

FEBRUARY 2010

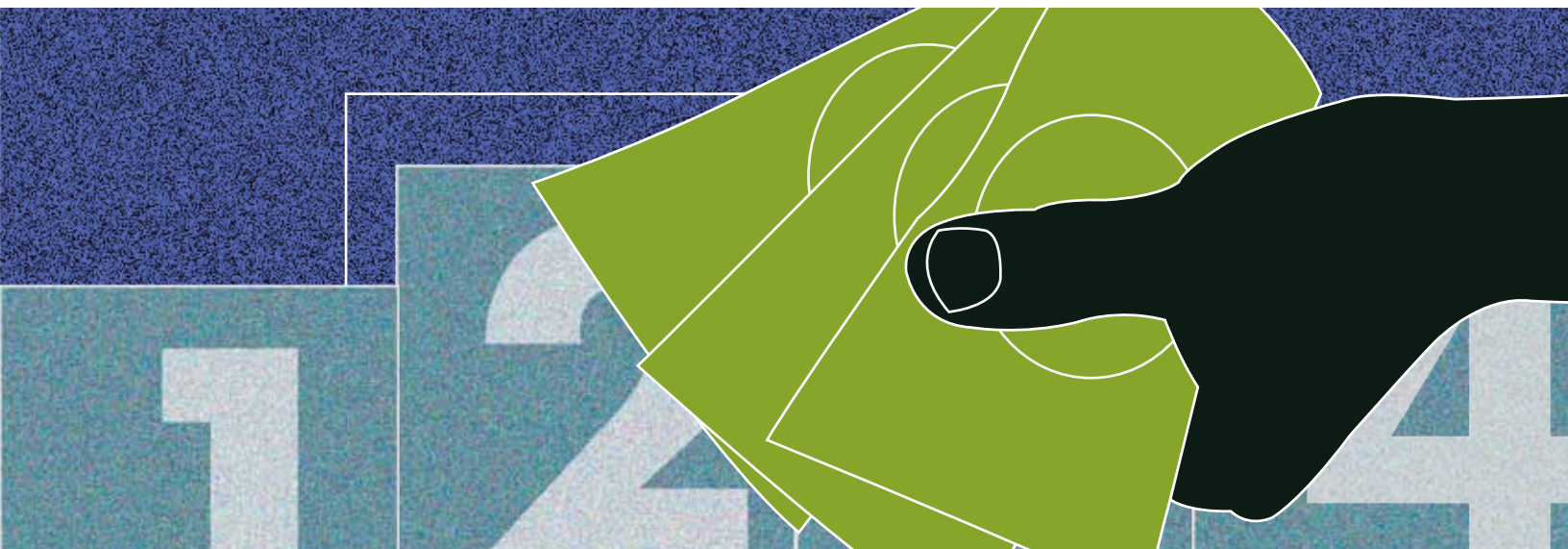
McKinsey Quarterly

MARKETING & SALES PRACTICE

A marketer's guide to behavioral economics

Marketers have been applying behavioral economics—often unknowingly—for years. A more systematic approach can unlock significant value.

Ned Welch



Long before behavioral economics had a name, marketers were using it. “Three for the price of two” offers and extended-payment layaway plans became widespread because they worked—not because marketers had run scientific studies showing that people prefer a supposedly free incentive to an equivalent price discount or that people often behave irrationally when thinking about future consequences. Yet despite marketing’s inadvertent leadership in using principles of behavioral economics, few companies use them in a systematic way. In this article, we highlight four practical techniques that should be part of every marketer’s tool kit.

1. Make a product’s cost less painful

In almost every purchasing decision, consumers have the option to do nothing: they can always save their money for another day. That’s why the marketer’s task is not just to beat competitors but also to persuade shoppers to part with their money in the first place. According to economic principle, the pain of payment should be identical for every dollar we spend. In marketing practice, however, many factors influence the way consumers value a dollar and how much pain they feel upon spending it.

Retailers know that allowing consumers to delay payment can dramatically increase their willingness to buy. One reason delayed payments work is perfectly logical: the time value of money makes future payments less costly than immediate ones. But there is a second, less rational basis for this phenomenon. Payments, like all losses, are viscerally unpleasant. But emotions experienced in the present—*now*—are especially important. Even small delays in payment can soften the immediate sting of parting with your money and remove an important barrier to purchase.

Another way to minimize the pain of payment is to understand the ways “mental accounting” affects decision making. Consumers use different mental accounts for money they obtain from different sources rather than treating every dollar they own equally, as economists believe they do, or should. Commonly observed mental accounts include windfall gains, pocket money, income, and savings. Windfall gains and pocket money are usually the easiest for consumers to spend. Income is less easy to relinquish, and savings the most difficult of all.

Technology creates new frontiers for harnessing mental accounting to benefit both consumers and marketers. A credit card marketer, for instance, could offer a Web-based or mobile-device application that gives consumers real-time feedback on spending against predefined budget and revenue categories—green, say, for below budget, red for above budget, and so on. The budget-conscious consumer is likely to find value in such accounts (although they are not strictly rational) and to concentrate spending on a card that makes use of them. This would not only increase the issuer’s interchange fees and financing income but also improve the issuer’s view of its customers’ overall financial situation.

Finally, of course, such an application would make a genuine contribution to these consumers' desire to live within their means.

2. Harness the power of a default option

The evidence is overwhelming that presenting one option as a default increases the chance it will be chosen. Defaults—what you get if you don't actively make a choice—work partly by instilling a perception of ownership before any purchase takes place, because the pleasure we derive from gains is less intense than the pain from equivalent losses. When we're "given" something by default, it becomes more valued than it would have been otherwise—and we are more loath to part with it.

Savvy marketers can harness these principles. An Italian telecom company, for example, increased the acceptance rate of an offer made to customers when they called to cancel their service. Originally, a script informed them that they would receive 100 free calls if they kept their plan. The script was reworded to say, "We have already credited your account with 100 calls—how could you use those?" Many customers did not want to give up free talk time they felt they already owned.

Defaults work best when decision makers are too indifferent, confused, or conflicted to consider their options. That principle is particularly relevant in a world that's increasingly awash with choices—a default eliminates the need to make a decision. The default, however, must also be a good choice for most people. Attempting to mislead customers will ultimately backfire by breeding distrust.

3. Don't overwhelm consumers with choice

When a default option isn't possible, marketers must be wary of generating "choice overload," which makes consumers less likely to purchase. In a classic field experiment, some grocery store shoppers were offered the chance to taste a selection of 24 jams, while others were offered only 6. The greater variety drew more shoppers to sample the jams, but few made a purchase. By contrast, although fewer consumers stopped to taste the 6 jams on offer, sales from this group were more than five times higher.¹

Large in-store assortments work against marketers in at least two ways. First, these choices make consumers work harder to find their preferred option, a potential barrier to purchase. Second, large assortments increase the likelihood that each choice will become imbued with a "negative halo"—a heightened awareness that every option requires you to forgo desirable features available in some other product. Reducing the number of options makes people likelier not only to reach a decision but also to feel more satisfied with their choice.

¹Sheena S. Iyengar and Mark R. Lepper, "When choice is demotivating: Can one desire too much of a good thing?" *Journal of Personality and Social Psychology*, 2000, Volume 79, Number 6, pp. 995–1006.

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4. Position your preferred option carefully

Economists assume that everything has a price: your willingness to pay may be higher than mine, but each of us has a maximum price we'd be willing to pay. How marketers position a product, though, can change the equation. Consider the experience of the jewelry store owner whose consignment of turquoise jewelry wasn't selling. Displaying it more prominently didn't achieve anything, nor did increased efforts by her sales staff. Exasperated, she gave her sales manager instructions to mark the lot down “ $x^{1/2}$ ” and departed on a buying trip. On her return, she found that the manager misread the note and had mistakenly doubled the price of the items—and sold the lot.² In this case, shoppers almost certainly didn't base their purchases on an absolute maximum price. Instead, they made inferences from the price about the jewelry's quality, which generated a context-specific willingness to pay.

The power of this kind of relative positioning explains why marketers sometimes benefit from offering a few clearly inferior options. Even if they don't sell, they may increase sales of slightly better products the store really wants to move. Similarly, many restaurants find that the second-most-expensive bottle of wine is very popular—and so is the second-cheapest. Customers who buy the former feel they are getting something special but not going over the top. Those who buy the latter feel they are getting a bargain but not being cheap. Sony found the same thing with headphones: consumers buy them at a given price if there is a more expensive option—but not if they are the most expensive option on offer.

Another way to position choices relates not to the products a company offers but to the way it displays them. Our research suggests, for instance, that ice cream shoppers in grocery stores look at the brand first, flavor second, and price last. Organizing supermarket aisles according to way consumers prefer to buy specific products makes customers both happier *and* less likely to base their purchase decisions on price—allowing retailers to sell higher-priced, higher-margin products. (This explains why aisles are rarely organized by price.) For thermostats, by contrast, people generally start with price, then function, and finally brand. The merchandise layout should therefore be quite different.



Marketers have long been aware that irrationality helps shape consumer behavior. Behavioral economics can make that irrationality more predictable. Understanding exactly how small changes to the details of an offer can influence the way people react to it is crucial to unlocking significant value—often at very low cost. ○

²Robert B. Cialdini, *Influence: Science and Practice*, New York: HarperCollins, 1993.

The author would like to acknowledge Micah May's contribution to this article.