

Cognitive Errors and Group Decisionmaking

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Who are these people?



- On the left: Cynthia Cooper (WorldCom).
- In the middle: Colleen Rowley (FBI).
- On the right: Sherron Watkins (Enron).

Scandals aren't anything new.

- BCCI.
- S&L crisis.
- Enron (and WorldCom, Tyco, Global Crossing, Parmalat, etc.).
- The subprime crisis.
- Bernie Madoff.
- Every other corporate scandal.

From *Fun With Dick and Jane* (Sony Pictures Entertainment 2005):

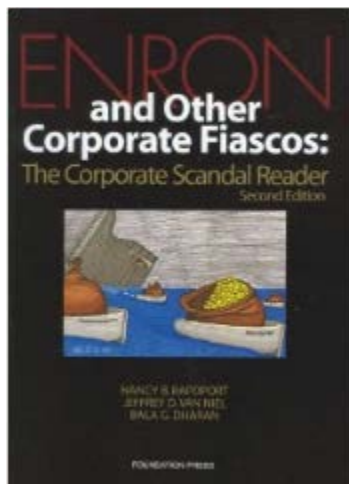


Law, by itself, can't regulate behavior.

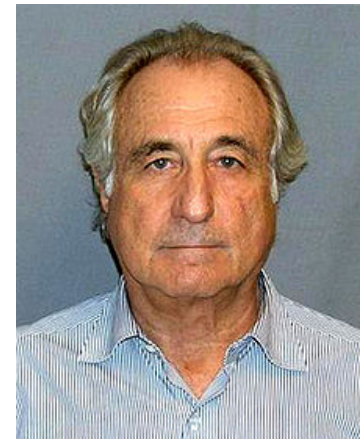
- Goal of our first Enron book: explain, understand, learn.
- Goal of our second Enron book: why can't we learn?



March 19, 2009
REUTERS/Mario
Anzuoni



http://en.wikipedia.org/wiki/Bernard_Madoff



Smart people ran Enron (and they run other scandal-plagued companies).

- Smart people; dumb actions.
- Tougher rules don't work.
- What might work?
- Can you help your organizations not to make dumb decisions?

From *Enron: Smartest Guys in the Room*
(Magnolia Home Pictures 2005):



What can we learn from Enron & other, more recent, corporate scandals?

- RULE #1: Never underestimate human cognitive errors.
 - The individual.
 - The situation.

What can we learn from Enron & other, more recent, corporate scandals?

- All other rules flow from Rule #1:
 - Checks and balances & human cognition.
 - “Rules on paper”: not enough.

Hard-wired cognitive errors.

- Mix of psychological and sociological errors.
 - Cognitive dissonance error.
 - Diffusion of authority error.
 - Social pressure error.
 - Anchoring error.
- You combine these four and you get “the person and the situation” examples.

From *Enron: Smartest Guys in the Room*
(Magnolia Home Pictures 2005):



Cognitive dissonance.



“I am a good person.”



“I am doing a bad thing.”



“There’s a good reason I’m doing this.”

When it comes to cognitive dissonance,
there are no lobsters, only frogs.



Other personal and group cognitive errors:

- Diffusion of authority and the bystander effect.
 - “Someone else will do it”—the Kitty Genovese story.
 - (A new book argues that fewer people were witnesses—maybe just 6—but that still implicates the error.)

Kitty Genovese

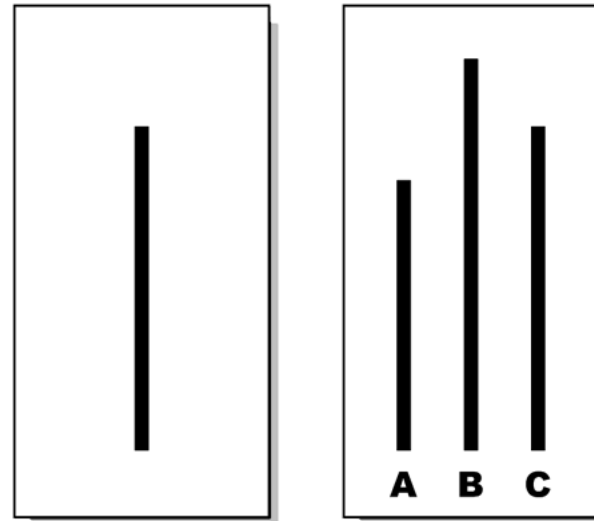


Kitty Genovese, picture from *The New York Times* article: "Thirty-Eight Who Saw Murder Didn't Call the Police"

Photo available at http://en.wikipedia.org/wiki/Murder_of_Kitty_Genovese.

Other personal and group cognitive errors:

- Social pressure.
 - Solomon Asch's
“lines”
experiment.



Anchoring error.

- “Anchoring” involves “the common human tendency to rely too heavily, or ‘anchor,’ on one trait or piece of information when making decisions.”*
- Best article describing anchoring: Amos Tversky & Daniel Kahneman, *Judgment under Uncertainty: Heuristics and Biases*, available at www.hss.caltech.edu/~camerer/Ec101/JudgementUncertainty.pdf.

* Quote & description available at www.sciencedaily.com/articles/a/anchoring.htm.

Anchoring in action:

- [Try this one yourself.](#)
- (No calling out if you've seen it before!)

How cognitive errors can affect your behavior.

- Talking yourself into believing that something you did was OK, even when it wasn't OK.
- Assuming that, if you discover a problem, everyone else knows it, too, so you don't have to act on your discovery.
- Letting “everyone else does it” determine whether you do it, too.
- Focusing on one factor and ignoring all others.

Given our cognitive predilections, what can we do?

- We need to be conscious of the fact that humans can find themselves doing dumb things.
- We also need to think about the ways that our organizations can help us do, or hinder us from doing, what we should be doing.

Enron's incentives and culture.

- Incentives.
 - Paper profits = bonuses.
 - Bad news = banishment.
 - Individuals > teams.
- Organizational culture matters.
 - Valhalla.

Enron wasn't an anomaly.

- WorldCom.
- HealthSouth—Aaron Beam, former HealthSouth CFO:
“So when we had trouble hitting Wall Street expectations, [Scrushy] encouraged us to cook the books. I was intimidated by [Scrushy]. . . . I was afraid to stand up to him.”*

* John L. Smith, HealthSouth co-founder knows how greed grows on you, Las Vegas Review-Journal, May 19, 2010, at B1.

Having a gate isn't the same as
having one that works.



A culture's myths predict future behavior.

- Stories of bravery and cowardice.
 - Celebrating “successes”?
 - Punishing “failures”?
 - “False positives”?

Your own organizations.

- Bending the rules for “top performers”?
- What gets rewarded?
 - Enron’s code of ethics: “RICE.”



Can we even fix the problem?

- Increased punishment alone won't work.
 - Smart people and risk of sanctions.
 - General counsel as influencers of corporate culture.*

* Colin Marks & Nancy B. Rapoport, Corporate Ethical Responsibility and the Lawyer's Role in a Contemporary Democracy, 77 *FORDHAM L. REV.* 1269 (2009), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1376475 .

The Rapoport “designated naysayer” proposal.

- Build in a structure of “questioning.”
- Force ways to slow down decisions, except in emergencies.
- Rotate role to avoid stigma.
- Double-check “results” that agree with hypotheses.
- Reward critical thinking and false positives.

Hard life of a nay-sayer.

- Ostracism.
- Social pressure.
- Active resistance.

Nudging:

- People work to meet the incentives they're given—whatever those incentives may be.
 - To change behavior, it's important first to identify the incentives that triggered that behavior.
 - Every change in incentives involves a risk of creating new, bad incentives.
- Humans make certain cognitive errors.
- An organization's culture matters.

Subtle default rules and other ways of changing behavior:



Bank of America  Deposits

[View Account Types](#)

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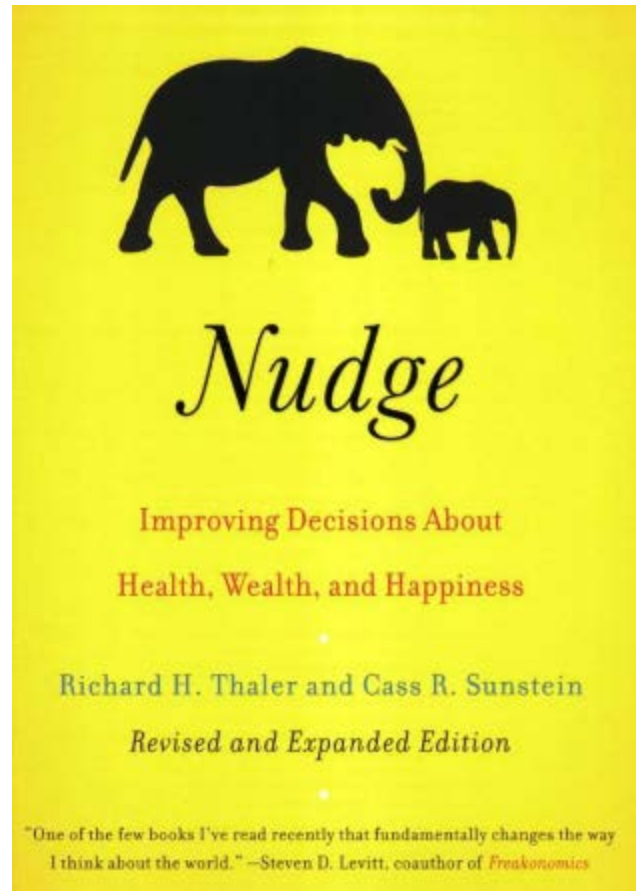
[Access Accounts](#)

Keep the Change[®] Savings Program

Examples of bad incentives:



In addition, think about “small changes”:



Some barriers to change

- Don't discount the “perceived losses” problem.
- Smart people will find workarounds to any changes that a firm imposes.
- Few firms want to be the “first” to make big changes.
 - *But see* Duane Morris as an example.