**The 6 Ways of Influence**

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**On Recognizing and Preventing Financial Trickery**

One of the best books I have ever read concerning human behavior is [Influence: The Psychology of Persuasion](http://amzn.to/2pxvSQl) by Robert Cialdini. In the opening chapter, Cialdini describes a peculiar trait about mother turkeys that has an interesting parallel to how humans behave:

*Turkey mothers are good mothers — loving, watchful, and protective. They spend much of their time tending, warming, cleaning, and huddling the young beneath them. But there is something odd about their method. Virtually all of this mothering is triggered by one thing: the “cheep-cheep” sound of young turkey chicks. Other identifying features of the chicks, such as their smell, touch, or appearance seem to play minor roles in the mothering process. If a chick makes the “cheep-cheep” noise, its mother will care for it; if not, the mother will ignore or sometimes kill it.*

Cialdini goes on to describe how mother turkeys will even care for fake stuffed polecats (natural enemies of the turkey) as long as the fake polecat makes the “cheep-cheep” sound.

You might laugh at how easily we can trick animals based on exploiting their use of simple signals, but as humans we aren’t that different. Yes, our signals for processing information are more complex, but Cialdini illustrates how a handful of simple tricks (6 to be exact) can be used to influence us all. Today, I plan to discuss how those 6 ways of influence show up in the financial world and how you can prevent yourself from falling for such trickery. So let’s begin:

 (Photo: Wikimedia Commons)

**1. Authority**

*Trust me, I’m an expert.*

This phrase has probably done more damage to investors than just about any other in all of market history. Don’t believe me? Consider the examples set by [Long Term Capital Management](http://amzn.to/2pAK223), [Orange County](https://www.nytimes.com/1994/12/08/business/orange-county-s-bankruptcy-the-overview-orange-county-crisis-jolts-bond-market.html), or [Bernie Madoff](https://amzn.to/2GZi5cx) and you might feel differently. In all of these cases, experts (i.e. Nobel Prize winners, experienced financiers, etc.) used their *authority* to convince investors to give them money before eventually losing it all.

Authority bias is so powerful because it can drive people to behave in ways that are at odds with reason. The famous [Milgram experiment](https://en.wikipedia.org/wiki/Milgram_experiment), where individuals were told to shock patients with higher and higher doses of electricity, illustrates this well. The punchline of the experiment was that 65% of individuals ended up delivering the maximum electrical dosage to their “patients” (they were actors) though all of them had concerns about doing so.

If authority bias can make you administer lethal doses of electricity to people, imagine what kind of havoc you could get into when you trust someone else with your money? Don’t get me wrong, expertise is not a bad thing. But if their investment strategy hinges heavily on “Trust me, I am an expert,” run for the hills.

**2. Commitment and Consistency**

*Just say yes.*

Do you want to grow wealthy? Do you want to not worry about money again? If I told you that I had the perfect financial product for you, would you like to hear more?

The sample line of questioning above can be used to get people on what I call the “Yes” train. Once you start answering “Yes” repeatedly, the commitment and consistency bias makes it harder to say “No.” The only problem with this bias is that if a financial trickster gets you to say “Yes” to [products with extraordinarily high fees](http://theirrelevantinvestor.com/2018/03/26/no-nothing/), you can get into trouble.

Lastly, commitment and consistency bias is also present when investors sell their winners while holding onto their losers in what is known as [the disposition effect](https://en.wikipedia.org/wiki/Disposition_effect). Once someone has committed to a particular position, it can be difficult for them to exit that position, especially at a loss. Remember this as you make financial decisions in the future. Are you holding onto a losing asset because of commitment and consistency, or do you have other reasons that make you believe it will recover in value?

**3. Social Proof**

*Everyone else is doing it.*

Whether it be [performance chasing](https://pressroom.vanguard.com/nonindexed/Quantifying_the_impact_of_chasing_fund_performance_July_2014.pdf) or buying into the hottest, newest asset class in the market (crypto anyone?), seeing others follow a particular investment strategy can have a large effect as to whether you will follow suit. While following the crowd can have [its benefits](https://ofdollarsanddata.com/follow-the-money-eb1ae0c9a3bd), there are also [dangers to look out for](https://ofdollarsanddata.com/and-the-crowd-goes-wild-858189b4243).

The biggest problem with social proof in investing is that it contributes to the volatile asset prices that characterize market booms and busts. When investors rush into a particular asset class, prices can move to the point where they are far above their intrinsic value. The crash that eventually follows causes panic selling (more social proof) and can leave many investors empty handed. As a result, you should be wary when your investment decisions rely primarily on social proof as a justification.

**4. Reciprocity**

*An eye for an eye.*

When someone does you a favor, you have this deep feeling like you need to repay them, don’t you? This is reciprocity bias (i.e. [tit for tat](https://en.wikipedia.org/wiki/Tit_for_tat)) and it is probably the most difficult of the 6 ways of influence to completely ignore. Why? It feels so unnatural to *not* help someone that has helped you. Ignoring that feeling of reciprocity would have probably gotten you eliminated from the gene pool historically, so we have a strong urge to uphold it.

However, financial tricksters can use reciprocity bias to get you to buy their products even though they know they won’t be in your best interest. Complimentary financial plans or investment presentations are a few ways in which you can be made to feel like you need to reciprocate. Before you do though, ask yourself: “Is this product/service in my best interest, or am I just paying back a favor?”

**5. Liking**

*You like me. You really, really like me.*

You already know that people would rather do business with people they like than people they don’t like. However, you should realize that there are methods that people use to get you to like them. Many of these methods are sold in self-help books such as Dale Carnegie’s [How to Win Friends and Influence People](https://amzn.to/2Gt3chQ). There is nothing wrong with using these tactics, but it is important to remember that these methods can influence how you make decisions.

Don’t get me wrong, liking bias is probably the least harmful of the 6 ways of influence, but that doesn’t mean you should put your guard down because you like someone. If anything, when you like someone, you are probably prone to overlook flaws in their advice.

**6. Scarcity**

*While supplies last.*

Scarcity can play all sorts of tricks on you as an investor because it can force you to make decisions under time pressure. When making decisions quickly, you are far more likely to rely on the emotional part of your brain (i.e. System 1) than the analytical part (i.e. System 2). This idea comes from Daniel Kahneman’s [Thinking Fast and Slow](https://amzn.to/2Ihk8rO), but perfectly illustrates how scarcity can wreak havoc on your decisions as an investor.

The other thing that makes scarcity so powerful is that it can make you feel special as an investor. Anyone can buy Vanguard’s S&P 500 fund, but who can get access to this elite hedge fund that only charges 1.5% AUM and a 15% performance fee?

While I am not implying that everything that is scarce is bad (i.e. some hedge funds are closed to additional funds for a reason), but if the scarcity is artificial, watch out.