Consumer Decision Making: Session II

Priyali Rajagopal
G. Brint Ryan College of Business
Recap

• Problem/Need recognition
  • Difference between actual and desired states

• Search
  • Internal vs external

• Alternative evaluation
  • Attraction effect
  • Compromise effect
  • Trivial attributes
Music in advertising: some findings

- Increases attention, engagement, liking and memory for the ad
- Type of music matters
  - E.g., classical music works best for luxury products
- Why?
  - Classical conditioning

Before conditioning

<table>
<thead>
<tr>
<th>FOOD (UCS)</th>
<th>SALIVATION (UCR)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

During conditioning

<table>
<thead>
<tr>
<th>BELL + FOOD (UCS)</th>
<th>SALIVATION (UCR)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>+</td>
</tr>
</tbody>
</table>

After conditioning

<table>
<thead>
<tr>
<th>BELL (CS)</th>
<th>SALIVATION (CR)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Classical conditioning and music

• Pleasant music ➔ Positive response (attention, memory, liking)

• Brand ➔ No response

....Over time

• Pleasant music + Brand ➔ Positive emotions (attention, memory, liking)

• Brand alone ➔ Positive emotions (attention, memory, liking)
Heuristics in decision making

• Formal decision making models are based on two key assumptions:
  1. People have well-defined preferences
  2. People choose optimally relative to those preferences

• Two problems with this formulation
  1. People do not have well-defined preferences that they can just "look up" – preferences are often constructed as needed
  2. People have limited information processing capabilities
Behavioral economics

• People do not behave in accordance with rational economic principles
  • Maximizing utility versus satisficing
  • Use of heuristics (mental short cuts)

• Performance
  • “It works the best”
  • “Best customer service”

• Habit
  • “I always buy Tide”
  • “I just grab the closest toothpaste”

• Brand loyalty
  • “I only drink Coke”
  • “Hertz is number 1 in my book”

• Price
  • “It was on sale”
  • “The most expensive brand is usually the best”

"Good enough" vs "Best"
Heuristics based on emotions

• **Variety seeking**
  • Brand switching in category *despite satisfaction with present brand* (e.g., yogurt, toothpaste)
  • Often greater variety seeking for products purchased in advance of consumption
    • Students were given a choice of six snacks (candy, chips, etc.) that they could have over the next three weeks.
    • Group 1: in the first week they chose the items they would consume in week 1, week 2, and week 3.
    • Group 2: Asked to make a decision each week for immediate consumption.
Heuristics based on emotions

• **Impulse purchases**
  • Intense urge to buy
  • Higher incidence in hedonic product categories; Usually high margin items
  • Conflict between self-control and indulgence
    • Vohs and Faber (2007) experiment
      • Group 1: write down all thoughts for 6 minutes; Group 2: write down all thoughts except that pertaining to white bears
      • When given $10 to spend, which group spent more money?
    • Using self control in one area can deplete it for use in another area (e.g. people on diets bought clothes impulsively when exposed to cookie scent)
In Class Activity

You will be given a series of scenarios and asked to choose between different choice options. Please record your answers on a sheet of paper. We will discuss each scenario after you have finished responding to all the scenarios.

Please do not try to write down the "correct" answer as there are no right or wrong answers. Write down what you think you would choose in the situation.
Scenario 1

At which of the two gasoline stations described below would you prefer to buy gasoline?

Station A. Sells gasoline for $2.30 per gallon, and gives a $0.10 discount if the buyer pays with cash

Station B. Sells gasoline for $2.20 per gallon, and charges a $0.10 surcharge if the buyer pays with a credit card
Choose between:

a. A sure gain of $3,000

b. An 80% chance of winning $4,000 and a 20% chance of winning nothing
Choose between

a. A sure loss of $3,000

b. An 80% chance of losing $4,000 and a 20% chance of losing nothing
Scenario 4

In Sommers, Inc., a Fortune 500 computer software company, there are 20 office staff employees (administration, secretarial, and sales) and 80 computer programmers.

Sharon works for Sommers, Inc. She is a tall, attractive 28-year-old woman who knows how to touch type, communicates well with other people, and loves her job.

What is the likelihood (from 0–100%) that Sharon is an office staff employee?
Scenario 5

In a typical English text, does the letter ‘K’ appear more often as the first letter in a word or the third letter?

a. ‘K’ appears more often as the first letter
b. ‘K’ appears more often as the third letter
Scenario 6

- Write down the last two digits of your SSN or ID number
- Would you be willing to pay this amount in dollars for the following item (heart shaped box of chocolates)?
- Now write down the maximum amount of money you are willing to pay for this product
Which of the two gasoline stations described below would you prefer to buy gasoline?

Station A. Sells gasoline for $2.30 per gallon, and gives a $0.10 discount if the buyer pays with cash.

Station B. Sells gasoline for $2.20 per gallon, and charges a $0.10 surcharge if the buyer pays with a credit card.

The price is the same but we dislike surcharges (loss) and like discounts (gains).
Framing...

- Similar effects with:
  - Chance of living/ chance of dying.
  - Chance of winning/ chance of losing.

- Perceptions are affected by “irrelevant” wording changes.
Framing and Perceptions of Quality

- Ground beef that is:
  - 25% fat
  - 75% lean

- How greasy do you think it will taste (1 - 7 scale)?
  - 25% fat: Average answer = 4.49
  - 75% lean: Average answer = 2.96

- How would you rate the quality (1 - 7 scale)?
  - 25% fat: Average answer = 3.66
  - 75% lean: Average answer = 5.33
Choose between:

a. A sure gain of $3,000

b. An 80% chance of winning $4,000 and a 20% chance of winning nothing

The expected value of gains is higher in option b, but we are risk averse for gains and hence like “sure things” and option a
Choose between

a. A sure loss of $3,000

b. An 80% chance of losing $4,000 and a 20% chance of losing nothing

The expected value of losses is lower in option a, but we are risk prone for losses and hence like option b
Framing Effects and Risky Choice: Prospect Theory (Kahneman & Tversky, 1979, 1992)

• We value outcomes as "gains" and "losses" relative to a reference point.

• Losses "loom larger" than equivalent gains.

![Psychological Value Diagram]

<table>
<thead>
<tr>
<th>Gains</th>
<th>Losses</th>
</tr>
</thead>
<tbody>
<tr>
<td>PV(+$100)</td>
<td>PV(-$100)</td>
</tr>
</tbody>
</table>

- $100

+$100
- **Current price:** $35,225

- You can **add:**
  - Premium package ($2,100)
    - Auto dimming interior and exterior lights
    - Universal garage door opener
  - Cold weather package ($750)
    - Retractable headlight washers
    - Heated front seats
    - Heated steering wheel

- **Current price:** $38,075

- You can **remove:**
  - Premium package ($2,100)
    - Auto dimming interior and exterior lights
    - Universal garage door opener
  - Cold weather package ($750)
    - Retractable headlight washers
    - Heated front seats
    - Heated steering wheel
In Sommers, Inc., a Fortune 500 computer software company, there are 20 office staff employees (administration, secretarial, and sales) and 80 computer programmers. Sharon works for Sommers, Inc. She is a tall, attractive 28-year-old woman who knows how to touch type, communicates well with other people, and loves her job.

What is the likelihood (from 0–100%) that Sharon is an office staff employee?

- The best estimate that Sharon is an office staff employee would be 20%.
- Touch typing, working well with others, and being an attractive woman are no more diagnostic of a secretary than it a computer programmer.
- But in our society, we consider those qualities representative of secretarial workers, thus we tend to give a probability of higher than 20%
Representativeness Heuristic

• Judge the probability that an item is a member of a class by the degree to which the item is representative of (resembles) the class.

• The evaluation of an item or event is affected by the resemblance of that item/event to similar items/events.

• However, decision makers often ignore other information and overweigh these perceived similarities.

• Examples
  • Price and quality
  • Country of origin and quality
Availability Heuristic

- Focus on the ease with which instances can be brought to mind.
- Use that ease to judge frequency.

In a typical English text, does the letter ‘K’ appear more often as the first letter in a word or the third letter?
   a. ‘K’ appears more often as the first letter
   b. ‘K’ appears more often as the third letter

- Easier to search for words that start with "k."
- But, availability does not equal frequency.
Availability...

- Other examples
  - Lung cancer vs. Motor vehicle accidents
  - Emphysema vs. Homicides

People act on the basis of availability, not actuality.

- Product quality perceptions
  - Your friend's lemon vs. Consumer Reports

<table>
<thead>
<tr>
<th>Cause</th>
<th>Choice %</th>
<th>Annual US totals</th>
<th>Newspaper reports/year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lung cancer</td>
<td>43%</td>
<td>140,000</td>
<td>3</td>
</tr>
<tr>
<td>Motor vehicle accidents</td>
<td>57%</td>
<td>46,000</td>
<td>127</td>
</tr>
<tr>
<td>Emphysema</td>
<td>45%</td>
<td>22,000</td>
<td>1</td>
</tr>
<tr>
<td>Homicides</td>
<td>55%</td>
<td>19,000</td>
<td>264</td>
</tr>
</tbody>
</table>
Availability Heuristic

• Marketing implications
  • Try and create positive vivid images
  • Try and harness positive Word Of Mouth (Opinion leaders/Influencers, Viral campaigns)

• Viral marketing campaigns
Anchoring and Adjustment

• Start estimate at an initial value (anchor) and then adjust accordingly. But:
  • Adjustment is often insufficient.
  • Anchors are often irrelevant.

• How much were you willing to pay for the box of chocolates?

• How did your estimate relate to your SSN/ID?
Anchoring and Adjustment

• Real-Estate Study
  • All agents shown identical house.
  • Listing price manipulated.
  • Asked to give recommended price.

"Listing"         Average "Recommended"
119,900           117,745
129,900           127,836
139,900           128,530
149,900           130,981

• "How much are you willing to give?"
  ___ $1000  ___ $500  ___ $250  ___$100  ____ $50
Overcoming heuristics

- Does thinking more about the problem help consumers avoid decision errors?
- Not necessarily
  - Sometimes, thinking more worsens judgments
  - Sometimes, people can't explain why they do things
- Marketing implications
  - Consumers' decisions do not match well with economic theory.
  - Consumers use decision heuristics more often than not.
  - Use of heuristics decreases decision effort but leads to biases in decision-making
More Information

• Useful Texts
  • Mindless Eating (Wansink)
  • Blink and/or Tipping Point (Gladwell)
  • Influence (Cialdini)
  • Made to Stick (Heath & Heath)
  • Almost anything by Seth Godin
  • Paradox of Choice (Schwartz)
  • Predictably Irrational (Ariely)
  • Nudge (Thaler & Sunstein)
Being a Smarter Consumer

• Be aware of your affective state and any environmental factors that may be influencing it
• Use heuristics, but use them wisely and not blindly
• When given a reference point, adjust – and then adjust some more
• Watch how information is framed; try reframing it and see if you’d make the same decision
• Know if an affective reaction is due to the product or the result of conditioning
• Social environments matter, so take the time to decide if a particular social norm is one you actually want to follow