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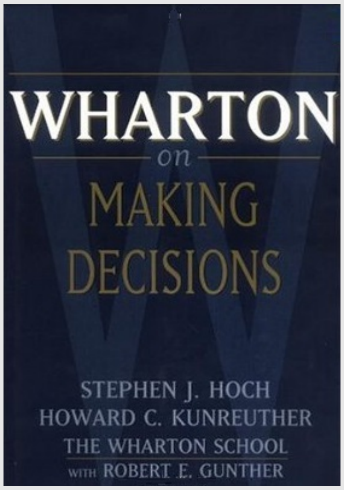

Wharton on Making Decisions

Howard C. Kunreuther and Stephen J. Hoch
John Wiley & Sons, Inc. © 2001
352 pages
Book: getab.li/1310

Rating

8

7 Applicability
9 Innovation
7 Style

Focus

Leadership & Management
Strategy
Sales & Marketing
Finance
Human Resources
IT, Production & Logistics
Career & Self-Development
Small Business
Economics & Politics
Industries
Global Business
Concepts & Trends

Take-Aways

- People make decisions on four levels: as an individual, as a manager, in negotiations (or multi-party interactions) and on a societal level.
- Become aware of how you and others make decisions.
- Even with logical models, decision makers don't always decide logically.
- Negative emotions greatly influence decision-making, and can prolong it.
- People usually don't plan more than one step beyond a current decision.
- A desire for variety can cause confusion and lead to poor decisions.
- To improve your decision-making, combine your intuition with decision-making models.
- One good decision-making strategy is to combine the West's emphasis on expedience with the East's emphasis on reflection.
- Use data mining and large-scale simulation models in making complex decisions.
- Since most people can't detect deception, the best defense is to reduce the likelihood that people will use deception in a negotiation.

Relevance

What You Will Learn
In this summary, you will learn: 1) Why you should become aware of how you make decisions; 2) Why you should not rely on your intuition alone; and 3) How a desire for variety can lead to bad decisions.

Review
Stephen J. Hoch and Howard C. Kunreuther present a series of articles about making decisions written by professors at the Wharton School of Business at the University of Pennsylvania. The articles describe how decisions are made using an ideal scenario, and then offer practical suggestions on how to make better business decisions. The book is designed to help top executives and managers use the latest methods of analysis and reasoning in decision making. Some may find this approach overly academic - in that many of the research findings are based on social laboratory experiments, statistical analysis and modeling - but if you've been making decisions based on guts, glory and a coin toss, the latest scholarship does offer some stronger strategies. *getAbstract* found several in this solid book that will be of great help to managers dealing with employees, executives formulating strategy and finance or compliance officers weighing corporate risks.

Summary

The Complex Web of Decision Making
To make better decisions, become proactive by reshaping your decision-making process to be completely conscious. Become more aware of how you make decisions. Draw on deliberate insights about how people make decisions and how to make better ones.

"Decision makers have great difficulty in evaluating low-probability, high-risk events before disaster strikes, so they tend to under-protect themselves beforehand and over-protect themselves afterward."

There are four levels of decision making:

- **Individual** - A person's decisions are often influenced by emotions, intuitions and a focus on the present versus consequences in the future.
- **Manager** - Making decisions as a manager, you may be more concerned with using models to facilitate making decisions, particularly complex decisions.
- **Negotiations** - This includes decisions made in various interactions with multiple parties.
- **Societal** - Decisions that are made on the societal level affect choices about such issues as environmental protection and health-care coverage.

These different levels of decision making can contribute to the success or failure of an organization. For example, examine the failure of the Barings Bank. Nick Leeson, the manager of the bank's Singapore office, made a decision to conceal an error an employee made - to sell rather than buy a contract in the futures market. This decision led to a series of other decisions to engage in deceptive actions, and the problem was compounded by other bank officials' decisions to supervise Leeson's actions insufficiently and to ignore signs of danger in the Singapore branch.

"People have a much harder time giving up something than acquiring it (loss aversion), even though it is the same object with the same value."

Both Barings and Leeson made numerous strategic decision-making errors that contributed to the bank's failure, including being blinded by emotions, relying too much on intuition, overly emphasizing speed, failing to detect deception, underestimating risks, using insufficient information technology to support the decisions being made and being protected by insufficient regulation.

Making Personal Decisions

Decision makers don’t always think logically, even if they have logical decision models. "The Emotional Nature of Decision Trade-Offs," an article by Mary Frances Luce, John W. Payne and James Bettman, explains that emotions affect your choices. For instance, your company is downsizing a department and you have to fire two of your 10 current employees. As you weigh a number of factors - such as job skill, age, tenure with the organization, family situation and current rate of pay - your compassion for employees and your concern about your own reputation may come into play.

“As the stakes of a decision increase, the desire to find the best normative solution may coexist with the desire to manage or minimize one’s negative emotions.” (Mary Frances Luce, John W. Payne and James R. Bettman)

While you may want to find the best normative solution based on what you consider a "normatively appropriate strategy," your desire to control or minimize your negative emotions may unduly influence you. You may spend more time making the decision, because you want to avoid these difficult emotions. In fact, as the stakes of decision-making go up, your negative emotions gain an increasing influence over the way you weigh the trade-offs that are part of making any decision. To make better decisions, recognize the influence of your emotions. Then, try to reduce the emotional difficulty of decision making by considering the factors sequentially and confronting your emotional reactions directly.

You can also make better decisions if you avoid relying too much on your intuition, particularly when making complex decisions, as discussed by Robert J. Meyer and J. Wesley Hutchinson in their article, "Bumbling Geniuses: The Power of Everyday Reasoning in Multistage Decision Making." As they note, humans are often poor at looking into the future and making intuitive guesses about how to solve complex problems. Although your intuition may give you a good result at times, decision makers tend to be overconfident about their occasional successes and too often think that a good solution to one problem will work in solving another problem. The result can be a very serious error with long-term consequences. One big problem, according to Meyer and Hutchinson, is that decision makers are often myopic about forward planning, since people generally plan no further than one step beyond a current decision.

“When processing information, we are inherently prone to give more weight to that which is more concrete and vivid at the expense of that which is more intangible and ambiguous.” (Robert J. Meyer and J. Wesley Hutchinson)

Managers frequently undervalue the costs of an opportunity in making investment decisions and use moment-by-moment opportunism in scheduling activities rather than long-term comprehensive planning. Managers are also likely to give more weight to concrete and vivid information - like a cash outlay - as opposed to intangible, ambiguous information - such as improved future profits. This leads to bad decisions, for example, choosing not to make current investments in improved processes for future gains.

Confirmation Bias

People are also biased toward information that confirms their current opinions and have a better memory for information that supports their biases. Thus, to make better decisions, avoid being myopic. Pay more attention to future possibilities and consider whether your starting analogy is appropriate for the problem at hand. Also, pay more heed to feedback, so you can learn from your mistakes as you pursue a complex decision-making process.

“Every decision involves trade-offs. Decision making is essentially the process of accepting less of something to get more of something else.” (Mary Frances Luce, John W. Payne and James R. Bettman)

To make better decisions, become more aware of the influence of wanting variety, as pointed out by Barbara E. Kahn and Andrea Morales in their article: "Choosing Variety." People are drawn to variety because they are seeking a new outlook or wishing to enhance routine activities. But in decision making, too much variety can add confusion and waste time. To better manage variety, decision makers should increase their perceived variety while keeping down costs.

For example, focus on the more meaningful dimensions of variety - such as when a car salesman offers you several color choices but only two warranty options. If you are presenting a decision, don't offer an overwhelming number of options.

"In general, decision makers construct their choice strategies by maximizing accuracy, minimizing decision effort and minimizing negative emotions." (Mary Frances Luce, John W. Payne and James R. Bettman)

Making Decisions as a Manager

To improve your managerial decision making, combine your intuition with decision-making models, as Stephen J. Hoch explains in "Combining Models to Improve Decisions." By using a model - such as an information-driven decision support system (DSS) - you minimize the human element, harness information technology as a power tool and use information technology to cover up or complement any weaknesses you may have as a decision maker.

This balanced approach works because experts and models have complementary strengths and weaknesses. Whereas models excel at objective evaluation, experts are subject to biases of perception and evaluation, and can suffer from overconfidence and or the influence of organizational politics. Experts can also get tired, bored and emotional, and do not consistently combine the data gained from one occasion with the data from another.

On the other hand, models know only what the experts tell them and, thus, can predict, but not diagnose. Models can also be too rigid in their consistency.

"Although our cognitive abilities are poorly equipped to solve complex dynamic-optimization problems, our intuitive guesses about optimal solutions turn out to be, in some instances, surprisingly good." (Robert J. Meyer and J. Wesley Hutchinson)

For best advantage, combine your intuition and a model to benefit from the strengths of both. Use your intuition to identify relevant attributes and place a value on the level of each attribute. Then use the model to integrate these individual attributes and improve your ability to make judgmental forecasts, such as what items to put on sale in the future.

Wisdom, East and West

In their article, "Reflective Versus Expedient Decision Making: Views from East and West," Karen A. Jehn and Keith Weigelt suggest drawing on the wisdom of both the East and the West in making decisions. Western decision making emphasizes reaching a quick, expedient decision on the basis that "time is money," whereas Eastern decision makers prefer more patient reflection. While faster decision making can result in poor decisions, they can be better in a crisis situation where some decision is needed and patient contemplation is inappropriate.

Quick decisions get the job done and overcome the inertia of large organizations, but haste makes waste, and increases the danger of myopia and excess emotion. Conversely, careful reflection can result in a good decision and cuts the danger of being surprised by an unexpected outcome. Ideally, combine the best of both approaches by using patient, reflective decision making when you can - particularly to look for disconfirming evidence - and by directing your energy. But when necessary, be expedient.

"As decision makers, we are prone to be over-confident in our occasional success and over generalize the degree to which good intuitive solutions to some dynamic problem also offer good solutions to other problems. (Robert J. Meyer and J. Wesley Hutchinson)

Further your ability to make complex decisions by using new tools, such as data mining and large-scale simulation models, as described by Paul R. Kleindorfer in "Decision Making in Complex Environments: New Tools for a New Age." You can also decide by using different "frames," cognitive structures that organize and simplify a complex environment, as described by Paul J. H. Schoemaker and J. Edward Russo in "Managing Frames to Make Better Decisions."

Start with a frame audit to identify and change inferior frames, using a variety of reframing techniques. Such frames include problem frames to generate solutions, decision frames to choose among alternatives, and thinking frames to apply experience to the way you consider things. Create a mental model to describe a frame visually. Then, assess whether your own frames are effective. Do they lead you to ask the right questions and to be amenable to change? Examine your reference points and assumptions, experiment with multiple frames and try to align your frames with other peoples' to reach a mutual decision.

"The human desire for variety does not always have positive consequences for organizations. Variety can add cost and complexity to decision making and slow down the process as managers or customers sift through endless arrays of options." (Barbara E. Kahn and Andrea Morales)

Multi-Party Decision-Making

In negotiations, you can make better decisions if you think strategically. As Colin F. Camerer and Teck H. Ho point out in "Strategic Learning and Teaching," you can use theories of interactive learning, belief learning and experience-weighted attraction to respond to others more productively.

To adapt your approach effectively, realize that people learn differently, based on three key factors - considerations about lost opportunity, perceptions about change in the environment and commitment to a strategy, even if it isn't working well. Whatever the situation, you can do better if you understand how others learn and if you look for opportunities to learn from the situation as well.

You can improve your negotiation skills by becoming more aware of the styles of the other parties in negotiations, based on their reputation. In "Reputations in Negotiation", Steven Glick and Rachel Croson point out that negotiators are more likely to use tough tactics defensively with tough partners and offensively with those perceived as lightweights. Conciliatory approaches are more likely with middle-of-the-road negotiators.

Pay attention to the dangers of deception, as Maurice E. Scheitzer notes in "Deception in Negotiations." Since most people are not very good at detecting deception, the best defense is to reduce the likelihood that people will use deception, such as establishing trust by convincing others you will not use deception. Heed non-verbal cues, ask direct questions, keep records and get things in writing.

"Although humans are not well-suited to memorization of minute details, they have great strength in finding and remembering meaning. The inevitable weakness is that humans tend to see patterns and fill out pictures that may not be there." (Stephen J. Hoch)

You can use e-mail and other information technologies to assist in a negotiation, as G. Richard Shell notes in "Electronic Bargaining: The Perils of E-Mail and the Promise of Computer Assisted Negotiations." E-mail can facilitate a less emotional approach to negotiations. It can shield negotiators who dislike face-to-face confrontations or it can include lower-level employees on a more even playing field. You can even use e-mail to build electronic coalitions of far-flung people who share a common goal.

Finally, decision makers can make better decisions about societal issues, such as health care and the environment, by understanding the decision-making process more clearly. In "A Change of Heart: Unexpected Responses to Medical Testing," John Hershey and David A. Asch discuss how managers make decisions about medical testing and what to tell patients.

About the Authors

Stephen J. Hoch is a professor of marketing at the Wharton School, University of Pennsylvania. He previously taught at the University of Chicago **Howard C. Kunreuther** is a professor of decision sciences and public policy and management, as well as co-director of the Risk Management and Decision Process Center at the Wharton School. **Robert E. Gunther** was the coordinating writer for *Wharton on Dynamic Competitive Strategy and Wharton on Managing Emerging Technologies.*