BIAS

#10 Anchoring

Anchors Aweigh!

Where *confirmation* bias has a dark side, the *anchoring* bias is perhaps the most insidious and remarkably robust of the cognitive biases. BEWARE!

***ANCHORING BIAS***

Earlier articles in this series mention the *anchoring* bias (the tendency to 'anchor' on some reference value or piece of information), which leads us to not diverge (i.e., move away) sufficiently enough from the anchor, regardless if we adjust from a high or low anchor. Given the insufficient adjustment, our final estimates are biased towards the initial anchor value.

Countless studies (e.g., Kahneman, 2011; Ariely, 2008; Plous, 1993) show that when people are given a reference value and then asked to estimate something (e.g., cost of item, population, etc.), they invariably stay close to that anchor and estimate poorly. For example, studies show that judges can be influenced by a prosecutor's demand for a length of sentence in their closing argument, as this provides them with an anchor. (See Blog Article #9 for references)

This bias works because we are so good at judging attributes or merits relative to one another, and hence let our estimates stay close to an 'anchor' that previously entered our thinking.

What is so insidious about the *anchoring* bias is that the reference value can be completely unrelated or uninformative to the question. For example, researchers asked participants to write down the last two digits of their social security number (i.e., government ID number) and then to estimate the cost of an item. Those with high numbers estimated a high value, and those with low numbers estimated the cost significantly lower. An arbitrary two-digit number, and yet it clearly affected the estimations.

This bias can have significant negative consequences for us. For example, people are often focused on their purchase price (i.e., the anchor) of a particular stock, ignoring current pricing or fundamentals of the company when deciding if they should hold or sell the equity, sometimes at their detriment.

***AND THE RELEVANCE TO E&P BUSINESS …..***

The anchoring bias is quite prevalent in the E&P business and can have significant ramifications on interpretations and decisions. For example, focusing on a single reservoir parameter when estimating porosity, rather than what the porosity could average across the trap; expressing a view of chance of success for prospect considering only one geologic model, without considering the other possible scenarios; or focusing on the 'sunk cost' when making a decision about an opportunity.

The data and numbers in our evaluations provide us with anchors, which is further exacerbated when the sample size is small. By focusing on the anchor and not the range of possible outcomes (including small analogues), we tend to end up with too narrow of a range, and the outcome often fall outside of that range.

***WHAT CAN I DO?***

The *anchoring* bias can be so pervasive and powerful that it can be exceedingly difficult to mitigate. Studies have shown that incentives or awareness alone have a minimal impact on reducing the *anchoring* effect.

One of the first mitigation tactics is to shift focus off of the reference value, being aware how this can influence your judgment. You can do this by discounting or ignoring a completely divergent anchor; although it can be difficult to do so. For example, if the Manufactured Suggested Retail Price (MSRP) of a car is $20,000, your first negotiating tactic could be to offer a (not too) absurdly low price like $15,000. You now have two anchors, and both of you will negotiate away (car salesperson from $20,000 and you from $15,000). You should end up with a final sale price lower than if you would have just focused on the MSRP. In other words, work with multiple anchors. Similarly, relating this approach to the oil and gas industry, consider more than one analogue for your prospect.

***UNTIL NEXT TIME***

The next article in this series will explore if we are really irrational creatures as suggested by the definition of cognitive bias!

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