

Prospect theory term paper

[Business](#), [Customers](#)



Introduction

Prospect theory is defined as human thriftiness behavior that explains how the human opt the most risky casuistry alternatives knowing the level of consequences they will have to face afterwards. This theory describes that usually people assess the probabilistic alternatives keeping in mind their possible gains and losses using common sense techniques rather than keeping focus on the final consequences. This model focuses on real-life facts rather than talking about idealistic approach. Professor Daniel Kaheman, in assistance of Amos Tversky, developed this theory in 1979 at Psychology Department of Princeton University as a more realistic and psychologically quite optimum explanation of decisiveness relative to expected utility approach. In actual conceptualization, prospect is taken in the meaning of lottery to anyone.

One of the most significant entailment of prospect theory is the way how subsequences and transactions are categorically framed in their imaginations by economic agents. Mental accounting and behavioral economics also second to this fact of prospect theory. This theory provides optimum solution to a diversified array of circumstances and situations that are highly discrepant to standard economic rationalities like exchange rate puzzles, excess return puzzle and equity premium puzzles using the endowment effect, status quo technique, inter-temporal expenditure, puzzle betting and gambling, imperfect knowledge economics and endogenous prospect theory.

Framework of Prospect Theory

In this so uncertain world, prospect theory gives us the sense of making our preferences the best one, focusing on how a normal person will react in such situation, while taking decision in choosing from a diversified range of options available. Prospect theory can be explained on the basis of following four aspects:

Relative positioning: obviously everyone wants to get the most out of any situation and hence, while making decision, takes interest in knowing the relative pros and cons of the adopted option on its final transaction.

Regardless of any drastic increments in your economy can satisfy you if you don't feel any relative position gain in the decision taken. For example its natural that if you get an annual increment of 20 percent and colleague also get the same annual increment, you will not feel better, but yes if you get even just a 15 percent annual increment and your colleague doesn't get any annul increment then automatically feel yourself rich .

- Certainty: Certainty is another significant factor that people keep in mind while going for any economical decision because they are willing to compromise increments on securing certainty. For example, if you have two job offers, first one will give you 20, 000 per month and guarantees 2 years contract, second one will give you 30, 000 per month but no certainty of job mean you can be fired anytime without giving you any prior reason and warning. Then definitely 80-85 percent people will go for the first one.

- Small probability: low-probability options remain unable to get the interest of mostly people as they involve high risks and there is every chance of losing it all which is not at all termed logical in economics.

- Low aversion: researches makes the fact evident that people give more weightage to possible losses rather than the positive outcomes of the option available, this concept is called loss Aversion. For example, in some business you gain 1000 and lose 700, you don't feel satisfied because you only focus on the loss you had not considering the 30 percent of profit you have gained.

Basic prefaces and assumptions of Prospect theory are given below:

- Some of the risky choices present preemptive effects that go totally unparalleled to utility theory basics.
- Especially, people are more leaned to the transactions that are more liable to certainty rather than going for those which contain probabilities.
- This certainty factor contributes a lot in risk aversion as the options involving sure profits are more liable to be selected comparative to options involving confirm losses.
- People will usually reject and show least interest in the options that are equally shared by all.
- There exists another alternative theory which gives more weightage to profits and losses instead of transactions and consequences. Here decision weights substitute the probabilities.
- If projected on graph, value functions are commonly bursiform for profits and normally convex for fall backs, in fact steeper for fall backs than for profits.
- Corresponding probabilities are generally higher than the decision weights with some exception in low probabilities range.
- Gambling and insurance agencies can easily cash the stoutness of low

probabilities.

Prospect theory model is generally comprised of two phases. In editing phase, basic cognitive conditions and shared realization of decision scenario is made by the decision maker. While in evaluation phase, realization and cognitive condition of problem scenario is made using weighting functions and value functions.

Creativity methods like Rich pictures and synoptic are used in editing phase of prospect theory model. These methods are also used in complex methodologies like Casual mapping, Peter Soft Systems and SODA. Editing phase is quite a vast approach in which almost all diversified range of possible outcomes is taken under consideration. While evaluation is somewhat related to convergence phase as in case of creative problem solving where you have to wind up and compromise to an agreement to be implemented later on. So we can say that creativity is the core factor affecting Prospect theory. Using this theory we can easily examine the subsequent outcomes and fluctuating results of the innovations, modifications and creative methods we had made earlier .

Example of Prospect Theory

Use of drugs and illegal food supplements to enhance the performance during major events has come to some serious considerations in today's sports world. In 1999, World Anti-Doping Agency was developed in order to make an internationally acceptable check and balance system for culminating this menace. A wide range of illegal supplements and doping substances have been banned to which lab tests had come positive but regardless of the international recognition and timely warnings from WADA,

many of the sportsmen still addicted to their regular usage. Complete data of all the athletes around the globe is not easily possible because of three reasons. Firstly, it's not economical feasible to do screening of all the athletes existing despite availability of highly advanced doping-test facility. Secondly, it's entirely an underground act that cannot be visually examined or estimated. Thirdly, doping-test equipment needs not to be accurate all time; it might be unable to detect some advanced drugs and supplements. Analysts and researchers are of the view that illegal drug and food supplement usage for performance enhancement has increased in the recent decade to an alarming situation. For example, according to annual sports journal 1989, The Australian committee reports manifest that approximately more than 75% of athletes have been abducted to illegal drug usage by some means. Similarly another investigation depicts that in 1995 by UK Council of sports reports that 448 Olympic British athlete were interviewed and half of athletes have declared that drug is involved in sports trouble usually in events of field and track. Noticeably, from 1960's, sports like cycling, weightlifting and athletics have created a great hype in drug usage other than all sports.

Originating evidence cleared that drug usage is increased from bluer stage of competition. Vernal athletes in fitness of population take anabolic steroids in specific. Although the prevailing effects of drug usage vary from sport to sport. Concluding all, we can say that doping is circulated and many athletes are take drugs. Two factors can be the reason for banning the performance increasing drugs; one is that using these drugs for increasing the physical function is against the merit of sports. It is argued that competition of

athletes is designed to distinguish the dearest performer by level of natural capacity that reflects the field of playing. So it is not fair when one performer is provided with performance increasing drug and other's do not. The other argument is more important and effective as it directly involved in harming the health of athlete, as the mental health and cardio vesicles are damaged by anabolic steroids. Gigantism of feet, face and hand, PED'S 3hypertension, cardiac illness and human growth hormone of user can participate in Prospect theory; these are few known examples of risks. The future drugs that enhance the performance and the amalgam these drugs, may be more damaging and harmful for physiological and physical health .

Analysis

Apart from classical rational models for choice of making the risky decisions, Prospect theory accounted in many situations. it is observed that the aspirations can assists the effect of recognized usefulness of outcomes, if taken as reference, for one decision can take the theory, PROSPECT THEORY, that predicts the applications of usage of drugs in sports . on the other hand , the athletes , who take the drugs that increased the performance, may can suffer a lot of risks that are not only related to health but also with the spotted and the linked penalties that will ban the sport for lifetime, potentially. If any athlete uses the banned drugs for enhancing the performance for prolonging the careers by guarantying the win, it is cleared by the framework of Prospect theory that the athlete should have the frame of reference point that is goal and aspiration for the sport career. This theory (Prospect theory) has the most significant importance in reducing and curing the addiction of drugs which enhance the performance of the athlete in

sport. This theory is responsible, particular for, delivering the addict the hazards of performance increasing illegal drugs, it is responsible for creating the frame as anti-doping usage of drugs in athlete and also for giving the threats as designed messages or deliverables, to the athletes during the sport activities now and then for delivering the hazards at the different times so the athletes are well aware of them. At the same time the athletes ambitions are also be considered by the athlete during the usage of performance enhancers (illegal drugs).

Other important potential enhancing factors are the cultural, social, economic groupings. Although it is under research that different social culturing groups of literature take, respond and understand the risks or threats, of usage of performance enhancing illegal drugs, in various ways and fashions. Although these manifestations where inherited from minor associates or groups of socio-economic, race and also the entities distinguished on the basis of gender. The paramount risks in the usage of illegal drugs by the athletes are the risks related to finance, these risks belong from the sporting athletes' culture (of wider range of frame), and this has significant implications on it. We are not confirm of the reaction of the public, may the general public condemn the risks of illegal drugs of athlete or may not give an eye on it which we can say in simple words that the public will conceal or heal the doping. It is proposed that such demeanor are viewed or seen as the cultural statistics in sports. From all these perspective it is cleared that the illegal drug usage for enhancing the performance of the athlete in sports according to cultural, social group, as minor part, will definitely serve the point of views of athletes as related with health and also

with the moral risks or hazards. So we can say that the usage is not only damaging for the goal achievement of the athletes as it has after effects of that illegal crime by the athlete, regardless of the type of sports concerned. This is also not healthy and for the health. Every Athlete must take these risks or hazards seriously and be aware of its effects as life is not only the name of money but the name of health and fitness .

Conclusion

Prospect theory comprehensively manifests the decisions made often that seem quite illogical to a normal person but actually have long-lasting results. It's quite obvious fact that if people would always have made practicable and simple decisions, need of insurance would have been vanished then and people with evil minds would be very few in numbers. In other words, if the decision making has only been related to the utilities then the subject of marketing wouldn't have existed ever but it's not so. In real-time decision making there are number of other indirectly influencing factors that can affect your final transactions very badly. You have to go through a lot of other economical and psychological things that aren't visible in black and white. But generally it's been notified that people remain unable to visualize the odd perspectives and hidden facts of the scenario while making any sort of decision. In such circumstances, prospect theory model gives us a sense of how to choose the best option out of the available casuistry alternatives so that it not only can ensure certainty, low aversion, better relative positioning and high probability but also affirms better final transactions and future consequences in the decision made .

Prospect theory model using editing and evaluation phases completely

provides you the in-depth visualization of the situation and likewise allow you to think innovatively and creatively to render some effective and lasting decision making. The threat of unknown is vanished up to some extent by proactive analysis of the fluctuating outcomes and subsequent results. Having said all this we cannot declare prospect theory model to be a universal solution to all decision making problems because regardless of all its time-compliance analysis, real-world issue solving methods and spacious approach to problems, it's still not applicable to decisions involving high uncertainty factor. Many other elements involved in uncertain decision making situations are beyond the scope of Prospect theory. But its quite sure that in future whenever some research regarding uncertain decision making and low aversion situation handling will be done or some hypothesis will be proposed in the field of proactive decision making, prospect theory will prove as a prime leading model to them because it provides us the basic concept and understanding of the decisions to be made and also the possible final transactions that come as consequences.

Recommendations

Prospect Theory is highly recommended to make a good apprehension and understanding regarding effective decision making and time-compliance conclusion in today's so uncertain world. In the light of scholarly hypothesis and recommendation it gives you a complete insight of all the lawful behaviors and acts that should be applied to effective decision making in uncertain and risky situations. Rules and thoughts in it are crafted after long-time research and critical analysis by judges, regulators and scholars in order to respond wisely and keep in mind the desirable behavior according to

the requirement of the situations. This theory will prove quite helpful in discouraging the undesirable response of people in problems involving high uncertainty and risk liability. People usually rely on rational thinking methods and instead of focusing on the core problems and its prevailing after effects, use behavioral law being devised by common layman which not only problems him in the form of future consequences but also deficient final transactions.

Besides its behavioral impact and effectiveness in decision making, it also manifests some empirical prepositions concerning legal authenticity. After going through this paper, the reader will be able to implement its traits like selecting the best one from risk-averse options regarding profit factor and likewise from risk-seeking options regarding losses. Another great thing about prospect theory is its universal applicability which means that you can take assistance from its time-compliance methods and effective decision making techniques in any situation that you may come across in your daily official or casual life. Keeping in mind the individual decision taking techniques and having an in-depth analysis of external validities of the decision made in uncertain conditions, prospect theory encourages the people to think out of the box and visualize the situation differently from a common man. It allows you to entertain any innovative decisions that come in your mind while analyzing the problem and be creative by focusing on the way people had already thought about certain situation in the past. Editing and evaluation phase provides him with excess of knowledge and broadens up his horizon and hence the decisions made then are less suspected to uncertainty and risk-aversion.

Policy makers and legal scholars can gain a lot by prospect theory model while taking short notices and making immediate decisions in situation prevailing high level of uncertainty and vulnerability to risk-aversion because they have to exemplary and effects of their decision are long-lasting prevailing great final transactions and future consequences. On the other hand, psychiatrists can take this theory as a reference for themselves in evaluating anyone's IQ level and effective decision making powers. Moreover, prospect theory must be made compulsory for intermediate and sophomores because its amateur age and if they will get acquaintance with such time-compliance decision making techniques and effectively handling of cumbersome situations involving high level of risk and uncertainty, it can be very helpful in their future as tomorrow when they will lead other people they should be competent enough to judge the adequate decisions out of available risky casuistry options.

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