



SPRING 2005: MAKING BETTER DECISIONS

Findings from the Behavioral Research Lab at Columbia Business School

From the Dean



At Columbia Business School, our active teaching and research community spawns powerful ideas. I hope you

enjoy this sample of the fruits of our faculty research. The projects described below represent the School's cross-functional approach to understanding decision making. Addressing marketing and management, behavioral finance and public policy, these topics will surely change the way you think about corporate sponsorship, negotiating with international partners, doing favors and presenting choices to your customers.

Making better decisions is important for individuals, firms and public policy.

Understanding the psychology of decision making is therefore an important area in business research. Some of this investigation takes place in our Behavioral Research Lab, on the Web and in the field. Our goal is to help business practitioners and policy setters better understand the decision-making process.

I am proud to introduce you to the world-class group that is leading this work in research and in the classroom. And I look forward to presenting to you other fascinating research topics in this periodic newsletter.

Glenn Hubbard
Dean and Russell L. Carson Professor
of Finance and Economics

Ideas at Work

Columbia Ideas at Work is a bridge between business research and practice, offering key insights from our faculty's leading-edge research in a format that is easily accessible to busy executives.

Watch for the Columbia Ideas at Work Web site, slated to launch in June 2005 at www.gsb.columbia.edu/ideas. The site includes a magazine as well as a searchable archive of faculty publications. In the magazine's first issue, focused on entrepreneurship, Dean Glenn Hubbard discusses entrepreneurial entry from a policy perspective, while other articles present research findings on venture capital, product development, entrepreneurial networks and founder succession.

When Culture Counts

Do Chinese avoid conflict? If so, how will this cultural trait affect negotiations with your Chinese joint venture partner? These days, all managers need to understand how culture influences people's decisions and behavior. Whether you negotiate contracts across the globe or work in a diverse firm in the United States, you deal with people who have cultural perspectives that differ from yours in many important ways. So how can you prepare yourself and adjust your expectations?

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Some people rely on guidebook generalizations about culturally typical patterns: Chinese avoid confrontation, Germans are rule oriented, and so forth, from country to country. Although research comparing large samples of managers across countries provides statistical support for these patterns, managers are often wrong when they expect counterparts and colleagues to always behave in culturally typical ways.

What managers really need is insight into when culture affects people in business settings. For example, if Chinese tend to avoid confrontation, when is a Chinese counterpart likely to be affected by this cultural norm?

Professor **Michael Morris** worked on this problem with fellow researchers in the Behavioral Research Laboratory at Columbia Business School and parallel facilities abroad. They ran experiments in which participants solved negotiation problems under varying conditions. The researchers found that people fall back on cultural traits when faced with specific kinds of pressures, such as time constraints, multitasking and having to explain themselves on the spot.

These initial findings can help you anticipate when cultural differences may arise in a negotiation. Moreover, by reducing deadlines, distractions and the need to provide rationales, you can reduce the likelihood that negotiators will interpret problems through the lens of their cultural preconceptions.

Further experiments have shed light on the psychology of bicultural individuals who move between cultural worlds. This research shows that “cultural lenses” are not like permanent contact lenses—ever-present filters of perception—but are more like sunglasses. The same person can shift between different sets of lenses, but this process is not always a conscious one. Cultural lenses

Cultural lenses are like glasses that darken automatically when a person steps into the light: they respond automatically to the environment.



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Experiments with Chinese-American biculturals found that when negotiation problems were written in Chinese, participants exhibited more Chinese behavior patterns, such as avoiding confrontation. When researchers “primed” participants by incidentally exposing them to images associated with American culture—such as a U.S. flag and a bald eagle—the participants responded to negotiation problems with more American tendencies. Likewise, priming with a Chinese flag and a dragon invoked more typically Chinese behavior. These priming studies won a major research award and launched a new paradigm for researching cultural influences in behavioral management and marketing.

Priming has enormous implications at the negotiating table. Sometimes you can benefit from a counterpart’s cultural tendencies. If you want your bicultural Chinese counterpart to avoid confrontation, then meet in a Chinese restaurant, not a Texas steak house. If you want your bicultural German counterpart to be rule oriented, then meet in Düsseldorf, not Dallas.

More broadly, this research suggests that everyone is bicultural or multicultural to some degree, not only because more and more people come from

multiple national backgrounds, but also because there are many levels of culture. An Italian lawyer, for example, carries the occupational culture of lawyers as well as the national culture of Italians. Priming can help determine which cultural lenses dominate a person’s perceptions in a given negotiation.

Read More

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Michael Morris is professor of management at Columbia Business School.

Defaults Make a Difference

Since 1995, more than 45,000 Americans have died waiting for organ transplants. If more people signed up as organ donors and followed through on their pledge, how many lives would it save?

People sometimes sign up for things and then opt out later. Or they opt out now and opt in later. In both cases, they change their decision. Does it matter? In some cases, no, but in other cases it matters a great deal.

Take organ donation: when you renew your driver's license, you can sign a card that makes you a potential donor. Can hospitals that handle organ donations rely on your pledge, and if so, to what degree? And what about people who don't sign up—do they actually opt in at a later date? Knowing who will come through and who will not—and how best to sign them up—could help hospitals plan how many needy patients to put in their pipeline.

In organ donation, these are matters of life and death. In other domains—like flight insurance, retirement savings or Internet privacy—the stakes are lower but still high enough to make it worthwhile to look for an answer.

Professor **Eric Johnson** worked on this problem with Daniel Goldstein, using the Virtual Laboratory of the Center for Excellence in E-Business at Columbia Business School. They ran experiments over the Internet that gave hundreds of people essentially the same choice but in two different forms: (A) agree to be a donor, with an opt-out clause, and (B) decline to be a donor, with an opt-in clause. The researchers expected some difference, but the size of the spread shocked them. A's outnumbered B's by a factor of 2 to 1; people were twice as likely to agree to be a donor when they had to opt out as when they had to opt in.

Further research on different countries showed similar results. Rates of donor agreement and actual donation were low in Denmark, Germany, the Netherlands and the United Kingdom, where potential donors had to opt in. These rates were much higher in Austria, Belgium, France, Hungary, Poland, Portugal and Sweden, where potential donors had to opt out.

In many situations, which default you build in makes a big difference. If you want people to do something in the future, ask them to agree to it now,

with an opt-out clause. The default option—where they take no further action—is then in your favor. Johnson and Goldstein noted this result even in simple online agreements, where the default is a box already checked and the viewer can opt out by unchecking the box. That approach yields more positive results than asking the viewer to check the box.

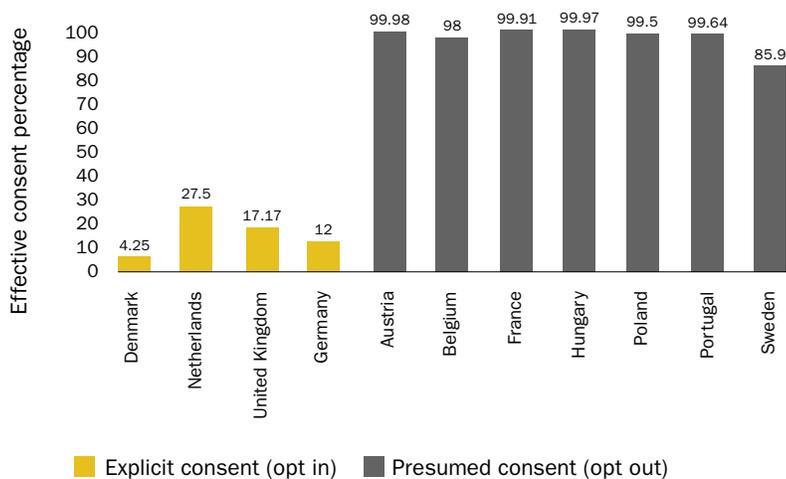
The principle behind the results of this research might have even wider implications. When people see an option for the first time, they don't yet have a preference one way or the other. Instead, they construct both the problem and the solution right there and then. So how you present the question—opt in or opt out—makes them see the whole matter in two very different lights. This is true for minor items like online offers and for major decisions like how much to save for retirement—and even, as we see with organ donation, for questions of life and death.

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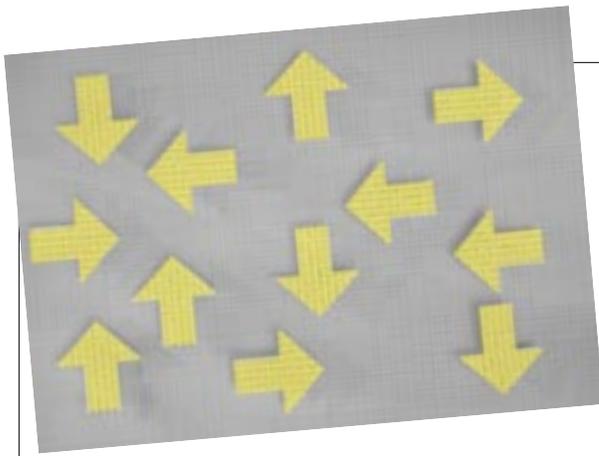
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Eric Johnson is the Norman Eig Professor of Business at Columbia Business School.

Organ Donation: Effective Consent Rates by Country



In many situations, which default you build in makes a big difference. If you want people to do something in the future, ask them to agree to it now, with an opt-out clause.



Process fairness has a direct economic payoff. The benefits are great: fewer lawsuits, greater productivity and fewer employees letting their work slide.

The Value of Fair Process

We both get fired. We had similar jobs, but I sue the company and you do not. What explains the difference?

Companies tend to think that written policies ensure that everyone gets equal treatment, yet they constantly find that different employees have different reactions to the same policy. Sometimes those reactions cost the company a lot of money and ill will. For example, two employees in the same company-wide layoff suffer roughly the same hardship; one sues the company, but the other does not. Or two managers relocate overseas at great expense to the company and both find that their families have trouble adjusting; one manager leaves early, but the other one sticks it out. Or two older employees have similar workloads and full responsibility for their children and aging parents at home; one keeps up at work, but the other one slacks off.

Professor **Joel Brockner** studied these and many other similar situations. He found one factor that helped explain them all: process fairness. The policy is one thing, but how the manager implements it is just as important. If employees think the manager is being fair procedurally, then they tend to accept bad news without conflict. If they think the manager is unfair, they fight back or bail out or turn off.

The elements of process fairness in decision making include

- giving serious consideration to employees' input
- consistency
- the use of accurate information
- opportunity for correction
- ample advance notice
- explaining why
- expressing concern and respect for the employee

When the decision process included these elements, Brockner found that employees accepted decisions as fair. The absence of these elements led to claims of unfairness and costly trouble for the company.

Process fairness has a direct economic payoff. The benefits are great: fewer lawsuits, greater productivity and fewer employees letting their work slide. And process fairness is hardly expensive; in fact, it costs nothing at all, except for a manager's time and attention.

You would think that the economic incentives would tend to make companies implement process fairness across the board. But many firms ignore process fairness and choose to deal with problems after they arise instead of going back to their source. Process

fairness is a hidden resource you can take advantage of easily and quickly, to the benefit of employees and the company overall.

Read More

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Joel Brockner is the Phillip Hettleman Professor of Business at Columbia Business School.

The Cost of Choice

When it comes to retirement savings, the more options the better, right? Wrong.

Is retirement savings something you'd rather not think about? You have plenty of things to spend your money on now, and you don't even want to picture yourself old enough to retire. If that's you, you're not alone. But the years will catch up with you. If current trends continue, by 2030 American retirees will be \$45 billion short of the income they need to cover basic living expenses. The country faces a crisis.

How can we get people to put more money into retirement accounts? The conventional answer is, offer more choices. Many retirement plans have done just that, but does it work?

Professors **Sheena Iyengar** and **Wei Jiang** studied 647 companies to find out. Each company offered a different 401(k) retirement plan. The plans offered different choices of funds: the lowest number of choices was 2, and the highest was 59. There were a total of 800,000 employees in all the plans.

Did the plans with more options get a larger percentage of employees to sign up? Quite the opposite: results showed that more choices lowered the rate of participation. Overall, for every 10 funds

added, the rate of participation dropped by 2 percent. The drop was most dramatic—almost 7 percent—for an increase from 2 to 10 funds.

Adding more choices has an even greater effect on how employees balance safety and risk—that is, bonds and money market funds versus stocks. For every 10 funds added, there was a shift of more than 5 percent to bonds and money market funds, and 8 percent less money in stocks. So more choices led to safer investments in the short term but less money at the time of retirement.

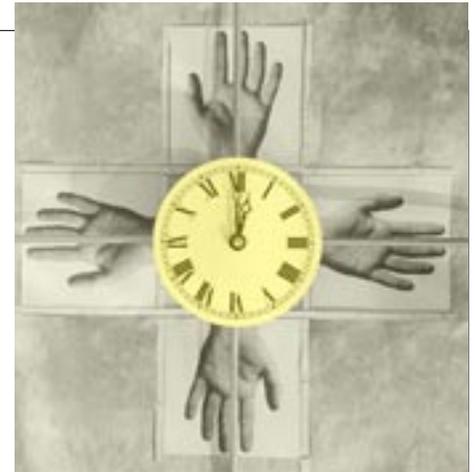
People do need choices, but they also need direction. Give them fewer choices, with a healthy long-term balance of safety and risk, or at least a tiered system that allows them to opt for more choices if they wish.

Even many financial experts neglect their own retirement accounts; we all need help in planning for the future.

Read More

Iyengar, Sheena S., and Wei Jiang. "Choosing Not to Choose: The Effect of More Choices on Retirement Savings Decisions." *Journal of Personality and Social Psychology* (forthcoming).

Sheena Iyengar is the Sanford C. Bernstein Associate Professor of Leadership and Ethics and **Wei Jiang** is assistant professor of finance and economics at Columbia Business School.



To Give Is to Get

Should I urge my staff to help one another or to stick to their own work?

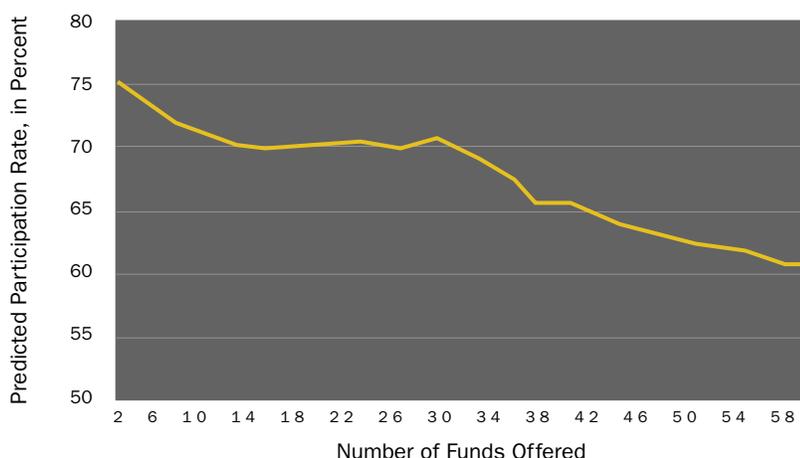
In some teams, people take a lot of time out from their own work to help other members of the team. Is that good or bad? Maybe you should stop it and tell people to concentrate on their own assignments. Or what about the opposite: if team members never help one another, should you encourage them to do so? On the one hand, taking time out to help others is a terrible distraction. On the other hand, maybe they can use the help. On balance, does lending a hand to someone else help or hurt the team?

Professor **Frank Flynn** studied how helping out really works in practice. He collected data on 161 engineers at a big telecommunications company. The engineers made up eight teams. Each team had responsibility for a different geographic area. When a problem arose in the field, the company directed the problem to the team for that area. Within the team, the assignment went to an individual member.

The research asked the engineers how often they helped or received help from each of their other team members. The help included technical advice, a second opinion or taking over when the other person had too much else to do. The company also kept detailed records on jobs completed, mistakes and deadlines.

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Effect of Number of Choices on 401(k) Participation



As it turned out, you were most productive if you both gave and got a lot of help.

To Give continued from page 5

So the research was able to ask, Did helping out hurt or help productivity?

As it turned out, you were most productive if you both gave and got a lot of help. The less you helped or the less you got help, the more your productivity went down. The engineers who both gave and got help were also most well liked by their peers. They got better at helping too—you learn about the strengths, weaknesses and personal traits of each of the other team members, and that makes it easier to help the next time.

Lending a hand is not unbusinesslike; it's very good business indeed.

Read More

Flynn, Francis J. "How Much Should I Help and How Often? The Effects of Generosity and Frequency of Favor Exchange on Social Status and Productivity." *Academy of Management Journal* 46, no. 5 (2003): 539–53.

Frank Flynn is associate professor of management at Columbia Business School.

The Sponsor Trap

Does anyone recall who sponsored the Olympics—and do you remember correctly?

Eleven major companies—including Coca-Cola, Kodak and Adidas—paid \$60 million each to become official sponsors of the 2004 Summer Olympic Games in Athens. The event reached 220 countries around the world, with a total of four billion consumers. It was an outstanding example of a growing trend, where companies spend more and more money on more and more sporting events. It's time to ask, Is it worth it?

Professors **Gita Johar** and **Michel Pham** studied how well consumers recall the sponsor after major sporting events. The answer: not well at all. Worse, they often credit a competitor. For example, Adidas sponsored the 2004 European soccer championships, but consumers were almost as likely to name Nike as the sponsor. Even correct responses often came from luck rather than from successful advertising; athletic-shoe companies often sponsor soccer, so Adidas makes a good guess.

As it turns out, consumers have a hard time associating sponsors with one-time events. A different group of companies sponsor the Olympics each time, so consumers don't identify them with the Olympics over the longer term. Having multiple sponsors for the same event further weakens the link, and then even more companies find their way in by sponsoring individual teams. It's no wonder consumers can't keep it all straight. Last but not least, audiences don't remember sponsorship nearly as well as more conventional marketing, like print and television ads.



So what can a sponsor do?

Make sure you sponsor events closely related to your products so that guesses come out in your favor. That helped Adidas in the European soccer championships. On the other hand, maybe you will get the same benefit anyway, as Nike did, as long as you are a major brand; if you are a minor brand, you will certainly lose out, as consumers will give credit to your bigger competitors.

Also make sure to sponsor a series of events, rather than just one, and make sure to advertise before and after too.

Otherwise competitors can steal your thunder by advertising during the event, even if they're not sponsors, and so confuse consumers about who the sponsor really is. And track how consumers recall your sponsorship between events too, not just right after. Supplement sponsor recall measures that may simply reflect educated guesses with other measures of sponsorship effectiveness, such as brand equity and associations.

But remember: in the end, it might not be worth it. It's hard to make sponsorship stick.

Read More

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Gita Johar and Michel Pham are professors of marketing at Columbia Business School.

More Competition, Please

You can sometimes improve your product's market share by adding competition.

Consumers have more and more information on more and more products, especially thanks to the Internet. Conventional wisdom tells you to limit the choices you offer consumers to what you want them to buy. But advances in behavioral economics are overturning that wisdom. As it turns out, consumers rank available choices and tend to avoid extremes. So sometimes you can improve a product's market share by showing consumers a competing product that's higher or lower in price or quality.

In a series of experiments, Professors **Ran Kivetz** and **Oded Netzer** of Columbia and Professor V. Srinivasan of Stanford asked consumers to choose from among a variety of personal computers, speakers and magazine subscriptions. They found that changing the rank of two products among available options changes how much consumers favor one or the other.

One experiment asked consumers to pick among three speakers. The introduction of the extreme speaker C (see left panel in the figure) increased the market share of option B relative to option A, because B became the intermediate or compromise option. In their study, Kivetz, Netzer and Srinivasan found that a product's relative share increased by as much as 34 percent when the product moved away from an extreme end of the price or quality spectrum.

The study illustrates the *compromise effect*, which results when you introduce an extreme option that increases the market share of a nearby option, and the *decoy effect*, which results when you introduce an intermediate option that makes a more extreme one look better. The introduction of the decoy option C (see right panel in the figure) increased the market share of option B relative to option A, because B became an asymmetrically dominant option.

This research can help managers make better decisions about pricing and positioning their products relative to the competition. Telling consumers you have the lowest prices, highest quality or latest design is not as useful as you might think, since consumers tend to shy away from extremes. This research method can help you figure out where to position your product and which of your own or your competitor's products to highlight in the consumer's ranking.

The method is especially useful for predicting the impact of new competition and how line extensions will affect the sales of your existing products. You can use this research method to help you make key decisions about your product portfolio in any line. It can also help you design product menus that favor your high-end products by getting the ranking right.

You don't always have to avoid competition. Sometimes it's better to bring it on—strategically—and let consumers decide in your favor.

Read More

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Ran Kivetz is the Sidney Taurel Associate Professor of Business and **Oded Netzer** is assistant professor of marketing at Columbia Business School.

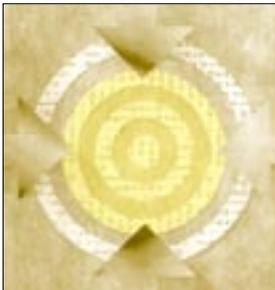
Schematic Illustrations of the Compromise and Decoy Effects

The Compromise Effect



The Decoy Effect





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