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| **FE Standard** | **Behavioral Economics Principle** |
|  | **ACTIVE CHOICE AND ENHANCED ACTIVE CHOICE**  THE IDEA IN BRIEF:  Highlighting the fact that a decision needs to be made increases the attention paid to the decision-making process. This is especially useful for choices which are typically passive (e.g. Getting a flu shot, renewing a health club plan, donating organs). Enhanced active choice refers to the presentation of options that highlight the cost of making a “no” choice.    ILLUSTRATIVE EXAMPLES:  Rather than waiting for individuals to stop by a clinic to get a flu shot, they could be actively asked whether they intend to get one (active choice). Alternately, the could be presented with two options – a) yes, I will get a flu shot and protect me and my family, or b) no, I am willing to expose me and my family to the risk of disease. The likelihood of getting a flu shot should increase with active choice, and further increase with enhanced active choice.    REFERENCES:  Keller, P. A., Harlam, B., Loewenstein, G., & Volpp, K. G. (2011). Enhanced active choice: A new method to motivate behavior change. Journal of Consumer Psychology, 21(4), 376–383.    **ANCHORING**  THE IDEA IN BRIEF:  Numerical judgments tend to be influenced by prominent numbers that are available in the context. These prominent numbers – called anchors – need not even be relevant to the judgment.    ILLUSTRATIVE EXAMPLES:  Two groups of people were asked to estimate the population of Perth, Australia. Before estimating, one group was asked whether they thought the population was greater or less than 50,000. The second group was asked whether they thought the population was greater or less than 10,000,000. The actual estimates provided by the second group were significantly higher.  Similarly, shoppers who encounter high price items early in their shopping trip are more likely to purchase cheaper items later.    REFERENCES:  Tversky, A., & Kahneman, D. (1974). Judgment under uncertainty: Heuristics and biases. science, 185(4157), 1124–1131.    **AUTOMATIC ENROLLMENT**  THE IDEA IN BRIEF:  Automatically enrolling people in benefit programs or provident funds but giving them the option of withdrawing increases the likelihood that they will continue to participate.    ILLUSTRATIVE EXAMPLES:  Company A requires all employees who want to participate in their benefits program to sign a form and send it to the human resources department. Company B automatically enrolls all employees into an identical benefits program, but allows them to withdraw with no penalties by signing a form and sending it to the human resources department. In the long run, company B has a significantly higher participation rate in its benefits programs.    REFERENCES:  Madrian, B. C., & Shea, D. F. (2001). The power of suggestion: Inertia in 401 (k) participation and savings behavior. The Quarterly Journal of Economics, 116(4), 1149–1187.    **CHANNEL FACTORS**  THE IDEA IN BRIEF:  Features of the physical space and surroundings in a task oriented environment can either facilitate or hinder the achievement of the task. Eliminating features that hinder the task will increase the likelihood of completion.    ILLUSTRATIVE EXAMPLES:  Two groups of low-income consumers heard a (identical) seminar about the importance of opening bank accounts. At the end of the seminar, one group was given the forms needed to open bank accounts, while the second was given forms as well as a map and directions to the bank. Significantly more people from the second group opened bank accounts.    REFERENCES:  Mullainathan, S., & Shafir, E. (2009). Savings policy and decision-making in low-income households. In M. Barr & R. Blank (Eds.), Insufficient funds: Savings, assets, credit, and banking among low-income households. Russell Sage Foundation Press (pp. 121–145).    **COMPROMISE EFFECT**  THE IDEA IN BRIEF:  When people choose between three options that vary along two dimensions, the option in the middle (which is average on both dimensions) tends to get chosen more often. Conversely, the likelihood of choice of an option can be increased by making it the “compromise” option. This effect is particularly strong for options where it is difficult to evaluate quality.    ILLUSTRATIVE EXAMPLES:  1)      A gas station sold 89 and 91 octane petrol. The sales of 91 went up after they now introduced a 94 octane grade, because 91 now became the “compromise” option.  2)      In most coffee shops offering three sizes of beverages, the medium is the most popular size.    REFERENCES:  Simonson, I. (1989). Choice Based on Reasons: The Case of Attraction and Compromise Effects. Journal of Consumer Research, 16(2), 158–174.    **DECISION POINTS**  THE IDEA IN BRIEF:  People often start consumption episodes with a decision to consume, but then passively continue consumption ‘till they hit a constraint. Inserting an opportunity to pause and think about the consumption in an active manner (a decision point) will increase vigilance and hence, the likelihood that consumption stops. Decision points could take the form of reminders, small transaction costs, or physical partitions.    ILLUSTRATIVE EXAMPLES:  Mr. X is given a large bucket of popcorn. Mr. Y has the same quantity of popcorn in four equal bags. Assuming that they are both conscious of the need to control consumption, Mr. Y will consume less than Mr. X.    REFERENCES:  Soman, D., Xu, J., & Cheema, A. (2010). A theory of decision points. Rotman Magazine, Winter, 64–68.    **DEFAULTS: OPT-IN VS. OPT-OUT**  THE IDEA IN BRIEF:  The default choice in any decision task refers to the outcome that would happen if the individual did not make a choice. If the likelihood that people will choose not to choose is high, making a desired outcome the default will increase the likelihood of it being chosen.    ILLUSTRATIVE EXAMPLES:  1)      In Canada, citizens wishing to donate organs must follow a procedure to get registered. Is France, the assumption is that everybody will donate organs, but citizens wishing to not donate can follow a procedure to get de-registered. Organ donation rates are significantly higher in France than in Canada.  2)      In country A, credit card applicants must sign a consent allowing for their mailing address to be shared on a mailing list. In country B, applicants need to sign to prevent their addresses from being on a mailing list. The average citizen in country A receives a lot less junk mail than in country B.    REFERENCES:  Johnson, E. J., & Goldstein, D. (2003). Do Defaults Save Lives? Science , 302 (5649 ), 1338–1339.    **EARMARKING**  THE IDEA IN BRIEF:  Money that is designated toward a particular cause is more likely to be spent on that cause. Earmarking can be achieved by physically segregating money.    ILLUSTRATIVE EXAMPLES:  Labourers in India were given a savings target rs. 40 per pay period. Some of them were encouraged to earmark rs. 40 by putting it in a separate envelope. These labourers were more likely to save.    REFERENCES:  Soman, D., & Cheema, A. (2011). Earmarking and Partitioning : Increasing Saving by Low-Income Households. Journal of Marketing Research, 48(Special), S14–22.    **FRAMING: GAIN VS. LOSS (LOSS AVERSION)**  THE IDEA IN BRIEF:  Presenting the same outcome as a loss has a greater psychological effect than presenting it as a gain.    ILLUSTRATIVE EXAMPLES:  1)      When a 3% credit surcharge was framed as a cash discount, the price difference between paying by credit cards and cash was seen as more acceptable.  2)      In one neighbourhood, employees of a utility company tried to convince households to purchase energy—efficient appliances cy saying “If you use these appliances, you will save $10 per month.” In a second neighbourhood, this statement was changed to “If you fail to use these appliances, you will lose $10 per month.” The likelihood of purchasing was significantly greater in the second neighbourhood.    REFERENCES:  Kahneman, D., & Tversky, A. (1979). Prospect Theory: An Analysis of Decision under Risk. Econometrica, 47(2), 263–291.    **FRAMING: PENNIES A DAY**  THE IDEA IN BRIEF:  Presenting a large dollar amount as an equivalent number of dollars per day could increase the acceptability of this expense. However, this effect reverses if the per day expense is very large.    ILLUSTRATIVE EXAMPLES:  A charity asked individuals to donate $350 towards a certain cause. Subsequently, they changed their request and framed the money as “less than a dollar a day”. Donations increased significantly.    REFERENCES:  Gourville, J. T. (1998). Pennies-a-day: The effect of temporal reframing on transaction evaluation. Journal of Consumer Research, 24(4), 395–403.    **GOAL VISIBILITY**  THE IDEA IN BRIEF:  When people are in the middle of a goal-oriented task, they work harder towards accomplishing the goal when it is in sight. Consequently, reminding people of their goal or making the goal more salient or visual increases motivation.    ILLUSTRATIVE EXAMPLES:  1)      Competitive swimmers swim faster on laps in which they face the end point of the race, and slower when they are swimming away from the endpoint.  2)      Putting photographs of children on savings envelopes increased the saving rate of parents who were waving for their children’s education.    REFERENCES:  Cheema, A., & Bagchi, R. (2011). The Effect of Goal Visualization on Goal Pursuit : Implications for Individuals and Managers. Journal of Marketing, 75(2), 109–123.    **HEDONIC EDITING**  THE IDEA IN BRIEF:  People either integrate or segregate monetary outcomes in order to maximise their psychological impact. In particular:  •         A single loss is preferred to multiple losses  •         Multiple gains are preferred to a single gain.  •         In situations where there is a large loss and a small gain, the gain should be separated from the loss (the silver lining principle)    ILLUSTRATIVE EXAMPLES:  A tire shop that charged $200 for tire replacement offered a $10 discount. This small benefit was lost in the context of the large price tag. A second tire shop instead mailed their patrons a $10 gift certificate two weeks after getting their tires replaced. By separating this small gain, they made its psychological value much higher.    REFERENCES:  Thaler, R. H. (1999). Mental accounting matters. Journal of Behavioral Decision Making, 12(3), 183–206.    **PAIN OF PAYMENT AND PAYMENT TRANSPARENCY**  THE IDEA IN BRIEF:  In addition to the negativity of paying a certain amount, the manner in which the payment is made can create further negativity. Certain methods of payment that are extremely transparent (e.g. Cash or cheque) feel more painful than others that are not as transparent (e.g. Electronic or direct debit). The pain of payment determines the willingness to spend.    ILLUSTRATIVE EXAMPLES:  1)      When a Laundromat shifted from accepting cash to accepting prepaid cards, the number of people running multiple loads of laundry increased.  2)      When a cafeteria in Hong Kong moved from accepting cash to accepting the Octopus (a prepaid electronic card) the sales of desserts and beverages increased.    REFERENCES:  Soman, D. (2001). Effects of payment mechanism on spending behavior : The role of rehearsal and immediacy of payments. Journal of Consumer Research, 27(4), 460–474.    **PARTITIONING/BRACKETING**  THE IDEA IN BRIEF:  Partitioning multiple objects into separate categories increases the nature of the choice process between those alternatives.    ILLUSTRATIVE EXAMPLES:  A mutual fund company sorted their offering of mutual funds along the country of origin. As a result, their customers diversified by trying to purchase funds from different countries. When the same set of mutual funds was sorted by the industry type, diversification by country decreased, while diversification by industry increased.    REFERENCES:  Fox, C. R., Ratner, R. K., & Lieb, D. S. (2005). How subjective grouping of options influences choice and allocation: diversification bias and the phenomenon of partition dependence. Journal of Experimental Psychology: General, 134(4), 538–551.    **PAYMENT DEPRECIATION**  THE IDEA IN BRIEF:  The pain of payment decreases as time passes from the payment. As a result, the strength of the sunk cost effect (a pressure to consume events that have been prepaid for) decreases with time.    ILLUSTRATIVE EXAMPLES:  The attendance rates at a physical fitness centre gradually decline from the time of making n annual membership payment. On the other hand, patrons that make monthly payments show a more stable attendance rate as a function of time.    REFERENCES:  Gourville, J. T., & Soman, D. (1998). Payment depreciation: The behavioral effects of temporally separating payments from consumption. Journal of Consumer Research, 25(2), 160–174.    **PEER PROGRAMS AND SOCIAL COMPARISONS**  THE IDEA IN BRIEF:  Making a commitment in the presence of peers increases the likelihood that the commitment will be followed by appropriate action. Also, the presence of peers who have high levels of accomplishment increase the motivation to similarly increase accomplishment.    ILLUSTRATIVE EXAMPLES:  1)      Members of a self help group savings program increase their savings rate when their peers routinely met to discuss progress and outcomes.  2)      Households in the UK were sent letters encouraging them to pay taxes on time. When these letters included a statement of peer performance (e.g. “9/10 people in the UK pay their takes on time”) the letters were more effective.    REFERENCES:  Kast, F., Meier, S., and Pomeranz, D. (2012). Under-savers anonymous: Evidence on self-help groups and peer pressure as a savings commitment device, Discussion Paper series, Forschungsinstitut zur Zukunft der Arbeit, No. 6311, http://nbnresolving.de/urn:nbn:de:101:1-201204239864    **PERCEIVED PROGRESS**  THE IDEA IN BRIEF:  People in a goal-oriented task are more motivated to accomplish the task when they receive feedback about the progress they have made. Their motivation is driven not only by actual levels of progress, but also by their perception of progress.    ILLUSTRATIVE EXAMPLES:  1)      People waiting in a long queue were more likely to continue waiting when the queue took the form of a line that moved as some people were being served, rather than a take-a-number-and-wait queue.  2)      Two groups of people were given 400 lines of text to proofread. The first group received 20 pages of 20 lines each; the second group received 40 pages of 10 lines each. Members of the second group found themselves flipping through pages faster, had a greater perception of progress, and were hence more likely to finish the task.    REFERENCES:  Zhou, R., & Soman, D. (2003). Looking back: Exploring the psychology of queuing and the effect of the number of people behind. Journal of Consumer Research, 29(4), 517–530.    **PRECOMMITMENT**  THE IDEA IN BRIEF:  When people view events that are in the future, they are more likely to be rational and wise about their choices. When the same events are in the present, people act impulsively and make foolish choices. Therefore, the best way of nudging people to make wise choices is to ask them to commit to making those choices for the future.    ILLUSTRATIVE EXAMPLES:  Employees in an organization were asked if they would like to increase their savings rate in the future. Most agreed, and committed to setting aside a proportion of their future salary increase into a separate savings account. These people who were asked to save more saved significantly more than people who worked with a traditional financial advisor.    REFERENCES:  Thaler, R. H., & Benartzi, S. (2004). Save More Tomorrow: Using Behavioral Economics to Increase Employee Saving. Journal of Political Economy, 112(1), S164–S187.  **SELF AWARENESS/IDENTITY**  THE IDEA IN BRIEF:  Any intervention that increases one’s identity as a virtuous person increases the likelihood that they will make virtuous choices. However, it is important that the intervention happens before the choices have to be made.    ILLUSTRATIVE EXAMPLES:  People often misreport (cheat) in domains ranging from tax forms to insurance claims. In most of these situations, people have to sign and declare that the contents of the form are true – but the declaration is made at the end of the form, after all the reporting has been done. When the declaration is made prior to the reporting, the extent of misreporting and cheating significantly declines.    REFERENCES:  Shu, L. L., Mazar, N., Gino, F., Ariely, D., & Bazerman, M. H. (2012). Signing at the beginning makes ethics salient and decreases dishonest self-reports in comparison to signing at the end. Proceedings of the National Academy of Sciences, 109(38), 15197–15200.    **SUNK COST EFFECT**  THE IDEA IN BRIEF:  People who have prepaid for a consumption opportunity are driven to consume so that they can satisfactorily close their mental account without a loss. The drive to consume will be greater when the amount prepaid is higher.    ILLUSTRATIVE EXAMPLES:  Jack and Jill both had rink side seats for a basketball game. On the day of the game, there was a heavy snowstorm and the game was being shown on TV. Jill decided to stay home, while Jack braved the treacherous conditions to attend the game. Jill had received her ticket as a gift, while Jack had paid $100 for it.    REFERENCES:  Thaler, R. H. (1999). Mental accounting matters. Journal of Behavioral Decision Making, 12(3), 183–206.    **TEMPTATION BUNDLING**  THE IDEA IN BRIEF:  Creating a mechanism where people can only consume an indulgence while they consume a virtuous product will increase the likelihood that the virtuous product is consumed.    ILLUSTRATIVE EXAMPLES:  Two groups of people were encouraged to exercise more often. One of the groups was allowed to watch their favourite TV show only in the gym room, while the other had no such constraint. People in the first group exercised more because they could bundle their temptation along with the exercise.    REFERENCES:  Milkman, K., Minson, J., & Volpp, K. (2013). Holding the Hunger Games Hostage at the Gym: An Evaluation of Temptation Bundling. The Wharton School Research Paper No. 45. Available at SSRN: http://ssrn.com/abstract=2183859 |

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| The phenomena and principles come from BE101x: Behavioural Economics in Action, a FREE online class archived on edX and YouTube:  Soman, Dilip. (2014, Oct-Dec). BE101x: Behavioural Economics in Action. https://www.edx.org/course/behavioural-economics-action-university-torontox-be101x  https://www.youtube.com/channel/UCJu8CarSKdKx-x0LKNBSv-w |