Vocatus – Knowledge for Decision Makers

flashlight

Applied behavioral economics

The easy way to increase profits

Rational customers?

In order to survive in the market, every company must persuade customers to buy its own products. Consumers ultimately have to opt for or against the company, yet it's astonishing that so little attention is devoted to this self-same decision process. The strategy pursued by many companies is often based on long-refuted assumptions about a rational, perfectly informed customer who in reality is as rare as hen's teeth.

The reality is different...

Behavioral economics demonstrates in a variety of ways that we by no means decide as rationally as we would like to believe. Our decisions aren't particularly rational (even though we frequently try to make them so), we don't have all the information at our fingertips, and our emotions usually come into play. Instead, people tend to act impulsively, emotionally, short-sightedly and forgetfully, may not be well-informed, and can even be indifferent.

...because we're all human

Mental accounting

People save up their small change in piggy banks so they can go on vacation, yet at the same time they pay interest to finance their new car. Mental accounts make expenditure behavior clearer, but this expenditure is suboptimal and can duly be exploited by companies.

Relativity

Most shoppers would spend 20 minutes driving halfway through town in order to get a 10 euro discount on a radio that's worth 35 euros. However, the same people would be unwilling to repeat this to likewise get 10 euros off a television worth 595 euros—even though they would make the same 10 euro saving for the same 20 minutes' worth of effort.

Choice paradox

If a store offers 5 varieties of jam for customers to try, it'll sell far more jam than it would if it were to offer 25 varieties to test. Too much choice makes it harder for customers to reach a decision, so then they'd rather buy nothing at all.

Loss aversion

People would rather avoid a loss than make a gain—an insight which won the Nobel Prize for Daniel Kahneman. This means there's a big difference between getting a 3% discount for paying in cash or having to pay 3% more if you pay by credit card.

Anchor effect

When people assess prices, they're influenced by reference anchors that are available in the given situation. The luxury coffee machine that's displayed in a store may be so ridiculously expensive that nobody will buy it, yet it sets the price anchor for the other coffee machines which duly appear to be inexpensive.

Good news for companies...

Even irrational decisions follow clear patterns, which means they can be influenced

Experiments relating to behavioral economics not only demonstrate that people often make irrational decisions, but that this happens constantly and on a very large scale. Companies cannot afford to ignore these insights if they want to be successful.

At the same time, these experiments reveal that these decisions nevertheless follow clear patterns and are thus predictable. Once companies have truly understood these decision processes, they can begin to influence them. After all, it's vital for every company to persuade a larger number of customers to buy its own products.

An international study with 150,000 interviews

We thought it made no sense for corporate strategy and marketing to continue relying on "gut feeling" or the empirically refuted hypotheses of a rational decision-maker, so we conducted an international study to examine people's decision behavior.

After 150,000 interviews in 26 countries, one thing was obvious: All purchase decisions can be subsumed in five different "decider types".

...there are only 5 "decider types"

Every purchaser decides differently...

Loyal Buyers have plenty of trust in brands and products

Price Accepters get excited about products, and often spend more than they'd originally planned

Risk Avoiders are cautious customers who are afraid of being fleeced

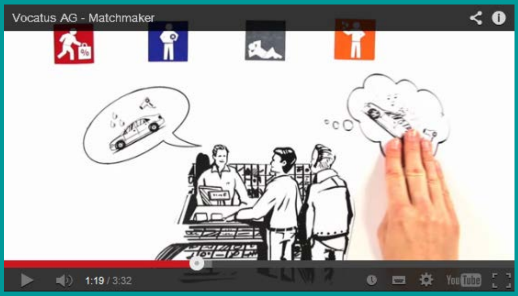
Bargain Hunters enjoy searching and comparing, and love discounts and extras

Indifferent Buyers aren't interested in comparing products and prices (low involvement customers)

...and it depends on the sector

However, just as fascinating as the 5 "decider types" was the finding that each person decides differently in each and every situation. For example, a customer can be a Loyal Buyer when it comes to newspapers, but a Bargain Hunter when looking for new shoes.

The video (right) shows how each of us can combine the behavior of all 5 "decider types" during a single visit to a gas station:



Play video

Each market is different

The same person might decide quite differently when faced with different products, so the distribution of the "decider types" in each market differs too:

in %	Bargain Hunter	Price Accepter	Risk Avoider	Loyal Buyer	Indifferent Buyer
Automotive	52%	20%	13%	11%	4%
Mobile Telco	36%	7%	42%	11%	4%
Magazines	10%	38%	2%	15%	35%
Pharmacy	19%	13%	14%	42%	12%
Insurance	20%	11%	43%	14%	12%

What about your market?

Let's take discounts as an example: The pharmacy market is dominated by Loyal Buyers, so discounts will fail to increase turnover—but margins will fall noticeably. By contrast, the automobile market is characterized by more than 50% Bargain Hunters, so you'll struggle to sell anything if it isn't discounted. You can only offer discounts to Bargain Hunters in the mobile telecoms market, but not to Risk Avoiders since the latter would become mistrustful as a result of what they perceive to be an unjustified discount.

Once you have understood the decision processes in your market, you can begin to influence customers' decisions in your favor. Analyses mostly lead to some surprising insights, and occasionally to paradoxical suggestions too. Yet all these studies have one thing in common: They have a direct and positive effect on corporate profits.

So what's in it for me?

mobilcom-debitel

25% more contracts

mobilcom-debitel's call center began to cater for its most important "decider types" (Bargain Hunters and Risk Avoiders) by adopting a customer-focused procedure, and duly achieved a 25% increase in its conversion rate when selling mobile telecoms contracts.

L'TUR tourism

70% more bookings

When we analyzed the role of price in booking travel, we came to the conclusion that L'TUR ought to show all its competitors' prices too in its online travel search facility—even if they were cheaper than L'TUR. This may seem paradoxical, but L'TUR's conversion rate rose by 70%. Vocatus was awarded the 2010 German Market Research Prize for this project.

Frankfurter Allgemeine Zeitung

€9.6 million extra profits

Thanks to clever price increases based on a behavioral economics study conducted by Vocatus, the *Frankfurter Allgemeine Zeitung* was able to increase its annual profits from sales revenue by 9.6 million euros without suffering any fall in circulation.

Vocatus and the *Frankfurter Allgemeine Zeitung* were presented with the 2012 ESOMAR Effectiveness Award for this project.

vocatus:

The current book from Vocatus about **behavioral economics**.

2013	ESOMAR – winner of the "Research Effectiveness Award"
2012	ESOMAR – winner of the "Research Effectiveness Award"
2010	ESOMAR – winner of the "Award for the Best Methodological Paper"
2010	German Market Research Prize – winner of "Best Study"
2005	German Market Research Prize – winner of "Best Study"

If you'd like to talk to our experts about how behavioral economics can be used in your company, simply email us at florian-bauer@vocatus.de

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