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Dispute Thinkers

Social Psychology

Kahneman – Why Employers Reject Good Offers

Have you ever watched two companies spend £100,000 arguing over £20,000?

Of course you have! Construction would be eerily quiet if people behaved economically.

The remarkable thing is that everyone usually knows it.

The employer knows the dispute is becoming ridiculous. The contractor knows it. The lawyers certainly know it.

But by then, reason has left the building and somebody is preparing another witness statement. Daniel Kahneman explained why. He won the Nobel Prize for demonstrating something economists had somehow overlooked: Human beings are not nearly as rational as they imagine.

We like to think we are because we have spreadsheets, board papers and use words like "commercial." But none of it makes us nearly as rational as we think because underneath the process, the reports and the presentations, the brain is still running some very old software.

One of Kahneman's most important ideas is loss aversion. It's simple.

Losing £1,000 hurts more than gaining £1,000 feels good.

Losses shout whereas gains cough politely from the back of the room. Now consider a dispute.

A contractor claims £500,000. Then offers to settle for £350,000.

Objectively, the employer has just been offered a £150,000 reduction. That sounds rather good!

But psychologically, that may not be what the employer sees.

The employer is not comparing £350,000 with £500,000. They are comparing £350,000 with paying nothing. And suddenly the settlement does not feel like a saving. It feels like losing £350,000. That changes everything because once something feels like a loss, people will do remarkably expensive things to avoid accepting it. Including spending £100,000 trying not to lose £350,000. Which is an extraordinarily expensive way of avoiding a loss.

Contractors do exactly the same thing. Suppose a contractor believes a claim is worth £500,000.

An offer arrives for £450,000. Everyone else thinks: "That's close." The contractor thinks: "They've taken £50,000 off me." The £450,000 becomes almost invisible. The missing £50,000 becomes the entire dispute. And that is the problem.

People do not judge an offer simply by what it gives them. They judge it against a reference point.

What they expected. What they claimed. What they had already decided belonged to them.

So depending on the reference point, the same offer can look either generous or insulting.

That is why sensible settlement offers are rejected every day.

Not because the arithmetic is difficult but because of some very old programming running in our heads.

So, in many disputes, the most expensive money is not the first £450,000, it's the last £50,000, because that is the money everyone spends the next year proving belongs to them.

Kahneman's point was simple. People do not fight hardest for what they are gaining. They fight hardest for what they think is being taken away. And once a dispute becomes about avoiding a loss rather than making a deal, the mathematics usually loses.

#ConstructionDisputes #Kahneman #LossAversion #Negotiation #DisputeResolution #ConstructionLaw #Claims #CommercialManagement #Adjudication #Arbitration #Psychology #Settlement

Video: https://youtu.be/qBO9ecAbMrk

Sources and additional information:

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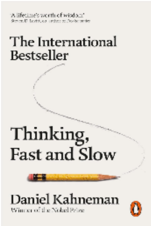
2. Tversky, A., & Kahneman, D. (1992). Advances in prospect theory: Cumulative representation of uncertainty. *Journal of Risk and Uncertainty, 5*(4),

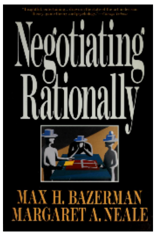
297–323. https://doi.org/10.1007/BF00122574.

3. Kahneman, D. (2011). Thinking, Fast and Slow. London: Allen Lane. Thinking, Fast and Slow. *As Kahneman later observed in* Thinking, Fast and Slow *(2011), people do not simply evaluate the numbers in front of them; they evaluate those numbers through a psychological lens shaped by perceived losses, expectations and reference points.*

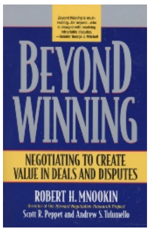


4. Kahneman, D., Knetsch, J. L., & Thaler, R. H. (1990). Experimental Tests of the Endowment Effect and the Coase Theorem. Journal of Political Economy, 98(6), 1325-1348. https://doi.org/10.1086/261737. Related work by Kahneman, Knetsch and Thaler demonstrated the 'endowment effect': once people believe something belongs to them, they consistently value it more highly than outsiders do.

5. Bazerman, M. H., & Neale, M. A. (1992). Negotiating Rationally. New York: Free Press. Negotiation researchers Bazerman and Neale observed that disputants frequently become trapped by prior commitments, investing increasing resources in positions that are becoming progressively harder to justify economically.



6. Mnookin, R. H., Peppet, S. R., & Tulumello, A. S. (2000). Beyond Winning: Negotiating to Create Value in Deals and Disputes. Harvard University Press. https://doi.org/10.2307/j.ctvjf9wbw. Negotiation scholars have long observed that disputes are rarely driven solely by money. Perceptions of fairness, respect, vindication and legitimacy frequently become as important as the underlying financial claim.



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