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Making Decisions in Times of Uncertainty

- **The Year 2009**

The year 2009 has more uncertainty about it than previous years experienced by our generation. These economic uncertainties concern virtually everybody in some way or another. It makes governments hold meetings till late at night and causes managers of organizations to take all sorts of drastic actions. They all seem to be **extremely unsure**.

The President of the USA and most other leaders spend unthinkable amounts of money on programs intended to help citizens keep their jobs, homes and cars.

grams will make it better or worse for the short and long term.

Many individuals go through similar **crises at home.**

What would you do if you received an email from the managing director, circulated yesterday, saying: "Due to economic unforeseen circumstances we regrettably found ourselves in a position where 25% of all employees are redundant. If drastic actions are not taken immediately, the risk of the organization having to **close its doors** is amplified. We will therefore, with the aid of our consultants, identify who first will receive offers of retrenchment……."

Even when we do not receive such messages, our decisions are pretty much **irrational most of the time** (Ariely, 2008), so lets consider how we tend to decide in times of uncertainty and how perhaps we can make less ‘crazy’ decisions.

- **More emotional, less rational!**

In these times one cannot but recall the groundbreaking work of Nobel laureate, Daniel Kahneman and his associate Amos Tversky (1982), who researched peoples irrationality in decisionmaking (particularly in uncertainty). Many ot-hers emphasized it more recently (e.g. Neal J. Roese, 2004; Ariely, 2008; and others).

In one of their most famous experiments, Kahneman and Tversky confronted a random group of people with a choice between a **smal-ler-guaranteed- financial gain** and a potentially greater **-unnassured- gain**. Substantially more people chose the sure gain. On the other hand, when the same people were confronted with a **smaller -guaranteed- financial loss** and a potentially greater **yet unnassured loss**, almost all chose the **unnassured** loss! From this they concluded that losses or potential losses create a significantly **stronger emotion**, causing people to take more drastic risks in an attempt to avoid it.

So, in the face of loss or looming loss (redundancy, death, divorce, bankruptcy, crime, a court case), we know now that individuals are willing to make **irrational decisions** in an attempt for them to be avoided. They emigrate without sufficient research, they accept new jobs with doubtful employers, they buy franchises without proper analysis, and they sell their shares without calculating the odds. They settle for mediocre amounts. This tendency can start with one group and can then spread right around the world (such as the **market crash** since September 2008).

Ariely (2008) also showed clearly how a group of students change their values regarding sexual practices radically in the face of **passion**. For example, although students believed strongly **before** an experiment, that they ‘will never indulge in group sex ’, they changed their stance radically in moments of passion. In the same context we cannot resist great food although we strongly committed ourselves to a strict diet!

- **Hindsight Bias**

In times of uncertainty, we try to cope and justify our bad decisions by general **confirmatory statements** such as: “John became a millionaire within a year after buying this franchise”, or: “Sol Kerzner also started with only twenty rand in his pocket”, or: “If you do not take the jump, such as Rich Sally, you’ll never get anywhere”, or: “Wealthy Charles told me something very important, namely that life is about taking risks. That’s why I resigned and am going on my own next month!”

The statements such as the ones above may help to make you feel better, but they supply you with very little to base important **life changing decisions** on. If the history of Rich Sally yielded certain good financial returns, it does not necessarily mean the same for you.

This kind of thinking also suffers under a major thought constraint, namely **‘dead evidence’** (‘silent statistics’). In other words: we know about Rich Sally, but, what of all those who made the same decisions and went bankrupt. They are ‘dead’ or silent.

Those who are alive write history; those who are dead write nothing (See Taleb, 2004).

To make matters worse, we refer to a statistical population of **one**, in the case above. So, apart from a hindsight bias, we suffer from a further inference of assuming: 'that if it worked for Sol Kerzner, it will work for me.'

The hindsight bias also includes assumptions that, due to you being successful last time, it is certain to happen again (the **'I-am-as-good-as-my-last-deal-syndrome'**). Sports teams often suffer from this kind of bias; thinking that, because they won last time, they will win the next time, under-estimating the strength of their next opponents.

We are great at inventing **excuses for our past mistakes** and bad decisions. "I resigned because I refuse to work for such a devious bunch".

Proper analysis may prove that your subsequent decision was as bad as the previous one!

- **The Relativity Error**

We are often caught in our own relativity traps. These traps are more severe in times of uncertainty, due to the 'gap' between yoursel-ves, your friends and neighbours often becoming vaster.

The relativity error refers to the inability to make judgements (or decisions) without a **'benchmark'**. For example: you can only be satisfied with your salary if it is better than your brother-in-law's salary. People from a squatter community may march the streets, complaining about poverty and lack of services; yet, it is only because they can see those neighbourhoods across the road that is better off. If they were able to see the millions in India (across the road), who grow up on sidewalks and do not even stay in 'squatter homes', they may rethink their actions.

If, due to bad economic times, your employer decided to reduce your salary from R90 000 per month to R75 000 per month, you may feel extremely unhappy; perhaps considering thoughts and resignation and labour action, yet, R75 000 may be completely sufficient to meet all your monthly needs.

Relativity often causes workers to feel less happy about bonuses than before, due to our own internal question: 'what did the others get!'

In the face of loss or uncertainty, we may make risky decisions, while rational budgeting and planning could have prevented drastic actions with a low probability of success.

- **Anchoring**

Anchoring refers to the tendency that we 'anchor' our prices, positions, values, beliefs and targets based on some logic that 'makes sense'. There are hundreds of examples and types of anchors. On the one hand they help us cope, but on the other hand they make us become quite irrational in the face of decision making (especially in tough times). Some typical anchors are:

Ego Anchors: Let's assume that you publicly stated that you, as director of the treasury, will not reduce interest rates by less than 1%. Any movement away from that anchor will be regarded (by yourself and some reporters) as a 'back-down.' So, regardless of all the facts pointing to a more drastic interest rate cut as being appropriate, you may **stick to your position**.

The President of the USA's decision to throw 'cash at valueless assets of banks' could have been based on anchors supplied by economic aids and/or historical anchors of previous actions in recessionary times. The success of this decision could be as low as 1:4 and heavily criticized by taxpayers, yet it is justified by even more anchoring assumptions.

Money Anchors: Your 'anchor' could be to 'not purchase anything before the economy looks better', yet this anchor could cause you to bypass many excellent and extremely affordable investments.

Some individuals are often heard saying that they will not sell their property for 'anything less than X-amount'. This anchor could make them bypass lower offers that could still be **lucrative** if they would immediately invest the income in an alternative investment, so that, over a year, they have exactly the same value in their portfolio.

Your anchor could be to: "Not pay her a cent even if I have to go to court", or it could involve an anchor in demanding a 15% pay rise (with mostly irrational justifications).

Value anchors: Imagine the irrationality of the following anchors: "I will only marry someone from my own church", or: "I will never buy from a Chinese source", or: "A true man will never take no for an answer".

Conflicting Anchors: It is obvious that **mediators and negotiators** most often deal with groups or individuals who have anchored themselves on 'ridiculous' anchors. It is also often of no use to try to 'un-anchor' someone as some anchors have been enforced and made public over extended periods of time.

Some typical anchors that cause conflict in mediation are when one party claims: "I will never allow him to get the Persian rug out of this deal", or: "I will rather lose the deal but not give a discount", or: "I'll never work overtime".

Anchors based on wrong information: Managers often base their anchors on simply **erroneous** mathematics, e.g. "No one will be rated "5" in the next performance appraisal", or: "The results **must** have a bell curve shape, or else your test was badly designed" (regardless whether your class consists of Harvard MBA's), or: "Your sales target must at least be that of last year."

Salary Anchors: "My salary must at least be similar to John because I have a degree and he does not", or: "My bonus was disappointing. All other executives received at least a million."

- **Cause and Effect Errors**

Are cause and effect errors more prevalent in times of uncertainty or is that premise itself based on a faulty cause and effect relationship?

Regardless of the answer, people often base their decisions on the **wrong cause and effect** assumption, e.g. "Lower interest rates will cause a rise in inflation"(perhaps inflation is related to interest rates in a much more complex way and vice versa), or: "If you drink these multi-vitamins you will have much more energy," (perhaps there is no clinical evidence to that effect, and, do all people with energy drink these vitamins?), or: "Advertising in our journal will make your sales jump"(did the sales of all advertisers increase?)

- **Over-confidence (Arrogance)**

Individuals could be over-confident due to many reasons. Perhaps they had some success in the past (which could be random and not of their own doing), or they had the **lucky streak** of getting what they wanted for a long time. Perhaps they had great success with their last venture.

Oskamp (1982) proved quite emphatically how over confidence does not yield great results in terms of judgement (not even in uncertainty). In fact he indicated in a study amongst psychologist, that, as their confidence soared, their **results became poorer**! Arrogant and over sure individuals are no better decision makers (often worse) than those with a lack of confidence.

- **A Lethal Combination**

Uncertainty combined with irrationality seems to be a devastating combination in regards to human thinking!

There are many more causes of irrationality in decision making. The problem then is: **How can we improve**? With all the above in mind, how is it that mankind is still surviving?
How can we trust our leaders in these times?

One cannot blame authors who wrote books such as: "Feel the Fear and Do it Anyway" (Susan Jeffers, 1991)! Perhaps Ms Jeffers realised the total inability of people to get it right only 50% of the time! Perhaps she realized, more than others, that 'believing you are right' often 'makes you right' due to the placebo effect. It is clear that we can never **separate emotions from decision-making**!

It is obvious, though; that we could, in theory, become much better if we are aware of our errors and biases. It would also help if we always have an **'open mind'** and have impartial people at hand to help us in analysing positives, negatives and probabilities of our actions.

What we could try to do, is to negotiate proper processes of decision-making. To understand the importance of time, emotional control, patience and analysis and to **ask many questions**. Questions that will reveal the dead evidence, the cause and effect misnomers, the alternatives to anchors and the unrealistic comparisons (relativity).

All of these **skills** are intimately tied with highly advanced **negotiation** and mediation skills. It is also a necessity for all leaders and managers to study the art and science of **effective decision-making**.

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