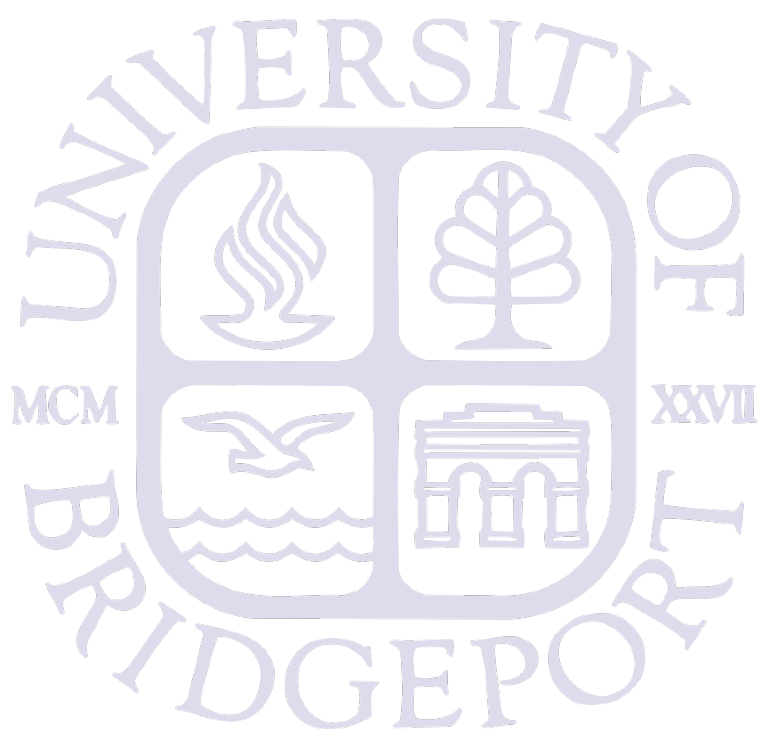


The impact of the framing effect on decision-making

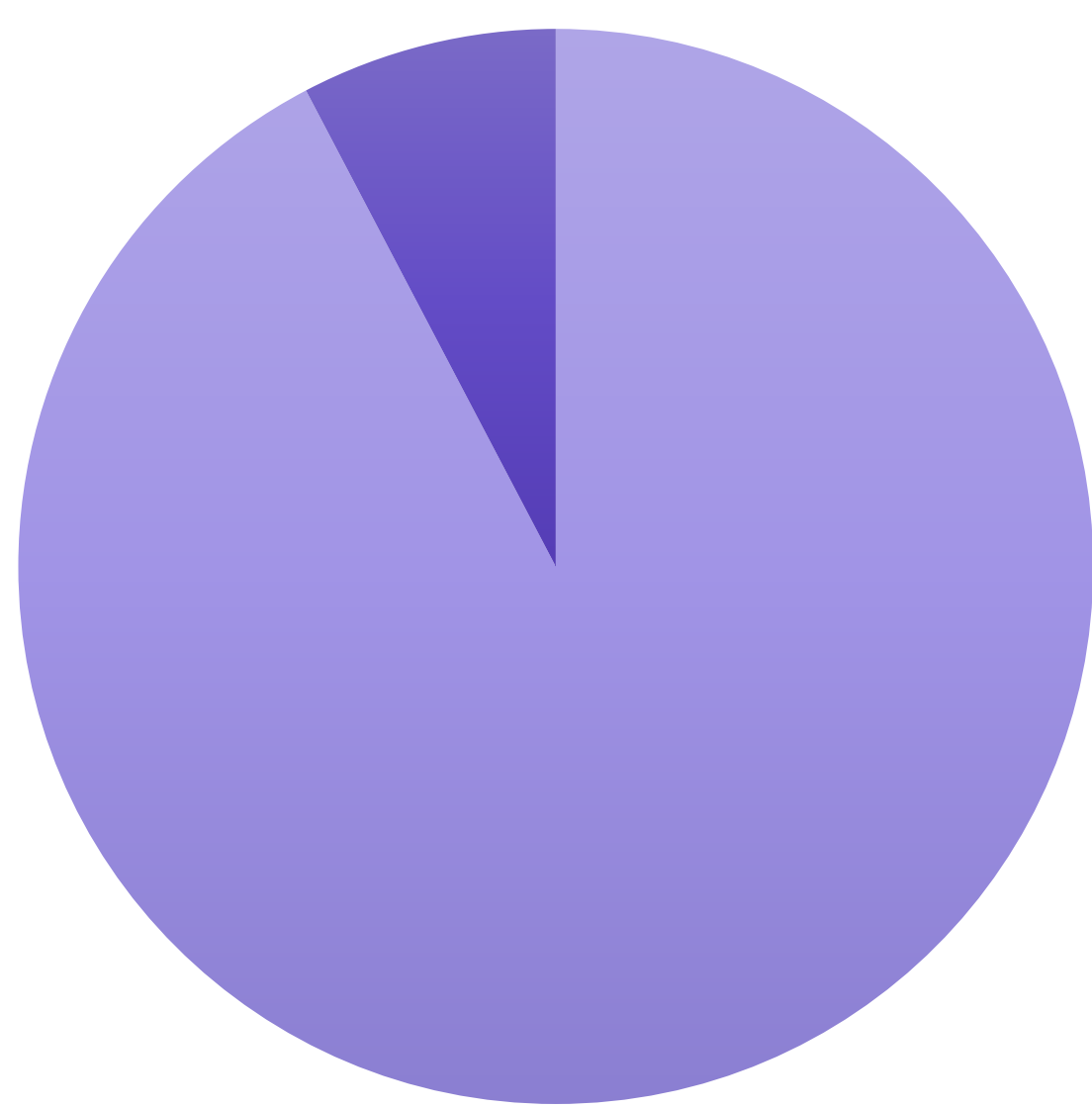


Boutaina Zaghurat , MBA Finance Student

University of Bridgeport – Ernest C Trefz School

Question 1 :

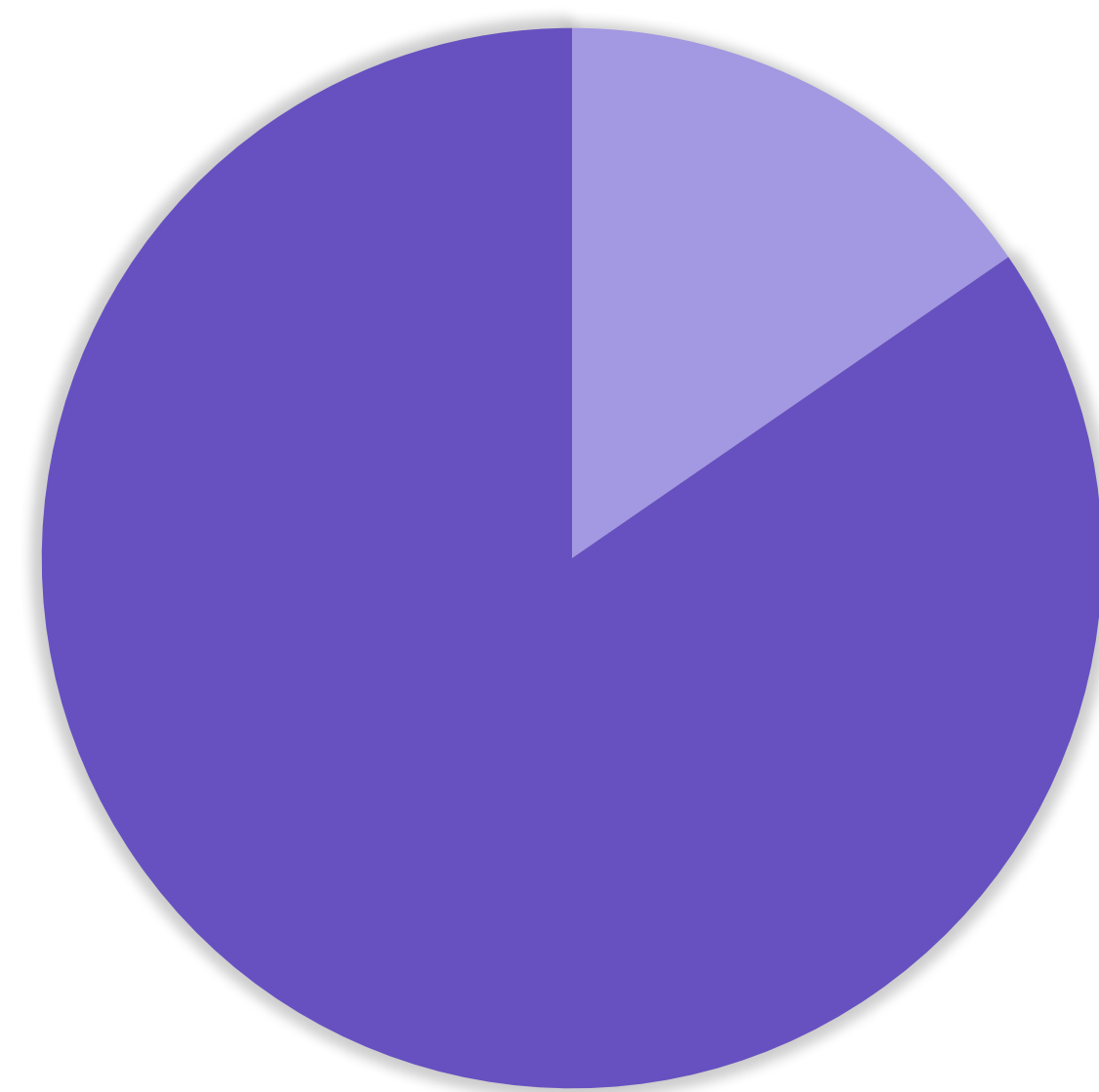
Would you like to invest in the stock of IBM? Historically, such an investment led to a profit 80% of the times



12 Persons out of 13 accepted this deal

Question 2 :

Would you like to invest in the stock of IBM? Historically, such an investment led to a loss 20% of the times



Only 2 Persons out of 13 accepted this deal

■ Yes ■ No

| | |
|--------------------|--------------------|
| Difference | 76.92 % |
| 95% CI | 39.8058 to 89.6584 |
| Chi-squared | 14.879 |
| DF | 1 |
| Significance level | P = 0.0001 |

It is clear that the two questions are identical, but the presentation of the consequences with a positive or negative frame radically changes the choices of the persons and their orientation towards the risk.

Findings

In the first scenario, 92.3% of the respondents answered yes to the question, while in the second scenario, only 15.38% of the respondents answered yes. The difference is about 76.92%. The p-value is significant which confirm the impact of the framing biases on decision making. According to the prospect theory, the options are represented either in terms of gains, or in terms of losses.

Gains and values are valued according to a value function. The subjective value of these frames depends on their projection on the value function. Gains have a positive subjective value, related to the notion of pleasure, while losses have a negative subjective value, related to the notion of suffering.

How to avoid framing biases ?

The first step to avoid this biases is to know that it exists, that way, whenever you are confronted to a similar situation, you will take the time to decipher its real content. The other step is to focus on future prospects of the investment rather than using the loss/gain references