

## The Psychology of Decision Making: Insights for Business Managers

Sara Khan

MS Scholar of Institute of Business Management (IoBM), Karachi [at-sarakhan@gmail.com](mailto:sarakhan@gmail.com)

### Abstract:

*The psychology of decision making is a critical aspect of effective business management, influencing outcomes ranging from strategic planning to day-to-day operations. This abstract explores key psychological theories and biases that shape decision-making processes within organizational contexts. By understanding the interplay between cognitive processes, emotions, and social dynamics, business managers can enhance their decision-making abilities and optimize organizational performance. This article synthesizes existing research and provides actionable insights for integrating psychological principles into managerial practices, ultimately empowering managers to make more informed and effective decisions.*

**Keywords:** *Decision making, Psychology, Business management, Cognitive biases, Rational choice theory, Heuristics, Behavioral economics.*

### Introduction:

In the dynamic landscape of business management, decision making stands as a cornerstone of success. However, decisions are not always made through purely rational processes; they are heavily influenced by psychological factors. Understanding the intricacies of human cognition and behavior can provide business managers with invaluable insights into how decisions are made and how they can be optimized to achieve organizational goals.

### Importance of decision making in business management:

Decision making stands as the lifeblood of effective business management, serving as the cornerstone upon which every organizational endeavor is built. At its core, the importance of decision making in business management lies in its ability to shape the trajectory of a company's success or failure. Whether it's a strategic choice that defines the company's direction or a tactical decision that influences day-to-day operations, every decision holds significant weight and consequences. Business managers are tasked with navigating a complex landscape of choices, often under conditions of uncertainty and risk, making their ability to make informed and timely decisions paramount to the organization's prosperity.

The significance of decision making in business management is underscored by its pervasive impact across all levels of the organization. From the executive boardroom to the frontline staff, decisions permeate every aspect of organizational functioning. Effective decision making ensures alignment with organizational goals, facilitates resource allocation, and drives performance improvement initiatives. Moreover, decision making serves as a

mechanism for innovation and adaptation, allowing businesses to respond agilely to changing market dynamics and capitalize on emerging opportunities.

The importance of decision making in business management extends beyond mere operational efficiency to encompass strategic advantage and competitive differentiation. In today's fast-paced and increasingly globalized business environment, companies must make strategic decisions that position them for long-term success and sustainability. Whether it involves entering new markets, investing in research and development, or forging strategic partnerships, strategic decision making is pivotal in shaping the company's competitive landscape and securing its future relevance.

Effective decision making in business management is not solely about making the "right" choices but also about managing the inherent risks and uncertainties associated with decision making. Business managers must navigate a complex array of variables, ranging from market volatility to technological disruption, all of which pose potential threats to the organization's viability. Therefore, decision making involves not only identifying opportunities but also assessing and mitigating risks, thereby safeguarding the organization against adverse outcomes and ensuring its resilience in the face of challenges.

In essence, the importance of decision making in business management cannot be overstated. It is the linchpin that holds together the fabric of organizational functioning, driving growth, innovation, and competitive advantage. As businesses navigate an increasingly complex and dynamic landscape, the ability of managers to make effective decisions will continue to be a decisive factor in determining their success or failure. Thus, investing in decision-making capabilities and fostering a culture that values informed and decisive action is essential for businesses striving to thrive in today's ever-evolving marketplace.

### **Overview of the role of psychology in decision making:**

Understanding the role of psychology in decision making unveils the intricate processes that shape our choices and actions in various contexts, including business management. At its core, psychology delves into the complexities of human cognition, emotion, and behavior, shedding light on the underlying mechanisms that influence decision making. By examining psychological principles, business leaders gain valuable insights into the drivers behind individual and collective decisions within their organizations.

One fundamental aspect of psychology in decision making is the exploration of cognitive processes and biases. Humans rely on mental shortcuts, known as heuristics, to make decisions efficiently. However, these heuristics can lead to systematic errors, or biases, that deviate from rational decision making. For instance, confirmation bias predisposes individuals to seek out information that confirms their existing beliefs, potentially leading to flawed decisions. Recognizing and mitigating these biases is crucial for business managers striving for optimal decision outcomes.

Emotions play a significant role in decision making, often guiding our choices in ways that may not align with logical reasoning. Emotions can influence perceptions of risk, preferences, and even ethical considerations in decision-making processes. Understanding the interplay between emotions and decisions empowers managers to navigate complex scenarios

effectively, leveraging emotional intelligence to make informed choices that align with organizational objectives.

Risk perception is another area where psychology offers valuable insights into decision making. Humans exhibit varying degrees of risk aversion or risk-seeking behavior, influenced by factors such as past experiences, individual traits, and cultural backgrounds. Business managers must grasp how individuals perceive and evaluate risks to make strategic decisions that balance potential rewards with potential consequences effectively.

The role of psychology in decision making underscores the importance of integrating psychological insights into business management practices. By acknowledging the cognitive biases, emotional influences, and risk perceptions that shape decision-making processes, managers can adopt strategies to enhance decision quality and drive organizational success. A comprehensive understanding of psychology equips business leaders with the tools and knowledge needed to navigate uncertainty, foster innovation, and ultimately, make sound decisions that propel their organizations forward.

**Purpose of the article: Providing insights for business managers:**

The purpose of this article is to equip business managers with a deeper understanding of the intricate psychology behind decision-making processes. In today's fast-paced and complex business environment, the ability to make effective decisions is paramount for organizational success. However, decisions are not always made through purely rational processes; they are heavily influenced by various psychological factors. By shedding light on these factors, this article aims to provide business managers with valuable insights that can enhance their decision-making capabilities.

Understanding the psychological theories and biases that underpin decision making is essential for business managers. Rational choice theory, prospect theory, and behavioral economics offer valuable frameworks for comprehending how individuals make decisions in uncertain and dynamic situations. By delving into these theories, managers can gain a deeper insight into the thought processes that drive decision making within their organizations.

This article explores the impact of cognitive biases on decision making. Biases such as confirmation bias, availability heuristic, and anchoring bias can distort judgment and lead to suboptimal decisions. By recognizing these biases, business managers can learn to mitigate their effects and make more informed and objective decisions. Additionally, the article discusses the role of emotions in decision making and strategies for managing emotions to facilitate better decision outcomes.

The article examines risk perception and decision making, highlighting how individuals evaluate and respond to risk. Understanding the psychology of risk can help business managers navigate uncertain situations with greater confidence and agility. Practical decision-making strategies, such as debiasing techniques and scenario planning, are also explored to provide managers with actionable tools for improving decision outcomes.

Ultimately, the goal of this article is to empower business managers with actionable insights derived from psychological principles. By integrating these insights into their decision-making processes, managers can enhance their ability to navigate complexities, anticipate challenges, and seize opportunities in today's dynamic business landscape. Through a deeper

understanding of the psychology of decision making, business managers can steer their organizations towards greater success and resilience.

### **Psychological Theories of Decision Making:**

Understanding the psychological underpinnings of decision making is essential for business managers seeking to navigate complex organizational challenges and capitalize on opportunities. Psychological theories provide valuable insights into the cognitive processes and biases that influence how individuals make decisions in various contexts. One of the foundational theories in this field is Rational Choice Theory, which posits that individuals make decisions by weighing the costs and benefits of available options and selecting the one that maximizes their utility. While this theory provides a framework for understanding decision making, it often oversimplifies the complexity of human behavior and fails to account for the influence of emotions and cognitive biases.

In contrast to Rational Choice Theory, Prospect Theory introduced by Kahneman and Tversky in 1979 offers a more nuanced perspective on decision making. This theory suggests that individuals evaluate potential outcomes based on perceived gains and losses relative to a reference point, rather than in absolute terms. Prospect Theory also highlights the asymmetry in how individuals respond to gains and losses, with losses typically having a greater impact than equivalent gains. This insight has significant implications for business managers, as it underscores the importance of framing choices in a way that minimizes perceived losses and maximizes perceived gains.

Behavioral Economics, another influential area of study, integrates insights from psychology and economics to understand decision making in real-world contexts. Behavioral economists challenge the assumption of rationality inherent in traditional economic models, instead focusing on how individuals' psychological biases and heuristics shape their choices. By studying phenomena such as loss aversion, present bias, and the endowment effect, behavioral economists offer valuable insights into decision-making processes that deviate from traditional economic predictions. Business managers can leverage these insights to design more effective strategies for marketing, pricing, and product design that align with consumers' behavioral tendencies.

However, while psychological theories of decision making provide valuable insights into human behavior, they also highlight the inherent complexity and variability of decision-making processes. Individuals' decisions are often influenced by a myriad of factors, including emotions, social context, and personal experiences, making it challenging to predict and control behavior with precision. Moreover, decision making within organizational settings is further complicated by factors such as power dynamics, groupthink, and organizational culture. Recognizing these complexities, business managers must adopt a multidisciplinary approach that integrates psychological insights with other disciplines such as sociology, anthropology, and management theory to develop comprehensive strategies for decision making and problem-solving.

Psychological theories of decision making offer valuable frameworks for understanding and predicting human behavior in various contexts, including business management. By examining the cognitive processes, biases, and heuristics that underlie decision making, business managers can make more informed choices and design strategies that resonate with

consumers' preferences and behaviors. However, it is crucial to recognize the limitations of these theories and to adopt a holistic approach that considers the multifaceted nature of decision making within organizations. Ultimately, by embracing psychological insights, business managers can enhance their ability to navigate uncertainty, capitalize on opportunities, and achieve sustainable success.

### **Rational Choice Theory:**

Rational choice theory, a cornerstone in economics and social sciences, posits that individuals make decisions by weighing the costs and benefits of available options to maximize their utility or satisfaction. At its core, the theory assumes that individuals are rational actors who possess complete information, have clear preferences, and make consistent choices. Developed from the neoclassical economic framework, rational choice theory has been applied across various disciplines, including sociology, political science, and psychology, to understand human behavior in decision-making contexts.

One key aspect of rational choice theory is its emphasis on individual decision making within constrained environments. It acknowledges that individuals face limitations such as time, resources, and cognitive capacity when making decisions. Despite these constraints, rational choice theory suggests that individuals strive to make the best possible choice given their circumstances. By analyzing the costs and benefits associated with different alternatives, individuals aim to optimize their outcomes and achieve their goals.

Critics of rational choice theory argue that it oversimplifies human behavior by assuming perfect rationality and complete information. In reality, individuals may not always have access to all relevant information or possess the cognitive abilities to process it effectively. Additionally, emotions, social influences, and other psychological factors may play significant roles in decision making, which rational choice theory often overlooks. Despite these criticisms, rational choice theory remains a valuable framework for analyzing decision-making processes and understanding the incentives driving human behavior in various contexts.

Rational choice theory has been applied in diverse fields, including economics, politics, and sociology, to explain a wide range of phenomena. In economics, it serves as the foundation for microeconomic models of consumer and producer behavior, where individuals are assumed to make rational decisions to maximize their utility or profits. In political science, rational choice theory is used to analyze voting behavior, policymaking, and collective action, highlighting how individuals pursue their self-interests within political systems. Similarly, in sociology, rational choice theory is applied to study social interactions, institutions, and organizations, shedding light on how individuals make decisions within social structures.

Despite its limitations, rational choice theory continues to be a valuable tool for understanding decision making and human behavior. Its emphasis on rationality, utility maximization, and individual choice provides a useful framework for analyzing a wide range of phenomena in economics, politics, sociology, and beyond. By recognizing the constraints and incentives that shape decision making, researchers and practitioners can gain valuable insights into human behavior and devise more effective strategies for addressing complex social and economic issues.

## **Cognitive Biases and Decision Making:**

Cognitive biases exert a profound influence on decision-making processes, often leading individuals to deviate from rationality and make suboptimal choices. These biases, rooted in the inherent limitations of human cognition, can affect decision making across various domains, including business management. One prominent cognitive bias is confirmation bias, wherein individuals seek out information that confirms their preexisting beliefs while disregarding contradictory evidence. In business settings, confirmation bias can lead managers to overlook alternative perspectives or data points that challenge their initial assumptions, potentially resulting in flawed decisions and missed opportunities for innovation.

Another prevalent cognitive bias is the availability heuristic, whereby individuals tend to overestimate the importance of information readily available to them. In the context of decision making, this bias can cause managers to place undue emphasis on recent or vividly recalled events, leading to skewed perceptions of risk and reward. For instance, a manager may overreact to a single negative outcome, such as a failed product launch, without considering the broader market context or historical performance metrics. By recognizing and mitigating the influence of the availability heuristic, managers can make more balanced and informed decisions grounded in comprehensive data analysis.

Anchoring bias is yet another cognitive bias that significantly impacts decision making in business contexts. This bias occurs when individuals rely too heavily on initial pieces of information (the "anchor") when making subsequent judgments or estimates. In negotiations, for example, anchoring bias may lead managers to fixate on the initial price offered by a potential supplier or client, thereby limiting their ability to negotiate more favorable terms. Awareness of anchoring bias is crucial for business managers, as it underscores the importance of critically evaluating and adjusting initial assumptions to avoid being unduly influenced by arbitrary reference points.

Cognitive biases are not only prevalent at the individual level but can also manifest within group decision-making processes. Groupthink, a phenomenon characterized by a desire for conformity and consensus within a group, can suppress dissenting viewpoints and hinder critical evaluation of alternatives. In business settings, groupthink can lead to premature consensus and prevent managers from fully exploring the potential risks and benefits of different courses of action. To mitigate the detrimental effects of groupthink, managers must foster an environment that encourages open dialogue, constructive dissent, and independent thinking among team members.

Cognitive biases represent inherent challenges in decision-making processes, requiring vigilant attention and proactive strategies to mitigate their impact. By understanding and addressing biases such as confirmation bias, availability heuristic, anchoring bias, and groupthink, business managers can enhance their decision-making capabilities and optimize organizational outcomes. Cultivating a culture of cognitive awareness and critical thinking is essential for navigating the complexities of the business landscape and making sound decisions grounded in logic, evidence, and objective analysis.

### **Confirmation Bias:**

Confirmation bias, a pervasive cognitive bias, significantly influences decision-making processes by predisposing individuals to seek out information that confirms their existing beliefs or hypotheses while disregarding contradictory evidence. This bias can manifest in various contexts, from personal beliefs to professional judgments, and has profound implications for business managers. In business settings, confirmation bias can lead managers to favor data that supports their preconceived notions, potentially overlooking valuable insights or alternative perspectives that could lead to more informed decisions.

One prominent example of confirmation bias in business management is seen in the evaluation of investment opportunities. Managers may become overly attached to their initial investment thesis, selectively seeking information that validates their decision to invest while downplaying or dismissing contrary evidence. This can result in suboptimal investment decisions and missed opportunities for diversification or risk mitigation. Moreover, confirmation bias can contribute to the persistence of unsuccessful strategies or initiatives, as managers may resist acknowledging failure and instead focus on interpreting outcomes in a way that aligns with their existing beliefs.

The prevalence of confirmation bias underscores the importance of cultivating awareness and critical thinking skills among business managers. By recognizing the tendency to seek out confirming evidence and actively seeking out disconfirming evidence, managers can mitigate the influence of confirmation bias on decision making. Implementing processes such as devil's advocacy or red teaming, where individuals are tasked with challenging prevailing assumptions and arguments, can help counteract the effects of confirmation bias and promote more rigorous decision-making practices within organizations.

Additionally, fostering a culture that values intellectual humility and encourages constructive dissent can serve as a bulwark against confirmation bias. By creating an environment where employees feel comfortable expressing alternative viewpoints and challenging conventional wisdom, organizations can harness the collective intelligence of their teams and reduce the risk of making decisions based on narrow or biased perspectives. Furthermore, incorporating diverse perspectives and interdisciplinary approaches into decision-making processes can help mitigate the effects of confirmation bias by exposing managers to a broader range of viewpoints and insights.

Confirmation bias poses a significant challenge to effective decision making in business management. By understanding the mechanisms underlying confirmation bias and implementing strategies to mitigate its impact, managers can enhance their ability to make more objective and informed decisions. Cultivating a culture of intellectual humility, critical thinking, and open-mindedness can empower organizations to navigate complex challenges and capitalize on opportunities with greater agility and resilience.

### **Availability Heuristic:**

The availability heuristic is a cognitive shortcut that humans use to make judgments and decisions based on the ease with which relevant examples come to mind. In essence, people tend to overestimate the likelihood of events that are easily retrievable from memory, whether due to their recent occurrence, vividness, or personal experience. This heuristic can lead

individuals to make biased assessments, as they rely on information readily available to them rather than considering a broader range of evidence or probabilities.

One classic example of the availability heuristic in action is the perception of risk. If individuals can easily recall instances of plane crashes or shark attacks from media coverage, they may perceive these events as more common or likely to occur than statistically supported. As a result, they may avoid flying or swimming in the ocean, even though the actual risks are minimal compared to other activities. This tendency to prioritize memorable events over statistical probabilities can have significant implications for decision making in various domains, including finance, healthcare, and personal safety.

The availability heuristic can be influenced by factors such as media coverage, personal experiences, and cultural beliefs. Events that receive extensive media attention or are personally impactful are more likely to be readily available in memory and thus have a disproportionate influence on judgments and decisions. Similarly, cultural narratives and stereotypes can shape individuals' perceptions of risk and likelihood, leading to biased judgments based on societal norms rather than objective data.

Despite its potential for bias, the availability heuristic serves as a valuable cognitive tool for processing information efficiently in everyday life. It allows individuals to make quick decisions based on limited information, which can be advantageous in situations where time and resources are limited. However, it is essential for individuals to recognize the limitations of this heuristic and employ critical thinking skills to mitigate its effects, particularly in contexts where accurate decision making is paramount.

The availability heuristic plays a significant role in shaping human judgments and decisions by influencing the accessibility of information in memory. While this cognitive shortcut can facilitate rapid decision making, it also introduces biases that may lead to errors in judgment. By understanding the mechanisms underlying the availability heuristic and actively seeking out additional information and perspectives, individuals can mitigate its effects and make more informed and rational decisions in various aspects of life.

### **Emotional Influences on Decision Making:**

Emotions play a profound role in the decision-making process, often exerting subtle yet significant influences on our choices. This phenomenon holds particularly true in the realm of business management, where decisions can have far-reaching implications for organizations and stakeholders. One key aspect of emotional influences on decision making is the way in which feelings such as fear, excitement, or stress can shape our perceptions and evaluations of potential outcomes. For business managers, recognizing and understanding these emotional influences is essential for making informed and effective decisions.

Emotional intelligence, or the ability to recognize, understand, and manage emotions in oneself and others, is a critical factor in decision-making effectiveness. Managers with high emotional intelligence are better equipped to navigate complex decision-making scenarios, as they can accurately assess their own emotional states and those of others involved in the process. This self-awareness and empathy enable them to make decisions that consider not only rational factors but also the emotional implications for individuals and teams.



However, emotions can also present challenges in decision making, particularly when they lead to biases or irrational behaviors. For example, individuals may be prone to making decisions based on short-term emotional gratification rather than long-term strategic objectives. Similarly, emotions such as anger or frustration can cloud judgment and lead to impulsive or reactive decision making. Recognizing these emotional biases and learning to manage them is essential for business managers striving to make sound and objective decisions for their organizations.

One approach to managing emotional influences on decision making is through mindfulness and emotional regulation techniques. By cultivating mindfulness, individuals can develop greater awareness of their emotional states and learn to regulate them more effectively, reducing the likelihood of making decisions driven purely by emotion. Additionally, creating a supportive and psychologically safe work environment can empower employees to express their emotions constructively and engage in collaborative decision-making processes that consider diverse perspectives.

Emotional influences on decision making are a fundamental aspect of business management that cannot be overlooked. Business managers must recognize the role of emotions in shaping perceptions, judgments, and behaviors, and strive to integrate emotional intelligence into their decision-making processes. By doing so, they can leverage emotions as valuable sources of information while also mitigating the risks of emotional biases and irrational decision making. Ultimately, fostering a balanced approach that integrates both rational analysis and emotional awareness is key to making decisions that drive organizational success and promote employee well-being.

### **Role of emotions in shaping decisions:**

Emotions play a profound role in shaping decisions across various facets of human life, including business management. While traditional models of decision making often prioritize rationality and logic, research has increasingly highlighted the significant influence of emotions on the decision-making process. Emotions serve as powerful signals that guide individuals' perceptions, preferences, and choices, profoundly impacting the outcomes of their decisions.

In business management, emotions influence decision making at multiple levels, from strategic planning to daily operations. Positive emotions such as enthusiasm and optimism can enhance creativity, risk-taking, and innovative thinking, leading to bold decisions that drive organizational growth. Conversely, negative emotions such as fear, anxiety, or anger can cloud judgment, leading to cautious or impulsive decisions that may undermine long-term goals.

The interplay between emotions and decision making is complex, influenced by individual differences, situational factors, and organizational culture. Emotional intelligence, the ability to recognize, understand, and manage one's emotions and those of others, emerges as a critical competency for effective decision making in business contexts. Business managers who possess high emotional intelligence can leverage emotions as valuable information sources, enabling them to make decisions that align with organizational objectives while also considering the needs and concerns of stakeholders.

Emotions not only influence individual decision making but also permeate group dynamics within organizations. Group decision making is inherently influenced by the collective emotions of its members, shaping the group's cohesion, communication patterns, and ultimately, the decisions reached. Effective leaders understand the emotional dynamics of their teams and foster a supportive environment that encourages open dialogue, constructive conflict resolution, and shared decision-making processes.

The role of emotions in shaping decisions within business management cannot be overstated. Recognizing the impact of emotions on decision making is essential for business managers seeking to optimize organizational outcomes and foster a culture of informed and empathetic leadership. By acknowledging and harnessing the power of emotions, business managers can navigate complex challenges with clarity and compassion, ultimately driving sustainable success for their organizations.

**Summary:**

This article highlights the critical intersection between psychology and decision making in the context of business management. By recognizing and understanding the psychological mechanisms at play, business managers can make more informed and effective decisions, ultimately enhancing organizational performance and success.

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