

# The Advisory Alliance

**60-Second E-mail™ – July 25, 2006**

## ***It's Not the Pursuit of Happiness; It's the Avoidance of Loss.***

*In this month's 60-Second E-mail™, we examine the human tendency for loss avoidance and why it makes change management and change implementation so difficult.*

It would seem self-evident that we'd rather be better off than be worse off. Common sense would say that's obvious. But as the saying goes, common sense is not always common practice. As noted in last month's 60-Second E-mail™, there are many examples of times when people prefer to be apparently worse off than better off. People stay with harmful habits, relationships and careers long after it's evident that it's not in their best interest to do so. What's more curious is that people frequently argue for why they *should continue* to do so. On the surface and to the outsider, this seems non-sensical. Why would anyone continue with something when it's blatantly obvious that it's not in their best interest? At the heart of the issue: Why don't people change when it's in their best interest?

Behind the question and the incredulity is a basic assumption: that people naturally want what's inherently good for them, that people will naturally do something if it benefits them. Simply put: more of a good thing is always desired. And yet common experience tells us that this is not always so.

Why?

Because just as powerful, if not more powerful, than the human desire for pleasure, is the human desire, or need, to avoid loss. The following scenario is based on one presented by Nobel Prize winner Daniel Kahneman in his 2002 acceptance lecture. (Kahneman, a psychologist, was awarded the Nobel Prize in economics, the first PhD in psychology to receive a Nobel Prize in economics.)

*Two people get their monthly report from their investment broker:  
Person A is told that her wealth went from \$4 Million to \$3 Million.  
Person B is told that her wealth went from \$1 Million to \$1.1 Million.*

*Who of the two individuals has more reason to be satisfied with her financial situation?  
But who is actually happier? And who is sadder?*

Most people observe that although Person A has more reason to be happier than Person B (given that A is wealthier), Person A will actually feel *less* happy than Person B, given A's recent *loss* of wealth.

Kahneman notes what most of us experience on a daily basis. Loss is a very powerful driver of human feeling, decision and ultimately, behavior. Bottom-line, people will do all that they can to avoid a loss. Again, who among us has stayed in a relationship (personal or business) longer than we should because we were certain of the loss we would feel and less certain about any future pleasure or benefit we would receive? Investment brokers can cite countless of examples of very intelligent insightful clients who, notwithstanding their giftedness, hold on to declining investments until they're worthless, forever avoiding taking the loss.

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To highlight this very real human tendency, Kahneman cites the following “thought experiment” in the same Nobel lecture:

*Would you accept the following gamble:*

*There’s a 50% chance you would win \$150 and a 50% chance you would lose \$100.*

According to Kahneman, “There will be few takers of the gamble.... The experimental evidence shows that most people will reject a gamble with even chances to win and lose, unless the possible win is at least *twice the size of the possible loss* [emphasis added].” Most of us *hate* a loss, and if we confront a situation where there’s a chance that we will lose, there must be a *dramatically* higher payoff should we win.

Kahneman also notes that people tend to *overweight* the impact of outcomes that are certain versus those where the outcome is uncertain. When you couple this with the human tendency to avoid loss, it becomes apparent why change involving certain loss (of any kind) is difficult for companies and leaders to implement.

And we will continue to explore Daniel Kahneman and the implications of his work for companies and leaders in the next 60-Second E-mail™.

You can access this and past 60-Second E-mails™, as well as subscribe to our mailing list, via the following link to our web site: <http://www.advisoryalliance.com/newsletter.php>

Until next month,

***David***

David Harper  
Principal Member

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