



# Indian Institute of Management Bangalore

Bannerghatta Main Road, Bengaluru, Pin – 560 076, India

## Behavioral Economics

Understanding human behavior for better decision making

EMBA Week, JUNE 2022

Faculty: Ritwik Banerjee

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Microsoft Teams: @ritwikbanerjee (preferred)

Class Time:

Class Room: zoom

Quizzes: 1

### ◆◆◆COURSE DESCRIPTION◆◆◆

The purpose of this course is to inform future managers, analysts and consultants of the deeper psychological processes which underlie decision making. The course will enable the students to incorporate the insights into marketing, human resource practices, finance and business strategies.

How a woman (or a man) fares in life depends to a large extent on a series of decisions that she takes. However, the process of how we arrive at decisions is often very complex. To keep things simple, economists assumed away much of the complexity and developed a rather simplistic framework for analyzing human behavior. The framework came to be known as the Rational Actor Model, where human beings were assumed to have many super human power. Let's call them *homo economicus* or simply, *Econs*. *Econs* are willful, selfish and have perfect foresight while also possessing extraordinary abilities to make complex calculation at very short period of time. Behavioral Economics was born as an antithesis to the Rational Actor Model. In this alternative paradigm, human beings were assumed to be less selfish and smart, prone to mistakes and procrastinations and often times myopic. Let's call them *homo behavioralis* or *Humans*. Do Humans sound more like you and me or for that matter, your neighbor next door? Consider the following: ask the person on your left the answer to the following:  $1 \times 2 \times 3 \times 4 \times 5 \times 6 \times 6 \times 7 \times 8 \times 9 = ?$  To the one on your right:  $9 \times 8 \times 7 \times 6 \times 5 \times 4 \times 3 \times 2 \times 1 = ?$  Chances are that the one on your right will quote a higher number. The reason is they are *Humans*. If they were

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all *Econs*, the answer they would give would all be the same and it would indeed be the correct answer.

Each topic covered in this course will have two facets. First, students will get a broad overview of important results from behavioral economics and psychological aspects of economic decision making. Second, the students will see applications corresponding to these results. The course will also introduce the students the idea of experimentation - the methodological tool in which one thing is changed at a time which in turn makes causal inference possible. Overall, the participants will have a better understanding of people and how they make decisions, which in turn will allow them to take effective managerial decisions.

## ◆◆◆COURSE OBJECTIVES◆◆◆

The objective of this course is to deliver:

- **Conceptual fundamentals** governing how decisions are made.
- **Ample business applications** of important results and principles of behavioral economics.

This course will enable students to have a better understanding of people and how they take decisions, which in turn will lead to effective decision making in the context of management.

## ◆◆◆COURSE PEDAGOGY◆◆◆

A variety of approaches will be used – lectures will contain short cases or caselets, presented in the form of Business Applications and newspaper articles. In class exercises in the form of Demonstration Problems and Examples will also be used. Performance in this course will depend on three quizzes and a class activity. How well you do on ALL these components will determine your final grade.

## ◆◆◆READINGS◆◆◆

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The lecture slides will contain the essential elements needed for the course. Readings and handouts will be given throughout the course.

The following are the textbooks for the course:

1. *Thinking Fast and Slow* by Daniel Kahneman
2. *Misbehaving* by Richard Thaler

The following are some of the suggested readings:

3. *Judgement in Managerial Decision Making* by Max. H Bazerman and Don A. Moore
4. *Nudge* by Richard Thaler
5. *Personnel Economics* by Peter Kuhn
6. *Personnel Economics in Practice* by Edward Lazear and Michael Gibbs
7. World Development Report 2013

## ◆◆◆CLASS DISCUSSIONS◆◆◆

Students should ideally contribute regularly to the class discussion, either when called upon by the instructor (a.k.a. 'warm' calling) or on a voluntary basis. To a substantial extent, the benefit that a student derives from the course will be related to his/her willingness to expose his/her viewpoint to the critical judgment of the class, and to his/her active participation in building upon the ideas of others.

## ◆◆◆EVALUTAION◆◆◆

Component	Unit	Weight
Quiz	Individual	40%
Project Presentation	Group	60%

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All the three quizzes are compulsory. A quiz will be ofp about 1 hour duration and will consist of MCQs and/ or descriptive questions/numerical problems. **All quizzes will be closed book.**

## ◆◆◆ TEAM BASED ACTIVITY◆◆◆

As part of this course, you are expected to work in groups of up to four members for a team based activity. The purpose of this activity is to apply some of the principles you learn on some real-life issues. At the end of the course, each group will be invited to make an 8-minute presentation and a activity report will have to be submitted. The activity report should be no more than 2000 words (excluding references). Students are expected to note the following:

- 1) Be concise and to the point. There should be a strong logical flow in your analysis.
- 2) You should be explicit with your assumptions whenever necessary.
- 3) The analysis should be thorough and should draw on the material covered in class or assigned in readings.
- 4) Your write up should offer specific recommendations on the problem you are analyzing.

The activity may comprise of one of the following:

- a) Conducting an actual experiment, online or offline.
- b) Analyzing a problem faced by a firm/customer/consumer using the lenses of behavioral economics (Example: Should Uber show its customer 1.8X of the base fare or simply quote the total fare?)
- c) Discussion of cases or simple papers which solve a specific managerial decision-making problem using some of the principles of behavioral economics.

## ◆◆◆ MAKE UP EXAMS◆◆◆

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As a general rule, there will be **no make-up exam**. All related issues will be decided in accordance to the PGP guidelines.

## ◆◆◆PLAGIARISM AND CHEATING◆◆◆

Significant amount of learning happens outside class room by interaction among your class mates. However, the same **MUST** not be carried forward in class. You must not be found talking with any class mate, looking at books/notes or chits of any kind in class room during the exams. Failure to do so would imply cheating. Violation of these norms would attract penalty as per instructor's discretion. Such instances in the past have led to a F. Your project report will go through anti plagiarism software such as Turnitin. Be very careful when you write it. Do not copy any sentence from anywhere.

## ◆◆◆CELL PHONE AND LAPTOP POLICY◆◆◆

Please make sure that your **cell phones/tablets/laptops are switched off before** the class begins and remain in switch off mode for the entire duration of the class.

## ◎◆◆◆COURSE ROADMAP◆◆◆

### Session-wise plan

Credits: 3. Total Hours: 30. No. of sessions: 20

Day	Session in the day	Lecture	Topic
1 [13 <sup>th</sup> Jun]	1	1	<b>Introduction to Behavioral Economics</b> <i>In class experiment</i> Econs and Humans Reading: "Humans and Econs" Chapter 1, Nudge
1	2-3	2-3	<b>Heuristics, Biases and Emotions</b> <i>In class experiment</i>

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			How do consumers use heuristics to make decisions? What are the biases in their decision-making process? Reading: “Part II: Heuristics and Biases” Chapter 10-13, Thinking Fast and Slow
1	3-4	3-4	<b>Overconfidence and Exponential Growth Bias</b> <i>In class experiment</i> What is exponential growth bias? Application: personal finance Application: COVID-19
2	1-2	5-6	<b>Loss Aversion</b> Why are losses more painful than gains pleasurable? Applications of loss aversion Reading: Chapter 26 and 27, Thinking Fast and Slow <b>Case:</b> Why Consumers Don’t Buy: The Psychology of New Product Adoption (HBR) (Gourville, 2003)
2	3	7	<b>Mental Accounting</b> How do we partition payment streams and set prices? Reading: Part II – Mental Accounting, Misbehaving, Richard Thaler
2	4	8	<b>Perceptions of Risk, Confidence and Consistency</b> Why do people buy lotteries when they are not worth it? Why do people not buy insurance when they are worth it? Reading: Chapter 19, 30, 31, Thinking Fast and Slow
3	1-2	9-10	<b>Impatience and self-control</b> How people really discount the future? Why do we buy alarm clocks when we actually prefer to sleep in the morning? Reading: Chapter 11 and 12, Misbehaving

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3	3-4	11-12	<p><b>Strategic Thinking among Humans</b> Level-k thinking How strategic do strategic people think others are Reading: Lecture Slides, Ch 21, Misbehaving</p>
4	1	13	<p><b>Perceptions of fairness</b> Is UBER's surge pricing fair? Is it fair for a hospital to charge surge pricing in times of dengue? Reading: Chapter 8, Judgement in Managerial Decision Making</p>
4	2	14	<p><b>Social Preferences</b> Peer effects, charitable contribution, cooperation, social norm How does Apple leverage social preferences to push the sale of iPhones? Reading: Chapter 8, Judgement and Managerial Decision Making In class experiment</p>
4	3	15	<p><b>Discrimination</b> Why does a Black/Dalit/Muslim/Female get paid less than an equally able White/Upper caste/Hindu/Male worker? Explicit and Implicit biases among managers Gender differences in self-confidence, competition, risk preference, leadership Reading: Chapter 16 Personnel Economics</p>
4	4	16	<p><b>Nudges and Public Policy: Defaults and Choice Architecture</b> How do we design lunchrooms so that children opt for healthier food? How do we make people save more without changing the interest rates? Reading: Chapter 4, 5 and 16, Nudge</p>

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5	1	17	<b>Economics of Gender</b> Gender and self confidence Gender and competition Gender and low-promotability jobs Reading: HBR article on low-promotability jobs
5	2	18	<b>Happiness Economics</b> What makes us happy? How good are we at predicting what will make us happy? Does money make us happy? Reading: Chapter 35, 37 and 38, Thinking Fast and Slow
5	3-4	19 - 20	<b>Student presentations on the team-based activity</b>

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