

# SMART CHOICES



## OBJECTIVE

This module covers how to think systematically about tough important decisions. But now we need to address a different category of decision making errors we call psychological traps. These errors happen because our minds sometimes play serious tricks on us. While we can't rid our minds of these ingrained flaws, we can learn to understand the traps and compensate for them.

In this lecture, we look at some of the most common psychological traps and how they affect decision-making. So familiarizing ourselves with these traps will ensure that the decisions we make are sound ones.

The best protection against the traps is awareness.

## TRAPS

### Let's Explore Each Trap

#### Over Relying on First Thoughts The Anchoring Trap

With anchoring, the mind gives too much weight to the first information it receives. Initial impressions, ideas, estimates, or data anchor your subsequent thoughts.

## LECTURE NOTES

### Chapter 10 PSYCHOLOGICAL TRAPS

## Keep on Keeping On The Status Quo Trap

In this case you may display a strong bias towards alternatives that perpetuate the current situation or the status quo. Maintaining the status quo may indeed be the best choice but you don't want to choose it just because it is the status quo.

## Protecting Earlier Choices The Sunk Cost Trap

We tend to make choices in a way that justifies past choices even if the past choices no longer seem valid. The expended time and money are sunk costs and not recoverable.

## Seeing What You Want to See The Confirming – Evidence Trap

In this case we tend to seek out the information that supports our point of view while avoiding information that does not.

## Posing the Wrong Question The Framing Trap

Here it is all about the framing of the question. Research shows that framing a question as a gain versus a loss will bias the responses. The same problem can elicit very different responses: when posed as a gain people tend to be risk averse but they are risk seeking when the same problem is posed as avoiding losses. Additionally, people are susceptible to reference points that are engrained in the problem.

## Being Too Sure of Yourself The Overconfidence Trap

This trap goes back to the idea of anchoring. When deciding on a value your initial estimate becomes your anchor and then the focus is usually on mid-range possibilities from this anchor point. This may lead to over confidence on a too narrow range.



## Focusing on Dramatic Events The Recallability Trap

We tend to exaggerate the probability of rare or catastrophic events because they receive more attention which tends to distort your ability to recall them in a balanced way.

## Neglecting Relevant Information The Base-Rate Trap

The base rate refers to the dominate probability of the question you are considering. For example, in your book they posed this scenario: "Donald Jones is either a librarian

or a salesman. His personality can best be described as retiring. What are the odds that he is a librarian?" The base rate here is the chances that he is a librarian NOT that because he has a retiring personality he is a librarian. Look at the probability that he is male librarian vs a male salesman first. Male salesmen far outnumber male librarians so chances are very slim that he is a librarian, regardless of his personality type.

## Slanting Probabilities and Estimates

### The Prudence Trap

To be "prudent" you may have a tendency to estimate the probability on the "safe side". These "just-to-be-safe" adjustments, if slanted similarly by everyone can cascade to a degree that makes aggregated judgments horribly inaccurate.

## Seeing Patterns Where None Exist

### The Outguessing Randomness Trap

We have all seen or heard of an instance when someone is having a great string of luck and someone tells that person they should play the lottery. No matter how lucky, random events are just that random. Dice rolls or lotteries have neither memory nor conscience – they are uninfluenced by previous events.

## Going Mystical about Coincidences

### The Surprised-by-Surprises Trap

This trap results from a failure or unwillingness to give reality its sometimes surprising due.

## What can we do about the psychological traps we are susceptible to?

In a nutshell – forewarned is forearmed. Each trap has specific suggestions. But in general, awareness of the traps is your best defense. If you feel predisposed to fall into any of these traps I suggest that you explore specific solutions to each that are listed in your book.

# HIGHLIGHTS

- View each decision problem from different perspectives being aware of the various traps to which one may be susceptible.
- Be open-minded and seek information and opinions of from others but think about the problem on your own first so you won't be unduly influenced.
  - Get opinions from those not impacted or involved in an earlier decision.
  - Ask someone to play devil's advocate.
- Always reflect on your objectives – does that solution really make sense?
- There is never only one alternative – examine others.
- Don't exaggerate the cost and effort to switch to another alternative.
- Don't avoid making a hard choice because it is hard – choose the best alternative.
- Set aside any concerns about sunk costs. Warren Buffett said: "When you find yourself in a hole, the best thing you can do is stop digging."
- Be conscious of how you frame your problems and ensure that the frame supports your objectives – otherwise reframe to avoid distortions.
- Routinely challenge your own experts and data.
- Substitute fact for opinion whenever possible.
- Be aware of situations where your memory may be unduly swayed by distorted reality.
- Pay close attention to what the appropriate base rate data shows.
- Be disciplined in your assessments of probabilities.

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