

M2L11. Common Judgement Fallacies

Slide #1



In uncertain business situations, decision makers often exhibit some psychological fallacies, whether knowingly or inadvertently.

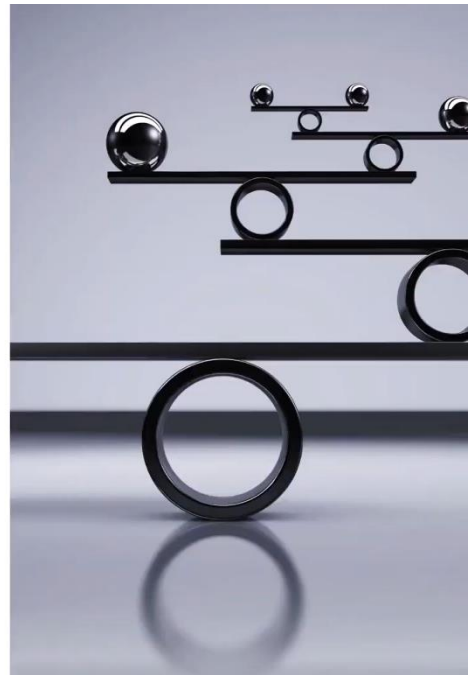
Understanding these behaviors is vital for navigating the complexities of decision making and achieving favorable outcomes.

Slide #2

Common Judgment Fallacies in Uncertain Business Situations

- Endowment effect
- Status quo bias
- Escalation of commitment fallacy

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We will discuss three prevalent judgment fallacies that decision makers frequently encounter.

The endowment effect, status quo bias, and escalation of commitment.

Slide #3

Endowment Effect

When individuals possess an item, they often perceive it as more valuable than when they do not.



Example: over pricing product and services



Impact: hinderance in negotiations and potentially stall beneficial deals.



Solution: objective approach to pricing

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First, the endowment effect explains why sellers tend to overprice what they own.

When individuals possess an item, they often perceive it as more valuable than when they do not.

This phenomenon can lead to overpricing products or services, making transactions more difficult.

For example, a business owner might value their company's proprietary technology higher than potential buyers do, simply because they developed and own it.

This inflated valuation can hinder negotiations and potentially stall beneficial deals.

By recognizing the endowment effect, decision makers can strive to adopt a more objective perspective, enhancing their ability to price assets realistically and facilitating smoother transactions.

Slide #4

Status quo Bias

A tendency to maintain the current state, even if change can lead to better outcomes.

Example: Reluctance to adopt efficient solutions

Impact: This inertia can stifle innovation and impede progress.

Solution: Encourage growth and adaptation

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Another common behavior is status quo bias, which illustrates the difficulty of making changes.

People often prefer to maintain their current state, even when change could lead to better outcomes.

This reluctance to change can manifest in business settings as a resistance to new strategies, technologies, or processes.

For instance, a company may stick with outdated software because employees are accustomed to it, despite the availability of more efficient solutions.

This inertia can stifle innovation and impede progress.

By acknowledging status quo bias, leaders can create a more dynamic environment that encourages adaptation and growth, fostering long term success.

Slide #5

Escalation of Commitment

Continuing to invest in a decision despite evidence suggesting it may not be the best course of action.



Example: continuing to fund a failing project due to significant resource investment



Impact: Likely loss of resources



Solution: Evaluate solutions objectively

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The escalation of commitment fallacy explains how we react to previous decisions or the actions of others.

This behavior involves continuing to invest in a decision despite evidence suggesting it may not be the best course of action.

Lastly, the escalation of commitment fallacy explains how we react to previous decisions or the actions of others.

Often driven by a desire to justify past investments, this can lead to further losses.

For example, a company might continue funding a failing project because significant resources have already been committed, hoping for an unlikely turnaround.

Recognizing escalation of commitment allows decision makers to evaluate situations more objectively, enabling them to cut losses when necessary and reallocate resources to more promising ventures.

To prevent unconsciously falling into these common behaviors, it's crucial to recognize and address them in decision making.

In the forthcoming lectures, we will discuss in detail these judgment behaviors and provide strategies for effectively managing them.