



## **Predictably Irrational - The hidden forces that shape our decisions by Dan Ariely**

### **IN A NUTSHELL**

The reality is we are all biased - we can't help it (and only by recognizing this inherent bias can we potentially counter against it).

Standard economics proclaims that all human decision-making is rational and informed. It's based on an accurate assessment of something's worth versus its costs (thus we are trying to optimize the relationship between cost and reward). But real life shows this to be wrong.

Behavioural Economics demonstrates we are easily influenced by sometimes seemingly irrelevant information and other forms of irrationality. Furthermore we are often unconscious of many of the influencers that affect our decision making. Ariely argues that rather than being unpredictable and random, such influences and behaviour are systematic.

This book shows us a range of common decision flaws that we all make.



## THE BOOK

### **The truth about relativity**

Relativity - People do not really know what they want or how much to pay for something. Thus they can be easily influenced. We need comparators to help us make decisions. High priced offerings are sometimes created to make the middle options appear more appealing. RRP, or opening bids often 'anchor' us to that initial price.

*Two subscription options were offered to 100 MIT students for the Economist:  
Internet only subscription @ \$59 -> 68% take-up rate  
Print and Internet subscription @ \$125 -> 32% take-up rate*

*Yet when a third 'stooge' offering was put into the mix it swung the votes in favour of the more expensive option because the stooge changed the perceived value of the print option:  
Internet only subscription @ \$59 -> 16% take-up rate  
Print only subscription @ \$125 -> 0% take-up rate  
Print and Internet subscription @ \$125 -> 84% take-up rate*

William Vickrey received a Nobel prize for economics on his analysis of auction sites. He found that people based the price they were prepared to bid for an item not on their own assessment of the price but on the price of the second highest bidder (as that person's valuation legitimized the perceived value of the item).

Money is relative - \$1 is not \$1 is not \$1. The value of money is relative to the item in question.

*Traveling 15 extra minutes to get \$7 off a \$25 pen is more compelling than traveling the same amount of time to save the same amount of money on a \$455 suit.*

The fallacy of supply and demand - We value things that are rare (and devalue things that are common).

*Tahitian Black Pearls had little demand. Assael (the Pearl King) persuaded a top gemstone dealer to put the pearls on show in his 5th Avenue shop window at an outrageous price. By linking the pearls to the highest grade jewelry available, their commensurate price point and rarity created a perception of value that made them become the accessory of the Manhattan rich.*

Irrelevant information can sometimes influence

*At MIT, Drazen Prelec ran a closed bid amongst MIT students. On offer was a bottle of Hermitage Jaboulet La Chapelle 1996 (a highly rated and rare wine), a wireless keyboard and 1lb box of chocolates - amongst other items. Before they entered their bids, he asked them to write down the last two digits of their social security number. When he analyzed the bids, he found those who had high social security numbers (80-99) bid between 216-346% more than those with low SS numbers.*

Social herding - We believe in the wisdom of the crowd. If a restaurant is full, we are more likely to go in than if empty - irrespective of the menu.



Make it easy - The easier or simpler we make something, the greater the chance people will take part. Bundling things together so to minimize decision-making makes our lives easier (cf MacDonald's menu options).

The confusion of choice - We are not restricted by a lack of choice but by an over-abundance of choice. In most areas of life we do not want to close options down as we hate the idea of losing something. The reality is too much choice confuses and distracts us (often we waste time deciding between two options when the differential is minimal or unimportant).

### **The high price of ownership (The endowment effect)**

Fear of loss - People hate loss, so some health places have charged a fee that is refundable if they show up. This boosted attendance rates.

We overvalue what we have (and discount the value of things we do not have) - Thus we weigh heavier the price of loss than the price of a gain.

*At Duke University, Basketball games are heavily oversubscribed. People who had failed to get a ticket were asked how much they would pay to get one? The most someone was prepared to pay was \$170 - about twice its face value. However, when those who had managed to get a ticket were asked how much they would be prepared to sell it for. Their average was 14x more at \$2400.*

Pre-ownership loss - We can feel the sense of ownership even before we own something. When we bid for something on eBay, we already have a sense of ownership. When someone outbids us, we feel the sense of loss and so we are then prepared to bid more for it! Likewise trial subscriptions capture us as we do not like giving up something we have.

### **The cost of zero cost**

The price of free - 'FREE!' presses the emotional hot button in all of us - but sadly there is a price to pay. If something is free we drop any faculties of rational judgement (as our simple conscious brains rationalise that there is no cost/risk and we feel we have beaten the system). Yet we end up buying a product we don't like as much!

*Ariley, Shampanier and Mazar offered people two kinds of chocolates - Hershey Kisses at 1 cent or Lindt for 5 cents. 27% people chosen the Hershey, whilst 73% chose the better chocolate in Lindt. however, when the price was dropped by 1 cent for both items to 0 cents for the Hershey and 4 cents for the Lindt, one would expect the purchase rates would remain the same (as nothing had changed relatively between the two prices), but suddenly becoming free Hershey's took 69% of the 'sales'. 1 cent is not just 1 cent. Becoming 'FREE!' moved it into a whole new league.*

Free shipping (often over a certain expenditure) has been shown to be a powerful influence.

*Amazon's free delivery boosts sales but in France, sales were flat. They found the French operation instead charged a minimum amount (equivalent to just 20 cents) but this meant*



*people did not buy extra items to hit the free delivery offer. When France offered free shipping they saw a dramatic increase in sales.*

*When AOL moved from a pay per hour service to a fixed monthly cost with unlimited usage, they expected a minimum shift in usage levels. Instead they saw an overnight lift from 140,000 people logged on to 236,000 customers.*

Applying 'FREE!' for social causes - 'FREE!' can shift even bigger behaviour changes. For example by offering zero charges for registration and inspection for electric cars has helped increased their sales (even if ironically they are more expensive in the first place). Thus the author speculates that if we want to increase health of the US citizen, offer checkups for free.

### **The cost of social norms**

Social norms are massively powerful. We are often unconsciously driven by such pressures.

Money versus Morals - When money gets introduced it changes the 'contract' and often social norms get pushed to one side.

*An Israeli children's day care centre imposed fines for late pick-up. Rather than improving punctuality, it made late arrival more prevalent. The rationale was that before it was a social contract. When a fine was imposed, the parents no longer had guilt as they felt they were 'paying' for the time.*

*Lawyers were asked to do some work for needy retirees and most said yes. However when another group of lawyers were offered a 'low' rate (\$30p/h) most refused as they now viewed the relationship differently (as anchored it against their professional rate).*

We all cheat (a little) - In 2004 the total cost of all robberies in the USA was \$525m whilst employee fraud and theft (the ruler, stapler etc) was \$600m! Insurance companies estimate over \$24,000m are bogus claims. In experiments it has been shown that if people feel they can 'get away with it', they will be inclined to cheat (but only by a little). It appears that social norms keeps us in check.

*In an experiment at Harvard, students were asked to take part in a maths test (where they could keep their papers and just tell the experimenters their score). Half were asked in advance to list 10 books they had read at school, whilst the other half listed the 10 commandments. The books group increased their average score from 3.1 (the control group) to 4.1, whilst the 10 commandments group did not.*

*At MIT the author placed 6-packs of cokes into the dorm community fridges. They had all gone within 72 hours. However, when a plate of dollars was left, none were taken. In another experiment students cheated more for tokens (that could be immediately changed into currency) than when money itself was used. People find 'theft' easier when a few steps removed from actual hard currency.*

Money versus Motivation - Money is the most expensive way to motivate a person. People who work in purpose driven organisations (such as Police, Firefighters, Armed forces or Healthcare) are often underpaid but more motivated as they see they are doing something really useful/important. Increasingly we are seeing organisations focusing on the purpose



as they know it is more effective in driving loyalty, energy, passion and commitment than monetary rewards. Companies like Linux have grown through people willingly volunteering their time for free.

Use of social norms - Making public personal commitments help to increase compliance (cf the debt bloggers such as [www.bloggingawaydebt.com](http://www.bloggingawaydebt.com)).

### **The influence of arousal**

Cold vs Hot decision-making - Emotions affect our decision-making. Thus advertising and the 'retail experience' aim to increase the emotional engagement we have to entice us to buy.

*When asked 19 questions about sexual preferences (some deviant) students were much more conservative than when aroused - ranging from 18% higher for spanking up to 420% for slipping a woman a drug to have sex (from 4% up to 26% of the sample). When gripped by passion, the boundary between right and wrong often blurs.*

Emotions influence beliefs - Often the emotional experience of an event is more effective at shifting/cementing beliefs than facts. Thus, the more emotionally committed we are to something, the less effective are facts to dissuade us.

### **The effect of expectations**

Expectations - Our expectations can influence the meaning we put onto something (as we see what we believe not vice versa). People can easily be 'primed' which can shape the way they perceive something. Hence a whisky tastes better from a heavy glass.

*In blind taste tests inside a fMRI scanner, there was little difference between Coca Cola and Pepsi. But when pre-told the brand, it triggered another part of the brain that is associated with memory, associations and higher order cognition (The Dorsolateral Prefrontal Cortex), which in turn stimulated the release of dopamine. Coke created a greater stimulation of the DLPFC (and hence dopamine) and so was liked more.*

Priming - Irrelevant information can steer our behaviour.

*In a test people were given a range of words they had to complete into a sentence. One group was given words like 'aggressive', 'rude' and 'intrude', whilst the other group had words like 'considerate', 'polite' and 'sensitive'. They were then sent to a purportedly second task in another lab. However, the experimenter was engaged in a long winded conversation with another person. Those who had been set the polite words waited 9.3 minutes before interrupting whilst the rude word group waited an average of just 5.5 minutes. In a similar experiment, people shown 'old' words walked slower down the corridor to the next test than those given more youthful words.*

Contexting - The 'frame' around something helps influence our perception of that event.

*Washington Post asked the world famous violinist, Joshua Bell to pose as a busker at L'enfant Plaza Metro station. Only \$32 was thrown into his Stradivarius case for one hour's virtuoso performance of Bach's 'Chaconne'!*



## The power of price

The mis-meaning of price - Expectations change the way we perceive and appreciate experiences. Often, we perceive something to be better *because* it has a high price tag. A \$4,000 leather sofa will no doubt be softer than a \$400 couch but the price tag itself (and the story behind it) also influences our perception of that sofa.

*Students were invited to test a new painkiller called Veladrone-Rx. They were given a professionally printed brochure that espoused the quality and potency of the painkiller with clinical studies demonstrating significant results within just 10 minutes. The cost was a high \$2.50 per dose. They were then given a series of electrical shock pre and post administering the drug. The results clearly showed a significant reduction in perceived pain after taking Veladrone-Rx - yet Veladrone-Rx was just a Vitamin C pill with no painkilling properties. Interestingly, when the price was changed to be just 10 cents per dose, the perceived pain relief dropped by a half.*

*In a similar experiment students were sold a power drink called SoBe and asked to assess how tired they were after a workout. Those who bought the drink at a 1/3rd off rated their fatigue significantly higher than those who had paid the full (high) price for it.*

Placebos run on the power of suggestion - they are effective because people believe them. Research has shown that placebos do cause a real chemical change inside the body - the thought process does help the body cope better without any outside chemical interference.

## CRITICISMS

Predictably Irrational is an enjoyable and easy to read book as it's full of interesting experiments and personal anecdotes. However, it's heavy on 'What's' but light on the 'How's'.

This book covers much of the same ground as other books - the difference is that this was the person who did many of the experiments! That said, many of the experiment are on college students (so hardly representative) and often you wonder if the conclusions drawn are always evidence of predictable irrationality and not just common sense? As Al Roth is quoted, "In theory there is no difference between theory and practice but in practice there is a great deal of difference".

The critics of Behavioural Economics suggest that there is little real evidence of BE creating major behavioural shifts (often BE is used in conjunction with other bigger change programmes so difficult to tease out the effects). Ariely himself recognises that enforced change through policies are more powerful than BE nudges.

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