The Krehbiel Letter

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Dear Publishing Professional,

In this issue I zoom out a bit and look at higher-level concerns – e.g., how we think, and how we should think. I'm inspired by Daniel Kahneman, the author of "Thinking Fast and Slow," who recently passed. I briefly review a few of his contributions, then end with a review of two-by-two matrices.

Anchoring bias and how to defeat it

Anchoring bias is when the first thing you judge influences your judgment of what follows – i.e., we rely too heavily on the first data we hear. If the salesman says the car is worth $50,000, that sticks in your head and your subsequent judgements are colored by it.

Here are seven ways to avoid anchoring bias.

Get information from multiple sources. When the salesman says the car is worth $50K, check that against Kelley Blue Book and prices listed at other dealerships.

Set expectations ahead of time. If you know what kind of car you're going to buy, get some price comparisons before you go to the dealership.

Actively consider the opposite. Deliberately consider why a fact might not be relevant to the decision at hand. For example, if someone says 4 out of 5 dentists recommend a particular gum, think of reasons why dentists might not be experts on chewing gum.

Identify and dispute the assumption behind the number. If someone says the minimum wage should be $25 an hour, ask whether there should even be a minimum wage.

Set your own anchors. Since you're aware of the effect of an anchor, use it to your advantage. Set your own anchor before your negotiating partner does.

Make analogies. When the salesman says $50K, put that number in another setting, such as a percentage of your annual income. You can also think of alternatives. How many Uber rides can you get for $50K? Is this one car better than two $25K cars?

Make the concrete relative. To avoid fixating on a specific number, think of the deal in a broader context such as depreciation and resale value.

Slow down. Salesmen want you to buy now, now, now, because they know that if you think about it for a while, that will dilute the impact of the pitch.

Prospect theory and fear of loss

Kahneman promoted the idea of "prospect theory," which says we don't evaluate gains and losses by strict utility – the way an accountant might – and that our perception of the potential gains or losses affects our decisions.

In short, **we're more afraid of loss than we are attracted by gain.**

Consider a homeowner who is wondering about buying insurance for a house that's worth $200,000. The insurance policy is priced at $2,000 per year, and it covers damages from a natural disaster that has a 1% chance of occurring each year.

According to traditional economics, the expected loss from the disaster is $2,000 -- the cost of the insurance. A "rational person" might be indifferent to buying such insurance.

This analysis ignores that the house is more significant than the money. There's value to the homeowner in knowing that he'll have a house despite a disaster.

Focusing illusion and the availability heuristic

If you want to understand or learn something, you often have to devote some time to focused, careful attention. There's a downside to that.

According to Kahneman, **"Nothing in life is as important as you think it is while you are thinking about it."** People have a tendency to overemphasize the importance of certain information or events simply because they are focusing on them at the moment.

Imagine you've been working on a new product. There's one feature the development team is particularly proud of. It's an innovative feature that's brand new in the market. Your focus on that feature might make you think it's more important to your market than it really is.

One simple way to combat the focusing illusion is to **get input from others**, who are probably not focused on the same things you are. Where possible, quantify the factors involved in a decision.

Somewhat related to the focusing illusion is the availability heuristic, which is a mental shortcut that relies on what immediately or easily comes to mind. The idea is that if it's easily recalled, it must be more important or more common – which isn't true.

To avoid the availability heuristic, **seek objective data and consider other perspectives**. It can also be helpful to use checklists and other structured decision-making tools.

The peak-end rule and event planning

The way an event is remembered is heavily influenced by the most intense point in the experience – or the peak – and by the end of the experience.

This can lead to some odd applications. In two groups of patients getting a colonoscopy, Group A was given the standard procedure. Group B had a few extra minutes at the end where the scope was in a more comfortable position. The people in Group B rated the procedure as less painful.

For *Krehbiel Letter* readers, this rule is applicable to event planning.

First, **focus on creating a memorable peak moment**. Identify and amplify the most exciting part of the event. This could be a keynote speech, a performance, or a special demonstration. Try to surprise and delight – maybe with a surprise guest appearance or with special gifts.

Note, however, that the peak-end rule applies to how people remember the event. It doesn't necessarily incentivize them to attend the event. Those are two different things. What people attend at an event is not what influences them to come.

Second, **end on an engaging, positive, enjoyable high note**, and make sure you have your logistics right so the departure process is pleasant. A personal anecdote: I still remember how much I disliked being stuck in the sanctuary waiting while everyone had to shake the pastor's hand on the way out of church!

One good way to end a business event is to have networking opportunities with high-quality refreshments and chances to make meaningful connections.

The planning fallacy is also relevant to events. Kahneman and his collaborator Tversky found that **humans often underestimate the amount of time and the required resources to complete a project**. This leads to overly optimistic timelines and budgets.

Here are some things you can do to avoid that.

- Look at historical data from similar projects
- Break down tasks into smaller, manageable tasks that are easier to estimate
- Establish clear milestones and checkpoints
- Include buffer time for unexpected delays
- Build in flexibility up front
- Ask experienced people to review your plan
- Use a pilot project to scope out things you're not sure about
- Use project management tools, including visualization tools

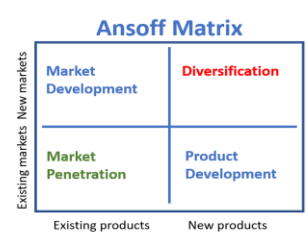
Two by Two Matrices

Leaving the world of Kahneman now .... You probably know and have used the **Risk vs. Reward matrix**. Everybody wants to find the low risk / high reward possibilities, but they're rare. Low risk low reward is where you want to run most of your business, with an occasional moonshot.

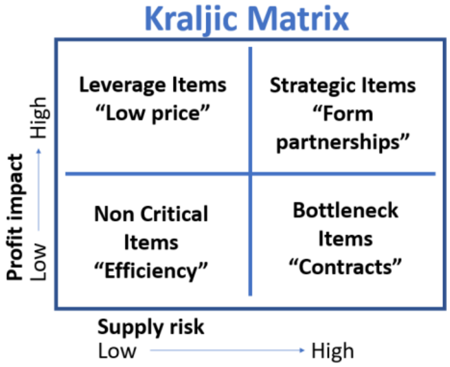
A slight modification of that matrix would be **Effort vs. Reward** where low effort and high reward is seen as low-hanging fruit.

The **Eisenhower Matrix** of urgent vs. important divides tasks into don't do, schedule, delegate, and do it now. Every executive should have this matrix front and center in their daily thinking.

Next is the **Ansoff Matrix**, which looks at the role of your product portfolio in existing and new markets with new and existing products. This matrix provides a framework for exploring growth strategies and balancing your portfolio.



The **Kraljic Matrix** (next page) sets supply risk against profit impact and helps companies maximize supply security and minimize supply risk.



- **Strategic items** are critical to the business's operations, but are often limited or subject to high risk, such as relying on a single supplier.
- **Bottleneck items** don't significantly impact profit, but can cause operational disruptions. These have to be managed to secure a secure supply.
- **Leverage items** are easy to source and have significant profit potential, and for that reason there's a lot of competition. These need to be continually monitored and optimized.
- **Non critical items** should be automated as much as possible.

The Boston Consulting Group's **Growth-Share Matrix** identifies where to allocate resources by categorizing business units or products into four quadrants.

- **Stars** have potential to generate significant revenue but also require significant investment. For stars, focus on growth, innovation, expanded market reach, and performance.
- **Cash cows** generate strong, steady cash flow with minimal investment. Maximize the profitability of your cash cows to fund other opportunities.
- **Question marks** have potential, but require a lot of work. Invest selectively in question marks and be prepared to get out quickly if they don't look like becoming stars.
- **Dogs** are ready for the trash bin unless you can make them into successful niche products.

Let me know – Are these sorts of mental models and frameworks helpful to you? I might make this a recurring theme in the letter, or I might do a special report on the subject. Tell me if you like that idea.

Sincerely,

Greg Krehbiel

P.S. – There isn't room in my 4-page letter to do justice to the concepts I have briefly summarized. If something struck your fancy, please look it up, or give me a call and we can chat about it.

P.P.S – **Please let me know if there's any way I can help you succeed, or if you know someone else who could benefit from my services.**