



Our Take:

OG's Point-of-View On Best-Seller Business Books

October 2010

In This Edition We Review

Predictably Irrational

The Hidden Forces that Shape Our Decisions

Dan Ariely
Harper Perennial, 2008

A Little Background

Predictably Irrational is a New York Times Book Review Notable Book of the Year. It was written by Dan Ariely, who holds dual Ph.D.'s in cognitive psychology and business administration and is the James B. Duke Professor of Psychology and Behavioral Economics at Duke University. The book was written while Ariely was a fellow at the Institute for Advanced Study at Princeton. Originally published in 2008, the book was republished in 2009 as a revised and expanded edition.

The work stems from Ariely's extensive research and his experiences from a serious accident, resulting in burns to 70% of his body. His experiences with both successful and unsuccessful treatments became the genesis for his interest in how our minds impact our perceptions, experiences and the choices we make.

The Basic Premise

Ariely proposes that human beings are not as rational as traditional economic theory would suggest. The traditional theory holds that people make decisions that are rational and informed, driven by an accurate assessment of the value of goods and services and the benefits they will provide. Instead, Ariely suggests people are susceptible to unrelated, more immediate influences such as emotions, social norms, desires and others. He labels this idea, "behavioral economics." Ariely further suggests that, while these influences result in irrational decisions and behavior, they are predictable in that they occur time and time again. The goal of the book is to identify those moments of predictable irrationality and guard against them.

Based on numerous cases of both hard research and anecdotal experiences, Ariely shares his understanding of how we are predictably irrational. First, he suggests that we do not make decisions in a vacuum, meaning that they are made in relation to the other things around us. Specifically, we tend to compare like things with one another. This holds true not only for tangible items such as toothpaste, microwaves or automobiles, but it applies for less tangible things like vacations and education.

Next, Ariely introduces the concept of "arbitrary coherence." He suggests that once pricing is "arbitrarily" established, it sets the standard by which current and future pricing is evaluated by the consumer ("coherence"). This approach flies in the face of the traditional assumption that price is evaluated by the consumer in terms of simple supply and demand. He cites the example of gas prices. When the price of gas goes up, there is an initial slow in demand, but as consumers become more acclimated to the new price, sales get back to normal levels. If and when gas returns to its previous price, consumers believe they are getting a good deal, when in fact, they are paying the same price as before.

Another time when consumers act predictably irrational is when we feel ownership towards something. Typically, Ariely argues, the more work we put into something, the more ownership we feel. The challenge is that we can begin feeling ownership even before owning it. He calls this idea, "virtual ownership." It is the basis on which companies make trial offers. Once a consumer "owns" it, it changes their perspective and hence their evaluation of the purchase.

Lastly, Ariely suggests that social pressures play a big role in consumer decisions and satisfaction. He cites a study in which groups of restaurant patrons were offered a list of microbrew beer samples and asked to make their selections verbally. Another group was offered the same list but asked to indicate their selection on an order form. Patrons who ordered verbally tended to make their selections based on what others at the table ordered. They also reported less satisfaction with their choices than those

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who made their choices privately. He concludes that consumers will derive greater satisfaction when allowed to make their selections anonymously.

In closing, the author posits that, while these behaviors are senseless and random, they occur in a predictable manner. The secret to overcoming irrational impulses is to recognize them and become more vigilant to their influence. He also suggests that businesses need to revise their thinking in order to appropriately understand and respond to these predictably irrational behaviors.

Where We Agree

We believe that Ariely has identified an important precept. Our work in measuring consumers' response to stimuli provides solid support to the notion that consumers often base purchase decisions on irrational influences. And we agree that businesses must develop a better understanding of irrational influences to be successful marketers.

In our experience, if you ask a consumer a rational question about their purchase preferences, you will get a rational answer. However, if purchase decisions are not made rationally, then "rational information" is not reliable – at least in terms of predicting consumer behavior. Instead, we try to present consumers with information that simulates a real world scenario. Imagine if you were searching for a flight from Los Angeles to Chicago. The rational approach would suggest that the shortest flight at the best price would be chosen. However, other factors can influence the decision, such as frequent flyer programs, travel companions, departure and arrival times, past experiences, etc.. To identify the "irrational" factors that have the greatest impact on consumer purchase decisions, it is essential to present them in real world scenarios.

In addition, we believe that, to gain insight on those factors that are most important and relevant to the consumers purchase decision, anonymity is essential. Focus groups have long been used as a method to obtain direct feedback from consumers and customers about products, services, pricing, etc. While focus groups can provide valuable information, they are, in our view, susceptible to influences similar to the microbrew experiment cited by Ariely. Giving consumers an opportunity to provide input and react to other's ideas in an anonymous, online environment provides an opportunity to understand what really motivates them.

Our Top 10 Quotes from PREDICTABLY IRRATIONAL

"Let me start with a fundamental observation: most people don't know what they want unless they see it in context." P. 3

"The basic idea of arbitrary coherence is this: although initial prices...are "arbitrary," once those prices are established in our minds they will shape not only present prices but also future prices (this makes them "coherent"). P. 28

"But as our experiments demonstrate, what consumers are willing to pay can easily be manipulated, and this means that consumers don't in fact have a good handle on their own preferences and the prices they are willing to pay for different goods and experiences." P. 47

"But we've seen that the perception of value, in medicine, soft drinks, drugstore cosmetics, or cars, can become real value." P. 242

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“In addition, a lot of our research has shown that people often have wrong intuitions about their own behavior – they can say one thing but do another.” P. 253

“Overall, those who made their choices out loud, in the standard way that food is ordered in restaurants, were not as happy with their selections as those who made their choices privately, without taking others’ opinions into consideration.” P. 313

“Getting people to order anonymously is most likely the cheapest and simplest way to increase the enjoyment derived from the experiences.” P. 316

“behavioral economists...believe that people are susceptible to irrelevant influences from their immediate environment (which we call context effects), irrelevant emotions, shortsightedness, and other forms of irrationality...” P. 318

“By the time we comprehend and digest information, it is not necessarily a true reflection of reality. Instead, it is our representation of reality, and this is the input we base our decisions on.” P. 321

“Our irrational behaviors are neither random nor senseless – they are systematic and predictable.” P. 317

OG's 1-9 Rating

On a scale from 1-9, we give *Predictably Irrational* a 7.

All in all, *Predictably Irrational* is an interesting read. Ariely has encapsulated an important issue in his book. While some of the ideas and examples he cites will be of more interest to social scientists than marketers, it is worth considering what irrational influences impact your customers. However, it focuses more time helping readers identify and avoid these influences rather than understanding and capitalizing on them.