I make you an offer… you can't refuse

BEHAVIORAL FINANCE

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Joost Drieman

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35+ years senior management experience in international business development, strategy, intelligence and coaching

PRESENT

- CEO at Marix International NV
- Executive coach and business mentor
- Intelligence development mentor at SCIP, USA
- Advisor for intelligence competences at MOA expertise centre, NL
- Visiting Lecturer at Beeckestijn Business School, Netherlands
- Member of the board at Fellow Digitals

PAST

- Vice president Intelligence Best Practices at M-Brain
- Director market and business intelligence at Cisco
- Advisor and subject matter expert at European Community
- General manager, board member and VP business development Telindus

EDUCATION

- MSc Coaching and development (Portsmouth University UK)
- MBA Strategy (University Antwerp, Belgium)
- Diploma Social Psychology (Laudius Institute, Netherlands)
- Behavioral Economics (The Wharton School, USA)
- Corporate Strategy (Harvard Business School, USA)
- Certificate Board Governance (IMD, Switzerland)
- Market Intelligence (University of Wisconsin, USA)
- Dipl Ing. Micro-electronics (HTS, Netherlands)

Email: joost.drieman@gmail.com
Tel: +32 472700117

Definition

- **Behavioral economics** is a branch of economics that examines how psychological, social, cognitive and emotional factors affect the economic decisions of individuals and institutions, and how these decisions differ from those predicted by traditional economic theories.

- **Behavioral finance** is the part of behavioral economics that studies the psychological and sociological factors that influence the financial decision-making process.


BEHAVIORAL FINANCE
ECONOMICS
PSYCHOLOGY

Rational reasons to decide to go for a deal (BUYING)

- Increase market share.
- Market expansion.
- Be able to operate more efficiently.
- More turnover, higher profit.
- Remove a competitor from the market.
- Negotiating power.
- Financial synergies.
- Risk minimizing or diversification.
- Attract talent.
- Retain knowledge.

Rational reasons for deciding in favor of a deal (SELLING)

- Value realization.
- Getting attractive price when market is favorable.
- Freeing up capital. (To reinvest)
- Focus on core business.
- Realignment of strategy.
- Limits to growth.
- Strategic acquisition: resulting in further expansion
- Disposal of unprofitable or non-strategic business units.
- Cost savings, lean, efficiency, scaling
- Personal reasons: retirement owners, health reasons.
- Technological advances

“The difference between successful people and really successful people is that really successful people say no to almost everything”.

Risk comes from not
knowing what you’re doing

Warren Buffet.

Standard economic and financial theories are not good at predicting behavior.

- 100% rational thinking
- No burden of faulty reasoning
- Unbiased.
- Not emotional, no intuition
- All information is known and considered proportionally in decision making

It does not reflect how people feel and therefore how they (will) behave.

Irrational reasons for deciding for a deal. Emotions and behavior to BUY.

- Ego and power (prestige)
- Wanting to belong (status) and personal wins (bonus)
- Personal rivalry against other companies (revenge)
- Emotional connections and personal relationships (sentiment)
- Being able to manage larger company (status)
- Change Avoidance. No major transformations within their own company.
- Outbid (overpay) competitors.
- Excessive optimism: they think this is easy to integrate
- FOMO: following trends, fear of being left behind.
- Market pressure. Feel pressure to grow through acquisitions.

Irrational reasons for deciding in favor of a deal. Emotions, and behavior to SELL

- Burnout owner
- Anxiety
- Financial pressure
- Recognition: being in the spotlight by selling to a prestigious buyer.
- Being overwhelmed: too much, too complex.
- Passion loss. No interest any longer
- New ambitions
- Economic uncertainty OR competitive pressure
- Selective perception: noticing only negative signs.
- Overreaction to minor problems
- Group pressure: everyone is selling, so should I
- Avoidance or fear of failure.
- Giving someone the deal.

LEFT BRAIN	RIGHT BRAIN
Lineair	Context
Factual	Emotional
Complete picture	Sailient
Systematic	Creative
Realistic	Fantasy
Logic	Intuïtion
Reasoning	Impulsive
Analytic	Feeling
Details	Conceptual
Rational	Relational
Convergency	Divergent
Objective	Subjective
Unbiased	Biased

Traditional Assumptions

Behavioral Reality

Are behaviors and feelings just getting in the way of a wise decision?

Or are they precisely indispensable for a successful professional life?

We are influenced by:

- Psychological theories/concepts
- Heuristics (rules of thumb for quick decisions)
- Cognitive biases (fallacies)
- Gut feeling (instinctive)
- Nudges (pushes in the right direction)

Leading to irrational decisions

Psychological theories/concepts

(understanding behavior and mental processes)

Why do psychological theories matter?

- **Understanding:** They help us explain human behavior.
- **Prediction:** By recognizing and explaining patterns of behavior, we can better predict how people will act in different situations.

Classical conditioning

Attribution theory

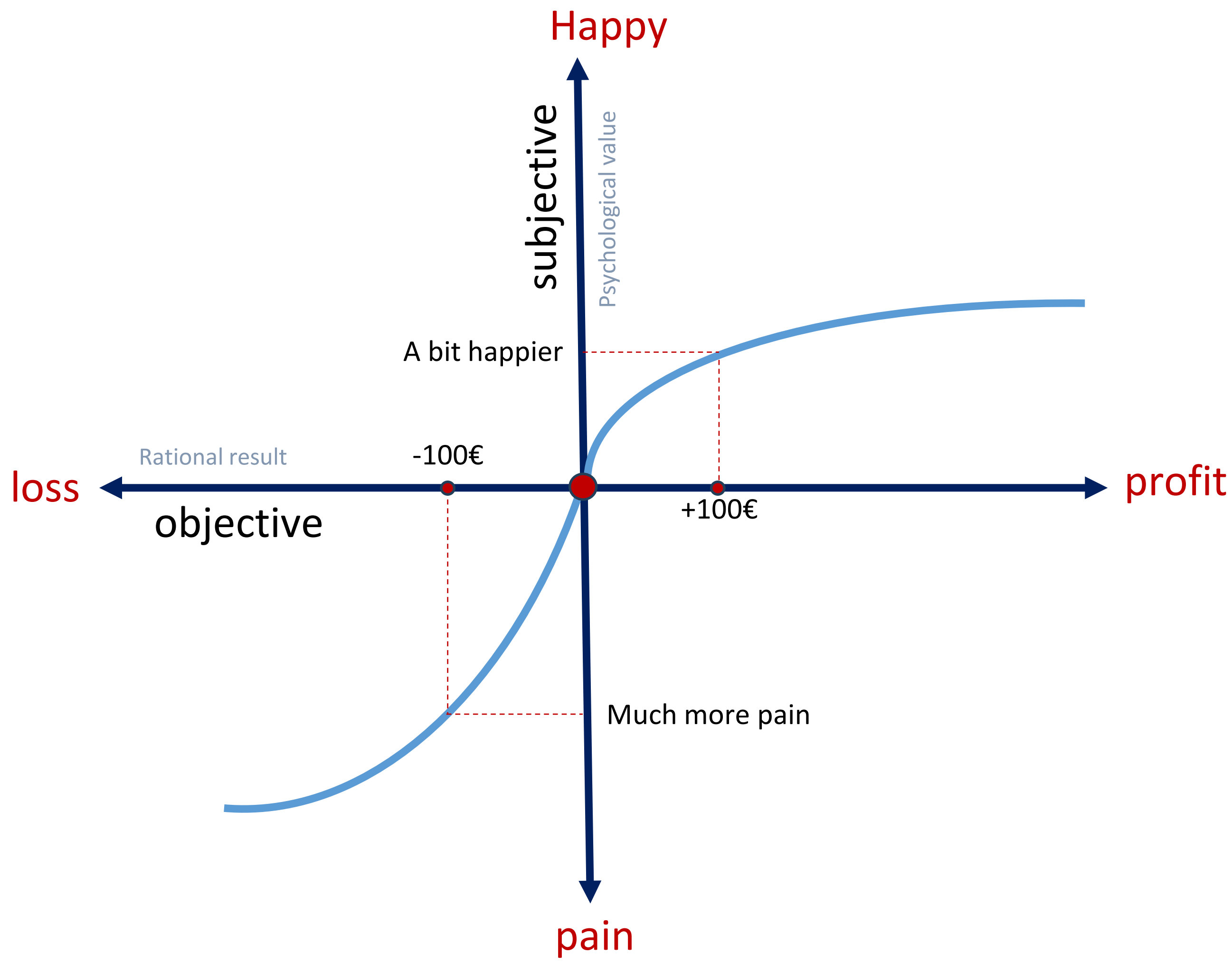
Operant conditioning theory

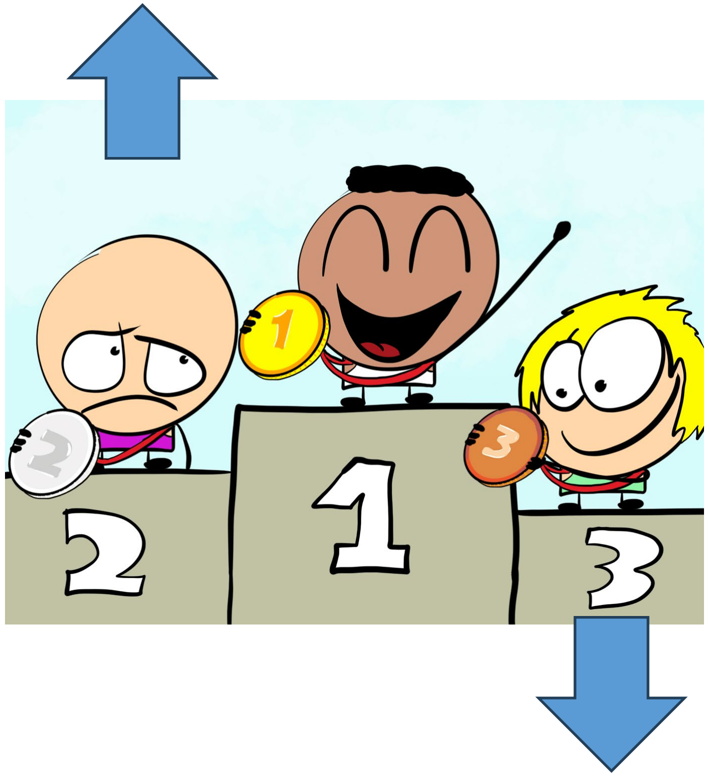
Prospect theory

Maslov

Selfdetermination theory

The prospect theory





Heuristics

(rules of thumb for quick decisions)

The brain system

Construct

the social perception, understanding and interpretation of the social environment within which a person functions.

Scheme

mental structure that organize knowledge of your social world. (pattern of thought or behavior.)

Memories and experiences you automatically recall when faced
with a new situation.

3 frequently used heuristics

Anchoring

The first piece of information

Availability

How easy and quickly to recall

Representative

Making judgments about probability.

Cognitive Biases

(Incorrect reasoning due to thinking errors)

Cognitive bias

A systematic error in thinking that affects the decisions and judgments people make.

- Present bias: it is all about now. Future is not important. Hyperbolic discounting.
- Herd mentality: Flocking. Be part of the group. Social trends, buying crypto.
- Confirmation bias: Only seeking out, interpreting, and remembering information that confirms my preexisting beliefs or expectations: distorted view of reality.

Heuristics can become cognitive biases

- Anchoring bias: too much trusting the first information we get, when taking a decision.
- Representativeness heuristic: stereotyping, judgment by similarity.


THE COGNITIVE BIAS CODEX
Over 150
What Should We Remember?
We store memories differently based on how they were experienced
Tip of the tongue phenomenon
Google effect
Next-in-line effect
Testing effect
Absent-mindedness
Levels-of-processing effect
We reduce events and lists to their key elements
Suffix effect
Serial-position effect
Part-set cueing effect
Recency effect
Primacy effect
Memory inhibition
Modality effect
Duration neglect
List-length effect
Serial recall effect
Misinformation effect
Leveling and sharpening
Peak-end rule
We discard specifics to form generalities
Fading affect bias
Negativity bias
Prejudice
Stereotypical bias
Implicit stereotypes
Implicit association
We edit and reinforce some memories after the fact
Spacing effect
Suggestibility
False memory
Cryptomnesia
Source confusion
Misattribution of memory
Too Much Information
We notice things already primed in memory or repeated often
Availability heuristic
Attentional bias
Illusory truth effect
Mere-exposure effect
Context effect
Cue-dependent forgetting
Mood-congruent memory bias
Frequency illusion
Baader-Meinhof Phenomenon
Empathy gap
Omission bias
Base rate fallacy
Bizarre, funny, visually striking, or anthropomorphic things stick out more than non-bizarre/unfunny things
Bizarreness effect
Humor effect
Von Restorff effect
Picture superiority effect
Self-relevance effect
Negativity bias
We notice when something has changed
Anchoring
Conservatism
Contrast effect
Distinction bias
Focusing effect
Framing effect
Money illusion
Weber-Fechner law
We are drawn to details that confirm our own existing beliefs
Confirmation bias
Congruence bias
Post-purchase rationalization
Choice-supportive bias
Selective perception
Observer-expectancy effect
Experimenter's bias
Observer effect
Expectation bias
Ostrich effect
Subjective validation
Continued influence effect
Semmelweis reflex
We notice flaws in others more easily than we notice flaws in ourselves
Bias blind spot
Naïve cynicism
Naïve realism
Not Enough Meaning
We tend to find stories and patterns even when looking at sparse data
Confabulation
Clustering illusion
Insensitivity to sample size
Neglect of probability
Anecdotal fallacy
Illusion of validity
Masked-man fallacy
Recency illusion
Gambler's fallacy
Hot-hand fallacy
Illusory correlation
Pareidolia
Anthropomorphism
We fill in characteristics from stereotypes, generalities, and prior histories
Group attribution error
Ultimate attribution error
Stereotyping
Essentialism
Functional fixedness
Moral credential effect
Just-world hypothesis
Argument from fallacy
Authority bias
Automation bias
Bandwagon effect
Placebo effect
We imagine things and people we're familiar with or fond of as better
Out-group homogeneity bias
Cross-race effect
In-group favoritism
Halo effect
Cheerleader effect
Positivity effect
Not invented here
Reactive devaluation
Well-traveled road effect
We simplify probabilities and numbers to make them easier to think about
Mental accounting
Appeal to probability fallacy
Normalcy bias
Murphy's Law
Zero sum bias
Survivorship bias
Subadditivity effect
Denomination effect
The magical number 7 ± 2
We think we know what other people are thinking
Illusion of transparency
Curse of knowledge
Spotlight effect
Extrinsic incentive error
Illusion of external agency
Illusion of asymmetric insight
We project our current mindset and assumptions onto the past and future
Telescoping effect
Rosy retrospection
Hindsight bias
Outcome bias
Moral luck
Declinism
Impact bias
Pessimism bias
Planning fallacy
Time-saving bias
Pro-innovation bias
Projection bias
Restraint bias
Self-consistency bias
Need To Act Fast
To act, we must be confident we can make an impact and feel what we do is important
Overconfidence effect
Social desirability bias
Third-person effect
False consensus effect
Hard-easy effect
Lake Wobegone effect
Dunning-Kruger effect
Egocentric bias
Optimism bias
Forer effect
Barnum effect
Self-serving bias
Actor-observer bias
Illusion of control
Illusory superiority
Fundamental attribution error
Defensive attribution hypothesis
Trait ascription bias
Effort justification
Risk compensation
Peltzman effect
To stay focused, we favor the immediate, relatable thing in front of us
Hyperbolic discounting
Appeal to novelty
Identifiable victim effect
To get things done, we tend to complete things we've invested time and energy in
Sunk cost fallacy
Irrational escalation
Escalation of commitment
Generation effect
Loss aversion
IKEA effect
Unit bias
Zero-risk bias
Disposition effect
Pseudocertainty effect
Processing difficulty effect
Endowment effect
Backfire effect
To avoid mistakes, we aim to preserve autonomy and group status, and avoid irreversible decisions
System justification
Reverse psychology
Reactance
Decoy effect
Social comparison effect
Status quo bias
We favor simple-looking options and complete information over complex, ambiguous options
Ambiguity bias
Information bias
Belief bias
Rhyme-as-reason effect
Bike-shedding effect
Law of Triviality
Conjunction fallacy
Occam's razor
Less-is-better effect

The gut feeling

(intuitive behavior)

The gut feeling

- The second brain: acting intuitively
- Using your subconscious mind: intuitive intelligence
- The brain-gut connection, to make decisions
- Combination of reason and feeling
- Intuition, premonition, instinct
- Pain, hunches, goose bumps
- We know more than we think
- Think fast (Kahneman)
- Blink, making decisions in an instant based on unconscious knowledge.
- Intuition uses the totality of our experiences

“Sometimes I feel I'm right, when I don't know what the reason is.”

“The intuitive mind is a sacred gift and the rational mind is a faithful servant.”

Albert Einstein

Is the gut feeling reliable?

RELIABLE

Experience-based decisions
Being familiar with similar scenarios

Familiar situations
Patterns, routine tasks.

Emotional or social situations
Reading nonverbal cues

UNRELIABLE

Cognitive biases
Preconceptions, beliefs, optimism

New or complex situations
No analytical approach

Overconfidence
False sense of confidence

“My intuition has made the difference for me in my life”.

Steve Jobs

Nudging.

(influencing unconscious behavior consciously)

Nudges

- It's a motivational technique. Subtle pushes that steers behavior toward desired choices.
- Nudges help people make faster decisions.
- Narrowing the field: Offering filter options makes your choice easier.

- Example: diapers and beer
- Defaults: tipping a taxi in New York

Nudging in professional deal-making

- Standard options and terms in contracts.
- Presenting prices in a way that emphasizes value over cost.
- Setting an initial high price during negotiations acts as an anchor.
- Offering a limited number of options instead of overwhelming with too many choices.
- Use social proof: “others have done this too.”
- Emphasize what the customer has to lose if s/he does not close the deal.
- Offering small concessions or free extras.
- Describing risks and benefits.
- Reciprocity for mutual benefit

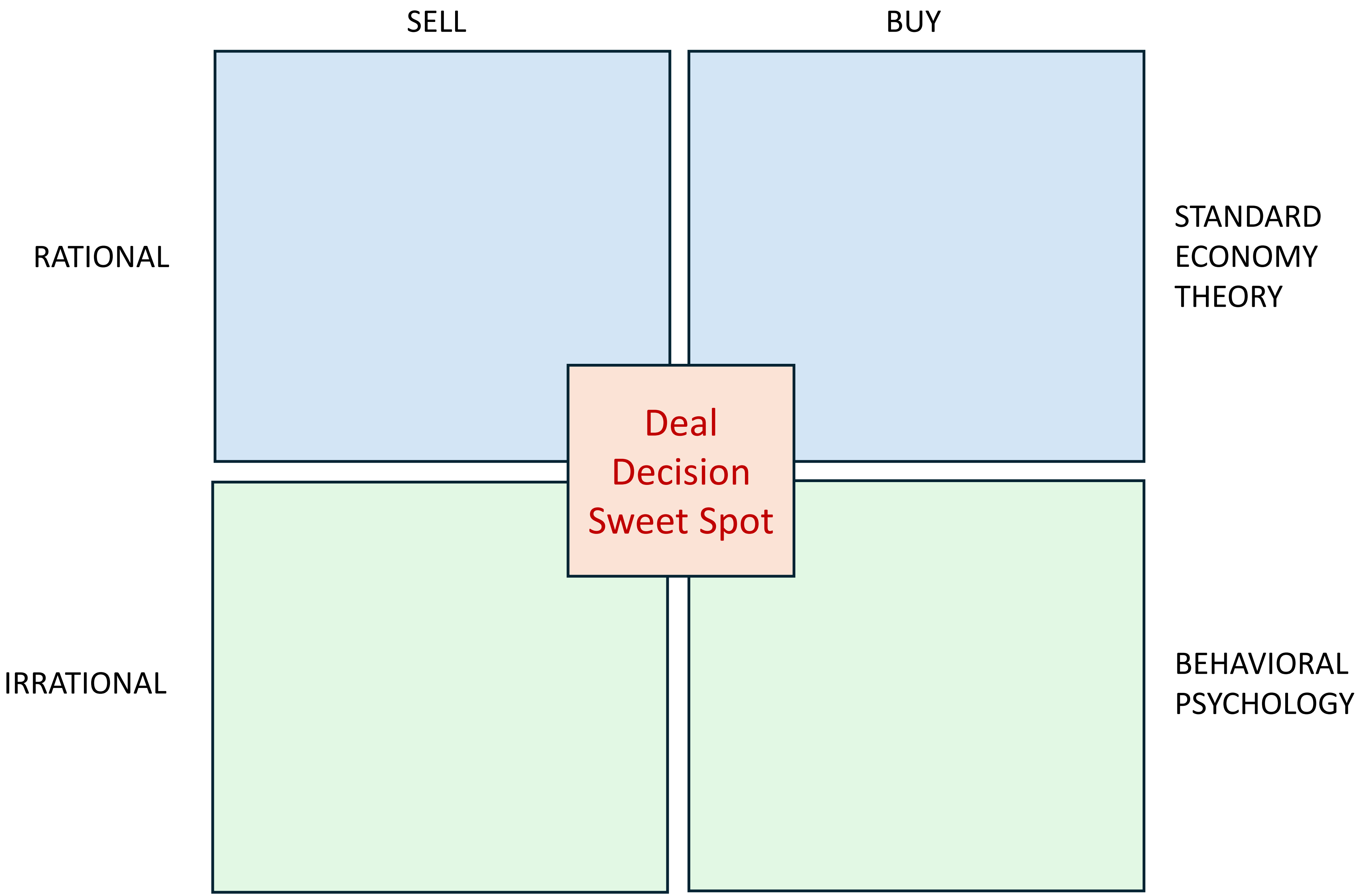
Behavioral Finance Principles

1	2	3	4	5	6
People try **to choose the best** viable option, but sometimes fail.	People **care** (in part) about how their circumstances relate to reference points.	People have problems with **self-control**.	Although we care primarily about our own material returns, we also **care about** the behavior, intentions and returns of **others**.	Sometimes it seems that **market changes** mean that psychological factors no longer matter, but the opposite is true.	**Limiting choices** might partially protect people from their behavioral biases, but in practice, imposing restrictions has a dubious reputation.
Defaulting	Anchor Heuristic	Decision Fatigue	Bandwagon Effect	Ambiguity Effect	Dualsystem Thinking
Loss Aversion	Attribution Error	Hindsight Bias	Halo & Horn Effect	Prospect Theory	Nudging
Endowment effect	Decoy effect	Rational Dishonesty	Social Norms	Illusory Correlation	Choice Architecture

Overarching principle

The ego

Irrational Value Allocation	Regret Aversion	Conspicuous consumption	Hot-Cold Empathy Gap	Confirmation Bias
False Consensus Effect	IKEA Effect	Self-serving Bias	Herd Mentality	Superiority Illusion
Illusion of explanatory depth	Egocentric bias	Illusion of control	Overconfidence Effect	Self reference effect


SELL
BUY
RATIONAL
STANDARD ECONOMY THEORY
Deal Decision Sweet Spot
IRRATIONAL
BEHAVIORAL PSYCHOLOGY

What are the advantages when Behavioral Finance is applied in the right way?

- Understand why people behave a certain way and what “mistakes” they make.
- The elephant in the brain. We need to understand the hidden motives behind someone’s behavior.
- Need to know the true reason why people do what they do.
- Understanding Behavioral Finance enables you to be a “Thought Leader.”
    - Generating new ideas
    - Make people think differently about familiar topics
    - Change behavior.
    - Build loyalty
    - People want to do business with you
    - It helps to make the final sprint faster and more successful. (The devil is in the tail)
    - Ensure positive results

Definitions

- **Ambiquity Effect:** the tendency to avoid options with unknown probabilities or uncertain outcomes. People prefer choices where the risks are clear, even if the uncertain option could potentially offer better rewards. This bias often leads to risk-averse behavior in situations where information is incomplete or unclear.
- **Anchor Heuristic:** the cognitive bias where people rely heavily on the first piece of information (the "anchor") they encounter when making decisions. Once the anchor is set, people tend to adjust their judgments or estimates based on it, even if the anchor is irrelevant or misleading.
- **Attribution error:** a cognitive bias where people tend to overemphasize personal characteristics (disposition) and underestimate situational factors when explaining others' behavior.
- **Bandwagon Effect/Herd mentality:** a cognitive bias where people adopt a behavior, belief, or trend simply because others are doing so, regardless of their own beliefs or evidence. This "herd mentality" leads individuals to conform to the majority, often due to a desire for social acceptance or the assumption that the group knows better.
- **Choice architecture:** the way choices are presented or structured, influencing the decisions people make. It involves organizing the context in which people make decisions, with the aim of guiding them toward particular outcomes, often subtly. Key concepts are: nudging, defaults, framing.

Definitions

- **Confirmation bias:** the tendency to seek out, interpret, and remember information in a way that confirms one's preexisting beliefs or expectations, while ignoring or downplaying evidence that contradicts them. This bias leads people to favor information that supports their viewpoint and dismiss opposing perspectives, which can result in flawed decision-making or a distorted view of reality.
- **Conspicuous consumption:** the practice of buying and using goods or services primarily to display wealth, status, or sophistication, rather than for their intrinsic value or utility.
- **Decision Fatigue:** the mental exhaustion and reduced ability to make good decisions after a long session of decision-making. As people make more decisions throughout the day, their cognitive resources become depleted, leading to poorer choices, indecision, or opting for easier, less thoughtful decisions. Effects of Decision Fatigue include: impaired judgment, simplification, self-control erosion.
- **Decoy effect:** a cognitive bias where people's preference between two options changes when a third, less attractive option (the "decoy") is introduced. The decoy is designed to make one of the original options look more appealing by comparison.
- **Defaults:** pre-set options that take effect if an individual does not actively choose an alternative. Defaults play a powerful role in influencing behavior because people often stick with the default choice, whether due to inertia, a desire to avoid making complex decisions, or the assumption that the default is the "recommended" option.

Definitions

- **Dualsystem thinking** the idea that human decision-making is governed by two distinct cognitive systems, often called System 1 and System 2. S1 is fast, intuitive thinking. S2 is slow, analytical thinking.
- **Egocentric bias:** a cognitive bias where individuals overestimate the degree to which their own opinions, experiences, or abilities are shared by others. This bias leads people to believe that their perspectives are more common or significant than they actually are, influencing their judgments and behaviors. Key Characteristic are: self-Reference, overestimation of Influence and social comparisons (they are better than others).
- **Endowment effect:** a cognitive bias that causes individuals to assign more value to items they own compared to equivalent items they do not own. This effect suggests that people often overvalue their possessions simply because they possess them, leading to irrational decision-making regarding buying, selling, or trading.
- **False consensus effect:** a cognitive bias where individuals overestimate the extent to which their beliefs, opinions, and behaviors are shared by others. This bias leads people to assume that their own views are more common or widely accepted than they actually are. Key Characteristics include assumption of similarity and influence on social judgments.

Definitions

- **Hindsight bias** a cognitive bias that leads people to perceive events as having been more predictable after they have already occurred. This bias causes individuals to believe that they would have predicted an outcome, even if there was no way they could have foreseen it. Key Characteristics are retrospective predictability and distortion of memory.
- **Halo & horn effect:** cognitive biases that influence how we perceive others based on our overall impression of them. The halo effect occurs when a positive impression of a person leads us to view other qualities of theirs more favorably. The horn effect is the opposite bias, where a negative impression of a person leads us to view their other qualities unfavorably.
- **Hot cold empathy gap:** a cognitive bias where individuals have difficulty understanding and predicting their own and others' behaviors and emotions in different emotional states. “Hot" state is emotionally aroused or influenced by strong feelings. “Cold" state is calm and rational.
- **Ikea effect:** a cognitive bias that describes the tendency for people to place a higher value on products they have assembled themselves, compared to those that are pre-assembled. Labor enhances value and it creates an emotional attachment.
- **Illusory correlation:** a cognitive bias where people perceive a relationship between two variables that are actually not correlated or have a weaker relationship than believed. This phenomenon often occurs when individuals notice a pattern and mistakenly infer a connection, leading to skewed perceptions of reality. Linked to false associations and confirmation bias.

Definitions

- **Illusion of control:** a cognitive bias where individuals believe they have more influence over outcomes than they actually do. This bias leads people to overestimate their ability to control or predict events, particularly in situations that are largely determined by chance. Common in risky situations.
- **Illusion of explanatory depth:** a cognitive bias where individuals overestimate their understanding of complex topics or systems. People often believe they have a deeper knowledge of how something works than they actually do, which can lead to an inaccurate assessment of their own comprehension. It is Superficial Knowledge and people difficulty in articulation.
- **Irrational Vallue Allocation:** the tendency of individuals or organizations to allocate resources—such as time, money, or effort—based on flawed reasoning or emotional biases rather than rational analysis or objective criteria. Key Characteristics include emotional influences (like fear), sunk cost fallacy and overvaluation of losses and gains.
- **Loss Aversion:** a psychological phenomenon where individuals prefer to avoid losses rather than acquiring equivalent gains. This principle suggests that the pain of losing is psychologically more powerful than the pleasure of gaining, often leading to risk-averse behavior.
- **Nudging:** subtly guiding people's choices and behaviors without restricting their freedom to choose. It involves designing the context in which decisions are made to encourage individuals to make better or more beneficial choices, often by leveraging insights into human psychology and behavior.

Definitions

- **Overconfidence effect:** a cognitive bias where individuals have an inflated belief in their own abilities, knowledge, or predictions. This bias can lead to overestimating one's competence and underestimating the risks and uncertainties associated with decisions.
- **Rational dishonesty:** the concept of individuals making a calculated decision to engage in dishonest behavior based on perceived benefits versus the risks or consequences. This behavior is often justified by the individual through a rational assessment of the situation, where they believe that the advantages of being dishonest outweigh the potential negative repercussions.
- **Regret Averion:** a cognitive bias where individuals avoid making decisions due to the fear of experiencing regret from a potential negative outcome. This bias can lead people to stick with the status quo or make conservative choices rather than taking risks. Key Characteristics are fear of regret. status quo bias and impact on decision-making;
- **Self reference effect:** a cognitive phenomenon where individuals have better recall and recognition of information that is personally relevant or related to themselves compared to information that is not. This effect suggests that when people can connect new information to their own experiences, feelings, or identities, they are more likely to remember it.

Definitions

- **Self serving bias:** a cognitive bias that leads individuals to attribute their successes to internal factors (such as their skills, effort, or intelligence) while blaming external factors (such as luck or other people's actions) for their failures. This bias helps maintain a positive self-image and can influence how individuals perceive their own performance and the performance of others.
- **Social norms:** the unwritten rules and expectations that govern behavior within a group or society. They provide guidelines for what is considered acceptable or unacceptable behavior in specific contexts and can influence a wide range of actions, from everyday interactions to broader societal practices. Think of etiquettes, dress-code, queuing in line and respecting personal space.
- **Superiority Illusion:** a cognitive bias where individuals believe they possess greater abilities, qualities, or knowledge compared to others. This illusion leads people to overestimate their own competence and to see themselves as above average in various traits, skills, or behaviors, despite statistical evidence suggesting otherwise.