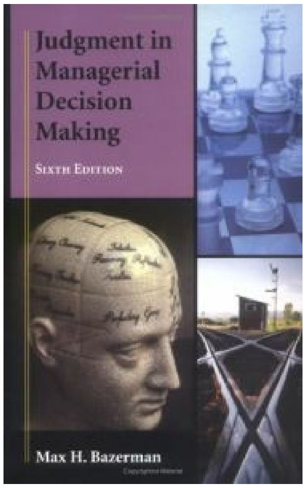

Book Judgment in Managerial Decision Making

Max H. Bazerman
Wiley, 2005

Recommendation

Consider this scenario: Two groups are playing basketball. One group wears black, the other white. Researchers film each group separately passing a basketball back and forth, and superimpose the two films on a television monitor. They ask research participants to add up the number of passes the players make. Because the separate images of basketballs flying here and there overlap, the counters must pay close attention. Under such circumstances, how many of the observers would fail to see a man dressed as a gorilla stroll through the basketball court while dramatically thumping his chest? Believe it or not, eight out of ten. Scientists call this "inattentional blindness." Distinguished Harvard professor Max H. Bazerman refers to such tests as he explains the concept of "bounded awareness." When people fail to notice information, their lack of perception may preclude them from making sound decisions. Bazerman fills his book with learned insights, fascinating research and intriguing tests. He exposes the mental biases, skewed logic, false premises and misleading emotions that interfere with good decision making. *BooksInShort* recommends this tantalizing book to those who want to understand the nuts-and-bolts of the thinking process, and to enhance their decision-making prowess.

Take-Aways

- Managers often make biased, illogical, selfish and emotional decisions.
- Good decision making requires determining your ultimate goal.
- "System 1" thinking is intuitive and emotional, while "System 2" thinking is rational and methodical.
- To use System 2 thinking, define the problem, identify and weigh the criteria, list and compare your alternatives, and then decide.
- People use heuristics – easy rules for thinking – when making decisions.
- Fairness and social equity often color the decision-making process.
- Develop your decisions by looking toward the future, not at past choices.
- Few companies encourage sound executive decisions.
- Instead, they focus on short-term results. This can reward bad behavior.
- To make better decisions, eliminate or reduce mental bias, avoid emotional thinking, examine your premises and be logical.

Summary

Decision-Making Bias

When Enron went bankrupt in 2001, U.S. federal courts found its auditors, Arthur Andersen, guilty of obstruction of justice. Shortly thereafter, Andersen closed its doors. Andersen's auditors probably did not willfully misrepresent Enron's books. Most likely, they were guilty of failed decision making due to a phenomenon called "self-serving bias," in which individuals are likely to err when their judgments relate to self-interest. Indeed, numerous "cognitive biases" profoundly color people's viewpoints. Most people try to make rational decisions – or at least they say they do. If you have to make a major managerial decision, having a clear, distinct goal in mind will help. Ironically, decision making sometimes lacks this vital element. Rational decision making follows a formal process referred to as "System 2" thinking, which works like this:

- **"Define the problem"** – Don't mistake the symptoms for the problem.
- **"Identify the criteria"** – Pinpoint what is relevant.
- **"Weight the criteria"** – Decipher what is important and what is less so.
- **"Generate alternatives"** – Come up with possibilities without wasting time.

- **“Rate each alternative on each criterion”** – This is difficult because it involves predicting how things will transpire in the future.
- **“Compute the optimal decision”** – Figure out which solution is the best with the lowest possible investment of time, effort, emotion and capital.

> “Many good decisions turn out badly, and many bad decisions turn out well.”

People rarely use this step-by-step judgment process. In most instances, they rely on what is known as “System 1 thinking,” which is intuitive, immediate and emotional. Unfortunately, intuition leads to flawed thinking processes. Your intuition can make mistakes. People also use “heuristics” to guide their decisions. These “rules of thumb” are supposedly logical (though often they are not), common sense guidelines for weighing alternatives. Unfortunately, heuristics can also result in flawed thinking and faulty decision making. Common heuristic forms include:

- **“The availability heuristic”** – This approach involves matters that occur frequently and are vivid and quickly accessible by memory. For example, a supervisor will most likely be more judgmental of a worker whose office is right next door than of someone in a room down the hall. Managers easily err in many ways, including misjudging suppliers, employees and retail outlets. They may focus more on factors that are apparently important due to locale or publicity, but that have no real relevance. People also draw incorrect conclusions when two things co-occur and they assume that an indelible bond exists between them. For example, some managers may mistakenly think that because a beautiful, blond female clerk cannot file well, then all beautiful, blond female clerks are poor filers. Though clearly illogical, such thinking is common.
- **“The representative heuristic”** – This judgment is based on incorrect or incomplete generalizations, such as, “This person will probably be lazy because people from his country often are lazy.” Such statements are wildly misleading and discriminatory. Potential bias often results when people draw conclusions based on small or insufficient samples. For example, if three black-and-white spotted dogs walk past your porch, one every 15 minutes, you could assume that the neighborhood is filled with black-and-white spotted dogs, while an empirical survey might reveal that of the area’s hundreds of dogs, the only black-and-white spotted ones are the three that passed you. Bias may also result from “misconceptions of chance.” For instance, say that you invest in five stocks that immediately tank. You purchase another stock, assuming that your luck will change. This is illogical – the value of the sixth stock will fluctuate based on how people judge that company, not on your prior purchase of five unrelated stocks. Using this heuristic could lead to other “systematic irrationalities” in your decision making.
- **“The affect heuristic”** – This includes judgments based on emotions, not logic. Such judgments precede and, in effect, replace cognition. In an opinion like, “I don’t know what it is, but there is just something about that guy that I don’t like,” the potential bias is unlimited. Emotional thinking is almost always misleading.

> “It is far easier to identify a bias while you are reading a book about decision making than when you are in the midst of an organizational crisis.”

Numerous other problematic biases which are not specifically based on “availability” or “representative” heuristics can also taint your thinking and decision making. Avoiding flawed heuristics is difficult because such reasoning is almost always intuitive, deeply ingrained and the product of habit. To deal with flawed heuristics, closely examine your premises. Always watch how people frame things, so you don’t base your decisions on irrelevant information. For example, a politician may say: “If you criticize current tax policy, that means you want to raise taxes for everyone.” Such either-or framing does not present *bona fide* alternatives.

> “One of the most important subjective influences on information processing is self-interest.”

Also watch how people word things. Fail to do so and you may end up basing your decisions on information that is not relevant. Factor in human emotions when making decisions. Everyone has multiple personalities (selves) – a “want” self and a “should” self. An overweight man eats an extra slice of cherry pie to satisfy his “want” self. A marathoner trains hard every day to satisfy his “should” self. People have “long-term” and “short-term” selves. One woman might spend every penny of her paycheck to satisfy her “short-term” self, while another might invest $50 weekly in a Christmas club to satisfy her “long-term” self. These multiple selves often come into play when people make decisions. Use your “umpire self” to “negotiate” internally with these individual selves, and thus improve your judgments and actions. Hold yourself accountable for your decisions.

Should You Double Down?

Another decision-making problem, known as the “non-rational escalation of commitment,” refers to a series of co-dependent choices. You hire someone who doesn’t meet expectations. You invest more time and training in this person, who still doesn’t work out. You are inclined to fire this frustrating, failing staffer, but realize that would mean throwing away major investments of time and money. Accountants or economists would say that you are not examining the issue correctly. The time, money and training you invested in the new employee represent unrecoverable “sunk costs” that should not figure into your decision making. Look to the future, not the past.

> “Many of the errors we make are the result of motivational and affective influences.”

Divorcing yourself from equity concerns and “social comparisons” is particularly difficult because people are hard-wired to factor fairness and social equity into their decision making. In terms of fairness, most disputes involve *status quo* issues. If a car’s list price is $20,000, then all subsequent negotiations between buyer and seller will focus on this price, even if the manufacturer has set a totally arbitrary figure. Bottom line: Be aware that fairness and social equity concerns often color decision making. That is simply human nature. When it comes to issues of right and wrong, the mental bias known as “bounded ethicality” often cause people to act unethically while being truly unaware that they are behaving poorly. Minor ethical inconsistencies, which are often steps down a “slippery slope,” can lead to major transgressions.

> “Decision makers who commit themselves to a particular course of action have a tendency to make subsequent decisions that continue that commitment beyond the level suggested by rationality.”

In negotiations, your best chance of avoiding cognitive errors and biases is to arm yourself with as much solid information as possible. What viable alternatives does each party have? What are their most important interests? During negotiations, establish trust, ask intelligent questions, disclose information in a strategic manner, present numerous offers and look for “post-settlement settlements.” You cannot achieve your goals through negotiation unless you are well prepared.

> “Fairness considerations lead to systematic departures from the predictions of economic models.”

People often display grossly illogical thinking when making decisions regarding investments. For example, the way a stock performed yesterday has little to do with how it will perform tomorrow, and yet the financial investment industry employs thousands of experts to convince you that they can predict how stocks will perform in the future. The best way to invest is to put as much money as you can reasonably afford into a balanced retirement plan. Minimize your risk and protect yourself from taxes. Adopt a long-range approach. Paying financial advisers hefty fees to invest your money in some "can't lose" stock is a sucker's game. You probably will do no better than the Standard and Poors 500 value-weighted index.

You Can Make Better Decisions

Executives are not stupid – quite the opposite. However, like everyone, they often make irrational, flawed decisions. Avoid, or at least limit, such highly specific, systematic decision-making errors by following these six strategies:

1. **"Acquiring experience and expertise"** – Experience is a valuable teacher. However, it will not necessarily stop you from making bad decisions, which often are more a result of incorrect reasoning, mental bias or emotion than of experience. Nevertheless, over time you can learn what constitutes a good decision as you begin to grasp conceptually what rational decision making is all about, and then proceed accordingly.
2. **"Debiasing judgment"** – Eliminating bias from your decision making is difficult but possible. First, "unfreeze" your view of yourself as a decision-maker. Executives customarily assume that they could not have risen through the ranks without being excellent decision makers. However, everyone makes cognitive errors. Avoid assuming a rigid personality, and being afraid to admit problems or deficiencies. Be willing to watch for and eliminate your judgmental biases, thereby improving your thinking and decision making. Routinely examine the heuristics you use to make decisions. Be diligent about the way you decide.
3. **"Analogical reasoning"** – When it comes to thinking more precisely and carefully, consciously benefit from the multiple experiences and situations you encounter. As analogous experiences repeat themselves, intuitively abstract lessons from them that you can apply to future circumstances, even contextually different ones. In this way, experience can be a worthwhile teacher of decision making.
4. **"Taking an outsider's view"** – Peoples' decisions are based on either an "insider" or an "outsider view." To illustrate, a contractor building his own home tells himself that he will complete the project at or below the projected cost estimate (insider's view), but his experience indicates that most construction projects exceed the original estimate by 20%-50% (outsider's view). Nevertheless, he convinces himself (insider's view) that this time things will be different. Call such reasoning what it is: magical thinking. When deciding which voice to listen to, always pay attention to your outsider view, not your insider view. Ask informed outsiders for their opinions when you are making decisions in which the outsider-insider dynamic is crucial.
5. **"Using linear models and other statistical techniques"** – You may want to turn to your computer for help in making a decision. Indeed, studies indicate that computer-based decision making often trumps human decisions, because people are influenced by mood, deadline pressure and other non-rational factors. Automated decision making relies on regression analysis, statistical analysis and linear models.
6. **"Understanding biases in others** – As a manager and executive, you are responsible not only for your own decisions, but also for those of the people you supervise. Be aware, therefore, that your direct reports' biases may result in incorrect decisions that can harm your organization, thwart progress and reflect poorly on you. To avoid this, pay close attention to the context of your staff members' decisions. Be watchful for any biases in their thinking, and make any adjustments needed in their final conclusions.

> "Ours is not a fully rational world, particularly when it comes to our own decision-making processes."

Organizations can vastly improve their decision making by rewarding employees who make rational, sound business decisions. Unfortunately, current managerial thinking emphasizes results, which may have nothing to do with good decisions and may even be based on bad decisions, such as a focus on short-term profits. Don't expect to improve your decision-making prowess over night. It takes time, considerable effort and constant monitoring. Everyone's decision making is subject to cognitive biases, incorrect assumptions, irrelevant emotional factors and faulty logic. Accepting this fact is the vital first step toward making better managerial and personal decisions.

About the Author

Max H. Bazerman is the Straus Professor at the Harvard Business School, and author of *Negotiating Rationally* and *Conflicts of Interest*.
