

Behavioral Economics Guide 2021

TIRED OF BEHAVIORAL ECONOMICS?

Article

**HOW TO PREVENT
THE HYPE AROUND
BEHAVIORAL ECONOMICS
FROM TURNING INTO
DISILLUSIONMENT.**

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vocatus:

Tired of Behavioral Economics? How to Prevent the Hype Around Behavioral Economics From Turning Into Disillusionment

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Vocatus

Applying the behavioral economics effects found in academic experiments to marketing is becoming more and more popular. However, there is increasing evidence that copy-and-pasting academic effects does not achieve the desired effects in real life. This article aims to show that this is not because customers are becoming wise to nudges or that behavioral economics does not work at all, but because the application of behavioral economics typically ignores the contextual aspects of the actual decision to be influenced. Herein, we present a framework that considers these aspects and helps develop more effective behavioral interventions in marketing, pricing, and sales.

Situation: Doubts and Disillusionment Replace Initial Enthusiasm

Over the past few decades, behavioral economics has not only revolutionized economic thinking, but it has also significantly changed business management. The focus on the decision-making process of customers and the associated greater attention to touchpoints in the customer journey make behavioral economics a great source of ideas on how to influence decision-making behavior systematically. Ultimately, there is additional potential for increasing conversion and margins behind every effect of predictable irrationality. It seems as if the only thing to do is to transfer individual effects from the academic literature to practice, in order to increase company results significantly.

As great as the enthusiasm was—and still is—for taking up and implementing the findings of behavioral economics in marketing, pricing, and sales, doubts are growing that a simple transfer of academic effects into practice does not always work (Smets, 2018):

- **In B2C:** Obtrusiveness and the extent to which the

effects are used (S-M-L portfolios on every corner; artificial scarcity (“Only 3 rooms left!”) are not only implausible, but they have also become annoying to many customers. Effects that are so crudely implemented in practice cause customers to lose trust in providers (Shaw, 2019).

- **In B2B:** Here is where the transferability of the behavioral economics effects has always been questioned more strongly, based on the assumption that professional decision-makers should act much more rationally than private customers when making complex decisions.

This can give the impression that the findings of behavioral economics are a dying form of hype (B2C) or that they are not even worth trying in the first place (B2B).

This skepticism is well-founded. However, this is not because behavioral economics does not work generally (B2B) or any more (B2C) but because we tend to make it too easy for ourselves when it comes to practical application: We may spot a funny effect in a book or even a scientific article and then try to apply it to our own marketing (Piper, 2020). This can be done swiftly, especially in e-commerce, where traffic is often high, and A/B tests are quickly implemented. Sometimes, this direct transfer

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works and is rewarded with higher conversion rates, sometimes nothing happens at all, and sometimes it backfires and results in fewer sales than before.

Why do the effects work sometimes, but sometimes they do not do so? Is it really because the behavioral economics insights are not—or no longer—valid, as customers have become accustomed to them, or is it because they have never been valid?

As we shall show in this paper, there are two answers to this question: The nature of academic empirical behavioral economics, based on which the widely cited effects were found, and the typical approach of transferring scientific findings into practice. We shall show that the combination of experience background, situation, and heuristics (condensed in a typology of decision-making strategies) helps resolve the issues of transferring academic insights into practice.

Background: The Goal of Empirical Behavioral Economics

Academic behavioral economics is not primarily about helping practitioners find new marketing tricks. Instead, it was—and continues to be—directed towards a very simple goal: It wants to refute the model of rational decision-making that underlies neoclassical economic theory.

Academic research focusses on model falsification and has an entirely different goal to practical application. It is about disproving that people always decide rationally and always maximize their utility. It is about showing that people are not always perfectly informed or always have stable and intransitive preferences. This makes behavioral economics essentially a ‘negative’ endeavor that repeatedly shows us how people are *not* making decisions. Yet, the effects, based on which this is shown, neither embody the actual scientific message nor claim generality through their selective proof. They are only a means to an end. This procedure is entirely legitimate, albeit from a strictly academic point of view.

Experimental results—very many of them—do not show us what things are but at best what they are not. Take Popper’s famous black swan, for example

(Popper, 1963): Even if you see only white swans your entire life, that does not mean you should claim that all swans are white. But if you see a black swan, you can certainly say that not all swans are white. In the best case, this means that what we learn with every empirical observation or experiment is which model of the world is wrong, but never which is right. The purpose of experiments is not to develop a theory but to falsify it. Experimental results can be—at most—inspirations for developing a theory, but they can never replace it.

In this respect, behavioral economics has impressively succeeded in showing that people do not decide rationally. However, what behavioral economics has not yet achieved is to contrast the model of rational decision-making with an alternative model that can explain all the experimental findings with as few assumptions as possible (‘Ockham’s Razor’). Only such a model would allow marketing practitioners to plan interventions, which, provided the theory is valid, we could expect to have an effect in the intended sense (e.g., to influence people’s decisions in a particular direction).

The Conceptual Consequence: ‘Homo Heuristicus’ as a New Paradigm

In the absence of an alternative empirically-based model of human decision-making behavior, popular science and practitioners have quickly settled on ‘Homo Heuristicus’ (alias ‘Homer Simpson’; Gigerenzer & Brighton, 2009) as a counter-model to ‘Homo Economicus’ (alias ‘Mr. Spock’) or ‘Econ’ (Thaler, 2005). This model is bold and intuitive.

However, this model is negative in the sense that it is not only designed to falsify ‘Homo Economicus’, but also that it primarily points out the inadequacies of the human perception and decision-making apparatus (take the terms ‘biases’ or ‘misbehaving’ as an example; see Tversky & Kahneman, 1974, and Thaler, 2005, respectively). While this model is very easy to understand, it also complicates the acceptance of behavioral economics: The fact that customers are biased and can misbehave may make us smirk, but it is hard to convey, especially when we talk about business customers and professional purchasers.

The Practical Consequence: Nudging as an Imperative, and Copy-and-Paste as a Method

Scientific behavioral economics experiments are not—and were never intended to be—a positivist guide to practice. However, in the absence of a practical theory to apply behavioral economics to real-life problems, the nudging hype has elevated precisely this positivism religiously (even though this may not have been the intention of the original authors). Now, the key insight of behavioral economics is no longer seen in the refutation of the rational decision-making model or other basic assumptions of neoclassical economic theories. It is rather seen in the selective result in itself, which is transferred to practice with the expectation that the experimentally elaborated effects found under laboratory conditions will also show up in practice.

The fact that many of the published effects are contradictory to each other (because they suggest conflicting recommendations for practice) makes clear that this is the wrong approach. Take the question of how many options to offer a customer to convince him to buy: Only one option to avoid the ‘paradox of choice’? Two options in order to use one as an ‘anchor’? Three options for the ‘Goldilocks’ effect? Behavioral economics has no answer to this question, as this was not the aim of the research efforts. Each of these effects in itself contradicts one or more basic assumptions of rational choice theory and thus has an epistemic value from an academic point of view—but it has no specific value from a practical point of view. This paradox leads to the following notion: The more effects we find, the more difficult it is to apply them, because the more likely it is that effects contradict each other.

This makes the fascination around nudging a double-edged sword: It is nice to get more ideas for implementation with every new scientific publication (and scientific journals explicitly ask for such suggestions), but we should not forget that this superficial derivation often harbors more risks than opportunities. The most considerable risk of all is that based on a superficial and ultimately unsuccessful transfer, the whole topic of behavioral economics is dismissed either as unhelpful or as hype

that has become no longer useful.

Nudging via copy-and-paste is a lot of fun and suits the zeitgeist of corporate organization, thanks to its agile approach. However, that alone is not a guarantee of success. Successful interventions are based on valid models. This is where Einstein’s famous quote holds true: “Nothing is more practical than a good theory.” With this in mind, we set out in the following sections to find a consistent decision-making model that will enable and facilitate practitioners to apply the findings to practice.

From Academic Behavioral Economics to Practical Behavioral Marketing

From Biases to Heuristics

Let us start with the following question: Why do people actually make predictable mistakes in their decisions? Why don’t we just learn to make the ‘right’ decisions?

Why we decide the way we do inevitably leads us to the bigger question of why we are the way we are. We are the way we are because the mechanisms of evolution have shaped us that way. Our entire constitution has simply proven to be sufficiently well adapted, given the environment in which we live. This is also what is meant by the famous and often misused phrase ‘survival of the fittest’. Put simply, the traits that survive best and are more likely to be inherited are those that are best adapted to prevailing environmental conditions. This is not an active selection or development towards an ‘ideal’ goal but a passive selection. Thus, those characteristics that were a hindrance to survival and inheritance in the past simply ceased to exist.

For example, we do not perceive light, volume, and many other stimuli in absolute terms, such as a physical measuring instrument, but in relative terms: The brighter the light, the more additional light intensity it takes for us to notice a difference. While this is not optimal in the sense of ‘objectivity,’ it is extremely efficient, because it allows us to cope with a much wider range of brightness differences. This is why our ancestors could still perceive the saber-toothed tiger at dusk as well as in bright sunshine and run away in time. In this respect,

such biased brightness perception has evolved into a survival advantage and could be passed on to the next generation, as the tiger did not eat our ancestors. The contrast effect and the relativity effect of behavioral economics can be traced back to this perceptual heuristic.

Just as our bodies are not designed for any kind of optimum, our decision-making apparatus is not made for utility maximization; rather, it functions ‘well enough’ in most, but not perfectly in all, situations (‘satisficing’ instead of ‘optimizing’; Simon, 1956). Decision-making rules that have proven to be ‘good enough’ in certain situations are stored as ‘heuristics’, which can be thought of as conscious or unconscious rules of thumb. They allow us to make decisions even with limited capacity, ability, time, and energy. The core message of behavioral economics is not that people always make irrational and error-prone decisions but that their cognitive

capacities are always limited. Thus, people constantly apply heuristics, to be able to make decisions at all.

The use of heuristics has nothing to do with incompetency (which the terms ‘biases’ and ‘misbehaving’ suggest). It is rather a handy and efficient (and indeed the only possible) way of processing information and making decisions, and it has proven good enough in many situations. However, while the same decision-making rule may lead to a utility-maximizing outcome in one situation, it may lead to a predictable decision error in another. The ‘irrationality’ of a given heuristic, thus, is rooted in the fact that it has proven to be ‘good enough’ in many situations, but in others, on the contrary, it has turned out to be inadequate.

Let us look at the following example of the scoring heuristic as illustrated in Figure 1 (Bauer, 2000). In many cases, it is good enough to rate offers ac-



Figure 1: Preferences for telco plans.

ording to their individual attributes on a binary scale (better/worse) and sum up these individual judgments to form an overall judgment. However, in some situations, it leads to a systematic misjudgment:

Although both offers have equal (absolute) costs

in both choice situations, the zero-sum shift of 270 DKK from device to installment costs for offer 2 in choice 2 means that offer 1 ‘wins’ in two out of three price elements. Consequently, offer 1 is perceived cheaper in choice 2 and preferred in the experiment, even though effective costs are still the same.

From Heuristics to Decision-Making Strategies

To understand (and influence) how people make decisions, i.e., to apply behavioral economics in practice, we need to understand when they use which heuristics (situation and experience background), and how specific heuristics are activated (by the design of choice architecture).

Let us look at the much-cited Decoy Effect (Ariely & Wallsten, 1995).

In choice 1, as illustrated in Figure 2, by an obviously inferior option (print-only), people strongly prefer the bundle option of both e-paper and print.

However, when removing the print-only option (that nobody wanted!), the decoy that makes the combination appear a good deal is missing, resulting in a shift of preferences to the cheaper e-paper-only option in choice B.

However, marketing practice can often not replicate this effect, because the situation is different. While one would make the same choice with regard to these offers in the experiment (preference), in an actual purchase situation getting two products of very different value for the same price might make people more skeptical and may keep them from buying (actual behavior).

		Preferences
Choice 1		
E-paper	USD 59	16%
Print	USD 125	0%
E-paper & print	USD 125	84%
Choice 2		
E-paper	USD 59	68%
E-paper & print	USD 125	32%

Figure 2: Decoy Effect.

Think of the ‘Goldilocks’ effect (De Ridder, 2008) for another example. Those who have had experiences with data throttling or high roaming costs in excessively cheap mobile plans, and being ripped off with overly expensive plans, will be more likely to opt for a mid-range plan in situations where there are several mobile plans from which to choose. Poor experiences thus make the use of heuristics that focus on minimizing risk more likely. In situations where uncertain customers perceive a high risk for wrong decisions, due to many decision options, highlighting mid-range plans (design of the choice architecture) can activate or reinforce the Goldilocks heuristic.

Although not all heuristics are applied in all situations, people use a rather systematic approach to making purchasing decisions. This is reflected in

the fact that different heuristics combine to form holistic decision-making strategies (e.g., reducing uncertainty), that certain decision strategies are more likely in certain decision situations (e.g., purchasing a mobile phone plan compared to, for instance, grocery shopping), and that different sets of heuristics (e.g. Goldilocks, Bandwagon) are activated in such situations.

For practical purposes, this suggests segmenting customers according to their decision-making strategies, to predict which behavioral economics effects are best suited for which marketing task, and to avoid the mistakes of an overly simple copy-and-paste approach.

From Decision-Making Strategies to Decision-Making Typology

The GRIPS typology (Bauer & Wätjen, 2018) is one way to segment customers according to their decision-making processes, with a focus on the application of behavioral economics to marketing, pricing, and selling:

Three aspects show the validity and practical relevance of this decision-making typology:

- The GRIPS types (Figure 3) replace the negative ‘Homo Heuristicus’ model with a positive model of how people really decide.

- Using the GRIPS types has been shown to influence decision-making behavior: In many projects across different industries, we have demonstrated significant increases in conversion and margins through the type-specific application of behavioral economics effects:

- Banking, branch office: Increasing the rate of scheduled consultation appointments by a factor of 3
- Energy, mailing: Reducing churn rate by 31%
- Insurance, branch office: Reducing average rebates by 44%
- Print media, call center: Increasing conver-

GRIPS type	Experience background	Exemplary situation	Typical heuristic
 Bargain Hunter	You can always make a good deal	Negotiating the price for a new car	Hyperbolic discounting
 Risk Avoider	There is a risk of being ripped off	Opting for a telco plan	Goldilocks effect
 Price Acceptor	The more you pay, the more you get	Buying a high-end smartphone	Anchoring effect
 Routine Buyer	Comparing is not worth the effort	Grocery shopping	Halo effect
 Indifferent Buyer	I will regret if I don't buy now	Refueling at the gas station	Effect of free

Figure 3: GRIPS typology.

- The GRIPS types do indeed react differently to behavioral economics effects (Figure 4), but differentiation by situation also resolves the contradictions that arise from the overly simple copy-and-paste approach.¹

¹ For example, bargain hunting (or seeking to optimize the transaction utility of a purchase decision) is an inherently consistent decision strategy. We can predict that the ‘decoy effect’ works well for a Bargain Hunter because it changes the decision context to give the option an obvious high transactional utility. And that ‘paradox of choice’

- Telco, call center: Increasing conversion rates by 148%
- Telco, call center: Increasing conversion

has no negative effect for the Bargain Hunter, because multiple options do not complicate the decision for his decision-making strategy. This contrasts with the Risk Avoider, who does not want to maximize the advantages of a decision but does wish to minimize its disadvantages. The ‘decoy effect’ makes him less decisive because he is more skeptical, and the ‘paradox of choice’ affects him because the numbers of possible wrong decisions increase.

rates by 35%

From B2C to B2B

Let us return to our second initial question: Are professional decision-makers more rational than

private customers are? Do the findings of behavioral economics apply here at all?

The answer is yes, because:

- First, heuristics have evolved and are hardwired

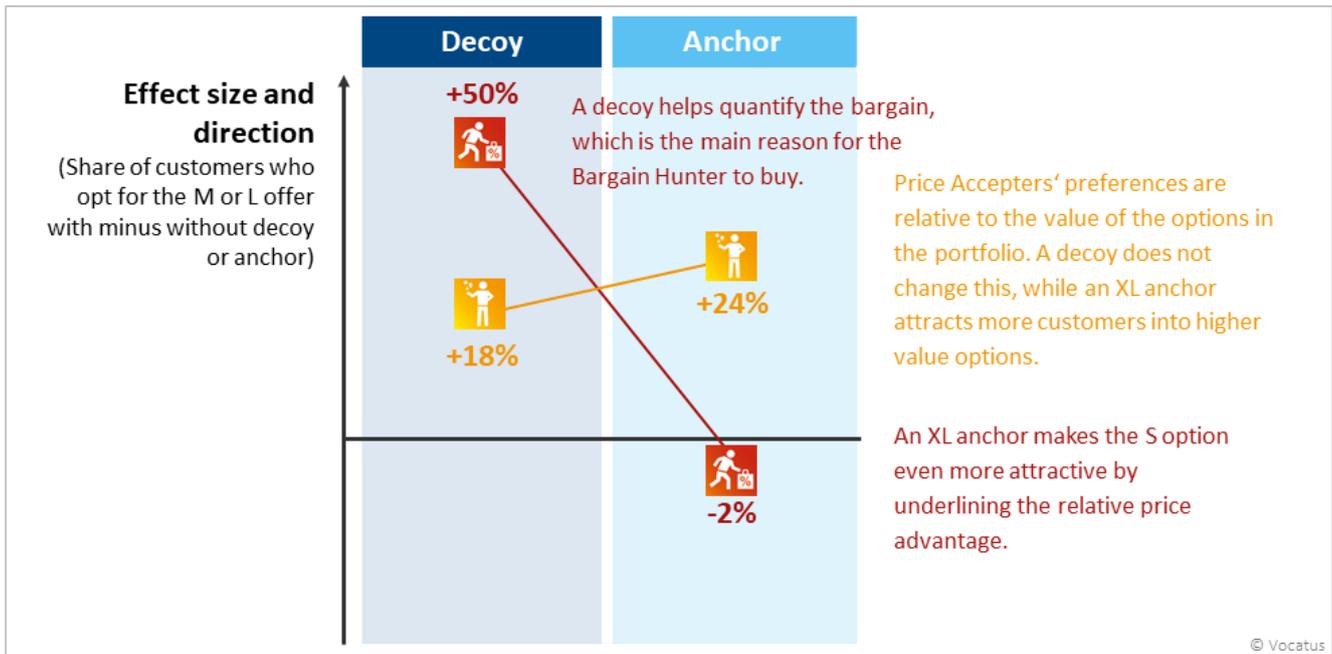


Figure 4: Reaction of the GRIPS types to behavioral economics effects.

into our perceptual apparatus. An example in this regard is the contrast effect, according to which we perceive differences (e.g., light/dark) stronger than they actually are. Given two different prices, the fact that the smaller one is perceived to be lower than it actually is, and the larger one is perceived to be higher, is a perception that even business customers cannot defy.

- Second, B2B is sometimes formally involved in more important decisions with more expensive consequences. Nonetheless, B2B decision-makers are rarely personally liable, and therefore they often do not have the same aspiration to make the 'right' decision compared to private consumption choices. And when they do, the 'right' decision is not necessarily the rational one but the one that the decision-maker can best represent and sell internally.

- Third, the decision-making structure often creates misaligned incentives and structural irrationalities. Incentivizing buyers with negotiated discounts, for example, does not necessarily lead to the optimal long-term, cost-effective purchasing decision but to the decision in favor of the supplier that gives the largest discount.

If we abandon the negative model of 'Homo Heuristicus', alias 'Homer Simpson', and use a positive model instead, for example the GRIPS typology, the acceptance of the validity of behavioral economics in the B2B sector will be much higher.

Summary and Implications

As we have shown, the unreflective collection of ever-increasing behavioral economics effects

	Bargain Hunter	Typical purchaser who receives incentives for rebates and loses sight of the total costs of operation
	Risk Avoider	Buyer who is afraid of making the wrong choice, thinking: "No one ever got fired for buying IBM"
	Price Acceptor	Buyer who values quality and features and is aware of the long-term costs of buying cheap solutions
	Routine Buyer	Orders from the same provider out of habit; especially when he/she doesn't have to pay himself/herself
	Indifferent Buyer	Doesn't want to spend too much time, not interested in extensive sales talk, often 'user chooser' without much involvement

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Figure 5: GRIPS in B2B.

harms the idea of applying behavioral economics in practice more than it helps: The negative, oversimplified ‘Homo Heuristicus’ model is a barrier to accepting the validity of behavioral economics, especially in areas like B2B. In addition, the application of nudging via copy-and-paste creates disappointments, as not every effect works in every situation, and it can even generate more and more contradictions.

The good news is, the combination of experience, situation, and heuristics solves the contradictions of the copy-and-paste approach, and it explains why which effects work in which situations. The decision typology GRIPS is (certainly not the only, but probably the best practically proven) a positive model that predicts and influences decision-making behavior, as it segments decision-making strategies (and the typical heuristics involved in these).

In sum, the key challenge for applying behavioral economics in practice is to understand which decision-making strategies are activated in which decision-making situations. What we can then do in marketing, pricing, and sales is to shape this decision context actively (choice architecture), in order to influence the likelihood of people using specific heuristics.

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