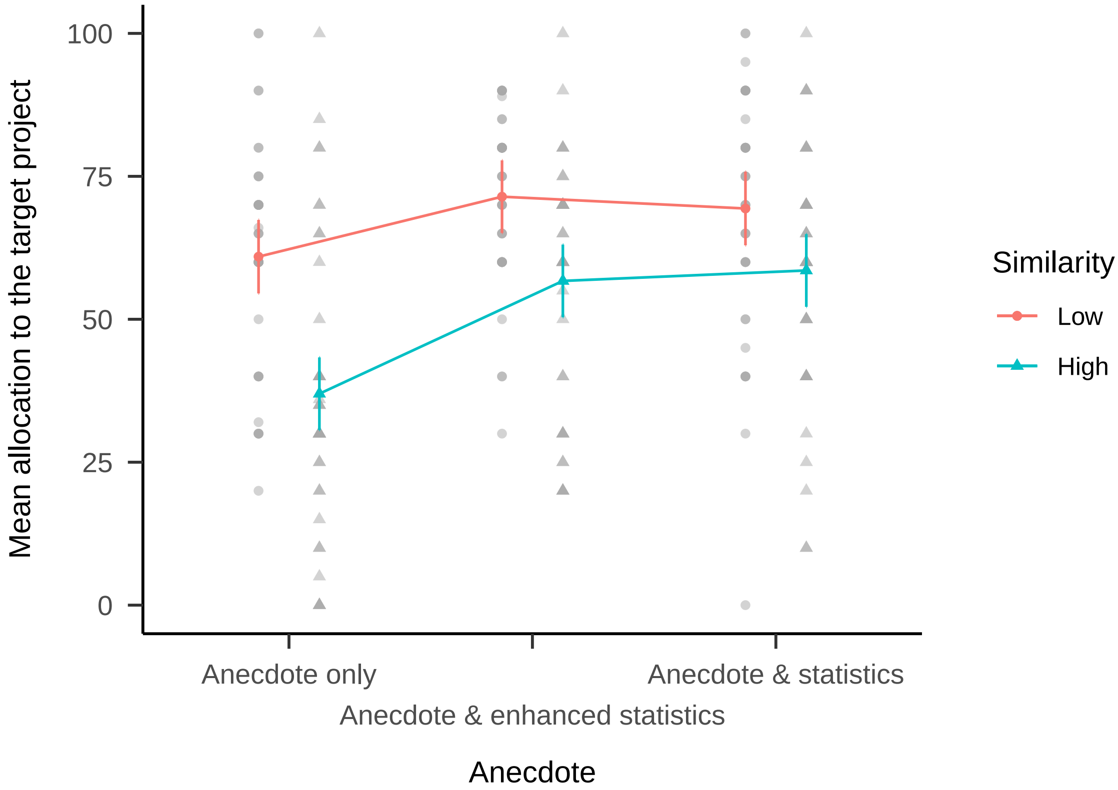

Figure 6.6: Mean allocation to the target project. Error bars represent 95% confidence intervals.

similarity condition, since the anecdote & statistics condition was lower than the statistics only condition (shown above), but higher than the anecdote only condition.

Relevance ratings

Regression analyses were conducted to determine the relationship between allocations and the follow-up relevance ratings. As seen in Figure 6.7 the specific relevance ratings interacted with similarity condition, $b = -2.84$, 95% CI $[-4.80, -0.87]$, $t(240) = -2.85$, $p = .005$. It appears that specific relevance ratings were related to allocations, but only in the high similarity condition. Further, there were no significant associations with the general relevance ratings. This suggests that people were reasoning about the connection between the anecdote and target, as opposed to simply reacting to the failed project and associating that with that project's industry.

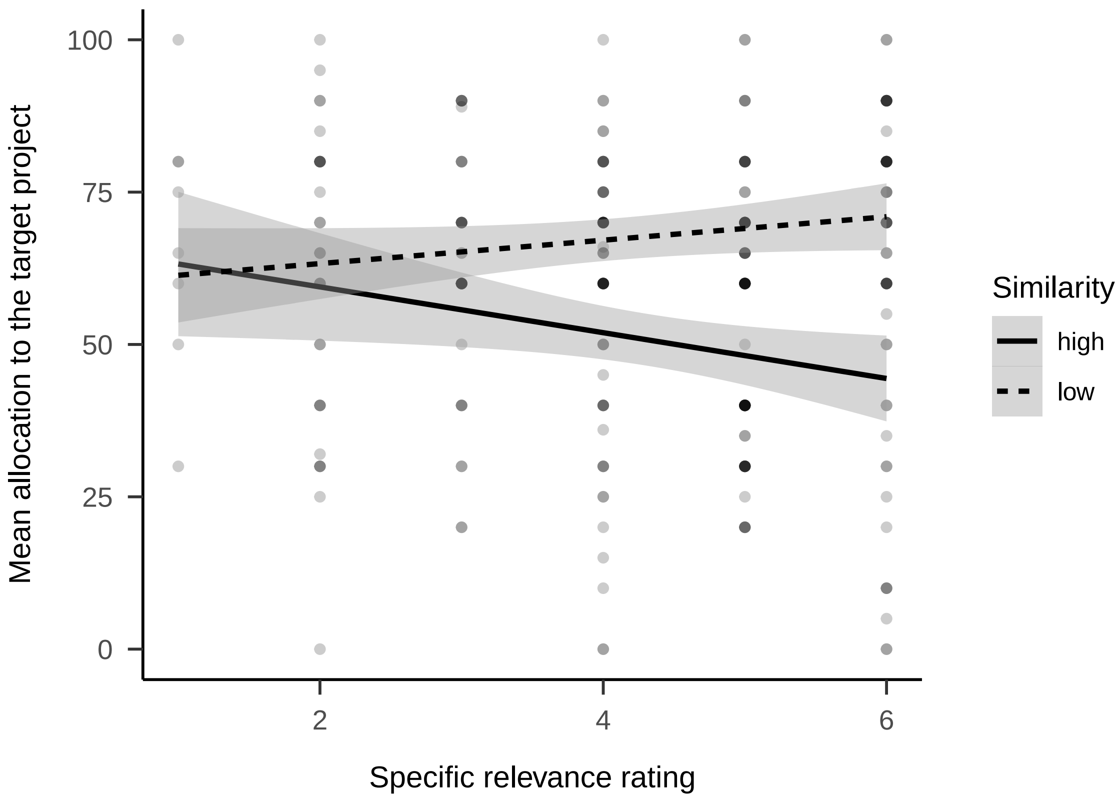

Figure 6.7: Mean allocations to the target project, by specific relevance rating and similarity condition.

6.2.3 Discussion

Hypothesis 6.1 was supported. Participants allocated less capital when seeing the anecdote with statistics than when seeing the statistics alone. This effect was moderated by similarity, however, as it was seen in the high similarity condition, but not in the low similarity condition. This shows that while anecdotal bias exists when the anecdote is similar, participants are not influenced when the causal mechanisms do not match. Contrary to Hypothesis 6.2, despite being influenced by the anecdote, participants still made some use of the statistics. This is different from Wainberg et al. (2013), who found no difference between an anecdote only and an anecdote & statistics condition, indicating a complete effect of anecdotal bias. Hypothesis 6.3 was also not supported, as the added enhanced statistical language used to encourage participants to use the statistical information did not contribute to reducing participants' reliance on anecdotes.

Experiment 1 was limited because it only considered an anecdote with a *negative* valence. That is, the case study was of a project that failed. In real life, however, these case studies are often ones with *positive* valence. That is, a story of a successful company. In fact, in business, the anecdotes that are used might be more likely to be positive, because of survivorship bias. Jaramillo et al. (2019) found an anecdotal bias effect in negative anecdotes, but not in positive anecdotes. This may be because the stimuli consisted of medical decisions and in this domain a loss of health may be felt stronger than an equivalent gain of health. Experiment 2 added a condition with a positive anecdote, in order to investigate whether anecdote valence will impact the anecdotal bias effect.

It was unclear if the effects found in Experiment 1 were related to participants' perceptions of the type of sampling used in selecting the anecdotes. The instructions in Experiment 1 did not explain how the anecdote displayed to participants was chosen. Whether sampling is believed to be intentional or random has been shown to affect people's decision-making (e.g., Hayes et al., 2019). In the case of the current experiments, the sampling assumption changes the extent to which it is rational to use the anecdote or not. It may be rational to choose the anecdote over the aggregated data if 1. the anecdote was not sampled randomly from the pool of anecdotes, and 2. the anecdote is more similar to the target project than any of the other anecdotes in the pool in relevant ways. That is, if the anecdote was chosen because of its high relevance to the target project, it would be irrational to ignore it. In Experiment 1 it was unclear whether participants might have held these beliefs. In order to control for these assumptions, in Experiment 2, text was added to the instructions that clarified that the anecdote 1. was sampled randomly from the pool of anecdotes, and 2. is not significantly more similar to the target project than any of the other anecdotes in the pool.

6.3 Experiment 2

Experiment 1 replicated the anecdotal bias effect found in the literature. That is, people used an anecdote more when presented with conflicting statistics than with anecdote alone and less than with statistics alone. However, anecdote similarity moderated this effect, such that anecdotal bias was stronger when the anecdote was similar to the current task, than when it was dissimilar. Experiment 1 only used a negative anecdote because previous research found anecdotal bias for negative, but not for positive anecdotes (Jaramillo et al., 2019). However, Jaramillo et al. (2019) considered medical decision-making, so this effect of anecdote valence may be different in a business context. In the study, the positive anecdote involved a treatment that led to a reduction in symptoms and the negative anecdote involved symptoms persisting. This framing might mean participants represented the positive anecdote as a return to a reference point and the negative anecdote as a continuation of a reduction in well-being, relative to the reference point. In business, however, both successful and failed business projects represents a deviation from a reference point. To test this difference further, Experiment 2 added an anecdote valence manipulation

In order to increase the experiment's power, anecdote valence and anecdote similarity were manipulated within-subjects. Further, Experiment 2 did not include the anecdote & enhanced statistics manipulation, because Experiment 1 did not find evidence for its effect. All participants saw the statistics only condition, as it did not contain an anecdote, and therefore did not need to be manipulated between-subjects. Each participant therefore saw five displays: one display for the statistics only condition; and four displays for either the anecdote only condition, or the anecdote & statistics condition. These four anecdote displays consisted of the similarity (low and high) × valence (negative and positive) conditions.

Experiment 1 did not clarify certain assumptions about the distribution from which the anecdote was sampled. In Experiment 2, participants were told that the anecdote was sampled randomly and that it was not uniquely similar to the target project. This should lead to a reliance on the statistical evidence, regardless of the anecdote's similarity. However, people often struggle to use statistical concepts presented descriptively, as seen in the enhanced statistics condition in Experiment 1, the variance neglect in Chapter 4, and the lack of risk aggregation in descriptive risky choice as in Chapter 2. Therefore, it was expected that the effects of Experiment 1 will replicate in the negative valence condition. Further it was expected that there will be a reverse effect in the positive valence condition. The appendix shows a simulation of the hypothesised effects (see Figures C.13 and C.14). Therefore, Experiment 2 tested the following:

Hypothesis 6.4—Overall effect. Three-way interaction of similarity $\times$ valence $\times$ anecdote, excluding statistics only

The main effect of interest was the moderation of anecdotal bias by similarity. Therefore, as well as again testing Hypothesis 6.1 for negative anecdotes, Experiment 2 tested the following:

Hypothesis 6.5—Anecdotal bias moderated by similarity for positive anecdotes. For positive anecdotes, allocations will be higher in the statistics only condition than in both the anecdote & statistics conditions (high and low similarity). Within these two anecdote & statistics conditions, allocations will be higher when the anecdote is similar than when it is dissimilar.

Contrary to both Wainberg et al. (2013) and Hypothesis 6.2, Experiment 1 found that participants do somewhat integrate statistics in their decisions. This effect was expected to replicate in Experiment 2. Therefore, Experiment 2 tested the following:

Hypothesis 6.6—Effect of statistics for negative anecdotes. For negative anecdotes, allocations will be higher for the high similarity anecdote & statistics condition than for the high similarity anecdote only condition.

Hypothesis 6.7—Effect of statistics for positive anecdotes. For positive anecdotes, allocations will be higher for the high similarity anecdote only condition than for the high similarity statistics & anecdote condition.

Table 6.2: Experiment 2 group allocation.

Anecdote between	N
Anecdote & statistics	48
Anecdote only	48
Total	96

6.3.1 Method

Participants

Ninety-six people (50 female) were recruited from the online recruitment platform Prolific. Participants were compensated at a rate of £5 an hour. The average age was 41.69 (SD = 11.29, min = 27, max = 74). Participants reported an average of 7.19 (SD = 8.34, min = 0, max = 43) years of work in a business setting, and an average of 3.91 (SD = 7.67, min = 0, max = 50) years of business education. The mean completion time was 14.98 (SD = 8.84, min = 2.57, max = 58.71) minutes. Table 6.2 shows the between-subjects condition allocation. Similarity and valence were manipulated within-subjects. Therefore, each participant was in one of two between-subjects anecdote conditions, and saw five displays (statistics only, and one for each of the four similarity and valence conditions). Appendix C.2.1 describes the power analysis conducted to arrive at this sample size.

Materials

Instructions Participants were shown similar instructions to Experiment 1 (see Section 6.2.1). The general instructions page included a test of the basic information expressed in the instructions. This test also functioned as an attention check. As in Experiment 1, participants also saw instructions that were specific to their condition. These were shown on the same page as the rest of the project display, above the case study and focal projects. The instructions clarified both that the anecdote was sampled randomly and that the anecdotes in the pool were all equally similar to the target project. Appendix C.2.1 shows the instructions used in Experiment 2.

Case study

Cweb struggled to establish itself in the regional market because of changes in privacy laws (that reduced consumer confidence in the business' apps) in the Mumbai area. A centralised organisational structure meant that poor performers took longer to be replaced, so some tasks needed considerable revision. Being vertically integrated meant that the project was reliant on in-house manufacturing and so was slow to adopt the newest technologies used by competitors. A post hoc analysis concluded that, to make up for these issues, the developers needed to write at least 800 lines a day and the the application needed to be certified with a security rating of at least 68%. Further, the number of potential first-year customers needed to be at least 2 million. Further, the problems in the application were slow to solve because of the lack of large-scale quantitative data due to it being for enterprise, and so added additional financial setbacks over the course of the project.

- Business details:
  - Business name: Cweb
  - Location: Mumbai, India
  - Integration: vertical
  - Structure: centralised
- Investment: software
- Predicted project features:
  - Code written: 600 lines a day
  - Security rating: 51%
  - Number of potential customers in first year: 2 million
  - Target users: enterprise

Figure 6.8: An example of the anecdote display in the negative valence, low similarity condition of Experiment 2.

Allocation task As in Experiment 1, the allocation task included a description and analysis of an anecdote (except for those in the anecdote only condition) and a project display with a table describing the two focal projects. Figures 6.8 and 6.9 show the anecdote and focal projects, respectively, for the negative valence low similarity condition. Figures 6.10 and 6.11 show the anecdote and focal projects, respectively, for the positive valence high similarity conditions. In the statistics only condition, participants only saw the focal projects display. Appendix C.2.1 details the counterbalancing and randomisation used in the experiment.

Target projects

Allocate your budget between the following two projects using percentage values (the two values should sum to 100):

Relevant information	Project 1	Project 2
Business name	Codeck	Enfuel
Project type	software	oil well
Location	Austin, USA	Houston, USA
Integration	horizontal	vertical
Structure	decentralised	centralised
Predicted project features	• Code written: 1000 lines a day • Security rating: 85% • Number of potential customers in first year: 3 million • Target users: ordinary consumers	• Oil extracted: 2000L an hour • Time the machinery lasts before requiring maintenance: 7 years • Probability of finding oil: 80% • Type of well: onshore
Project allocation (%)	Allocation:	Allocation:
Overall reliability rating (%)	91	90
NPV ($)	901	100

Figure 6.9: An example of the focal projects in the negative valence, low similarity condition of Experiment 2.

Case study

Microxy performed really well in the regional market because of decreased silicon taxes in the Montreal area. A decentralised organisational structure meant that the individual teams had greater autonomy to complete their tasks, increasing the efficiency of important project stages. Being horizontally integrated meant that the project can be easily marketed to the customer base of the other business units in the company. A post hoc analysis concluded that, to take advantage of these benefits, the microchips needed to be produced at a rate of at least 3200 an hour and the semiconductor yield needed to be at least 57%. Further, the percent of compatible devices needed to be at least 71%. Further, the chip has a relatively low power consumption due to it operating Reduced Instruction Set Computing, and so added additional financial resilience over the course of the project.

- Business details:
  - Business name: Microxy
  - Location: Montreal, Canada
  - Integration: horizontal
  - Structure: decentralised
- Investment: microchip
- Predicted project features:
  - Microchips produced: 4800 an hour
  - Usable semiconductor yield after testing: 63%
  - Compatible devices in the market: 79%
  - Type of chip architecture: Reduced Instruction Set Computing

Figure 6.10: An example of an anecdote display in the positive valence, high similarity condition of Experiment 2.

Interstitial Before each display, participants saw an "interstitial" page, whose role was 1. to introduce the next display, and 2. to provide an attention check (not required to answer, so can be skipped if the interstitial text isn't read). See Figure C.21 in the appendix for an example.

Follow-up questions Participants were shown similar follow-up questions as in Experiment 1, except that here the rating scales were 1-7, instead of 1-6. See Figure C.20 in the appendix for an example of the follow-up questions display.

Target projects

Allocate your budget between the following two projects using percentage values (the two values should sum to 100):

Relevant information	Project 1	Project 2
Business name	Solgistics	Altchip
Project type	shipping logistics	microchip
Location	Kuala Lumpur, Malaysia	Toronto, Canada
Integration	vertical	horizontal
Structure	centralised	decentralised
Predicted project features	• Packages shipped: 800 a week • Number of orders that do not spend time in a bottleneck: 400 a day • Average accuracy of shipments: 90% • Shipping type: parcel	• Microchips produced: 4000 an hour • Usable semiconductor yield after testing: 60% • Compatible devices in the market: 75% • Type of chip architecture: Reduced Instruction Set Computing
Project allocation (%)	Allocation:	Allocation:
Overall reliability rating (%)	93	90
NPV ($)	905	105

Figure 6.11: An example of the focal projects in the positive valence, high similarity condition of Experiment 2.

Procedure

Participants were introduced to the study through the general instructions page. They then saw five sets of two pages (in randomised order). Each set contained two pages: the allocation task and a follow-up questions page (except for the anecdotes only condition, in which participants did not see the follow-up questions page). Each allocation task page contained specific instructions relevant to the condition, followed by the anecdote analysis and description, and the description for the two focal projects. The only exception was the statistics only display, for which there was no anecdote description or analysis.

6.3.2 Results

Only the data that were relevant to the Experiment 2 hypotheses are reported here. See Appendix C.2.2 for manipulation check analyses, and analyses of the follow-up rating data.

Overall effect of manipulations

As seen in Figure 6.12, the similarity × valence × anecdote interaction (excluding the statistics only condition) was not significant, $F(1, 94) = 3.42$, $p = .067$, $\hat{\eta}_p^2 = .035$. However, the similarity × valence interaction was significant, $F(1, 94) = 76.41$, $p < .001$, $\hat{\eta}_p^2 = .448$, as was the anecdote × valence interaction, $F(1, 94) = 10.11$, $p = .002$, $\hat{\eta}_p^2 = .097$. The analyses below investigated the specific hypothesised effects.

Anecdotal bias moderated by similarity

To investigate whether anecdotal bias was moderated by similarity, a difference measure was calculated between each participant's allocation to the statistics only condition and their allocation to each of the two anecdote & statistics conditions conditions (high and low similarity). The statistics only comparison value was different for each valence condition to create equivalent comparisons. For negative valence, the allocation to the high NPV project was used; while for positive valence, the allocation to the low NPV project was used. Figure 6.13 shows these data.

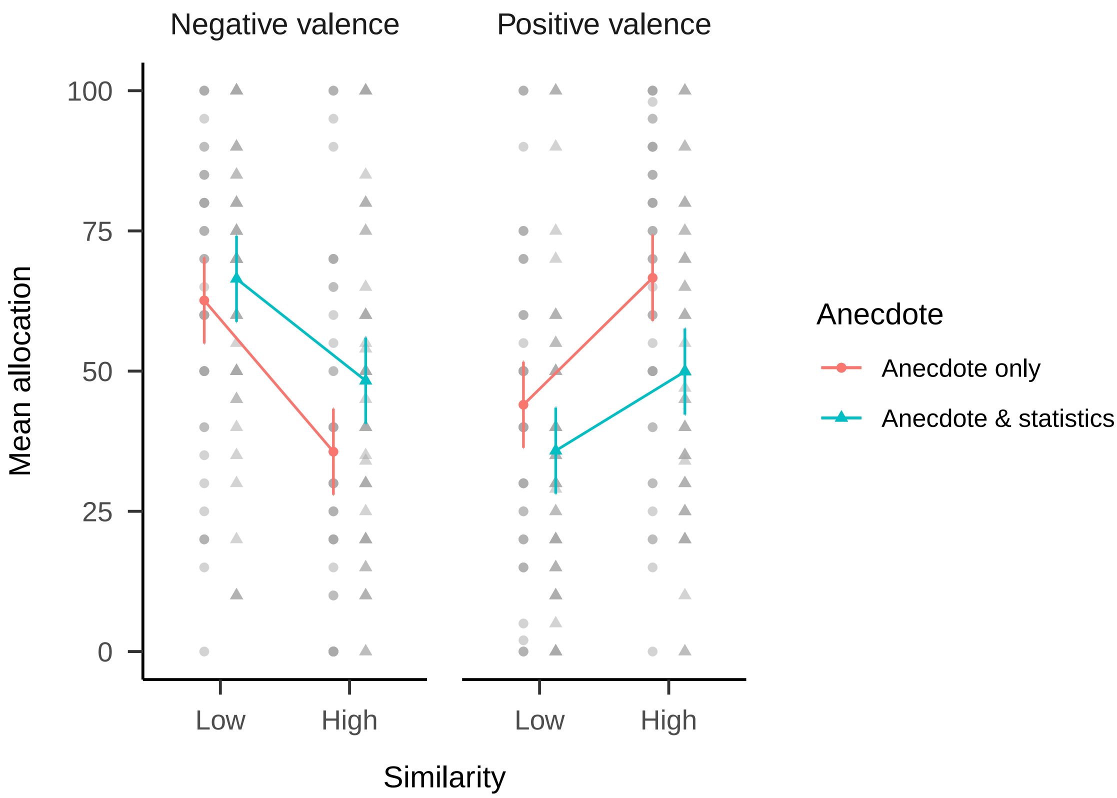

Figure 6.12: Mean allocation to the target project in Experiment 2. Error bars represent 95% confidence intervals, calculated from the model-based standard error. Note that due to the mixed within-between design, these error bars do not permit inferences "by eye" across repeated-measures factors.

The similarity × valence interaction was significant, $F(1, 47) = 30.66$, $p < .001$, $\hat{\eta}^2_p = .395$, as was the main effect of valence, $F(1, 47) = 9.85$, $p = .003$, $\hat{\eta}^2_p = .173$. The main effect of similarity was not significant, $F(1, 47) = 0.53$, $p = .469$, $\hat{\eta}^2_p = .011$.

The interaction was analysed further by comparing the two similarity conditions for each valence condition. For negative anecdotes, the allocation difference was greater when the anecdote was similar to the target than when it was dissimilar, $\Delta M = -18.17$, 95% CI $[-26.17, -10.17]$, $t(93.80) = -4.51$, $p < .001$. For positive anecdotes, the allocation difference was greater when the anecdote was dissimilar to the target than when it was similar, $\Delta M = 14.10$, 95% CI $[6.10, 22.11]$, $t(93.80) = 3.50$, $p = .001$. This provides evidence for the moderation of anecdotal bias by similarity for both negative and positive anecdotes. People seem to be sensitive to the relevance of the anecdote to the target problem.

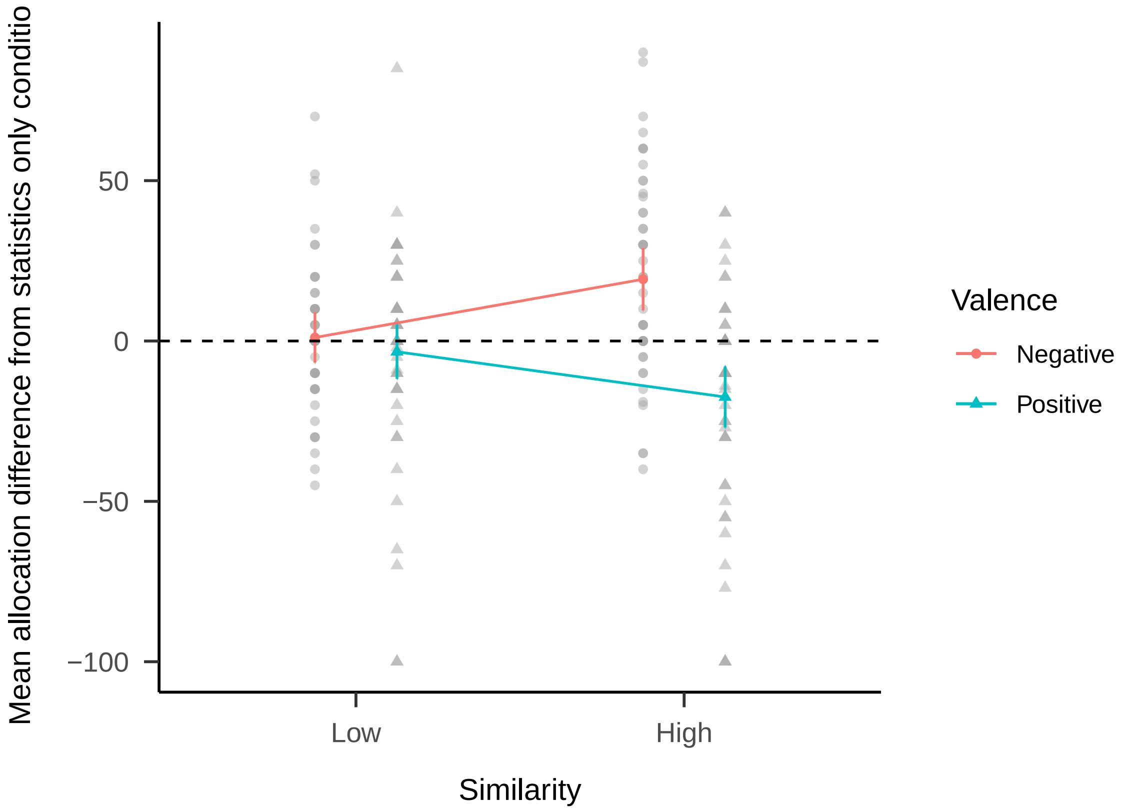

Figure 6.13: Mean allocation difference in Experiment 2 between the statistics only condition and the anecdote & statistics condition. The horizontal dashed line shows the point in which the two allocations were equivalent. Values that are higher than this line represent participants that allocated more when seeing only the statistics than when seeing the statistics with an anecdote. Error bars represent 95% confidence intervals, calculated from the within-subjects SEs using the method from Cousineau and O'Brien (2014).

Effect of statistics

As in Experiment 1, Experiment 2 investigated the extent to which the statistical information influenced participants' allocations. As seen in Figure 6.12, for negative anecdotes, participants allocated more to the high similarity anecdote & statistics project than those in the high similarity anecdote only condition, $\Delta M = -12.67$, 95% CI $[-23.53, \ -1.81]$, $t(336.36) = -2.29$, $p = .022$. When in the positive valence condition, they allocated more to the high similarity anecdote only condition than those in the high similarity anecdote & statistics condition, $\Delta M = 16.71$, 95% CI $[5.85, \ 27.57]$, $t(336.36) = 3.03$, $p = .003$. This provides evidence for the influence of statistics on participants' allocations for both negative and positive anecdotes.

6.3.3 Discussion

Hypotheses 6.1 and 6.5 were supported, as participants showed a stronger anecdotal bias effect when the anecdote was more similar to the target project, for both positive and negative anecdotes. Further, as per Hypotheses 6.6 and 6.7, participants incorporated the statistical information into their judgements, for both negative and positive anecdotes.

Experiment 2 therefore found that, unlike in the medical domain, the effect of anecdotes in financial decision-making does not depend on anecdote valence. Further, as in Experiment 1, and unlike in Wainberg et al. (2013), the anecdotal bias effect does not seem to be complete, with statistics still playing some role in participants' decisions despite the effect of the anecdote.

6.4 General discussion

Most of the hypotheses were supported. This chapter found that, in a capital allocation context, people's decisions are influenced by anecdotes even when aggregated data are available. There were three novel findings: 1. the anecdotal bias effect was only seen when participants considered the anecdote as sufficiently relevant to the target project, 2. participants integrated statistics in their decisions, and 3. these effects were found in both negative and positive anecdotes.

The first novel finding from these experiments was that participants moderated their use of anecdotal evidence. Specifically, when the anecdote appeared to be causally relevant, participants used it in their decisions. However, when it appeared irrelevant, participants relied on statistics almost entirely. The findings in the high similarity condition are largely congruent with findings from other work investigating anecdotal bias in business decision-making. As in Wainberg et al. (2013) and Wainberg (2018), this chapter found that people allocated less capital to a project that is successful according to statistical evidence co-presented with contradictory similar anecdote, than to a project with the statistics alone.

It seems that participants made the distinction between the low and high similarity conditions based on the underlying structure of the anecdote. The low similarity condition always consisted of the same project type, for each domain, as in the high similarity condition. For instance, in one variation, both the high and low similarity anecdotes involved oil well projects. However, the high similarity anecdotes also matched with the target project on a number of specific features. This means that participants were sensitive to the specific information presented to them in the anecdote description and analysis, and did not simply use the project type for their inferences. Further, participants' answers to the follow up questions indicated that they did not consider the anecdote to be necessarily relevant to other projects from the same industry. In other words, participants did not appear to carelessly use anecdotal evidence in their decisions, but instead appeared to carefully consider the anecdote based on its particular causal structure.

The second novel finding from these experiments was that participants that saw the statistics with anecdotal evidence did not completely disregard the statistical measures. Wainberg et al. (2013) found a complete effect of anecdotal bias, because in their study the anecdote only and anecdote & statistics conditions were equivalent. This meant that the statistics they provided had a negligible effect on participants' decisions. The experiments in this chapter, on the other hand, showed a partial anecdotal bias effect, seen as a difference in allocations between the anecdote only and anecdote & statistics conditions. It seems as if participants integrated the anecdotal information with the statistical information. This suggests that people's evaluation of evidence might be more sensitive than previously thought.

The discrepancy between these results and those in Wainberg et al. (2013) might be a result of the sampled population. Since Freling et al. (2020) found a stronger effect of anecdote when decisions were more personally relevant, the manager sample in Wainberg et al. (2013) may have simply been more personally invested in the task than the laypeople in the experiments in this chapter. Similarly, Yang et al. (2015) found that anxiety increases anecdotal bias in risky choice. The discrepancy might also, however, be due to the anecdote & statistics condition not being equivalent between Wainberg et al. (2013) and the present work. Specifically, the statistics shown in the anecdote & statistics condition in Wainberg et al. (2013) were not the same ones that were shown in the same study's statistics only condition, unlike in both the present experiments and Wainberg (2018). Instead, it was the anecdote & enhanced statistics condition that contained the same statistics as in the statistics only condition. This suggests that people only integrate statistics when they are sufficiently clear and no further interpretation is required.

The third novel finding from these experiments was that anecdotal bias was found in both negative and positive anecdotes. Most studies in the literature considered anecdotes that involve an example with negative consequences (a *negative* anecdote). For instance, a medication that does not treat the symptoms of an illness. However, there is not much work in the literature that involves an anecdote with positive consequences (a *positive* anecdote). Jaramillo et al. (2019) found an asymmetry in the effect of the anecdote, such that the effect was stronger when a person in a description did not get better after a medication (negative), compared to when they did get better (positive). The present experiments found a more symmetrical effect, such that both the effects of the moderated anecdotal bias and the influence of statistics were found in both valence conditions.

The difference between the findings from this chapter and those from Jaramillo et al. (2019) might be due to the negative anecdote in their experiment representing a persistence in a negative shift from the status quo (of not being sick). In the business domain, both the positive and negative anecdotes represent shifts from the status quo (of the company's financial position). Regardless, it is still surprising not to find an asymmetry because of the predictions of prospect theory. Loss aversion suggests that participants would have avoided the projects associated with the negative anecdotes more than they would have chosen those associated with the positive anecdotes. On the other hand, each choice was associated with the conflicting statistical information, so this may cancel out the change from the reference point. Future research should use more realistic incentives in order to investigate this effect further. Doing this will also increase the ecological validity of the rest of the findings.

6.4.1 Theoretical implications

This chapter adds to the current understanding of the way people use different forms of evidence in their decision-making. Previous work mostly investigated the relative influence of statistics and anecdotes by comparing anecdote and statistics conditions. The current work shows that comparing a joint anecdote & statistics condition to both an anecdote only and statistics only condition allows for a more specific representation of participants' anecdotal bias. The influence of anecdote can be seen in the comparison between statistics only and the anecdote & statistics condition, but the effect of statistics can be seen in the comparison between the combined condition and the anecdote only condition. These two effects allow to determine the independent influence of anecdote and statistics, respectively. Further use of such a design in future research might help to further understand the conditions under which these types of evidence are used.

It seems that in some of the anecdotal bias literature there is an assumption that using anecdotal evidence over statistical evidence is necessarily irrational. This likely arises from examples from the medical domain in which such decisions are indeed irrational (e.g., believing that vaccines cause certain disorders despite the available evidence). In such cases, people over-rely on anecdotes and should be relying more on aggregated data. However, a case could be made for a rational use of anecdote based on the similarity of the anecdote to the target. For instance, there are times in which an anecdote is so similar to the target situation (e.g., the identical twin example discussed in Section 6.1.3) that it would be unwise not to consider the anecdote. That is, the use of anecdote should depend on both 1. the extent of underlying structural similarity between it and the target problem, and 2. the distribution of this similarity across cases in the sample from which the anecdote was sampled. People should use an anecdote when casual structure is significantly more relevant than other cases in available data.

However, similarity can also be misleading. For instance, if a case is highly similar, but not along some key hidden dimension that is the real causal mechanism to care about, then using the anecdote may be the wrong thing to do. What seems to be important is a sensitivity to relational, rather than surface level similarity. Future research should further investigate how varying the assumptions that people have about sampling from a data set of anecdotes influences their anecdotal bias. Such assumptions can include the size of the sample and the shape of the distribution.

6.4.2 Practical implications

The current work can contribute to managerial decision making by suggesting insights into how managers make better decisions when using case studies and statistical information. Managers of large companies are often in a difficult position; they have incomplete information and an uncertain environment. Despite this, different biases and responses to those biases can be anticipated for different levels of uncertainty. For instance, a manager may be presented with both a convincing case study that suggests a certain course of action, and aggregated data. The manager needs to be able to weigh the evidence accordingly.

The work in this chapter suggests that there are three elements to consider: 1. the quality of the aggregated data (determined by factors such as the sample size), 2. the relative similarity of the cases in the data pool to the target situation, and 3. the similarity of the anecdote to the target. For instance, if the anecdote is relevantly similar to the target situation, and it is significantly more similar than the rest of the cases in the data set, then it should have more weight than an anecdote that comes from a pool of cases that are all equally similar to the target. Lovallo et al. (2012) found that similarity judgements increase prediction accuracy beyond a simple regression model. Taking into account the relative similarity to other cases is likely to further increase predictive validity.

In a situation in which aggregated data are not available, however, managers should rely more on anecdotes that are more similar in causal structure. That is, they should be wary of merely using the surface similarity to make inferences, and instead consider the underlying relational structures. The present data suggest that laypeople can do this to an extent, with participants not being completely swayed by the mere similarity of the type of business project. However, future research should investigate this further to better understand the boundaries of people's analogical reasoning in capital allocation decisions.

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work. . . primarily concerned with the psychological processes that govern judgment and inference. . . portrayed people as fallible, not irrational.

—Amos Tversky

7 Discussion

Contents

This thesis investigated the psychology of capital allocation decisions. The influence of psychological factors on such decisions has not been sufficiently considered in the literature despite their importance to the performance of hierarchical organisations. This discrepancy is likely due to a greater focus of the role of organisational influences on firm performance in the management literature. The thesis did not investigate expertise effects, but instead focused largely on participants without management experience. This allowed a study of the specific cognitive processes without the potential confound of experience. Though, it is also worth noting that, in the one case where the work examined people with management experience, the pattern of results was largely the same as with naive participants.

Each of the empirical chapters investigated distinct but related processes that are relevant to the capital allocation process. These chapters investigated whether people were able to account for the benefits of aggregation when considering multiple projects (Chapter 2), the influence of project feature alignability and metric variance when comparing projects directly (Chapter 4), and the influence of project anecdote similarity when the anecdote conflicts with statistical evidence (Chapter 6). Section 7.1 will first summarise the results of the empirical chapters, and Sections 7.2 and 7.3 will then discuss their theoretical and practical implications, respectively. Section 7.4 will conclude the thesis.

7.1 Summary of results

Chapter 2 investigated participants' choice of risky business projects, when these are displayed sequentially and without feedback in between decisions. This design modelled the real-life situation that managers face in hierarchical organisations: an evaluation of a set of separate business project proposals over time with no immediate indication of the performance of those projects. Aggregating a portfolio of such projects is likely to show a lower chance of potential loss overall than might be originally assumed. The results from this chapter showed that people not only did not do this spontaneously, but also were not facilitated by manipulations that encouraged grouping choices together as a portfolio. People only seemed to recognise the benefits of aggregation when they were presented with an outcome probability distribution of the aggregated set of projects. There was no strong evidence that more subtle manipulations aimed at encouraging aggregation worked. Specifically, presenting projects together, specifying the total number of projects, and presenting projects that were all from the same industry did not reliably encourage aggregation.

Chapter 4 investigated capital allocation when projects were evaluated jointly and capital was allocated as a proportion of the budget, rather than a binary choice. The main manipulation was whether all the project attributes were alignable, or only the abstract financial metric (NPV) was alignable. NPV was also manipulated to be considered as either a reliable metric or not. This information was expressed either as explicit verbal instruction or as numerical ranges. The results showed that when reliability information was presented verbally, participants used it appropriately when all project attributes were completely alignable. That is, they used it when it was reliable and used the intrinsic project features when it was unreliable. When only NPV was alignable, participants relied on it almost exclusively. However, when reliability information was presented numerically, there was no moderation of allocation based on the ranges—participants used NPV even when they had an opportunity to use the intrinsic features of the project. Overall, however, participants tended to rely on NPV more when projects were low in alignment than when they were high in alignment.

Chapter 6 investigated the effect of anecdote similarity on allocations when the anecdote conflicted with the statistical data. Participants were asked to allocate a hypothetical budget between two projects. One of the projects (the target project) was clearly superior in terms of the provided statistical measures, but some of the participants also saw a description of a project with a conflicting outcome (the anecdotal project). This anecdotal project was always in the same industry as the target project. The anecdote description, however, either contained substantive connections to the target or not. Further, the anecdote conflicted with the statistical measures because it was either successful (positive anecdote) or unsuccessful (negative anecdote). The results showed that participants' decisions were influenced by anecdotes only when they believed that they were actually relevant to the target project. Further, they still incorporated the statistical measures into their decision. This was found for both positive and negative anecdotes. Further, participants were given information about the way that the anecdotes were sampled that suggested that the statistical information should have been used in all cases. Participants did not use this information in their decisions and still showed an anecdotal bias effect. Therefore, people seem to appropriately moderate their use of anecdotes based on the anecdotes' relevance, but do not understand the implications of certain statistical concepts.

Together, these results show the bounds of people's decision-making capability in capital allocation. The participants in these experiments in general behaved rationally but struggled to incorporate certain statistical concepts into their decisions. Further, when confronted with multi-attribute choice, participants tended to allocate capital using a trade-off strategy. This was seen in the conflict between intrinsic project attributes and NPV in Chapter 4 and the conflict between the anecdotal and statistical evidence in Chapter 6. Participants were able to moderate their allocations when the moderating factors were sufficiently clear (as in the verbal reliability condition in Chapter 4). However, participants struggled to do this when the moderating factor involved using a relatively basic statistical concept. Each empirical chapter included such a concept: risk aggregation in Chapter 2, metric variance in Chapter 4, and sample distribution in Chapter 6. The aggregated distribution in Chapter 2 and the verbal reliability manipulation in Chapter 4 showed that a formal understanding of such concepts is not always necessary if they are expressed explicitly.

The statistical concepts used in these studies are all likely accessible for people without much formal mathematical knowledge. A basic concept of risk aggregation is clearly available to laypeople as seen in the responses to multi-play gambles (e.g., one vs. 100 gambles). Further, people certainly have a basic understanding of numerical ranges and that a wider range means more spread. Despite likely having this understanding, participants in the above experiments were unable to use it in the decisions. Similarly, other work has shown that people are sensitive to sampling (Carvalho et al., 2021). Therefore, it is unlikely that the people in the thesis experiments simply lacked statistical education. In fact, it is not clear that these effects will disappear with more maths knowledge and business experience. Previous work showed that expertise does not always remove biases and in some cases it seems to augment such effects (e.g., Haigh & List, 2005).

7.2 Theoretical implications

The main theoretical contribution of this thesis is the addition of evidence that further specifies the conditions under which people make rational decisions in capital allocation scenarios. People made good decisions most of the time, but sometimes do not take into account important moderating factors in their decisions. Amos Tversky explained in his response to Cohen (1981, p. 355) that the work on heuristics and biases "portrayed people as fallible, not irrational." That is, people are not constantly making mistakes, but often behave rationally, largely due to adaptive heuristics. However, sometimes shortcuts that are usually helpful can fail. Studying such biases is similar to the way that optical illusions help understand the visual system. In both cases, these are systems that most of the time function properly, but sometimes reveal deficits.

Similarly, Simon (1955) identified human rationality as *bounded*, meaning that people's cognitive processes are limited. The main aim of the thesis was to contribute evidence for the ways that capital allocation decisions are bounded. To this end, in each experiment, participants were given capital allocation scenarios alongside both cues that describe their options and cues that frame the options in different ways. Identifying which cues were used by participants in their decisions, which cues were ignored, and which cues were integrated allowed to specify the bounds of people's cognitive capacity in these decisions. The experiments showed that people struggle to use certain statistical concepts in their decisions, but that they are also capable of making nuanced trade-offs and can be assisted by decision aides. Understanding how decision-making in capital allocation is constrained and biased is important in order to improve decision-making. Even if decisions are largely consistent with normative concepts, falling prey to the biases identified in this thesis can have severe consequences for organisations.

7.2.1 Statistical concepts

Chapter 2 presented participants with a capital allocation situation in which an understanding of risk aggregation would have led to beneficial outcomes. Investing in all the hypothetical projects would have led to a much higher chance of gaining money than losing any. Each choice bracketing manipulation provided a hint of the possibility of combining the choices in this way. However, participants did not need to compute the aggregated value of the prospects themselves. An intuitive understanding of aggregation involved considering that some of the gambles will pay-off and make up for those that lost. However, this was not seen, with only weak evidence that people were influenced by the more subtle choice bracketing manipulations. Instead, people only seemed to respond to the concept of aggregation when it was explicitly showcased. Showing people a distribution of the outcome probabilities explicitly visualised the extent to which an aggregation of the risks can lead to an incredibly low chance of loss.

In Chapter 4, the NPVs that participants saw were critical to the allocation task. In the low alignment condition, NPV was the only alignable attribute in the comparison. In the high alignment condition, however, NPV was in competition with the intrinsic project feature values. An understanding of how to use numerical variance would have allowed participants to moderate their allocations according to the implied reliability of the comparison metric. In the low alignment condition, NPV was the only easy way to compare across projects, so it was a more useful cue than the rest of the non-alignable values. However, in the high alignment condition, the extent of numerical variance associated with each NPV could have been used to determine NPV reliability. There were two ways to do this: 1. noticing that in the low numerical reliability condition the ranges were all overlapping, and 2. noticing the difference in the width of the ranges between the two within-subjects reliability amount conditions. By doing this, participants would have then been able to know to (in the high alignment condition) use NPV when ranges were narrow and use the intrinsic values more or exclusively when ranges were wider and overlapping.

Participants were able to do this sort of moderated allocation when reliability was expressed explicitly as words, but not when it was expressed numerically.

In Chapter 6, participants did not make use of descriptive information about the anecdote sample distribution. As in Chapter 4, participants were confronted with a conflict of cues: statistical information vs. a potentially relevant anecdote. Regardless of the similarity manipulation, a consideration of the sample from which the anecdote was sampled should have informed how the anecdote was used. Imagine a distribution that represents the similarity of all the individual projects in the sample. That is, the x-axis represents the similarity to the target project and the y-axis is the frequency of projects that represent each level of similarity. Even if the sampled anecdote appears very relevant to the target project, if the underlying distribution of the sample is highly negatively skewed, such that most projects in the sample are equivalently similar to the target, then the sampled anecdote is not necessarily more informative than the aggregated measure. On the other hand, if the underlying distribution was positively skewed, normally distributed, or even uniform, then the fact that the sampled anecdote appears highly relevant to the target project may actually mean that it is more informative than the aggregated measure. Prior work shows that people can reason about distributions effectively when experiencing the sampling directly (e.g., Carvalho et al., 2021; Hertwig et al., 2004). Chapter 6 shows that people struggle to use this information when it is described verbally.

While people struggled to understand and use certain statistical concepts they still seemed to be able to integrate multiple cues and create trade-offs. As discussed in Chapter 5, both Chapters 4 and 6 provided participants with more than one cue to use for project evaluation. In Chapter 4, people seemed to strike a trade-off between NPV and the intrinsic project features as opposed to choosing one or the other with a consistent strategy. In Chapter 6, the anecdotal and statistical evidence provided conflicting cues for each target project. However, participants allocated as if both the anecdotes and statistics had some relevance. Similar to the above, participants appeared to integrate the influence of these two cues, as opposed to picking a consistent evidence reliance strategy for their allocation decisions.

These findings might be explained through satisficing (Simon, 1955) or a constraint satisfaction model (e.g., Glöckner et al., 2014). Future research can test these explanations, as well as further clarify to what extent constructs such as need for cognition or mathematical skill may explain individual differences.

7.2.2 Decision aides

While trade-offs allow people to integrate multiple cues, decision aides allow people to use statistical concepts for more nuanced moderation. Chapter 2 found that people's understanding of risk aggregation was facilitated when the mathematical work was done for them and the aggregated values were displayed visually as a distribution. However, a follow-up experiment to Chapter 4 (detailed in Appendix B.7) found that even explicit instructions sometimes do not work. That is, even explaining the way that ranges can be used as reliability information and telling participants how to implement this in the capital allocation task did not facilitate proper use of ranges.

Future work should investigate the impact of visualisation on people's use of variance information in these situations. Much work has investigated visualising uncertainty information (Bostrom et al., 2008; Brodlie et al., 2012; T. J. Davis & Keller, 1997; Johnson & Sanderson, 2003; Kinkeldey et al., 2017; Kox, 2018; Lapinski, 2009; Lipkus & Hollands, 1999; Lipkus, 2007; MacEachren, 1992; Padilla et al., 2018; Pang et al., 1997; Potter et al., 2012; Ristovski et al., 2014; Spiegelhalter et al., 2011; Torsney-Weir et al., 2015). A Hypothetical Outcome Plot (HOP; Hullman et al., 2015; Kale et al., 2019) expresses variance information as dynamic plots and is one method that is likely to be beneficial to people's understanding of ranges as used in this thesis. Visualisation could also apply to the work in Chapter 6. Using a visual array as in Jaramillo et al. (2019) is likely to facilitate people's understanding of the importance of statistical evidence over anecdotes. However, an additional visualisation of the distribution of the underlying similarity to the target might also be necessary to facilitate understanding of the relevance of the sample distribution. Ultimately, visualisations of the effects of certain statistical concepts might be necessary for people to use them appropriately.

7.2.3 How bounded is bounded rationality?

The boundary between the cues that participants were able to use and the statistical concepts that they did not use is unclear. That is, the cues that they were able to use were not trivial, and the concepts that they were not able to use are relatively basic. For instance, the finding in Chapter 6 that people were able to use relevance information to guide their allocations shows an ability to moderate choice based on quite specific information. On the other hand, the statistical concepts that participants ignored in each empirical chapter are all relatively intuitive. While concepts of aggregation, variance, and sample distribution are typically studied at a tertiary level, they can be understood when acted out or experienced.

Clark and Karmilff-Smith (1993) proposed a distinction between two levels of representing knowledge. At the *implicit* level an individual can only make use of a certain system of knowledge, while it is only at the *explicit* level that they develop insight into that system. For instance, young children can use closed class words such as “the” or “to,” but only identify them as words later in development. Adults may have a similar distinction in knowledge representation. Concepts that can be used when experienced directly, such as in risky choice from experience, are not represented in a way that they can be used when presented descriptively, such as in risky choice from description. This kind of distinction may explain why participants in the thesis experiments failed to use concepts that have been shown to be accessible to laypeople.

7.2.4 Expertise effects

Future research should also investigate the potential expertise effects that may influence the findings of the thesis. This is important because of the potential downstream effects of biased managerial decision-making. For instance, it is unclear to what extent psychological factors such as the ones discussed in this thesis may account for the finding that undiversified firms often perform better than diversified firms. On the one hand, business professionals tend to work with numbers, so the effects found in this thesis may be less pronounced for them. For instance, Smith and Kida (1991) reviewed the heuristics and biases literature and concluded that certain cognitive biases are not as strong for accounting professionals as they are for naive participants.

On the other hand, these effects may actually be stronger in managers. For instance, Haigh and List (2005) found that professional traders show more myopic loss aversion than students. Chapter 2 showed that people tend to consider risky choices one at a time and therefore tend to be more risk averse to a set of projects than they would be if the risks were aggregated. Managers might be even more risk averse in these situations because of the increased stakes for their jobs. Lovallo et al. (2020) discussed the ways in which managers tend to have a blind spot for such project evaluations: they aggregate their personal stock market portfolio, but not their intra-firm project portfolio.

Chapter 4 found evidence of variance neglect for both laypeople and Masters of Management students. Further, in the case of the work in Chapter 6, it is possible that business managers prefer anecdotal cases to inform their decisions because of their higher salience, compared to statistical data. Managers are also more likely to feel as if the situation is relevant to them, which acording to Freling et al. (2020) would suggest more anecdotal bias.

7.3 Practical implications

The findings of this thesis have a number of potential implications for managerial decision-making. Despite the uncertainty about potential expertise effects, this section assumes that the findings of the thesis generalise to experienced managers, if not in degree, at least qualitatively. Management researchers have suggested ways of overcoming psychological biases in managerial decision-making ever since such biases were identified. Many practitioner-oriented papers have used the findings of the judgement and uncertainty literature both to explain managerial decision-making processes and to suggest ways of reducing bias (Courtney et al., 1997; Courtney et al., 2013; Hall et al., 2012; Koller et al., 2012; Lovallo & Sibony, 2014; Sibony et al., 2017), with only some specifically focused on capital allocation decisions (Birshan et al., 2013). This section will review some of the implications the findings of this thesis may have on both organisational policies and manager decision-making.

The findings of Chapter 2 show that the way that the framing of business project proposals important for the way that people perceive their risk. Specifically, in order to better account for the risks of business projects it is important to 1. make it easier for managers to group projects together, and 2. aggregate a portfolio of projects for them. This suggests implementing organisational changes that will facilitate the capital allocation process. For instance, Lovallo et al. (2020) suggested that companies change the frequency that they evaluate projects to better allow for an aggregation of the projects. Doing this will enable an explicit computation of the aggregated values and therefore a visualisation of the outcome probability distribution. Such a process could facilitate aggregation without a need to rely on managers' intuition during sequential project evaluation decisions.

One implication of Chapter 4 is that it is important to expose the variance that underlies abstract financial measures. Further, translating such numerical variance estimates into clear verbal information would help facilitate managers' understanding and implementation of such estimates. Organisational changes could include reducing diversification so that there is less reliance on abstract metrics. This would allow for more of a comparison between alignable project attributes, potentially reducing forecast error. Koller et al. (2017) found that companies with more similar business units report faster growth and greater profitability than competitors, compared to companies with dissimilar business units. Further, companies can also work to develop better metrics and establish norms about how much to discount a metric given its underlying variance.

The main implication of Chapter 6 is that managers should pay attention to the way that they compare target projects to other cases. It is important to collect prior cases that are relevant, and to have as many such cases as possible. Ideally, each such prior case should be weighed by similarity (Lovallo et al., 2012). If this is done, the prior distribution of the similarity of the sample would be taken into account when computing subsequent aggregation. When identifying such similarity ratings, it is important to focus on relevant underlying structure. This would reduce any erroneous connections to cases that only have a mere surface similarity. This distinction is also relevant in a situation in which only one prior case can be found. Research on analogy shows that analogical comparison helps expose the underlying relational structure between objects (e.g., Kurtz et al., 2013; Markman & Gentner, 1993). Therefore, managers should take care to first identify such relational structures first before making subsequent inferences.

Addressing these psychological effects will help eliminate some of the biases in the capital allocation process, but will not address other related biases. For instance, the above effects all involve decisions that require an evaluation of financial forecast estimates such as future cash flows and the related uncertainty. Therefore, a further source of error could arise from the initial estimation of these probability and cash flow values. For instance, such estimates could be influenced by optimism or confidence biases. These biases, however, can in turn be addressed (Flyvbjerg et al., 2018).

7.4 Conclusion

Capital allocation decisions can be consequential for large organisations. This thesis tested the conditions under which people behave rationally or are fallible when allocating capital. The experiments found that people struggle to incorporate concepts such as risk aggregation, estimate variance, and sample distribution into their decisions. People only seemed to be able to do this when the concept was expressed visually very explicitly. However, when there were multiple cues for choice evaluation, the results also showed that people were capable of integrating conflicting information in their decisions. Identifying such cognitive bounds helps to better understand how people evaluate multiple choices and helps future research develop methods to facilitate better decisions.

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A

Chapter 2 appendix

Contents

This appendix contains supplementary materials and analyses for the two experiments reported in Chapter 2. In addition, it also report two experiments that were conducted to follow-up the findings in Experiments 1 and 2. Both follow-up experiments tested project choice as in the first two experiments, but Experiment 3 further investigated the effect of similarity, and Experiment 4 further investigated the effect of awareness.

All four experiments featured probability outcome distributions. These were

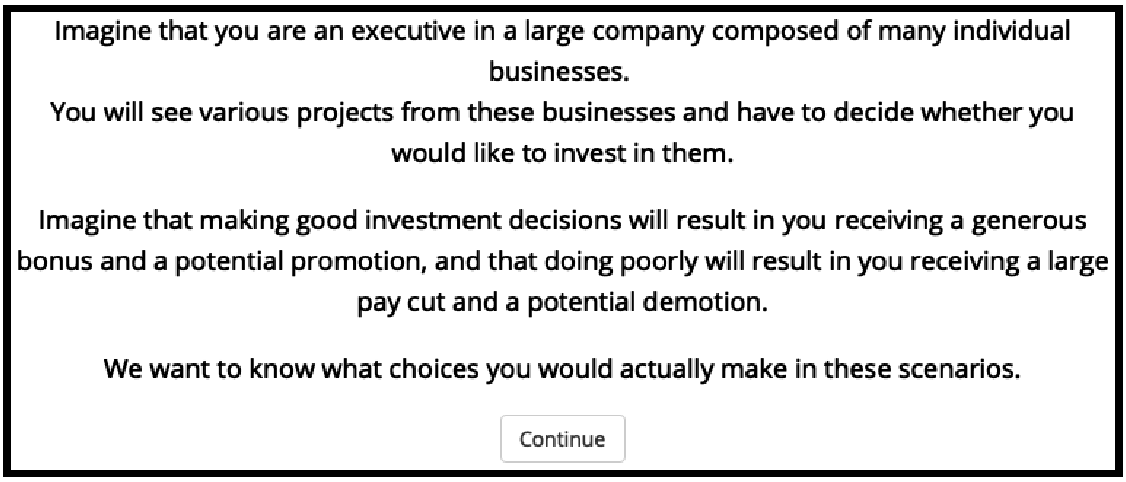


Figure A.1: Experiment 1 instructions. Border added for clarity.

Poisson binomial distributions that were calculated using the R package `poibin`, which uses calculations described in Hong (2013).

A.1 Experiment 1

A.1.1 Method

Materials

Instructions Participants were shown the instructions in Figure A.1.

Outcome distribution decision Figure A.2 shows the outcome distribution display that participants saw in Experiment 1.

Follow-up gambles

Negative EV gambles It was important to make sure that participants were generally making decisions that were in line with EV theory and that the sample was not abnormally risk tolerant. As such, participants saw two project decisions that had a negative EV. Out of the 396 negative EV gambles included (two per participant), all but four were rejected.

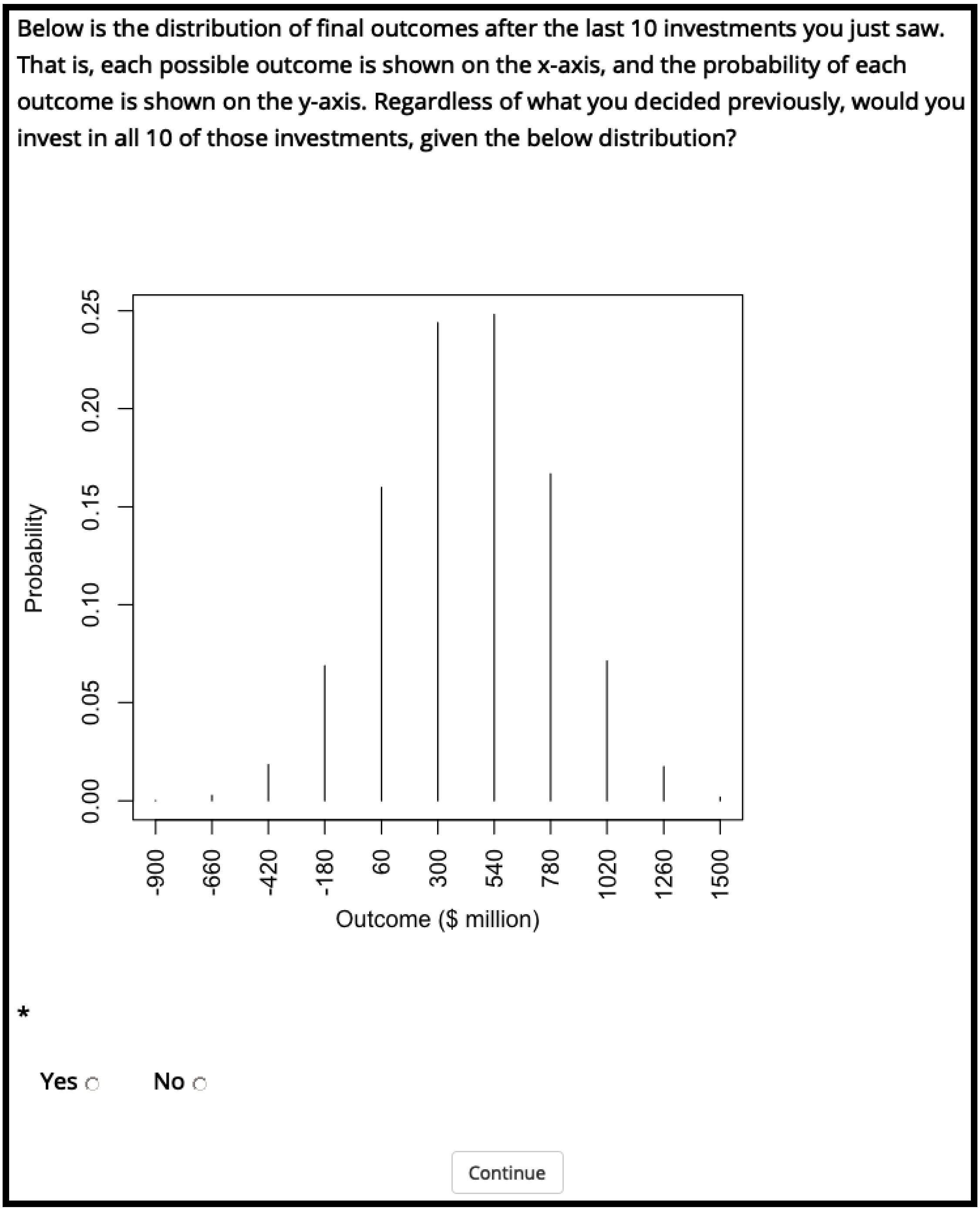


Figure A.2: The outcome distribution of the 10 gambles used in Experiment 1. Border added for clarity.

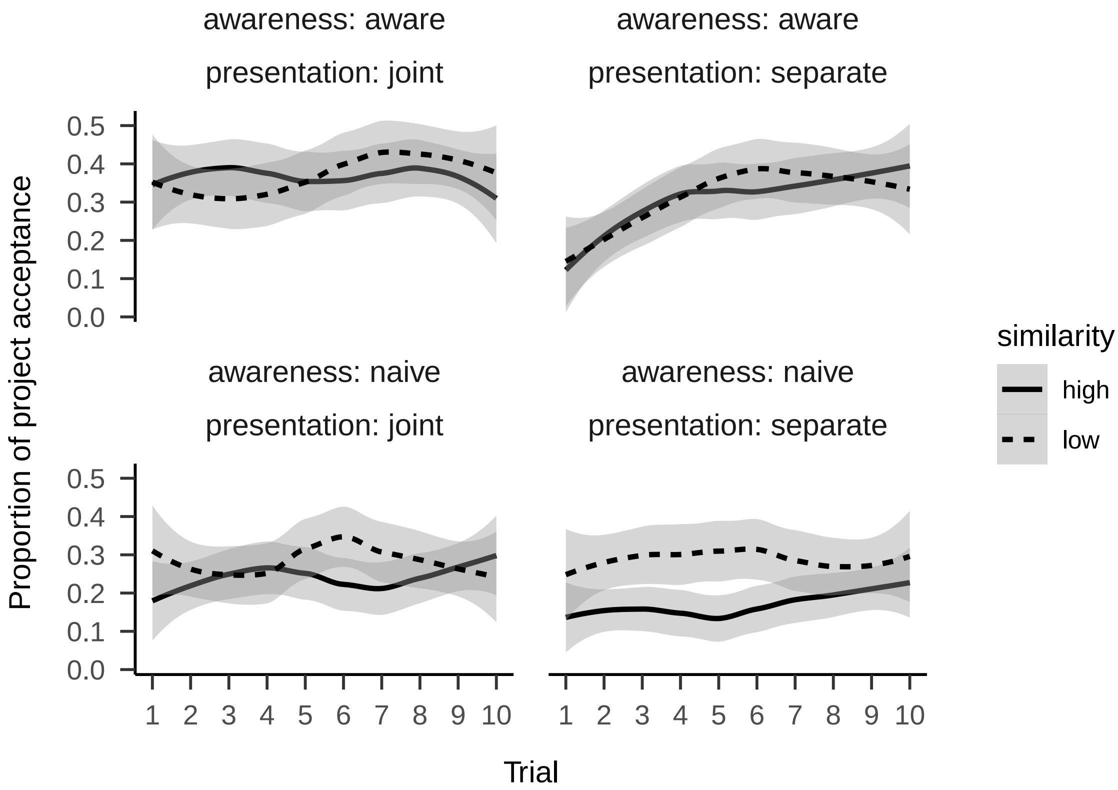


Figure A.3: Proportion of project acceptance by trial, similarity, awareness, and presentation conditions. LOESS is used for smoothing over trials, and the shading represents 95% confidence intervals.

Samuelson (1963) gambles Participants saw the original Samuelson (1963) gamble, were asked whether they would accept 10 of that gamble, and whether they would accept those 10 given the associated outcome distribution. They then saw the same three questions, but using outcome magnitudes that were similar to the ones in the risky investment task. That is, $100 million instead of $100.

Redelmeier and Tversky (1992) gambles Participants saw the same three types of gambles (single, 10, and aggregated), but with the values from the gambles that were used by Redelmeier and Tversky (1992).

A.1.2 Results

Trial-by-trial analysis

Figure A.3 shows proportions of project acceptance across all conditions and trials.

Outcome distribution

A paired-samples t-test was conducted to compare participants' decision to invest in the 10 projects while seeing an aggregated distribution, and their decisions to invest in the projects individually, without the distribution. Participants invested in the 10 projects more when seeing the distribution both in the separate presentation phase, $t(197) = 5.48$, $p < .001$, $d_z = 0.50$, 95% CI $[0.31, 0.68]$; and in the joint presentation phase, $t(197) = 4.17$, $p < .001$, $d_z = 0.37$, 95% CI $[0.19, 0.56]$.

However, it was subsequently discovered that the code that generated this distribution mistakenly flipped the outcome values. This means that although it appeared from the distribution that the probability of loss was 0.09, the actual probability of loss of the underlying values given the correct distribution was 0.26. As such, even though Experiment 1 found an effect of distribution, it was unclear if the effect was driven by participants actually accurately assessing the riskiness of the individual gambles, and therefore showing a difference between the isolated and aggregated gambles in a normative way.

A.2 Experiment 2

A.2.1 Method

Participants

Power analysis The power analysis was conducted using the `pwr` package (Champely, 2020), based on the presentation effect size from Experiment 1, since it was the smallest effect. The analysis suggested that a minimum sample size of 164 ($41 \cdot 4$) was required for the presentation effect with an expected power of at least 80%.

Materials

Follow-up Figure A.4 shows the project number question. The maximum value that they could enter was set to 20. Figures A.5 and A.6 ask participants whether they are willing to take all or none of the projects; and how many projects would they choose if they could pick randomly (maximum value was set to 20). Those

Figure A.4: Experiment 2 project number question. Border added for clarity.

in the distribution absent condition were asked the same questions, but without the distribution and its explanation.

A.2.2 Results

Follow-up

Project number Participants were asked how many projects they thought they saw. Figure A.7 shows that overall people correctly estimated the number of projects, with more accuracy for those in the aware condition.

Portfolio choice - binary Participants were then asked if they would rather invest in all or none of the projects. As Figure A.8 shows, the difference between presentation conditions was not significant, $\hat{\beta} = -0.30$, 95% CI $[-1.19, 0.58]$, $z = -0.67$, $p = .500$. The awareness effect was also not significant, $\hat{\beta} = -0.55$, 95% CI $[-1.44, 0.34]$, $z = -1.21$, $p = .225$. However, those that that saw a distribution chose to invest in all 10 projects significantly more (71.43%) than those that did not see a distribution (36.59%), $OR = 4.33$, 95% CI $[1.76, 11.24]$, $z = 3.11$, $p = .002$.

Portfolio choice - number Subsequently, participants were asked how many projects they would invest in out of the 10 that they saw. As Figure A.9 shows, the difference between presentation conditions was not significant, $d_s = 0.08$, 95% CI [-0.35, 0.52], $t(80) = 0.38$, $p = .706$. The awareness effect was also not significant, $d_s = 0.09$, 95% CI [-0.34, 0.53], $t(79) = 0.42$, $p = .678$. However, those that that saw a distribution chose to invest in significantly more projects than those that did not see a distribution, $d_s = 0.60$, 95% CI [0.15, 1.03], $t(81) = 2.70$, $p = .009$.

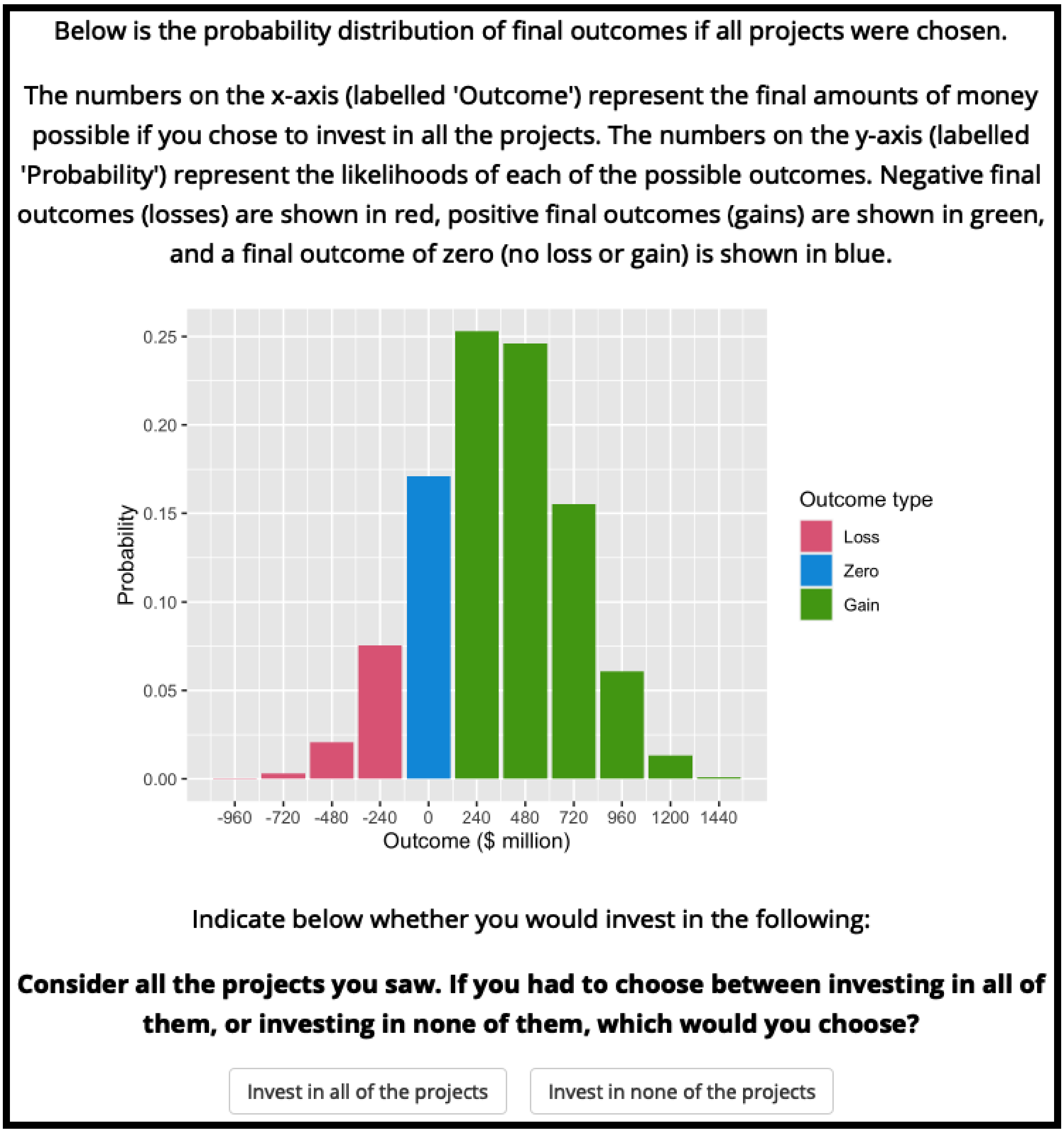


Figure A.5: Experiment 2 binary portfolio question. Border added for clarity.

Gambles

Figures A.10 and A.11 show that the overall people seemed to prefer gambles with higher probabilities of gain, sometimes regardless of expected value or value of the gain.

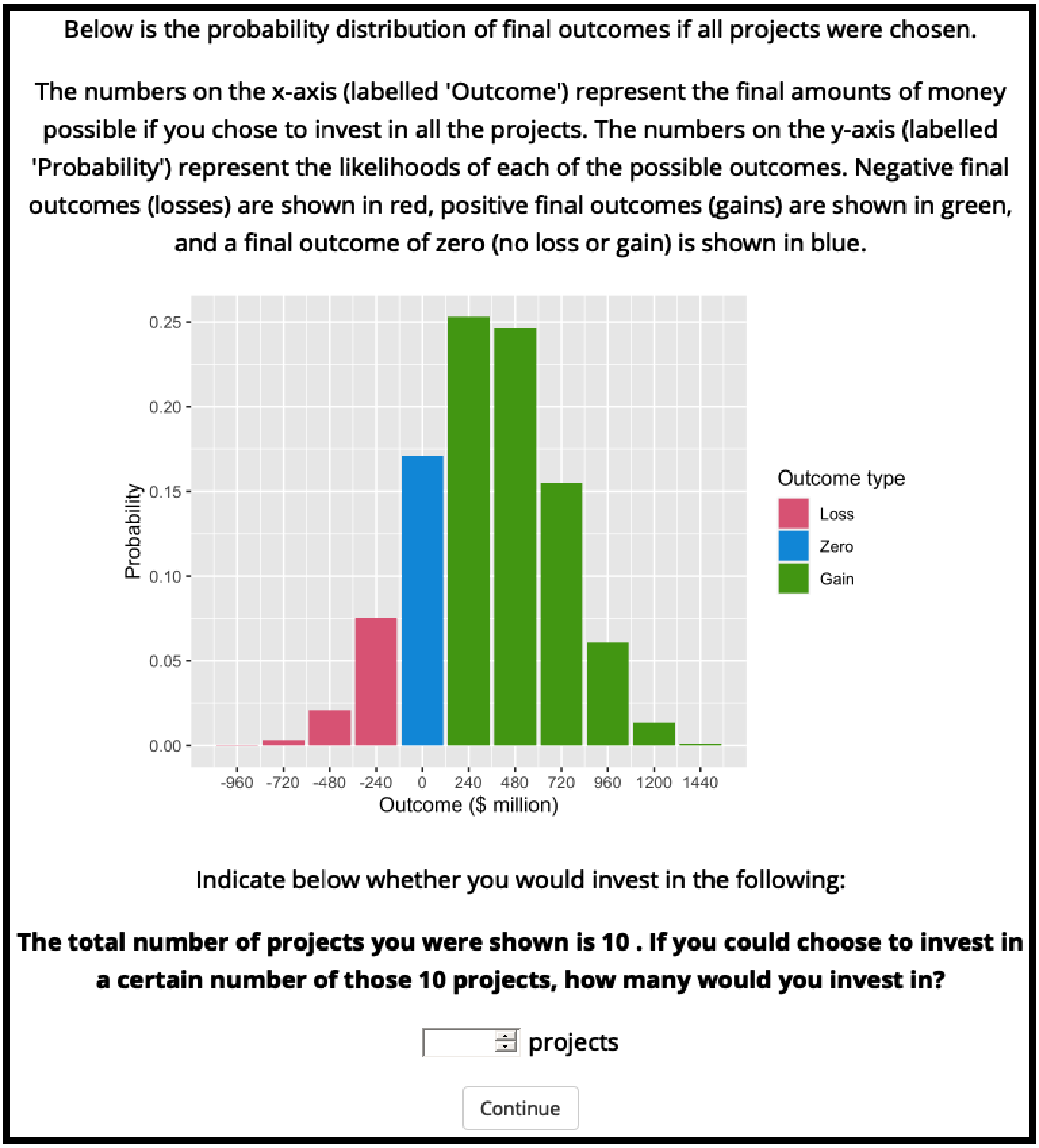


Figure A.6: Experiment 2 numerical portfolio question. Border added for clarity.

A.3 Experiment 3

Experiment 3 investigated the effect of similarity on project choice. The previous experiments did not counterbalance the project domain when displaying the 10 projects to participants. Experiment 3 used 10 different potential business domains when constructing the project descriptions in order to reduce any potential effect that the specific domain may have on people's choice. Therefore, Experiment 3

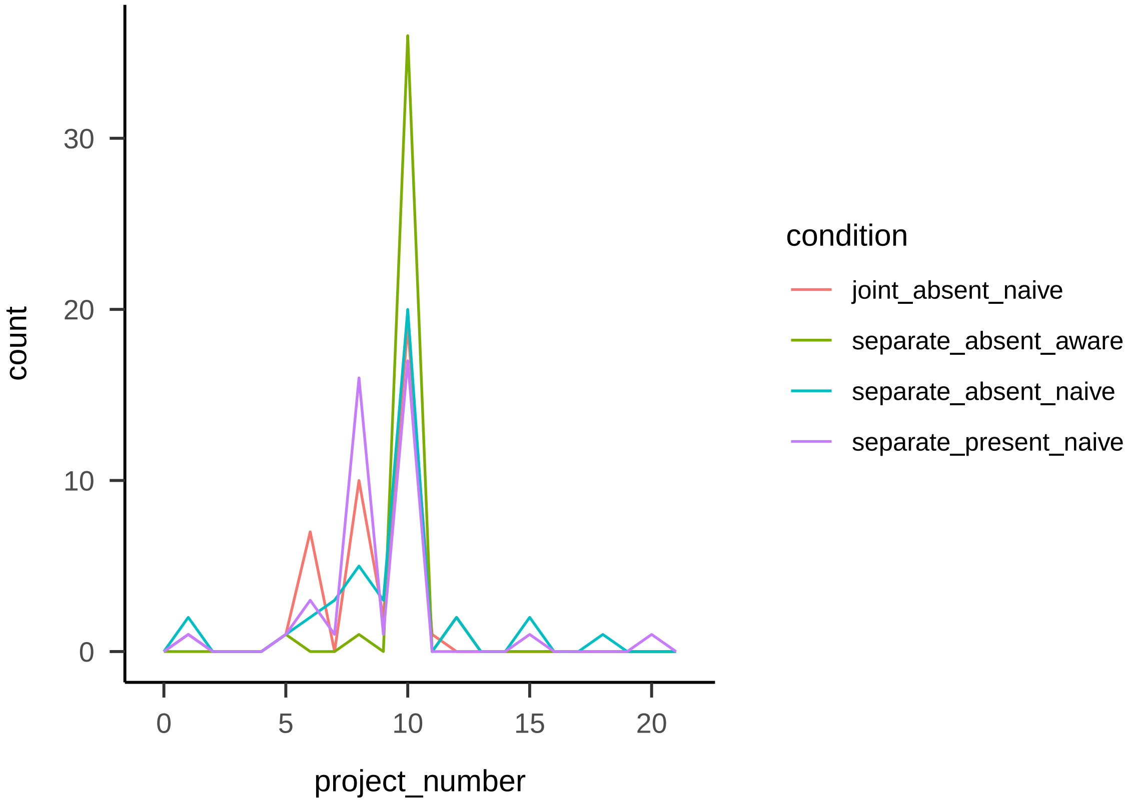


Figure A.7: Number of projects participants reported seeing, by condition.

again tested Hypothesis 2.3.

A.3.1 Method

Participants

Two hundred and sixty-six people (127 female) were recruited from the online recruitment platform Prolific. Participants were compensated at a rate of £5 an hour. The average age was 39.56 (SD = 8.77, min = 25, max = 71). Participants reported an average of 5.64 (SD = 6.45, min = 0, max = 40) years of work in a business setting, and an average of 3.28 (SD = 4.92, min = 0, max = 30) years of business education. The mean completion time was 9.23 (SD = 7.2, min = 1.41, max = 65.46) minutes. Table A.1 shows the between-subjects condition allocation.

Materials

Instructions Participants were shown the same instructions as in Experiment 1 (see Section 2.2.1).

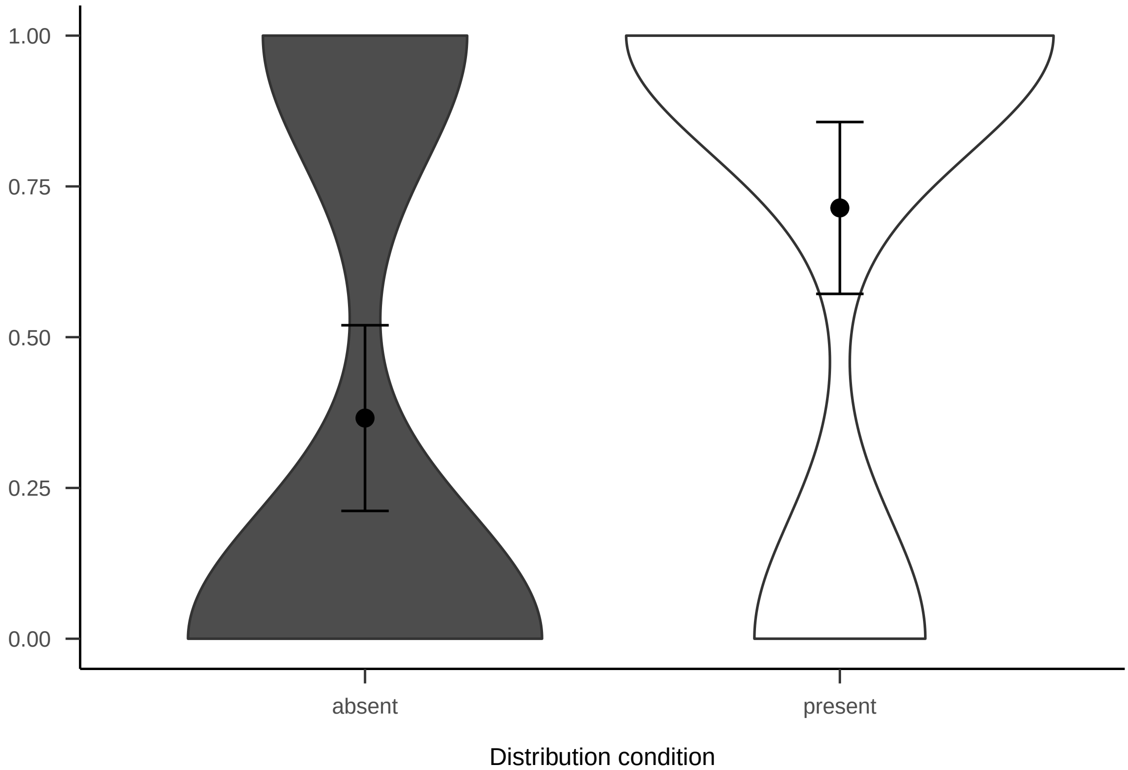


Figure A.8: Mean choice of investing in all 10 projects for the presentation, awareness, and distribution effects. Note, the condition on the left of each effect is the reference condition (separate presentation, naive awareness, distribution absent). As such, it is identical for the three effects.

Table A.1: Experiment 3 group allocation.

Similarity	N
High	133
Low	133
Total	266

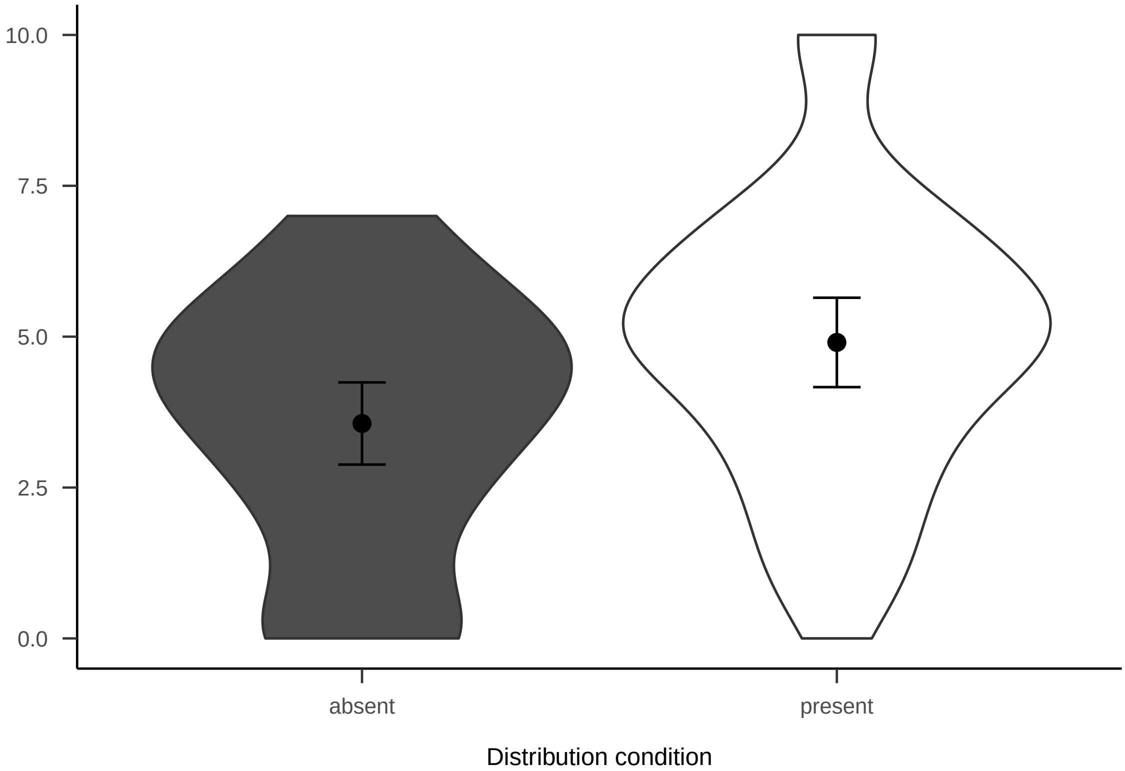


Figure A.9: Mean number of projects chosen in the follow-up for the presentation, awareness, and distribution effects. Note, the condition on the left of each effect is the reference condition (separate presentation, naive awareness, distribution absent). As such, it is identical for the three effects.

Risky investment task Participants saw displays with the same gamble values as those in Experiment 2 (see Section 2.3.1), but with some changes in wording and sentence structure. The gamble information was the same, but extra prose was added to describe the projects. Further, the order of the sentences was randomised, so that the descriptions would not appear so similar. See Figure A.12 for an example.

The similarity manipulation was as in Experiment 1. However, project domain was varied so that in the high similarity condition participants saw one of ten project domains.

Follow-up The follow-up questions were similar to those in Experiment 2 (see Section 2.3.1), except in the portfolio number question participants were also shown the total number of projects that they saw (10). Further, another question was added, asking how many projects participants were expecting to see at the

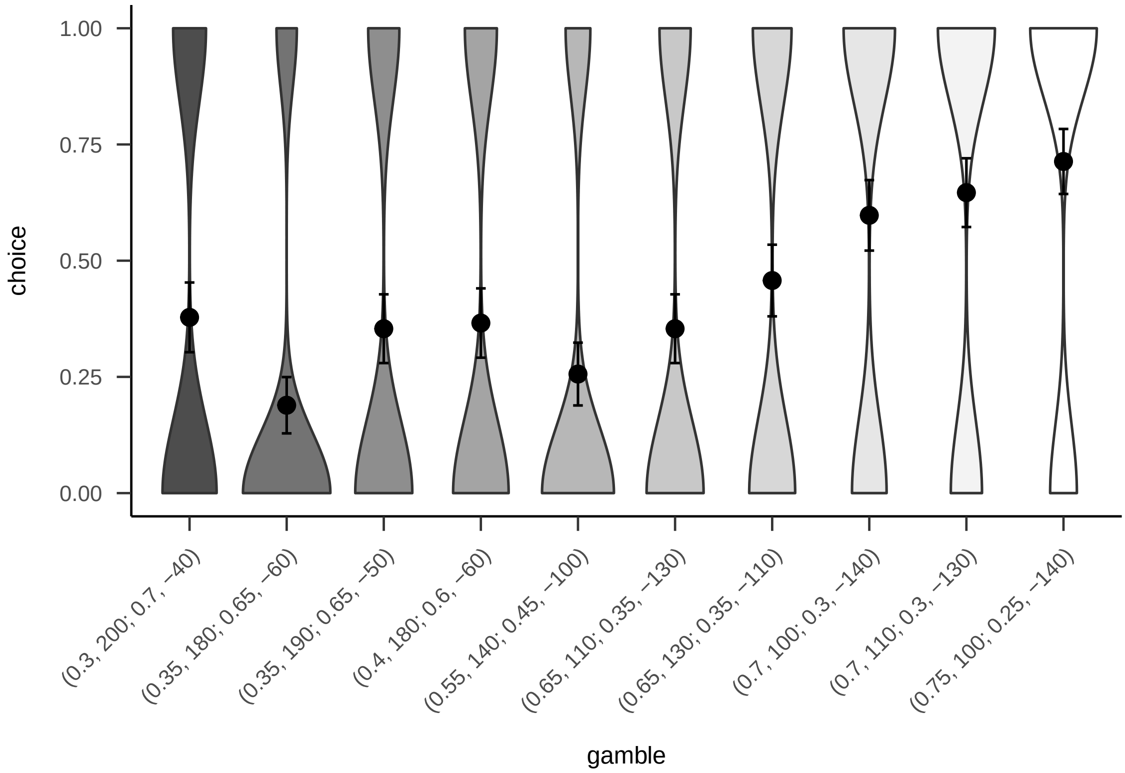


Figure A.10: Mean project acceptance for the 10 gambles. The format of the labels indicates: (gain probability, gain value; loss probability, loss value).

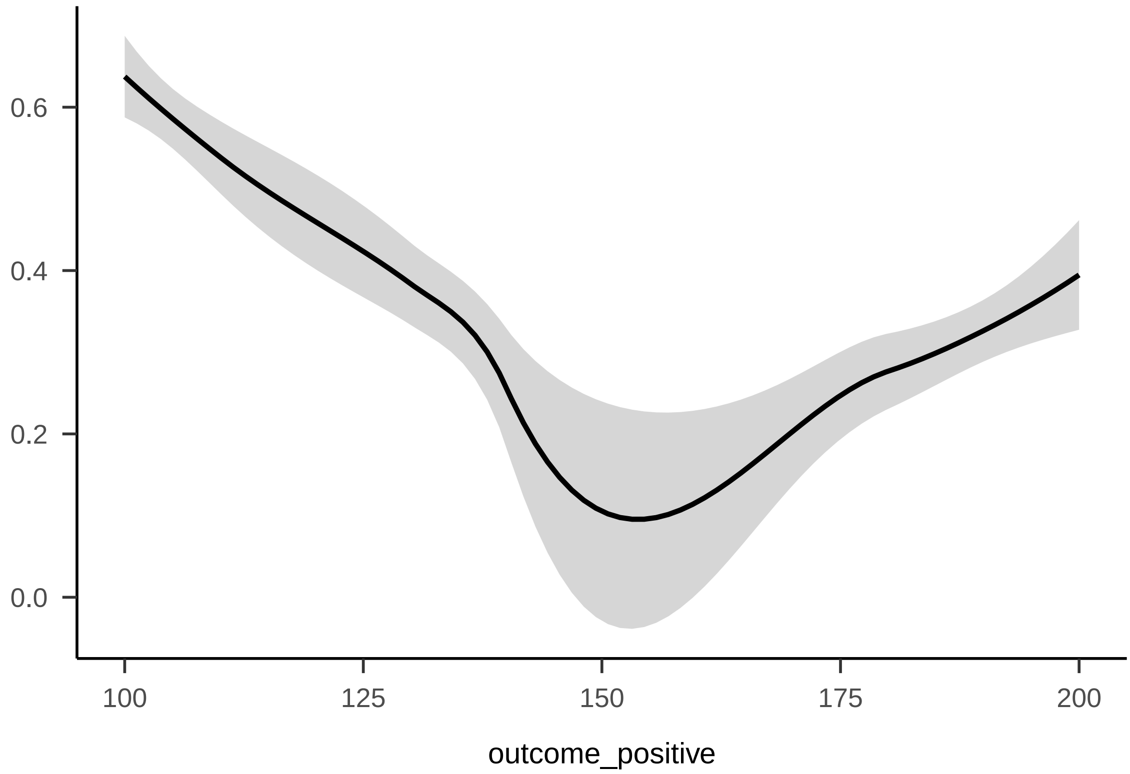
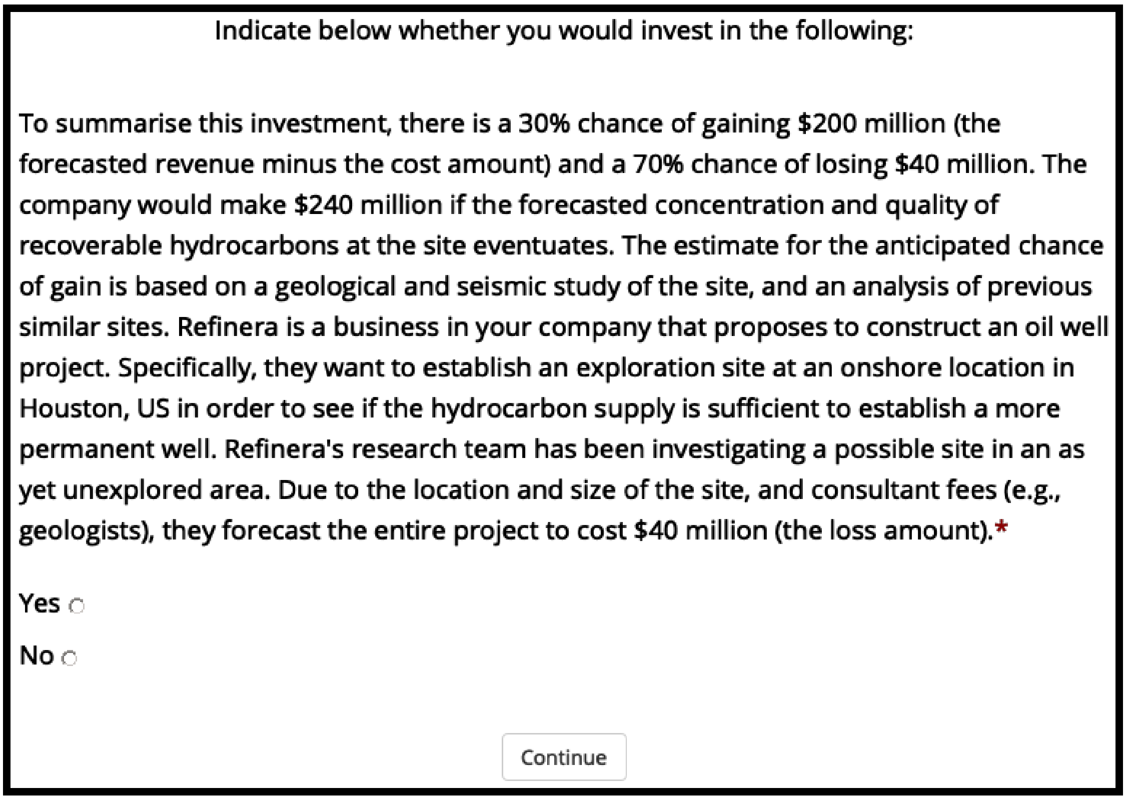


Figure A.11: Mean project acceptance for the gambles' expected value, positive probability, and positive outcome.



Indicate below whether you would invest in the following:

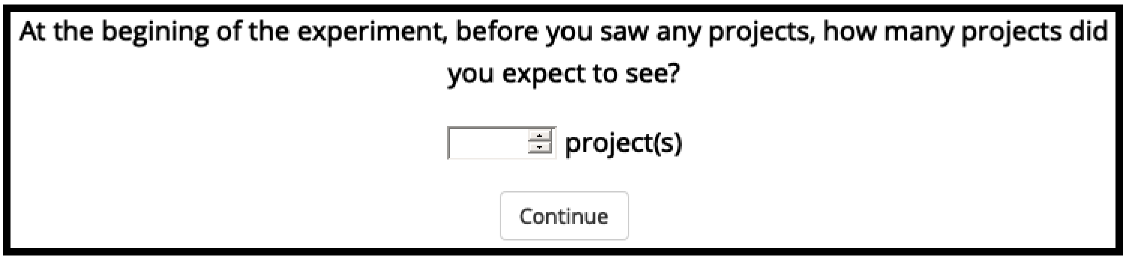
To summarise this investment, there is a 30% chance of gaining $200 million (the forecasted revenue minus the cost amount) and a 70% chance of losing $40 million. The company would make $240 million if the forecasted concentration and quality of recoverable hydrocarbons at the site eventuates. The estimate for the anticipated chance of gain is based on a geological and seismic study of the site, and an analysis of previous similar sites. Refinera is a business in your company that proposes to construct an oil well project. Specifically, they want to establish an exploration site at an onshore location in Houston, US in order to see if the hydrocarbon supply is sufficient to establish a more permanent well. Refinera's research team has been investigating a possible site in an as yet unexplored area. Due to the location and size of the site, and consultant fees (e.g., geologists), they forecast the entire project to cost $40 million (the loss amount).*

Yes

No

Continue

Figure A.12: An example of a project display in Experiment 3. Border added for clarity.



At the begining of the experiment, before you saw any projects, how many projects did you expect to see?

project(s)

Continue

Figure A.13: Experiment 3 project expectation question. Border added for clarity.

beginning of the experiment (see Figure A.13).

Procedure

Participants read the instructions and completed the risky investment task in their respective conditions. After seeing the individual projects, participants were then asked the four follow-up questions.

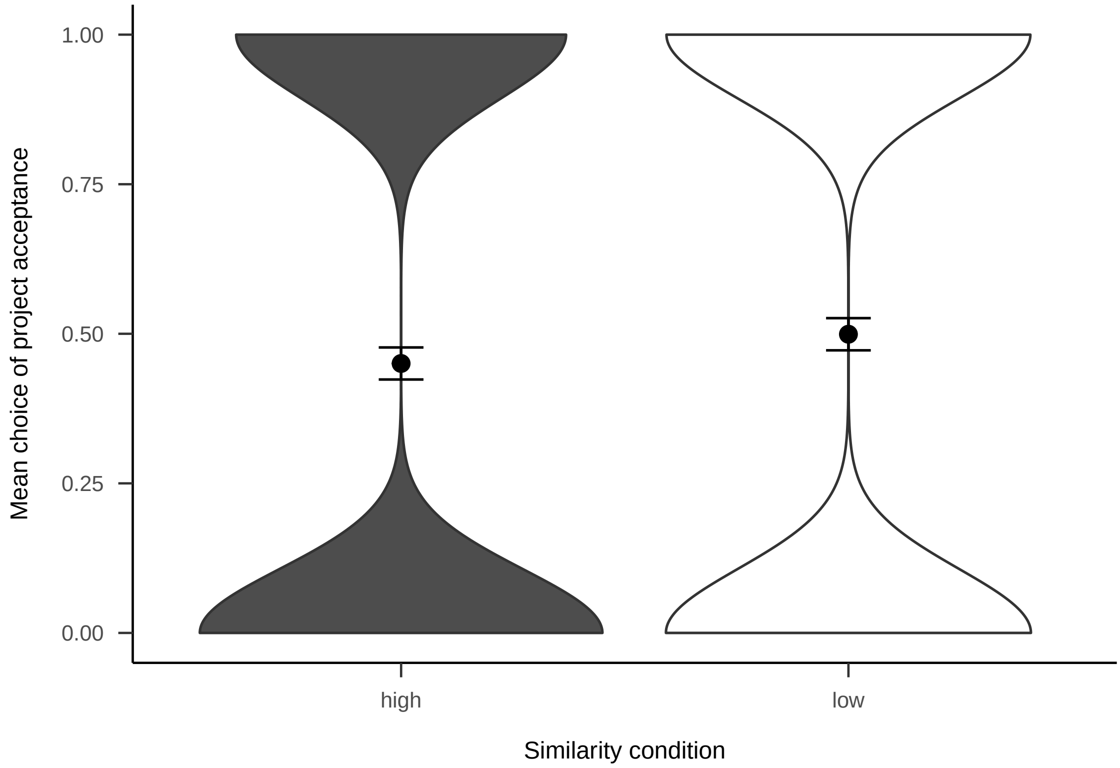


Figure A.14: Mean project acceptance for the similarity effect.

A.3.2 Results

Project investment

The project investment data were analysed as in Experiment 2 (see Section 2.3.2). Figures A.14 and A.15 show the choice and proportion data, respectively. The difference between similarity conditions was not significant, both in the logistic regression $b = 0.00$, 95% CI $[-0.18, 0.17]$, $z = -0.04$, $p = .966$, and in the t-test, d_s = -0.21, 95% CI [-0.45, 0.03], $t(264)$ = -1.69, p = .093.

Further, Figure A.16 shows the choice data as a function of the order of the project in the sequence. As Table A.2 shows, there were no main effects or interactions.

Follow-up

Project expectation Participants were asked how many projects they expected to see. As Figure A.17 shows, the difference between similarity conditions was not significant, d_s = -0.23, 95% CI [-0.47, 0.01], $t(264)$ = -1.85, p = .065.

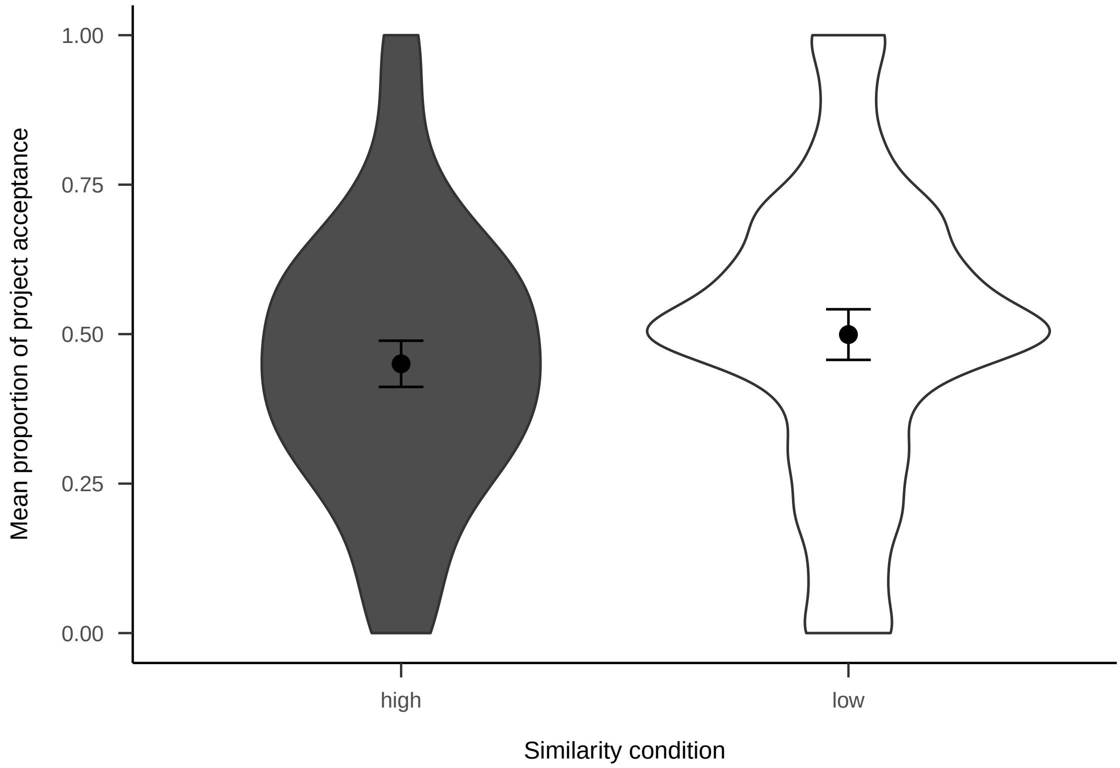


Figure A.15: Mean proportion of project acceptance for the similarity effect.

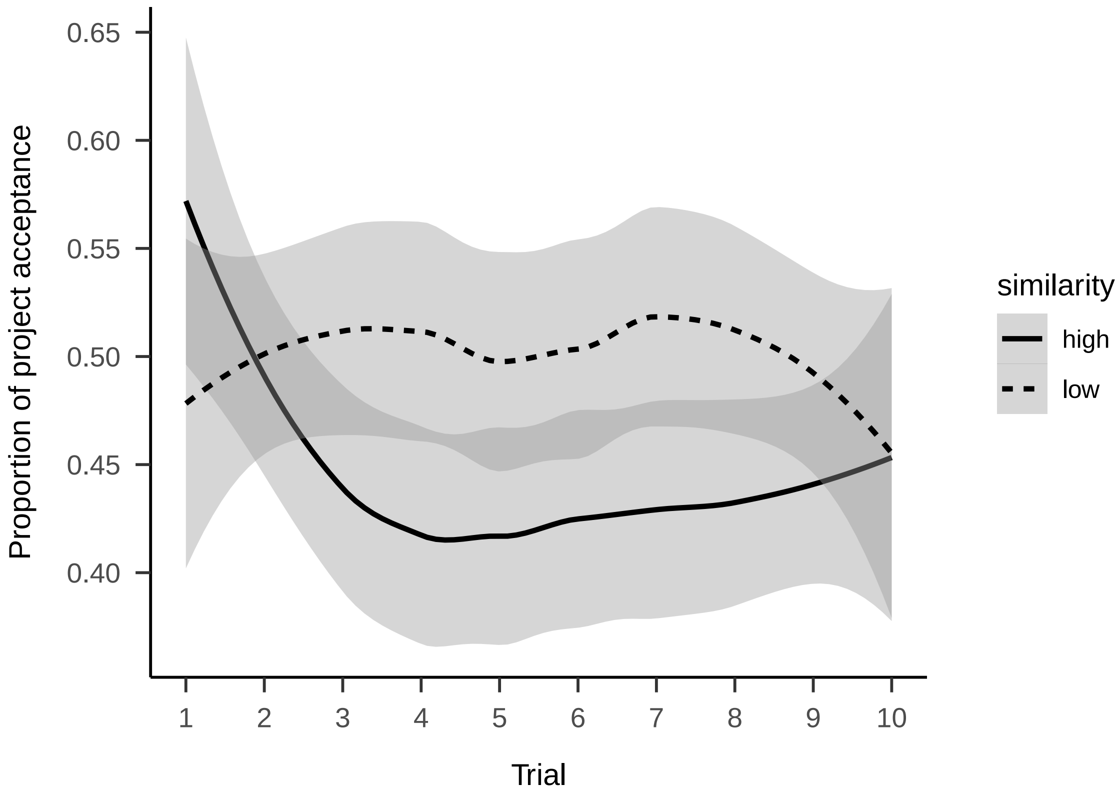


Figure A.16: Mean project acceptance by similarity and trial.

Table A.2: Logistic regression table of project acceptance by similarity and trial.

Term	$\hat{\beta}$	95% CI	z	p
Intercept	0.01	[-0.20, 0.22]	0.07	.944
Similarity1	-0.02	[-0.23, 0.18]	-0.22	.826
Project order	-0.02	[-0.05, 0.01]	-1.52	.127
Similarity1 × Project order	-0.02	[-0.05, 0.01]	-1.07	.284

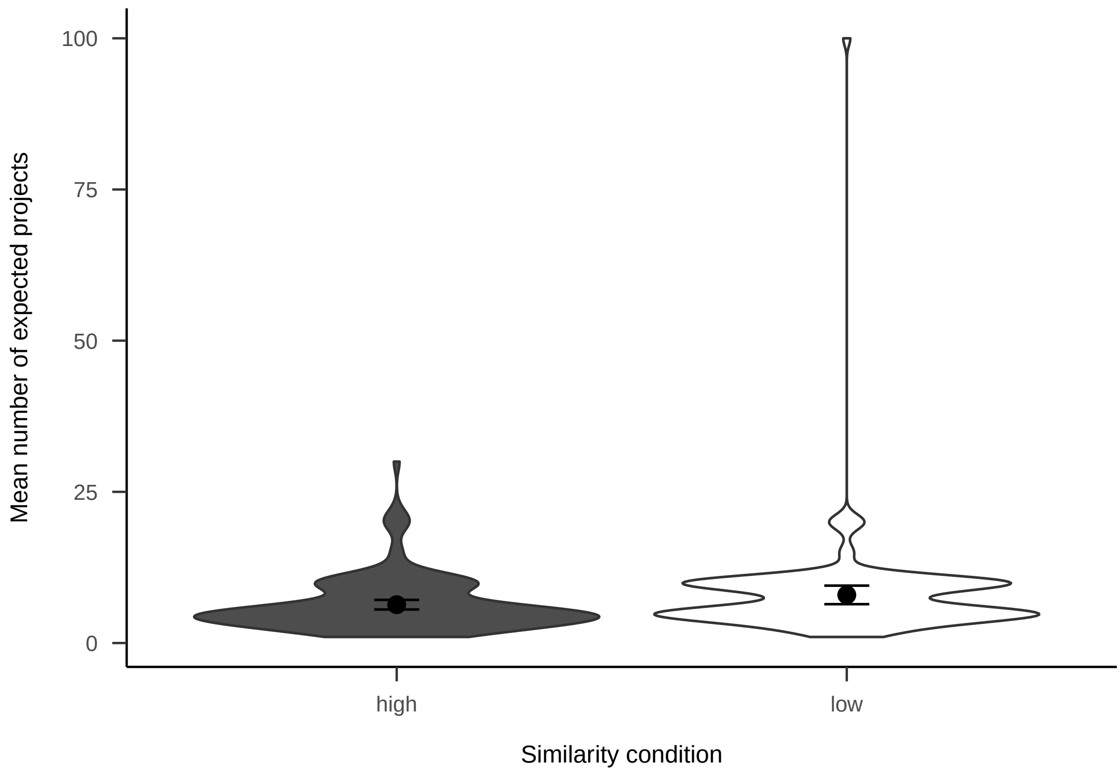


Figure A.17: Number of projects participants expected to see, by similarity.

Project number Participants were asked how many projects they thought they saw. Figure A.18 shows that overall people correctly estimate the number of projects.

Portfolio choice - binary Participants were then asked if they would rather invest in all or none of the projects. As Figure A.19 shows, those in the low similarity condition were significantly more likely to want to invest in all of the projects, $b = -0.26$, 95% CI $[-0.51, -0.02]$, $z = -2.10$, $p = .036$.

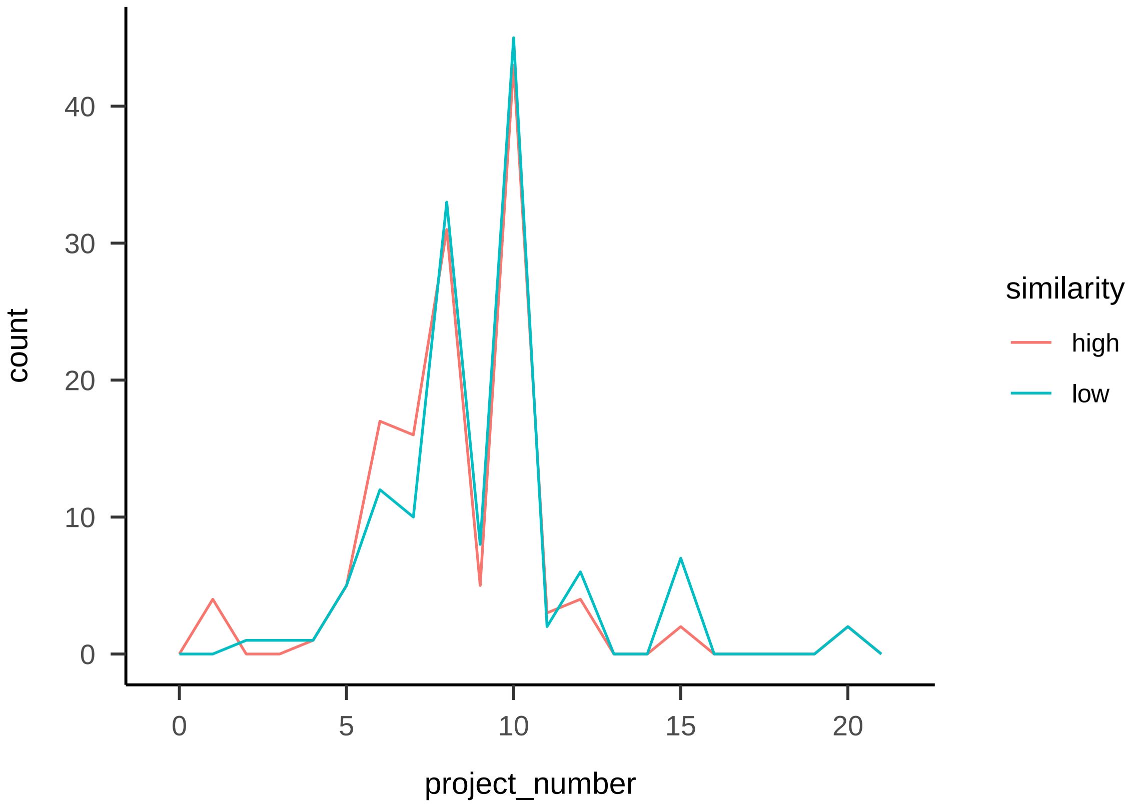


Figure A.18: Number of projects participants reported seeing, by similarity.

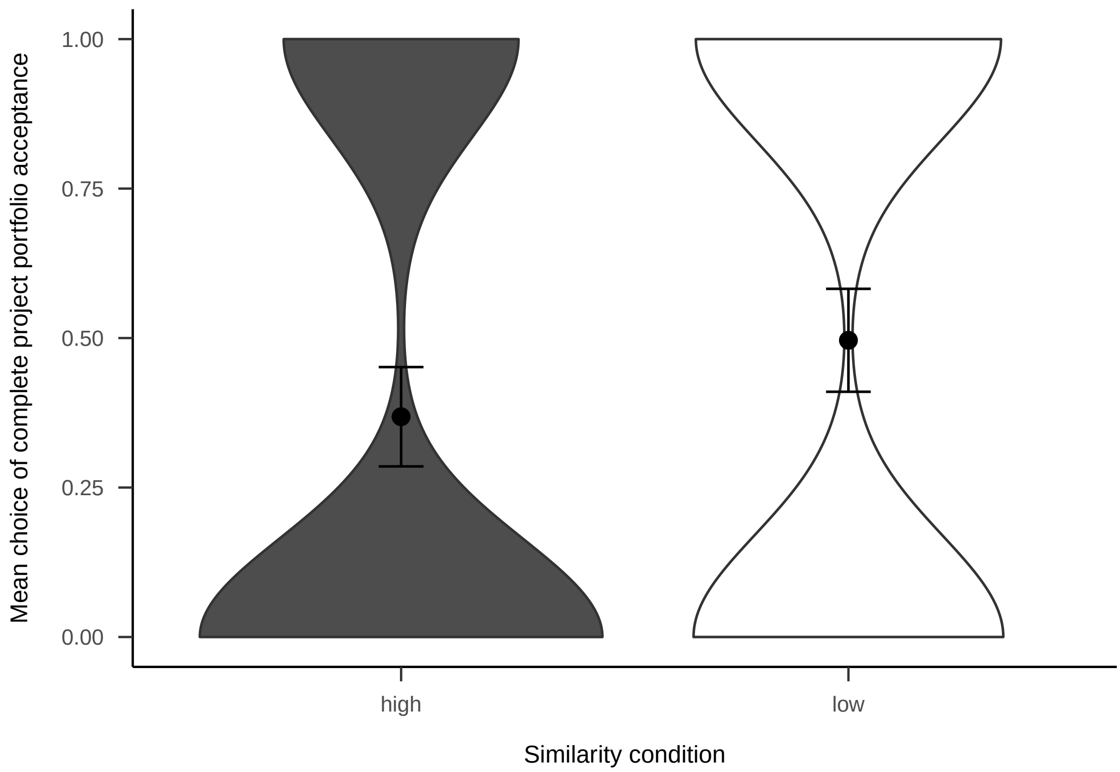


Figure A.19: Mean choice of investing in all 10 projects for the similarity effect.

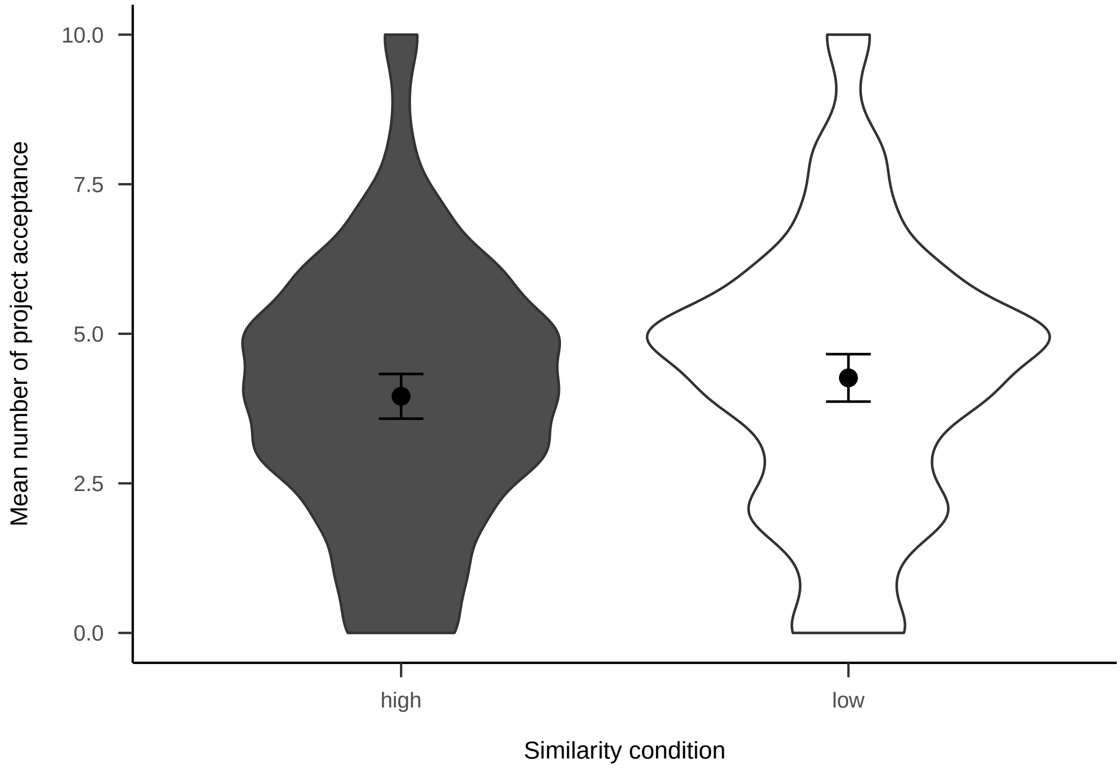


Figure A.20: Mean number of projects chosen in the follow-up for the similarity effect.

Portfolio choice - number Subsequently, participants were asked how many projects they would invest in out of the 10 that they saw. As Figure A.20 shows, the difference between similarity conditions was not significant, d_s = -0.14, 95% CI [-0.38, 0.10], $t(264)$ = -1.12, p = .264.

Gambles

Figures A.21 and A.22 show the overall people seemed to prefer gambles with higher probabilities of gain, sometimes regardless of expected value or value of the gain.

A.3.3 Discussion

Experiment 3 found some evidence for the effect of similarity on project choice, but it was in the opposite direction to the one hypothesised. Specifically, the results showed that when considering projects individually, participants' risk aversion did

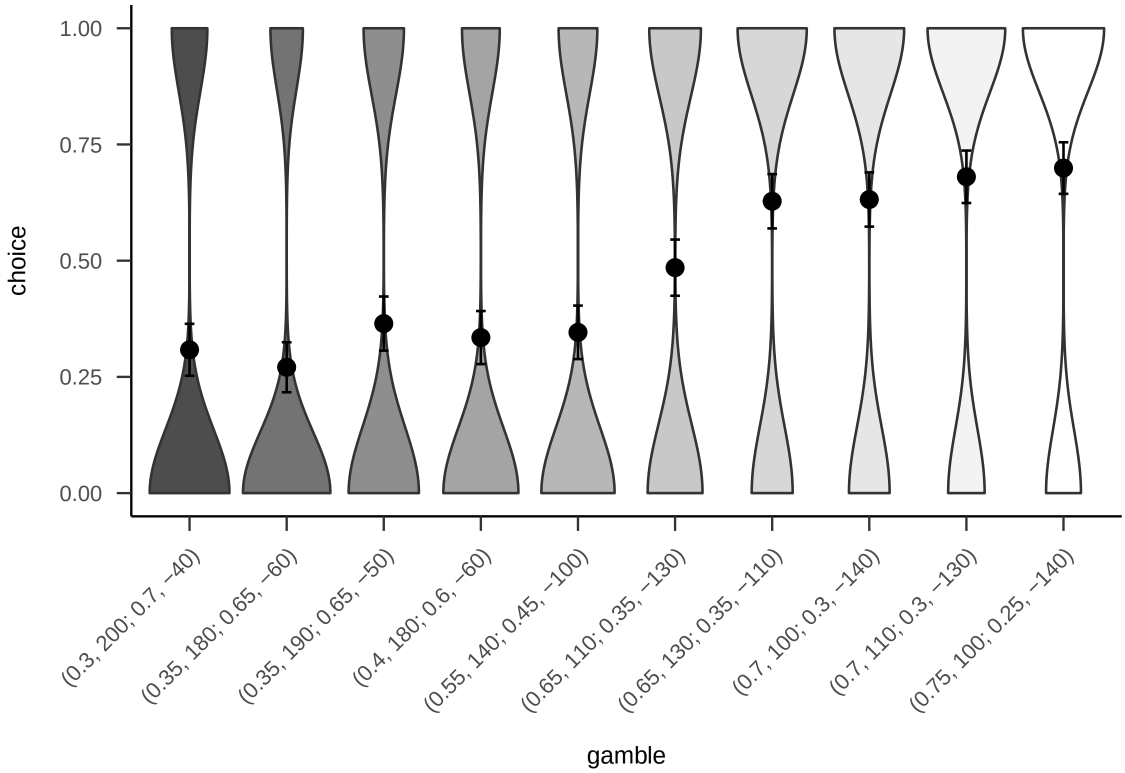


Figure A.21: Mean project acceptance for the 10 gambles. The format of the labels indicate: (gain probability, gain value; loss probability, loss value).

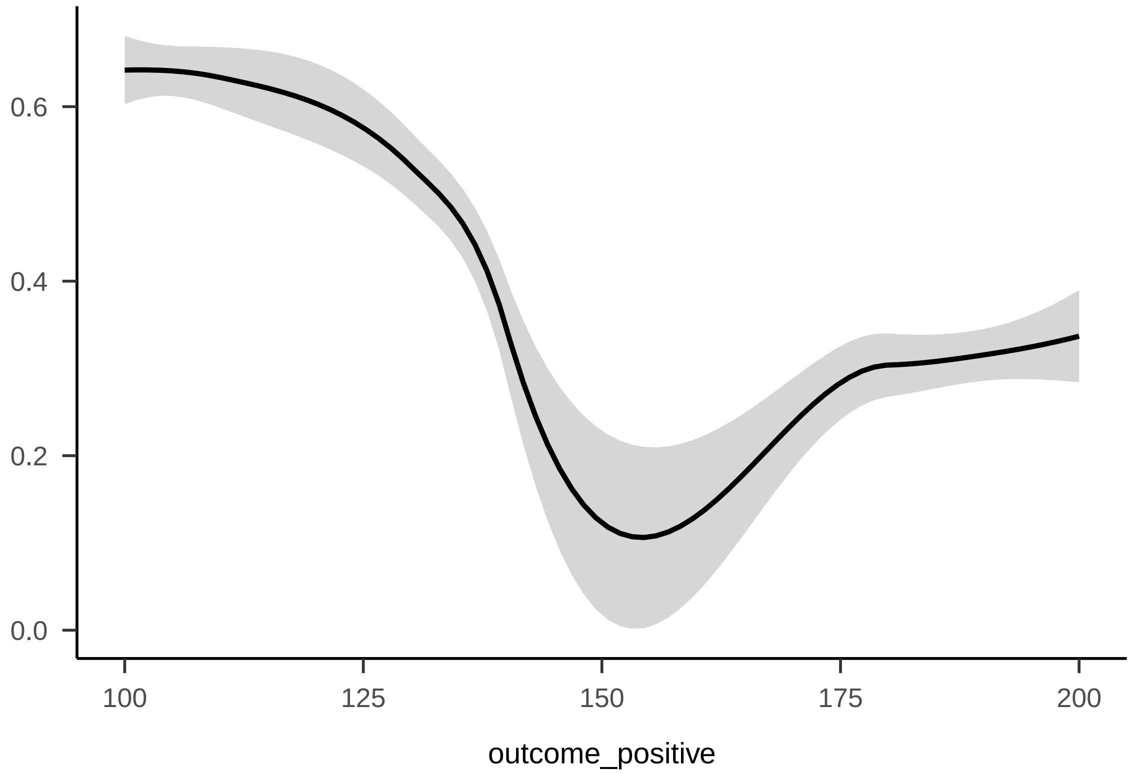


Figure A.22: Mean project acceptance for the gambles' expected value, positive probability, and positive outcome.

not differ between similarity conditions, but when offered a portfolio of the projects, those that saw the dissimilar projects were more likely to invest.

These results provide evidence for the naive diversification account expressed above (see Section 2.2.3). Specifically, participants may really be naively diversifying, but only when they are explicitly given an opportunity to do so. This is similar to the multi-play effects because the question itself provides a sort of choice bracketing. That is, the gambles are grouped together as a portfolio by the question. Together, this suggests that people are not naively aggregating when viewing gambles in isolation, but when the choices are bracketed explicitly, then the choice seems to be driven by a naive diversification.

A.4 Experiment 4

Experiment 4 investigated the effect of awareness on project choice. Experiment 1 found an effect of awareness in the trial-by-trial data that was not replicated in Experiment 2. Above, this effect was explained through the law of small numbers: people may have been anticipating less risky gambles towards the end of the set. As such, the effect could be seen with more trials. Experiment 4 attempted to replicate the effect from Experiment 1 with 20 projects. The *naive* condition attempted to encourage participants to focus on projects one at a time and did not reveal the total number of projects. The *aware* condition attempted to encourage participants to think of all 20 projects. This was done by revealing the total number of projects in the beginning of the task and by identifying at each project display its order in the sequence. Experiment 4 again tested Hypothesis 2.4.

A.4.1 Method

Participants

Two hundred and sixty-six people (110 female) were recruited from the online recruitment platform Prolific. Participants were compensated at a rate of £5 an hour. The average age was 40.62 (SD = 9.59, min = 25, max = 74). Participants reported an average of 7.45 (SD = 7.8, min = 0, max = 47) years of work in a

Table A.3: Experiment 4 group allocation.

Awareness	N
Aware	133
Naive	133
Total	266

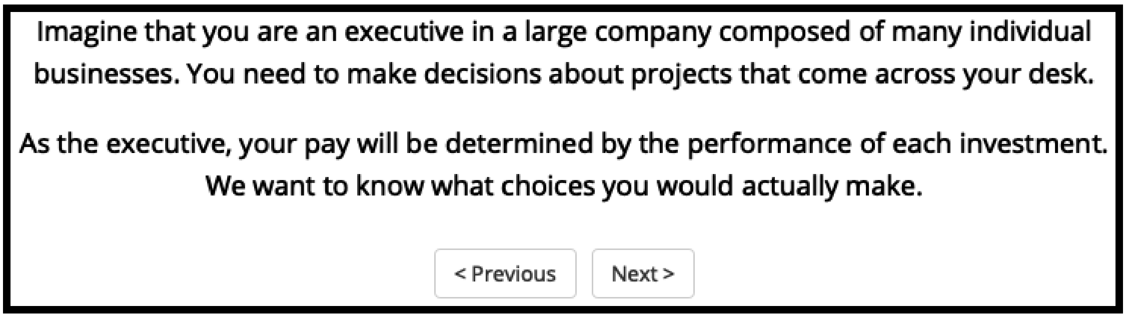


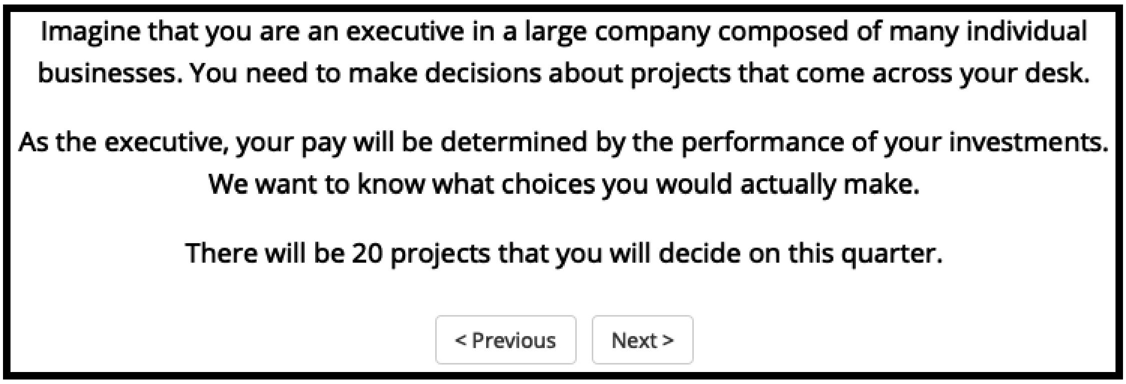
Figure A.23: Instructions for those in the naive condition of Experiment 4. Border added for clarity.

business setting, and an average of 5.52 (SD = 7.27, min = 0, max = 48) years of business education. The mean completion time was 12.66 (SD = 8.26, min = 1.48, max = 53.47) minutes. Table A.3 shows the between-subjects condition allocation.

Materials

Instructions Participants were shown similar instructions to Experiment 1 (see Section 2.2.1), except that the awareness manipulation was incorporated into the text. Participants in the naive condition saw the instructions in Figure A.23, and those in the aware condition saw the instructions in Figure A.24.

Risky investment task Participants saw similar displays to those in Experiment 3 (see Section A.3.1). However, here participants viewed 20 projects, so while the gamble constrains explained above were still applied, the actual gamble values were different. Further, those in the aware condition saw an added sentence that identified the number of the project they were currently considering in the context

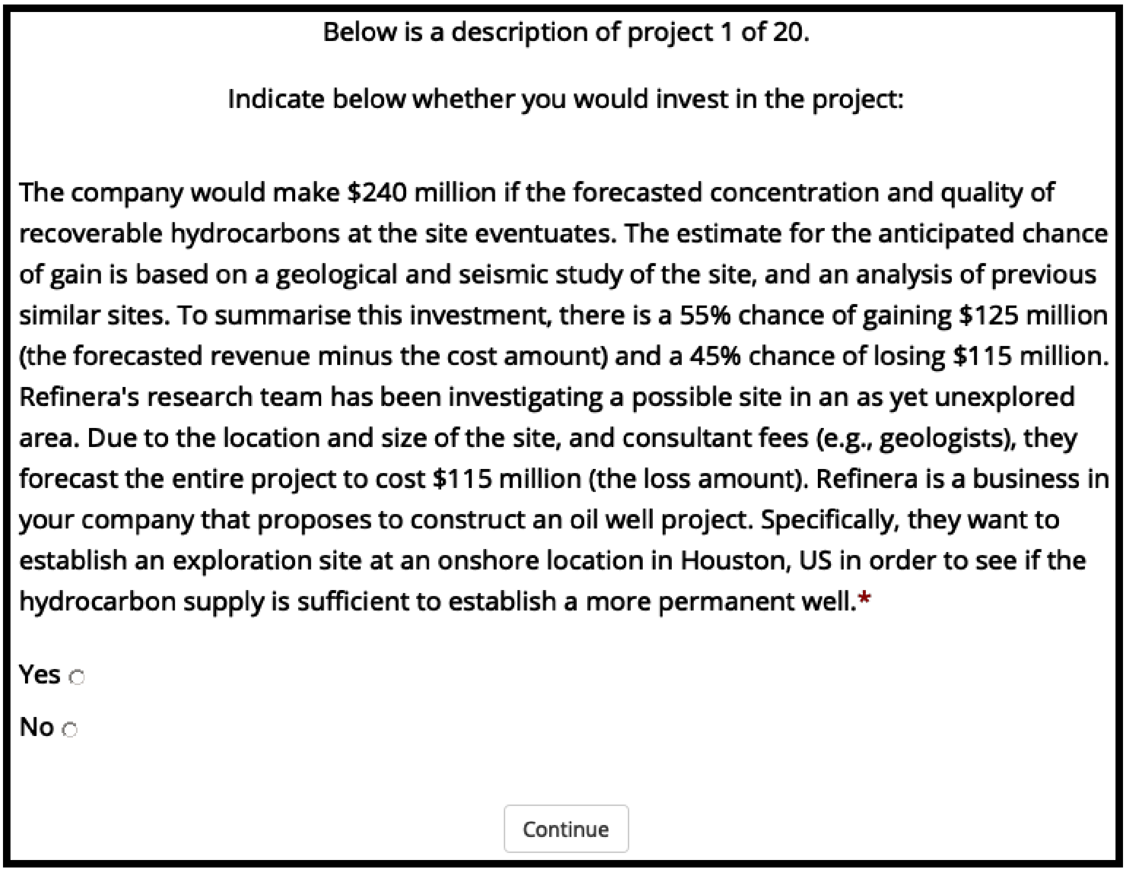

Imagine that you are an executive in a large company composed of many individual businesses. You need to make decisions about projects that come across your desk.

As the executive, your pay will be determined by the performance of your investments. We want to know what choices you would actually make.

There will be 20 projects that you will decide on this quarter.

< Previous | Next >

Figure A.24: Instructions for those in the aware condition of Experiment 4. Border added for clarity.


Below is a description of project 1 of 20.

Indicate below whether you would invest in the project:

The company would make $240 million if the forecasted concentration and quality of recoverable hydrocarbons at the site eventuates. The estimate for the anticipated chance of gain is based on a geological and seismic study of the site, and an analysis of previous similar sites. To summarise this investment, there is a 55% chance of gaining $125 million (the forecasted revenue minus the cost amount) and a 45% chance of losing $115 million. Refinera's research team has been investigating a possible site in an as yet unexplored area. Due to the location and size of the site, and consultant fees (e.g., geologists), they forecast the entire project to cost $115 million (the loss amount). Refinera is a business in your company that proposes to construct an oil well project. Specifically, they want to establish an exploration site at an onshore location in Houston, US in order to see if the hydrocarbon supply is sufficient to establish a more permanent well.*

Yes

No

Continue

Figure A.25: An example of a project display in Experiment 4. Border added for clarity.

of the total 20. See Figure A.25 for an example. Those in the naive condition saw the same display without this sentence.

Follow-up The follow-up questions were identical to those in Experiment 3 (see Section A.3.1), except that the portfolio number question identified the number

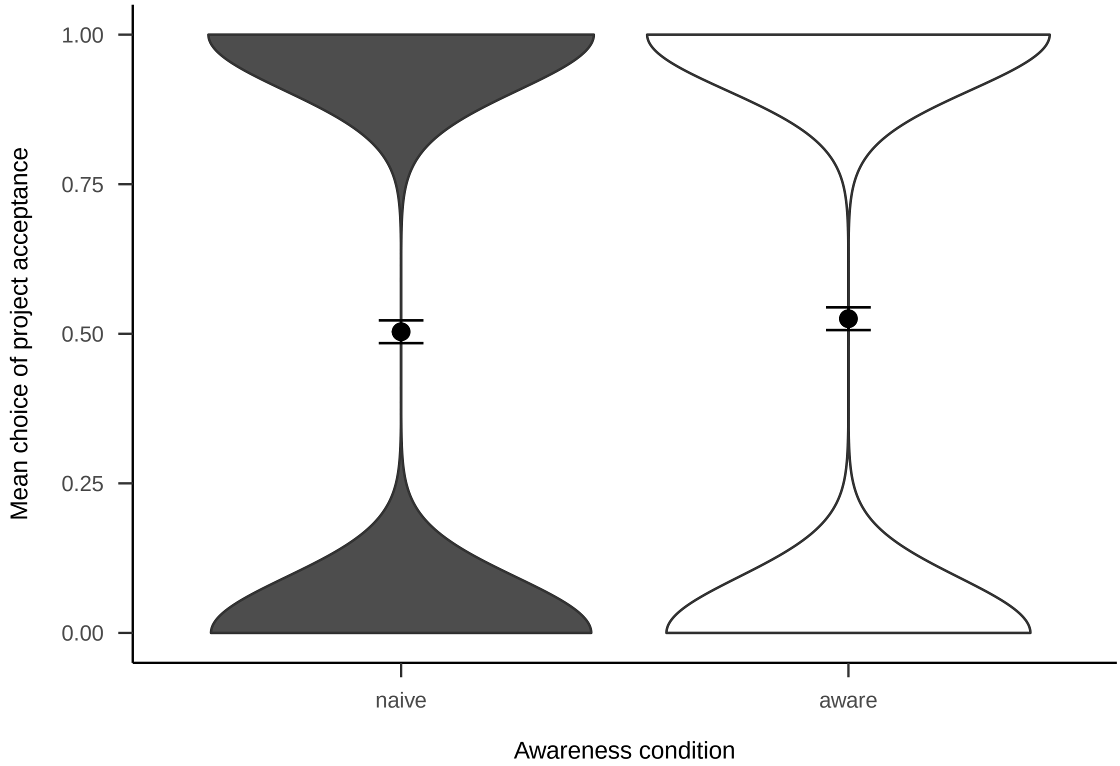


Figure A.26: Mean project acceptance for the awareness effect.

of projects they saw as 20.

Procedure

Participants read the instructions and completed the risky investment task in their respective conditions. After seeing the individual projects, participants were then asked the four follow-up questions.

A.4.2 Results

Project investment

The project investment data were analysed as in Experiment 2 (see Section 2.3.2). Figures A.26 and A.27 show the choice and proportion data, respectively. The difference between awareness conditions was not significant, both in the logistic regression $b = -0.05$, 95% CI $[-0.22, 0.13]$, $z = -0.53$, $p = .595$, and in the t-test, d_s = -0.09, 95% CI [-0.33, 0.15], $t(264)$ = -0.73, p = .464.

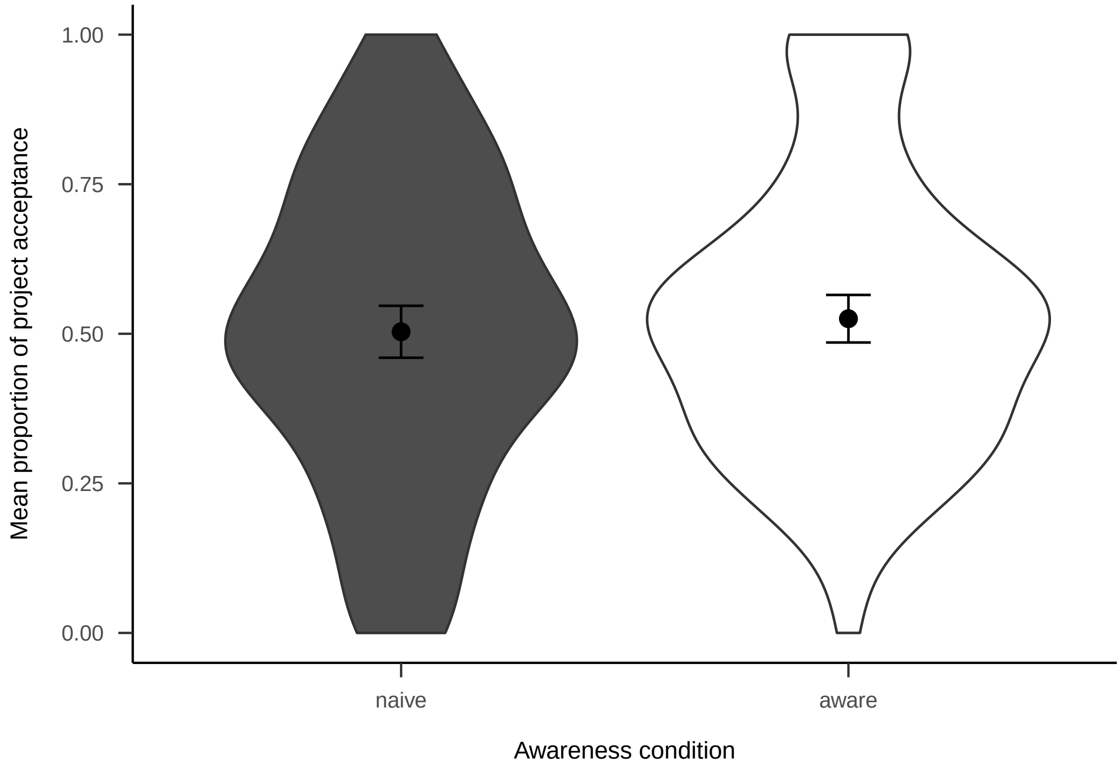


Figure A.27: Mean proportion of project acceptance for the awareness effect.

Table A.4: Logistic regression table of project acceptance by awareness and trial.

Term	$\hat{\beta}$	95% CI	z	p
Intercept	-0.01	[-0.20, 0.17]	-0.12	.907
Awareness1	-0.10	[-0.28, 0.09]	-1.05	.293
Project order	0.01	[0.00, 0.02]	1.66	.096
Awareness1 × Project order	0.00	[-0.01, 0.01]	0.29	.775

Further, Figure A.28 shows the choice data as a function of the order of the project in the sequence. As Table A.4 shows, there were no main effects or interactions.

Follow-up

Project expectation Participants were asked how many projects they expected to see. Figure A.29 shows that those in the aware condition reportedly expect to see more, d_s = -0.94, 95% CI [-1.19, -0.69], $t(264)$ = -7.67, $p < .001$. However, this is likely to be due to the fact that they were told how many projects there were.

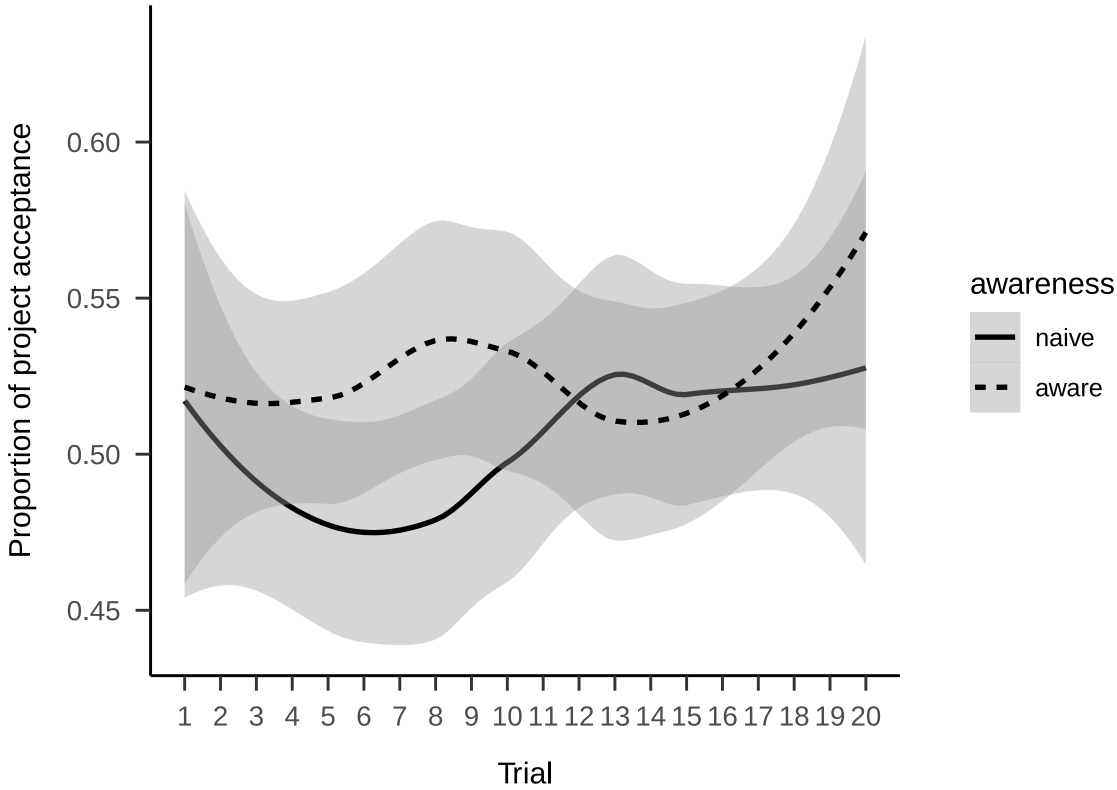


Figure A.28: Mean project acceptance by awareness and trial.

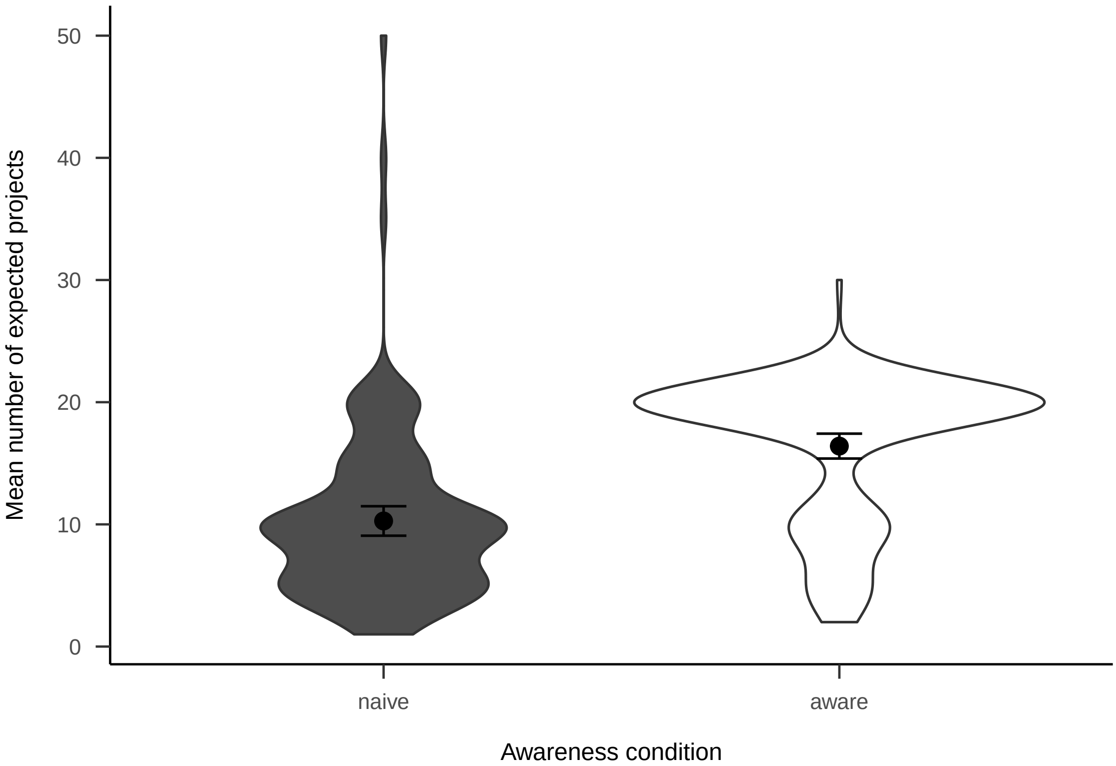


Figure A.29: Number of projects participants expected to see, by awareness.

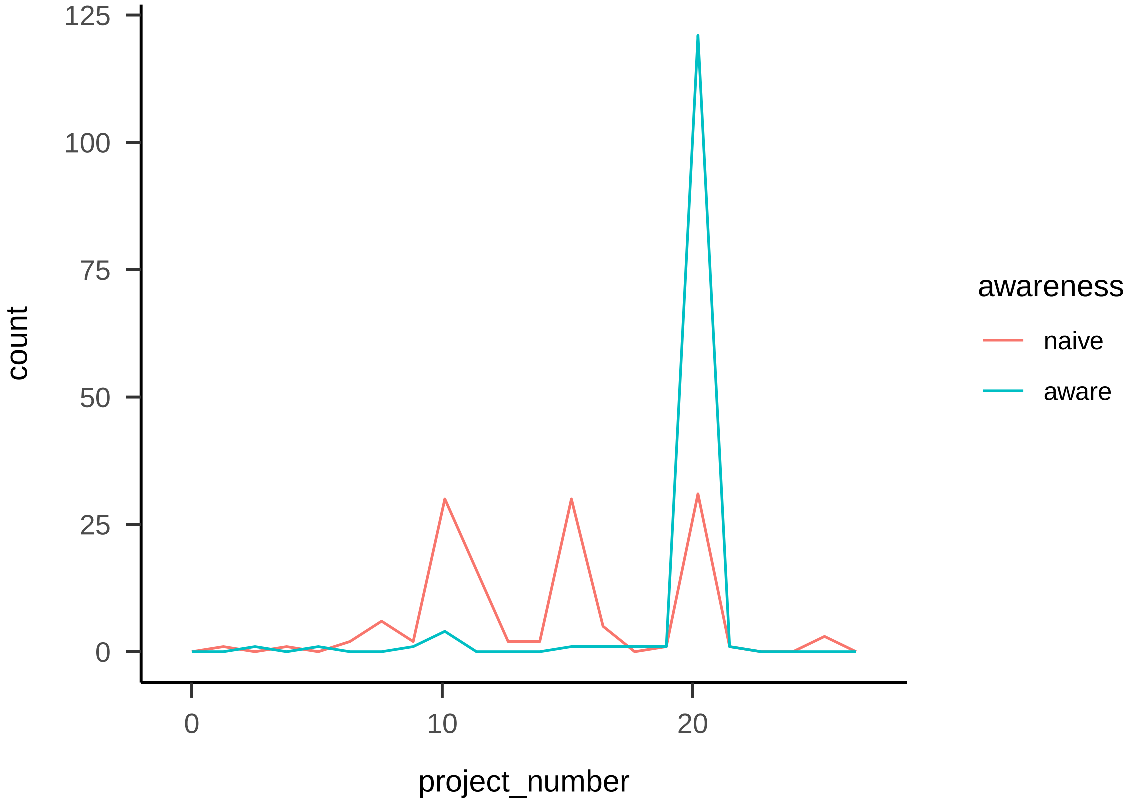


Figure A.30: Number of projects participants reported seeing, by awareness.

Project number Participants were asked how many projects they thought they saw. Figure A.30 shows that overall people correctly estimated the number of projects, with higher accuracy for those in the aware condition.

Portfolio choice - binary Participants were then asked if they would rather invest in all or none of the projects. As Figure A.31, there was no significant difference between awareness conditions in wanting to invest in all of the projects, $b = -0.09$, 95% CI $[-0.33, 0.15]$, $z = -0.74$, $p = .460$.

Portfolio choice - number Subsequently, we asked participants how many projects they would invest in out of the 20 that they saw. As Figure A.32 shows, the difference between awareness conditions was not significant, d_s = -0.12, 95% CI [-0.36, 0.12], $t(264)$ = -0.97, p = .334.

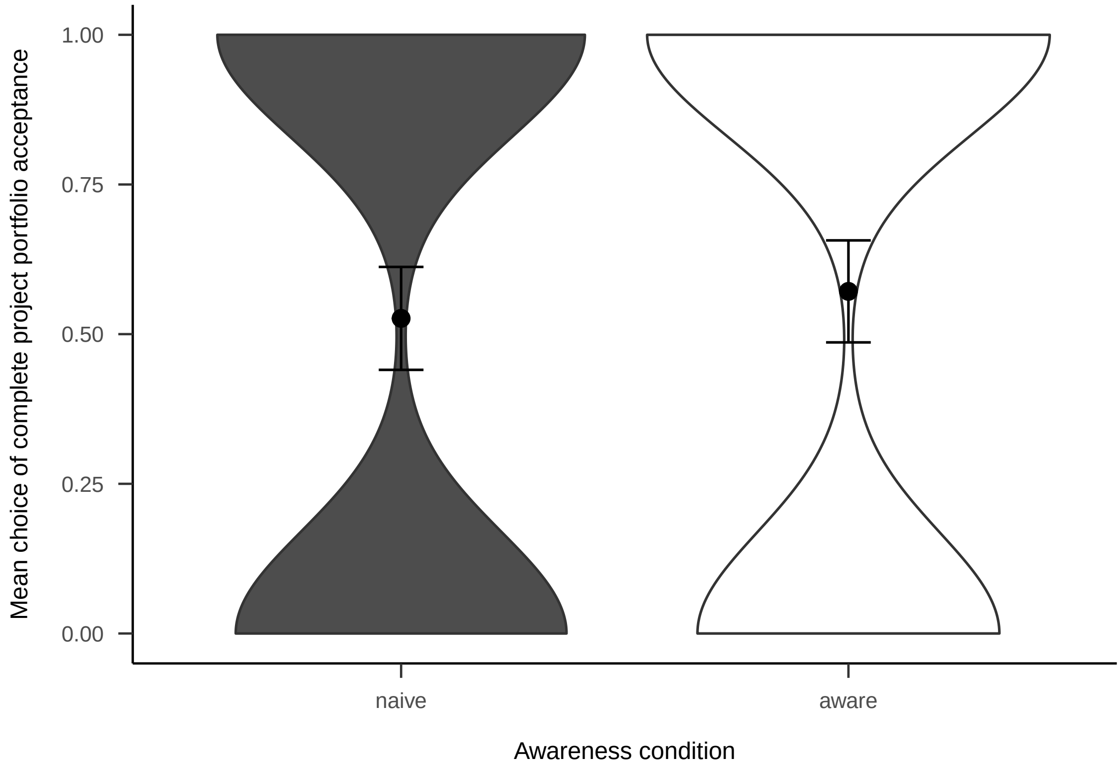


Figure A.31: Mean choice of investing in all 20 projects for the awareness effect.

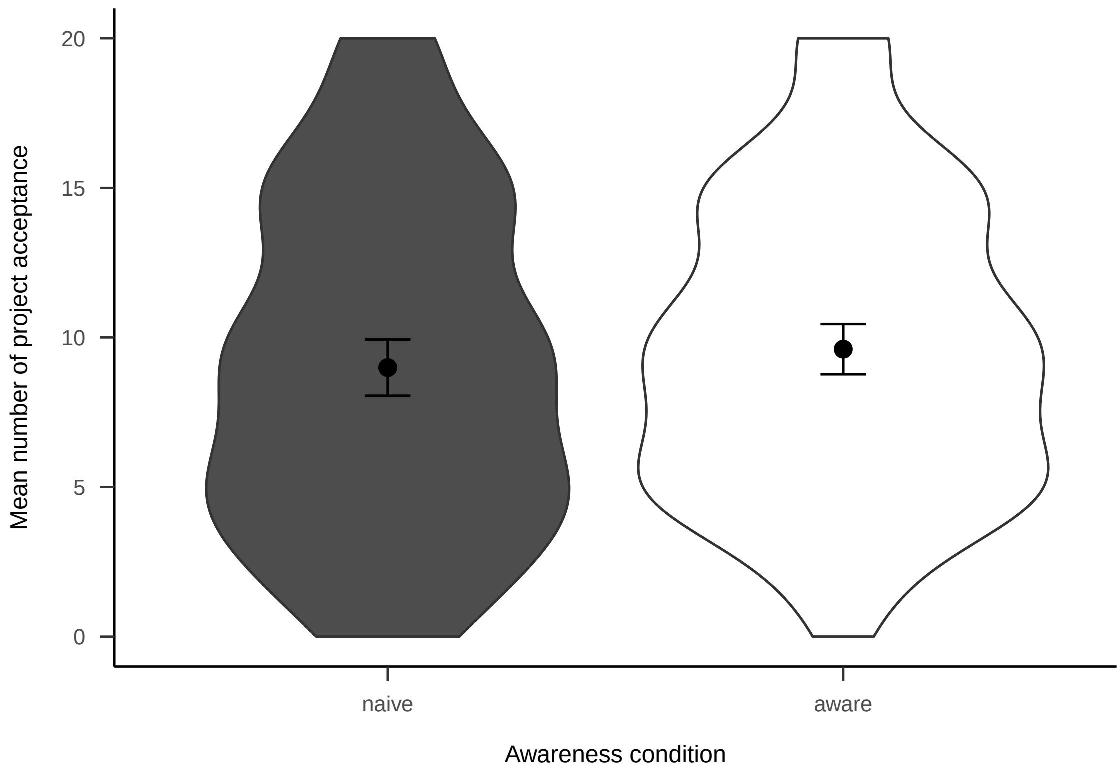


Figure A.32: Mean number of projects chosen in the follow-up for the awareness effect.

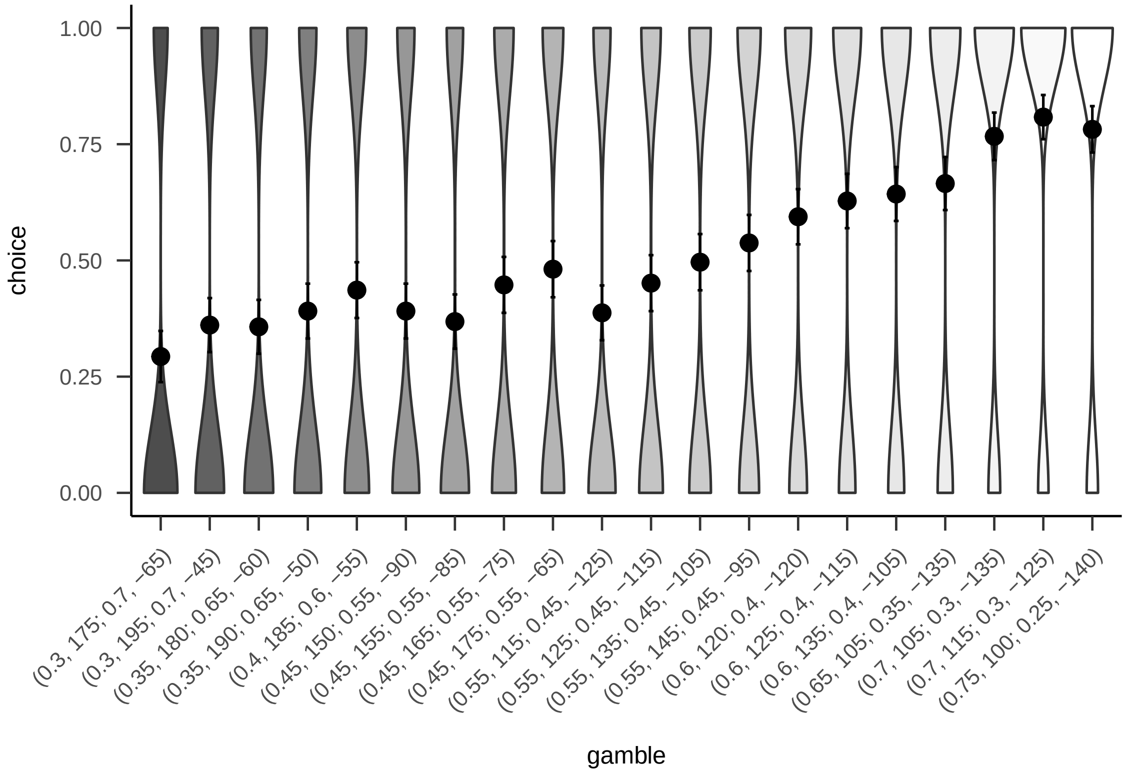


Figure A.33: Mean project acceptance for the 20 gambles. The format of the labels indicate: (gain probability, gain value; loss probability, loss value).

Gambles

Figures A.33 and A.34 show the overall people seemed to prefer gambles with higher probabilities of gain, sometimes regardless of expected value or value of the gain.

A.4.3 Discussion

Experiment 4 did not find evidence for Hypothesis 2.4. There was no significant effect of awareness on project choice by trial. Participants in the aware condition were expected to become less risk averse as they continued with the experiment if they were using a strategy similar to the law of small numbers. The fact that this effect was not replicated in Experiment 4 might mean that the finding in Experiment 1 was due to the specific gambles used in that experiment, or statistical chance.

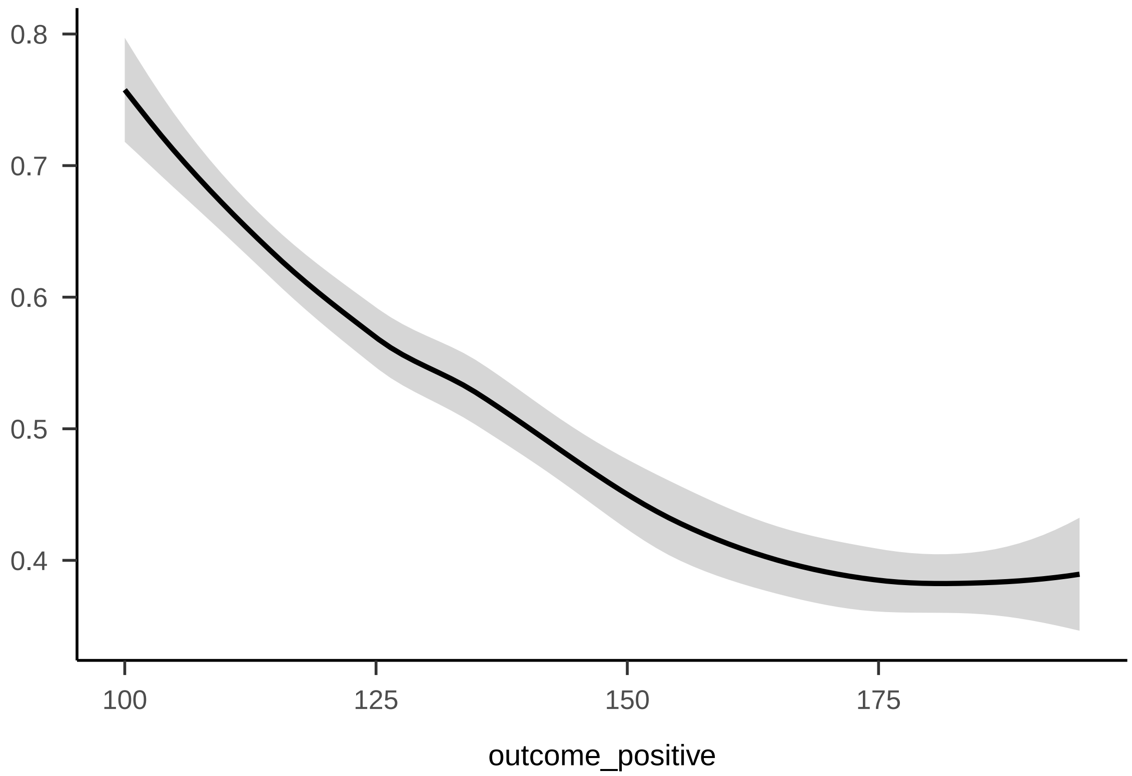


Figure A.34: Mean project acceptance for the gambles' expected value, positive probability, and positive outcome.

B

Chapter 4 appendix

Contents

This appendix contains supplementary materials and analyses for the three experiments reported in Chapter 4. In addition, five related experiments are reported. Experiment 4 was identical to Experiment 1, except that alignment was manipulated within-subjects, it did not include a no NPV condition, and there was no forecasting measure. Experiment 5 replicated Experiment 1, but only tested the forecasting effect and did so with a sample that had investing experience. Experiment 6 replicated Experiment 5 but with a larger sample size and a lay sample. Experiment 7 attempted to facilitate a use of numerical reliability through explicit hints. Experiment 8 tested both verbal and numerical reliability effects in an all within-subjects design. However, unlike Experiment 3, the design of Experiment 8 did not allow for a direct comparison of alignment conditions.

B.1 Experiment 1

In addition to the allocation measure, participants were also asked to rank the projects and forecast their future returns. The ranking task was included before the allocation task in order to encourage alignment and to have another measure of participants' decision-making. The forecasting task was added (described further below in Section B.1.1) in order to test whether the variance in people's forecasts is affected by alignment and NPV reliability.

Hypothesis B.1. All allocation effects will replicate in the ranking measure.

Hypothesis B.2. All allocation effects will replicate in the forecasting mean measure.

In the forecasting measures, more alignable differences were expected to bring about more certainty about forecasting decisions, since participants will have more easily comparable information. As such, people's forecasting should be less variable when comparing projects with alignable differences, than when comparing projects with non-alignable differences.

Hypothesis B.3. The standard deviation of participants' forecasts will be higher, on average, in the low alignment condition than in the high alignment condition.

B.1.1 Method

Materials

Instructions Figures B.1, B.2, and B.3 show the instructions given to those in the low NPV reliability, high NPV reliability, and no NPV condition, respectively.

Forecasting Participants were asked to respond to a forecasting task (adapted from Long et al., 2018), seen in Figure B.4. Participants were asked to predict each project's rate of return after one month. This allowed to calculate each participant's forecasting mean and standard deviation (the latter as inversely proportional to forecasting precision).

Ranking As seen in Figure B.5, participants were asked to rank the projects in order of investment priority.

Confidence As Figure B.6 shows, participants were asked to indicate how confident they were about each of their allocation decisions on a scale from 0 ("Not confident at all") to 100 ("Extremely confident").

Justification As Figure B.7 shows, participants were asked to justify their allocation decision in a free-response text-box.

B.1.2 Results

Ranking

A mixed factorial ANOVA was conducted to investigate the effects of alignment and verbally-instructed NPV reliability on participants' rankings of the target

You will be shown information about a number of projects that a consumer products firm is considering to invest in. Some specific information about the product itself is provided. In addition to those numbers, you will find each project's net present value (NPV), which is the company's estimation of the future returns of the project. An NPV that is greater than 0 (zero) indicates that there is an expectation of profit. **The higher the NPV, the better the expectations for each project.** However, it is important to note that NPV is a very noisy measure relative to the other more specific measures because it relies on future forecasting. As such, **NPV is very unreliable and should be relied upon only as a last result; the specific project's measures should be used instead.**

We would like you to take the role of the manager in charge of capital allocation for the firm. This firm is specifically interested in investing in the development of high-end goods, so your valuations should reflect this. That is, even though there might be a market for the lower-end products in the descriptions that you will see, **you should be aiming to invest in the products with the highest objective value**. The features of the products that are listed matter because they reflect the direct value of the product, whereas financial measures such as NPV may reflect other factors, thus making it noisier, as mentioned above.

You will see a set of five different projects for which you must predict the investment returns after one month. For example, how likely is it that the project will return more than 9% after one month, how likely is it that the project will return 7% to 9%, etc.

You will also decide how to rank the projects in order of investment priority, and decide how to allocate the capital available for investment this year among the different projects. Note that this is not the operational budget (advertising, etc.), but rather the funds to be used for investment in developing the new products. You will do this by selecting a percentage value for each project, such that the budget is allocated completely among each set of projects.

Figure B.1: Experiment 1 low reliability instructions. Border added for clarity.

project. As seen in Figure B.8, the alignment × reliability amount × NPV amount interaction was significant, $F(6.62, 370.54) = 2.70$, $p = .011$, $\hat{\eta}_p^2 = .046$. This effect seems to be driven by the differences between the no NPV condition and the conditions with NPV across the two alignment conditions. Specifically, in the low alignment condition, the linear NPV trend was significantly lower in the no NPV condition than both the low reliability condition, $M = -6.56$, 95% CI $[-10.26,\ -2.85]$, $t(112) = -3.50$, $p = .001$, and the high reliability condition, $M = -7.38$, 95% CI $[-10.83,\ -3.93]$, $t(112) = -4.24$, $p < .001$. However, in the

You will be shown information about a number of projects that a consumer products firm is considering to invest in. Some specific information about the product itself is provided. In addition to those numbers, you will find each project's net present value (NPV), which is the company's estimation of the future returns of the project. An NPV that is greater than 0 (zero) indicates that there is an expectation of profit. **The higher the NPV, the better the expectations for each project.** However, it is important to note that NPV is a very noisy measure relative to the other more specific measures because it relies on future forecasting. As such, NPV is very unreliable and should be relied upon only as a last result; the specific project's measures should be used instead.NPV is a very useful measure relative to the other more specific measures because it can be calculated regardless of the type of product. As such, **NPV is very reliable in most cases.**

We would like you to take the role of the manager in charge of capital allocation for the firm. This firm is specifically interested in investing in the development of high-end goods, so your valuations should reflect this. That is, even though there might be a market for the lower-end products in the descriptions that you will see, **you should be aiming to invest in the products with the highest objective value.**

You will see a set of five different projects for which you must predict the investment returns after one month. For example, how likely is it that the project will return more than 9% after one month, how likely is it that the project will return 7% to 9%, etc.

You will also decide how to rank the projects in order of investment priority, and decide how to allocate the capital available for investment this year among the different projects. Note that this is not the operational budget (advertising, etc.), but rather the funds to be used for investment in developing the new products. You will do this by selecting a percentage value for each project, such that the budget is allocated completely among each set of projects.

Figure B.2: Experiment 1 high reliability instructions. Border added for clarity.

high alignment condition, the linear NPV trend was only significantly lower in the no NPV condition than the high reliability condition, $M = -8.37$, 95% CI $[-11.85,\ -4.88]$, $t(112) = -4.76$, $p < .001$, and not the low reliability condition, $M = -1.71$, 95% CI $[-5.54,\ 2.13]$, $t(112) = -0.88$, $p = .380$.

Confidence

A mixed factorial ANOVA was conducted to investigate the effects of alignment and verbally-instructed NPV reliability on participants' confidence rating of their decisions. As seen in Figure B.9, the alignment × reliability amount × NPV amount

You will be shown information about a number of projects that a consumer products firm is considering to invest in. Some specific information about the product itself is provided.

We would like you to take the role of the manager in charge of capital allocation for the firm. This firm is specifically interested in investing in the development of high-end goods, so your valuations should reflect this. That is, even though there might be a market for the lower-end products in the descriptions that you will see, **you should be aiming to invest in the products with the highest objective value**. The features of the products that are listed matter because they reflect the direct value of the product, whereas financial measures may reflect other factors.

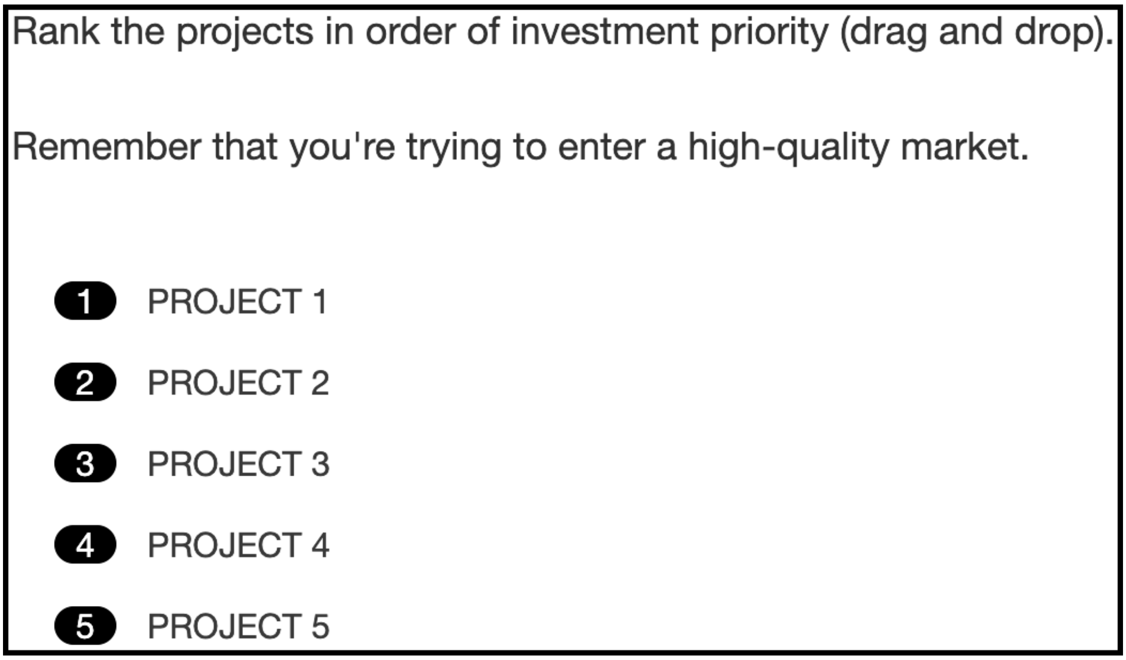
You will see a set of five different projects for which you must decide how to rank in order of investment priority, and decide how to allocate the capital available for investment this year among the different projects. Note that this is not the operational budget (advertising, etc.), but rather the funds to be used for investment in developing the new products. You will do this by selecting a percentage value for each project, such that the budget is allocated completely among each set of projects.

Figure B.3: The instructions for the no NPV condition in Experiment 1. Border added for clarity.

Imagine that you have 100 points to assign to the following options for Project 1's rate of return on investment after one month. Assign points according to how likely you think each rate of return is.

	0 10 20 30 40 50 60 70 80 90 100	
more than 9%		0
7% to 9%		0
5% to 7%		0
3% to 5%		0
1% to 3%		0
-1% to -3%		0
-5% to -7%		0
-7% to -9%		0
less than -9%		0
Total:		**0**

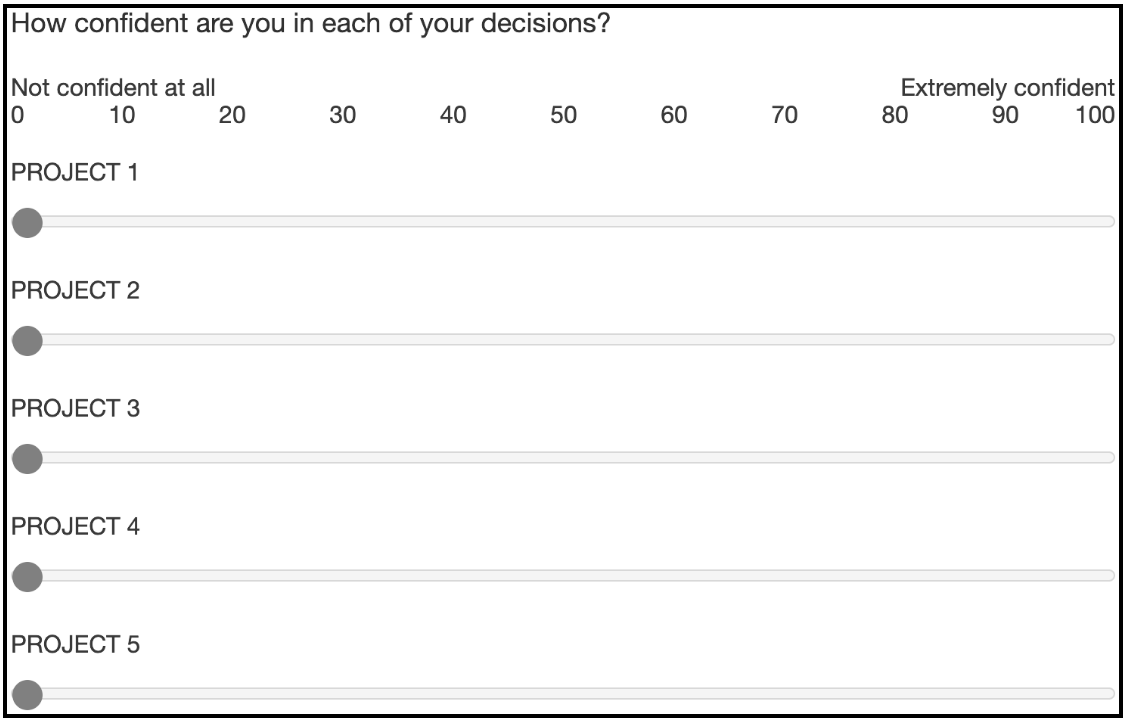
Figure B.4: The forecasting task. Border added for clarity.


Rank the projects in order of investment priority (drag and drop).

Remember that you're trying to enter a high-quality market.

1 PROJECT 1
2 PROJECT 2
3 PROJECT 3
4 PROJECT 4
5 PROJECT 5

Figure B.5: The ranking task. Border added for clarity.


How confident are you in each of your decisions?

Not confident at all — Extremely confident
0 10 20 30 40 50 60 70 80 90 100

PROJECT 1

PROJECT 2

PROJECT 3

PROJECT 4

PROJECT 5

Figure B.6: The confidence task. Border added for clarity.

Figure B.7: The justification task. Border added for clarity.

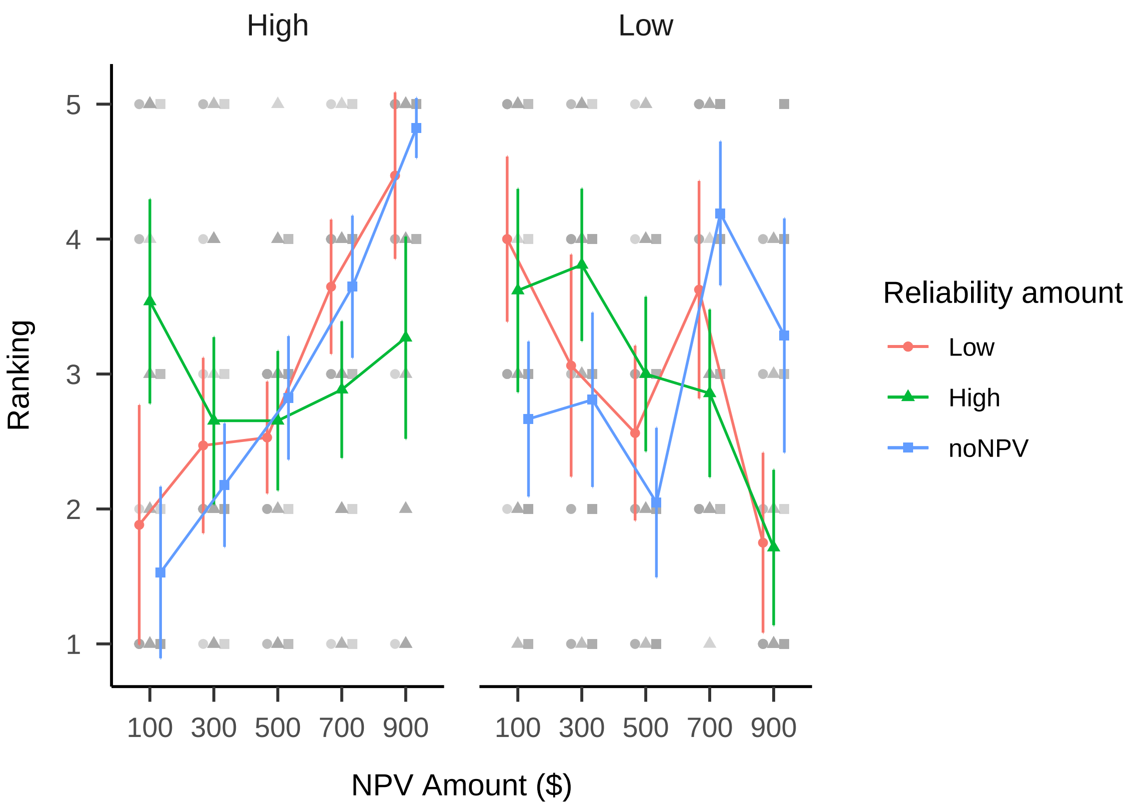


Figure B.8: Mean ranking.

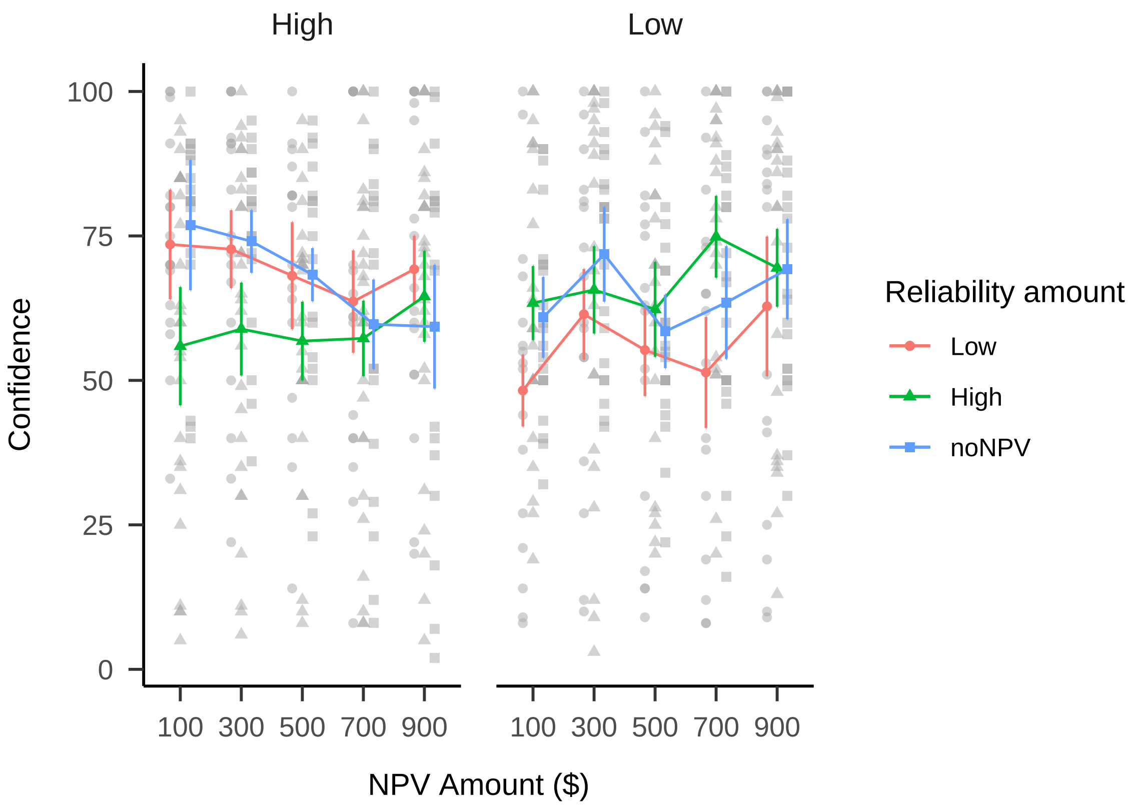


Figure B.9: Mean confidence.

interaction was not significant, $F(7.47, 418.08) = 1.26$, $p = .267$, $\hat{\eta}_p^2 = .022$. Contrary to the allocation and ranking data, in the low alignment condition, there were no significant differences in the linear NPV trend between the no NPV condition and low reliability condition, $M = 10.73$, 95% CI $[-30.15,\ 51.61]$, $t(112) = 0.52$, $p = .604$, nor the high reliability condition, $M = 13.05$, 95% CI $[-24.97,\ 51.07]$, $t(112) = 0.68$, $p = .498$. However, as above, in the high alignment condition, the linear NPV trend was significantly lower in the no NPV condition than the high reliability condition, $M = 65.14$, 95% CI $[26.72,\ 103.57]$, $t(112) = 3.36$, $p = .001$, and not the low reliability condition, $M = 31.88$, 95% CI $[-10.38,\ 74.14]$, $t(112) = 1.49$, $p = .138$.

Forecast mean

A mixed factorial ANOVA was conducted to investigate the effects of alignment and verbally-instructed NPV reliability on participants' forecast means. As seen in Figure B.10, the alignment × reliability amount × NPV amount interaction was not significant, $F(5.26, 142.10) = 1.89$, $p = .095$, $\hat{\eta}_p^2 = .066$. However, the alignment ×

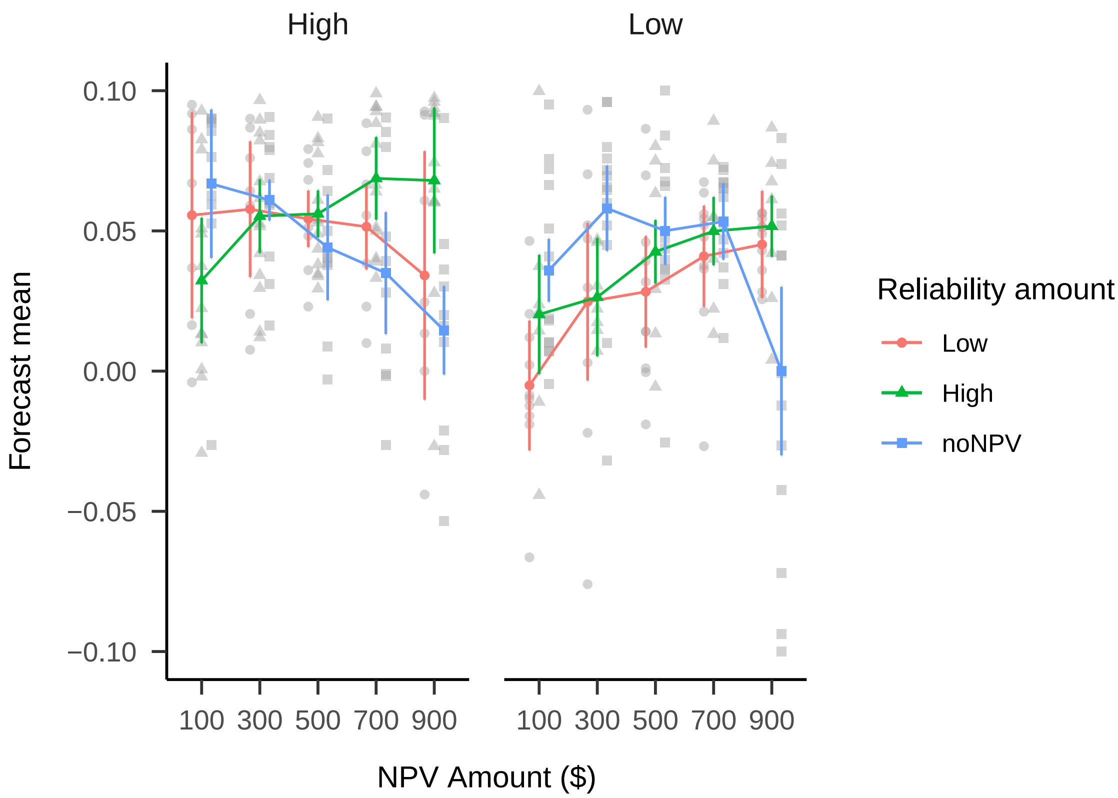


Figure B.10: Mean forecasts.

NPV amount interaction was significant, $F(2.63, 142.10) = 2.89$, $p = .044$, $\hat{\eta}_p^2 = .051$; as well as the reliability amount $\times$ NPV amount interaction, $F(5.26, 142.10) = 7.91$, $p < .001$, $\hat{\eta}_p^2 = .227$. The simple effects appear to be as above. Specifically, in the low alignment condition, the linear NPV trend was significantly lower in the no NPV condition than both the low reliability condition, $M = 0.19$, 95% CI $[0.09,\ 0.30]$, $t(54) = 3.63$, $p = .001$, and the high reliability condition, $M = 0.16$, 95% CI $[0.04,\ 0.28]$, $t(54) = 2.75$, $p = .008$. However, in the high alignment condition, the linear NPV trend was only significantly lower in the no NPV condition than the high reliability condition, $M = 0.22$, 95% CI $[0.11,\ 0.32]$, $t(54) = 4.04$, $p < .001$, and not the low reliability condition, $M = 0.08$, 95% CI $[-0.04,\ 0.21]$, $t(54) = 1.30$, $p = .198$.

Forecast SD

A mixed factorial ANOVA was conducted to investigate the effects of alignment and verbally-instructed NPV reliability on participants' forecast SDs. As seen in Figure B.11, the alignment $\times$ reliability amount $\times$ NPV amount interaction was

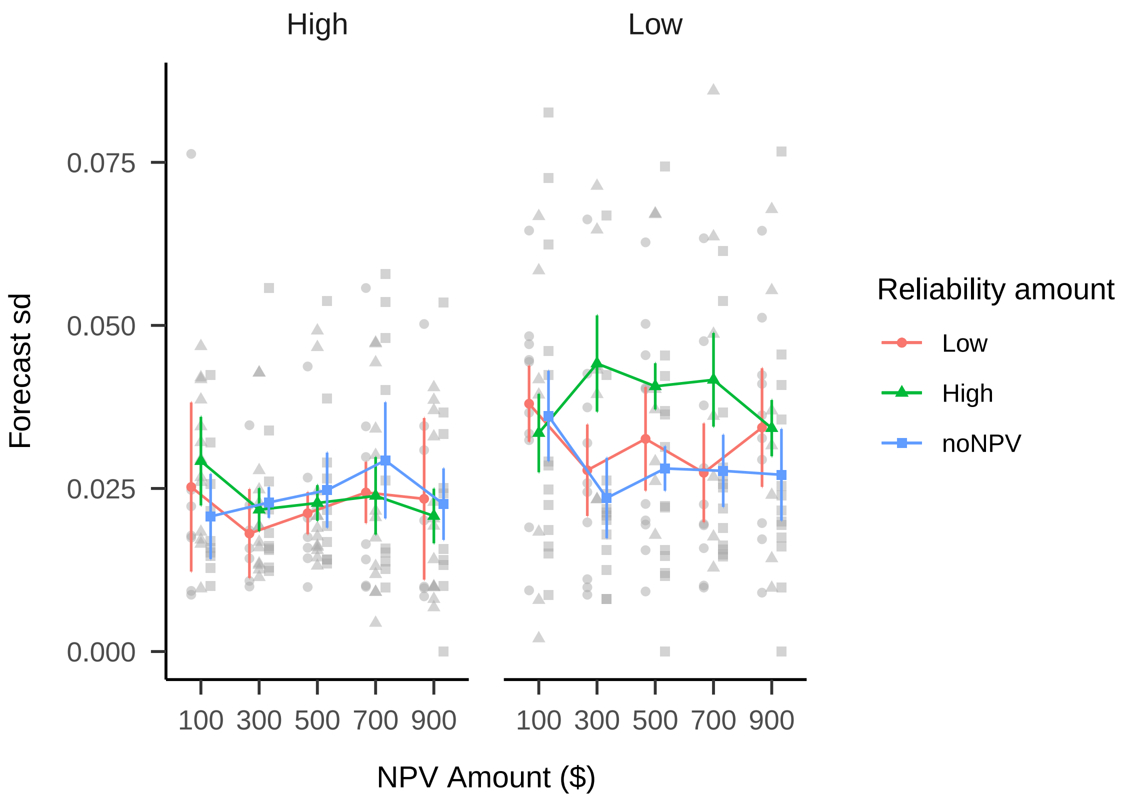


Figure B.11: Mean forecast SD.

significant, $F(6.87, 185.42) = 2.91$, $p = .007$, $\hat{\eta}_p^2 = .097$. However, none of the linear NPV trends were significantly different from each other as above. Of relevance, the low alignment condition on average had higher SDs than those in the high alignment condition, $F(1, 54) = 5.77$, $p = .020$, $\hat{\eta}_p^2 = .097$.

B.1.3 Discussion

Hypothesis B.4 was not supported, as there was no evidence of a main effect of alignment on participants' confidence in their allocation decisions. Instead, exploratory analyses showed that the difference in confidence between reliability conditions is greater in the low alignment condition. This may reflect participants' difficulty in making sense of their choices when alignment was low, given more confidence when assured of the reliability of NPV. In the high alignment condition, on the other hand, regardless of reliability condition, they had a way of using the reliability information. Further, confidence also seemed to increase more with NPV, on average, more when projects were dissimilar, which provides evidence

Investment task

You will be shown information about a number of projects that a consumer products firm is considering to invest in. Some specific information about the product itself is provided. In addition to those numbers, you will find each project's projected cash inflow for each year, and the net present value (NPV) that was calculated using those figures. The discount rate will always be 10% and the initial investment will always be $5000. These are taken into account in the NPV calculations.

We would like you to take the role of the manager in charge of capital allocation for the firm. This firm is specifically interested in investing in the development of high-end goods, so your valuations should reflect this. That is, even though there might be a market for the lower-end products in the descriptions that you will see, **you should be aiming to invest in the products with the highest intrinsic quality.**

You will decide how to rank the projects in order of investment priority, and decide how to allocate the capital available for investment this year among the different projects. Note that this is not the operational budget (advertising, etc.), but rather the funds to be used for investment in developing the new products. You will do this by selecting a percentage value for each project, such that the budget is allocated completely among each set of projects.

Importantly, each page's set of five projects should be treated independently of the other pages' project sets.

Figure B.12: Experiment 2 instructions. Border added for clarity.

for their reliance on NPV in this situation. There was limited evidence for the effect of alignment on forecast variability. Experiments 5 and 6 attempted to replicate this result with more participants.

B.2 Experiment 2

B.2.1 Method

Materials

Instructions Figure B.12 shows the instructions.

NPV test Participants were given more extensive information about NPV than in the previous experiment and were tested on their ability to calculate simple averages from given numerical ranges, as seen in Figures B.13 and B.14.

NPV knowledge ratings A similar design to Long et al. (2018, Study 1) was used to test whether this sample may be overconfident in their understanding on NPV. Therefore, participants were asked to rate their knowledge of NPV in various points in the study (see the procedure in Section 4.3.1).

Understanding NPV

Net Present Value (NPV) is used as a measure of a project's potential profitability. A positive value indicates that the project is profitable, while a negative value indicates that a project is not profitable.

When calculating NPV, the potential future cash inflows are converted to their "present values". This is important, because we know that an amount of money is more valuable in the present than it is in the future. The time value of money is accounted for by dividing each year's cash inflow by the discount rate. Finally, the sum of all the present values is deducted from the value of the initial investment.

To calculate the NPV you need the following components:

1. The cash inflow for each year of the project
2. The discount rate
4. The initial investment

Below is the generic formula for calculating NPV:

$$NPV = \frac{Cash\ inflow\ for\ year\ 1}{(1 + discount\ rate)^1} + \frac{Cash\ inflow\ for\ year\ 2}{(1 + discount\ rate)^2} + \frac{Cash\ inflow\ for\ year\ 3}{(1 + discount\ rate)^3} \ldots - Initial\ investment$$

Some of the time, it might be unclear exactly what the future cash inflow is, so it might be given as a range of possible values.

Below is an example of an NPV calculation with the discount rate calculations and initial investment already filled in. Notice that instead of a single cash inflow value, a range is provided (assume that the distribution is uniform). The value that should be used as the cash inflow is the mid point of these values. This is done by calculating the average of the two values.

For this session, you will get some practise in calculating NPV. However, we will give you the value that is in the denominator (the discount rate calculation) and the initial investment. All you need to do is calculate each year's cash inflow and enter them into the formula.

Example 1

$$NPV = \frac{[range: 1500 - 2500]}{1.1} + \frac{[range: 750 - 1250]}{1.21} + \frac{[range: 1875 - 3125]}{1.331} - 3000$$

Please calculate the mid-points for these ranges and type them in below:

Year 1 cash inflow

Year 2 cash inflow

Year 3 cash inflow

Figure B.13: Experiment 2 NPV test. Border added for clarity.

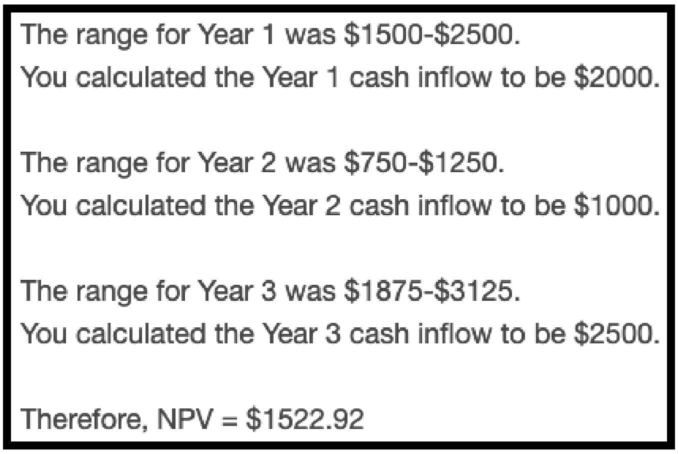


Figure B.14: Experiment 2 NPV test answers. Border added for clarity.

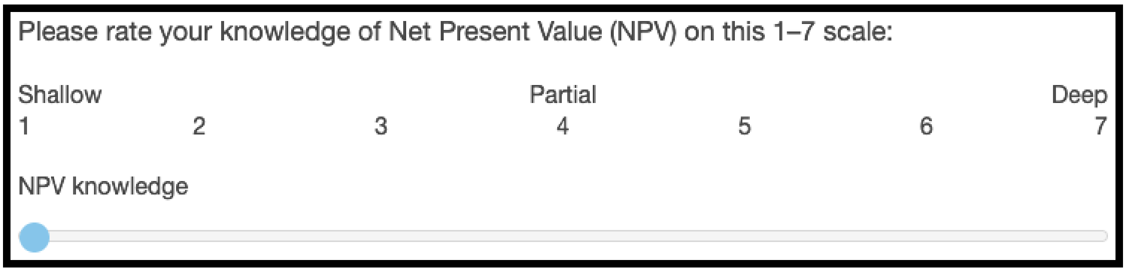
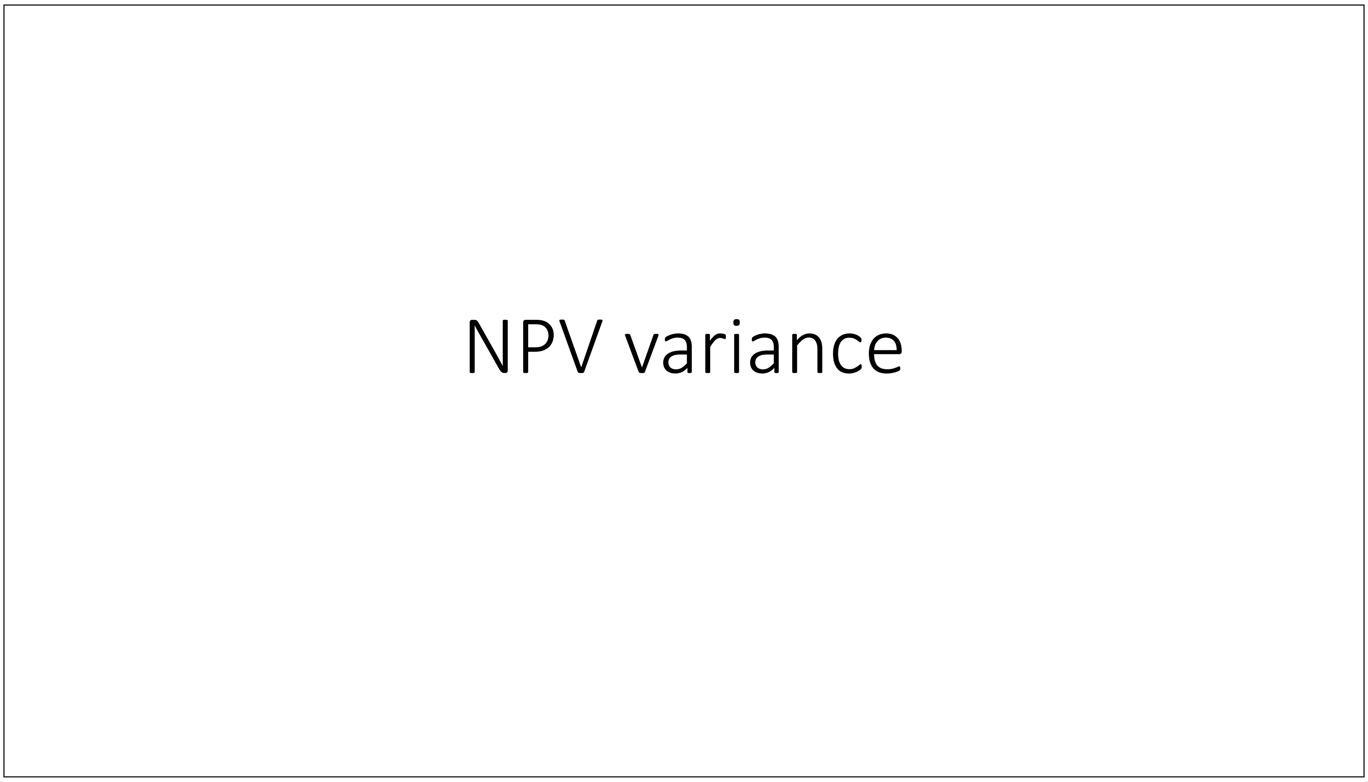


Figure B.15: Experiment 2 NPV knowledge rating task. Border added for clarity.

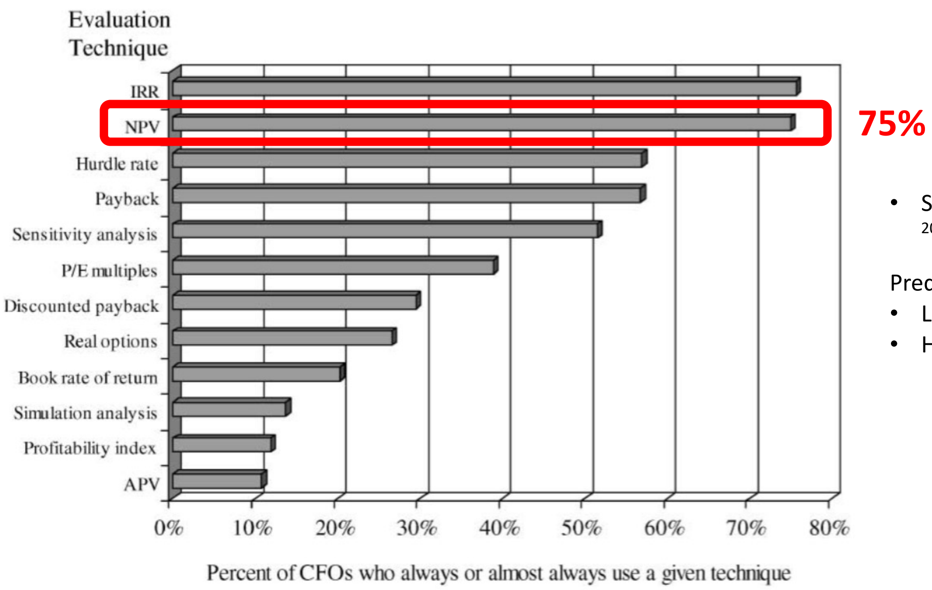
Variance lecture See below the slides for the variance lecture.



NPV

$$NPV = \frac{Year\ 1\ inflow}{(1+discount\ \%)^1} + \frac{Year\ 2\ inflow}{(1+discount\ \%)^2} + \frac{Year\ 3\ inflow}{(1+discount\ \%)^3} \ldots - Initial\ investment$$

NPV is used very frequently



- Sample: 392 CFOs (Graham & Harvey, 2001)

Predictors:
- Large firms > small firms
- High debt ratio > small debt ratio

The NPV paradox

- "Although the NPV method is criticized by both practitioners and academics, the traditional NPV calculation is by far the most commonly used tool for [exploration & production] project valuation." (Willigers et al., 2017)
- "NPV is almost always applicable but is almost always wrong" (Fox, 2008)
- "the NPV rule as governing all capital budgeting decisions may not be appropriate" (Arya et al., 1998)

Consequences

- Researchers studied 174 cases of fraudulent financial reporting
  - Fraudulent "facts" vs "forecasts"
- Forecasts based on unreasonable accounting assumptions
  - Form 40% of fraud cases
  - Account for 44% of economic losses
- Total damages by fraudulent *facts*: US$ 27 billion
- Total damages by fraudulent *forecasts*: US$ 23 billion

NPV

$$NPV = \frac{\boxed{Year\ 1\ inflow}}{(1+discount\ \%)^1} + \frac{\boxed{Year\ 2\ inflow}}{(1+discount\ \%)^2} + \frac{\boxed{Year\ 3\ inflow}}{(1+discount\ \%)^3} \ldots - Initial\ investment$$

Where do these cash inflows come from?

"It's impossible to forecast most projects' actual cash flows accurately" (Myers, 1984)

Forecasting is error-prone

- Future forecasts tend to be overly-optimistic
  - For longevity
  - For relationships
  - When dopamine is increased
  - In animal behaviour

- Executives are similarly overly-optimistic
  - In stock market returns
  - For firm earnings

Forecasting is error-prone

- CFO survey between 2001-2011

- *Over the next year, I expect the annual S&P 500 return will be:*
  - *There is a 1-in-10 chance the actual return will be less than ___%.*
  - *I expect the return to be: ___%.*
  - *There is a 1-in-10 chance the actual return will be greater than ___%.*

- 13,346 estimates

Forecasting is error-prone

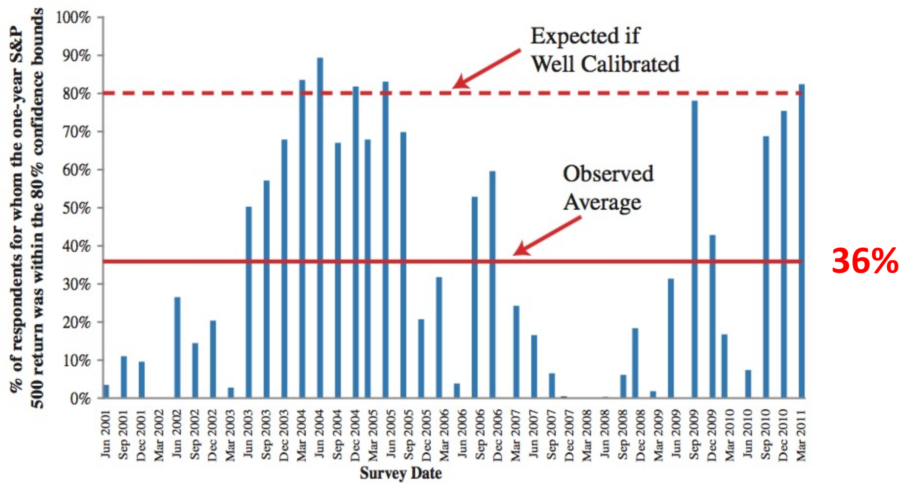
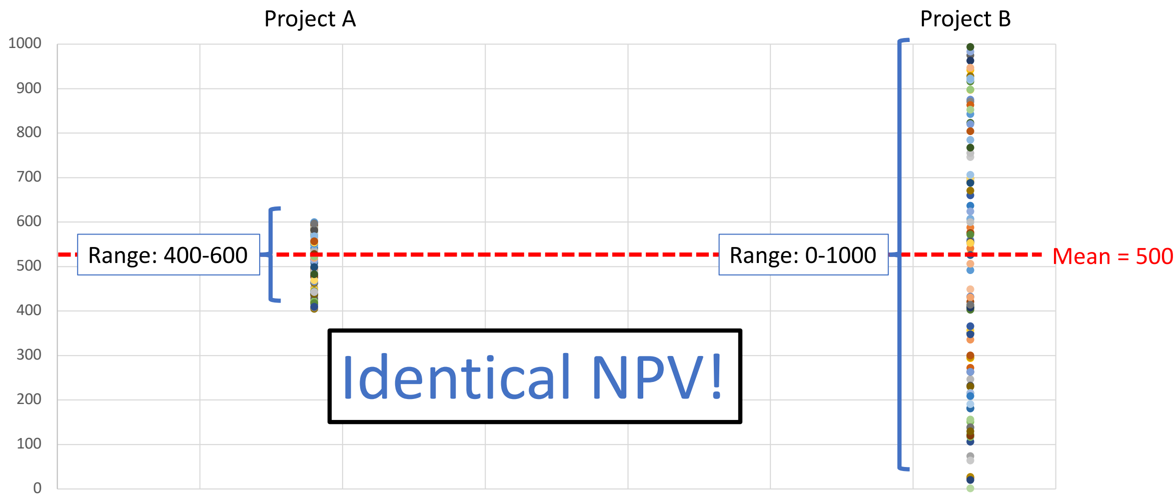


FIGURE I
Time-Series of CFO Miscalibration

Paying attention to variance

- Ranges are frequently used for forecast estimates
  - 80% of the time between 2002-2010
- Taking account of variance increases forecasting accuracy

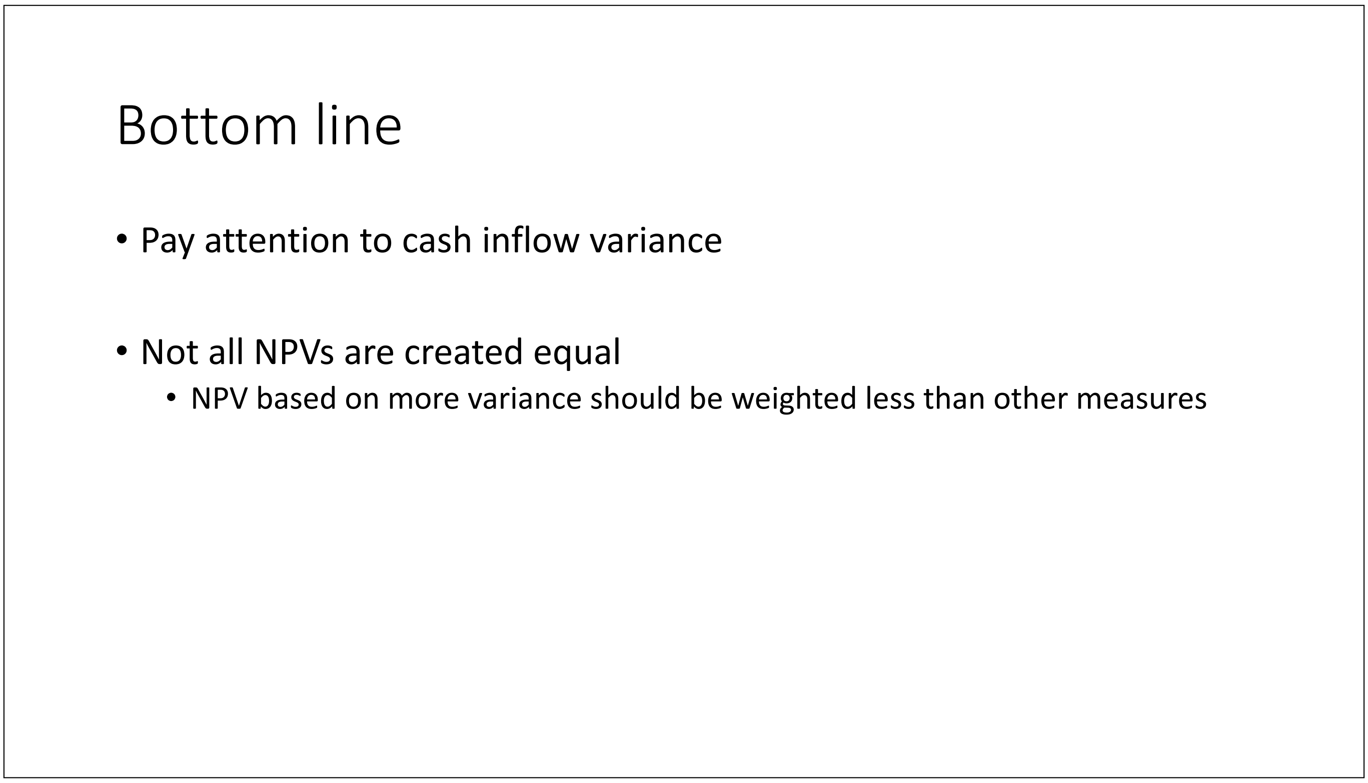
Paying attention to variance - Example



Will you rely more on both measures equally?

Summary

- NPV is used a lot, but criticised by some
- The costs of poor forecasting are potentially high
- NPV relies on forecasting
- Executives may underestimate forecast variance



B.2.2 Results

Ranking

A mixed factorial ANOVA was conducted to investigate the effects of NPV amount, alignment, and numerical NPV reliability on participants' project rankings. Figure B.16 shows these data. The alignment × reliability amount × NPV amount interaction was not significant, $F(3.00, 159.10) = 2.44$, $p = .066$, $\hat{\eta}^2_p = .044$. However, the alignment × NPV amount interaction was significant, $F(3.31, 370.54) = 21.00$, $p < .001$, $\hat{\eta}^2_p = .158$; as well as the reliability amount × NPV amount interaction, $F(6.62, 370.54) = 9.73$, $p < .001$, $\hat{\eta}^2_p = .148$. As in the allocation data, the linear NPV trend did not differ between reliability amount condition in neither the low alignment condition, $\Delta M = 0.43$, 95% CI $[-0.77,\ 1.63]$, $t(53) = 0.71$, $p = .480$, nor the high alignment condition, $\Delta M = 0.46$, 95% CI $[-0.92,\ 1.84]$, $t(53) = 0.67$, $p = .504$. However, averaging over reliability amount, the linear NPV trend was higher in the low alignment condition than in the high alignment condition, $\Delta M = -4.54$, 95% CI $[-6.39,\ -2.68]$, $t(53) = -4.91$, $p < .001$.

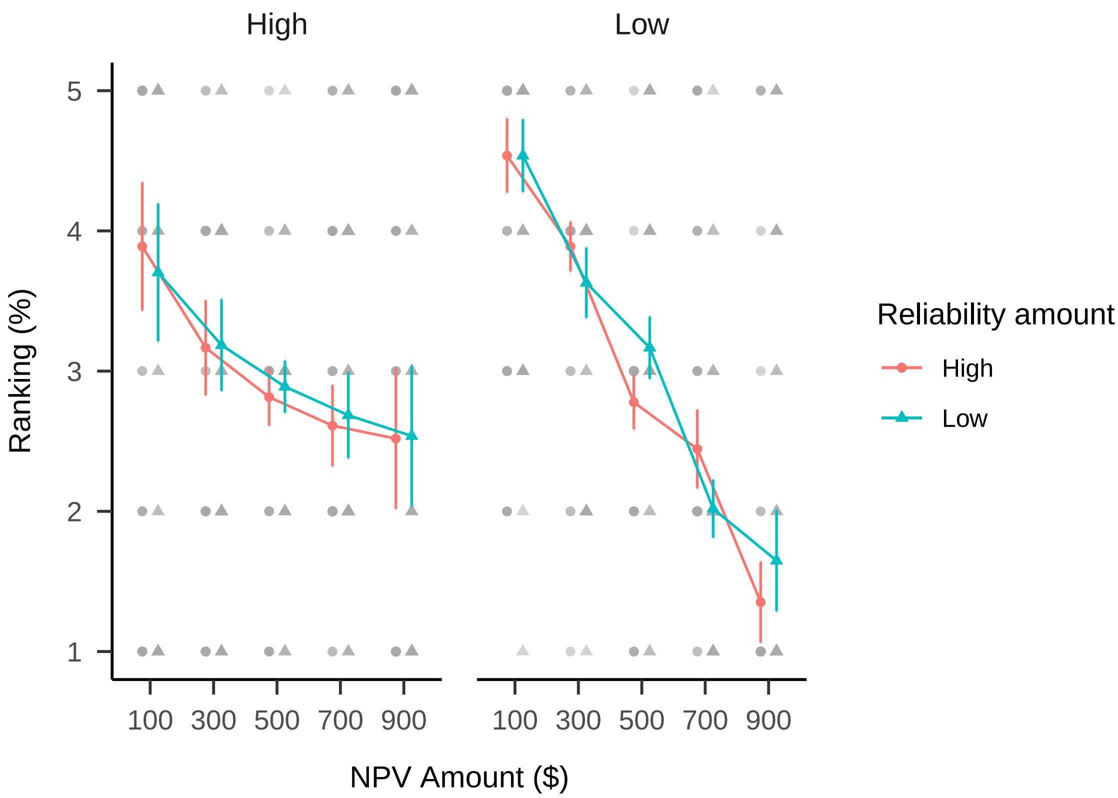


Figure B.16: Mean ranking.

Confidence

A mixed factorial ANOVA was conducted to investigate the effects of NPV amount, alignment, and numerical NPV reliability on participants' confidence ratings. Figure B.17 shows these data. Only the main effect of NPV amount was significant, $F(2.62, 139.08) = 2.97$, $p = .041$, $\hat{\eta}_p^2 = .053$.

NPV knowledge

A repeated-measures ANOVA was conducted to investigate the effects of experiment phase condition on participants' NPV knowledge rating. Figure B.18 shows these data. The main effect of phase was significant, $F(2.43, 128.59) = 7.80$, $p < .001$, $\hat{\eta}_p^2 = .128$. The post-explanation rating was significantly higher than the pre-explanation rating, $\Delta M = -0.59$, 95% CI $[-0.92, -0.26]$, $t(53) = -5.07$, $p < .001$. However, there were no significant differences in rating between any of the later phases.

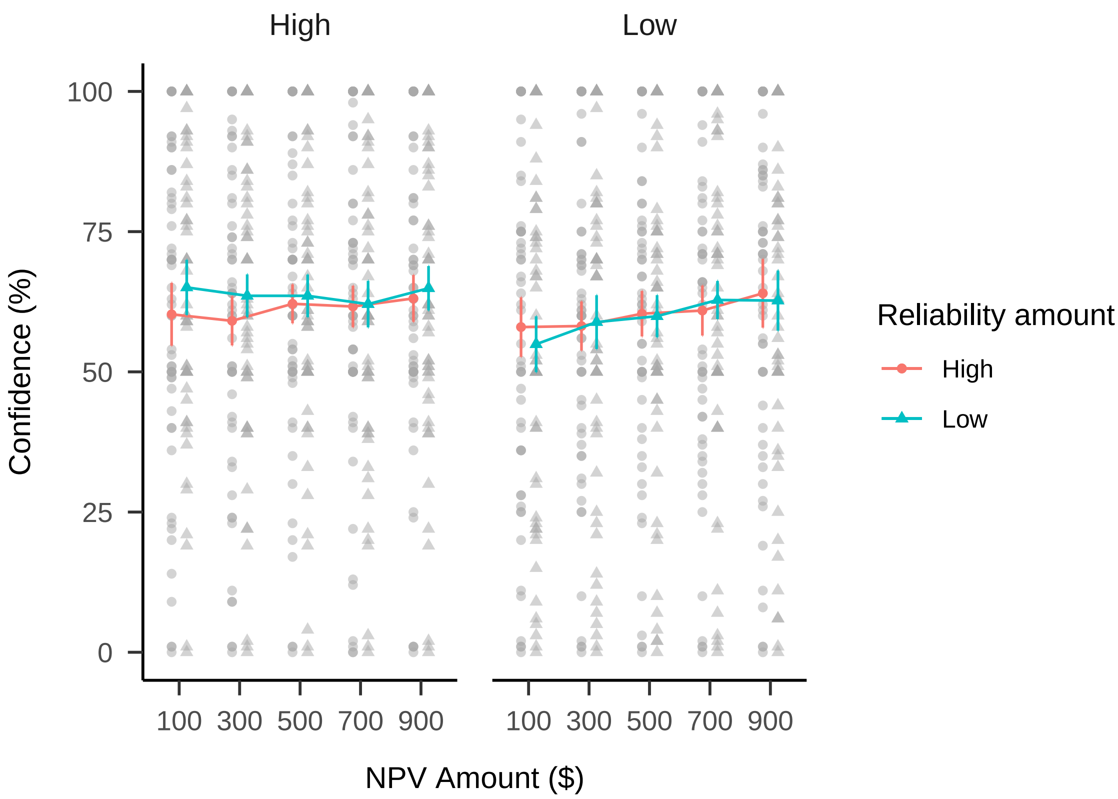


Figure B.17: Mean confidence.

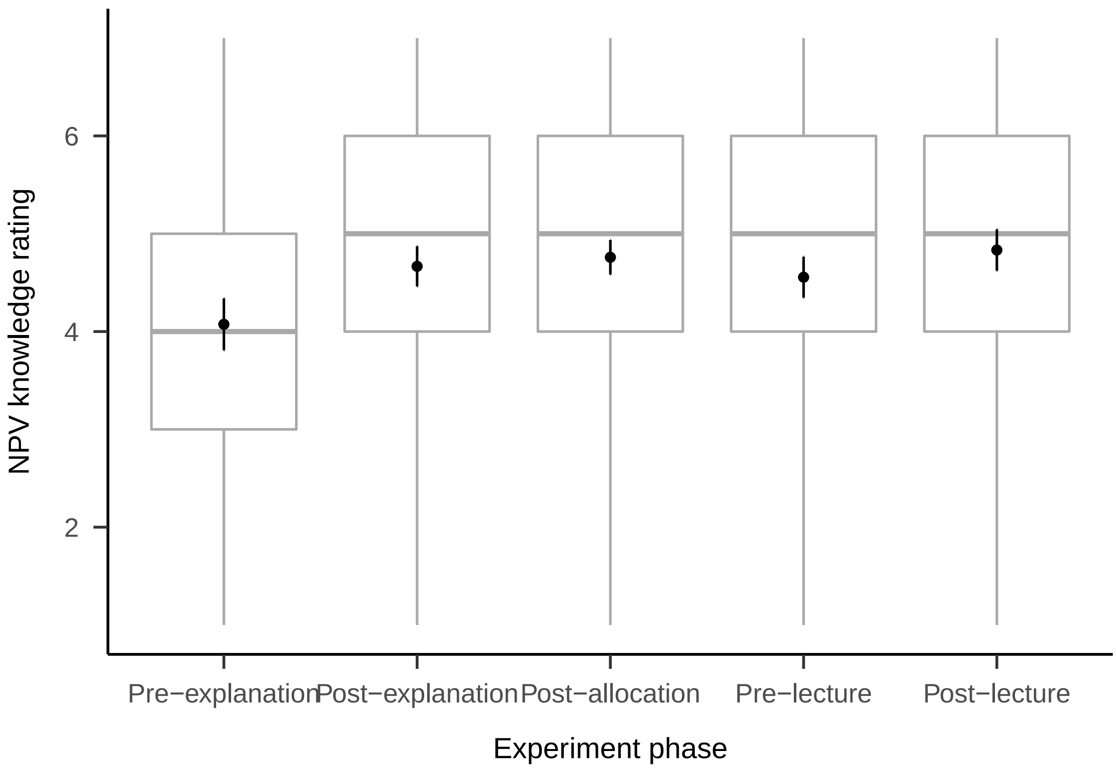


Figure B.18: Mean NPV knowledge rating.

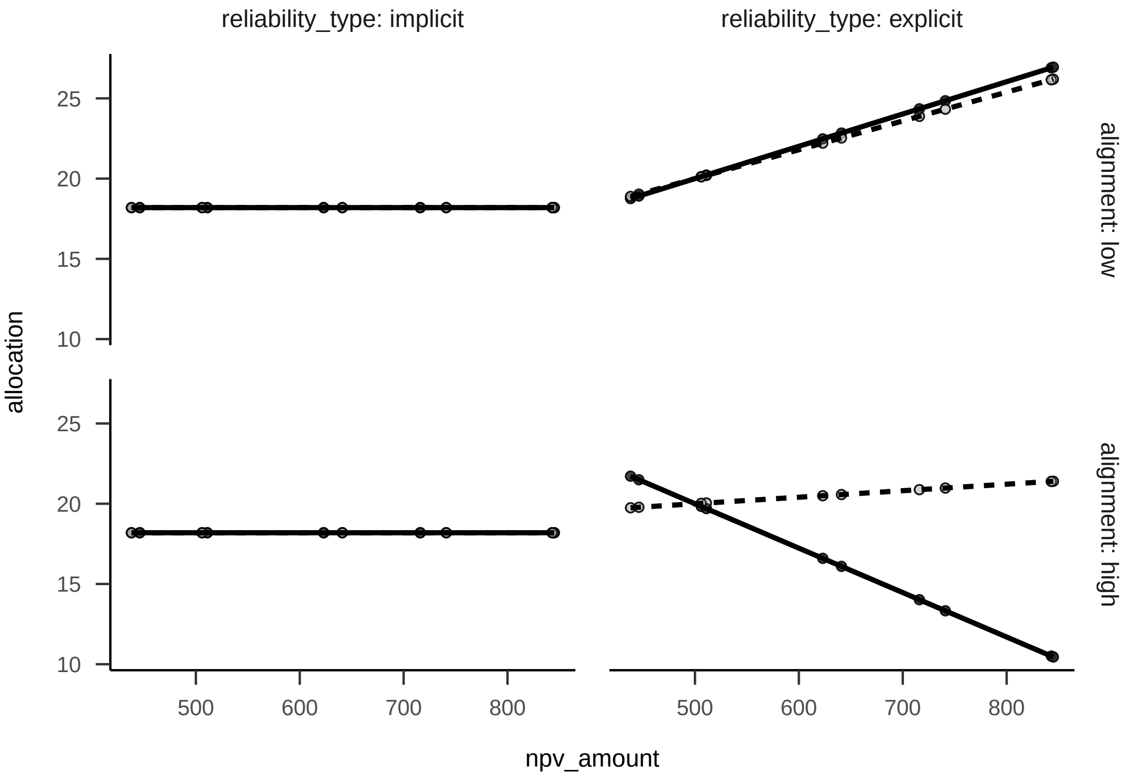


Figure B.19: Experiment 3 predicted data.

B.3 Experiment 3

Figure B.19 shows the simulated hypothesised effects for Experiment 3. These effects were constructed as a composite of Experiment 1 data (without the no NPV condition) for the verbal reliability type condition, and data from a pilot study (see Appendix B.8) for the numerical reliability type condition. Variance was removed to see the effects clearer.

B.3.1 Method

Participants

Power analysis A power analysis was conducted through simulation of the effects hypothesised in Experiment 3 (and the simple effects implied by them). The simulated data used the same regression coefficients as Experiment 2 for the explicit condition, no effects for the implicit condition (as shown in Figure B.19), and the intercept and residual variance of Experiment 2. The null effects were analysed using the two one-sided tests (TOST) procedure, or *equivalence* testing (Lakens et al., 2018), and setting the smallest effect size of interest to the smallest difference that leads to a significant equivalence between low and high implicit reliability for low alignment in Experiment 8 (see Appendix B.8). Figure B.20 shows the resulting power curve. The analysis suggests a total sample size of 448 ($112 \cdot 4$).

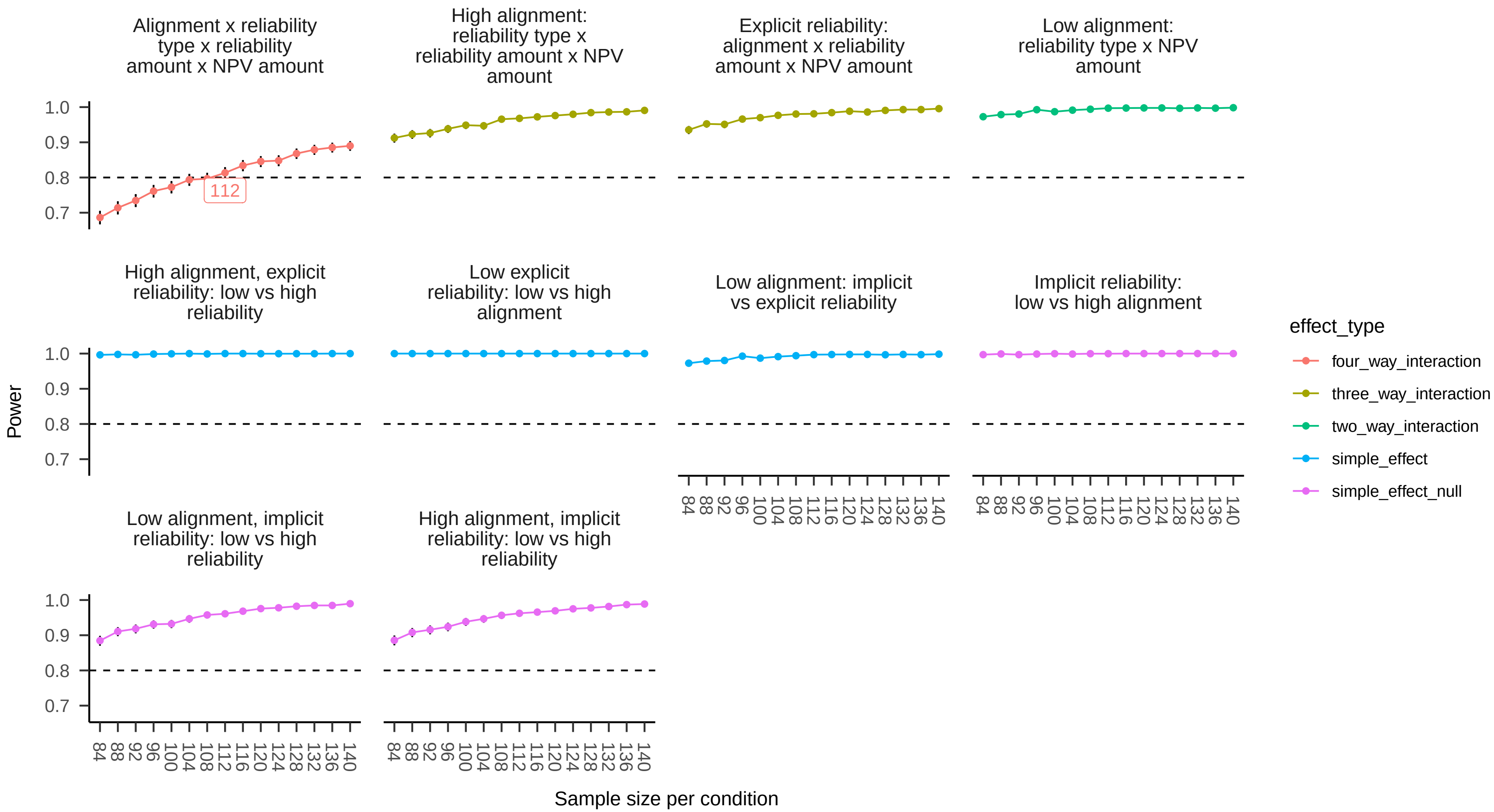


Figure B.20: Alignment Experiment 3 power curve. Labels indicate lowest sample size above 80% power.

Materials

Instructions Figures B.21 and B.22 show the instructions for the verbal and numerical reliability conditions, respectively.

Interstitial display Figure B.23 shows an example of an interstitial display.

B.3.2 Results

Allocation

The three-way interaction (reliability amount × NPV amount × reliability type) in the high alignment condition was significant, $\Delta M = 35.43$, 95% CI $[20.74, 50.12]$, $t(444) = 4.74$, $p < .001$. The NPV amount × reliability type (averaging over reliability amount) in the low alignment condition was significant, $\Delta M = 11.48$, 95% CI $[0.19, 22.77]$, $t(444) = 2.00$, $p = .046$. The association between allocation and NPV amount for those in the explicit low reliability condition was significantly stronger for those in the low alignment condition, than for those in the high alignment condition, $\Delta M = 35.68$, 95% CI $[22.27, 49.09]$, $t(444) = 5.23$, $p < .001$. The linear NPV amount trend for those in the low alignment condition was significantly stronger for those in the explicit reliability condition, than for those in the implicit reliability condition (averaging over reliability amount), $\Delta M = 11.48$, 95% CI $[0.19, 22.77]$, $t(444) = 2.00$, $p = .046$. The linear NPV amount trend for those in the implicit reliability condition was not significantly "equivalent" between those in the low and high reliability conditions for both those in the low alignment $\Delta M = 1.64$, 95% CI $[-8.74, 12.03]$, $t(444) = 0.31$, $p = .620$ and high alignment conditions $\Delta M = -1.21$, 95% CI $[-11.59, 9.18]$, $t(444) = 0.22$, $p = .589$. However, this is likely to be because the "lowest effect size of interest" estimate originated from an analysis used before data collection that was different to the one that one used after data collection. Specifically, a univariate linear model was originally used (treating NPV amount as a continuous predictor), whereas the data were ultimately analysed using a multivariate linear model (treating NPV amount as a repeated measures factor).

Imagine that you are a CEO of a large company composed of many individual businesses.

You will be shown information about a number of projects that your company is considering to invest in. Each project is independent of the others. Some specific information about the project itself is provided. In addition to those numbers, you will find each project's net present value (NPV), which is the company's estimation of the future returns of the project. An NPV that is greater than 0 (zero) indicates that there is an expectation of profit. The higher the NPV, the better the expectations for each project.

For each project, you will see an NPV, alongside a statement of whether NPV is considered to be a reliable (or an unreliable) metric for that project. There are usually a range of plausible NPV outcomes, so when NPV is considered to be "reliable" this means that the range of possible values is relatively narrow (indicating high confidence in the estimate). Conversely, when NPV is considered to be "unreliable", this means that the range of possible values is relatively wider (indicating low confidence in the estimate).

Your task is to rank the projects in order of investment priority and decide how to allocate the available budget (as a percentage) between them.

Test yourself on the above instructions. If Project A has an NPV of $100, and Project B has an NPV of $200, write in the following text box the name of the project that has a greater expectation of profit: Project

Continue

Figure B.21: Experiment 3 verbal reliability instructions. Border added for clarity.

B.4 Experiment 4

Experiment 4 further investigated the effects of alignment and verbal NPV reliability information on capital allocation decisions. Experiment 4 used the same methodology as in Experiment 1 (see Section 4.3.1), except for two main changes. First, the alignment conditions were manipulated within subjects. Second, the no NPV condition in the NPV reliability variable was removed.

The results of Experiment 1 were expected to replicate (see Section 4.3.2). Specifically, it was expected that in the high alignment condition, participants will be able to respond to each reliability condition, whereas, in the low alignment condition, they will rely more on NPV regardless of reliability condition.

In addition to the all-project allocation data analysed above, analyses for just the

Imagine that you are a CEO of a large company composed of many individual businesses.

You will be shown information about a number of projects that your company is considering to invest in. Each project is independent of the others. Some specific information about the project itself is provided. In addition to those numbers, you will find each project's net present value (NPV), which is the company's estimation of the future returns of the project. An NPV that is greater than 0 (zero) indicates that there is an expectation of profit. The higher the NPV, the better the expectations for each project.

For each project, you will see a range of possible NPVs alongside a 'midpoint'. The range literally represents the range of plausible outcomes (a uniform distribution), but the midpoint is the best guess, and hence is the same as a single NPV. That is, all values within the range are equally likely, but the midpoint is still the best guess because it is the value that is closest to all the other values.

Your task is to rank the projects in order of investment priority and decide how to allocate the available budget (as a percentage) between them.

Test yourself on the above instructions. If Project A has an NPV of $100, and Project B has an NPV of $200, write in the following text box the name of the project that has a greater expectation of profit: Project

Continue

Figure B.22: Experiment 3 numerical reliability instructions. Border added for clarity.

You will now see project display #1. It is important that you pay attention and read through the task carefully.

To show that you are reading and paying attention, please click on the following checkbox **before** clicking on "Continue":

Continue

Figure B.23: An example of an interstitial display in Experiment 3. Border added for clarity.

Table B.1: Experiment 4 group allocation.

Reliability amount	N
High	34
Low	37
Total	71

"target project" are also reported. This refers to allocation of capital to the project that had the highest NPV, but the lowest value on concrete measures intrinsic to the actual product (e.g., the capacity of a laptop in gigabytes). Therefore, a higher allocation value indicated a higher reliance on NPV. Further, the method and analyses for the confidence measure are also reported.

Hypothesis B.4. Participants will be more confident about their decisions in the high alignment condition than in the low alignment condition.

B.4.1 Method

Participants

Seventy-one people (44 female) were recruited from the online recruitment platform Prolific. Participants were compensated at a rate of £5 an hour. The average age was 33.27 (SD = 10.21, min = 18, max = 65). Table B.1 shows the between-subjects condition allocation. The two alignment conditions (low and high) were presented within subjects and the order of their presentation was randomised. Further, NPV amount was varied within subjects.

Materials

The project display, allocation task, and confidence task were the same as in Experiment 1 (see Section 4.2.1).

Instructions Participants were shown similar instructions to Experiment 1 (see Section 4.2.1), except for the addition of references to the multiple displays and

You will be shown information about a number of projects that a consumer products firm is considering to invest in. Some specific information about the product itself is provided. In addition to those numbers, you will find each project's net present value (NPV), which is the company's estimation of the future returns of the project. An NPV that is greater than 0 (zero) indicates that there is an expectation of profit. **The higher the NPV, the better the expectations for each project.** However, it is important to note that NPV is a very noisy measure relative to the other more specific measures because it relies on future forecasting. As such, **NPV is very unreliable and should be relied upon only as a last result; the specific project's measures should be used instead.**

We would like you to take the role of the manager in charge of capital allocation for the firm. This firm is specifically interested in investing in the development of high-end goods, so your valuations should reflect this. That is, even though there might be a market for the lower-end products in the descriptions that you will see, **you should be aiming to invest in the products with the highest objective value**. The features of the products that are listed matter because they reflect the direct value of the product, whereas financial measures such as NPV may reflect other factors, thus making it noisier, as mentioned above.

You will see a set of five different projects in each page, and for each set you must decide how to allocate the capital available for investment this year among the different projects. Note that this is not the operational budget (advertising, etc.), but rather the funds to be used for investment in developing the new products. You will do this by selecting a percentage value for each project, such that the budget is allocated completely among each set of projects. Critically, treat each set of projects as independent of one another; one page's project set allocation does not impact another page's allocation.

Figure B.24: Experiment 4 low reliability instructions. Border added for clarity.

the removal of an explanation about the forecasting task. Figures B.24 and B.25 show the instructions for each NPV reliability condition.

Procedure

The procedure was the same as in Experiment 1, except that there were no forecasting or ranking tasks.

B.4.2 Results

A mixed factorial ANOVA was conducted to investigate the effects of alignment, verbal NPV reliability, and NPV amount on participants' project allocations. As

You will be shown information about a number of projects that a consumer products firm is considering to invest in. Some specific information about the product itself is provided. In addition to those numbers, you will find each project's net present value (NPV), which is the company's estimation of the future returns of the project. An NPV that is greater than 0 (zero) indicates that there is an expectation of profit. **The higher the NPV, the better the expectations for each project.** NPV is a very useful measure relative to the other more specific measures because it can be calculated regardless of the type of product. As such, **NPV is very reliable in most cases**.

We would like you to take the role of the manager in charge of capital allocation for the firm. This firm is specifically interested in investing in the development of high-end goods, so your valuations should reflect this. That is, even though there might be a market for the lower-end products in the descriptions that you will see, **you should be aiming to invest in the products with the highest objective value.**

You will see a set of five different projects in each page, and for each set you must decide how to allocate the capital available for investment this year among the different projects. Note that this is not the operational budget (advertising, etc.), but rather the funds to be used for investment in developing the new products. You will do this by selecting a percentage value for each project, such that the budget is allocated completely among each set of projects. Critically, treat each set of projects as independent of one another; one page's project set allocation does not impact another page's allocation.

Figure B.25: Experiment 4 high reliability instructions. Border added for clarity.

seen in Figure B.26, the alignment × reliability amount × NPV amount interaction was not significant, $F(3.64, 250.93) = 1.71$, $p = .153$, $\hat{\eta}_p^2 = .024$. This is most likely due to the fact that the reliability amount × NPV amount interaction was significant in the high alignment condition, $\Delta M = -64.82$, 95% CI $[-102.70,\ -26.93]$, $t(69) = -3.41$, $p = .001$, the low alignment condition, $\Delta M = -37.74$, 95% CI $[-70.92,\ -4.56]$, $t(69) = -2.27$, $p = .026$, as well as averaging over alignment conditions, $F(2.98, 205.65) = 4.90$, $p = .003$, $\hat{\eta}_p^2 = .066$. Despite this, the alignment × NPV amount interaction was significant, $F(3.64, 250.93) = 3.19$, $p = .017$, $\hat{\eta}_p^2 = .044$, such that the linear trend of NPV amount was stronger in the low alignment, $\Delta M = 13.28$, 95% CI $[-3.31,\ 29.87]$, $t(69) = 1.60$, $p = .115$ than in the high alignment condition, $\Delta M = -10.67$, 95% CI $[-29.62,\ 8.27]$, $t(69) = -1.12$, $p = .265$. However, neither of these trends were individually significant.

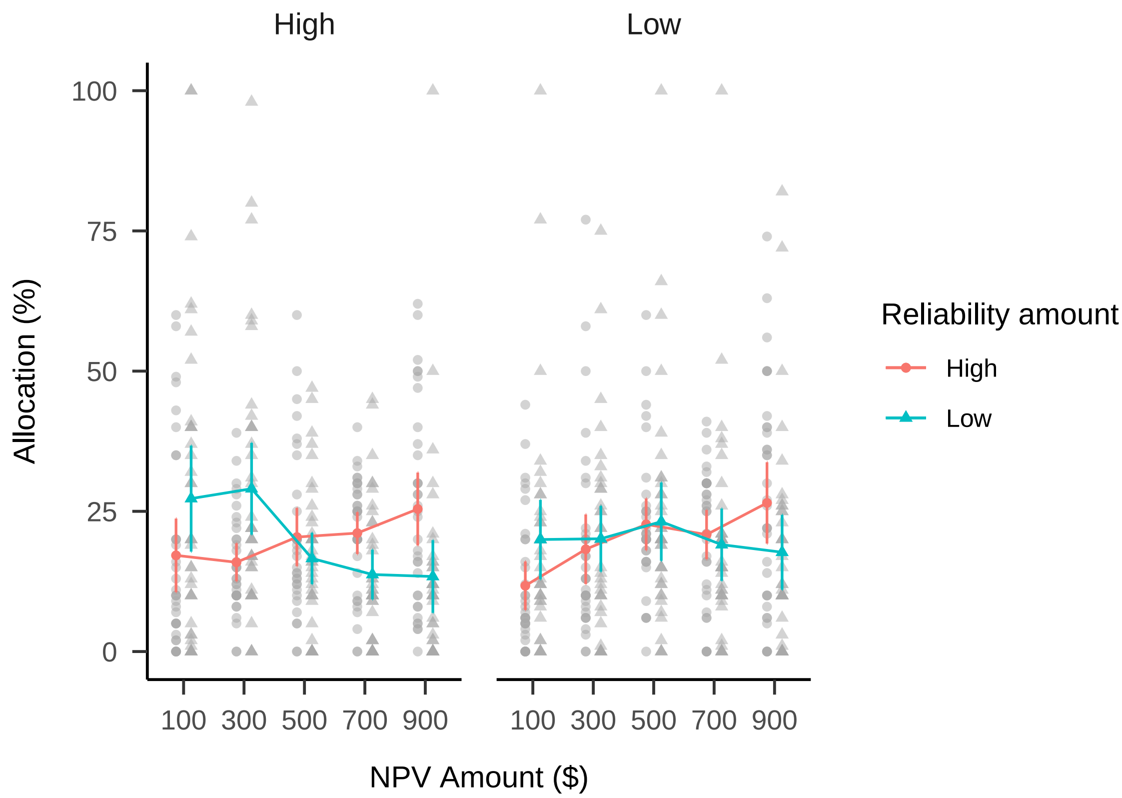


Figure B.26: Mean project allocation in Experiment 4. Error bars represent 95% confidence intervals based on the multivariate model. Note that this mixed factorial design does not allow for using confidence intervals to make inferences by "eye" across conditions.

Confidence

A mixed factorial ANOVA was conducted to investigate the effects of alignment, verbal NPV reliability, and NPV amount on participants' confidence in their allocations. As seen in Figure B.27, the difference between alignment conditions was not significant, $F(1, 69) = 2.76$, $p = .101$, $\hat{\eta}_p^2 = .038$. However, the reliability × alignment interaction was significant, as well as the NPV amount × alignment interaction. An exploratory analysis was conducted of the relevant simple effects for each interaction, applying a Šidák correction to the p values for each effect. None of the simple effects were significant after the correction.

The raw mean differences indicated that there was a greater difference between reliability conditions in the low alignment condition, $\Delta M = -8.83$, 95% CI $[-17.84,\ 0.18]$, $t(69) = -1.95$, $p = .055$ compared to the high alignment condition, $\Delta M = 2.37$, 95% CI $[-8.65,\ 13.40]$, $t(69) = 0.43$, $p = .669$. Further, there was a

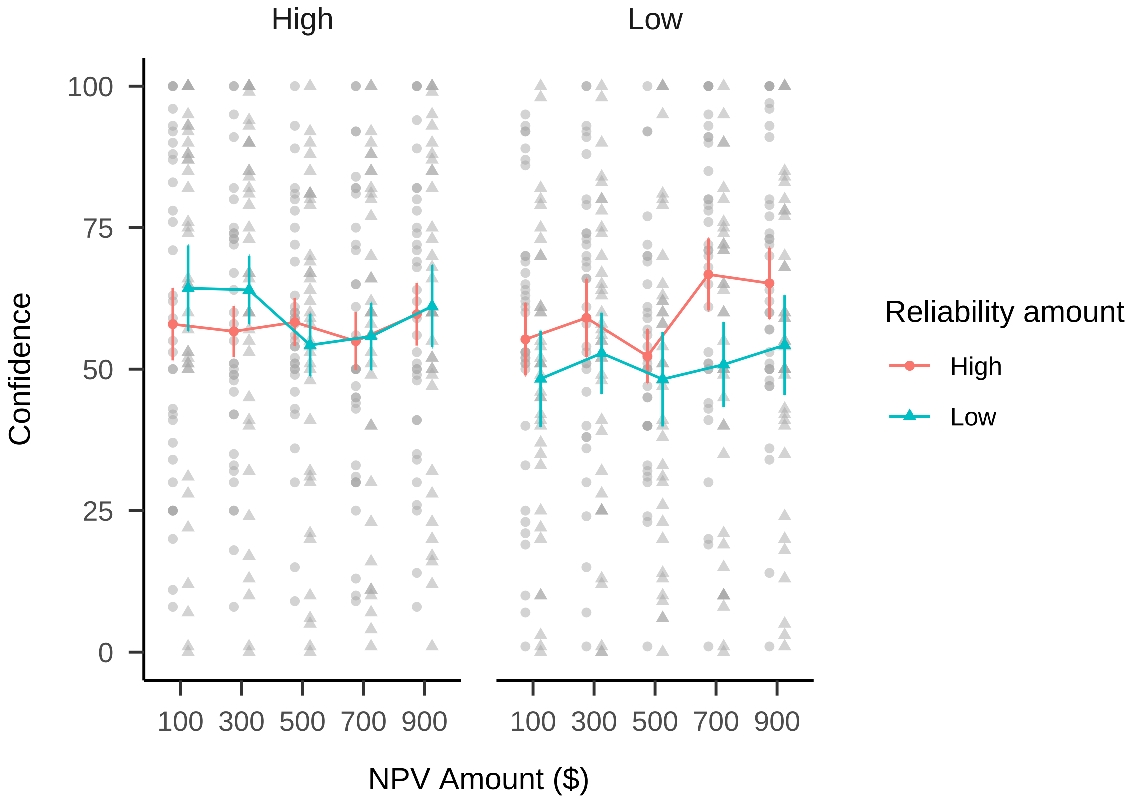


Figure B.27: Mean confidence. Error bars represent 95% confidence intervals based on the multivariate model. Note that this mixed factorial design does not allow for using confidence intervals to make inferences by "eye" across conditions.

stronger linear trend of NPV amount in the low alignment condition, $\Delta M = 18.70$, 95% CI $[-0.87,\ 38.26]$, $t(69) = 2.44$, $p = .067$ compared to the high alignment condition, $\Delta M = -6.40$, 95% CI $[-26.84,\ 14.04]$, $t(69) = -0.80$, $p = .891$.

B.4.3 Discussion

Experiment 4 found evidence for most of the hypotheses. As per Hypothesis 4.4, laypeople responded appropriately to verbal reliability instructions in the high alignment condition. Contrary to Hypothesis 4.5, however, participants also did this in the low reliability condition. That is, regardless of the type of project display, participants tended to use NPV more when they were told that it was reliable and tended to use it less when they were told that it was unreliable. Further, there was no evidence that this effect was moderated by alignment condition, contrary to Hypothesis 4.3. However, the linear NPV amount trend was higher in the high than low alignment condition, when averaging over reliability amount, as predicted in Hypothesis 4.2. This suggests that overall participants still make more use of NPV information when it is hard to compare between projects.

Hypothesis B.4 was not supported, as there was no evidence of a main effect of alignment on participants' confidence in their allocation decisions. Instead, exploratory analyses showed that the difference in confidence between reliability conditions was greater in the low alignment condition. This may reflect participants' difficulty in making sense of their choices when alignment was low, given more confidence when assured of the reliability of NPV. In the high alignment condition, on the other hand, regardless of reliability condition, they had a way of using the reliability information. Further, confidence also seemed to increase more with NPV, on average, more when projects were dissimilar, which provides evidence for their reliance on NPV in this situation.

B.5 Experiment 5

Experiment 5 further investigated the effects of alignment and explicit NPV Presence information on forecasting. The goal of this experiment was to replicate the forecasting results of Experiment 1, but with a sample that has investing experience. As before, the hypothesis was that people's forecasting would be less variable when comparing projects with alignable differences, than when comparing projects with non-alignable differences.

B.5.1 Method

Participants

Sixty people (2 female) were recruited from Reddit. Participants were compensated with a virtual Gold Award, which gives the recipient a week of a premium version of Reddit and 100 virtual coins. The average age was 28.17 (SD = 8.73, min = 16, max = 61). Table B.2 shows the between-subjects condition allocation.

Table B.2: Experiment 5 group allocation.

Alignment	Reliability amount	N
High	Absent	19
High	Present	17
Low	Absent	14
Low	Present	10
Total	-	60

Materials

Risky investment task The only task that was used was the forecasting task used in Experiment 1, except that it was fixed by adding the relevant percentage intervals that were left out in Experiment 1, seen in Figure B.28.

Procedure

The procedure was the same as in Experiment 1, except participants only completed the forecasting task.

B.5.2 Results

Forecast mean

A mixed factorial ANOVA was conducted to investigate the effects of alignment and NPV presence on participants' forecasts. As seen in Figure B.29, the alignment × reliability amount × NPV amount interaction was not significant, $F(2.75, 154.16) = 0.72$, $p = .531$, $\hat{\eta}^2_p = .013$. Despite this, as in the previous experiments, the interaction between the linear NPV trend and NPV presence was significant in the high alignment condition, $M = -0.12$, 95% CI $[-0.21, -0.02]$, $t(56) = -2.50$, $p = .015$, but not in the low alignment condition, $M = -0.05$, 95% CI $[-0.16, 0.07]$, $t(56) = -0.81$, $p = .424$.

Forecast SD

A mixed factorial ANOVA was conducted to investigate the effects of alignment and NPV presence on participants' forecast SDs. As seen in Figure B.30, there

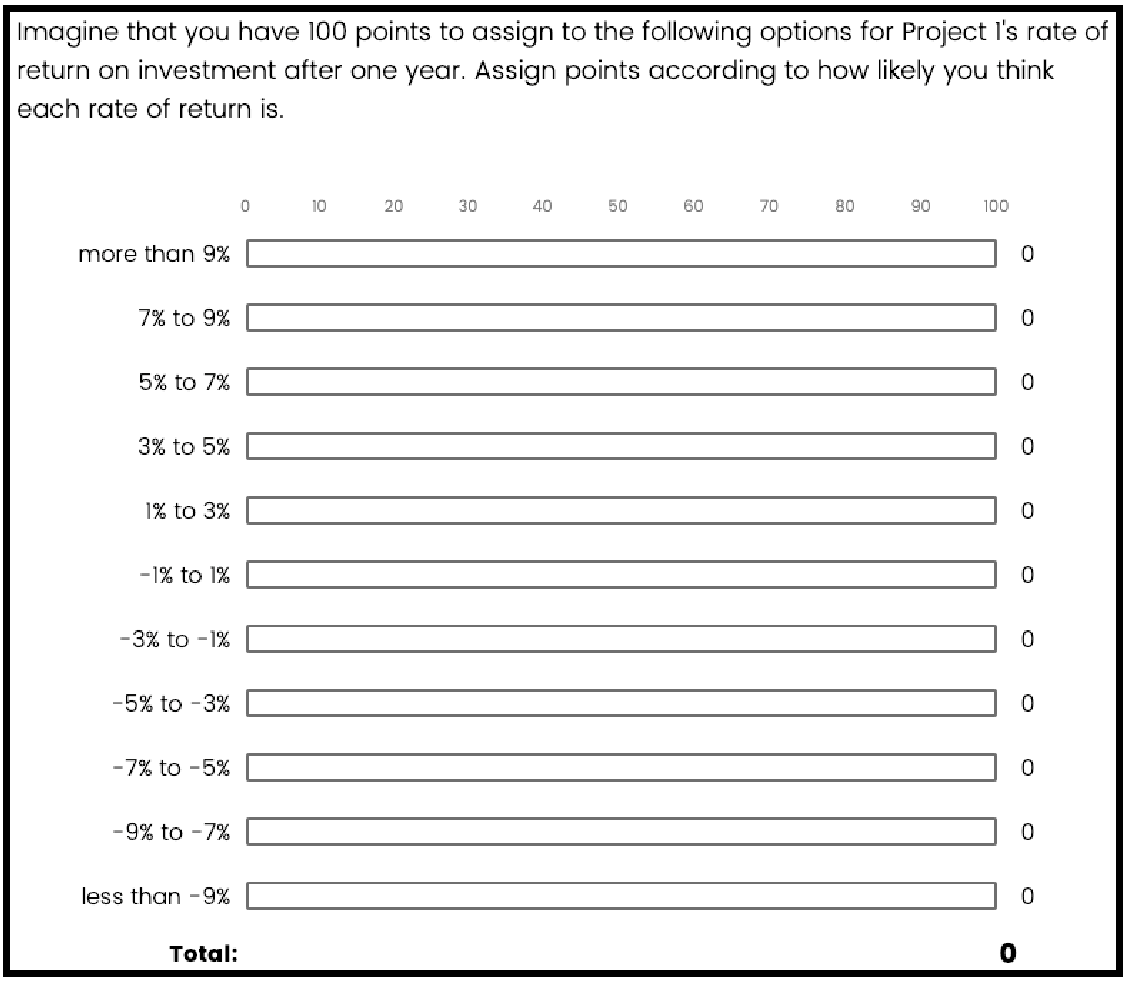


Figure B.28: An example of the forecasting task in Experiment 5. Border added for clarity.

were no significant differences between alignment conditions, $F(1, 56) = 0.41$, $p = .522$, $\hat{\eta}_p^2 = .007$. The alignment × reliability amount × NPV amount interaction was not significant, $F(2.99, 167.18) = 1.27$, $p = .287$, $\hat{\eta}_p^2 = .022$. However, as above, the interaction between the linear NPV trend and NPV presence was significant in the high alignment condition, $M = 0.02$, 95% CI $[0.00,\ 0.04]$, $t(56) = 2.06$, $p = .045$, but not in the low alignment condition, $M = 0.01$, 95% CI $[-0.02,\ 0.03]$, $t(56) = 0.38$, $p = .709$.

B.5.3 Discussion

Experiment 5 found that people with some investing experience responded to alignable information in the form of NPV when it is given, but did not show the

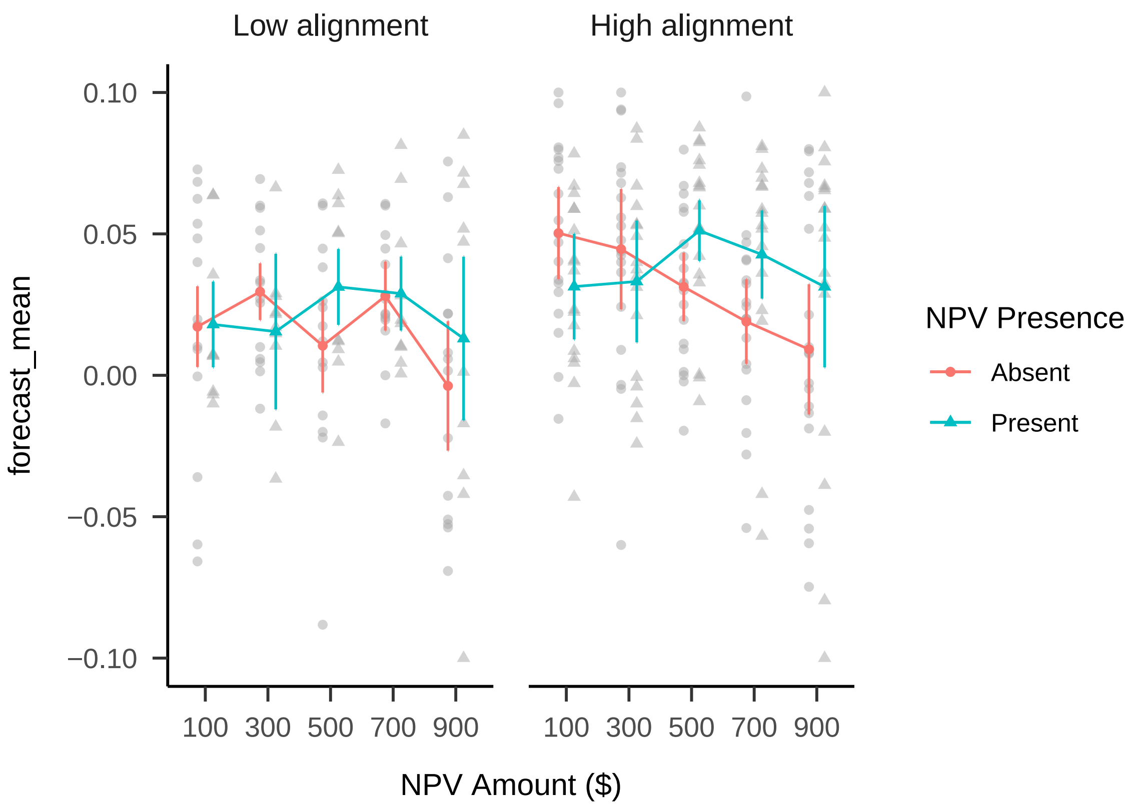


Figure B.29: Mean forecasts.

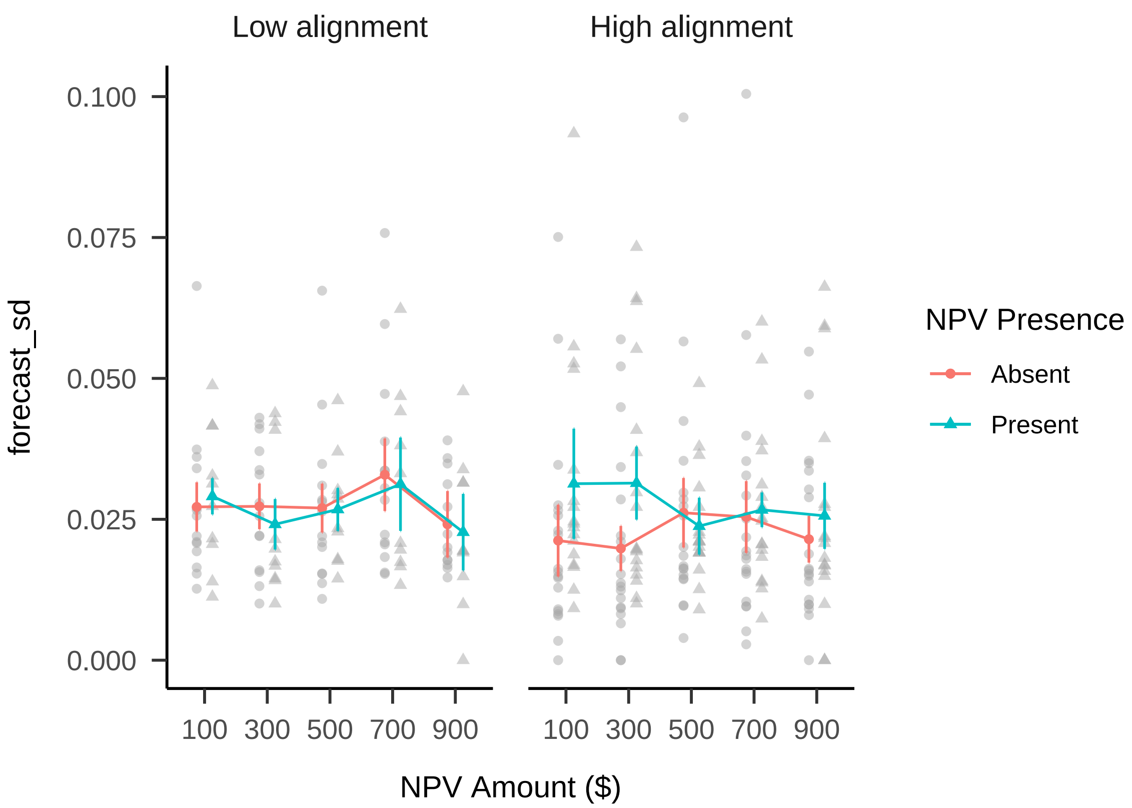


Figure B.30: Mean forecast SD.

Table B.3: Experiment 6 group allocation.

Alignment	Reliability amount	N
High	Absent	97
High	Present	87
Low	Absent	101
Low	Present	104
Total	-	389

same effect of alignment on forecast SD that was seen in Experiment 1.

B.6 Experiment 6

Experiment 6 further investigated the effects of alignment and NPV Presence information on forecasting. Experiment 5 did not clearly replicate the forecasting results of Experiment 1, potentially due to low power, so this experiment collected a much larger sample size. As before, it was hypothesised that people's forecasting would be less variable when comparing projects with alignable differences, than when comparing projects with non-alignable differences.

B.6.1 Method

Participants

Three hundred and eighty-nine people (170 female) were recruited from the online recruitment platform Prolific. Participants were compensated at a rate of £5 an hour. The average age was 32.39 (SD = 11.89, min = 18, max = 75). Table B.3 shows the condition allocation.

Materials

The materials were the same as in Experiment 5.

Procedure

The procedure was the same as in Experiment 5.

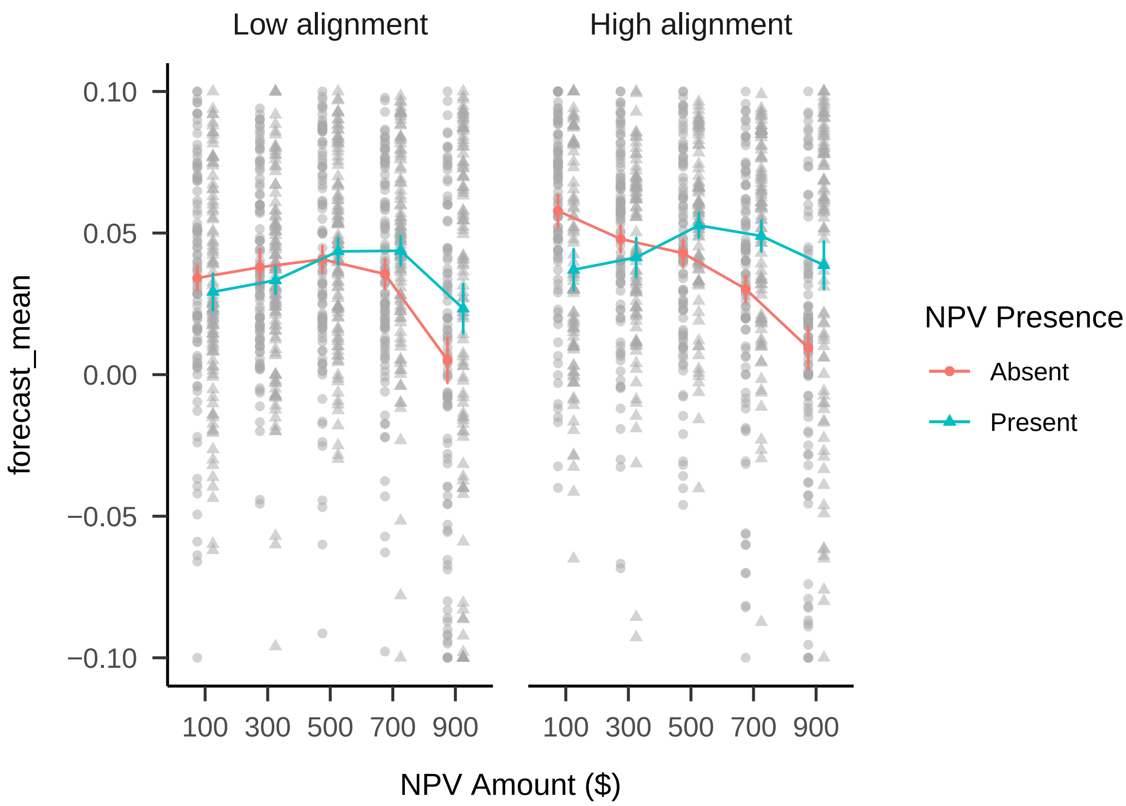


Figure B.31: Mean forecasts.

B.6.2 Results

Forecast mean

A mixed factorial ANOVA was conducted to investigate the effects of alignment and NPV presence on participants' forecasts. As seen in Figure B.31, the alignment $\times$ reliability amount $\times$ NPV amount interaction was significant, $F(3.08, 1, 186.45) = 3.13$, $p = .024$, $\hat{\eta}_p^2 = .008$. As in the previous experiments, the interaction between the linear NPV trend and NPV presence was significant in both the high alignment condition, $M = -0.13$, 95% CI $[-0.16, -0.09]$, $t(385) = -6.57$, $p < .001$, and in the low alignment condition, $M = -0.06$, 95% CI $[-0.09, -0.02]$, $t(385) = -3.28$, $p = .001$.

Forecast SD

A mixed factorial ANOVA was conducted to investigate the effects of alignment and NPV presence on participants' forecast SDs. As seen in Figure B.32, the

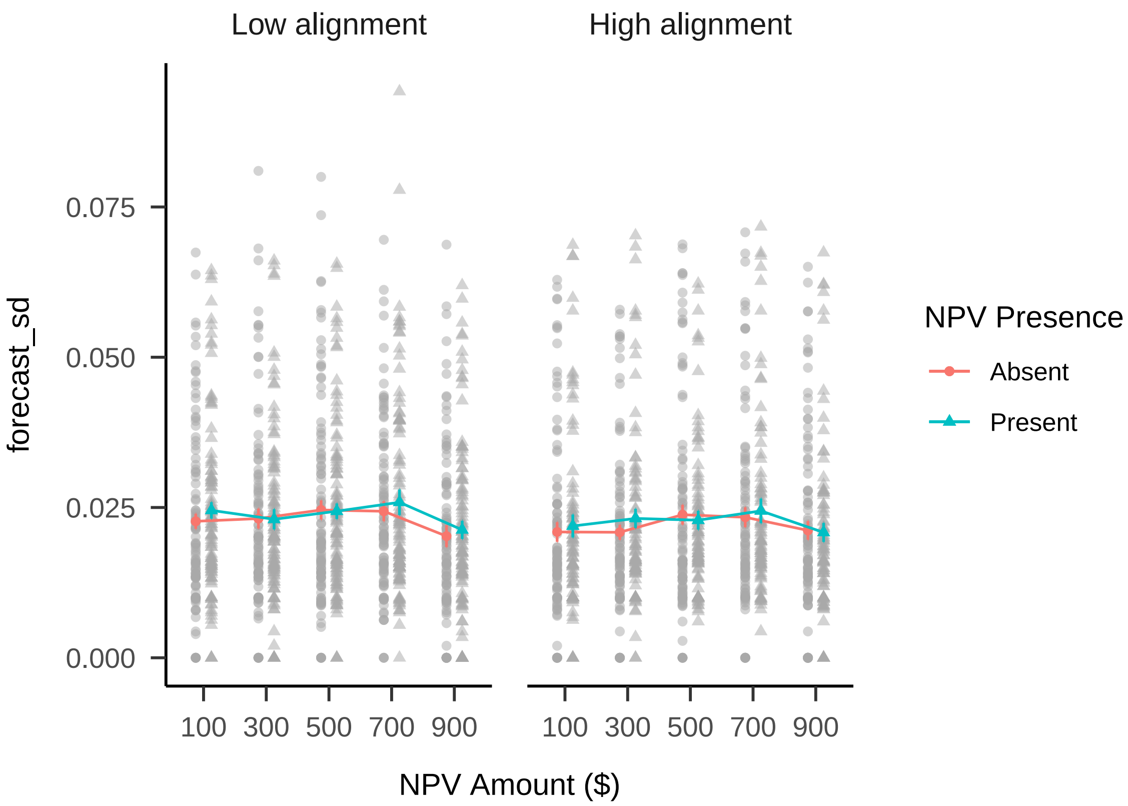


Figure B.32: Mean forecast SD.

alignment × reliability amount × NPV amount interaction was not significant, $F(3.45, 1, 328.06) = 0.82$, $p = .496$, $\hat{\eta}_p^2 = .002$. The main effect of alignment was not significant, $F(1, 385) = 0.64$, $p = .424$, $\hat{\eta}_p^2 = .002$.

B.6.3 Discussion

Experiment 6 did not replicate the effect of alignment on forecast SD seen in Experiment 1. However, participants still seemed to pay attention to the task, as seen in their higher forecasts for the high NPV project when NPV was present.

B.7 Experiment 7

Experiment 7 investigated potential ways to facilitate people's use of variance in capital allocation. Arguably, people's decisions should be moderated by variance, especially with a small set of projects. That is, when considering between two potential measures to use for capital allocation, underlying variance should serve as a

Table B.4: Experiment 7 group allocation.

Hint	Variance	N
Hint salience	High	11
Hint salience	Low	11
No hint	High	9
No hint	Low	13
Salience only	High	19
Salience only	Low	16
Total	-	79

moderator for decision making, with measures with narrow ranges being relied upon more than those with wider ranges. As such, this experiment presented participants with the same capital allocation scenario as in Experiment 2, but only in low numerical reliability displays. Experiment 7 varied both the variance associated with NPV, and the extent to which participants were explicitly hinted to use the variance information. It was predicted that participants would be more likely to moderate their allocations through variance when told explicitly to do so with increased salience for variance, than when only salience is increase, or when no hint is given.

B.7.1 Method

Participants

Seventy-nine people (35 female) were recruited from the online recruitment platform Prolific. Participants were compensated at a rate of £5 an hour. The average age was 31.15 (SD = 11.11, min = 16, max = 71). Table B.4 shows the between-subjects condition allocation.

Instructions

As seen in Figure B.33, participants in the no hint condition saw the same instructions as in Experiment 1. As seen in Figure B.34, those in the salience only condition saw the instructions along with a sentence that drew attention to the *Cash inflow range* row. As seen in Figure B.35, those in the salience + hint

Allocation task

You will be shown information about a number of projects that a consumer products firm is considering to invest in. Some specific information about the product itself is provided.

In addition to those numbers, you will find each project's projected cash inflow for the first year (the money that it is expected to generate), and the net present value (NPV) that was calculated using those figures. It is usually unclear exactly what the future cash inflow is, so instead of a single cash inflow value, it will be given as a range (assume that all the values in that range are equally likely). Also assume that all the other elements that are required to calculate NPV (i.e., the discount rate and initial investment) are identical for all projects.

We would like you to take the role of the manager in charge of capital allocation for the firm. This firm is specifically interested in investing in the development of high-end goods, so your valuations should reflect this. That is, even though there might be a market for the lower-end products in the descriptions that you will see, **you should be aiming to invest in the products with the highest intrinsic quality.**

You will decide how to rank the projects in order of investment priority, and decide how to allocate the capital available for investment this year among the different projects. Note that this is not the operational budget (advertising, etc.), but rather the funds to be used for investment in developing the new products. You will do this by selecting a percentage value for each project, such that the budget is allocated completely among each set of projects.

Figure B.33: Instructions for the no hint condition. Border added for clarity.

condition saw the instructions along with a specific description of how to use the variance information in their allocation decisions.

Project display

The project displays were the same as Experiment 2 (see Figure B.36).

Procedure

Participants read the instruction page as per their hint condition, and then proceeded to complete one set of ranking and allocations.

Allocation task

You will be shown information about a number of projects that a consumer products firm is considering to invest in. Some specific information about the product itself is provided.

In addition to those numbers, you will find each project's projected cash inflow for the first year (the money that it is expected to generate), and the net present value (NPV) that was calculated using those figures. It is usually unclear exactly what the future cash inflow is, so instead of a single cash inflow value, it will be given as a range (assume that all the values in that range are equally likely). Also assume that all the other elements that are required to calculate NPV (i.e., the discount rate and initial investment) are identical for all projects.

We would like you to take the role of the manager in charge of capital allocation for the firm. This firm is specifically interested in investing in the development of high-end goods, so your valuations should reflect this. That is, even though there might be a market for the lower-end products in the descriptions that you will see, **you should be aiming to invest in the products with the highest intrinsic quality.**

You will decide how to rank the projects in order of investment priority, and decide how to allocate the capital available for investment this year among the different projects. Note that this is not the operational budget (advertising, etc.), but rather the funds to be used for investment in developing the new products. You will do this by selecting a percentage value for each project, such that the budget is allocated completely among each set of projects.

Pay special attention to the cash inflow ranges as they are important to the decision making process.

Figure B.34: Instructions for the salience only condition. Border added for clarity.

B.7.2 Results

Allocation

A mixed factorial ANOVA was conducted to investigate the effects of hint and NPV variance on participants' allocations. As seen in Figure B.37, none of the interactions or main effects were significant.

Ranking

A mixed factorial ANOVA was conducted to investigate the effects of hint and NPV variance on participants' project rankings. As seen in Figure B.38,

Allocation task

You will be shown information about a number of projects that a consumer products firm is considering to invest in. Some specific information about the product itself is provided.

In addition to those numbers, you will find each project's projected cash inflow for the first year (the money that it is expected to generate), and the net present value (NPV) that was calculated using those figures. It is usually unclear exactly what the future cash inflow is, so instead of a single cash inflow value, it will be given as a range (assume that all the values in that range are equally likely). Also assume that all the other elements that are required to calculate NPV (i.e., the discount rate and initial investment) are identical for all projects.

We would like you to take the role of the manager in charge of capital allocation for the firm. This firm is specifically interested in investing in the development of high-end goods, so your valuations should reflect this. That is, even though there might be a market for the lower-end products in the descriptions that you will see, **you should be aiming to invest in the products with the highest intrinsic quality.**

You will decide how to rank the projects in order of investment priority, and decide how to allocate the capital available for investment this year among the different projects. Note that this is not the operational budget (advertising, etc.), but rather the funds to be used for investment in developing the new products. You will do this by selecting a percentage value for each project, such that the budget is allocated completely among each set of projects.

Pay special attention to the cash inflow ranges, because they imply the extent to which you should be relying on that particular NPV. NPVs with higher variance (greater cash inflow ranges) should be relied upon less. For instance, imagine two NPVs, one with a future cash flow range of \$100-\$1900 (range of ±90% around the average), and one with a range of \$900-\$1100 (range ±10% around the average). The average of each range is the same (\$1000), and yet the first estimate is more uncertain than the second. As such, with the first estimate, other factors should be used more in the decision making than the NPV, while with the second estimate, the NPV can be relied on more confidently. In general, ranges of less than 10% either way of the average are considered very low variance, and those more than 80% are considered very high variance.

Figure B.35: Instructions for the salience + hint condition. Border added for clarity.

	Project 1	Project 2	Project 3	Project 4	Project 5
Product	Laptop	Laptop	Laptop	Laptop	Laptop
RAM (GB)	4	8	32	2	16
Hard drive (GB)	500	750	2000	250	1000
Resolution (px)	900	1080	1440	768	1200
Processor (Ghz)	2.4	3.2	3.8	1.6	3.6
Cash inflow range for Year 1 ($)	$5,890-$6,510	$5,738-$6,342	$5,244-$5,796	$6,137-$6,783	$5,538.50-$6,121.50
NPV ($)	$636.36	$490.91	$18.18	$872.73	$300.00

Figure B.36: The projects display.

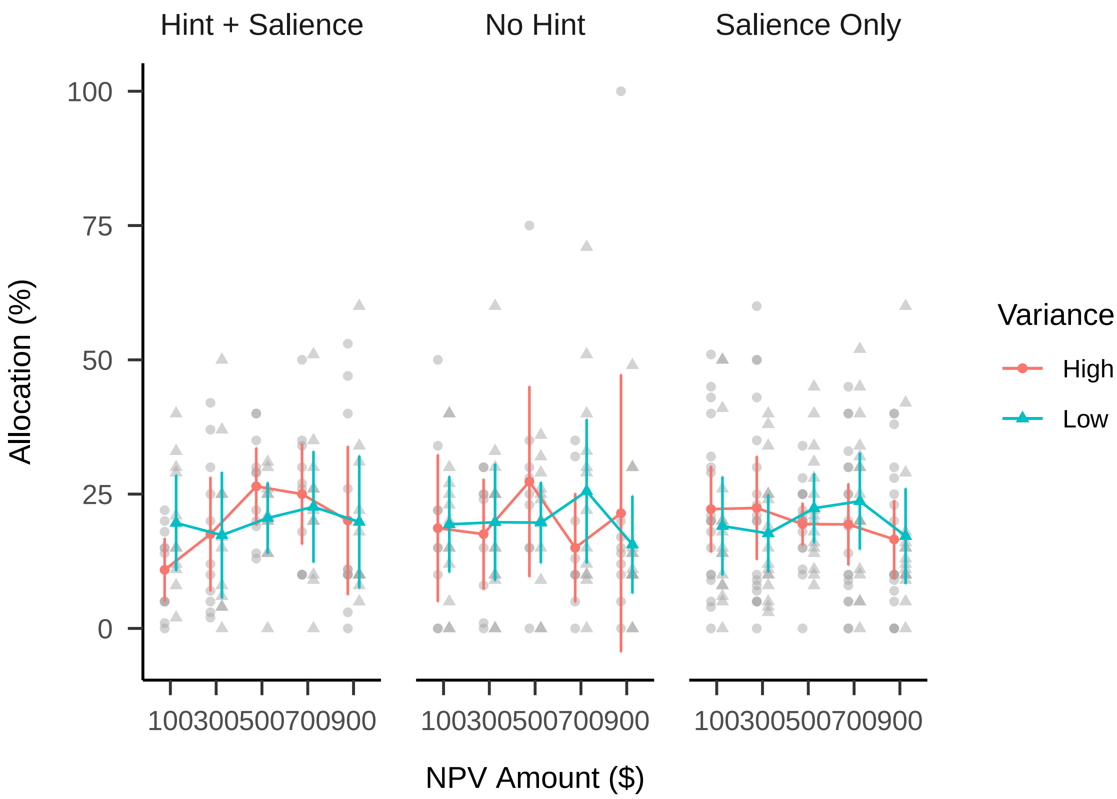


Figure B.37: Mean allocation.

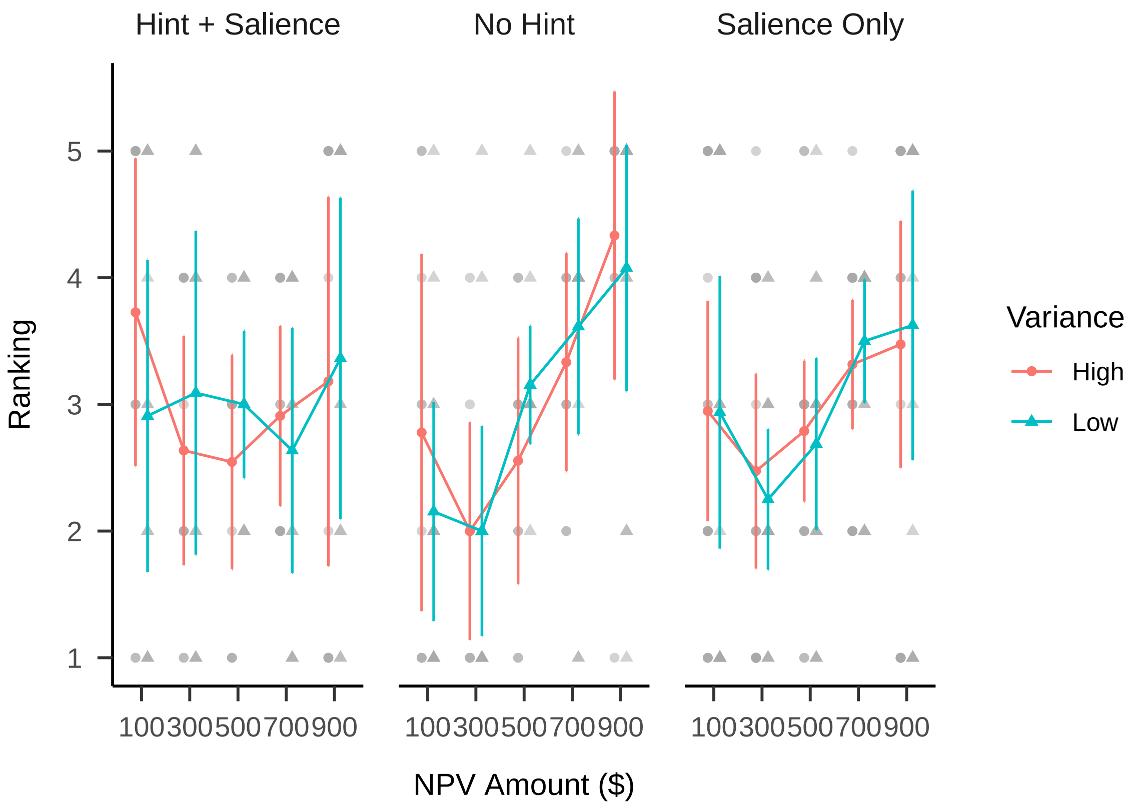


Figure B.38: Mean ranking.

only the main effect of NPV amount was significant, $F(2.03, 148.33) = 7.59$, $p = .001$, $\hat{\eta}_p^2 = .094$.

B.7.3 Discussion

Experiment 7 found that explicitly telling participants how to use variance information to moderate their allocations did not help them do so. However, there was an increased reliance on NPV with more hints in the ranking data. This suggests that the hint manipulations potentially simply increase participants' attention to NPV. It is possible that the study was under-powered, as there was substantial variance in both the allocation and ranking data. Future work should attempt to replicate this experiment with a larger sample.

B.8 Experiment 8

Experiment 8 tested the alignment and reliability effects found in the previous experiments, while addressing their limitations. Experiments 1 and 4 found a verbal reliability effect. That is, laypeople allocated more capital to a high NPV project, depending on how reliable they were told NPV was as a measure. Experiment 2 found a lack of a numerical reliability effect. That is, business students allocated an equivalent amount of capital to projects associated with a high variance NPV, as projects with a low NPV. Testing these two effects in two different populations did not account for potential expertise effects. As such, Experiment 8 tested both effects with a naive sample. Further, Experiment 8 used projects whose features more clearly indicate their profitability, and included more project domains.

B.8.1 Method

Participants

Fifty-two people (33 female) were recruited from both the online recruitment platform Prolific and a Psychology undergraduate sample at The University of Sydney. Participants from Prolific were compensated at a rate of £5 an hour, and participants from the undergraduate sample were compensated with course credit. The average age was 24.46 (SD = 7.77, min = 18, max = 68). Participants reported an average of 2.63 (SD = 4.16, min = 0, max = 25) years of work in a business setting, and an average of 0.81 (SD = 1.39, min = 0, max = 5) years of business education. The mean completion time was 35.57 (SD = 71.96, min = 7.36, max = 511.74) minutes. All conditions were presented within-subjects: alignment (low and high), NPV reliability type (numerical and verbal), NPV amount (low and high), and NPV reliability amount (low and high).

Materials

Instructions Participants saw instructions similar to the previous experiments.

Project display Participants saw and responded to four webpage displays. At the top of each display was a text preamble, and underneath this a table that contained project descriptions. The two columns to the right of each description contained text boxes for participants to enter a value for the project ranking and budget allocation. Alignment was manipulated by asking participants to either compare between each of the project pairs (high alignment), or across all eight projects in the display (low alignment). For instance, in the high alignment display, participants had to compare between two railway projects, and then separately between two logistics projects, etc. However, in the low alignment display, participants had to compare railway projects to logistics projects directly. This was manipulated within-subjects, such that project descriptions were identical across alignment conditions and only the type of comparison (and the associated preamble text) varied.

Figures B.39, B.40, B.41, B.42 show the four conditions that participants saw (counterbalanced). Each description provided the name of the business involved in the project, the type of project, three specific features of the project, an NPV, and an indication of reliability (either numerical through ranges or verbal through explicit labels).

The value of each type of reliability was also manipulated. Explicit reliability was manipulated by varying whether participants were told that a project pair was in an industry in which NPV is considered a reliable or unreliable measure. Implicit reliability was manipulated by presenting NPVs alongside numerical ranges instead of verbal reliability information about them, and varying whether the range was high or low. Both of these were manipulated within-display, such that NPV was reliable for four projects in each display, and NPV was unreliable for the other four.

Each project had an associated NPV, which was crossed with each project pair's intrinsic features. That is, each pair had one project with a high NPV and low intrinsic feature values, and one project with a low NPV and high intrinsic feature values. As such, a reliance on NPV was inferred if participants allocated the high NPV project more capital, or a reliance on the intrinsic features if participants allocated the low NPV project more capital.

For the following set of projects, the budget is shared among all eight projects.

The total budget is $400 million.
Therefore, the sum of allocations for all the projects should be 400 and the rankings will be between 1 and 8.

Business name: FreightCog. - Investment: railway. - Predicted project features: - Railway lines built: 5 a decade. - Number of seats filled by paying customers at peak hour: 2000. - Time before the train carriages will need to be serviced: 12 years. - NPV: $128 million. (In this particular industry, NPV is a **reliable** predictor of project success.)	Project ranking:	Budget allocation: $
Business name: Railmont. - Investment: railway. - Predicted project features: - Railway lines built: 3 a decade. - Number of seats filled by paying customers at peak hour: 1200. - Time before the train carriages will need to be serviced: 7 years. - NPV: $974 million. (In this particular industry, NPV is a **reliable** predictor of project success.)	Project ranking:	Budget allocation: $
Business name: Pharmacore. - Investment: pharmaceutical. - Predicted project features: - Pills pressed: 180000 an hour. - Shelf life: 12 months. - Probability of symptom reduction after a week: 54%. - NPV: $952 million. (In this particular industry, NPV is an **unreliable** predictor of project success.)	Project ranking:	Budget allocation: $
Business name: Biotechly. - Investment: pharmaceutical. - Predicted project features: - Pills pressed: 300000 an hour. - Shelf life: 20 months. - Probability of symptom reduction after a week: 90%. - NPV: $194 million. (In this particular industry, NPV is an **unreliable** predictor of project success.)	Project ranking:	Budget allocation: $
Business name: Pressbloom. - Investment: national newspaper. - Predicted project features: - Newspapers printed: 30000 a day. - Number of weekly advertisers: 48. - Ink that is not discarded due to impurities: 3000L a day	Project ranking:	Budget allocation: $

Figure B.39: Experiment 8 low alignment, verbal reliability display. Cropped for space (full display had eight projects).

For the following set of projects, the budget is shared among all eight projects.

The total budget is $400 million.
Therefore, the sum of allocations for all the projects should be 400 and the rankings will be between 1 and 8.

Business name: Dinerly. - Investment: restaurant chain. - Predicted project features: - Restaurants established: 9 a year. - Number of reservations on a Saturday night: 100. - Positive reviews: 40 a month. - NPV: $27-339 million. (Midpoint: $183.)	Project ranking:	Budget allocation: $
Business name: Savoro. - Investment: restaurant chain. - Predicted project features: - Restaurants established: 5 a year. - Number of reservations on a Saturday night: 60. - Positive reviews: 24 a month. - NPV: $137-1689 million. (Midpoint: $913.)	Project ranking:	Budget allocation: $
Business name: Altchip. - Investment: microchip. - Predicted project features: - Microchips produced: 2400 an hour. - Usable semiconductor yield after testing: 36%. - Compatible PCs in the market: 48%. - NPV: $143-1761 million. (Midpoint: $952.)	Project ranking:	Budget allocation: $
Business name: Microxy. - Investment: microchip. - Predicted project features: - Microchips produced: 4000 an hour. - Usable semiconductor yield after testing: 60%. - Compatible PCs in the market: 80%. - NPV: $29-359 million. (Midpoint: $194.)	Project ranking:	Budget allocation: $
Business name: Enfuel. - Investment: oil well. - Predicted project features: - Oil extracted: 1200L an hour. - Time the machinery lasts before requiring maintenance: 4 years. - Probability of finding oil: 54%	Project ranking:	Budget allocation: $

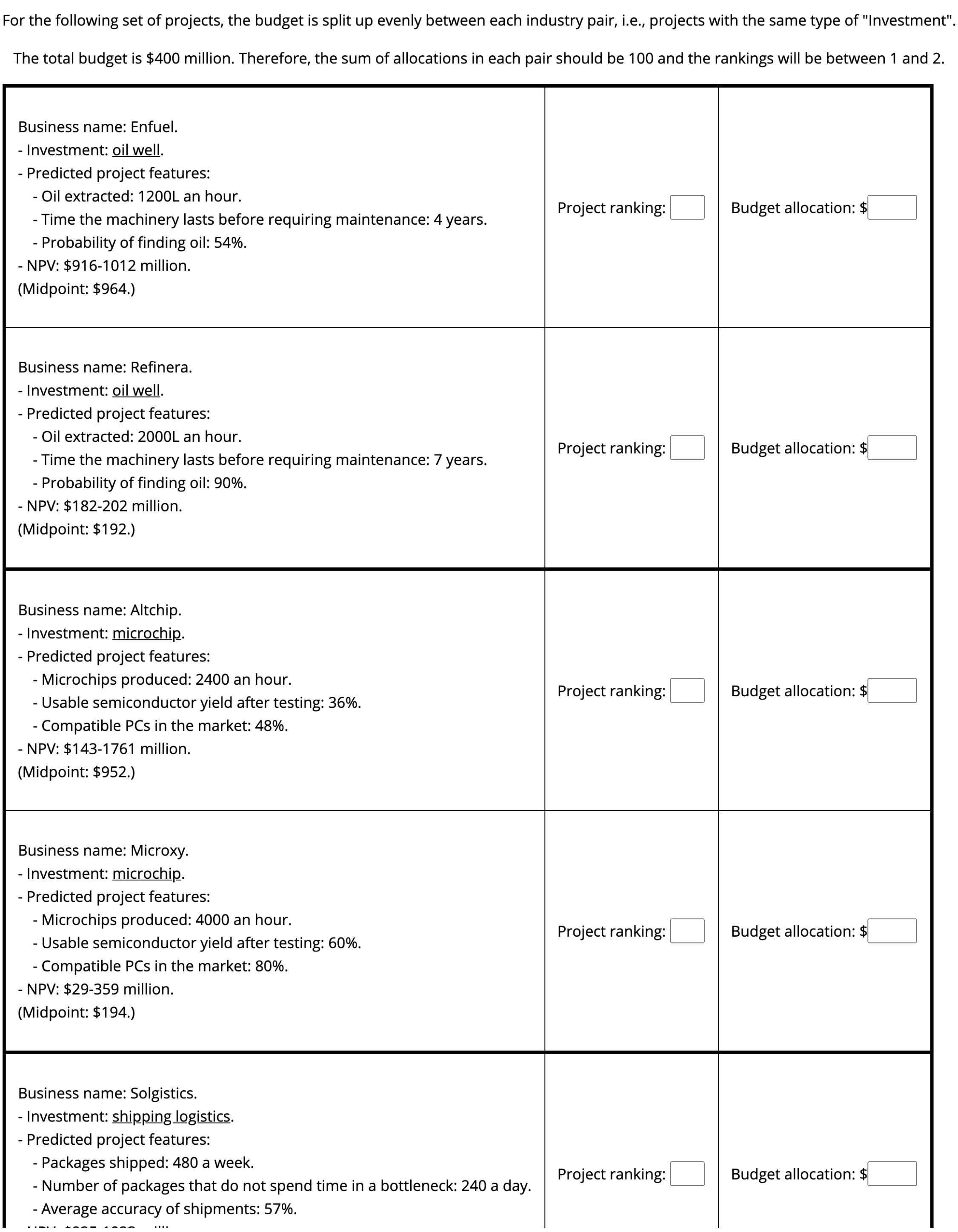
Figure B.40: Experiment 8 low alignment, numerical reliability display. Cropped for space (full display had eight projects).

For the following set of projects, the budget is split up evenly between each industry pair, i.e., projects with the same type of "Investment".

The total budget is $400 million. Therefore, the sum of allocations in each pair should be 100 and the rankings will be between 1 and 2.

Business name: Erectic. - Investment: high-rise construction. - Predicted project features: - High-rises built: 5 a year. - Probability that the builders complete construction within a month of the due date: 42%. - Number of tenant expressions of interest: 60. - NPV: $913 million. (In this particular industry, NPV is an **unreliable** predictor of project success.)	Project ranking:	Budget allocation: $
Business name: Refit. - Investment: high-rise construction. - Predicted project features: - High-rises built: 8 a year. - Probability that the builders complete construction within a month of the due date: 70%. - Number of tenant expressions of interest: 100. - NPV: $183 million. (In this particular industry, NPV is an **unreliable** predictor of project success.)	Project ranking:	Budget allocation: $
Business name: Pressbloom. - Investment: national newspaper. - Predicted project features: - Newspapers printed: 30000 a day. - Number of weekly advertisers: 48. - Ink that is not discarded due to impurities: 3000L a day. - NPV: $964 million. (In this particular industry, NPV is a **reliable** predictor of project success.)	Project ranking:	Budget allocation: $
Business name: Grown Media. - Investment: national newspaper. - Predicted project features: - Newspapers printed: 50000 a day. - Number of weekly advertisers: 80. - Ink that is not discarded due to impurities: 5000L a day. - NPV: $192 million. (In this particular industry, NPV is a **reliable** predictor of project success.)	Project ranking:	Budget allocation: $
Business name: FreightCog. - Investment: railway. - Predicted project features: - Railway lines built: 5 a decade.	Project ranking:	Budget allocation: $

Figure B.41: Experiment 8 high alignment, verbal reliability display. Cropped for space (full display had eight projects).



For the following set of projects, the budget is split up evenly between each industry pair, i.e., projects with the same type of "Investment".

The total budget is $400 million. Therefore, the sum of allocations in each pair should be 100 and the rankings will be between 1 and 2.

Business name: Enfuel. - Investment: oil well. - Predicted project features: - Oil extracted: 1200L an hour. - Time the machinery lasts before requiring maintenance: 4 years. - Probability of finding oil: 54%. - NPV: $916-1012 million. (Midpoint: $964.)	Project ranking:	Budget allocation: $
Business name: Refinera. - Investment: oil well. - Predicted project features: - Oil extracted: 2000L an hour. - Time the machinery lasts before requiring maintenance: 7 years. - Probability of finding oil: 90%. - NPV: $182-202 million. (Midpoint: $192.)	Project ranking:	Budget allocation: $
Business name: Altchip. - Investment: microchip. - Predicted project features: - Microchips produced: 2400 an hour. - Usable semiconductor yield after testing: 36%. - Compatible PCs in the market: 48%. - NPV: $143-1761 million. (Midpoint: $952.)	Project ranking:	Budget allocation: $
Business name: Microxy. - Investment: microchip. - Predicted project features: - Microchips produced: 4000 an hour. - Usable semiconductor yield after testing: 60%. - Compatible PCs in the market: 80%. - NPV: $29-359 million. (Midpoint: $194.)	Project ranking:	Budget allocation: $
Business name: Solgistics. - Investment: shipping logistics. - Predicted project features: - Packages shipped: 480 a week. - Number of packages that do not spend time in a bottleneck: 240 a day. - Average accuracy of shipments: 57%.	Project ranking:	Budget allocation: $

Figure B.42: Experiment 8 high alignment, numerical reliability display. Cropped for space (full display had eight projects).

Procedure

Participants viewed the instructions and then completed the ranking and allocation tasks in the four sets of project descriptions. The order of the display was counterbalanced, and the order of the project pairs on each page was randomised.

B.8.2 Results

A mixed factorial ANOVA was conducted to investigate the effects of alignment and NPV reliability type on participants project allocations. A direct comparison of the two alignment conditions was not possible due to the different allocation input scales, so the NPV reliability amount $\times$ NPV amount interaction was tested separately in each alignment condition (see Figures B.43 and B.44). This interaction was significant for both the high alignment condition, $F(1, 51) = 27.81$, $p < .001$, $\hat{\eta}_p^2 = .353$; and the low alignment condition, $F(1, 51) = 7.63$, $p = .008$, $\hat{\eta}_p^2 = .130$. However, there was a significant effect of NPV in the low verbal reliability condition in high alignment, $\Delta M = 18.69$, 95% CI $[2.87,\ 34.52]$, $t(113.10) = 3.17$, $p = .012$; but not in low alignment, $\Delta M = 6.04$, 95% CI $[-9.24,\ 21.32]$, $t(121.35) = 1.06$, $p > .999$.

B.8.3 Discussion

Experiment 8 found that when variance was presented verbally, participants allocated according to the reliability information, for both low and high alignment conditions. When variance was presented numerically, there were no differences in allocations, for both low and high alignment conditions. Further, there was an effect of NPV in low reliability for the high alignment condition, but not the low alignment condition. This effect shows that people still relied on NPV more than they should when comparing across dissimilar projects.

This experiment shows that similar to the previous experiments, when controlling for presentation and domain, people still find it easier to allocate capital based on explicit reliability information when projects are comparable. However, due to the difference in scale across alignment conditions, a direct alignment effect

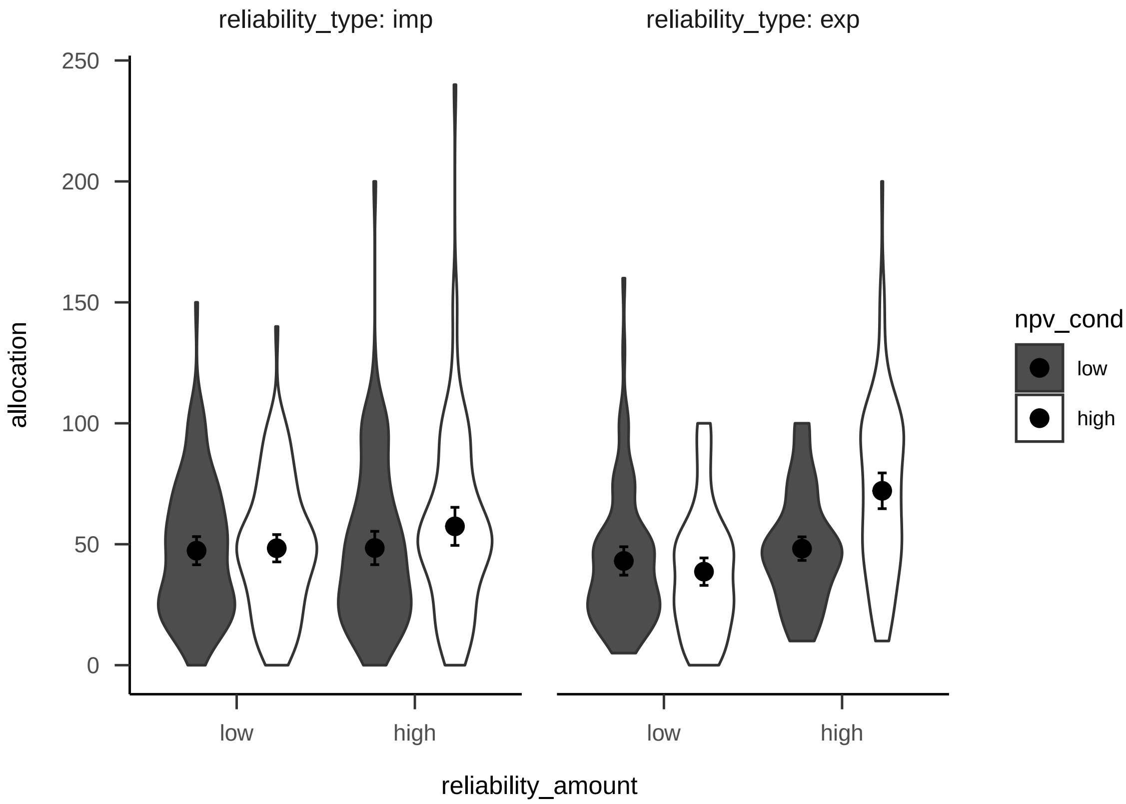


Figure B.43: Mean project allocation, for the low alignment condition. Error bars represent 95% confidence intervals.

was more difficult to test than with the previous experiments. Further, similar to Experiment 2, Experiment 8 showed that people without much business experience also struggle to use range information in capital allocation to such an extreme extent that they do not seem to be using any coherent allocation strategy.

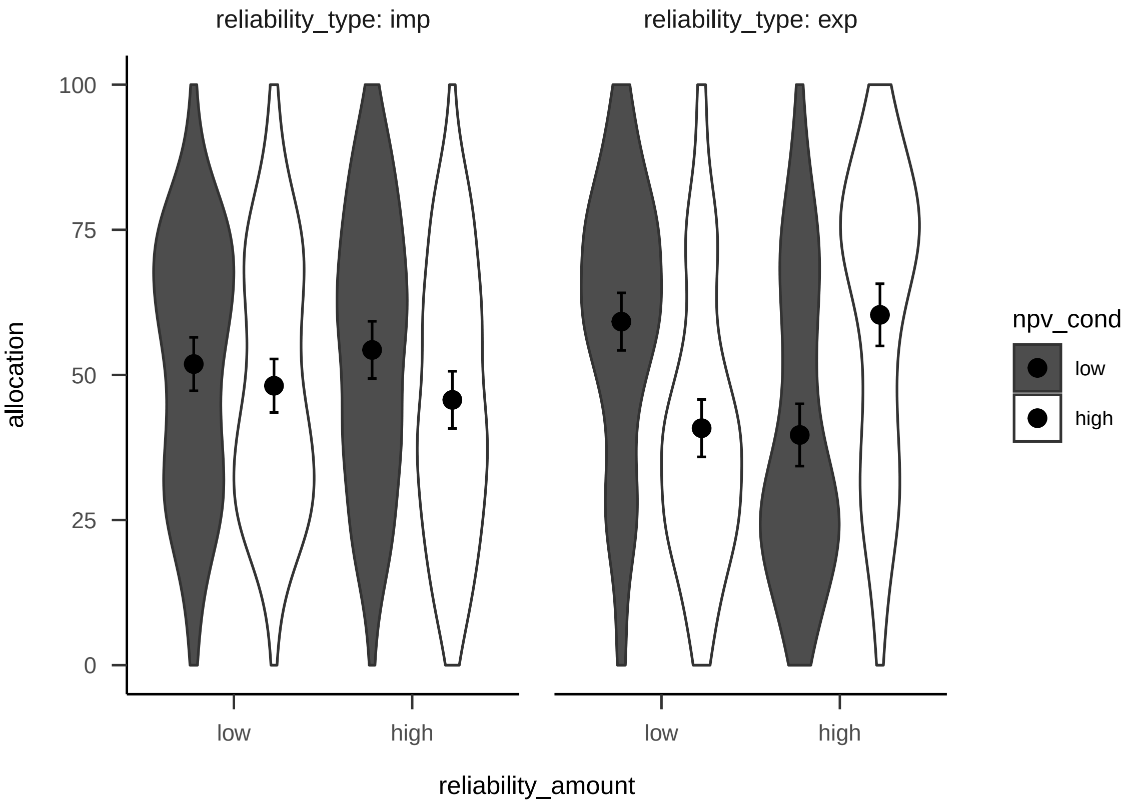


Figure B.44: Mean project allocation, for the high alignment condition. Error bars represent 95% confidence intervals.

C

Chapter 6 appendix

Contents

This appendix contains supplementary materials and analyses for the two experiments reported in Chapter 6.

C.1 Experiment 1

Below are hypotheses that were tested, but were not sufficiently relevant for Chapter 6 to be reported in the main text.

Hypothesis C.1—Allocation similarity manipulation check for negative anecdote. For negative anecdotes, allocations for the anecdote only low similarity condition will be higher than those in the anecdote only high similarity condition.

Hypothesis C.2—Relationship between allocation and perceived similarity for negative anecdote. In the negative valence condition, the correlation between allocation and similarity rating will be negative

Hypothesis C.3—Relationship between allocation and specific-relevance for negative anecdote. In the negative valence condition, there will be no correlation between allocation and specific-relevance rating in the low similarity condition, but a negative correlation in the high similarity condition.

After the allocation task, participants were asked to rate the relevance of the anecdote to the target project. It was predicted that those that saw only an anecdote would be more influenced by the similarity of the anecdote than those that saw an anecdote as well as statistics. Therefore, the following hypotheses were tested:

Hypothesis C.4. The similarity effect on specific relevance will be greater in the anecdote only condition than in the anecdote + statistics condition.

Hypothesis C.5. The similarity effect on specific relevance will be greater in the statistics + anecdote condition than in the anecdote + enhanced statistics condition.

Further, participants were asked to rate the relevance of the anecdote to other projects in the same industry. It was predicted that those that saw only an anecdote would be more influenced by the similarity of the anecdote than those that saw an anecdote as well as statistics. Therefore, the following hypotheses are tested:

Hypothesis C.6. The similarity effect on general relevance will be greater in the anecdote only condition than in the anecdote + statistics condition.

Hypothesis C.7. The similarity effect on general relevance will be greater in the statistics + anecdote condition than in the anecdote + enhanced statistics condition.

C.1.1 Method

Participants

Power analysis The sample size for Experiment 1 was determined by conducting power analyses using the `Superpower` package (Lakens & Caldwell, 2019). The package uses experimental design, and predicted means and standard deviation, to conduct a priori power calculations. Data from Wainberg (2018), Jaramillo et al. (2019), and Hoeken and Hustinx (2009, Study 3) was used to determine realistic means and standard deviations for the evidence and similarity factors. According to the power functions, the resulting sample size is assumed to allow for an expected power of at least 80%.

Data from Wainberg (2018) were used to determine the predicted means for the anecdote conditions. Specifically, the values for the high similarity condition were taken from the anecdote & statistics, anecdote & enhanced statistics, and statistics only conditions for the corresponding anecdote conditions. This was done because in Wainberg (2018) the anecdote was always of a similar case. Wainberg (2018) did not use an anecdote only condition, but Wainberg et al. (2013) did and found no significant differences between the anecdote only condition and the anecdote & statistics condition. As such, the same mean value was used for both conditions.

It was hypothesised that there will only be an effect of similarity for the anecdote only and anecdote & statistics conditions. As such, the data from Hoeken and Hustinx (2009, Study 3) were used to determine the corresponding mean values for the low similarity condition. Specifically, each predicted mean was multiplied by the Cohen's d_z of the similarity effect in Hoeken and Hustinx (2009, Study 3).

To determine the predicted standard deviation, the data from Jaramillo et al. (2019) Experiment 2 and Hoeken and Hustinx (2009, Study 3) were re-analysed to determine the coefficient of variation (CV) of each condition. Each CV was then converted to a standard deviation value in the relevant scale by multiplying the mean of the CV values by the predicted means from above.

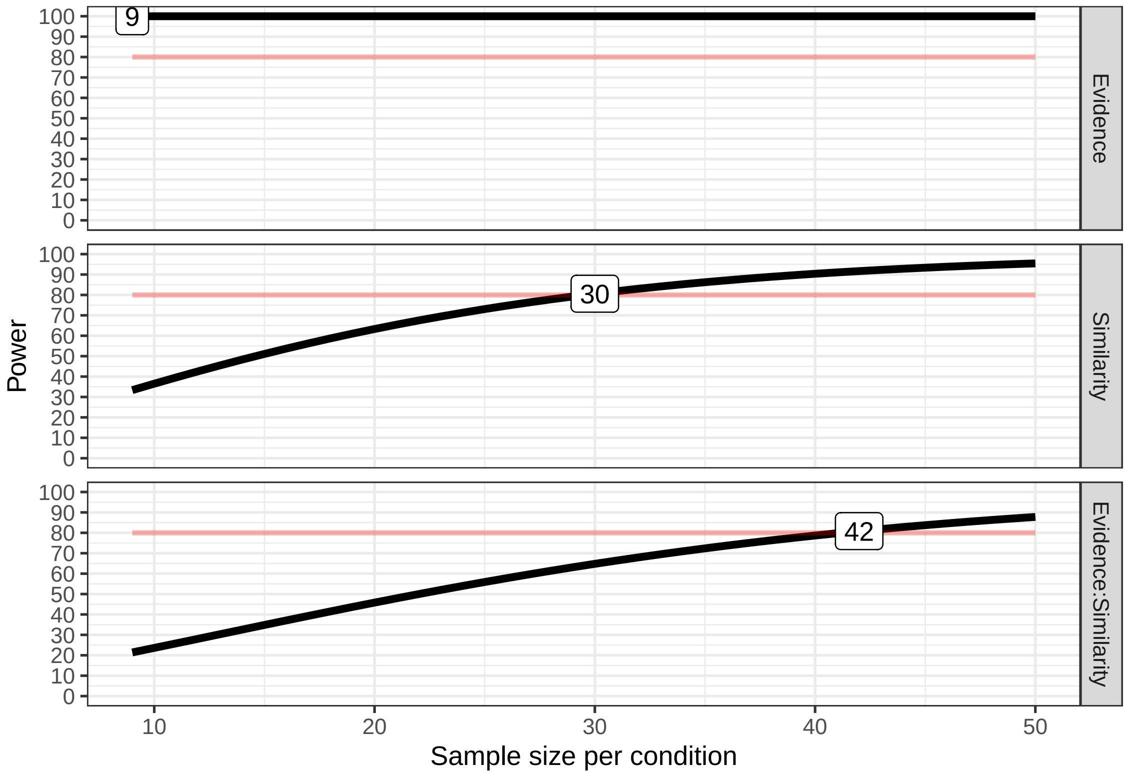


Figure C.1: Power curves for the similarity and anecdote effects.

Imagine you are a executive in a multi-business company and that you are presented with two projects to potentially invest in. Your job is to decide how to allocate the capital available in your budget between these two projects.

In a moment you will see a table that details the two target projects and relevant information about them.

Figure C.2: Experiment 1 general instructions. The two boxes were split between two separate web-pages.

As seen in Figure C.1, the power analysis suggested that a minimum sample size of 294 ($42 \cdot 7$) is required for the interaction effect with an expected power of at least 80%.

Method

Instructions Figure C.2 shows the general instructions all participants received, and Figures C.3, C.4, C.5, and C.6 show the condition-specific instructions.

Managers often find it useful to consult with previous case studies before making important decisions. As well as seeing the two target projects, you will also be provided with an example of a failed project with some information that was available just before the company decided to invest in it. Further, you are also provided with an analysis of this investment decision after it became clear that the project will not meet its expected return on investment.

Figure C.3: Experiment 1 specific instructions for those in the anecdotes only condition.

Managers often find it useful to consult with previous case studies before making important decisions. As well as seeing the two target projects, you will also be provided with an example of a failed project with some information that was available just before the company decided to invest in it. Further, you are also provided with an analysis of this investment decision after it became clear that the project will not meet its expected return on investment.

As a part of the relevant information that will be provided for each target project, you will be provided with measures of overall reliability and Net Present Value (NPV). The NPV is the company's estimation of the future returns of the project. An NPV that is greater than 0 (zero) indicates that there is an expectation of profit. The higher the NPV, the better the expectations for each project. Both these measures were collected as part of a research study conducted by an international consulting company that aggregated data from thousands of other projects in relevant industries.

Note that the project in the case study was included in the research study, so its features are subsumed in the aggregated data.

Figure C.4: Experiment 1 specific instructions for those in the anecdote & statistics condition.

Allocation task A horizontally integrated company is one which is made up of multiple businesses that operate in similar markets, and may have previously been competitors (Gaughan, 2012a). A vertically integrated company, on the other hand, is one which is made up of multiple business than operate in the same market, but in different levels of the supply chain (Gaughan, 2012b). A centralised organisational structure is one in which a company decisions tend to come from a specific business unit or leader, whereas a decentralised structure is one in which decisions can be

Managers often find it useful to consult with previous case studies before making important decisions. As well as seeing the two target projects, you will also be provided with an example of a failed project with some information that was available just before the company decided to invest in it. Further, you are also provided with an analysis of this investment decision after it became clear that the project will not meet its expected return on investment.

As a part of the relevant information that will be provided for each target project, you will be provided with measures of overall reliability and Net Present Value (NPV). The NPV is the company's estimation of the future returns of the project. An NPV that is greater than 0 (zero) indicates that there is an expectation of profit. The higher the NPV, the better the expectations for each project. Both these measures were collected as part of a research study conducted by an international consulting company that aggregated data from thousands of other projects in relevant industries.

Note that the project in the case study was included in the research study, so its features are subsumed in the aggregated data.

Alongside its results, the research study also encouraged managers to use 'scientific thinking'.

Scientific thinking can be characterized as a process of objectively analyzing information about a given topic. A scientific thinker is one who very carefully considers the quality of each piece of information so as not to be unduly swayed by insignificant and/or less significant facts.

Progress in science is generally achieved via the deliberate process of obtaining quantifiable evidence through observation and/or experimentation. The scientific method requires that experimental and observational findings be reproducible and cautions against drawing strong conclusions from any single study or observation. You may recall from statistics that this scientific principle is consistent with the fact that small samples of observations tend to have a higher probability of error while larger samples tend to be more accurate. Scientific knowledge is therefore based on an accumulation of carefully designed studies or observations which lend support to a given assertion.

Figure C.5: Experiment 1 specific instructions for those in the anecdote & enhanced statistics condition.

As a part of the relevant information that will be provided for each target project, you will be provided with measures of overall reliability and Net Present Value (NPV). The NPV is the company's estimation of the future returns of the project. An NPV that is greater than 0 (zero) indicates that there is an expectation of profit. The higher the NPV, the better the expectations for each project. Both these measures were collected as part of a research study conducted by an international consulting company that aggregated data from thousands of other projects in relevant industries.

Figure C.6: Experiment 1 specific instructions for those in the statistics only condition.

made by separate units or people independently (Kenton, 2021).

Follow-up Figure C.7 shows the follow-up questions.

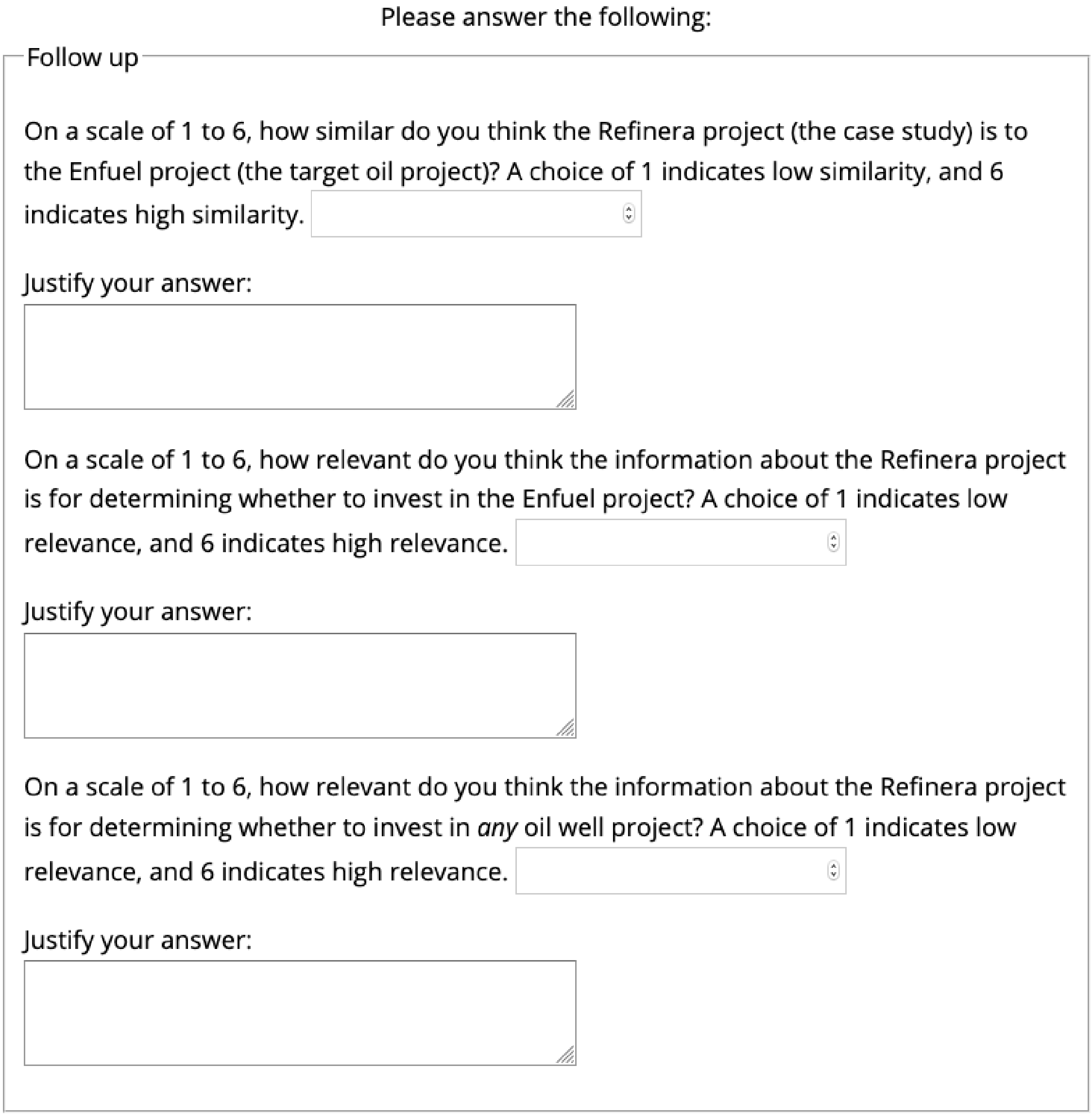
C.1.2 Results

Allocation

A two-way ANOVA was conducted to investigate the interaction of similarity (low and high) and anecdote conditions (anecdote only, statistics & anecdote, anecdote & enhanced statistics). The main text reports the more relevant interaction that excludes the enhanced statistics condition. There was a main effect of anecdote type, $F(2, 238) = 14.47$, $p < .001$, $\hat{\eta}^2_p = .108$; and a main effect of similarity, $F(1, 238) = 38.91$, $p < .001$, $\hat{\eta}^2_p = .141$. However, the interaction was not significant, $F(2, 238) = 2.16$, $p = .118$, $\hat{\eta}^2_p = .018$. The difference between the anecdote only condition and the anecdote & enhanced statistics condition was not significant, $M = -9.24$, 95% CI $[-22.00,\ 3.51]$, $t(238) = -1.43$, $p = .155$.

Manipulation check

Figure C.8 shows participants' ratings of the similarity of the anecdote to the target project. As intended, participants in the high similarity condition rated the anecdote as more similar to the target project than those in the low similarity condition, $F(1, 238) = 27.01$, $p < .001$, $\hat{\eta}^2_p = .102$.


Please answer the following:

Follow up

On a scale of 1 to 6, how similar do you think the Refinera project (the case study) is to the Enfuel project (the target oil project)? A choice of 1 indicates low similarity, and 6 indicates high similarity.

Justify your answer:

On a scale of 1 to 6, how relevant do you think the information about the Refinera project is for determining whether to invest in the Enfuel project? A choice of 1 indicates low relevance, and 6 indicates high relevance.

Justify your answer:

On a scale of 1 to 6, how relevant do you think the information about the Refinera project is for determining whether to invest in *any* oil well project? A choice of 1 indicates low relevance, and 6 indicates high relevance.

Justify your answer:

Figure C.7: Follow-up questions in Experiment 1.

Follow-up

Figure C.9 shows participants' ratings of the specific relevance question. There was no significant effect of evidence type $F(2, 238) = 0.96$, $p = .383$, $\hat{\eta}^2_p = .008$; or similarity, $F(1, 238) = 1.54$, $p = .216$, $\hat{\eta}^2_p = .006$. The interaction was also not significant, `r results_anecdotes_1$relevance_specific$anecdote_alignment`.

Figure C.10 shows participants' ratings of the general relevance question. There was no main effect of similarity, $F(1, 238) = 3.32$, $p = .070$, $\hat{\eta}^2_p = .014$, or interaction of similarity and evidence type, `r results_anecdotes_1$relevance_general$anecdote_alignmen` However, there was an unexpected main effect of evidence type, $F(2, 238) = 3.80$,

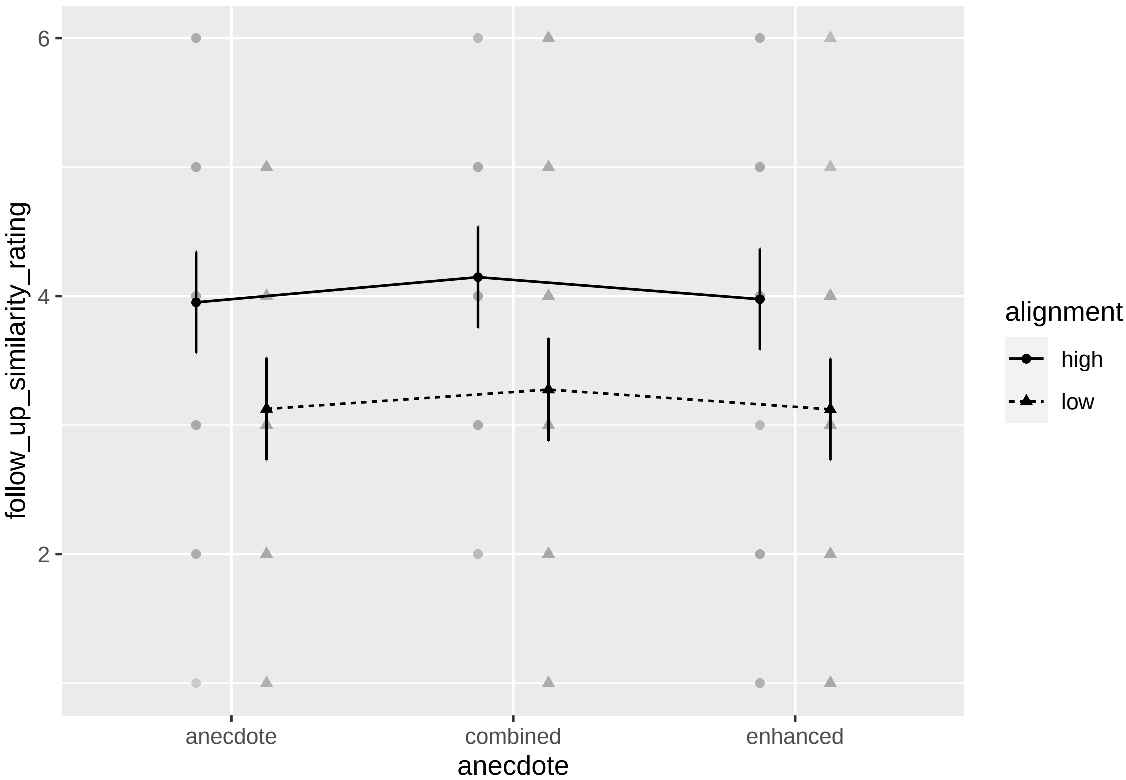


Figure C.8: Mean similarity rating of Project A (the target project) to the anecdote. Error bars represent 95% confidence intervals.

$p = .024$, $\hat{\eta}^2_p = .031$. A contrast analysis with Bonferroni correction revealed that the anecdote only condition was rated significantly higher than the anecdote & statistics condition, $\Delta M = 0.58$, 95% CI $[0.06,\ 1.10]$, $t(238) = 2.71$, $p = .022$. However, the difference between the two anecdote & statistics conditions was not significant, $\Delta M = -0.39$, 95% CI $[-0.90,\ 0.13]$, $t(238) = -1.81$, $p = .212$.

Regression analyses were conducted to determine the relationship between allocations and the follow-up ratings of similarity and relevance. As seen in Figure C.11, similarity ratings were negatively correlated to allocations, $b = -3.53$, 95% CI $[-5.70, -1.37]$, $t(242) = -3.21$, $p = .002$. Finally, as seen in Figure C.12 similarity ratings were positively correlated to specific relevance ratings, $b = 0.30$, 95% CI $[0.17, 0.43]$, $t(242) = 4.59$, $p < .001$.

Participants' justifications for the ratings were not analysed, so are not reported.

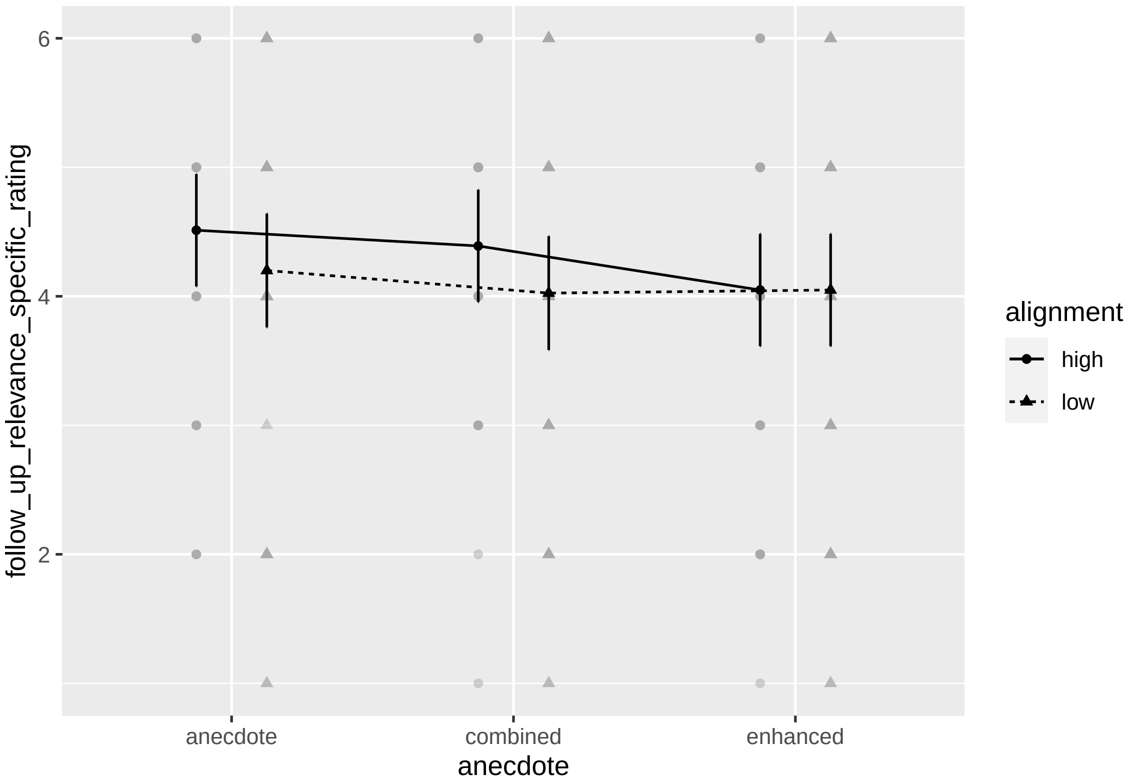


Figure C.9: Mean rating of how relevant participants thought the anecdote was to Project A (the target project). Error bars represent 95% confidence intervals.

C.2 Experiment 2

Figures C.13 and C.14 show the simulated data for the negative and positive valence conditions, respectively.

Hypothesis C.8—Allocation similarity manipulation check for positive anecdote. For positive anecdotes, allocations for the anecdote only high similarity condition will be higher than those in the anecdote only low similarity condition.

The rating effects found in Experiment 1 were expected to replicate in the Experiment 2 negative valence condition. The reverse effects were expected to be found in the positive valence condition.

Hypothesis C.9—Relationship between allocation and perceived similarity for positive anecdote. In the positive valence condition, the correlation between allocation and similarity rating will be positive

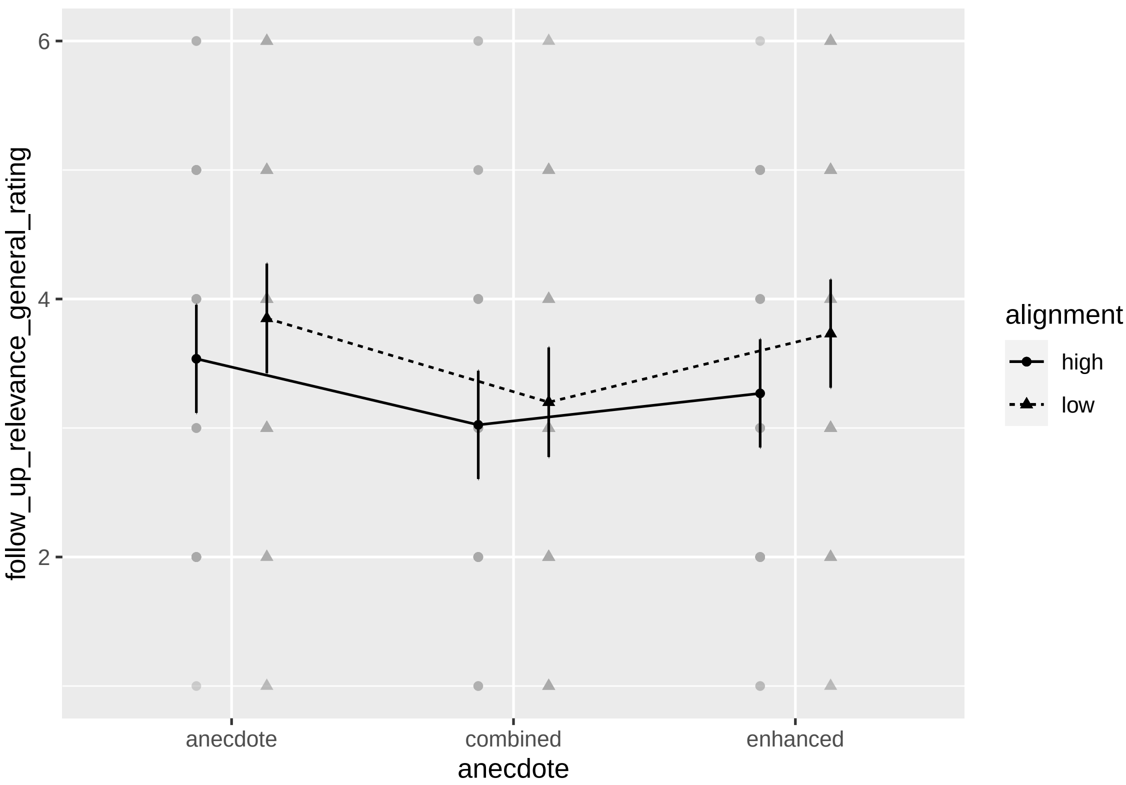


Figure C.10: Mean rating of how relevant participants thought the anecdote was to other oil projects. Error bars represent 95% confidence intervals.

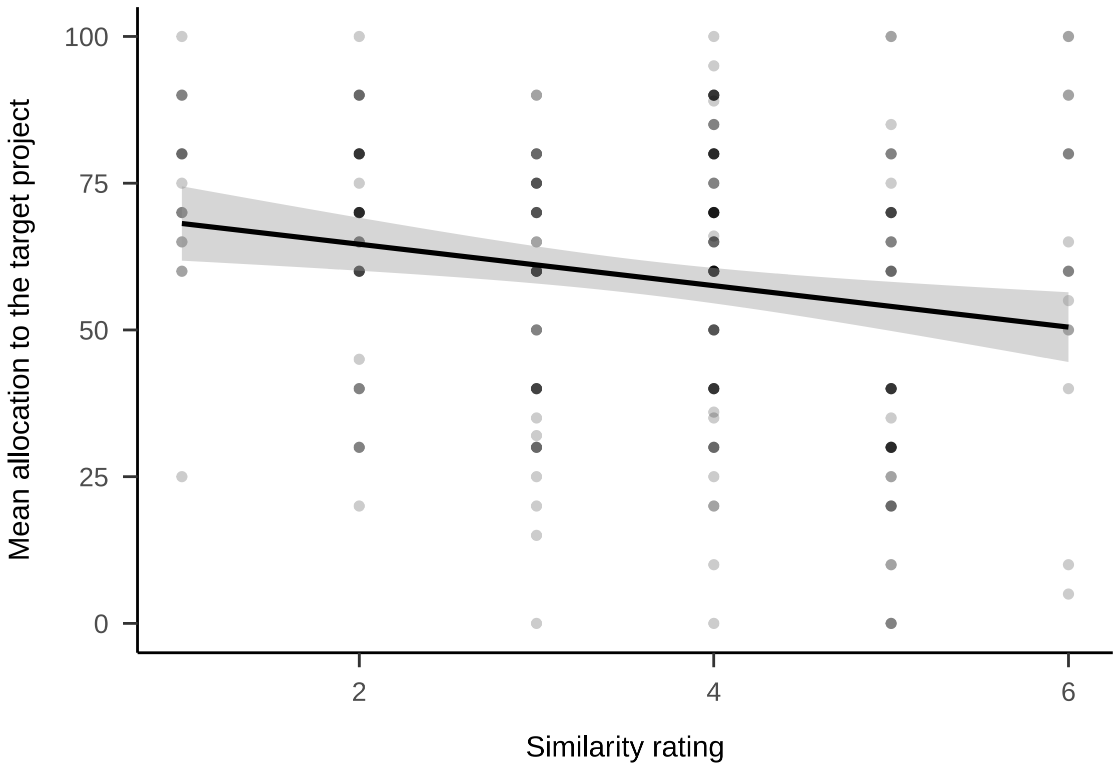


Figure C.11: Mean allocations to the target project by similarity rating. The shading represents 95% confidence intervals.

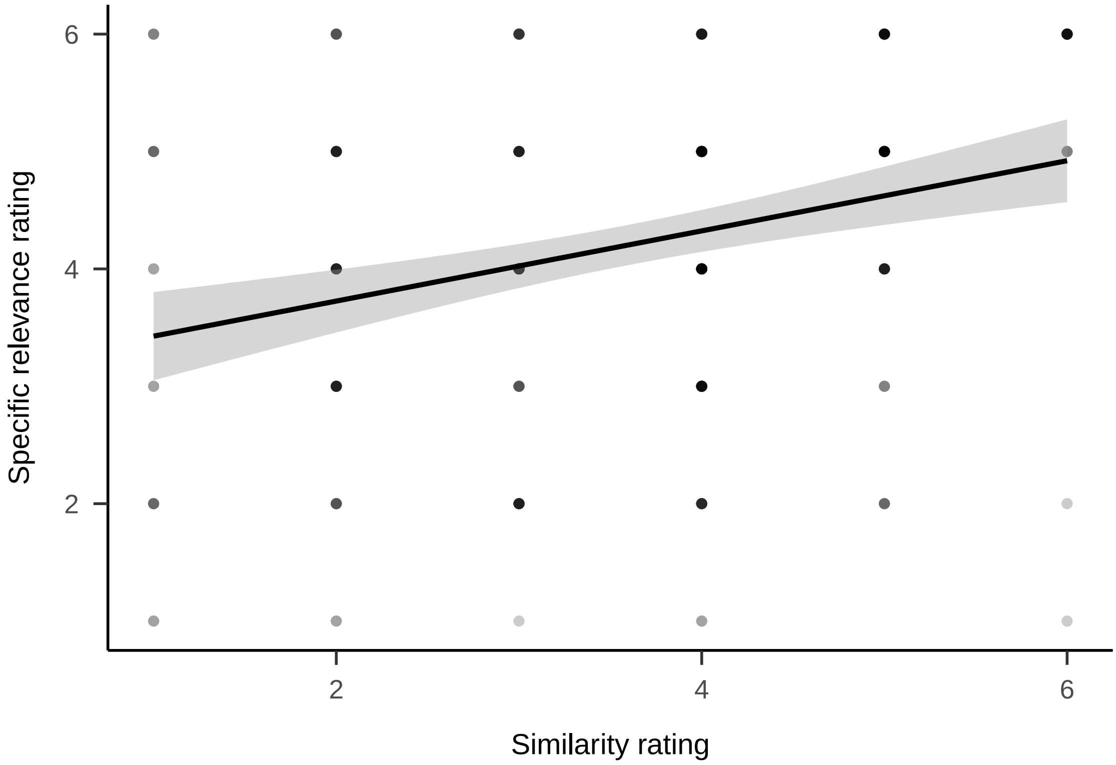


Figure C.12: Rating of how relevant participants considered the anecdote to the target project, by similarity rating. The shading represents 95% confidence intervals.

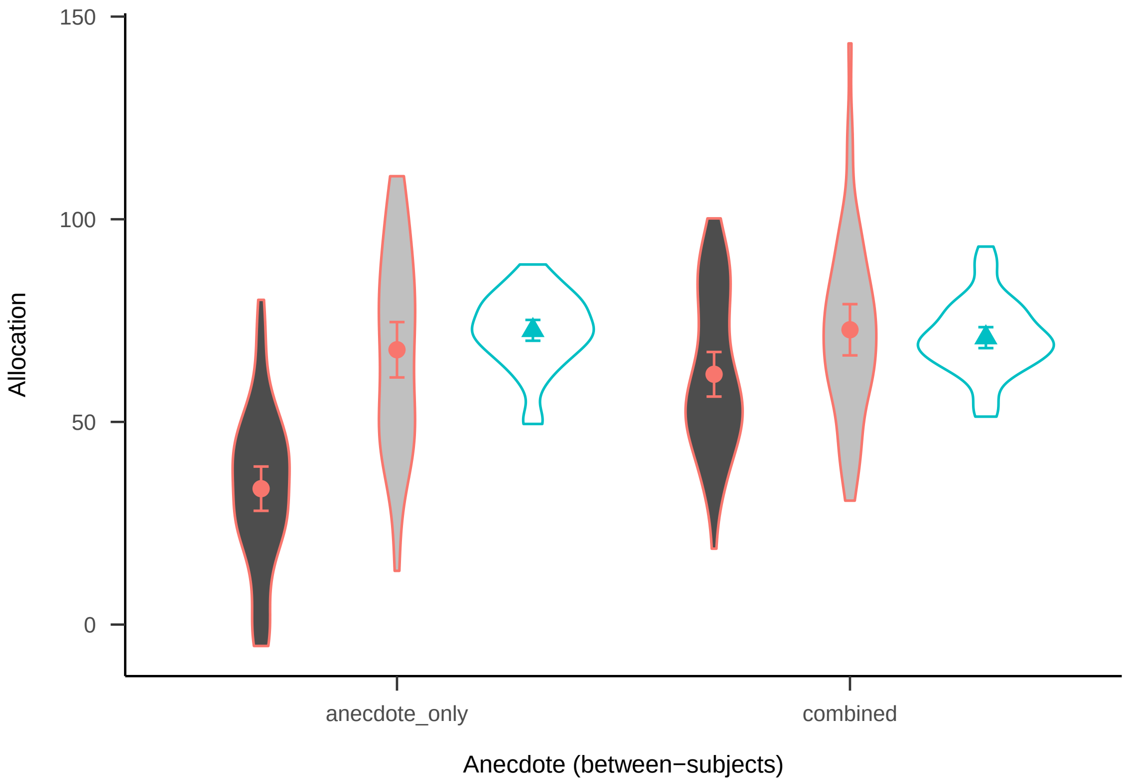


Figure C.13: Anecdotes Experiment 2 predicted data for the negative valence condition

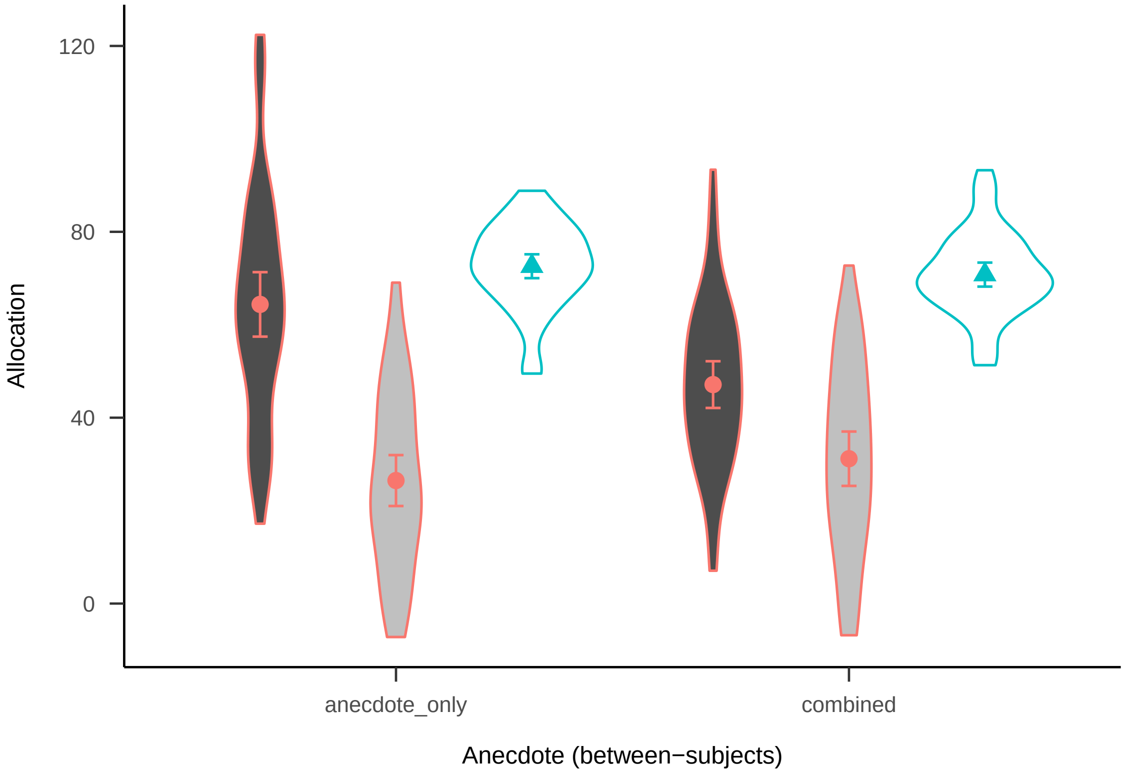


Figure C.14: Anecdotes Experiment 2 predicted data for the positive valence condition

Hypothesis C.10—Relationship between allocation and specific-relevance for positive anecdote. In the positive valence condition, there will be no correlation between allocation and specific-relevance rating in the low similarity condition, but a positive correlation in the high similarity condition.

Hypothesis C.11—Relationship between allocation and general-relevance for positive anecdote. There will be no significant correlations between allocation and general-relevance rating

C.2.1 Method

Participants

Power analysis A power analysis was conducted through simulation of the effects implied by the hypotheses in Experiment 2. Data were simulated with the same mean values as Experiment 1 for the effects that were previously significant (i.e., similarity, statistics, and moderation effects), and no effect for the differences that were non-significant (as shown in Figures C.13 and C.14). The null effect was analysed using the two one-sided tests (TOST) procedure, or *equivalence* testing (Lakens et al., 2018), and setting the smallest effect size of interest to the smallest difference that leads to a significant equivalence between the combined low similarity and statistics only conditions in Experiment 1. Figure C.15 shows the results of this analysis, which suggested a total sample size of 96 (48 $\times$ 2).

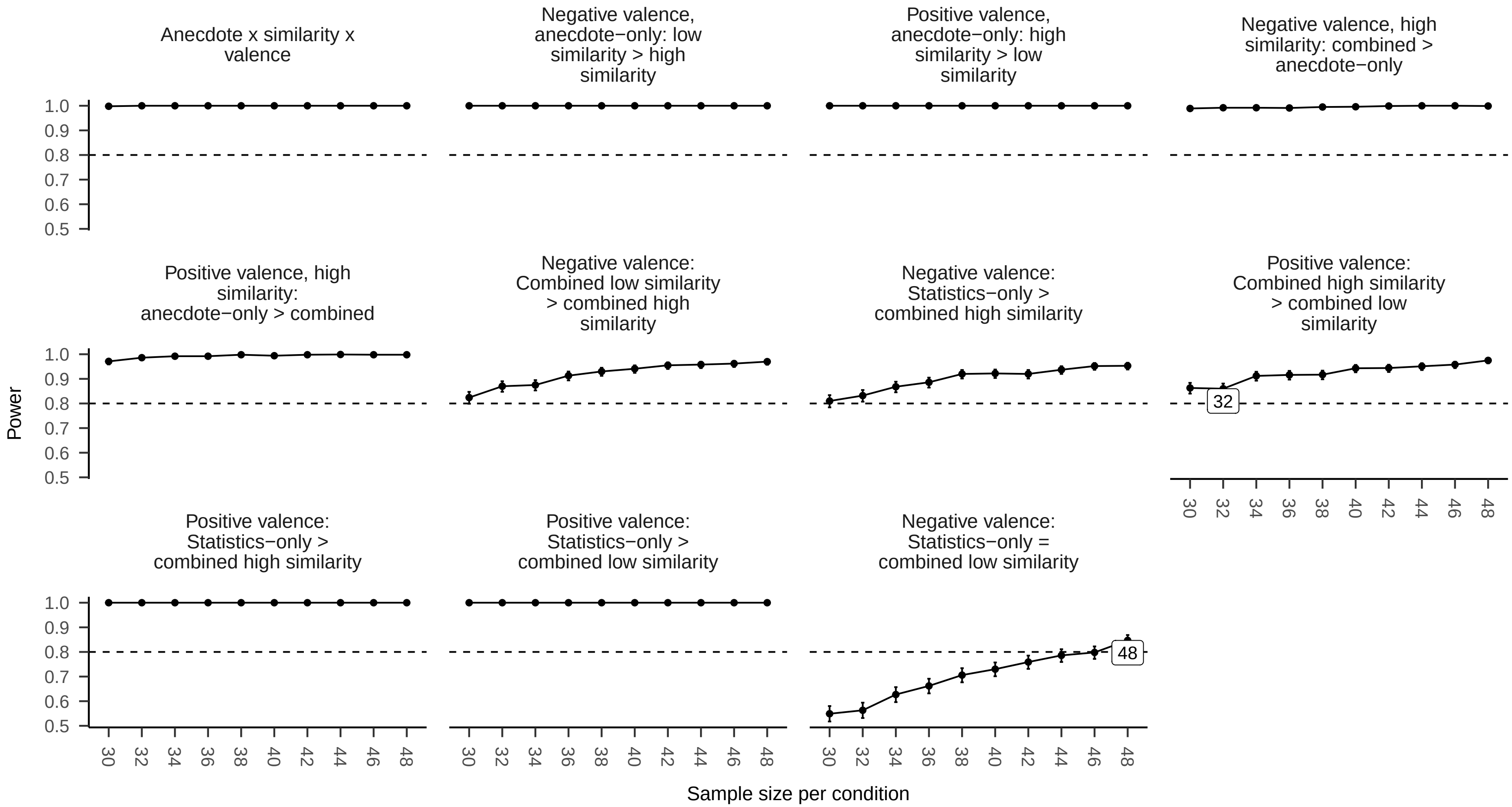
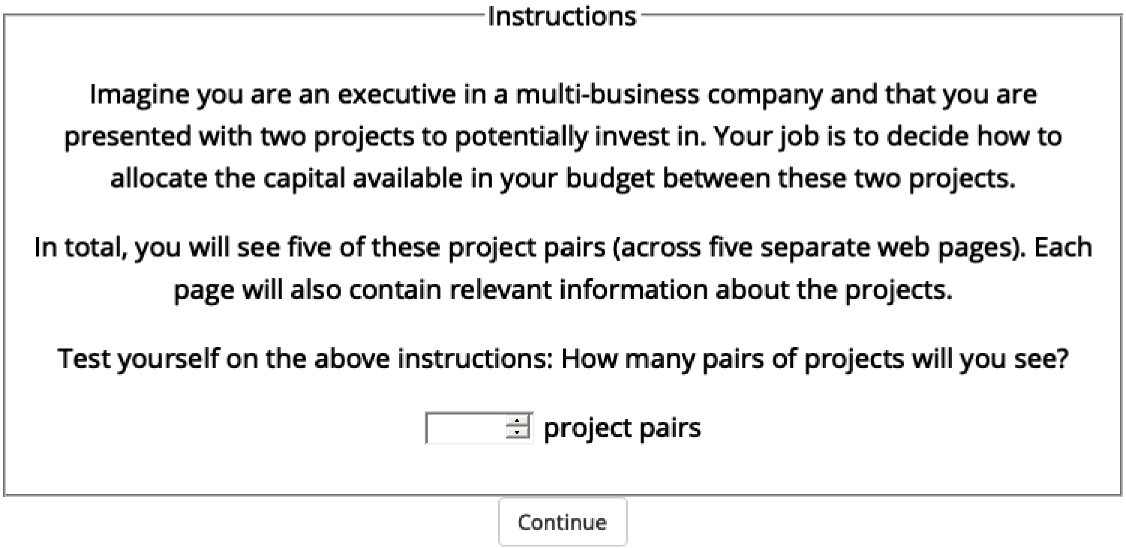


Figure C.15: Anecdotes Experiment 2 power curve. Labels indicate lowest sample size above 80% power.


Instructions

Imagine you are an executive in a multi-business company and that you are presented with two projects to potentially invest in. Your job is to decide how to allocate the capital available in your budget between these two projects.

In total, you will see five of these project pairs (across five separate web pages). Each page will also contain relevant information about the projects.

Test yourself on the above instructions: How many pairs of projects will you see?

project pairs

Continue

Figure C.16: General instructions for Experiment 2.

Materials

Instructions Figure C.16 shows the general instructions all participants received, and Figures C.17, C.18, and C.19 show the condition-specific instructions.

Allocation task The following were counterbalanced: 1. project variation (five latin square variations), which is the association of each display content with each within-subject condition; and 2. anecdote variation (two variations), which is the association of each project display and being either the target or comparison project. Table column order and project display order were randomised.

Follow-up questions Figure C.20 shows an example of the follow-up questions.

Interstitial display Figure C.21 shows an example of one of the interstitial displays.

C.2.2 Results

Allocation

Similarity manipulation check The similarity manipulation worked as expected, with the negative anecdote only low similarity condition being allocated significantly

Instructions

Managers often find it useful to consult with previous case studies before making important decisions. As well as seeing the two target projects, you will also be provided with an example of a failed project with some information that was available just before the company decided to invest in it. This project was randomly chosen from a pool of thousands of projects. Others rated the similarity of all the case studies to the below target project based on dimensions such as the overall money invested, the quality of the proposal, the experience of the managers that proposed it, and the specific operations that were required. This case study was found to be, on average, as similar to the target as the others in the sample. Further, you are also provided with an analysis of this investment decision after it became clear that the project will not meet its expected return on investment.

Figure C.17: Experiment 2 specific instructions for those in the anecdotes only condition.

more than those in the high similarity condition, $\Delta M = 26.98$, 95% CI $[18.12,\ 35.84]$, $t(186.55) = 6.01$, $p < .001$. For positive anecdotes, participants allocated more to the high similarity condition than those in the low similarity condition, $\Delta M = -22.62$, 95% CI $[-31.48,\ -13.77]$, $t(186.55) = -5.04$, $p < .001$

Ratings

Similarity manipulation check Evidence for the similarity manipulation working was also seen in the rating data. Participants rated anecdotes in the high similarity condition as more similar to the target than those in the low similarity condition, $F(1, 94) = 48.36$, $p < .001$, $\hat{\eta}^2_p = .340$.

Allocation is influenced by perceived similarity As hypothesised, allocation was influenced by perceived similarity. That is, in the negative valence condition, there was a negative correlation between allocation and similarity rating, $\Delta M = 0.34$, 95% CI $[-3.72,\ 4.39]$, $t(376) = 0.16$, $p = .870$. However, in the positive valence condition, there was a positive correlation between allocation and similarity rating, $\Delta M = 2.86$, 95% CI $[-1.47,\ 7.18]$, $t(376) = 1.30$, $p = .195$.

Instructions

Managers often find it useful to consult with previous case studies before making important decisions. As well as seeing the two target projects, you will also be provided with an example of a failed project with some information that was available just before the company decided to invest in it. This project was randomly chosen from a pool of thousands of projects. Others rated the similarity of all the case studies to the below target project based on dimensions such as the overall money invested, the quality of the proposal, the experience of the managers that proposed it, and the specific operations that were required. This case study was found to be, on average, as similar to the target as the others in the sample. Further, you are also provided with an analysis of this investment decision after it became clear that the project will not meet its expected return on investment.

As a part of the relevant information that will be provided for each target project, you will be provided with measures of overall reliability and Net Present Value (NPV). The NPV is the company's estimation of the future returns of the project. An NPV that is greater than 0 (zero) indicates that there is an expectation of profit. The higher the NPV, the better the expectations for each project. Both these measures were collected as part of a research study conducted by an international consulting company that aggregated data from thousands of other projects in relevant industries.

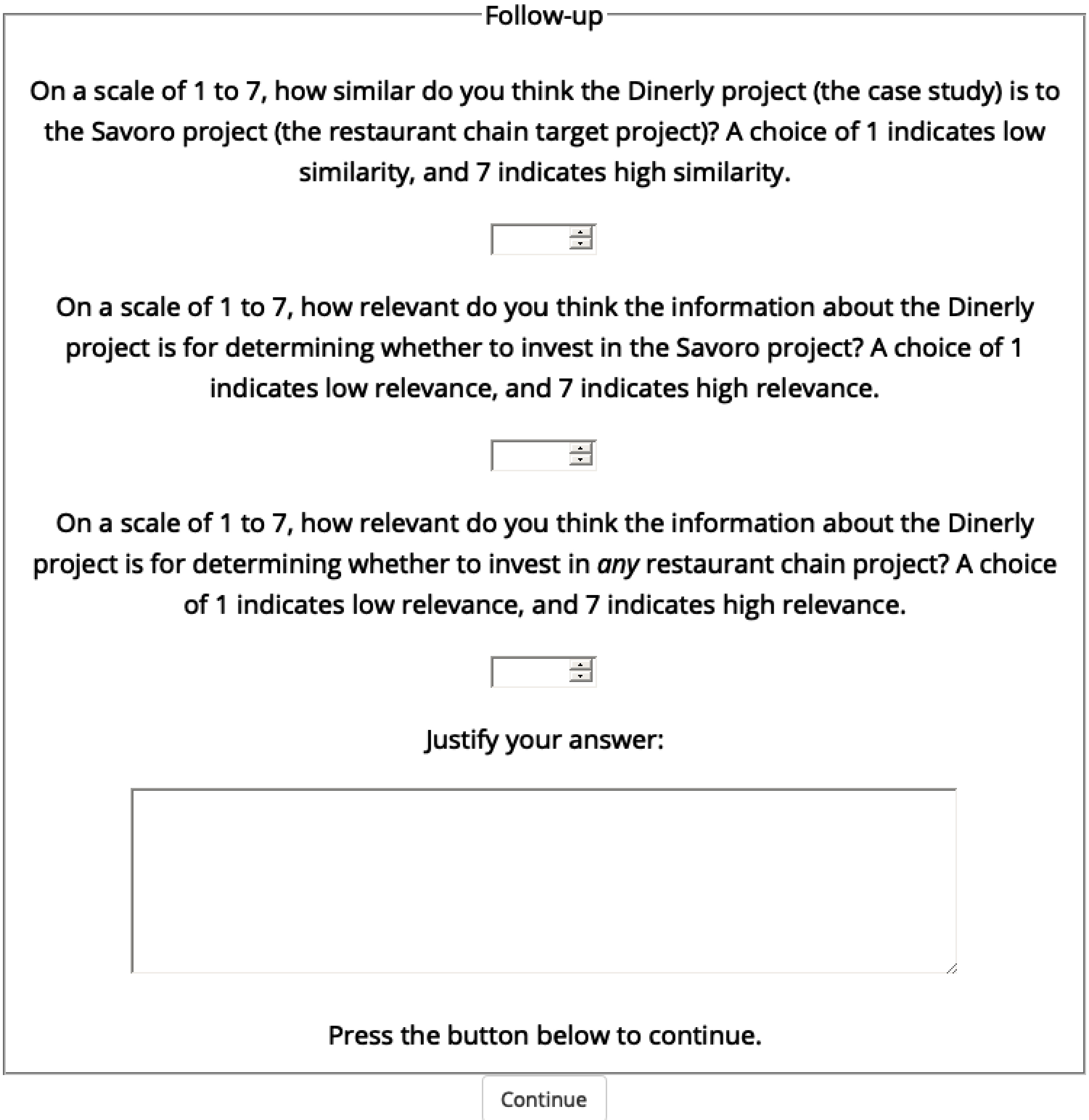
Note that the project in the case study was included in the research study, so its features are subsumed in the aggregated data.

Figure C.18: Experiment 2 specific instructions for those in the combined condition.

Instructions

As a part of the relevant information that will be provided for each target project, you will be provided with measures of overall reliability and Net Present Value (NPV). The NPV is the company's estimation of the future returns of the project. An NPV that is greater than 0 (zero) indicates that there is an expectation of profit. The higher the NPV, the better the expectations for each project. Both these measures were collected as part of a research study conducted by an international consulting company that aggregated data from thousands of other projects in relevant industries.

Figure C.19: Experiment 2 specific instructions for those in the statistics only condition.



Follow-up

On a scale of 1 to 7, how similar do you think the Dinerly project (the case study) is to the Savoro project (the restaurant chain target project)? A choice of 1 indicates low similarity, and 7 indicates high similarity.

On a scale of 1 to 7, how relevant do you think the information about the Dinerly project is for determining whether to invest in the Savoro project? A choice of 1 indicates low relevance, and 7 indicates high relevance.

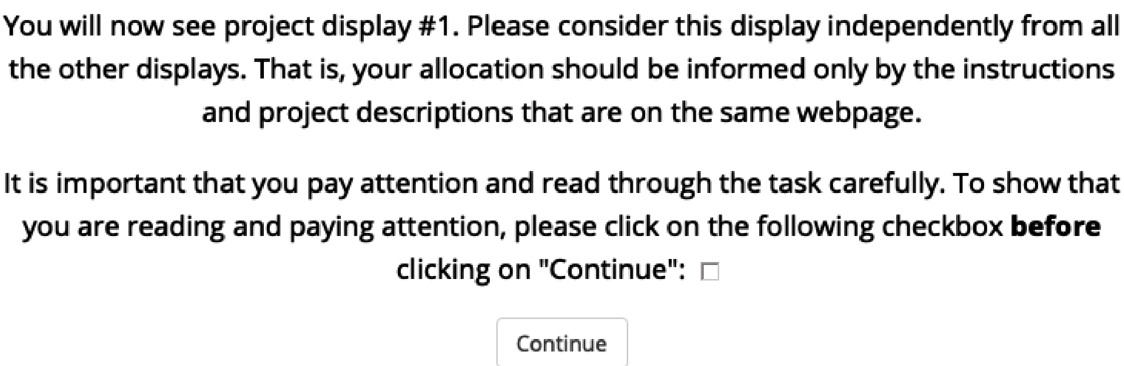
On a scale of 1 to 7, how relevant do you think the information about the Dinerly project is for determining whether to invest in *any* restaurant chain project? A choice of 1 indicates low relevance, and 7 indicates high relevance.

Justify your answer:

Press the button below to continue.

Continue

Figure C.20: An example of one of the follow-up question displays in Experiment 2.



You will now see project display #1. Please consider this display independently from all the other displays. That is, your allocation should be informed only by the instructions and project descriptions that are on the same webpage.

It is important that you pay attention and read through the task carefully. To show that you are reading and paying attention, please click on the following checkbox **before** clicking on "Continue":

Continue

Figure C.21: An example of an interstitial display in Experiment 2.

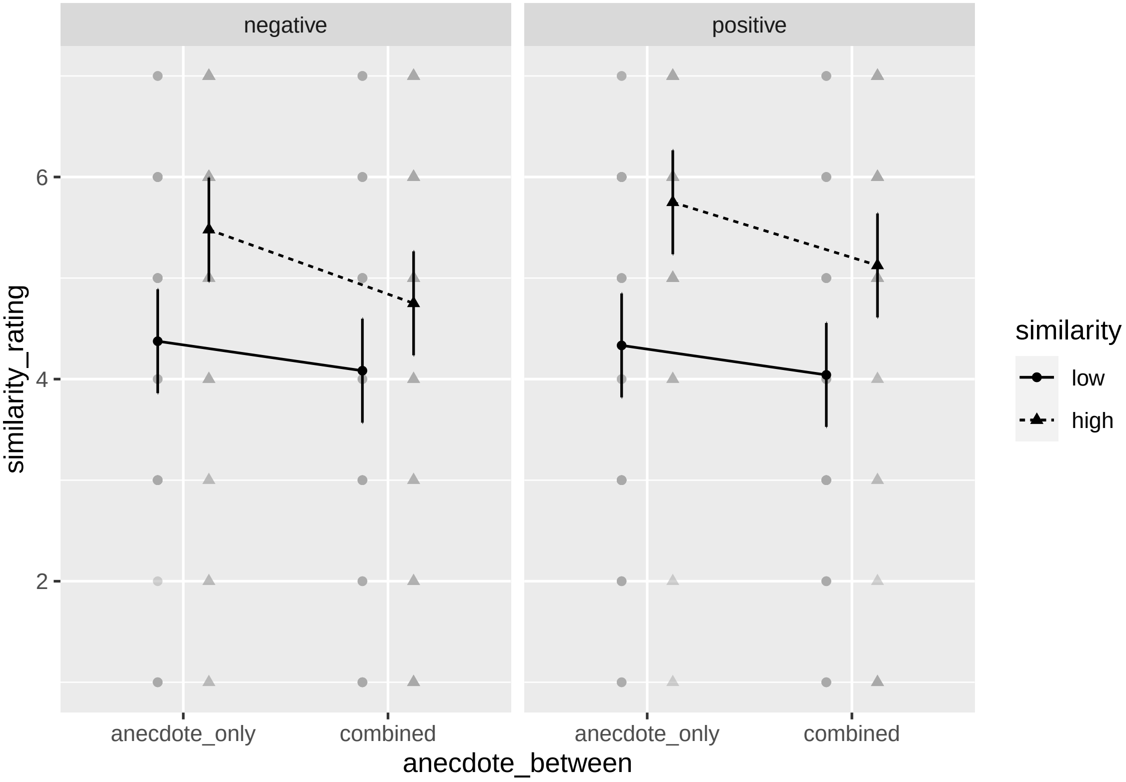


Figure C.22: Mean similarity rating of Project A (the target project) to the anecdote. Error bars represent 95% confidence intervals.

The relationship between allocation and specific-relevance is moderated by similarity In the negative valence condition, there was no significant difference between the slopes of the high and low similarity conditions, $M = -2.02$, 95% CI $[-6.44,\ 2.41]$, $t(376) = -0.90$, $p = .371$. In the low similarity condition, allocation and specific-relevance rating were not correlated, $\Delta M = 1.01$, 95% CI $[-1.21,\ 3.22]$, $t(376) = 0.90$, $p = .371$, as in the low similarity condition, $\Delta M = -1.01$, 95% CI $[-3.22,\ 1.21]$, $t(376) = -0.90$, $p = .371$.

In the positive valence condition, there was no significant difference between the slopes of the high and low similarity conditions, $M = 4.25$, 95% CI $[-0.20,\ 8.70]$, $t(376) = 1.88$, $p = .061$. In the low similarity condition, allocation and specific-relevance rating were not correlated, $\Delta M = -2.12$, 95% CI $[-4.35,\ 0.10]$, $t(376) = -1.88$, $p = .061$, as in the low similarity condition, $\Delta M = 2.12$, 95% CI $[-0.10,\ 4.35]$, $t(376) = 1.88$, $p = .061$.

People do not consider general-relevance in their allocation There were no significant correlations between allocation and general-relevance rating.

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