The R3 000 skin care products

I once bought R3,000 worth of skincare products from a lady during a run-of-the-mill trip to a mall in Pretoria. I am not sure whether it was due to her provocative Italian accent, overestimating my age or the free sample that led to my absurd behaviour, yet there I was with my packet of skincare products that I knew for a fact I would never use, and worst of all, at a cost that could've fed a small community. In retrospect, there were at least 3 or 4 cognitive obstacles that my brain simply couldn't circumvent.

I would like to conclude this series by focussing on 3 brain blunders, namely reciprocity, induction and neglect of probability. All 3 are applicable to your daily interactions with people and the awareness of these pitfalls could save you money, spare you sorrow and help you avoid unwanted purchases.

Reciprocity:

It is human nature to detest being indebted to someone, and this trait is often exploited by people (usually salesmen) who understand this human condition. Consider the "free" holiday offered by Holiday Club, or the free sample cheese in the supermarket, or the businessman inviting you to an all-expenses paid golf day, just to phone early on the Monday morning enquiring about the possibility to quote on your business. One more commonly used in the financial planning industry is the advisor offering a no-obligation free overview of your portfolio.

The problem with all these "free" offerings is the alterior motive it originates from. You immediately feel indebted to someone the moment you accept anything with a monetary value (quite often something as simple as their time). It then becomes very difficult to say NO to that person when he expects you to reciprocate his generosity.

How to avoid this: Remember the old saying that there is no such thing as a free lunch. Exercise extra caution when someone offers you his services for "free" or invites you to a costly affair at no cost. Such actions are often followed by an expected reciprocation, often of far greater value than the original benefit you enjoyed.

Induction:

The farmer feeds the turkey on a regular basis. The cautious turkey is reluctant to accept the food at first, questioning the farmer's intent. The turkey's suspicion slowly withers over time, and after a couple of months he is convinced that the farmer is his new best friend and only has good intentions. With their newly formed bond, the turkey wasn't surprised at all when the farmer took him out of his cage on Christmas day, until he realised they were on their way to the chopping block.

This technique of fattening the turkey is well understood and implemented by people running Ponzi Schemes. John is initially very sceptical about the high returns earned by his neighbour. This continues for a few weeks, but eventually John is convinced to wager some of his own money too. After numerous months of prosperous growth, John decides to invest the bulk of his life's savings into this high return venture. Another 2 years of aggressive growth has removed all of John's scepticism, causing him to take out a mortgage on his property to increase his investment. Until Christmas Day dawns!

Feel free to contact the Author, should you have any questions or comments on this month's article in the TwoCents.
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How to avoid this: There has been many articles offering advice on this subject, but in most cases the best advice reverts back to using good old common sense. Basic mathematics should already question the sustainability of exponential growth. Most people make the basic mistake of not even trying to understand the origin and potential sustainability of this growth. To illustrate this, imagine taking a piece of paper and continuously folding it in half). Based on the thickness of a flat piece of paper, how thick would this folded paper be if it is folded in half 50 times (if this was indeed physically possible)? According to Rolf Dobelli in his book The Art of Thinking Clearly, it would be approximately 70 million miles thick! Once you do the maths it becomes clear that either the maths is wrong or it is physically impossible to achieve it.

Neglect of Probability:

We as human beings are not good at differentiating between the magnitude/impact of an event and the probability of its actual occurrence. Consider shark attacks, air disasters or terrorist attacks. The severity and grotesque nature of these events causes our minds to place a much higher **probability** on them than what is realistic, resulting in these factors dominating our decision-making process. How many people, for example, would've changed/cancelled their planned holiday to France after the recent terrorist attacks? This behaviour is prevalent in the financial planning industry when considering how individuals allocate money toward life insurance, disability insurance and retirement planning. Retirement has the highest probability of occurring first, yet people are the least prepared for this. People are willing to spend more money on life insurance and disability while completely disregarding their retirement planning. Ironically, part of retirement planning is ensuring sufficient capital to fund life policies after retirement. This inadequate planning often results in a failed financial plan.

How to avoid this: When evaluating risk, focus on assigning realistic probabilities to the events being considered. If a shark attack has a 0.01% probability and your drive to the movies has a 1% chance of ending in your death, you are better of going for a swim!

Herewith I conclude my series on cognitive errors. This only covers the tip of the iceberg, and if you are interested in further readings, I can recommend the following books:

- The Art of Thinking Clearly by Rolf Dobelli (2013)
- Thinking fast and slow by Daniel Kahneman (2011)
- Predictably Irrational by Dan Ariely (2008)
- Think Twice by Michael J Mauboussin (2009)

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