Bazerman and Moore

Chapter 3

Common Biases

Availability Heuristic	
Ease of recall (vividness and recency)	Easily recalled events appear to be more frequent than non-easily recalled events. [Insurance purchased after the event.]
Retrievability (search process)	Easily retrieved events appear to be more frequent than non-easily recalled events. [Use of one's social network for a personnel search.]

Representativeness Heuristic	
Base rates	Prior probabilities are ignored in assessing posterior probabilities. ["One year to live."]
Sample size	Sample sizes are ignored in assessing the quality of information. ["Four out of five dentists…" without reporting sample size.]
Chance	Short sequences of random events are expected to look "random". [Gambler's fallacy; hot hand fallacy.]
Regression	Extreme events are not expected to regress to the mean. [Flawed estimates due to the assumption of perfect correlation.]
Conjunction	P(A and B) is assessed to be greater than P(A), P(B), P(A or B). [Linda the bank teller.]

Confirmation Heuristic	
Confirmation trap	Seek confirming info; ignore disconfirming info. [The Yes Person consulting firm would be successful.]
Anchoring	Use of a non-informative fact as the basis for an estimate. [First impressions color ensuing assessments.]
Conjunctive/disjunctive	Overestimate P(A and B); underestimate P(A or B). [Cost- and time-overruns in complex projects.]
Overconfidence	Overconfident about one's own estimates and abilities. [Failure rate of start-ups, and mergers and acquisitions.]
Hindsight	Overestimate the likelihood of an event after it occurs. ["I could have told you that was going to happen."]
Curse of knowledge	Employing private information when anticipating the behavior of others. [Presuming the other person knows what you know.]

COMMON BIASES

Availability Heuristic	
Ease of recall (vividness and recency)	Easily recalled events appear to be more frequent than non-easily recalled events. [Insurance purchased after the event.]
Retrievability (search process)	Easily retrieved events appear to be more frequent than non-easily recalled events. [Use of one's social network for a personnel search.]

COMMON BIASES

Representativeness Heuristic	
Base rates	Prior probabilities are ignored in assessing posterior probabilities. [“One year to live.”]
Sample size	Sample sizes are ignored in assessing the quality of information. [“Four out of five dentists…” without reporting sample size.]
Chance	Short sequences of random events are expected to look “random”. [Gambler’s fallacy; hot hand fallacy; Kareev’s analysis is correct.]
Regression	Extreme events are not expected to regress to the mean. [Flawed estimates due to the assumption of perfect correlation.]
Conjunction	P(A and B) is assessed to be greater than P(A), P(B), P(A or B). [Linda the bank teller.]

COMMON BIASES

Confirmation Heuristic	
Confirmation trap	Seek confirming info.; ignore disconfirming info. [The Yes Person consulting firm would be successful; may I believe versus must I believe.]
Anchoring	Use of a non-informative fact as the basis for an estimate. [First impressions color ensuing assessments.]
Conjunctive/disjunctive	Overestimate P(A and B); underestimate P(A or B). [Cost- and time-overruns in complex projects; P(success) = p^n versus P(failure) = 1 - p^n.]
Overconfidence	Overconfident about one's own estimates and abilities. [Failure rate of start-ups, and mergers and acquisitions.]
Hindsight	Overestimate the likelihood of an event after it occurs. ["I could have told you that was going to happen."]
Curse of knowledge	Employing private information when anticipating the behavior of others. [Presuming the other person knows what you know. The Nerd in George's short movie.]

Bazerman and Moore

Chapter 5

Framing and the Reversal of Preferences

FRAMING

Asian Flu problem

Problem 1. Imagine that the US is preparing for the outbreak of an unusual Asian disease that is expected to kill 600 people. Two alternative programs to combat the disease have been proposed. Assume that the exact scientific estimates of the consequences of the programs are as follows:

Program A: If Program A is adopted, 200 people will be saved.

Program B: If Program B is adopted, there is a one-third probability that 600 people will be saved and a two-thirds probability that no people will be saved.

Which program do you favor? (Most favor Program A.)

FRAMING

Asian Flu problem

Problem 2. Imagine that the US is preparing for the outbreak of an unusual Asian disease that is expected to kill 600 people. Two alternative programs to combat the disease have been proposed. Assume that the exact scientific estimates of the consequences of the programs are as follows:

Program C: If Program C is adopted, 400 people will die.

Program D: If Program D is adopted, there is a one-third probability that no one will die and a two-thirds probability that 600 people will die.

Which program do you favor? (Most favor Program D.)

FRAMING

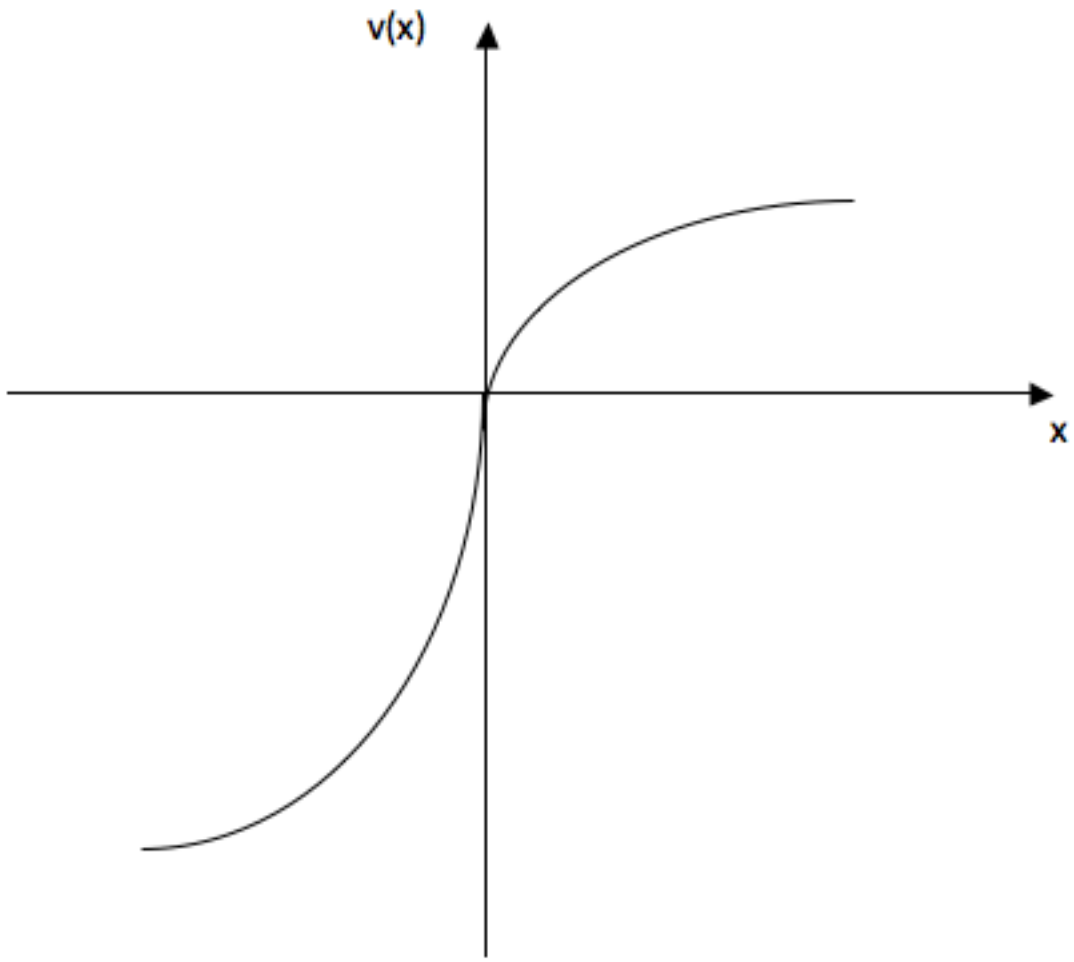
Choosing A over B in Problem 1 reveals risk aversion over gains, whereas choosing D over C in Problem 2 reveals risk seeking over losses. Note, however, that the problems are algebraically equivalent; they simply have different descriptions, i.e., different framings.

Framing is the process of describing a decision problem. If we frame a problem in terms of gains, we will induce risk aversion; if we describe the objectively same decision problem in terms of losses, then we will induce risk seeking.

Note that Problem 1 and Problem 2 are objectively the same under the MEV Rule. However, we induce reversed choices by framing in terms of gains (Problem 1) and in terms of losses (Problem 2).

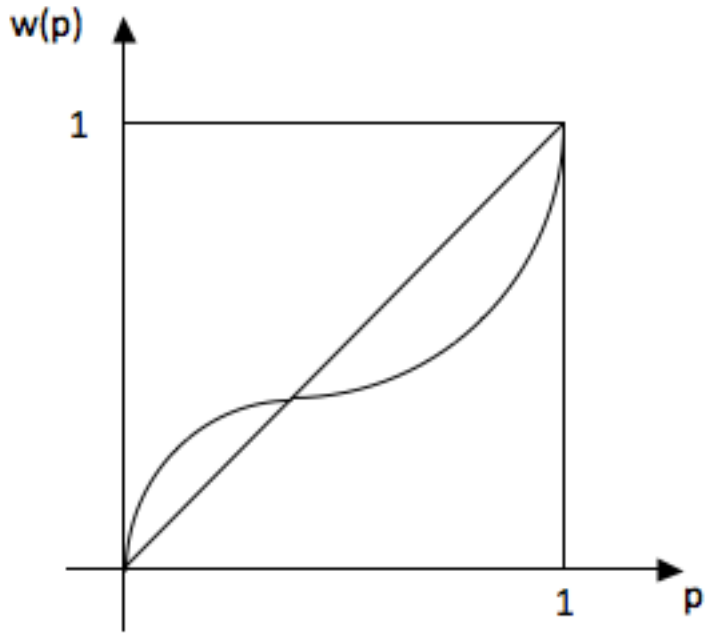
Prospect Theory

Valuation Function



Prospect Theory

Probability Weighting Function



Prospect Theory

Prospect theory can explain behavior in a wide array of settings, including:

finance (Dacey and Zielonka, 2013, 2008a),
assassination (Carlson and Dacey, 2011, 2009),
war and peace (Carlson and Dacey, 2013, 2012, 2010a, 2007, 2006, 2004);
strategic use of fear and anger (Carlson and Dacey, 2014)
social norms (Carlson and Dacey, 2010b),
migration (Dacey, 2004),
race relations (Dacey, 1998a),
insurrection (Dacey, 1998b),
inductive logic (Dacey, 2004),
water policy formation (Dacey, 2008b),
crime and punishment (Dacey and Gallant, 1997).

The Endowment Effect

We grossly over-value what we already possess.

The endowment effect has a very powerful impact on many decisions. Sellers are often so reluctant to sell at a "reasonable" price that they wind up holding assets that can only diminish in value. In finance, this leads to the down-side of the disposition effect.