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Risk and Decision-Making

Audio Dial-In Information:
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Melanie Lockwood Herman, Executive Director
Nonprofit Risk Management Center
Melanie@nonprofitrisk.org

www.nonprofitrisk.org

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Resources on Risk and Decision-Making

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1. THINKING, FAST AND SLOW
   Daniel Kahneman

2. THE IRRATIONAL ECONOMIST

3. ON BEING CERTAIN

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The only thing that’s certain is “uncertainty”

“Despite how certainty feels, it is neither a conscious choice nor even a thought process. Certainty and similar states of ‘knowing what we know’ arise out of involuntary brain mechanisms that, like love or anger, function independently of reason.” – Robert A. Burton, MD

Biases that impair our “view” of risk and our decisions about risk

- As we discuss 15 major (20 total) varieties of bias, consider:
  1. Whether this bias exists in your nonprofit; and
  2. What practical, proactive steps you might take to overcome the bias.

David Brooks


- “…humans are not great at measuring and responding to risk when placed in situations too complicated to understand.”

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Six Biases from “Drilling for Certainty”

1. **Risk creep:** We have a hard time imagining how small “failing things” can lead to catastrophic disasters.

2. **Familiarity bias:** We tend to get “acclimated” to risk. We assume that if a small failure wasn’t a problem today, it probably won’t be tomorrow.

3. **False security:** We place too much faith in back up systems and safety devices.

4. **Complication:** We match complicated technical systems with complicated governing structures.

5. **Good news bias:** We spread good news and hide bad news.

6. **Group think:** Over time we begin to “think alike” and permit overconfidence to rule the day.

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From “Why We Make Mistakes” – #7 - The Hindsight Bias

- After an accident, mistake or misstep, the “cause” seems obvious.
- Research shows that we often fail to identify and fix the true underlying cause. We prefer to affix blame on human beings then look for the “true” causes.
Tip for improving your analysis of the "cause" of an accident:

• Ask: is there a main cause—one that is more fundamental than others? Is it possible that instead of A causing B, it is actually B causing A—or that A and B are in a vicious cycle, each continually triggering the other?
• Could there be a third, hidden cause that is responsible for both A and B?
• Is it possible that the coincidence of A, B, and C is simply a fluke—that these events really have nothing to do with one another?

… next time you have a major decision to make, ask yourself: What could go wrong? This may strike you as needlessly pessimistic and even downright defeatist; since childhood most of us have been prodded to think positively, and with good reason… But thinking positively has its limitations; among other things, it can blind us to the pitfalls that lay camouflaged inside our ideas.

Think Negatively!

Decision-Making and Your Brain

Kahneman’s "Two Systems"

• System 1: intuitive, fast-thinking reactions; shaped by evolution and cannot be turned off
  - It "continuously constructs a coherent interpretation of what is going on in our world at any instant… operates automatically and quickly, with little or no effort and no sense of voluntary control…"

• System 2: slower; engages in “conscious reasoning”
  - Allocates “attention to the effortful mental activities that demand it, including complex computations”
  - Thinking and reacting involves an ongoing “conflict between an automatic reaction and an intention to control it.”
Instincts vs. Reason

- Risk management in the modern world relies upon two forms of thinking. Risk as feelings refers to our instinctive and intuitive reactions to danger. Risk as analysis brings logic, reason, quantification, and deliberation to bear on hazard management.

- Compared to analysis, reliance on feelings tends to be a quicker, easier, and more efficient way to navigate in a complex, uncertain, and dangerous world. Hence, it is essential to rational behavior. Yet it sometimes misleads us. In such circumstances we need to ensure that reason and analysis also are employed.

Source: Erwan Michel-Kerjan and Paul Slovic

#8 - Bad News Bias

- "The brains of humans and other animals contain a mechanism that is designed to give priority to bad news."

- "The brain responds quickly even to purely symbolic threats."

Source: Thinking, Fast and Slow

#9 - Environment / Context Bias

- Environment—including changes in the environment—influence the decisions we make.

- We are influenced by:
  - Short term rewards
  - By what others do
  - By what we perceive to be at stake
  - By how we feel
#10 - Anchoring Bias / Focusing Effect

- **Anchoring** – relying on a specific piece of information; resisting any adjustments or contrary interpretations
  - We become “anchored” to: first impressions, a narrow slice, one factor, etc.

- **Focusing effect** (focusing illusion) – placing too much importance on one aspect of an event
  - “Nothing in life is as important as you think it is when you are thinking about it”

#11 - Voluntary...or Not

- Humans tend to be far more accepting of risks to which they choose to be exposed.
  - We have exaggerated fears about circumstances/events where our participation is required/forced.

#12 - Availability Heuristic

- First reported by Kahneman and Tversky
- We rate events that are “familiar” and “available” as more likely
- If it’s easy to think of an example, we believe it is more likely to occur
  - Red cars...
#13 - Immediacy

- We rate risks with short-term consequences higher than risks of long-term consequences.
- We are more fearful of bungee jumping than cancer caused by years of smoking.
  - “It’s not the odds that matter, but the stakes.”

#14 - Complexity

- Human nature leads us to perceive more complex systems, activities and environments as “riskier” than their simple counterparts.
  - Are you missing the “risk” in simple systems or processes?

#15 - The Affect Heuristic

- **Affect**: feeling good, bad or surprised about something without “conscious awareness”
  - “Affect” is essential to the efficient understanding of what we read, see, feel and experience.
- **Affective forecasting**: forecasting one’s emotional state in the future
  - A “good feeling” towards a situation (positive affect) leads to a lower downside risk perception and higher benefit perception. – Melissa Finucane, 2000
  - A strong emotional first impression can inform a decision—even in the face of contrary facts (similar to “anchoring” bias).
What we don't know... could hurt

• Psychological studies that tell us what we see and hear is shaped by our preferences, our wishes, our fears, our desires and so forth.
  • We literally see the world the way we want to see it.
    • We see ourselves... (e.g., interviewees see themselves as they want to be, rather than as they are)

#16 - The Myopia Bias

• We focus on what we think will happen tomorrow, instead of...how our actions today have consequences in the long-term
  ➢ Risk Management 1.0 – make a list of likely risks and determine probability; risks are mostly local and routine.
  ➢ Risk Management 2.0 – focus on the resilience necessary due to a “wider variance” in possible losses and gains.
  ➢ think ‘data loss’ in 1982 or 1992 versus ‘data loss in 2012’

Source: The Irrational Economist

#17 - The Bias of Experience

• “Experience is inevitable. Learning is not.” — Paul J. H. Schoemaker

• We tend to “polish” the past and apply a filter to our memories of how things turned out.
The Bias of Experience

• When you’re unaware of filters and biases: you’ll be dominated by past habits and assumptions

• “Wholeception” – Randy Park
  • Looking at the bigger picture, appreciating consequences, and becoming more aware of filters and biases

The Bias of Experience

• We often fail to learn from failure… and mistakes. We treat “near misses” as successes.
  ➢ Repeated exposure to unlikely risks leads to an increase in risk tolerance (example: surviving a hurricane or flood).

#18 - The Bias of Proximity

“Seeing up close and personal clouds the bigger picture”

• Things tend to look very different up close…
• We’re so intent on getting a close-up look, that we neglect the big picture (or bird’s eye view)
  • Madeleine Van Hecke, author of Blind Spots, warns that it isn’t natural to assume a “systems perspective.”
Familiarity (similar to proximity)

- We attribute greater fear and dread to risks with which we are unfamiliar...
- AND
- We undervalue the danger in the "familiar."

The Familiarity Heuristic

- **Heuristic** = cognitive “rule of thumb” that saves us time and money (the benefit of habit and experience)
- BUT: there is “risk when we stop deliberating”
  - Ian McCammon, “Evidence of Heuristic Traps in Recreational Avalanche Accidents”
- Familiarity and comfort act as traps; familiar is unthreatening
  - Example: Avalanche accidents are more likely when skiers know the locale and conditions

Getting a Better View

- Challenge your nonprofit’s “conventional wisdom”
- **Look back:** reflect on trends you didn’t see coming
- **Look ahead:** seize opportunities to learn more about the changing environment
- Tap the perspectives of a wide range of stakeholders
  - What about the board?
#19 - The Trap of Extrapolation

Randy Park, “The Prediction Trap”

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Understanding the “trap of extrapolation”

- Over-reliance on the past creates a bias; we expect the future to look like the past
- We’re more inclined to say and think: “we’ve tried that and it didn’t work”
- Experience… influences our thinking
  - The bias of experience distorts our vision of the future

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A better approach is to:

- Recognize the winding path of the past
- Scrutinize assumptions about the past
- Envision alternate futures
- Work constantly to improve your “view”

“Past performance does not guarantee future returns.”

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#20 - The Default or “Consistency” Heuristic

- Human bias for sticking with a decision once made... "stay the course impulse" believing that switching can be perilous
- And it takes effort to reverse course!

- Your nonprofit: identify an example of an instance where the organization ignored data suggesting a course correction

Risk Management and Decision-Making

- “…anticipation and preparation are not always possible.”
- “…the crisis that you prepare for (today) may not be the one you experience, but that preparation will improve your resilience, come what may.”

Source: Surviving and Thriving in Uncertainty: Creating the Risk Intelligent Enterprise, by Frederick Funston & Stephen Wagner
Biases and Decision-Making

- Biases are rarely obvious... but they often lurk in the shadows of decisions we make about risk-taking and risk management.

- Unmasking our biases—learning to recognize them—is an important step towards getting the clearest possible view of the risks we face.

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January 19—Federal and State Employment Law Update
February 16—Why Can’t We All Get Along? Managing a Multi-Generational Workforce

Thank you!
Melanie Lockwood Herman
Melanie@nonprofitrisk.org
www.nonprofitrisk.org
(202) 785-3891