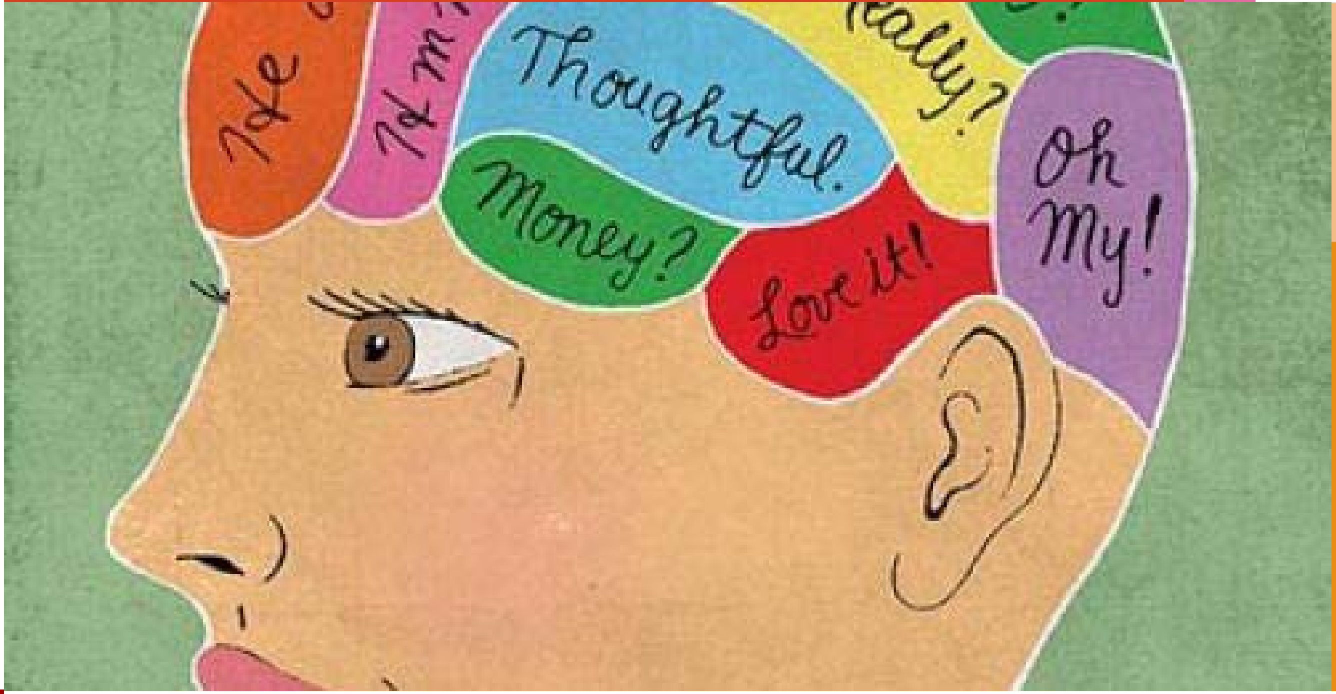
Overview of Behavioral Economics Principles



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Behavioral economics is the application of economics and psychology to explain irrational behavior*

Description

Neoclassical Economics

- People are rational and driven by self-interest
- People make decisions which maximize their own economic utility
- Assumptions break down when humans do not consider decisions in unemotional, strictly rational terms

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Cognitive Psychology

- Decision-making is affected by environmental influences
- Provides explanations as to why people's decisions differ from classical economic predictions

Benefits

- Identifies common "shortcuts" used in consumer decision-making
- Explains external variables affecting consumer decision-making
- Explains market inefficiencies
- Offers insights into product design and marketing

*Behavior not predicted by traditional economic theory (typically attributable to cognitive biases, limitations in knowledge/cognitive ability, or psychological/environmental factors)

Is Behavioural Economics Valuable?

A recent Gallop poll found companies that apply the principles of behavioural economics **outperform their peers by 85% in sales growth**

& outperform their peers by **more than 25% in gross margin.**

*BE can **add value** to your client's business*

- Improving the **customer experience**
- Increasing **product and service sales** (including ancillary items)
- Improving **debt collection** and compliance with payment timelines
- **Avoiding regulatory fines** and/or pressure for "predatory" lending practices or insurance policies
- Improving **employee** productivity, job satisfaction, and retention
- Reducing the likelihood of **fraudulent claims** and/or improving honest behaviour
- Improving **recovery rates** of injured employees or claimants
- **Reducing error rates** among employees, the supply chain, and distribution channels
- De-biasing **executive decision making**
- Optimizing **stakeholder decision making** and behaviour

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PwC's Behavioral Economics Analysis Framework

A	**Decision Shortcuts**	Consumer decisions are far more complex than they appear. Consumers use mental "shortcuts" to guide them to what they feel is the right decision. Understanding these shortcuts can help companies guide consumers to the "right" decision.	Relative Choices / Valuation Reliance on Defaults Attribute Priming Rules of Thumb	Mental Accounting Framing Purchase paralysis The Allais Paradox
B	**Value Assessments**	Value is a relative concept. . Is a television "worth" $300 or $400? Is a warranty "worth" $29.99? In assessing the "value" of a product or service consumers often use seemingly "irrational" metrics and concepts to guide their behavior.	Anchoring Endowment Effect Power of Expectations	Decoy Effect / Subtraction by Addition Hyperbolic Discounting / Medium Maximization Love of Free
C	**Emotional Impacts**	Emotions get the better of people. Emotional impacts can drive someone to or away from what would be considered the "rational" economic decision. Appealing to these emotional impacts can be more powerful than a price reduction in driving demand.	Ambiguity / Risk Aversion Overconfidence Effect Loss Aversion Self-Herding	Self Control Facilitation Hot vs. Cold States Closed Doors
D	**Social Impacts**	People are social. Consumers take into account behaviors of fellow consumers and social norms to guide them to what they believe is the "right" decision.	Social / Financial Domains Perceived Cheating Impact Bandwagon Effect	Sacred Values