

Thinking, Fast and Slow

Author: Daniel Kahneman

Thinking, Fast and Slow by Daniel Kahneman (winner of the Nobel Prize) gives a detailed explanation of some very simple yet basic concepts with far-reaching results. This book will make you realise that you are not as free in your decision making as you think you are. Working on your subconscious, this book has the power to make a direct impact on your conscious thoughts thereby changing your perspective and altering the way you think.

This book is aimed at helping you easily comprehend critical thinking processes like judgmental errors, decision making, perception, analytical thinking, and irrationality. The crux of this book is our intuition or 6th sense, as it is commonly called. Many times we tend to assume things without giving any proper thought to it or applying any logic or reasoning. Kahneman talks about mental processes using the terms System 1 and 2, which according to him, produce fast and slow thinking simultaneously. At large, the book deals with System 1 and its influences on System 2.

Key Takeaways

1. How does the human mind make decisions?
2. When do we take impulsive decisions and when do we indulge in deep thought before making decisions?
3. Why does advertising work in terms of getting us to buy things or services?
4. Why do we remember only painful memories, and forget the happy ones?
5. How the human thinking process determines effective business models?

The two players inside our mind: Systems 1 & 2

A human mind can be divided into two major parts- System 1 and System 2. Though these terms are used in psychological studies, this book attempts to delve deeper into the subject and present the same as if they are two characters who are interacting with each other.

- System 1 is a quick and intuitive operator and has almost zero control, making its action automatic.
- System 2 concentrates on activities that demand attention, including analysis and calculations. This is also the system which deals with decision making in an individual's life.

System 1 is largely responsible for the subconscious mind, leading to the creation of what is otherwise called as the “gut” or “instinct”. There are instances where it can go wrong, but the fact that it can operate without much effort is a huge advantage. System 2, on the other hand, is responsible for analysis-driven decision making. Unlike going by intuition, System 2 needs a lot of effort to conclude things.

I can answer that in a second! But why?

At a glance, it does seem that System 2 is the core of it all. However, System 1 is where the main action is. While System 1 throws up complex ideas, System 2 ensures the orderly steps leading to it. A simple basic action like completing the sentence “Bread and -----” requires almost no effort on your part. This is something you can answer even in your sleep. On listening to loud music all of a sudden, your first action is invariably to try and find the source of the sound (System 1). Though a little while later,

you consciously ignore the sound and proceed ahead with your work. The ignoring of the loud music is an action executed by System 2. The fill in the blank of “bread and butter” is an automatic task being done by System 1. But something as simple as giving your telephone number to someone cannot be done without System 2, as it requires attention to the task.

Why are some decisions taken from the gut?

Surprisingly enough, System 2 has the capacity to alter the functionalities of System 1. Multitasking is possible only if all, or at least a few, of those tasks are easily doable and do not demand your complete attention at any point in time. Whenever our mind is given a set of instructions to follow, we tend to set System 1 to work on it. Typically called being blind to the obvious, it emphasizes that we don't even realize when we turn a blind eye and to what. System 1 is where the belief of “feeling right” is born, which is not necessarily right. It could be over-confidence or just plain simple ignorance of many other existent factors. We need System 2 to help us take a rational decision.

How do the two systems work with each other?

System 2 is activated whenever System 1 finds itself in a situation which is beyond its call of “automatic” duty- like solving some difficult problems which might involve calculations or damage control. System 2 can also be called the monitor of System 1, responsible for the alertness while driving at night or asking us to be polite when we are angry. System 2 tries to curb the impulsiveness of System 1. Attention & effort go hand in hand, one often overriding the other, leading to relative decision making. In absence of rationality, the human mind tends to rely on intuition and believes it to be the ultimate truth.

Why are we seduced by advertising?

We tend to judge a person socially basis two things- One our own judgment in the initial meeting and two, the views of a person close to us who knows the other person as well. People tend to draw conclusions basis the skills and virtues listed by others rather than factors like luck and other things at work. When listening to a particular incident, we tend to interpret it basis System 1. However, when we retell the same incident to others, it takes our voice and has our thoughts strewn across the incident, rather than a faithful narration of the incident. In case we have played a role in that incident, it is possible we might portray ourselves much different than what we are in real life, and in most of the cases, a far better version of us.

Advertising targets System 1

If we want to impress someone by drawing his or her attention, we need to do so in a way that will directly put their System 1 into action, and make them reach a conclusion long before their System 2 can come into the picture. We normally do these using attractive fonts, rhyming lines and other such ideas to grab their attention, **something popularly known as advertising**. Every time we say no to easy money via betting or gambling, System 1 is at play because it is ingrained in our values that gambling is bad. But we can actually push ourselves to activate System 2 so that it analyses the pluses and the minuses before concluding on what to gamble on. If done in the right fashion, this “calculated risk” can end up reaping huge benefits for us.

Why does losing hurt?

A difficult economics concept like the Prospect Theory can essentially be explained in simple terms as follows:

1. The pain of losing Rs. 10 is larger if you have only Rs. 20 with you, as compared to when you have Rs. 100 with you.
2. The pleasure or pain of a gain or loss is proportionately connected to the amount of wealth one has. If you have Rs one million in your account, a loss of a few thousand is acceptable, while a loss running into lakhs is considered scary.
3. Losing money is considered derogatory, irrespective of the amount both in hand and in losses.

Why making well-informed decisions is important?

Taking decisions in isolation is perhaps one of the gravest mistakes that can be committed. Even in criminal cases, the judges, before sentencing, take a lot of factors under consideration like the circumstances in which the crime was done, the background of the criminal, heat of the moment crime or crime with a purpose etc. Anything observed in isolation often leads to incorrect decision making as there are a lot of factors that have not been considered and hence gives us a one sided perspective, which is flawed. Our mind responds to problems basis the way they are formed. Because System 2 is lazy, it won't give much thought to process the information given before reaching a conclusion.

Do you remember the picnic or the flat tyre?

The duration of an experience plays almost no role in creating an impact on either of the systems. Instead, what is important is the feeling that it invokes-leading to imprints on the systems. If I am out for a picnic and have enjoyed the whole day, but in the end came back with a flat tyre- making me push the car for quite a distance- **I would choose to remember the picnic bitterly rather than smile thinking about the fun I had during the day.** The next time I plan a picnic, I will be more cautious about my planning, especially when it comes to the vehicle that I will use to go to the picnic. This is where System 2 becomes active as it stores such memories and thereby gives birth to a certain set of fears and beliefs.

Why do we doubt happiness?

Human lives are largely defined by experiences and incidents. Surprisingly enough, we tend to remember all the emotions we felt during those incidents or experiences and not just the conclusion. If it had a happy ending, the jubilation would be occupying a very small part of our System 1 but the feelings that those moments evoked would be etched very deeply in System 1. Whenever we tend to think about those moments, our mind invariably goes back to those feelings, and not the conclusion of it- triggering a plethora of emotions in System 1. When we don't pay attention to what we are doing and choose to go with the flow, we end up taking some very wrong decisions, as at that time we allow those emotions to rule our mind, and not System 2- which would have rather analyzed it in depth and in a better fashion.

Should you take quick decisions?

System 1 is not prone to doubt, and it believes without any logic or reasoning. Any ambiguity is suppressed by it unless there is something that comes across as immediately negative to the mind. And that is where System 2 comes into the picture, as it tends to doubt. But there are high chances that people tend to get overconfident believing that their intuition not only works very strongly but correctly too. Anyone depending on such decisions and executing them is taking huge risks. You are highly prone to make miscalculations, leading to incorrect decisions when it involves huge risks. But share brokers, bankers and other such people who have to take such decisions day in and day out get used to switching off that side of their mind and heavily rely on System 1 to make such decisions.

How human psychology helps build business models?

Analyzing the above we can conclude how these studies have directly or indirectly laid the foundation of insurance and banking sectors, paving way for the financial structure of our society today. The core of every framework hence becomes human psychology and heavily involves our beliefs and emotions. Just like the law of diminishing need works on the first morsel of food consumed leading to satisfaction, it also works on materialistic things we gather. This is true for the single yet firm belief that the future is promising, as well. **What looks very dependable for a moment changes into a doubtful thing right after someone is successful in triggering our System 2 and putting it on active mode.**

Being deliberate in our decision making is an important human ability. Knowing that the System 2 is behind this thinking process further makes us aware of System 2. However, imagine if every decision requires System 2 to come into play? What if we think every time before we take a breath? The world requires us to use both Systems 1&2.

What we should aim at is applying System 2 to decision making that requires deep analysis. Otherwise we will be in a perennial 'analysis-paralysis' mode.

The idea of the two Systems is highly relevant to investing. When you follow the crowd and invest in the latest fads or start selling your investments when markets start falling, you are being impulsive and emotional. You are letting System 1 take over and influence your investment decisions. However, in order to make the best investment decisions, you need to keep System 2 in charge. This is where investing in mutual funds via the systematic investment plan (SIP) route comes into play. Mutual funds take money from investors, pool it together, and then invest it in different asset classes like equity, debt, and gold over different periods of time ranging from overnight to more than 5 years. More importantly, investing in mutual funds through the SIP route can act as your System 2. When you invest via an SIP, you systematically make a fixed investment in a mutual fund scheme of your choice. Plus, you can choose to invest fortnightly, monthly, or even quarterly. This way, you don't need to be impulsive about your investment decisions and you can continue investing in a disciplined manner.