Escalation Of Commitment

Idea In Short

Escalation of Commitment describes the tendency to continue investing in a failing course of action due to prior investment. Rooted in Prospect Theory and the sunk cost fallacy, it affects individuals and organizations across industries.

Escalation of Commitment is a heuristic based on Prospect Theory. Psychologists describe this as the sunk cost fallacy:

> when we invest in something, our emotional attachment to it is such that it becomes harder to abandon it.

Wikipedia defines this heuristic as:

> The phenomenon where people justify increased investment in a decision, based on the cumulative prior investment, despite new evidence suggesting that the decision was probably wrong.

Lottery & Gambling

This heuristic can be explained by understanding the behaviour of those who play lottery. Let's say you watch a series of advertisements on the television. The advertisements show the luxurious lives of the lottery winners. The advertisements leave a strong impression in your mind. After watching, you over-estimate your chances of winning the lottery. Later that day, you feel lucky and buy 6/49 Lotto ticket with a $40 million jackpot prize. Because of the advertisements, you think you have a good chance of winning; besides, all those lottery winners were just regular people like you. Later, you realize that your ticket did not win and you feel disappointed. Many buy lottery tickets because they believe that they will be the ones to will win the lottery.

Abysmal prospects

According to Investopedia, the odds of winning a lottery are abysmal. For example, the odds of winning a Powerball drawing is 1 in 292.2 million. With the lotto example, your odds of winning the 6/49 lottery were 1 in 13,983,816. To put this in perspective, you have a:

- 1:2,320,000 chance of dying through a lightning strike
- 1:3,441,325 chance of dying after coming into contact with a venomous animal or plant
- 1:10 million chance of getting struck by falling airplane parts

Vain hope

Most people agree that the risk of these events actually happening to them is pretty slim. Yet, despite the unfavourable odds, many continue to lose money on lottery tickets. Even when the gamblers lose time after time, and their money slowly dwindles, they drive back to the store to buy another ticket. They hope that they will win this time. If we think logically about the lottery, we would realise that the odds are not in our favour. That is one of the reasons why the sums of money that one could possibly win are so large. These large sums of money drive our logic to the side. We hope to make it big and this prospect gets us addicted. And, we continue spending our savings on lottery tickets, hoping to be the next winner.

Lessons from Mt. Everest

Similarly, Mt. Everest offers managers several valuable examples on this phenomenon with direct application in decision making. Year on year, several climbers throng to Mt. Everest to summit and earn recognition for their climbing prowess. At an altitude of 8848 meters above sea level, oxygen levels are sparse and turns of fortune highly unpredictable; a bad decision could cost the climber's life. In short, the stakes are high 1!

Into Thin Air

Into Thin Air: A Personal Account of the Mt. Everest Disaster is a 1997 bestseller by Jon Krakauer that details the author's experiences during the 1996 Mt. Everest disaster when eight climbers were killed 2 and several others were stranded by a rogue storm.

The world's highest graveyard

Thousands of climbers have attempted to summit Mt. Everest since the 1920s and died in the endeavor. Between 1921 and 2006, around 8,030 climbers and 6,108 Sherpas died on Mt. Everest. There were 212 climbing deaths (a death rate of 1.3%), 192 of which occurred above the base camp. Among climbers who died higher than 8,000 meters above sea level, 56% succumbed on their descent from the summit and 17% died after turning back. Only 15% died on the way up or before leaving the final camp. Yet, Mt. Everest continues to draw hordes of adventure lovers every year despite the death tolls.

Escalating risks

The victims were just short of the summit when poor weather kicked in. In this situation, the escalation of commitment kicks in. A climber has already weathered the odds and made it this far. So, taking a little extra risk to summit has a large payoff. So, the climber continues to risk his/her life and those of fellow comrades and continues to push forward when he / she should turn back and cut the losses. Mt. Everest is a hallmark case that highlights the need to engage in delicate balancing acts. As leaders and managers, we need to balance vision, confidence, trade-offs, and commitment. These are non-trivial tasks, often marked by inadequate data and uncertainty.

Sunk cost fallacy

A crucial aspect of managerial decision making involves managing the dangers of escalation of commitments, when faced with a failing course of action. It is especially hard when one considers the sunk cost. Once you've expended a great amount of resources, wishful thinking sets in. You hope to turnaround the situation by investing extra effort / resources. Though this is a flawed logic, but most managers and leaders fail to recognise this blind spot. It is especially hard when one's skin is in the game. The McKinsey article - Bias busters: Knowing when to kill a project - demonstrates the sunk cost fallacy that plagues many organizations:

> Multiple studies have indicated the degree to which business leaders are loath to kill projects. One such study developed by IESE Business School Professor Luis Huete found that companies and individuals that have had a track record of success have a harder time killing projects, because they carry with them an ingrained belief that they can turn everything into gold, so long as everyone works hard enough.

Why does it happen?

What commitment bias comes down to is that we are constantly trying to convince ourselves and others that we are rational decision-makers. We do so by maintaining consistency in our actions, as well as by defending our decisions to the people around us, as we feel that this will give us more credence. Not only do we attempt to justify our behaviors to ourselves, but we also try to make others see our behaviors as rational. In an attempt to save face, we may defend our behavior to others by trying to convince them that the choice we made was not a bad one after all. We may suggest that, while the immediate outcome was unfavorable, this decision will be beneficial in the long term. This is similar to confirmation bias, a cognitive bias which describes the phenomenon by which we selectively look for information that supports our stance, while ignoring information that discredits it. In the case of commitment bias, we cherry pick for information that makes our decision seem like a good one, while minimizing, or even disregarding completely, evidence that suggests we made the wrong choice. While our shared desire for consistency is what pushes us to justify our behavior to ourselves, it is our need to be considered rational and competent by others that motivates us to defend our behavior publicly. This causes us to remain committed to our initial decision, because we feel that to do otherwise would call our ability to make sound decisions into question.

Managing this heuristic

To effectively counter escalation of commitment is a difficult task. However, some practical advice scholars have offered to managers to combat escalation bias has been to shift escalation decisions to someone other than the initial decision maker so that the new individual is not so attached to the previously made decision 3. Likewise, it is very important for managers to be aware of the potential damage that can occur solely based on the decisions made by the leader in power. This knowledge can be constructively applied to management decisions in all industries; although it may not be a revolutionary new idea, the importance of the considerations for anyone in a management position cannot be understated. Even something so simple can be so valuable as knowledge brought to the forefront of a professional's critical thinking skills.

Summary

The feeling that our future behaviors must align with the things we have said and done in the past severely compromises our ability to make good decisions. This is especially true when our initial decision has led to unfavourable outcomes. Refusing to change one's stance may not only lead to undesirable results, but it can also act as a significant barrier.