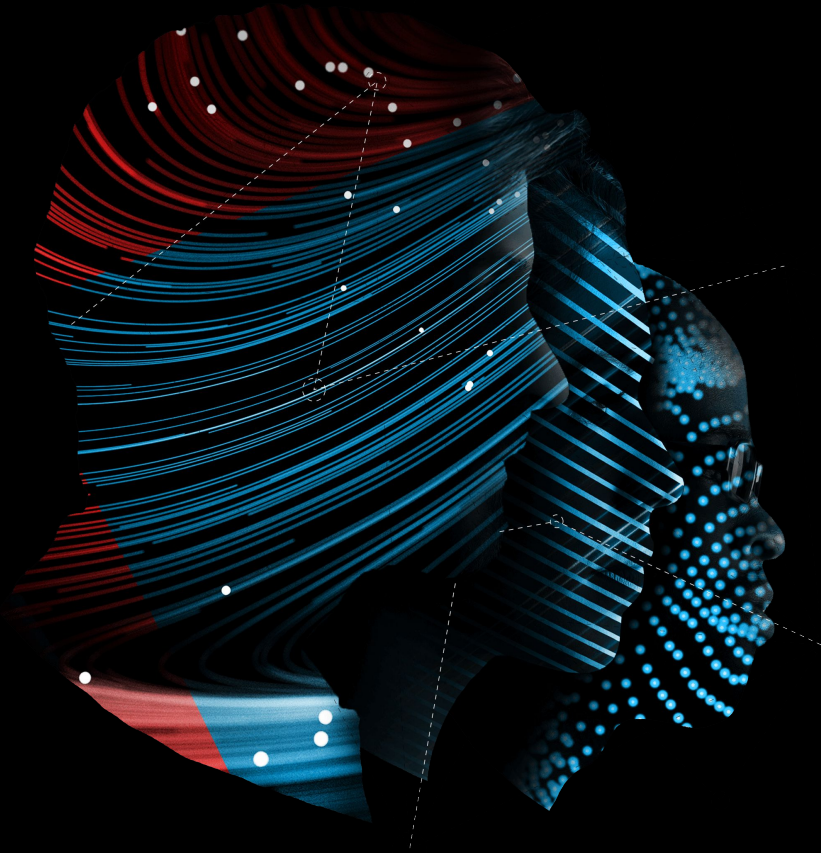


A modern interior space with a pink carpet. In the center, there is a large, textured red wall. To the left of the wall is a concrete block structure. To the right of the wall is another concrete block structure. In the foreground, there are two dark brown, tufted ottomans. The background is a white wall with vertical panels. The ceiling has a skylight.

AN INTRODUCTION TO BEHAVIOURAL ECONOMICS



FARFETCH



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1. WHAT IS BEHAVIOURAL ECONOMICS?

WHAT IS BEHAVIOURAL ECONOMICS?

Behavioural Economics is a field of study that seeks to **understand the human decision-making process.**

In order to do this, it examines the following attributing factors:

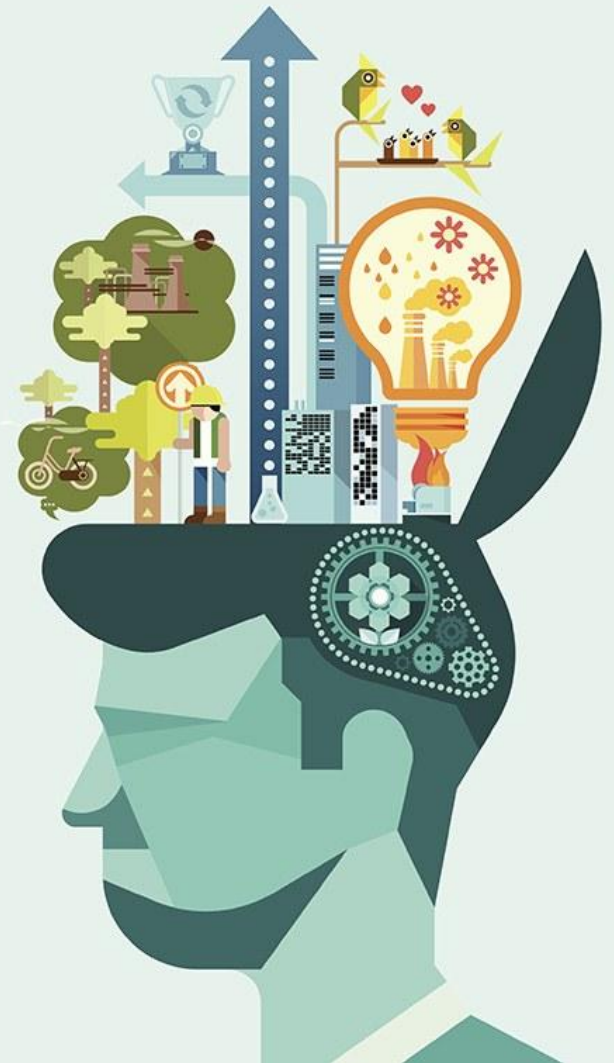
- Psychological
- Behavioural
- Emotional
- Social



2. WHY IS BEHAVIOURAL ECONOMICS USEFUL?

The human decision-making process is largely unconscious.

When asked why certain decisions are made, we tend to self-report in a way that contradicts our actual behaviour.



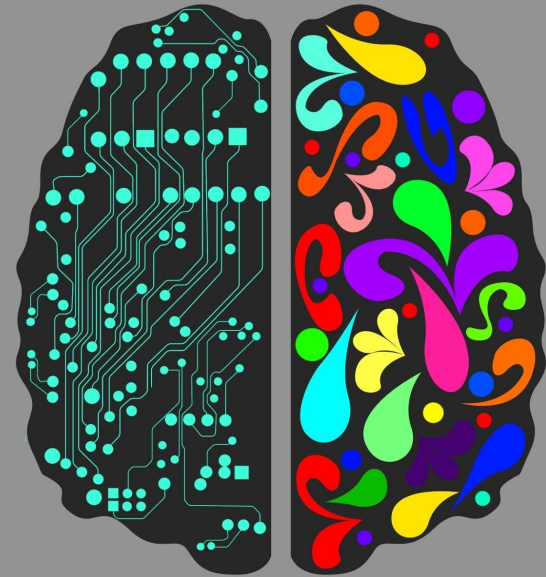
“What they say they do and what they do
are completely different.”

Margaret Mead, Anthropologist

WHY IS BEHAVIOURAL ECONOMICS USEFUL?

Traditional theories of Economics see people as rational beings who make rational decisions.

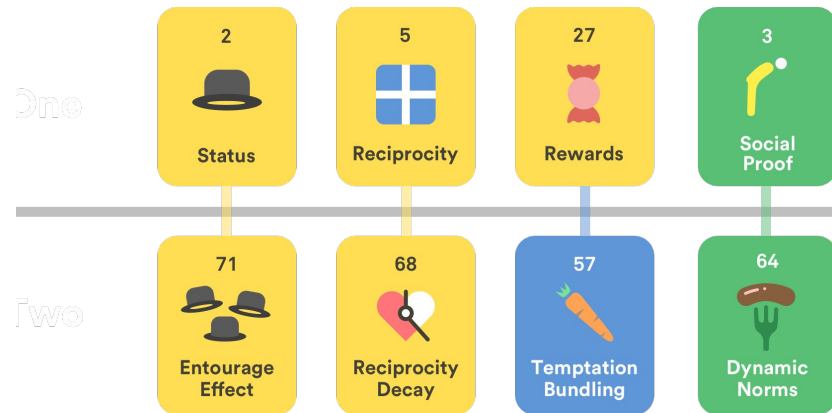
However, Behavioural Economics concludes that **people are irrational.**



WHY IS BEHAVIOURAL ECONOMICS USEFUL?

To help make sense of this irrational behaviour, **Behavioural Economics Principles** have been compiled.

Each principle (there are around 100) describes at a high level how the majority of us will **behave under specific circumstances**.



3. BEHAVIOURAL ECONOMICS PRINCIPLES

There are around 100 Behavioural Economics Principles.
Here are 3 that will help to introduce this field of study.

1. Endowment Effect

The 'Endowment Effect' occurs when we overvalue something that we own, regardless of its objective market value.

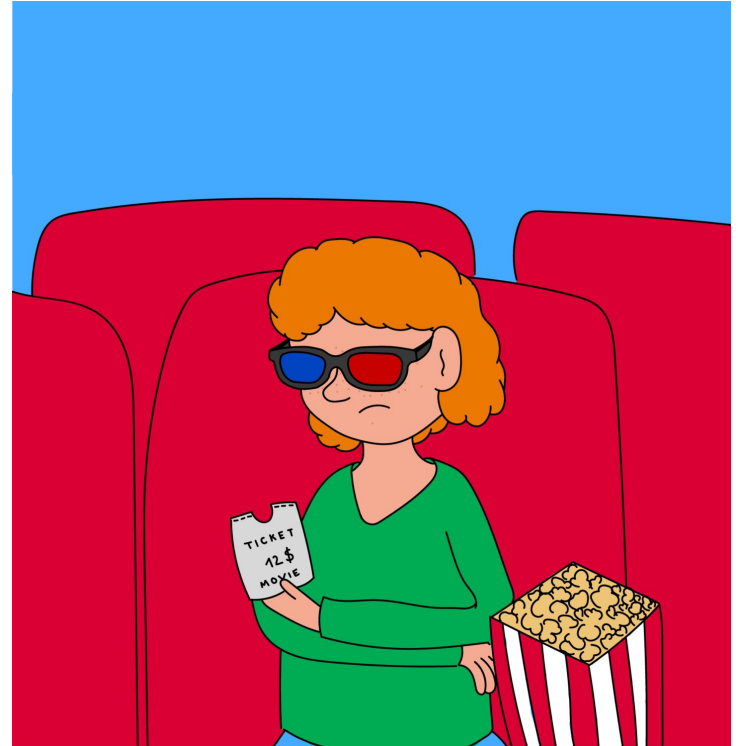
Example - A study found that 89% of participants who were first given a mug refused to trade it for chocolate. However, when chocolate was given first, only 10% of participants chose to trade it for the mug.



2. Sunk Cost Fallacy

Individuals commit the 'Sunk Cost Fallacy' when they continue a behavior or endeavor as a result of previously invested time, money or effort.

Example - Attending a gig/film because you've previously purchased tickets rather than because you actually want to go.



3. Peak-End Rule

Our memory of past experiences doesn't correspond to an average level of positive or negative feelings, but to the peak (the most extreme point) and the end.

Example - Instead of aiming to create a great in-store experience, IKEA applies the Peak-End Rule. In doing so, they offset any negative peaks by implementing positive ones to dilute these 'bad' touchpoints. The 'peak' being their great prices, and the 'end' being their restaurant.



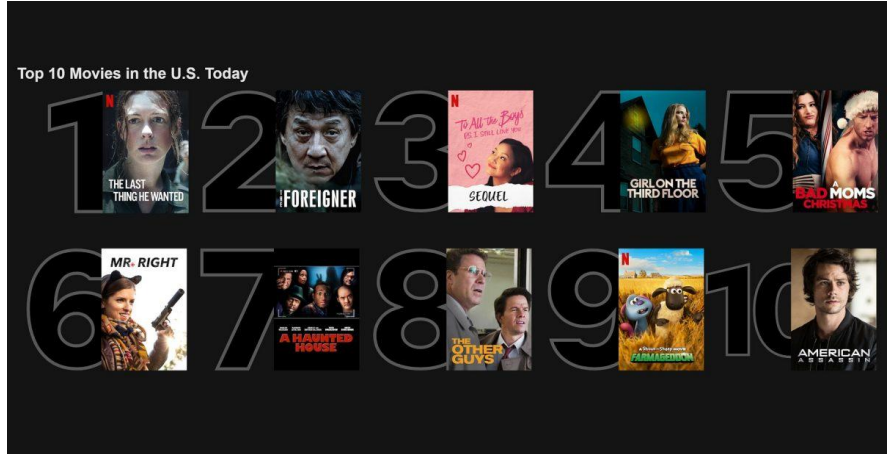
4. HOW **NETFLIX** USES BEHAVIOURAL ECONOMICS

A contributing factor to Netflix's success is their ability to leverage Behavioral Economics Principles to experiment towards better user experiences.

Social Proof

‘Social Proof’ is the idea that we tend to trust other people’s opinion more than we trust a companies.

Example - Netflix’s suggestion feed prominently displays shows that are ‘Trending now’ and the fact that these shows are trending is usually enough to make users watch them. Users want to follow the crowd to see what they might be missing.



Trending shows (by location) feature

Nudge

A 'Nudge' is any aspect of the choice architecture that alters people's behavior in a predictable way. To count as a nudge, the intervention must be easy and cheap to avoid.

Example - The 'Next Episode' feature on Netflix is an example of a nudge, which scientists have proved leads to binge-watching.



Next episode feature

HOW NETFLIX USES BEHAVIOURAL ECONOMICS

Chunking

When the same information is presented in a different form that is easier to process, our ability to receive it is greater.

Decoy Effect

Adding a third pricing option makes the customer change their preference towards an option the seller is trying to promote. The “decoy” is priced to make one of the other options appear more attractive.

NETFLIXSign Out

STEP 2 OF 3

Choose the plan that's right for you

Downgrade or upgrade at any time.

	Basic	Standard	Premium
Monthly price	£5.99	£9.99	£13.99
Video quality	Good	Better	Best
Resolution	480p	1080p	4K+HDR
Screens you can watch on at the same time	1	2	4
Watch on your TV, computer, mobile phone and tablet	✓	✓	✓
Unlimited films and TV programmes	✓	✓	✓
Cancel at any time	✓	✓	✓

Full HD (1080p), Ultra HD (4K) and HDR availability subject to your internet service and device capabilities. Not all content available in HD, Full HD, Ultra HD or HDR. See [Terms of Use](#) for more details.

CONTINUE

Default

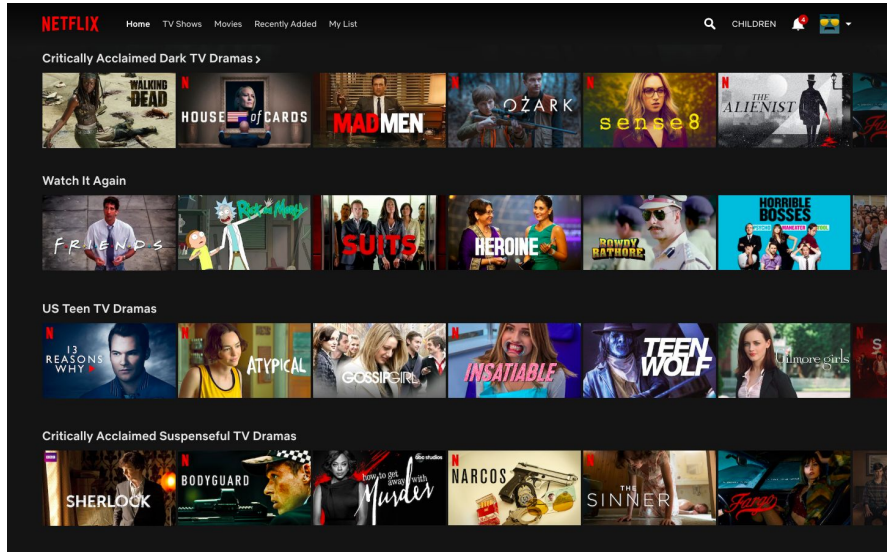
A pre-set course of action that takes effect if nothing is specified by the decision maker.

But Netflix doesn't get it right all of the time...

Choice Overload

‘Choice Overload’ occurs when too many choices are available to the customer. Overchoice has been associated with unhappiness, decision fatigue and deferral.

Deferral is the avoidance of making a decision altogether, which in Netflix’s case would be scrolling through the endless amount of shows and not watching anything.



Netflix home screen

5. THE KEY TAKEAWAY

THE KEY TAKEAWAY

The best way to understand Behavioural Economics Principles is to think of them as **universal research insights** that help to make sense of a largely unconscious decision-making process.



6. FURTHER READING / WATCHING

Want to learn more?

Further reading / watching

Online

1. Behavioural Economics Principles - [Link](#)
2. The Rise of Behavioral Economics and Its Influence on Organizations - [Link](#)
3. TED Talk: Are we in control of our own decisions? - [Link](#)

Books

1. Misbehaving: The Making of Behavioral Economics - **Richard Thaler**
2. Nudge: Improving Decisions About Health, Wealth, and Happiness - **Richard Thaler & Cass Sunstein**
3. Thinking, Fast and Slow - **Daniel Kahneman**



