

Behavioral Odds

By Jeffrey M. Saltzman, M.A.

I *f you are the only one she has, make sure you are one in a million.*
—Irish Folk Song

Imagine, while at a charity event, you had an opportunity to buy one of 15 lottery tickets that were to be sold to 15 different individuals for \$20 a ticket. Since this is a charity event, a corporate sponsor is giving coupons for \$50 worth of free pizza at the local pizza joint. If you are holding the winning ticket, you will claim the entire prize worth \$350.

Would you spend \$20 for a one out of 15 chance to win \$350? That doesn't sound too bad, does it? Now say one aspect is changed. Instead of the 15 tickets being sold to 15 different people, the tickets are sold to only two people. You get to buy one ticket and another person, let's call him Joe, buys the other 14. Joe-the-gambler has a 14 out of 15 chance of winning and you have a one out of 15 chance of winning. Would you still buy the ticket?

This option doesn't sound as attractive, does it? However, in reality, your chance of winning in these two scenarios is identical. You have a one out of 15 chance when there are 15 participants in the lottery and you have a one out of 15 chance when there are two participants in the lottery. Because Joe owns 14 of the 15 tickets, the opportunity appears to be less attractive and less fair—the deck appears to be stacked against you.

Traditional economic theory regarding how people make decisions assumes that they are completely rational, what is called perfect rationality. This theory says that the likelihood of someone purchasing the lottery ticket under the two differing scenarios would be identical. Yet it is easy to demonstrate in the real world that this is not the case. Behavioral economics tries to take into consideration the psychology of how people make decisions—decisions that might fly in the face of traditional economic equations.

A situation where the two starting positions can be mathematically shown to be equal, but one psychologically appears to be disadvantageous, is driven by what is called situational efficacy. Someone would be less likely to buy the lottery ticket under the second scenario because of a perceived situational deficit. In a sports comparison, it is the equivalent of being the visiting team. Visiting teams often labor under the assumption that there is a home team advantage. However, the game is played by the same players, playing the same game. Yet statistically, a home field advantage can be demonstrated by using a player's psychology, or situational efficacy, driven by the belief of a home team advantage and by the visiting team letting the situation (noisy crowds, unfamiliar physical location, etc.) affect them.

I saw the following demonstration in a room of about 1,000 people. The presenter said, "please raise your hand if you are personally fighting cancer right now." Five or six hands went up. Then he said, "please raise your hand if sometime in the past you had battled any form of cancer." A larger number of hands were raised. Then he said, "please raise your hand if someone in your immediately family is battling or has battled cancer." Predictably, an even greater number of hands were raised. He continued, "raise your hand if any relative of yours has battled cancer," then he said, "now raise your hand if anyone you personally know has battled cancer." He did not have to go that far to make his point. By the time he got to asking about the attendees' relatives, every hand in the room was raised. This exercise demonstrated that we are all interconnected and share common experiences to a much greater extent than we usually realize.

Even with our shared experiences and even though we can see something all around us, like cancer, sometimes we choose not to see and assume that things like cancer will happen to someone else. Not to us. Our brains are wired to assume that positive things will happen to us, at least the majority of us. Negative things happen to someone else; we hope for and desire positive things to happen to

us. Assuming positive outcomes is an evolutionarily derived survival mechanism, which allows us to forebear in the face of adversity. We are attracted to buying that lottery ticket when we think that everyone has an equal chance of winning or losing. We perceive that given an equal chance, positive things could happen to us, but when we perceive that the deck is stacked against us, even if personal chances don't change, the situation becomes less attractive.

If we apply these notions to the mortgage meltdown, why would someone take out an ARM, an adjustable rate mortgage, knowing that they will not be able to pay the mortgage if the rate goes up? Why would they choose the ARM, knowing the rate would increase once any teaser rates expire or when economic conditions change, but their incomes would not increase? Would they take that ARM if the bank were required to lay out what their monthly payments would be once the teaser expires, and if the rate raised to the maximum amount each year, they were clearly provided the worst-case scenario? Providing knowledge can have a dampening effort on the desire to gamble.

Why would an organization merge with another, knowing that the only way the joint organization could survive is if the entire entity is restructured, with new ways to reengineer business processes that would achieve greater efficiencies while maintaining phenomenal growth rates for an extended period?

Why would the federal government develop an annual budget that is dependent on assumptions about taxes, growth rates and other sources of revenue, while incorporating assumptions about expenses, all of which are simply unrealistic?

Why would schoolchildren assume they could earn a good grade if they do not put in the necessary effort, and then be disappointed when the grade does not come through?

I want to be careful here to delineate what I am describing from complete risk aversion. People can and will rise to new heights when faced with new and unexpected challenges. We can and do need to take risks in order to individually further ourselves and where we reside as a species. We are nothing else if not adaptable and resourceful. We need to be willing to reward people who try new things and fail so that they are willing to try other things that might succeed, perhaps wildly. Nevertheless, the above descriptions are based upon irrational assumptions, not thoughtful processes. Saying that, we are also a product of our evolution and it would be erroneous to assume that simply because someone points out particular behavioral flaws that are inherent to our psychology, the psychology can and will change. However, knowledge of why certain behaviors occur is the first step toward controlling and directing those behaviors.

Anyone want to buy a lottery ticket? ■

www.kenexa.com
866.391.9557