

# BFBV NEWSLETTER

## You've been framed!

*Why frames matter so much*



You might recall that over the last two weeks, I often referred to the idea of *framing* in the class. Frames matter — they matter a lot.

Let me give you a few examples and relate them to the mental models from psychology which were introduced in the class.

When a man refuses to travel by air after a vividly reported air crash in which many people died, he is probably making a mistake of judgement. He is being influenced by a *frame* of reference in his mind which is extra-vidid. All those photos of

the scattered metal parts make him feel that its suddenly more risky to travel by air than was the case before the crash.

Now what has that got to do with *framing*? A lot. Let me explain.

If you want to improve your persuasive skills you have to learn how to exploit other people's availability bias. You already know that people overweigh information which is extra-vidid, recent, and experienced

personally than vicariously.

First impressions count. So do last impressions. So when you



Hi,

This is the first issue of the BFBV Newsletter. I am writing this one in Barista Khan Market, New Delhi. I have my Mac and I have my cup of Marocchino — they make a great combination.

I plan to do this infrequently, adopting the idea from Outstanding Investor Digest, surely one of the greatest investment newsletters ([www.oid.com](http://www.oid.com)). OID is published whenever the publisher feels he has something useful to send to his subscribers. No pressure to publish means no pressure to fill up the pages with useless text!

I hope you enjoy reading the BFBV Newsletter. Suggestions for incorporating any specific topic in future issues are welcome.

Thank you,

*-Sanjay Bakshi*



make a pitch to anyone, *frame* it in such a way that people to whom you are pitching remember your first lines and your last lines. Often the lines in the middle don't really matter. What people remember is how they perceived you when they first met you and when they last met you.

*Frame* your requests as vividly as you can. *Frame* them around something personal to the requestee. And *frame* them around something that happened recently and which is in the forefront of the requestee's mind.

Lets talk about deprival super reaction syndrome. What a beautiful term coined by Mr. Munger — “deprival super reaction!” So much better than “loss aversion” used by the academic behavioral economists.

You already know that the quantity of a man's pleasure from a ten-dollar gain does not exactly match the quantity of his displeasure from a ten-dollar loss. You also know that this asymmetric response to profits and losses results in some very irrational human behavior in the markets waiting to be exploited by the psychologically astute people like you.

But how can you use your knowledge of deprival super reaction to increase your persuasion skills? Recall that when a problem is *framed* in *loss* terms people become risk seeking — to avoid losses and in the extreme case they become the functional equivalent of the reckless gambler who on his way to ruin bets everything that's left with him on the last draw of the card, throw of the dice etc.

But when the same problem is *framed* in terms of *profits*, they become risk averse. We discussed that bit in detail in the class...

Imagine that you have a request that you want to make to your boss. You have an idea which will, in your view, immensely benefit your company. Now there are two ways in which you can present

this information to your boss. First, you can tell her how your company stands to *gain* if your proposal is implemented. The second way is to reverse it by *framing* the request in loss terms. This time, you tell your boss how your company stands to *lose* if it did not implement your lovely proposal.

*Framing* it in *loss* terms will significantly improve your chances of succeeding in your efforts to convince your boss, unless there are other forces at work.



That bit about “other forces at work” is somewhat important because I don't want 113 of you in my class to approach your favorite potential employers at placement time with suggestions on how they stand to *lose* by not hiring you! If 113 of you frame it that way, well then there might be some very undesirable unintended consequences of your behavior!

Let me move on to contrast effect. What has that to do with framing and its influence on your persuasion skills? Lots. When you *frame* your request using the technique of reciprocal concessions described so well by Robert Cialdini in his book, and discussed in the class, you

increase your chances of compliance. Ask for the moon, expecting to be refused and then ask for what you wanted to get in the first place.

From an investment perspective, there is little downside in this approach. If the requestee agrees to your first request you have a fabulous outcome and in any case even if she does not, you have still increased the chances of getting what you wanted in the first place!

One recent example. I was in Singapore recently and a consulting firm called me to seek my expertise in behavioral finance. I was not really interested but I asked how much do they pay. They told me that they pay up to US \$700 per hour. I said I will get back and I slept over it.

The next morning I wrote back to the offerer that I might do it for \$2,000 per hour. I did not really expect them to agree.

As it turned out, they agreed! I had to find other means to wriggle out of it (I did not want the assignment) but the point is simple: If you ask for the moon you might get it, and if you don't get the moon, well then you can always retreat to a smaller request which is now more likely to be accepted! I like those odds and I would imagine, so should you!

Another example in *framing* is to do with what Mr. Munger calls “reason respecting tendency.”

People like reasons when they are asked to comply with a request. I call this the “power of because.”

The word “because” is a very powerful word in the English language. One very interesting experiment explains this so well.

The experimenter *framed* her requests to jump a queue for a library photocopying machine. She did this with three different groups using three different *frames*.

To one group of people ahead of her in the queue, she said: “Excuse me, I have five pages. May I use the Xerox machine *because* I am in a rush?” 94% of those asked let her skip ahead of them in line.

To the second group she *framed* it differently by asking: “Excuse me. I have five pages. May I use the Xerox machine?” In this case, only 64% of those asked, complied.

It seems that the compliance rate dropped because of exclusion of a valid reason expressed by the words “because I am in a rush.” It seems people want valid reasons for requests.

But that was not so! When she *framed* the request by asking, “Excuse me. I have five pages. May I use the Xerox machine because I have to make some copies?” something incredible happened.

The compliance rate jumped back to 93% — even though no valid reason was offered! After all why would anyone go to a photocopying machine but to make copies?

It turns out that the it wasn't the presence of a valid reason (“because I am in a rush”) but the presence of the word “because” which explained the jump in the compliance rate.

The lesson is obvious for you future framers. *Always* give a reason for your request *because* it will increase its probability of compliance. When you

have a good reason then provide it. When you don't, then just invent one!”

One last observation on *framing*. Recall that in one of the recent classes I listed several problems with DCF models for valuing stocks e.g. making somewhat heroic assumptions about how future will pan out — lasting several decades. I also showed how underneath all that elegant precision lies the imprecision of the irrational man with all of his biases which have a tendency to be reflected in those precise formulae. From this perspective, DCF is a flawed tool, which is often misused to rationalize a stupid valuation: Man is not a rational animal, but a rationalizing one — as I keep on telling you every time I get the chance!

Looked from another perspective however — that of the “DCF frame of mind” — the model becomes a very useful tool. The value of any asset is the present value of its future cash flows. Now suppose that you take the given stock price as correct and multiply by the number of outstanding shares to arrive at market cap. Then add debt to market cap to arrive at enterprise value. And then figure out the quantum as well as the timing of the cash flows the company will have to generate in the future to rationalize



the price of the stock today. Now that's a very neat trick — and I plan to show you how that works in a while...

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