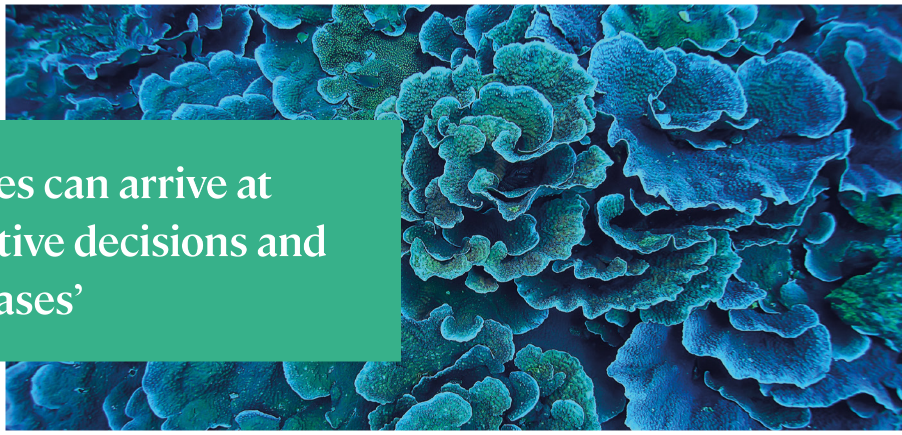
Wealth
Management



# How trustees can arrive at good collective decisions and 'beat the biases'

April 2024

In the fast-paced world of investments, investors utilise a huge landscape of data and analytics to help them make decisions. Data like this is no doubt important, but behavioural biases are deeply ingrained in our decision-making processes. Add to this the dynamics of group rather than individual decision-making, and the outcome is that many additional factors can weigh on the investment decisions made by charity boards. In this article, Laurence Gagen, Head of Charities, looks at how behavioural biases manifest, and suggests some strategies for boards to better navigate these treacherous waters.

## 1. Overconfidence bias: The illusion of invincibility

One of the most pervasive biases evident in investment decision-making is overconfidence. With many years' experience, trustees can start to think that they are 'good' at investing. In practice, markets tend to go up over time, which may lead to trustees overestimating their abilities to generate strong returns. This can lead to trustees focusing too narrowly on the investments of the charity rather than the organisation's charitable objectives.

**Mitigation strategy:** Encourage a trustee culture of humility and self-awareness. Regularly reassess assumptions and plans to ensure that investments continue to align with the over-arching aims of the charity. Above all, ask yourself regularly "what's the money for" and ensure trustees with investment responsibilities are connected to your charitable work. This starts with a great induction for new joiners which balances both the need for charity context and investment training.

## 2. Loss aversion: Fear of failure

Research suggests we feel our losses twice as much as we feel our gains. Avoiding losses becomes more important than seeking opportunity. This is common amongst charities considering investment for the first time and can lead to sub-optimal investment decisions.

**Mitigation strategy:** Establish good governance around investment policies. Document the reasons for investing at a point in time by developing and implementing an investment policy statement. This will help trustees overcome the emotional aspects of investment decision making. Consider workshops facilitated by a professional partner, to ensure all trustees are comfortable with the investment strategy and have the composure to remain calm in more challenging markets.

## 3. Herding behaviour: Following the crowd

Committees can be led by the loudest voice in the room. They may not be the most informed. This can lead to weaker investment decisions which are most acutely felt amidst market fluctuations. Trustees tend to follow the crowd, often risking selling out at the bottom of the market.

**Mitigation strategy:** Foster a culture that values independent thinking and diverse perspectives. Encourage others to challenge consensus before arriving at a final decision. Ring-fence adequate liquidity in advance to meet known expenditures.

## 4. Anchoring bias: The influence of past reference points

Anchoring occurs when one fixates on a past reference point, such as historical prices or metrics. Companies routinely use this bias to make something appeared cheaper than it is. This can lead to fear of changing the way investments have been made in the past, even though circumstances may have changed.

**Mitigation strategy:** Emphasize the importance of dynamic-decision making. Regularly reassess assumptions and challenge the relevance of benchmarks and historical data. Make decisions in the present; "what is the right decision if we were starting-out today".

## 5. Confirmation bias: Seeking affirmation and ignoring dissent

Confirmation bias is the tendency to seek or interpret information in a way that supports our view, and reject information which isn't supportive.

**Mitigation strategy:** Foster an environment which encourages open dialogue and challenge. Establish processes for independent review and challenge, perhaps asking a non-finance committee trustee to sit in on a finance committee meeting. Think through "what-if" scenarios to identify key risks to your strategy.

## Conclusions

Trustees, as stewards of assets (and human beings), must navigate the complexities of their own innate behavioural biases to preserve and enhance the impact of the charity's investments over time. By recognising and addressing biases such as overconfidence, loss aversion, herding behaviour, anchoring, and confirmation bias, trustees can create a culture of informed decision-making.

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