Simplification: A Catalyst for Employee Engagement and Operational Excellence

David Eskew, MBA Candidate, Lauren Moser, MBA/MDiv Candidate, Josh Arnold, JD/MBA Candidate, Troy Baker, MBA Candidate, and Russell Webb, MBA Candidate

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Charles Fifield, MBA

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C. Nathan DeWall, PhD, David S. Chester, PhD Candidate, and Dylan S. White, BA

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INSIDER: Thinking, Fast and Slow in Real Estate Sales

Mark McMullen, JD/MBA Candidate

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Luke Smith, MBA Candidate
INSIDER: *Thinking, Fast and Slow* in Real Estate Sales

*Mark McMullen, JD/MBA Candidate*

Our decision-making processes utilize two systems in our minds that function very differently, yet work together to help us analyze situations and draw conclusions. Dr. Daniel Kahneman’s *Thinking, Fast and Slow* explores the interaction between the automatic system, which Dr. Kahneman calls System 1, and the conscious system, System 2. Additionally, Dr. Kahneman includes excellent insights into how the automatic system interacts with and influences our conscious reasoning. His research into how the mind works can help anyone, including real estate professionals, to understand the client’s decision-making processes and the difficulty of consciously controlling our intuitive and automatic perceptions.

The automatic system is more influential than we may realize; our initial perceptions operate automatically without effort or voluntary control. Our conscious reasoning subconsciously incorporates the automatic perceptions into monitoring and controlling our thoughts and actions. Conscious reasoning may seem like it controls the decision-making process but every decision we make is first shaped by our automatic perceptions. This means that every buying or selling decision that real estate clients make is influenced by their automatic and subconscious perceptions of the property, the transaction process, and even their real estate agent. Your clients may not be aware of the subconscious influence their automatic perceptions are having on their decisions, but as their real estate agent you need to be.

Our automatic processing can distort perceptions and influence decisions. According to Dr. Kahneman, this occurs because many times *What You See Is All There Is* (WYSIATI). The result: a person’s automatic perceptions come to conclusions based on limited evidence and her intuitive beliefs. However, people tend to become too reliant on their automatic perceptions, which can lead to overconfidence, bias, improper valuation, or unrealistic expectations. Real estate agents should understand that while conscious reasoning may drive the buying and selling decisions of their clients, the clients’ automatic intuitions and perceptions influence conscious reasoning much more than even the client may realize. In order to overcome any negative automatic influences, an effective sales person needs to understand and manage the client’s auto-operative perceptions and create a relationship with the client in order to tailor and meet the client’s expectations. Therefore, the question becomes, how can a person manage other people’s automatic perceptions to help ensure those people make objective and unbiased decisions? In
other words, how can real estate agents manage their clients’ automatic perceptions to ensure their clients have realistic expectations for the home buying or selling process?

*Thinking, Fast and Slow* helps readers understand how automatic perception and processing works and discusses how to supplement the automatic processing with necessary context to objectively perceive and value situations. If real estate agents can understand and thereby manage their clients’ automatic perceptions, they can then ensure their clients are able to make objective and reasoned decisions based on accurate perceptions and realistic expectations. Real estate agents can draw many different lessons from Dr. Kahneman’s research, so we have identified four *Think Points* applicable to real estate sales and the home buying and selling process.

**THINK POINT #1: How Automatic Perceptions Influence Property Pricing and the Importance of Anchoring**

People have different expectations for value and pricing. One person may think X is a reasonable purchasing price for a home, while another person sets her reasonable purchasing price at Y. It is the exact same home, yet X and Y could be very far apart from each other. This happens, at least in part, because people view the value of the house differently in light of their own subjective expectations of what the price should be. As much as people may believe that they can be objective in determining value, their automatic intuitions influence their expectations and evaluations of prices.

One of the strongest influences on a client’s expectation of price is the presence of an initial asking price. How prices are first presented to buyers and sellers influence how those buyers and sellers will perceive the value of the home at that price. If a potential buyer is presented with a higher asking price before that buyer has been able to calculate how much he would be willing to pay for the home, the buyer’s estimate of a reasonable purchasing price will be higher than it would have been had the buyer been shown a lower initial asking price. The initial asking price serves as an anchoring point that the buyer’s automatic processing gravitates toward. The anchoring influence of the asking price impacts how much the buyer would be willing to pay for the home even if the buyer was determined to resist the influence of the asking price. It is a part of the limited evidence that the buyer may have on what to expect for a purchasing price. WYSIATI then tells us that the buyer’s conscious processing will come to a conclusion of what a reasonable purchasing price is by using that limited information as an influencing anchor.

Anchoring doesn’t just influence the client’s valuation, but also how real estate agents estimate home prices. *Thinking, Fast and Slow* presents this through an experiment that was conducted among real estate agents who were given the opportunity to value a real house on the market at the time of the experiment. The agents visited the house and were given a comprehensive booklet...
of information that included an asking price. Half of the agents were shown an asking price that was substantially higher than the listed price. Alternatively, the other half of the agents were shown an asking price that was substantially lower than the listed price. Each agent was then asked to give his or her own estimate on a reasonable buying price for the house and the lowest price at which he or she would sell the house if he or she owned the house.

After giving their estimates, the agents were asked what factors affected their judgments. While the real estate agents claimed that they ignored the asking price in their calculations, the results of the experiment showed otherwise. The amount of the asking price that the agents were shown actually did influence their judgments without them realizing. The asking price had a 41% anchoring effect on the real estate agents’ reasonable buying price calculations. Despite the fact that the real estate agents took pride in their self-perceived ability to ignore the asking price, the agents’ anchoring effect was only 7% lower than the 48% effect the asking price had on a set of business school students with no real estate experience who went through the same experiment. Dr. Kahneman makes note that the only difference between the study of the real estate agents and that of the business students was that the students were able to concede that the asking price did in fact influence their valuations. A real estate agent should realize that even subject matter experts are prone to the subconscious influence of anchoring.

Effective real estate agents are mindful of the anchoring effect that asking prices will have on their clients’ and their own valuations in the real estate sales process. However, real estate agents do not always need to be wary of anchoring and avoid its influence. Real estate agents can also utilize an anchoring strategy to properly calibrate their clients’ expectations for property pricing, but they must always be aware that even the agents’ own best estimates of buying or selling prices for a home are also influenced by the effects of anchoring.

**THINK POINT #2: Managing the Client’s Automatic Perceptions**

The anchoring effect is not the only way that a client’s automatic perceptions can influence that client’s expectations during a real estate transaction. Your clients will have their own subconscious perceptions and biases toward different properties or even the real estate transaction process itself. It is therefore important for real estate agents to understand that their clients will not view a property, offer, or negotiation the same way that they do. This is so because real estate agents come into the relationship detached from the property with rational and more objective expectations and valuations. Real estate agents value properties based on past experiences and market metrics calculated through that detached lens. However, clients will not have the same objective approach because their automatic intuitions will influence their beliefs of and expectations for the property. Clients may struggle to overcome their biases and experiences which can ultimately distort their expectations.
One example of the automatic influence of past experiences is the endowment effect, which occurs when the client’s ownership of the property increases her perceived value of the property. This effect is especially felt when the property was owner-occupied, such as clients who are looking to sell their own homes. A client who is selling the home that she raised her family in will have a distorted perception of the home’s value. It is understandably difficult to objectively value something that has provided the client with many years of non-quantifiable joy or happiness. Real estate agents must be aware of the impact of the endowment effect in order to help clients become more objective in their own valuations. It may be hard for the client to separate the inflated perception of value caused by many years of use, but that is a necessary goal of a real estate agent in order to manage the client’s expectations and perceptions.

At times, real estate agents may find it difficult to manage their clients’ expectations or perceptions, especially during the negotiation process. As the parties negotiate and present offers and counter-offers, the clients on either side will engage in mental accounting of each negotiation and offer. This accounting can create issues if the client keeps score of the negotiations and loses focus of the main objective: selling or purchasing the property under reasonable and acceptable terms for each side. A new proposal from the other side may include terms that the client will score as a loss. Scoring results in a person refusing to accept certain proposals because the person views accepting the proposal as admitting defeat or taking a loss. People respond much more strongly to losses than they do to gains. Therefore, if a person perceives that proposal as a loss then she is less likely to accept the proposal. However, if a proposal or counter-proposal is presented not as a loss, but as a cost of completing the transaction or as a cost of getting a more favorable term in a different area of the transaction, the client will be more receptive to accepting the proposal. It is important for a real estate agent to maintain communication and transparency with the client during the transaction process in order to help the client understand that the negotiation process is one of give-and-take and not necessarily a zero-sum game.

Further, in order for a real estate agent to understand the client’s aversion to a proposal, the real estate agent should ask the client why the client is against the term. Inquiring into the client’s aversion to a proposal serves a dual purpose. Not only will the real estate agent get a better insight into the client’s expectations, but it also forces the client to truly assess her position and feelings about the term. People become less confident in their decisions when they are asked to
produce additional arguments or reasons to support their choices. Therefore, real estate agents can overcome their clients’ biases or misperceptions by asking the clients why the client feels the asking price should be higher than it is or why the client is not willing to accept a term that the other side is attempting to negotiate. As a result, the real estate agent becomes better equipped to provide a solution that is more in line with what the client is looking for when the client explains the reasoning behind her decisions.

The real estate agent acts as a rational decision maker who is only interested in the future consequences of the current transaction. Detached rationality is a difficult concept for homeowners because when they look to value their home; they do not just see the present state of the property or the future benefits of the transaction. The homeowners also include the past experiences they have had in the home in their valuation. Therefore, it is extremely important for a real estate agent to manage the client’s automatic perceptions and intuitions in order bring the client’s expectations back to a realistic and objective level.

**THINK POINT #3: Understanding the Client’s Reference Point**

The best way for a real estate agent to understand and manage a client’s automatic perceptions is to know the client and the reference point at which the client is viewing things. It is not enough for a real estate agent to simply know what a buyer’s budget is or what property features or specifications the client may require, the real estate agent must know the reference point from which the client views her expectations. A real estate agent may think that a property has great value when priced at $400,000, but that means nothing as to how the client will perceive the value of the property at that price. It has long been said that where you come from is a large part of who you are, and the same can be said for how you perceive things. The client’s past environments and experiences will influence the client’s expectations and how the client perceives the real estate search and transaction processes.

Know where the client has been and the client’s past real estate experiences. It is important to know the demographics of the properties and geographic areas from which the client is coming. The client’s past experiences in different real estate markets can create unrealistic or biased expectations that are not in line with realistic expectations of the current real estate market. Additionally, the client’s past experiences serve as a reference point and impact how the client perceives property value. It is obvious that a buyer with a $1 million net worth will view a $400,000 dollar home very differently than a first-time home buyer who is just a few years out of college. Additionally, a buyer with a net worth of $1 million dollars who has just moved from Omaha, Nebraska, to Austin, Texas, will view a $400,000 home very differently than a buyer with a similar net worth of $1 million dollars who has just moved from Manhattan to Austin, Texas. The disparity in valuations occurs because buyers from different geographic markets will have different expectations for property value.
Geographic biases are not the only reference points that impact a client’s perceptions and expectations. The current climate of the real estate market can also be very influential on the client’s expectations. If the client has bought or sold property in the past, those previous experiences will influence the client’s reference point. The market may currently be depressed, but the client may have inflated expectations if the last time the client sold their home was during a real estate boom when the process was quick and easy. It will be important to recalibrate the client’s expectations from that inflated reference point from the client’s past to more current and realistic expectations. Reference points exist, and losses loom longer than any corresponding gain. The impact that looming losses have on people’s reference points is illustrated by the following study that is briefly discussed in Thinking, Fast and Slow.

One study looked at the market for condos in Boston during a time of economic downturn and compared the pricing behaviors of real estate agents and owners of similar units who bought their condos at different prices. For the rational real estate agent, the buying price of the condo is “irrelevant history,” but that was not the case for the condo owners when the housing market was down. The rational real estate agents only focused on current market value and priced the condos according to that number. However, the condo owners valued their condos relative to the price at which they purchased it, their reference point for pricing. Condo owners who had a high reference point set prices that were higher than the market value, because they faced higher losses if they sold at the current market value. The potential losses the condo owners would face if they sold the condo during the down-turn outweighed the corresponding gain they would get from selling the condo. Because of this, the condo owners were willing to leave the condo on the market for a longer time, at the higher price, to avoid the losses they perceived from their high reference point. The study showed that the condo owners did not give in to the market prices and eventually the condo owners did sell their condos for more money than the downturn market price.

Understanding the client’s expectations can help a real estate agent provide the best service and solution for the client’s real estate needs. However, a real estate agent cannot fully understand the client’s expectations without first knowing that client’s reference point. Knowing the client’s reference point and managing the client’s expectations are especially important in the real estate transaction process because when the client’s expectations are not met, the client will view those unmet expectations as a losses. Consequentially, if a real estate agent’s clients feel like the services the agent provided ended in a loss for the client, it is not likely that those clients would use the agent again or recommend the agent to someone else.

**THINK POINT #4: Managing the Client’s Expectations for the Real Estate Agent, and the Real Estate Agent’s Expectations for Herself**
A successful real estate agent is a real estate subject-matter expert. Clients look to their agents for guidance and hopefully trust their agents’ suggestions and insights. This client-expert relationship requires the real estate agent to properly manage their clients’ expectations. Managing the client relationship is so important because hindsight bias is especially harsh on agents and experts. When things turn out poorly, people look for someone to blame. It is easy to blame the expert who guided the client to a less-than-ideal result. Decision makers and experts are often blamed even if the decision was the “right” decision at the time it was made. The world is unpredictable, and therefore it is inevitable that even the best experts will make errors in their predictions. However, if a real estate agent properly manages the client relationship, the client is less likely to blame the real estate agent for a good decision that just didn’t pan out.

Additionally, a real estate agent should realize that her own subjective perceptions influence and distort her “expert” opinions and expectations of properties and transactions. As Thinking, Fast and Slow points out, even a trained professional’s subjective impressions are not as accurate as statistical predictions. Many times, real estate agents and other experts attempt to be clever, think outside of the box, and consider unnecessary complexities in their evaluations. Experts are also dependent upon their own automatic perceptions, as seen by the influence that listing prices had on real estate agents’ valuations in the earlier example. A real estate agent cannot become overconfident in her role as the real estate expert, because overconfidence in subjective valuations or predictions will never be as accurate as market measures or sales comparables. Experts are humans, and are therefore inconsistent at making summary judgments of complex information. However, formulas and statistics are not influenced by any automatic context perceptions. If a real estate agent relies more heavily on personal impressions than market measures, there is a greater chance that she will be wrong and the client will blame her for that error.

This is not to say that an agent’s clients shouldn’t trust her expert advice. Rather, Thinking, Fast and Slow’s explanations should serve as a learning tool for both real estate agents and their clients to be aware that not even an expert is impervious to the distortions that arise from automatic perceptions. People are more prone to trust the intuition and advice of “true experts,” because of the nature of the relationship between the client and that expert. True experts know the limits to their knowledge and expertise because they recognize subjective confidence is many times too high and uninformative. Real estate agents can earn the moniker of “true experts” from their clients by understanding the agents’ own automatic perceptions and building the client relationship through trust and respect. Again, what can be gained from Thinking, Fast and Slow is that clients are more likely to trust real estate agents when the agents build and manage the client-agent relationship and understand the reference points from which their clients’ expectations come.
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About the Author

Mark McMullen, JD/MBA Candidate
Baylor University

Mark McMullen is a graduate student from Milwaukee, WI. He received his BS in Marketing and Legal Studies from Indiana University Kelley School of Business. He is currently pursuing a JD/MBA at Baylor Law School and the Hankamer School of Business. While in school, he has focused on refining his research, writing, and presentation skills by representing Baylor Law School in the ABA NAAC national moot court competition and serving as a Senior Executive Editor on the Baylor Law Review. With his cross-functional education and skillsets, he hopes to transition into business transactional law or commercial litigation.