

ESM0252 expectations

Definition

Expectations, as defined here, are forecasts of how others will behave in competitive circumstances.

Abstract

Formulating expectations of others' behaviour depends on understanding these individuals, groups, or organizations. This form of perspective-taking is a cognitively demanding task that people routinely fail to perform perfectly. Perhaps the most common error is insufficient consideration of others or a failure to understand their perspectives. This error leads to a number of predictable biases, including false consensus, false uniqueness, better-than-average beliefs and (under some circumstances) worse-than-average beliefs. These errors produce systematic biases, such as entering competitions too frequently.

Strategic choice necessarily depends on one's expectations regarding what others will do. The simplifying assumption of much strategy work, especially in the economics tradition, is that others will be perfectly rational. In reality, however, humans deviate from this ideal standard, and understanding exactly how they do so is helpful for determining one's own strategic choices.

One inherent challenge we all face involves understanding others. Psychological evidence clearly shows that most of us begin by introspecting about ourselves and then projecting on to others (Krueger, Acevedo and Robbins, 2005). Assuming that others will behave as we do may not be a bad general approach because we are, after all, in the majority a majority of the time (Dawes, 1989). However, this useful heuristic can produce the false-consensus effect, in which we assume that others will be more like us than they actually are (Krueger and Clement, 1994). The cognitive machinery required to take others' perspectives and understand their points of view only comes with age, maturity and effort. Children, for instance, behave as if they think that others have the same feelings, possess the same knowledge and like the same sweets and toys as they do (Gopnik, Meltzoff and Kuhl, 2001). In fact, when we are busy or distracted, all of us have a childlike tendency to caricature others in our minds (Lin, Keysar and Epley, 2010).

Simplifying heuristics

When we lack the maturity or cognitive resources to accurately understand others, we fall back on the

heuristic that others will be like us. One direct consequence of this heuristic is what Shafir and Tversky (1992) called 'quasi-magical thinking'. For example, take choices in the prisoner's dilemma game. People often cooperate in this game, in part because they hope their partners will cooperate. 'If my opponent is thinking like me,' the reasoning goes, 'then if I decide to cooperate, then so will she.' This logic is problematic because one's own choice cannot influence the other person directly when players choose simultaneously. If, instead, people know what the other person did before they make their own choices, they often defect in a one-shot game. If they find out the other person defected, they will defect to avoid being the 'sucker'; if they find out the other person cooperated, they will defect to take advantage of the opportunity.

Because people routinely warm up to considering others' perspectives, choices and preferences by first considering their own, they become anchored to this view and thus fail to appreciate others' views (Epley et al., 2004). As a result, they end up inaccurately predicting others. Their predictions of others are overconfident in the sense that they behave as if they are too sure they know what others will do (Vallone et al., 1990). And too often, they are too sure that others will have the same ideas, preferences and plans as they do. That is in part why those who know the most about a particular product are not the best ones to write the instruction manual (Loewenstein, Moore and Weber, 2006): They fail to appreciate what others need to know. It may also help to explain why companies often make the mistake of introducing a product to market too quickly (Bayus, Jain and Rao, 1997): They become overly concerned that another company has had the same idea and will beat them to market.

In some ways, the failure to understand others should be entirely unsurprising. Every person and every firm knows more about itself than it does about other people and other firms. Some analyses of comparative social judgements conclude that many biases, including false consensus, false uniqueness and dislike of outgroups, can arise owing to the rational Bayesian processes of belief updating with biased data samples (Fiedler, 2000).

Competitive entry choices

Our expectations of others have profound implications for competitive entry choices. When people

expectations

neglect to think about the competition, they will make systematic mistakes in deciding where to compete. People who neglect to understand the competition will choose to compete in domains where they feel competent, regardless of how many strong COMPETITORS there are. If people incorrectly think they are better than others, they will be too likely to enter new markets and business contests. Camerer and Lovallo (1999) offered this explanation to explain high rates of entrepreneurial failure. The evidence of entrepreneurial failure is grim, with half of new firms failing within four years of their founding (Dunne, Roberts and Samuelson, 1989; Mata and Portugal, 1994). Nevertheless, entrepreneurs remain unaccountably upbeat regarding their own personal chances of success (Cooper, Woo and Dunkelberg, 1988). And indeed, there is evidence that managerial OVERCONFIDENCE contributes to higher rates of founding, more intense competition and higher rates of subsequent exit (Åstebro, Jeffrey and Adomdza, 2007; Koellinger, Minniti and Schade, 2007; Moore, Oesch and Zietsma, 2007).

But it is *not* the case that people always believe that they are better than others or that entrepreneurial entry rates are uniformly high. There are important instances in which, on average, people believe that they are below average (which is possible in skewed distributions) and even in which the majority of people believe themselves to be worse than the median (which is not possible). Although people think they are better than others at easy tasks, they believe they are worse than others at difficult tasks (Windschitl, Kruger and Simms, 2003). As a consequence, easy competitions see excessive rates of entry, and difficult competitions see insufficient rates of entry (Moore and Cain, 2007). Again, these effects can result from a failure to understand others. Undoubtedly, people naturally make the mistake of collecting too little information about competitors (Radzevick and Moore, 2008), thus making intelligence about competitors more valuable. Intuitive judgment also causes people to erroneously compare themselves not to the most relevant group of likely competitors but to the broader population (Klar, 2002).

Prospects for debiasing

Strategic decision-makers can counteract these biases of intuition by thinking more systematically,

gathering more data and filling in a more accurate picture of the competition. However, it will always be the case that individuals and organizations will know more about themselves and their own capabilities than about their competitors. And even rational Bayesians will make the predictable mistake of believing that they are better than others when the task is easier than everyone expects it to be (Moore and Healy, 2008). The best debiasing procedure for reducing this mistake is to obtain the best possible information about potential competitors, what it will take to become successful, and how likely each competitor is to succeed.

As they search for accurate information, individuals and organizations should always be on guard for the most robust form of overconfidence: the excessive confidence that they know the truth. This 'overprecision', as Moore and Healy (2008) have called it, can arise when people act as if their private beliefs and private signals are more accurate than they actually are (Harvey, 1997). Overprecision leads people to cut short their search for disconfirming information (Russo, Medvec and Meloy, 1996), to be too sure that their forecasts are accurate (Makridakis, Hogarth and Gaba, 2009) and to be too willing to trade with others who have different information (Daniel, Hirshleifer and Sabrahmanyam, 1998). When it comes to trading, people will discount the implication of another person's willingness to pay more than they think it is worth or accept less than they are willing to pay. Rational Bayesians would come to consensus about the asset's value and refuse to trade (Aumann, 1976), but people who are too sure of themselves will not sufficiently incorporate others' beliefs with their own. Overprecision and its biasing effects can be moderated somewhat by actively questioning one's beliefs and considering reasons why one might be wrong (Fischhoff, Slovic and Lichtenstein, 1977). However, such self-doubt is probably not characteristic of the most successful entrepreneurs or business leaders, perhaps because it can be at odds with other characteristics that promote success, such as the ability to persuade investors that you know what you are doing or the ability to persuade talented employees to join the company.

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See also

COMPETITIVE STRATEGY; COMPETITORS; DECISION-MAKING; ENTREPRENEURSHIP; OVERCONFIDENCE; STRATEGIC DECISION-MAKING

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