Knowledge for Decision Makers

vocatus:

Behavioral Economics

Companies want to influence customers' purchase decisions. This makes it all the more astonishing that they still know so little about the actual course of decision processes – something that "behavioral economics" has been investigating for more than 40 years.

Behavioral economics: a return to “real-life” customers

Companies want to influence customers‘ purchase decisions, since their survival depends on enough customers opting for their own products. This makes it all the more astonishing that they devote so little attention to customers‘ actual decision processes.

Most companies know very little about their customers‘ purchase decisions and the actual processes that are involved. They often don‘t know how long it takes or which criteria matter most at which particular point in time. Starting with the original “trigger” and moving on to the “decision funnel” and actually weighing up the various criteria, seemingly plausible assumptions frequently take the place of empirically based knowledge. Most companies therefore take it for granted that price cuts or discounts will lead to higher turnover. Alternatively, they regularly assume that a product which can boast more product attributes is superior to a product that has fewer attributes if the price is identical. However, the precise opposite is often the case. The reason for this – either conscious or unconscious – is the presumed existence of a rational consumer (homo oeconomicus) who is fully informed about every price and product, and who duly relies on a comparison of potential benefits or utilities to make decisions in a rational and detached fashion. Maybe this is how we‘d like to see ourselves. Nevertheless, the findings derived from behavioral economics have been published in a vast number of studies for more than 40 years now, and have demonstrated that we don‘t make decisions in that way: Our decisions aren‘t particularly rational, we don‘t have all the information at our fingertips, and we allow our emotions to

People‘s decisions are neither rational nor lacking in emotion.

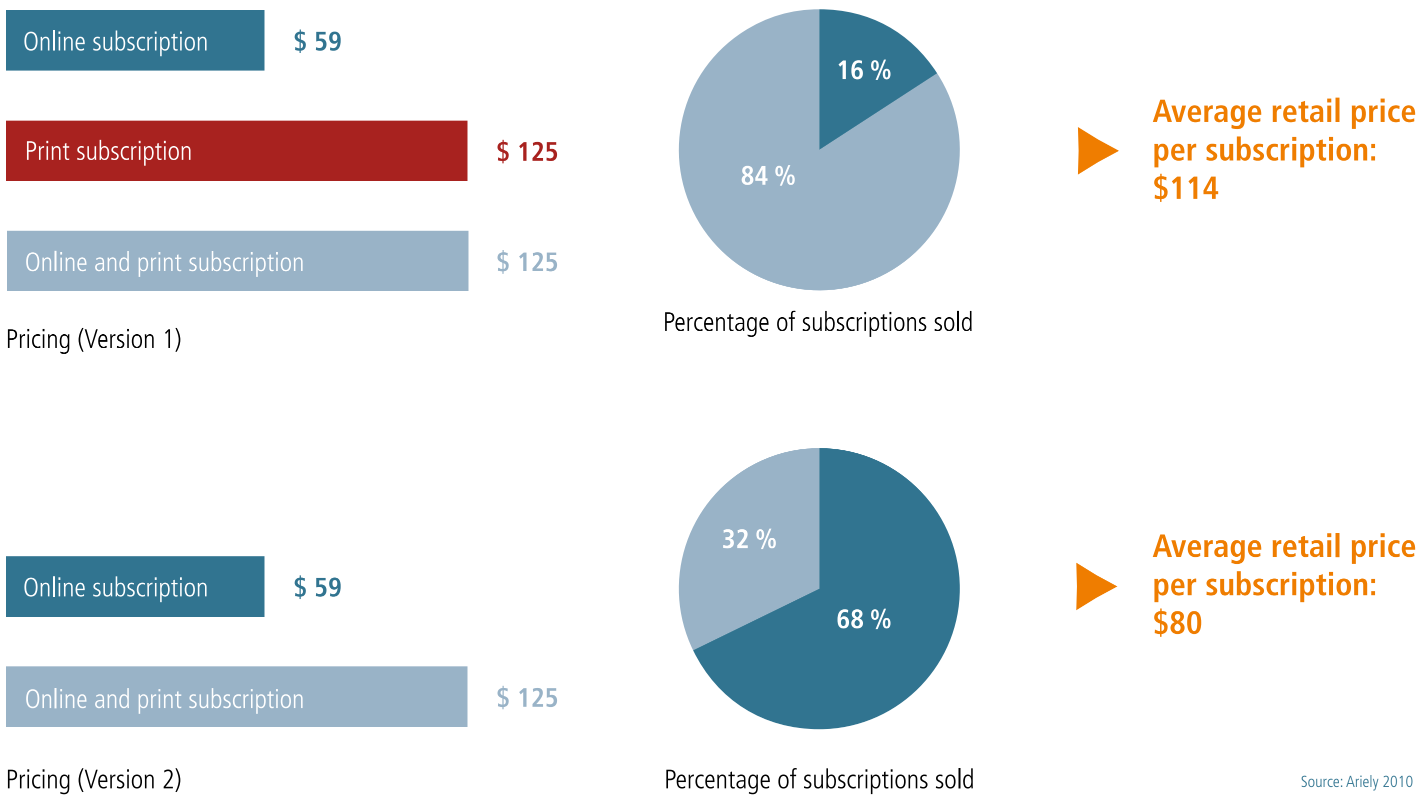
Right: Helle Jetzig, detail from Coney Island Baby 1 influence our decisions. Indeed, people are so likely to act absent-mindedly, impulsively, emotionally, short-sightedly, or indifferently that companies cannot afford to ignore this if they want to be successful. There are three principal and fundamental insights that emerge as a recurrent theme in the world of behavioral economics: Firstly, the context in which the decision is made crucially influ-ences its further course and ultimate outcome (framing). Secondly, people don't possess an absolute "utility function", but instead make their decisions in the light of the alternatives that happen to be available at the time (relativity). Finally, it has been shown that people frequently make decisions based upon a simple, fast and stable rule of thumb (heuristics) – and not because they've conducted a detailed assessment of the benefits associated with all the theoretical options. One frequently cited example of

> In order to influence "irrational" decisions, one has to understand them first.

Figure 1:

If one omits a price option which is supposedly unimportant, this suddenly alters people's purchase behavior.

Subscription prices for *The Economist*



a typical behavioral economics effect is the pricing of the British magazine The Economist (Figure 1). Even though nobody chooses the print subscription on its own (red), the purchase decision is fundamentally altered if this option is omitted.

Yet despite all the possible "errors" we make, our decisions are nonetheless predictable and thus susceptible to investigation, because even suboptimal decisions follow specific rules. Once the customer's decision process has been understood, the outcome can not only be predicted but influenced too. The very fact that people aren't fully informed and don't make optimal decisions offers companies plenty of strategic room for manoeuver. However, there is still a deeply rooted belief in the homo oeconomicus, so this potential is far too frequently overlooked.

Influencing “irrational” decisions

So how can the insights derived from behavioral economics be translated into a meaningful and practice-oriented model for companies? The unfortunate truth is that behavioral economics has a major downside: Until now there has been no holistic model of human decision behavior which can be used to explain and systematically transfer the numerous empirically based effects.

Behavioral economics currently encompasses a fascinating collection of unstructured individual effects, and there are various ways of applying the insights to marketing. One obvious way which is often observed is the attempt to directly apply an empirically based insight to one‘s own product or offer. If one therefore offers an online subscription to a magazine such as The Economist (in addition to the printed version), one should perhaps try – in some form or other – the pricing structure described in Figure 1. However, if one‘s company manufactures forklift trucks it‘ll be much harder to make this kind of direct transfer. Nevertheless, many approaches grind to a halt at this level, and leave the well-disposed listener with nothing but a fascinating effect and the vague feeling that this might conceal an intriguing correlation which one ought to somehow use for one‘s own product too. How this might happen is anyone‘s guess.

One must go beyond this simple form of direct transfer if one really wants to make use of the insights gained from behavioral economics. In order to achieve this, one could try to examine the multitude of findings and extract those that relate to a particular area of application (such as how people deal with the issue of price during the decision process). This would then allow one to extract those theses that appear to be valid regardless of the original research context. However fascinating these theses might sound, most companies are nevertheless faced with the problem that they‘re still very difficult to transfer to one‘s own offering: How would one actually implement the finding that “willingness to pay” is relative – and that it can be influenced by anchor prices – if one was selling forklift trucks? Moreover, it‘s extremely time-consuming (and only an option for diehard experts) to examine hundreds of effects and identify those that are relevant to specific applications.

A toolbox ensures that all the effects are adequately considered.

One should therefore refrain from observing individual effects and the theses that are derived from them. The most sensible way of transferring behavioral economics to one‘s own marketing issues is to firstly examine the multitude of effects that have been investigated and then filter out the influencing factors that are repeatedly responsi-ble for the emergence of suboptimal decisions. This will produce a universal market research model. If one subsequently analyses the influencing factors described by this model in the context of the decision process that one‘s own customers undergo, one will automatically have recorded all the effects that are relevant to one‘s own offering. Using this as a basis, one can systematically optimize one‘s own marketing approach, comprising product, price, promotion, and Point of Sale. This may

sound straightforward, but it is fundamentally different to what has gone before: Classic market research methods record far too few of the relevant dimensions that explain

Behavioral economics has hitherto been an unstructured collection of intriguing effects.

suboptimal decisions because they still presuppose an excessively rational and conscious decision process. By contrast, the development of an alternative market research model is the most comprehensive and systematic form of transfer since – unlike the application of individual effects – it transfers the essence of what behavioral economics has taught us: It demonstrates that we need to consider far more influencing factors than would be the case if we still believed in the homo oeconomicus.

Taking its cue from the procedure described above, Vocatus has developed a market research model which describes all the relevant dimensions in order to optimize the marketing mix in the light of behavioral economics, and each dimen-sion has been backed up with specific survey methods. The toolbox that is thus produced condenses the insights from behavioral economics to create a general approach which will scrutinize purchase decisions and thereby render them useful. This toolbox essentially comprises four modules which – depending on the question – dare relevant in various combinations:
The first is the GRIPS decider typology which was developed in the context of an international empirical study. It describes the systematic differences in terms of how people make their purchase decisions, and thus constitutes the antithesis of the homo oeconomicus (see brochure "Customer segmentation with GRIPS typology").*
The second stage analyzes the image of the provider/supplier, since this influences the actual purchase decision in advance. At a very early point in time – and often unconsciously – the image determines which products or offers will actually be shortlisted or included in the relevant set. This module analyzes the various drivers of value and price image. Thus, for example, one not only looks at the price-performance ratio, but several dimensions such as transparency or fairness (see brochure "Price Image").*
The third module, the so-called "Psychological Decision Profile", examines the actual purchase decision phase. It comprises motivation, cognitions (including the "knowl-edge", "interest", and "assessment" dimensions) as well as behavior. Only a joint analysis of all these facets can produce a meaningful picture: If, for example, someone deems a specific price to be too expensive (= assessment), this is only relevant if it‘s certain that this person will actually take note of the price when they make their decision (= interest) and be aware of it too (= knowledge). By contrast, classic approaches often record nothing but the "assessment" element, while interest is assumed and perfect knowledge taken for granted. This may be altogether appropriate for a rational decider, but it‘s no good for anyone else.

Whereas the first three modules illustrate the actual de-cision, the fourth module ultimately deals with somewhat methodological issues. Despite their inability to validly illustrate the stable decision errors, many classic tools

Individual effects are often hard to transfer to one‘s own company.

also have some major strengths: For example, conjoint analysis is valued as a result of its simulation options. In order to exploit these tools‘ strengths as well as offset their weaknesses, one can make use of correction algorithms which invest these classic/rationalistic methods with great-er validity (see next section).

Behavioral economics isn‘t a niche trend. Instead, it will transform market research as a whole because it requires a more theory-led procedure than has hitherto been customary. These insights must be incorporated in any kind of research that deals with human decision behavior, oth-erwise there‘s a danger that important levers with the potential to increase turnover and improve margins will be overlooked. The toolbox ensures that no element of the decision process is forgotten or unconsciously replaced by a "rational" assumption.

*Download by going to www.vocatus.de/feedbacks

Market research: revolution or evolution?

Behavioral economics doesn‘t revolutionize the methodology, but instead is a conceptional revolution because it questions the human model that underlies most quantitative methods. This means the methods have to be tested and adapted too in order to keep pace with the insights gained from behavioral economics.

The model of the homo oeconomicus underlies most quantitative market research methods, and is irreconcilable with the insights gained from behavioral economics. However, this doesn‘t mean one immediately needs to jettison all the quantitative methods and only conduct qualitative research. After all, virtually every "behavioral economics effect" has been discovered and investigated by using quantitative approaches. Likewise, the core message of behavioral economics is not that decisions are exclusively based on emotions or rules of thumb (often described as "System 1"). Nevertheless, if one is to understand every facet of the decision process it is often necessary to carry out longitudinal studies whereby

The real revolution is taking place at the conceptional level, and not at the methodological level.

Helle Jetzig, detail from The Dream 1

the same person is questioned at different stages of the decision process. One must also ensure that people are only asked about things to which they can provide meaningful responses. Behavioral economics shows us that people are unable to give meaningful answers to many seemingly logical questions, such as "How important is the price to you?)". In the context of market research studies, people also provide answers even if the question doesn't make any sense, and these results can also be used to calculate mean values and correlation coefficients.

If classic methods – such as conjoint analysis – are used, one also has to consider that some people aren't particularly interested in some of the products they buy, so they consequently know very little about the product itself or relevant prices. This means the methods need to be tested to see the extent to which they're applicable in the respective decision situation, and then supplemented if required. This is more a case of evolution rather than revolution, since one should retain the advantages of classic methods, such as the simulation options offered by conjoint analysis.

For example, one problem associated with conjoint analysis is that it presents a variety of options, and this presupposes that customers possess considerable prior knowledge of features and prices. It also sets anchor prices which can subsequently distort the results.

However, if a substantial number of customers in a given market are neither aware of prices nor in the slightest bit interested in the decision, but habitually go for the same shampoo at the shelf, this effect has to be taken account of when evaluating the conjoint analysis (c.f. Feedback article on "GAP: The Repair Kit for Conjoint Analyses").*

This can help one to avoid serious misinterpretations which would arise if conjoint analysis were used in isolation. Without these correction mechanisms, one would overrate

People unfortunately also provide responses to questions that they can't answer at all.

the importance of product features or price elements that nobody is bothered about in real life – with fatal consequences in terms of market share, turnover, and profits. By contrast, Vocatus took account of these behavioral economics findings and helped a newspaper publisher to substantially increase its profits. Yet here too, it is once again apparent that the real revolution is taking place at the conceptional level, namely at the level of a new decision model, and not at the methodological level. Given this backdrop, the methods that are deployed must nevertheless be tested and correspondingly adapted.

Companies will then end up with completely new business models and product ideas which at first glance might seem rather counter-productive, but which in reality are extremely successful (see brochure "Paradoxical Pricing").*

*Download by going to www.vocatus.de/feedbacks

Helle Jetzig, detail from Guys 1

Helle Jetzig

Helle Jetzig, whose work we're presenting in this issue, creates art that possesses its own very individual magic and power of expression. This is due to a specific and unique technique which the artist refers to in a no-nonsense manner as "painting and screen printing on black & white photographs" – multilayered transparent painting on photo collages, which is then covered with many layers of varnish.
The artist usually finds the themes for his images in New York or Europe's major cities. However, he doesn't intend his works to be portraits of cities, or want to make specific visual statements; instead, he's mainly interested in aesthetic qualities, in reflecting upon visual media such as painting and photography, representationalism and abstraction, or questioning how we look at things. Thanks to their rich detail and exuberant colorfulness, his works nevertheless invite one to make an individual interpretation of their content.

Helle Jetzig is represented in Germany by galleries in Munich, Hamburg, Frankfurt, Stuttgart and Berlin.

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His next solo exhibition takes place from 16 October to 16 November 2013 in the Barbara von Stechow Gallery in Frankfurt am Main.

vocatus:

Vocatus is an international consulting and market research company specialising in decision analysis, price optimisation, customer satisfaction, and employee commitment. In all its projects, the company gives priority to solving real-life problems, making concrete recommendations and delivering results that provide a basis for efficient implementation.
Vocatus has been honored several times, receiving international awards for its innovative studies and highly practical conceptual work.
Vocatus is an active member in the German Association of Market and Social Researchers (BVM) and the European Society for Opinion and Marketing Research (ESOMAR).

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Helle Jetzig, detail from Catman Do!