Rational Versus Nonrational Escalation of Commitment

Understanding Decision-Making Dilemmas

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Class Exercise

– Let's hold a special fantasy auction.
  • I am auctioning off a $20 bill. Bids will occur in increments of $1.00. The highest bidder will pay the amount that they bid and win the $20.00. In this auction, unlike others, the second highest bidder must pay up what s/he bid, but will not win the $20.00.
“If at first you don’t succeed, try, try again. Then quit. No use being a damn fool about it.”

-- W.C. Fields
Escalating Commitment

- Management research suggests that we are prone to a particular type of bias when decisions are approached serially (one decision on top of another) – namely, a tendency to escalate commitment!
Continuing the Course of Action

• You call for information and are put on hold. How long do you stay on hold?

• The car broke down last month and it was repaired. You have a new problem. Do you continue to put money in the lemon of a car?

Rather than quitting,

we often feel like we have too much invested to give up
Commitment to . . .

- Decision makers who commit to a course of action will have a tendency to make subsequent decisions that continue that commitment — *beyond the level of rationality*.

- Consequently, resources may be allocated that justifies previous commitments whether or not those initial commitments appear valid.
Misdirected Persistence

• The key to making intelligent decisions in dynamic contexts is being able to discriminate between situations in which persistence will pay off and situations in which it will not.

• Misdirected persistence can lead to wasting a great deal of time, energy, and money.
Directed Persistence

• The reference point for making decisions should be the “current state.”

• All alternative courses of actions under consideration should be evaluated by future costs and benefits associated with each alternative. (*In financial terms, this is called sunk costs*).
Directed Persistence

- A sunk cost example about continuing with one’s education:

  - It should not matter that it took you seven years to get to this point in your graduate degree program; the key decision involves future costs of exiting versus future benefits of continuing.
To Loan or not to Loan?

• Imagine that you are a loan officer. You agreed to give someone a $50,000 start up loan. Six months later, the individual returns to tell you that the business is failing and all $50,000 has been spent. The individual states that with current conditions there will be no way to re-pay the loan. On the other hand, the individual states with complete confidence that with another $50,000 loan, the company will turn around and succeed. Do you loan the individual another $50,000?
The Unilateral Escalation Paradigm

• Managers have difficulty separating previous decisions from related future decisions.
  – We tend to bias our decisions by our previous actions
  – We justify by Cognitive Dissonance. (Such as, “it was a good learning experience”

• All of the justification forces that lead to nonrational escalation lie within the individual.
The Competitive Escalation Paradigm

- The escalatory process results from additional competitive forces (not just within the individual).

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The Competitive Escalation Paradigm

In addition to making future decisions based on prior commitments, here the desire to win serves as a motivator to escalate commitment.
Why does Escalation Occur?

The psychological factors that feed escalation behavior include:

1. Perceptual Biases
2. Judgmental Biases
3. Impression Management
Perceptual Biases

Caldwell and O’Reilly (1982) empirically demonstrated that subjects who freely choose a particular course of action subsequently filter information selectively to maintain commitment to that course of action.
Judgmental Biases

Since information has been filtered (by perceptual bias) subsequent decisions will be based on distorted judgment.
Impression Management

• Managing the impressions of others may be a reason for escalating one’s commitment of a prior action.
  • For example, the “bad” hiring decision. To fire the individual is an announcement of making a mistake.
    – Escalate through providing confirming (rather than disconfirming) information.
    – Escalate in order to appear consistent.
Reducing Escalating Behavior

- Reducing escalating behavior requires strategies that counter the “nonrational” commitment to a course of action
• The End