Overview of Behavioral Biases

Anchoring

Anchoring is a cognitive bias that describes the com- mon human tendency to rely too heavily, or "anchor," on one trait or piece of information when making decisions. During normal decision-making, Anchoring occurs when individuals overly rely on a specific piece of information which then governs their thought-process. Once the anchor is set, there is a bias toward adjusting or interpreting other information to reflect the "anchored" information. Through this cognitive bias, the first information learned about a subject (or, more generally, information learned at an early age) can affect future decision-making and information analysis.

Probability Neglect

When strong emotions are vividly triggered by the description of a possible risk, one shows a remarkable tendency to neglect to compute the small probability that the risk will actually come to fruition. When strong emotions are involved, people tend to focus on the "badness" of the outcome, rather than on the probability that the outcome will occur. The resulting "Probability Neglect" helps to explain excessive reactions to low-probability risks of catastrophe.

Endowment Effect

The Endowment Effect is the hypothesis that one will value a good or service more once their property right to it has been established. In other words, people place a higher value on objects they own than objects they do not. In many experiments, people demanded a higher price for a coffee mug that had been given to them but put a lower price on one they did not yet own. The Endowment Effect is inconsistent with traditional economic theory which asserts one's willingness to pay for a good should be equal to their willingness to accept compensation to be deprived of the good.

Loss Aversion

Loss Aversion refers to one's tendency to strongly prefer avoiding losses over the expectation of gains when making decisions in the domain of risk. Many studies suggest that losses are felt twice as powerful psychologically as gains (Kahneman and Tversky say 2.5 times). This leads to Loss Aversion when one evaluates a possible gain—since one prefers "avoiding losing" to "winning". Conversely people strongly prefer risks that might possibly mitigate a loss (called risk seeking behavior). Loss Aversion was first proposed by Kahneman and Tversky as a component of Prospect Theory.