Designing policy to influence consumers

Briefing note 1: consumer behaviour and product policy

When designing policy to influence the way in which people buy products, you must take into account the way in which people make choices.

It is increasingly clear that consumers rarely weigh-up the full costs and benefits of their purchasing decisions. Instead, they are strongly influenced by emotional factors, the behaviour of other people, and by the use of mental short-cuts, which all help to speed up decision-making. Policy must take into account all of these different factors if it is to effectively influence consumer choice.

This briefing summarises the key findings of the project 'Designing policy to influence consumers: consumer behaviour relating to the purchasing of environmentally-preferable products'.

What do we know about consumers?

- **Consumers rarely weigh up all the costs and benefits of choices.** Instead, purchasing decisions may be made automatically, habitually, or be heavily influenced by an individual's emotions or the behaviour of others. This also means that consumers tend not to use all of the information available to them when shopping. Instead, people are more likely to read information when they perceive a benefit from doing so.

- **Consumers use mental short-cuts to help speed up decision-making.** These short-cuts can distort consumers' decisions. Short-cuts can include relying on labels or brand names that are recognised, and being influenced by the way in which information is presented and the context in which a decision is made.

- **Consumers respond more to losses than gains.** This means people are more reluctant to give something up or suffer loss than they are motivated by benefits of equal value. This aversion to loss has a significant impact on the way in which people interpret information and can lead to consumers avoiding making choices altogether.

- **Consumers value products much more once they own them.** In addition, the value placed on a product is inconsistent. It can vary over time, and can be affected by the previous cost of the product and the emotional attachment someone places on a product. This makes people reluctant to trade in old products, even when it would be cost-effective to replace them.

- **Consumers place a greater value on the immediate future and heavily discount future savings**. This impacts on the way in which consumers value the efficiency and lifetime costs of appliances.

- **Too much choice can be overwhelming to consumers, making decision-making difficult.** As choice increases, consumers may consider fewer choices, process less overall information and evaluate information differently. When choice is particularly excessive, consumers may actually avoid making a choice altogether.

- **Consumers are heavily influenced by other people.** This might take the form of an indirect influence, for example from seeing neighbours or friends buying a product, or a more direct, explicit influence, for example when a salesperson persuades someone to buy a certain product. Nearly all consumption choices are subject to some kind of social influence.

- **Consumers use products to make a statement about themselves.** Products meet far more than just a functional need; they make a statement about a person's identity and about the type of person they are and would like to be. One of the most important lessons from marketing is that people buy products for very different reasons; while some people may be motivated by concern for the environment, many others will not.

So what does this mean for product policy?

- **Reconsider the impact of price.** The impact that price has on consumer behaviour can be influenced by in-store marketing (such as special offers), by the prices of similar products, and by consumer perceptions of price changes. Policy should work with retailers to encourage price promotions on environmentally-preferable products. Although price incentives may initially cause consumers to react to price changes, evidence suggests this will not be maintained. Financial levers that increase over time can overcome this problem.
- **Help consumers consider long-term costs.** Consumers have a tendency to overvalue the short-term and undervalue the future so tend not to consider the long-term running costs associated with products. Policy could work with retailers to ensure that the long-term costs of products, rather than just the purchasing price, are highlighted to consumers.
- **Recognise the importance of recognition.** Consumer choice is often driven by recognition of products, brands or labels. Labels need to be consistent and easily recognisable, something which the current colour-coding system used within the European energy label will aid. Future labelling schemes should take advantage of the fact that consumers may already recognise 'A' rated products as the most energy efficient. A 'frontrunner' approach, whereby classes are updated periodically so that the most energy efficient products are always awarded an A label, would help to maintain this existing recognition.
- **Make it easier to make choices.** This may mean making it easier for consumers to research their purchases, for example by improving Internet-based price comparison sites. It could also mean 'editing' the choices that consumers face, for example by removing the most unhealthy or the most environmentally damaging products from the market.
- **Fines may be more effective but incentives are preferred.** People feel the loss from a fine more than they value gains from an incentive. The difficulty is that, because individuals are loss averse, they are equally averse to policies that suggest future losses. Policies that fine people are likely to be less publicly acceptable for precisely the same reason that they are likely to prove more effective.
- **Ensure that standard models are environmentally-preferable**. If a consumer feels overwhelmed by choice or perhaps is just in a rush when shopping, they are often likely to accept the standard product model, or 'default'. Policy should work with retailers to ensure that standard product models (for example those that consumers receive if they do not specify otherwise) are the most environmentally preferable.
- **Allow consumers to change their minds.** Often consumers make poor decisions because they are under pressure to make a decision. 'Cooling off periods' provide consumers with the space to calmly consider the costs and benefits of a purchase, away from pressure of a sales environment. This is especially useful for high value purchases, like cars or expensive electronics, where the influence of salespersons in-store is known to be powerful.
- **Remember that all consumers are different.** Gender and income levels impact on product choice, as do attitudes, values and beliefs. While some people may carry out extensive information searches before shopping, others may be content to decide in-store or to listen to the advice of a sales person. No single policy intervention is likely to change the behaviour of all consumers. Instead, a mix of policies will be the most effective way of influencing different consumers.

Introduction

Consumer behaviour in the real world often differs from that predicted by economics and policy. In light of this, findings from psychology, marketing and behavioural economics are helping to build a more realistic understanding of consumer behaviour. This briefing summarises key findings from the project ‘Designing policy to influence consumers: consumer behaviour relating to the purchasing of environmentally-preferable goods’. It begins by considering what is known about the way that people make decisions, before looking at wider findings from the project and the implications of these for policy.

The two dimensions of decision-making

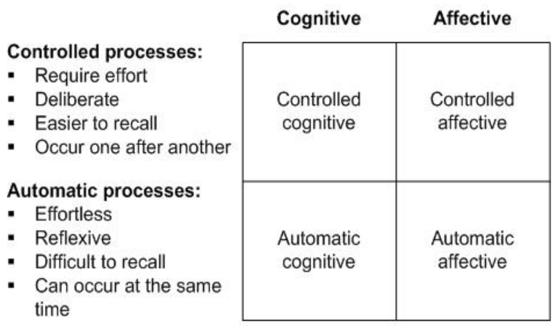


Figure 1: The two dimensions of decision-making[i]

There are two different dimensions to the way in which people think. One dimension relates to the amount of time and effort used when we make a decision: these thoughts can be either automatic or controlled. The other dimension distinguishes between two types of thought processes:

- Cognitive, which are those more traditionally associated with slow, rational thought, and
- Affective, which are linked to emotions or feelings.

Emotions, or affective thoughts, have not in the past been linked to decision-making, particularly by standard economics. Where the link has been made it has often be considered a secondary process. However, it is now clear that both cognitive and affective processes have a valuable role in real world consumer choice. It is our affective thoughts that often help us decide whether or not to buy a product. Emotional responses are therefore essential to decision-making; without them, making choices would result in excessive and costly indecisiveness. This is an important lesson for policy because it confirms that many choices that people make are not subject to a considered, deliberative assessment of the costs and benefits. In fact, it is this twin-functioning way in which we think that accounts for much of the consumer behaviour we observe in the real world.

Short-cuts when shopping

When individuals make decisions quickly, they often rely on mental short-cuts that help to speed up decision-making. Some of the most frequently used short-cuts include:

- **Ease of thinking.** Consumer judgements are affected by how easily and quickly similar examples or experiences spring to mind. The easier it is to think about an event or bring it to mind, the more likely we are to judge it to happen. For example, if asked to judge the average lifespan of a new fridge, I may think about how long my previous fridge lasted. If my last fridge broke after only one year, I will judge the probability of a new fridge breaking after its first year as quite high – even though the chance of this actually happening might be quite small. In the context of product purchasing, our prior experiences of a product can heavily impact on future purchasing decisions, regardless of whether these experiences are reliable.

- **Recognition.** When forced to make a decision quickly, consumers may make decisions based purely on their recognition of a particularly make, brand or label, regardless of what is known about the product itself. This means that consumers will sometimes grab an item that they recognise, regardless of the other information on the label. Labels, such as energy labels, need to be consistent and easily recognisable, something which colour-coding systems do.
- **Anchoring and adjustment**. When we need to estimate the unknown value of something, we often use a mental fix or anchor – a number that is known or about which a reasonable estimate can be made – as the basis for estimating value. Although this is a useful way of making a reasonable judgement about an unknown, the process of anchoring can be problematic if irrelevant or distorted anchors are adopted, or if people fail to adjust their estimations over time. Anchoring has implications for the long term effectiveness of financial incentives, because consumers may readjust behaviour to new anchors and prices. This means that any initial changes in behaviour may not be maintained over time. Financial levers that increase over time can overcome this problem.
- **Aversion to loss.** Individuals are more averse to loss (or to giving something up) than they are to gain. This has an impact on both the way we interpret information and the way in which we value products. It also means people value the cost of a fine (a loss) more highly than they value the gains of an incentive. The challenge for policy is that, because individuals are loss averse, they are equally averse to policies that suggest future losses. Policies that involve charging or fining people are likely to be less publicly acceptable for precisely the same reason they are likely to prove more effective.
- **The way in which information is presented.** Consumers' interpretation of information or different options is affected by the way in which the information is presented, or 'framed'. For example, if an energy efficient product saves someone money through reduced energy bills, the information could be presented in one of two ways: in terms of the losses compared to a more efficient product, or in terms of the savings that result from the more energy efficient product. Box 1 illustrates the way in which framing effects work.

Box 1: *Framing: an energy saving example*

Campaign A:

'Insulating your loft and cavity walls could save you around €250 a year on energy bills'

Campaign B:

'If you don't insulate your loft and cavity walls, you could be losing as much as €250 a year on energy bills'

Even though the above statements convey the same information about energy saving, they are framed differently. Campaign A emphasises the benefits of installing insulation, while campaign B emphasises the costs. In this instance, because people are naturally more averse to loss than they are attracted to gains, the phrasing of campaign B will be the more effective campaign.

The impact of ownership

The amount someone is willing to pay to obtain a good is usually much less than they require to part from it. In short, we value something more once we own it. This particular aversion to loss is linked to our past experiences using that product, rather than a realistic assessment of its future use. This can make it difficult to encourage people to replace old products with new, more energy efficient models.

A reluctance to choose

Our avoidance of loss means that we often favour what we have. In general, when we make a choice, we weigh up the advantages and disadvantages of a choice relative to our current situation. When we imagine a change in situation, the disadvantages loom larger than advantages so we decide it is preferable to avoid making a decision. This effect has been used as one explanation for consumers' reluctance to switch energy suppliers as the costs of switching seem so great.

This reluctance to choose means that standard models, known as 'defaults', are a powerful policy tool. A 'default' might be the product model that a consumer receives if they do not explicitly choose an alternative, or the energy tariff they receive if they do not switch. Standard models are powerful because they can be taken to indicate endorsement. For example, a standard product model may be interpreted as the option that policy-makers have identified as the most beneficial for individuals. They are also powerful because consumers can rely on them when they are reluctant to make choices.

Box 2: *Real world example: green energy defaults*

There is growing evidence that domestic consumers are not switching energy supplier as much as anticipated at the point of deregulation. It has been estimated that in many cases, consumer welfare would have been greater if the state had regulated prices on consumers' behalf. This 'willingness not to choose' has been utilised by the authorities in two German areas who offered choice but made green energy the default option. The result is that 94% and 99% of customers kept their default green tariff. These examples seem to suggest that offering the product as the default saves time for the consumer, takes advantage of peoples tendency to keep what they have and avoid losses.

Source: Pichert and Katsikoupoulous (2008)

Thinking about the value of products

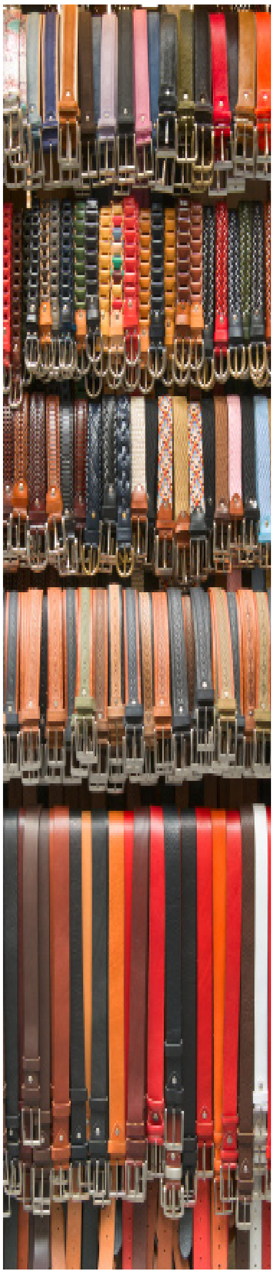
People are often unrealistic about the true value of things that they own. The value consumers place on a product is not simply the replacement value but a value that reflects a range of factors, such as whether or not the item has fulfilled its use and emotional attachment to the product. For example, people who feel emotionally attached to their cars value them more highly than people who think about their cars solely as a mode of transport. Consumers are also influenced by the price they originally paid for a product, known as 'sunk costs', as well as the future value of the product. This is the case even when it would save them money to buy a more efficient replacement. Rather than replacing an item, there is a tendency to hang on to broken or useless products because they cost us a lot of money in the past. For example, people are much more likely to give a cheap pair of shoes to a charity shop than a more expensive pair, even if in both situations the shoes hurt the wearer and have been sitting in a wardrobe unworn for months.

Valuing the future

People value the immediate future highly while placing much less value on the distant future. The different ways we think about future values have been found to be unstable and reflective of different factors, like the size of the good we are valuing. Similarly, the way in which we value the future varies across different types of behaviour. For example, we tend to favour immediate rewards and avoid immediate costs. The use of loans which are linked to the savings from more efficient products can help people value longer-term benefits, as well as ‘commitment devices’ (for example, a club or group in which people commit to doing something in the presence of other people).

The impact of too much choice

When faced with too much choice, people have difficulty making decisions. As choice increases, consumers may actually consider fewer options, process less overall information and evaluate information differently. For example, when presented with one good option, a consumer may be happy. But if presented with two good options, they are more likely to evaluate both and to notice their relative disadvantages. Whichever option the consumer then chooses, they will be aware of its disadvantages – something that might not be the case if there was only one option.



Close consideration of a suite of options may also lead consumers to form an emotional attachment to all options, so that choosing one option then feels like losing the others. When faced with multiple undesirable options, consumers are happier if someone else makes the choice for them than if they have to make the choice themselves. For example, if someone is on a diet and has to choose between a selection of unappealing meals, they will be happier if someone else chooses the meal for them.

Policy-makers can help consumers overcome the problems of excessive choice by making it easier for people to compare different products and prices. Setting prices and packaging products in standardised, easily comparable way makes it easier for consumers to make informed decision. Similarly, ensuring that price comparison websites present information in an easy-to-understand, neutral manner will reduce the search costs that consumers incur when looking for information. Comparison websites that give consumers the option of choosing how search results are displayed present consumers with a fairer method of comparison than those that allow retailers to pay for prominent positioning.

In addition, setting tough minimum product standards to ensure environmentally damaging products are removed from the market is acceptable to many consumers. People often think it is acceptable for government to restrict the sale of the least environmentally preferable products and often assume that this is already being done. The focus in such an instance should be on removing the least environmentally preferable products from the market, thereby ‘editing’ rather than restricting choice.

The impact of too much information

Across many areas of consumer policy, information provision is favoured as a policy tool because of its relative low cost and because it is assumed that too much information cannot harm consumers. This is not always the case.

In part, the limitations of information provision stem from the fact that consumers rarely search out, read or properly digest all of the information available to them. The sheer volume of information now found on products and packaging can make understanding information harder rather than easier. In addition, consumers will only read all the information available to them if they perceive personal benefits from doing so. If consumers are not concerned with energy efficiency or environmental protection, highlighting more specific personal benefits – in terms of reduced running costs or total product lifetime savings – could prove more motivating. Where feasible, indicating the potential savings over the expected lifetime of a product would prompt consumers to consider these costs when shopping.

Another reason that the provision of information rarely leads to direct changes in consumer behaviour is the number of other factors which motivate and impact upon behaviour - for example, the social impact of other people.


© Gursky (1999)

The impact of other people

Individuals are heavily influenced by the behaviour of other people and often look to others to understand how best to act. This is especially the case in times of uncertainty. For example, when shopping online, we may feel unsure about a product and choose the product most frequently bought by other customers, without realising that these other customers might simply be following the choices of others as well. People are increasingly using the Internet and consumer guides to research the purchasing of new products. Although there is a limited role for policy in the functioning of 'star rating' schemes and other peer-to-peer information systems, it is important to ensure the authenticity of these is guaranteed. Pairing up with independent, trusted providers of consumer information is another way that policy can effectively provide information.

Intermediaries, such as sales assistants, have a great influence on consumer decision-making at the point of sale. Working with retailers and trade associations to ensure their staff and members are well-informed about the advantages (for example, the energy efficiency) of different products will improve the communication of these messages. Although sales representatives can be very persuasive, this can also lead to some consumers treating their recommendations with caution or feeling pressured to buy a product. Offering consumers in-store price comparisons and opportunities to change their mind about a purchase once they get it home (for example, money -back guarantees or cooling-off periods) helps to reassure consumers that they are not being persuaded into a purchase they may later regret.

The impact of payment

Rather than motivating people, the imposition of monetary incentives can sometimes have precisely the opposite effect. For example, the imposition of a fine for not recycling may be interpreted as a price to be paid. Prior to the introduction of the fine, people may have been willing to recycle because they felt it the socially acceptable way to behave. Rather than acting as a deterrent, a person might assume that the fine makes it acceptable not to recycle because they are paying to do so. If the fine is set too low, this could in fact lead to a reduction in rates of recycling. Incentives may therefore be more useful in prompting completely new behaviours, rather than focusing on activities that some individuals already undertake.

Wider policy implications

The power of social influence over individuals' behaviour can be harnessed through social marketing campaigns, which highlight what most other people in society do, or suggest what is socially acceptable. Examples of successful campaigns include campaigns that have reduced domestic energy consumption by providing feedback to households on the average level of energy consumption in their community and those that have targeted recycling.

Source: New York Times

Across all product policy…

In addition to some of the more specific policy opportunities considered above, both marketing and behavioural economics provide two important lessons for product policy more generally:

A tailored approach to policy-making. Given the number of factors that determine behaviour, it is unrealistic to model policy aimed at a single 'consumer'. Instead, policy should recognise that different people will react differently to different policies. Splitting up populations into different groups according to their attitudes and behaviours – an approach known as 'segmentation' – enables policy-makers to consider how different groups may react differently to policies.

From products to practice. In order to understand patterns of consumption, we need to consider the much wider context in which products sit. If the washing of clothes is determined by socially-determined ideas of hygiene and 'freshness' as well as external (and completely incidental) factors like the weather, it is just as important to understand how these factors affect individuals' behaviour as it is to think about the in-store promotions that might affect consumers' choice of washing machines.

Further reading: The briefing provides a summary of evidence from behavioural economics and marketing relating to the purchasing of consumer products. Full references for all of the evidence presented here can be found in the full project report 'Designing policy to influence consumers' from which a series of briefs has been produced. Other briefings in the series: 'Consumer behaviour and electronics'; 'Consumers and their cars', 'Food and drink', 'Consumer behaviour and white goods', and 'Consumer behaviour and energy purchasing'