



Indian Institute of Management Indore

POST GRADUATE PROGRAMME IN MANAGEMENT AY 2018-19 TERM: VI

TITLE OF THE COURSE: BEHAVIOURAL ECONOMICS AND CONSUMER CHOICE
CREDITS: 2 **SECTIONS:** 2

Name of the Faculty	Faculty Block/ Room No.	Email	Telephone Number
Prof. Punarjit Roychowdhury	J-214	punarjitr@iimidr.ac.in	+91-731-2439481

CONSULTATION TIME FOR STUDENTS

Name of the Faculty	Timing
Prof. Punarjit Roychowdhury	By appointment only

COURSE DESCRIPTION: The purpose of this course is to inform future managers, analysts, consultants, and advisors of the psychological processes and biases underlying consumption decisions of individuals, with an emphasis on how to incorporate such insights into marketing and business strategies. The course has two dimensions. First, it gives students a broad overview of important results from behavioural sciences that illustrate how people make economic decisions. Second, it provides students with knowledge about applying these findings to topics in consumer behaviour analysis. Classroom time will be devoted to a combination of lectures and discussion of experimental findings illustrating the main concepts.

Successful business and marketing strategies depend on a thorough understanding of how consumers make decisions. Traditional models of consumer decision-making (i.e., the rational choice models) predict how consumers *should* behave. However, rather than making decisions in the manner postulated by these models, consumers often use a variety of rules and processes (called heuristics or cognitive shortcuts) that can lead to counterintuitive behaviour. For instance, consumers have an exaggerated tendency to select default options when making choices or when consumers need to choose between a fixed-fee option and a per-use option for a particular service, they often end up choosing the fixed-fee option although they would have been better off choosing the per-use option. Seemingly “irrational” consumer decision phenomena such as these abound. This course seeks to examine a series of similar findings or behavioural anomalies from research in consumer decision-making by augmenting the rational choice framework with principles developed in the fields of psychology, sociology, marketing and even anthropology to understand the decision-making process of flesh-and-blood humans who often do not seem to know what they want or how to get things in the most logical way.

COURSE OBJECTIVES: By the end of this course, the participants should:

- Become familiar with the core concepts of behavioural economics that are used to understand consumer decision-making and consumer choices.
- Be able to analyze the relationship between rational models, behavioural models and procedurally rational models of consumer behavior.
- Have a thorough understanding of the psychological and behavioural biases that influence consumer choices.
- Be able to apply the key principles of behavioural economics in various kinds of consumer problems.
- Ultimately have all the necessary insights about consumer decisions that are required to become successful managers, marketers, analysts, consultants and decision-makers.

PEDAGOGY/TEACHING METHOD: This is primarily a lectures-based course. The lecture notes are drawn from a rich source of research papers in economics, psychology, sociology, and marketing. Additionally, we will also discuss the design and findings of some important experiments from the behavioral economics literature to illustrate the core concepts covered in class.

PRE-REQUISITE FOR COURSE, IF ANY: None

IF DOUBLE SECTION, ATTENDANCE IN SISTER SECTION: Not Allowed

EVALUATION

Individual Component	Group Component	Weightage
Mid-Term Examination		40
Final Examination		60
Total		100%

ACADEMIC DISHONESTY

IIM Indore believes in Academic honesty. Academic dishonesty or misconduct is cheating that relates to an academic activity. It is a violation of trust between the Institute and its stakeholders. Plagiarism, fabrication, deception, cheating and sabotage are examples of unacceptable academic conduct. Please consult the Programme manual for the section on academic dishonesty.

SCHEDULE OF SESSIONS

Module I: Introductory Module

Module Objective: To understand the core ideas of behavioral economics.

Session 1	Introduction to behavioural economics and its role in consumer choice
Objective:	Understanding the fundamental idea of behavioural economics, the relationship between rational model of consumer choice and behavioural economics, the theory of bounded rationality, and overview of the role of behavioral economics in consumer decision-making.
Reading:	<ul style="list-style-type: none"> Lecture notes

Module II: Transaction Utility and Consumer Pricing

Module Objective: To understand the concept and theories of transaction utility and how it can explain the sunk cost fallacy.

Session 2	Basics of Transaction Utility and the Sunk Cost fallacy
Objective:	Understanding the principal of cost-benefit analysis, concepts of transaction utility and sunk cost fallacy. Additionally, two important models of sunk cost fallacy – Thaler’s model of transaction utility and Kahneman and Tversky’s model of Prospect Theory – will be discussed.
Readings:	<ul style="list-style-type: none">• Lecture Notes• Thaler, R. (1985). “Mental Accounting and Consumer Choice,” <i>Marketing Science</i>, 4, 199-214.• Arkes, H.R., and Blumer, C. (1985). “The Psychology of Sunk Costs,” <i>Organizational Behavior and Human Decision Processes</i>, 35, 124-140.
Session 3	Theories of Flat Rate Bias and Reference-Dependent Preferences based on Transaction Utility
Objective:	Discussion of the concept of flat rate bias, procedural explanations for flat rate bias and understanding the idea of context dependent preference.
Readings:	<ul style="list-style-type: none">• Lecture Notes• Della Vigna, S., and Malmendier, U. (2006). “Paying Not to Go to the Gym,” <i>American Economic Review</i>, 96, 694-719.

Module III: Mental Accounting

Module Objective: To understand the core issues related to mental accounting and how it can be used to understand apparently non-optimal consumption decisions.

Session 4	The Theory of Mental Accounting
Objective:	Understanding the concept and theory of mental accounting and how mental accounting/budgeting can lead to non-optimal consumption choices.
Readings:	<ul style="list-style-type: none">• Lecture Notes• Thaler, R. (1985). “Mental Accounting and Consumer Choice,” <i>Marketing Science</i>, 4, 199-214.
Session 5	Mental Accounting: Further Issues
Objective:	Understanding the effects of integrating versus segregating gains and losses, concept of acquisition utility, ideas of payment decoupling and payment depreciation, limiting temptations based on mental accounts and the role of gifts, understanding consumer spending out of anticipated and unanticipated earnings.
Readings:	<ul style="list-style-type: none">• Lecture Notes• Prelec, D., and Loewenstein, G. (1998). “The Red and the Black: Mental Accounting of Savings and Debt,” <i>Marketing Science</i>, 17, 4-28.• Thaler, R. (1999). “Mental Accounting Matters,” <i>Journal of Behavioral Decision Making</i>, 12, 183-206.

Module IV: Status Quo Bias and Default Options

Module Objective: To understand the concept of status quo bias, how default options influence consumer preferences and the basic idea of endowment effect.

<p>Session 6</p> <p>Objective:</p> <p>Readings:</p>	<p>Introduction to Status Quo Bias and Default Options</p> <p>Understanding the concept of status quo bias and default option bias, rational choice and default options, the role of default options in preference formation, the concepts of anchoring and adjustment, rational explanations of the status quo bias, and loss aversion in consumption space.</p> <ul style="list-style-type: none">• Lecture Notes• Madrian, B.C., and Shea, D.F. (2001). "The Power of Suggestion: Inertia in 401(k) Participation and Savings Behavior," <i>Quarterly Journal of Economics</i>, 116, 1149-1187.• Johnson, E.J., and Goldstein, D. (2003). "Do Defaults Save Lives?" <i>Science</i>, 302, 1338-1339.
<p>Session 7</p> <p>Objective:</p> <p>Readings:</p>	<p>Additional Topics in Status Quo Bias and Default Options</p> <p>Understanding the ideas of diminishing sensitivity and constant sensitivity to distance from reference point, rational choice and getting and giving up goods – the disparity between maximum willing to pay and minimum willingness to accept, the endowment effect – loss Aversion and how it explains endowment effect, rational explanation for the endowment effect.</p> <ul style="list-style-type: none">• Lecture Notes• Kahneman, D., Knetsch, J.L., and Thaler, R.H. (1991). "The Endowment Effect, Loss Aversion, and Status Quo Bias," <i>Journal of Economic Perspectives</i>, 5, 193-206.

Module V: Auction Behavior & Research Paper Discussion

Module Objective: To understand rational bidding strategies in different auction formats and review of experimental findings pertaining to auctions. The last session of this module (which is also the last session of the course) will be used for discussing some recent research on behavioral economics in detail.

<p>Session 8</p> <p>Objective:</p> <p>Readings:</p>	<p>Auction Fundamentals</p> <p>Understanding rational bidding in second price sealed bid (Vickrey) auction, second price open auction and first price open auction, overbidding in Vickrey auctions, sniping behavior in auctions, bidding in English auctions and difference in bidding behavior between Vickrey and English auctions.</p> <ul style="list-style-type: none"> Lecture Notes
<p>Session 9</p> <p>Objective:</p> <p>Readings:</p>	<p>Auctions with Uncertainty and the Winner's Curse</p> <p>Understanding rational bidding under first price sealed bid auctions and Dutch auctions, rational prices in English, Dutch and first price auctions, auction with uncertainty: common value auctions, and the Winner's Curse – definition, explanations and experimental findings.</p> <ul style="list-style-type: none"> Lecture Notes Thaler, R.H. (1988). "The Winner's Curse," <i>Journal of Economic Perspectives</i>, 1988, 191-202.
<p>Session 10</p> <p>Objective:</p> <p>Readings:</p>	<p>Paper Discussion</p> <p>We will cover a couple recent papers <i>in detail</i> that apply the behavioral concepts/insights discussed in the course. Active participation from the students is expected.</p> <ul style="list-style-type: none"> TBA

Text Book for the course: Please give the details of the book if students need to buy the book

<u>Author</u>	<u>Title</u>	<u>Publisher</u>	<u>Edition</u>	<u>Remarks, if any</u>

Reference Text Book: The following books are recommended for supplementary reading:

1. Thaler, R. & Sunstein, C.R. (2009). *Nudge: Improving Decisions About Health, Wealth and Happiness*. UK: Penguin.
2. Ariely, D. (2010). *Predictably Irrational: The Hidden Forces that Shape Our Decisions*. New York: HarperCollins Publishers.
3. Kahneman, D. (2011). *Thinking, fast and slow*. New York: Farrar, Straus, and Giroux.

Additional Readings:

None.
