



Customer Analysis I

Session 3

Marketing Management

Prof. Natalie Mizik

Outline

- How do you think about customers?
- How do customers think?
 - Overview of approaches.
 - Focus on behavioral economics.
 - Useful in understanding many marketing phenomena.
 - Alternative to 'rational' and 'motivational' approaches.

The Consumer Quiz

- Asked you to estimate common marketing statistics
- Measured your confidence in these estimates
- Results?

Key Learning

- You are not alone: Executives, MBA students in other schools make similar errors.
- Why do people make these “mistakes”?
 - False consensus: believe that the others are more like yourself than they really are
 - Overconfidence: people believe that they are right more often than they really are

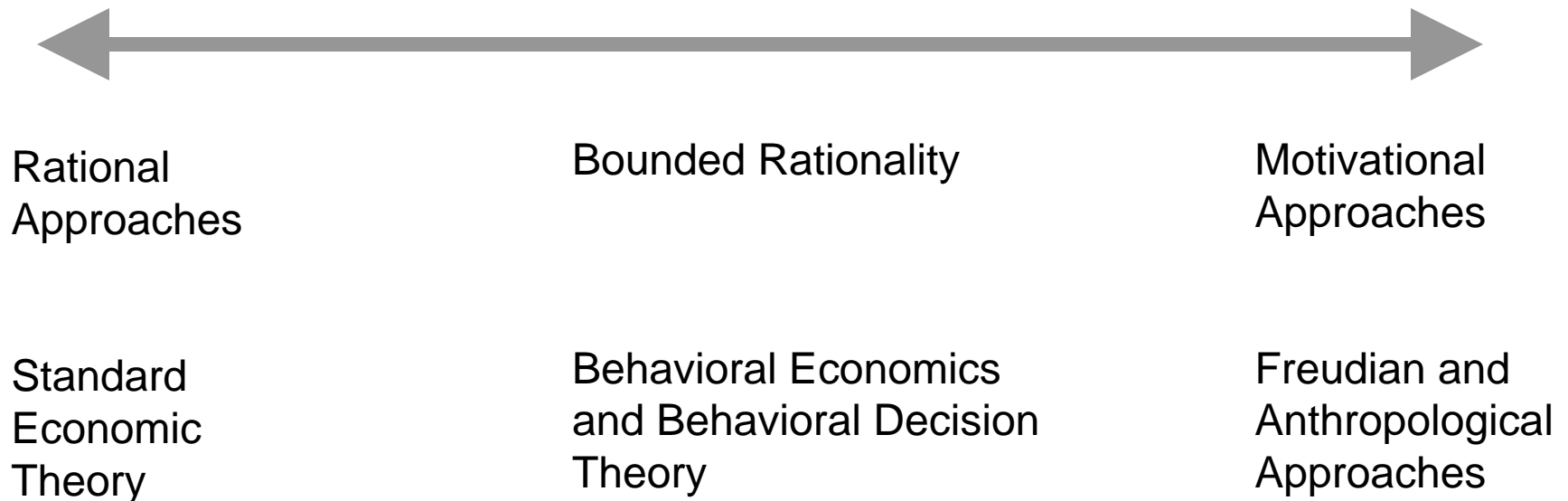
How do you prevent this?

Implications for Marketing:

- You are a member of (at most) one segment
- Possible Solution:
 - Customers *must* provide the data, do not rely just on your intuitions
 - Globally, mktg research is essential
- Overconfidence keeps you from seeing this
- Possible Solution:
 - Diverse teams and involving customer inputs at every stage

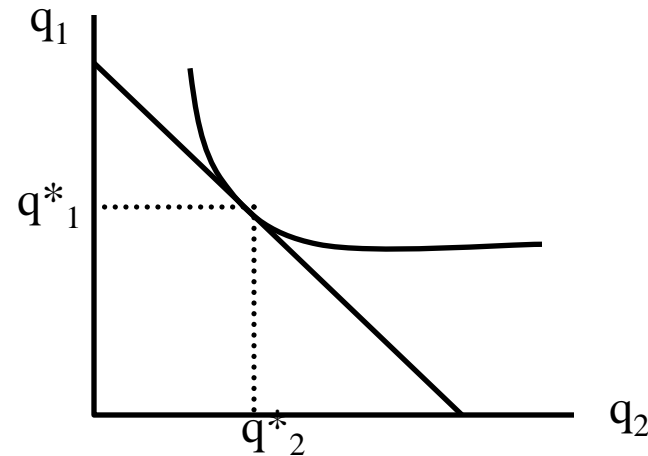
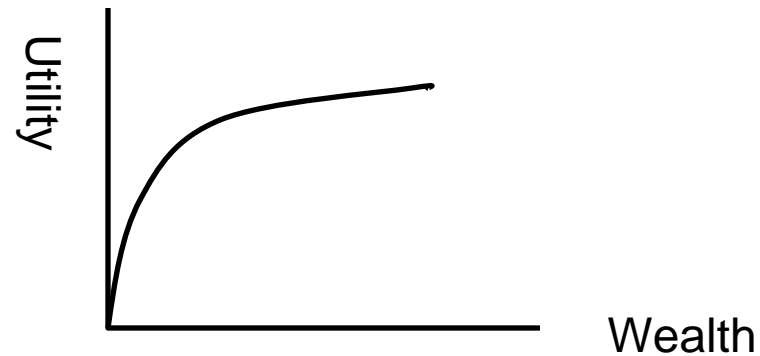
How Customers Think

- A continuum of views:



The Standard Economic Theory

- Customers assess options relative to their net worth
- Pick the best option to maximize utility subject to budget constraint



Motivational Approaches

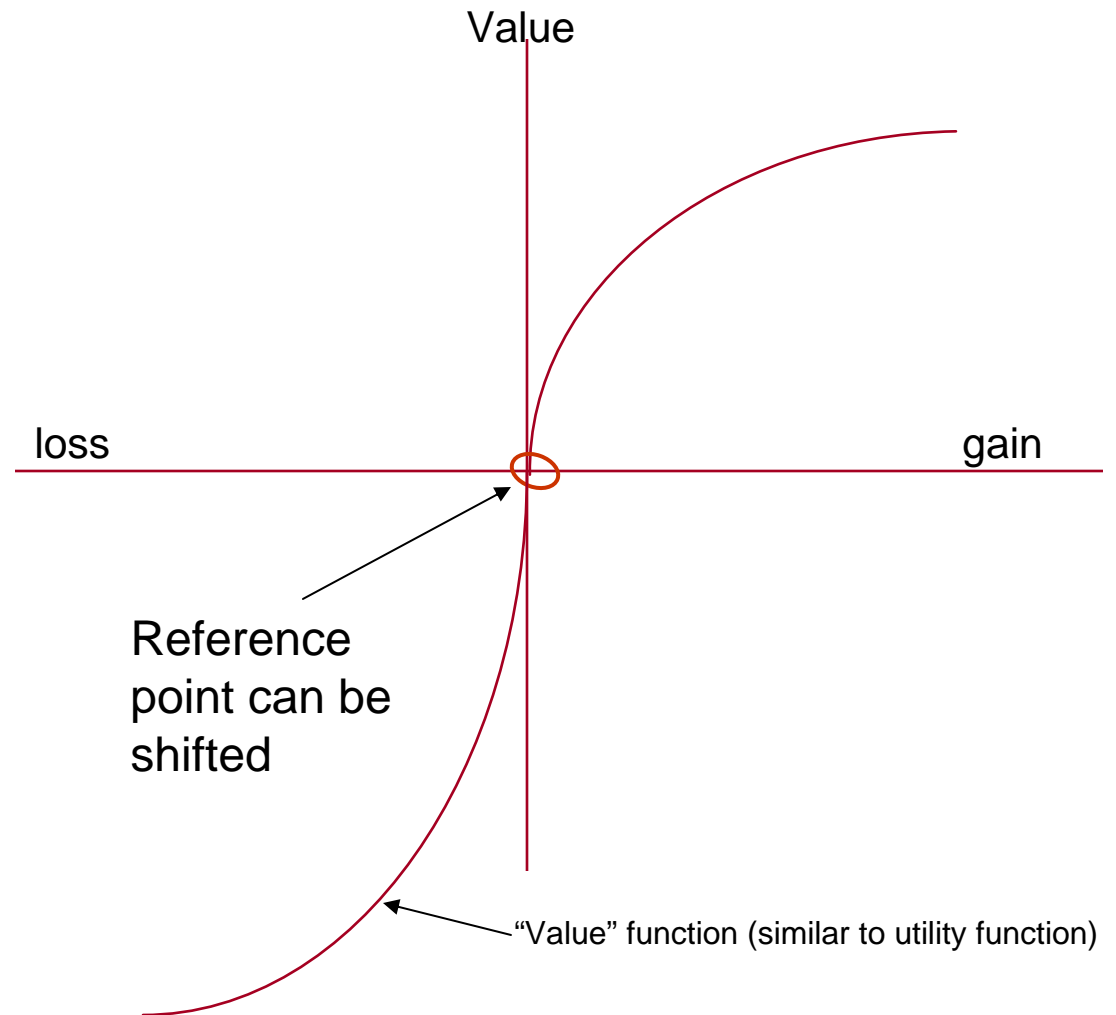
- People are less than rational, driven by unconscious and uncontrolled motivations
- Best studied by observation
- Examples of motivational approaches
 - For the ladies: [Diet Coke](#) (USA)
 - For the fellas: [Tuborg beer](#)
 - Fear appeal: [Aussie underpants](#)
 - Fear appeal: [More Australian underpants](#) (Underdaks)
 - Fear appeal: [Philippines anti-smoking](#)

Behavioral Approaches

- People, because of limited processing capacity, use simplified ways of making decisions

Behavioral Approaches: Prospect Theory

- Value is judged relative to a reference point
- Losses loom larger than gains (estimates range 2.0-2.5)
- Diminishing sensitivity

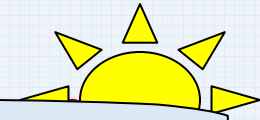


Three concepts from PT

- Reference pricing
- Framing
- Loss aversion

Do these apply to you?

A beer at the beach



Reference Price Matters

You are lying on the beach on a hot day. All you have to drink is ice water. For the last hour you have been thinking about how much you would enjoy a nice cold bottle of your favorite brand of beer. A companion gets up to go make a phone call and offers to bring back a beer from the only nearby place where beer is sold, [a fancy resort hotel] [a small, run-down grocery store]. He says that the beer might be expensive and so asks how much you are willing to pay for the beer. He says that he will buy the beer if it costs as much or less than the price you state. But if it costs more than the price you state he will not buy it. You trust your friend and there is no possibility of bargaining with the [bartender] [store owner]. What price do you tell him?

	Hotel	Store
CBS 2009	9.38	7.40

Cornell MBA's 1985

Store: \$1.50

Hotel: \$2.65

Your Answers:

\$ 7.29

\$ 9.21

Different Frames, Same Alternatives.

A large car manufacturer has recently been hit with a number of economic difficulties and it appears as if three plants need to be closed and 6,000 employees laid off. The vice president of production has been exploring alternative ways to avoid this crisis. She has developed two plans:

Your answers:

Gain	Loss
A: 79%	C: 67%
B: 21%	D: 33%

Gain Frame:

- **Plan A** : This plan will save one of the three plants and 2,000 jobs.
- **Plan B**: This plan has one-third probability of saving all the three plants all 6,000 jobs but has a two-thirds probability of saving no plants and no jobs.

Loss Frame:

- **Plan C**: This plan will result in the loss of two of the three plants and 4,000 jobs
- **Plan D**: This plan has two-thirds probability of resulting in the loss of all of the three plants and all the 6000 jobs, but has one-third probability of losing no plants and no jobs.

	Gain Frame		Loss Frame	
	Plan A	Plan B	Plan C	Plan D
CBS 2009	57	43	50	50

Two simultaneous choices:

- Choose between:
 - a) A sure gain of \$2,400
 - b) A 25 percent chance to gain \$10,000 and a 75 percent chance to gain nothing.

And

- Choose between:
 - c) A sure loss of \$7,500
 - d) A 75 percent chance to lose \$10,000 and a 25 percent chance to lose nothing.

- Your answers:

First choice	Second choice
A: 72%	C: 24%
B: 28%	D: 76%

- **Notice:**
risk aversion for gains,
but
risk seeking for losses.

	Decision 1		Decision 2	
	Plan A	Plan B	Plan C	Plan D
CBS 2009	65	35	20	80

Applications of Prospect Theory

- Reference Price
- Defaults (Status Quo effects)
- Framing (“Mental Accounting”)

Applications of PT: Reference price

- Price increases hurt more than price decreases help
 - Dannon yogurt
- Impact of the List Price: **40% off !!!**
- Bad behavioral marketing: Teach people a reference price of zero, as did many dot-coms.
- Comparisons in infomercials

Applications of PT: Rebates

- Rebates are particularly good because at the time of purchase they are seen as a gain, instead of the reduction of a loss (framing effect)
- Yet while they are almost as effective as price cuts in boosting sales, they have 'modest' (20-30%) redemption rates
- What does PT tell us about duration of promotion campaigns?

Real Estate

- What happens when real estate prices decrease?
 - People are hesitant to realize the loss.
 - Asking prices are too high
 - Sales slow down
 - Economic Theory?
- Evidence:
 - Boston condos, 1990's and mid-2000s
 - Asking prices were 25-35% higher than selling prices
 - Sell more slowly
 - Happens to owners more than investors.

Applications: Defaults (Status Quo Bias)

- Loss aversion contributes to a tendency to favor stability over change, the status quo is (too) often chosen:
 - Privacy policy on web sites
 - Pension plans
 - Insurance choices and right to sue in NJ (opt-in full tort; 21%) and in PA (opt-out; 75%). Annual savings of \$500.

Applications of PT: Mental Accounting

- Mental accounting is categorization of money and spending. Money mentally coded as gain or loss in a category.
- Mental accounting affects behavior
 - Pay more with credit cards (like not paying)
 - People pay high% interest on credit cards while keeping money in their saving accounts
 - Examples from your own experience?

Examples of Mental Accounting

What would you do under Scenario I and Scenario II?

Scenario I:

- You are on your way to see a play and have a ticket which cost \$40. When you arrive at the theater, you discover that you have lost your ticket. Would you buy another?

Scenario II:

- You are on your way to see a play and are about to purchase a ticket which cost \$40. As you step up to the box office, you discover you have \$40 less in you pocket than you thought when you left home. Would you still buy the ticket?
- Jackie is shopping with a friend. She need to buy a calculator. The store offers a price of \$50. A friend tells her that another store, which is 10 block away is selling the same calculator for \$40. Jackie decides to go to the other store. Jane goes to a store to buy a TV. The store offers a price of \$500. Jane's friend tells her that another store, which is 10 blocks away, is selling the same TV for \$490. Jane decides it is not worth walking 10 blocks for \$10 savings.

Summary

- How do Customer think?
 - Customers think differently (than what standard economic theory predicts), but systematically.
 - They judge value:
 - Relative to a reference level.
 - Losses loom larger than gains.
- How do you think about customers?
 - They are more different than you realize
 - You are overconfident of it

Does all this matter?

BUSINESS/FINANCIAL DESK | October 10, 2002, Thursday
A Nobel That Bridges Economics and Psychology

By DANIEL ALTMAN (NYT) 1178 words

Late Edition - Final, Section C, Page 1, Column 2

ABSTRACT - Daniel Kahneman of Princeton University and Vernon L Smith of George Mason University are awarded Nobel Memorial Prize in Economic Science; tried to explain idiosyncrasies in people's ways of making decisions, research that has helped incorporate insights from psychology into discipline of economics; photos (M)

Open questions

- Are customers rational?
- Are companies rational?
- Are markets rational?

“The evidence is mixed: Theory says one thing, the data say another”

Richard Thaler

For further reading:

- See:
 - Dan Ariely (2010)
“Predictably Irrational”
 - Richard H. Thaler and
Cass R. Sunstein (2009)
“Nudge: Improving
Decisions About Health,
Wealth, and Happiness”

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15.810 Marketing Management
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