Chapter 1

The Hidden Forces That Derail Your Team's Decisions

Or

Why would they do that?

The Myth of the "Rational Employee" — A 2,500-Year-Old Lie

Imagine Socrates standing in the bustling Agora of ancient Athens, debating the price of olive oil with a merchant. He carefully weighs supply, demand, risk, and reward. He engages multiple vendors, and samples a plethora of other oils to evaluate each in comparison to his known preference for flavor. He has complete information, and after thoughtful deliberation, he chooses the perfect oil at the best price. There is no emotion in his decision. There is no distraction. His choice is driven by pure logic (Thaler & Sunstein, 2008).

This scene represents the classical economic ideal. From the marble forums of Athens to the glass towers of Wall Street, we have built entire civilizations on this foundation. The core assumptions are simple and powerful: Humans are rational actors. They know their preferences. They maximize their happiness and benefit (utility) with every decision.

Classical economic theory is based upon the belief that behavior is the result of a desire to maximize one's own utility. This principle allows people to know how others will behave, because it assumes that others know their preferences and act in accordance with them. It assumes predictability. After all, great economies grow due to stability and the security that comes from the predictability of the behaviors of the participants. If individuals can predict the behaviors of others in the market, they can plan successfully for engagement, contributions, and rewards as participants in the system.

If you have studied humanities or been a student in a western college or university, you are conditioned to believe that individuals know what they want and can choose according to those desires. But if you've spent any time actually observing people and the decisions they make, you know that they make mistakes all the time. Some behavior experts say people are "irrational" in their choosing of most things (Ariely, 2008). Most of the time, people lack key information or ignore it and let random noise drive the decision instead. Unlike Socrates who had a grasp of all the available information, including his own preferences, most users have only partial data, a cloudy idea of their preferences, and are often emotive and/or distracted from thoughtful decision-making. Instead of logic and

reason, they decide based on feeling/gut, or only after minimum effort that satisfies a personal desire to do “some” research to feel good about their decision (Kahneman, 2011).

If we were all Socrates, marketing materials would focus on features and value instead of celebrity endorsements, trend-influencers, and impulse positioning. They would be selling products, not feelings. Marketers figured out a long time ago that *presentation* was more important than *explanation*. Marketing built empires based on nudging consumers to buy not the things they need, but rather the things marketers wanted them to, and often in excess.

Today, influencers lurk at every corner of the internet, bombarding consumers with ads disguised as authentic content that bypass the rational brain and deliver a dopamine hit — the feel-good rush of buying what others love, hoping for the same result (Ariely, 2008) Unfortunately, this shortcut often leads to suboptimal decisions, followed by dissatisfaction, disappointment, remorse, waste, and a negative experience overall. That low mood leaves people psychologically vulnerable to the next marketing message, perhaps a nudge to buy the new model or next generation just to feel better, on the silent promise: "This time you'll be happy."

Because your employees and customers are not always rational thinkers, they make these same mistakes. The time and effort you spend building logical systems means nothing when those that use them are not thinking rationally. This is why you continue to see mistakes after extensive training and constant feedback. Your system may be logical — but your users are not, even when they try. They are under the influence of a variety of cognitive forces that distort the way they intake, process, and evaluate information (Kahneman & Tversky, 1979). You will continue to see mistakes until you reconfigure your systems to account for these distortions.

Yet, with all this evidence that extraneous noise trumps features and facts, why do operations consultants and other experts still insist on the opposite? Classical economic theory is based on the concept of market forces. Individual behaviors of multiple users are summative and when evaluated in whole, the market behaves as a composite of all behaviors. But individually, there are winners and losers, good and poor decisions. We assume that because the market is efficient, the participants are also efficient. This seems reasonable after all because the individuals make up the market; but the market does not prohibit poor decisions, it only punishes them. Punishment is for the individual, not the market; bad decisions persist because sometimes the punishment feels like a reward. Worse, under your current system, your employee might get an actual reward from you while the business gets punished for their poor decisions. Don’t believe me?

Walk into your office on any given weekday and you might find…

- Sarah, your bookkeeper, reviewing an unusually high $12,400 invoice. She spots a $220 credit at the top of the invoice. Sarah accepts the credit, takes a victory sip from her coffee, and moves on to the next invoice without further investigation.
- Mike, an account manager, reviewing his delinquent accounts. He sorts the data using a new feature: descending by % of account value. He secures full payments from 3 clients each over 50% delinquent and pulls in $15K. Mike ignored the low %s including a $25K delinquency on his biggest client but gets an "atta boy" from his manager.
- Jen, a top salesperson, gloating over $200K in technical sales in the first 3 weeks of April. She secured $10K in bonuses, so instead of hustling the new sales lead and tying up her fourth weekend in a row, she tells the newbie to take it as a learning experience. Jen is highlighted in the monthly newsletter for her success.

If these scenarios sound familiar, you do not have bad people, you have bad systems.

The Experiment That Shattered the Myth

In 1974, psychologists Daniel Kahneman and Amos Tversky ran a groundbreaking test at Hebrew University. They presented two groups with mathematically identical choices, framed differently (Kahneman & Tversky, 1979).

Group A (Gains Frame): "You are given **$1,000**. Now choose:"

- **A**: Guaranteed **$500 more** → Total: **$1,500**
- **B**: 50% chance of **$1,000 more**, 50% chance of **$0 more** → Expected value: **$1,500**

Group B (Losses Frame): "You are given **$2,000**. Now choose:"

- **A**: Guaranteed to **lose $500** → Total: **$1,500**
- **B**: 75% chance of **losing $1,000**, 25% chance of **losing $0** → Expected value: **$1,500**

Classical prediction: Indifference. **Reality**: Frame Effects

- **84% in Group A** chose the sure gain
- **69% in Group B** chose the gamble

Researchers repeated the experiment across money, health, and time. Framing flipped every preference, demonstrating that emotion and not logic drove choice. These results demolished 2,500 years of belief in rational decision-making and ignited a behavioral revolution that still reshapes marketing today. The same principles now power choice

architecture embedded in every eCommerce checkout, restaurant menu, government form, mobile app, and social feed — quietly nudging users toward someone else's preferred outcome. Our mission? Equip you to wield these tools too, not to manipulate, but to upgrade your systems so employees make better decisions and fewer mistakes, saving valuable time and money.

The experiments resulted in three interlocking discoveries. First, loss aversion: losing $100 hurts about twice as much as gaining $100 feels good, so people fight harder to avoid pain than to chase pleasure. Second, reference dependence: we do not judge outcomes in absolutes, we measure them against a personal starting point, our own status quo. Third, diminishing sensitivity: the farther we move from that reference point, the less each additional unit matters—the leap from $0 to $1,000 electrifies, but $15,000 to $16,000 barely registers. These three distortions explain why your team plays it safe with small wins, gambles to dodge losses, grows numb to repeated rewards, and why a motivating bonus for one, is not worth the effort for another. These are predictable patterns we will use to redesign your systems.

Here Are The 3 Distortions That Sabotage Your Systems

Force	Core Principle	Your Business Impact
1. Loss Aversion	Losses hurt **2x** more than gains feel good	Employees will settle for the easy gains, and take risks to avoid losses
2. Reference Dependence	Value is **relative** to a starting point	Where you start determines what you value
3. Diminishing Sensitivity	Impact **fades** as we move from reference	First $1K saved = celebration; 100th = shrug

Think of these distortions as invisible magnets beneath your decision-making surface pulling choices toward psychological comfort, skewed comparisons, and emotional numbness. Your job is to redesign the terrain.

Distortion 1: Loss Aversion — The Pain Multiplier

In 1979, Daniel Kahneman and Amos Tversky published their landmark paper, *Prospect Theory: An Analysis of Decision under Risk* in Econometrica, presenting participants with paired choices that tested decision-making under risk in both gain and loss domains. They recruited university students and gave them written decision problems with real monetary

stakes (paid out proportionally), ensuring responses reflected actual preferences rather than hypotheticals. The experiment isolates framing effects by keeping expected values identical across conditions while varying only the presentation: gains (sure win vs. gamble) or losses (sure loss vs. gamble) (Kahneman & Tversky, 1979).

Here is one example for the experiment:

Choice Set A (Gains):

- **A1**: Sure gain of **$240**
- **A2**: 25% chance of **$1,000**, 75% chance of **$0**

Choice Set B (Losses):

- **B1**: Sure loss of **$750**
- **B2**: 75% chance of **losing $1,000**, 25% chance of **$0**

Results:

- **84% chose A1** (risk-averse in gains)
- **87% chose B2** (risk-seeking in losses)

Participants overwhelmingly chose the sure gain in the gain domain (84% preferred $240 certain over a 25% chance of $1,000) but became risk-seeking in the loss domain (87% preferred the gamble to avoid a sure $750 loss). This reversal proved that losses loom larger than gains, directly contradicting classical utility theory's prediction of consistent risk preferences.

A real-world example of loss aversion in action is known at the *disposition effect*. Here individuals tend to sell winning stocks too early and hold onto losing stocks. Well-researched investment performance models tell us that investments that performed well over six months tend to perform better over the next six months (Odean,1998; Shefrin & Statman, 1985). Investments that performed badly during a six-month period will also continue to underperform in the next six months. Why then do investors often sell their winning stocks after a period of gain, but hold their losing stocks hoping for a comeback? The reason is that investors — all of us, really — fear losses. After a gain on a winning stock, we want to preserve that win and not risk losing it, so we sell prematurely. Conversely, we will hold the losing stock to avoid realizing the loss. Once the losing stock is sold, the investor commits to the loss. This is psychologically painful. Understanding these behavioral patterns is crucial for us to update your systems.

Distortion 2: Reference Dependence — The Moving Target

Central to Prospect Theory is the concept of reference dependence, asserting that individuals evaluate outcomes relative to their reference point rather than in absolute terms. This reference point is subjective and varies across individuals and contexts, influencing the perceived desirability of different options. The reference point is set as part of any decision and typically remains stable through the decision process. This means it takes time for a reference point to adjust to recent increases and decreases in actual value (Tversky & Kahneman, 1981).

The gambler that loses $1,000 in his first game does not move to the next game with an adjusted reference point; he evaluates his position as a loss from where he started and feels that loss intensely. This drives risk-seeking behavior, to make up for the loss. On the contrary, if the gambler wins early, they are subjected to the feelings of "house money" (the winnings are not yours yet), which nudges winners to continue to play. It is not until the day ends that the gambler will evaluate their overall performance as a gain or loss from their initial starting point. New reference points emerge over time as users adjust to changes in value.

Financial decisions help demonstrate reference dependence. Take the sum of $10,000. Given as a figure, a user evaluates the value of $10,000 differently based on their own unique reference point in the context of money. To some, this is a significant amount and to others less so. The individual and unique reference point therefore affects how users process value. Even when the intrinsic value of $10,000 is unchanging, it means more or less to users based on their own circumstances.

As abundance in any context grows, so moves the reference point. An employee who works her way to CEO of the firm grows her salary over time. The initial salary of $50,000 seems like a tremendous sum as a first job after college. Over time that grows to say $350,000 as CEO. Along the way, our subject's reference point for money has also changed. Her reference point now is significantly higher than before. This means that she will evaluate options from wherever she is at the time of the decision, and not from the initial $50,000 salary baseline. Spending $5,000 on a vacation would seem outrageous at a $50,000 reference point. The same $5,000 vacation might be doable a few times a year with the CEO salary reference point. The key to refence points is knowing that they are uniquely induvial and context specific, so a one-size fits all mentality will cause unpredictable responses to your systems.

Reference Point Experiment: The Theater Ticket

In the early 1980s, Tversky and Kahneman designed a deceptively simple experiment to test reference dependence — one of the core pillars of Prospect Theory. They wanted to show how we mentally account for money dramatically changes our decisions, even when the objective cost is identical (Tversky & Kahneman, 1981).

The experiment was conducted with undergraduate students at Stanford and UC Berkeley. Participants received one of two written scenarios and asked a single yes/no question. No real money changed hands. This was a hypothetical choice, which made the results even more striking: people revealed their true mental accounting rules without financial stakes.

Scenario 1: The Lost Cash

You are going to a theater to see a play. The ticket **costs $20**. You arrive at the theater, reach into your pocket — and discover you've lost a $20 bill. You still have enough money to buy a ticket.

Would you buy a new ticket?

Result: **88% said YES**.

Mental Accounting: The $20 bill is part of your general cash account — your wallet, your "spending money." Losing it feels like a separate, unrelated event. The cost of the ticket remains $20, so most people treat it as a fresh expense and buy the ticket (Thaler, 1985).

Scenario 2: The Lost Ticket

You bought a **$20** ticket to a play earlier in the day. You arrive at the theater, reach into your pocket — and discover you've lost the ticket. The theater does not offer replacements. You must buy a new one to enter.

Would you buy a new ticket?

Result: Only **46% said YES.**

Mental Accounting: The original $20 ticket is part of a specific mental account — "theater outing." Losing the ticket feels like doubling the cost of the outing to $40. Most people experience this as unacceptable and walk away.

Key Insight: The Reference Point Shift

Scenario	Reference Point	Perceived Cost of Entry
Lost Cash	General wallet balance	$20 (fresh expense)
Lost Ticket	"Theater outing" account	$40 (original + replacement)

Even though both scenarios require spending $20 to see the play, the mental frame changes everything. This is reference dependence in action. We do not evaluate outcomes in absolute terms. We evaluate them relative to a subjective reference point.

Why This Happens: Cognitive Buckets

Humans do not treat money as fungible. We create mental buckets:

Bucket	Example
Entertainment	Concert, movies, dining out
Transportation	Gas, Uber, and car maintenance
Work Expenses	Supplies, software, travel

When you violate a bucket, it hurts more than a general loss.

- **Lost $20 cash** → Comes from "daily spending" bucket → **easy to replace**
- **Lost $20 ticket** → Violates "theater budget" → **Feels like $40 total damage**

The bottom line for a psychological perspective is that the same $20 can feel like $20 — or $40 — depending on the mental bucket. Your job as a choice architect? Control the bucket (Thaler, 1985).

Distortion 3: Diminishing Sensitivity — The Fading Signal

Prospect Theory proved that framing distorts how people evaluate options. Researchers measured this by gradually adjusting outcomes until participants viewed two choices as equally appealing, even when the math said otherwise. The result was a value curve showing that losses sting about twice as much as equivalent gains feel good. The first $100 excites far more than the last. This curve tracks emotion relative to a personal starting point and reveals *diminishing sensitivity*: as we move farther from that reference, each additional

change feels smaller. That asymmetry explains many behaviors that appear irrational under classical economic theory. Recall that classical economic theory tells us that the value of the first dollar is equal to the value of the last dollar. This follows logic but take this next example as proof that the farther we move from the reference point, subjective valuation diminishes appeal even when actual value does not decline (Kahneman, 2011).

Let's consider our CEO from earlier, who starts with a portfolio valued at $100,000. Her reference point is this initial investment, and she perceives gains and losses relative to this starting point. In the first scenario, she experiences a gain of $10,000 in the first year. This gain represents a 10% increase from her initial investment. The emotional impact of this gain is likely to be substantial for her, and she will feel a sense of satisfaction or happiness.

In the second scenario, the CEO experiences the same absolute gain of $10,000, but this time it occurs when her portfolio is valued at $500,000. In this case, the gain represents only a 2% increase from her current portfolio value. According to the principle of diminishing sensitivity, the emotional impact of this gain is expected to be less significant for her compared to the earlier scenario. As the portfolio grows, individuals become less emotionally responsive to the same absolute amount of gain or loss. In Scenario 2, even though the dollar amount of the gain is identical, its percentage impact is smaller relative to the larger portfolio size. Consequently, the emotional response to the gain diminishes.

In the mid-1980s, Richard Thaler asked 154 Cornell students how far they'd drive for a $200 discount. When the deal cut a $599 TV to $399—a 33% drop—68% said they'd go at least 16 miles. The same $200 off a $37,599 car, bringing it to $37,399, a mere 0.5% savings, inspired only 5% of students to take the 16-mile journey. Same dollars, vastly different worlds. Thaler concluded that people anchor to the item's price range, not the absolute gain; the farther any change sits from that reference point, the less it registers emotionally. His fix: slice big rewards into small, frequent hits so every victory lands close to home (Thaler, 1980; Thaler, 1985).

Experiment: TV vs. Car

- **TV**: $599 → $399 ($200 off) → **68% drive 16 miles**
- **Car**: $37,599 → $37,399 ($200 off) → **5% drive**

Understanding diminishing sensitivity is crucial for you as a leader in your organization because you are responsible for motivating behavior that grows the business. We now know that behavior is a product of motivation and intent, and diminishing sensitivity

modulates motivation. The same reward loses its motivational power the farther it sits from the individual's reference point.

Deciding Under the Influence (DUI)

Loss aversion, diminishing sensitivity, and reference dependence distort facts and impair judgment, analogous to the effects of alcohol on our decisions. Loss aversion narrows vision: any risk of loss feels catastrophic, so people cling to small certain gains and dodge bigger opportunities. Reference dependence warps the map: outcomes are judged against a personally subjective starting point, making identical values feel urgent in one context and trivial in another. Diminishing sensitivity dulls the gauges: the farther you move from the reference point, the less each additional dollar – gain or loss—registers emotionally. When systems are designed without account for the influence of these forces, employees can't help but make mistakes. Think of these as causing cognitive intoxication.

A Real-Time Loss Aversion DUI

For Sarah, it's all about the quick win.

It's 9:47 a.m. on Thursday. Sarah, your senior bookkeeper with six years on the job, sits at her corner desk in the open floor plan accounting pod. The hum of the HVAC is steady. Her second coffee of the day freshly poured. A vendor invoice from Acme Supplies stares back at her from the screen — the $12,400 total seems high, but wait, there's a $240 credit applied in bold green.

Sarah's cursor hovers over the **"Approve & Post"** button. She knows the math. She's seen this vendor before. She's caught errors. She's *good* at this. Here's what runs through her mind in the next **7 seconds**:

Option 1: Take the $240 credit. It's right there. Clear. Documented. Guaranteed. She clicks "Approve," the entry posts, and she moves to the next invoice. Win locked in. No risk. No follow-up. No time wasted. No cold coffee.

Option 2: Audit the invoice. Bypass the credit, open the PDF, cross-check line items, call the vendor rep. There's maybe a 25% chance she finds a $1,000 overcharge — a big win for the company. But there's a bigger chance she finds nothing, and she's just burned an hour and has cold coffee. Worse: if she's wrong, she's the one who "held up payroll" or "made a big deal over nothing."

Sarah's stomach tightens. Not because she's lazy. Not because she doesn't care. But because losing feels worse than winning feels good. She remembers last quarter when she flagged a $180 discrepancy. It turned out to be correct, but the vendor delayed the next shipment. Her boss got a complaint call. She took the heat. Now? $240 is real. It's here. It's safe. She exhales. Clicks. Posts. Moves on. No risk. No blame. No regret. Warm coffee.

What Just Happened? Loss Aversion in Action

Choice	Objective Value	Emotional Weight
Take $240 credit	+$240	Sure gain → Feels safe, protective, win, move-on
Audit for 25% of $1,000	Expected value: +$250	Risk of wasting time + looking wrong → Feels like a loss

Even though auditing could yield $1,000 catch, Sarah — like 84% of people in Kahneman and Tversky's gain-framed trials — avoids the perceived loss of time and chooses the sure thing. This is not incompetence. This is human wiring.

A Real-Time Reference Point DUI

For Mike, his reference point led him to the wrong destination.

It's 2:12 PM on Tuesday. Mike's reviewing his accounts. This new dashboard is so powerful, he can slice the data 5 ways to Sunday. While toying around, Mike sees an option he did not have before: *% Delinquent*. Mike clicks the feature, and his screen populates with his delinquent accounts as a **% of account value, in descending order**. He sees three screaming red lines: **61 %, 58 %, 52 %** - overdue. "Yikes, how did that happen?," Mike thinks. Better get on these ASAP. He attacks them over the course of the next week. After plenty of follow-up calls, emails, and a few hours from the interns helping him reproduce bills, he collects 3 full payments totaling $15K and earns a loud **"atta boy!"** from his manager in stand-up. Buried at the bottom: a $20K delinquency from his $300K client — missed entirely. While Mike was chasing the other accounts, the client quietly disputes the bill, and the tiny % is written off for goodwill.

Here's the reference point trap:

- Reference point = % of account, not absolute dollars.
- 52 %, 58%, and 61% feel *urgent*.
- 6.6 % ($20K on a $300K account) feels fine.

What Just Happened? Reference Dependence

Choice	Objective Value	Emotional Weight
Chase High % on low $ accounts	+ $15,000	High % Overdue -> feels urgent
Ignore low % on high $ account	- $25,000	Low % Overdue -> feels fine

Mike's mental frame was set by percentage, not dollars and his reference point distorted the priorities. The feelings of urgency to collect the smaller amounts increased because they felt larger to Mike than reality.

A Real-Time Diminishing Sensitivity DUI

For Jen, the last dollar was not as valuable as the first.

It's 4:12 p.m. on a Friday. Jen, your top rep, closed **$200K in three weeks** and pocketed **$10K in bonuses**—five crisp $2K payouts. She had to work the last 3 weekends to book these sales, but it was worth it. Mentally, she's getting ready for a night on the couch, tired from the long week. Without warning, a $50K lead lands in her inbox. Unvetted, this lead will require a weekend push to clear and close. The reward? This one will take a lot of effort, but it could mean a $2500 bonus.

Back on April 1, that **first $2K** felt electric— that pays half the rent with a little left over! Hungry for the next, Jen puts in the hours doggedly pursuing the next several leads. Wow, in 3 weeks, another $8K in bonuses banked. When the new sales lead hits her inbox, Jen thinks, "Is this one worth it?" She checks her watch, taps her pen against the desk 5 times and then forwards the lead to the newbie. 'A learning opportunity,' she tells herself. The deal stalls without Jen's expertise. In the May newsletter, Jen is highlighted for her stellar April and feels nothing about the lost deal.

What Just Happened? Loss Aversion + Diminishing Sensitivity

Choice	Objective Risk	Emotional Risk
Hustle the lead	Lose the weekend and maybe not earn the bonus	**Feels routine, not worth the effort**
Delegate	Gain the weekend and lose nothing	**Feels like relief with no real loss**

For Jen, the incremental bonus did not seem worth the effort this weekend like it did in the beginning of the month. The greater her bonus grew, the less motivating the rewards became. The first $2K felt amazing; the sixth barely registered — diminishing sensitivity in action.

As you close this chapter, take a moment to look around your business. Do you see employees fighting for the small gains, working on the wrong priorities, and pumping the breaks when they should be hitting the gas? If so, recognize that these are not failures of character, but failures of design. The same behavioral forces uncovered in labs are quietly eroding your efficiency every day, yet they are also the levers you can pull to build systems that work with the human mind, not against it.

Do you still have that broken process in mind? Good, bring it to Chapter 2. Let's dive into the nature of the decision. Your profitability is waiting.

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