BEHAVIORAL ECONOMICS & DECISION MAKING

Professor Eric J. Johnson

B8619 SPRING 2024 (3.0 CREDITS)

MBA SYLLABUS DRAFT, SUBJECT TO CHANGE

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TEACHING ASSISTANTS
TBA

Office Hours: Wednesdays 1:40-3:00 and by appointment.

Office hours will <u>not</u> be held on the following dates:
TBA

Communications from the instructor and teaching assistants about the course will take place through Canvas. Students should make sure they regularly check for announcements and messaging notifications.

COURSE DESCRIPTION

The purpose of this course is to inform future managers, analysts, consultants, and advisors of the psychological processes and biases underlying decision-making, with an emphasis on how to incorporate such insights into marketing and business strategies.

The class has two main facets. First, it will give you a broad overview of important results from the behavioral sciences that clarify how people make decisions. Second, it will provide you with advice about applying these findings to topics in marketing, management, and finance (each the focus of approximately one-third of the class material). Classroom time will be devoted to a combination of lectures, discussions, and exercises illustrating the main concepts.

The first half of the class will be more theory focused to build the foundations that we need to move into a discussion of applications (the second half of the class).

REQUIRED AND RELATED COURSES

The course has limited overlap with *The Psychology and Economics of Consumer Finance*, a course that focuses on how these principles apply to household financial decisions. Students who have taken both have reported that they are complimentary.

STUDENT LEARNING OUTCOMES

You will examine the basic principles of how people make decisions and be able to contrast them to the principle of standard economics, applying them to marketing, management, and finance. The course will teach you to:

- Be able to explain how people perceive changes in value.
- Recognize and apply how decisions makers think about outcomes across time and employ this knowledge to predict when people will seem impatient and overweight immediate outcomes.
- Explain how people judge risk and uncertainty and use this knowledge to predict when and why people will be over-confident.

The second half of the course will focus on analyzing business, organization and consumer problems using these tools. Through a series of cases, you will assemble new and innovative perspectives on these problems generating solutions that you might have missed otherwise.

CLASSROOM NORMS AND EXPECTATIONS

Core Culture

Students are expected to adhere to CBS Core Culture in this class by being Present, Prepared, Participating.

Inclusion, Accommodation, and Support for Students

At Columbia Business School we believe diversity strengthens any community or business model and brings it greater success. The School is committed to providing all students with equal opportunity to thrive in the classroom by providing a learning, living, and working environment free from discrimination, harassment, and bias on the basis of gender, sexual orientation, race, ethnicity, socioeconomic status, or ability.

Students with documented disabilities may receive reasonable accommodations. Students are encouraged to contact Columbia University's Office of Disability Services for information and to register for services.

Columbia Business School adheres to all community, state, and federal regulations as relate to Title IX and student safety. Read more about CBS' policies to support Inclusion, Accommodations and Support for Students.

Honor Code and Academic Integrity

The Columbia Business School Honor Code calls on all members of the School community to adhere to and uphold the notions of truth, integrity, and respect both during their time in school, and throughout their careers as productive, moral, and caring participants in their companies and communities around the world. All students are subject to the

Honor Code for all of their academic work. Failure to comply with the Honor Code may result in Dean's Discipline. Here you can review examples of Academic Misconduct which may result in discipline.

Course materials (videos, assignments, problem sets, etc) are for your use in this course only. You may not upload them to external sites, share them with students outside of this course, or post them for public commentary without the instructor's permission.

Course Attendance Policies

Students from all programs should review and be familiar with the MBA Core Attendance Policy and the Exam Policy. Please complete this form if you are absent for an excused reason: Core Excused Absence Form.

Generative AI Policy

Students in this course may only use Generative AI tools, such as ChatGPT, for idea generation and must include a citation describing any usage. Using these tools to generate responses to assignments violates CBS's Honor Code, and I will report suspected instances of plagiarism. Please contact me if you have any questions about this policy.

READINGS

There are two required books for this course:

> *Thinking, Fast and Slow* by Daniel Kahneman (referred to as "Thinking" hereafter)

> *Misbehaving: The Making of Behavioral Economics* by Richard H. Thaler (referred to as "Misbehaving" hereafter)

All other readings will be available online through Canvas. The location of the readings is specified in the Course Roadmap below.

Please note: readings from Thinking and Misbehaving will **not** be reproduced online due to copyright restrictions, except for those required for the first week.

The readings in the course packet and listed in the syllabus are required material that should be **read before class**. **Cases listed in the syllabus should always be prepared before class**.

1. COURSE ROADMAP/SCHEDULE

Session	Topic(s)	Required Pre-Readings	Assignments Due (Assignment Types)
Week 1 01/24/2024 (W)	Your Two Brains: Econs vs. Humans	Thinking Ch. 1 Ch. 2 (Online)	▪ **Complete the pre-class survey BEFORE the start of class Complete the Personal Assessment as a Decision Maker BEFORE the start of class**

	Loss Aversion: Why Losses Have More Impact Than Gains Reading: Thinking Ch. 26, Ch. 27 (online)		
Week 2 01/31/24 (W)	Perception of Risks: The Use of Heuristics (Part 1)	▪ Thinking, Ch. 10, 11, 12 The Signal and the Noise (Nate Silver), pp. 240-249 (online)	Do the Matterhorn Simulation before class
Readings:	See Above		
Week 3 02/07/24 (W)	Confidence & Consistency	Thinking, Ch. 19	
	Mental Accounting		
Readings:	▪ Misbehaving, Ch. 7, 10 JC Penney Case (online)		
To Do:	▪ **Read the JC Penney Case before class Submit writing assignment before class**		
Week 4 02/14/24 (W)	Perceptions of Fairness		
Readings:	▪ Misbehaving, Ch. 14 ▪ Coca-Cola's New Vending Machine (A) Case (online)		
	Impatience and Self-Control		
Readings:	▪ Misbehaving, pp.85-94		
Week 5 2/21/24 (W)	(1) Choosing and (2) Helping Consumers with Risk		
Readings:	▪ Toro No S'no Case (online)		
To – Do:	▪ **Read the Toro No S'no Case before class ▪ Submit case writing assignment before class**		
	Memory & Decisions		

Readings:	▪ Thinking, Ch. 4 and 5		
Week 6 02/28/24 (W)	Emotion, Affect, and Consumer Choice		

Readings:	▪ Thinking, pp. 101-104
	▪ Cialdini (2001): [Harnessing the Science of Persuasion](#) (HBR) (online)
	▪ Selling CFLs at Wal-Mart Case (reader, online)
	    Part 1: https://www8.gsb.columbia.edu/caseworks/EricJohnson/1eda0
	    Part 2: https://www8.gsb.columbia.edu/caseworks/EricJohnson/1eda1		

To – Do:	▪ **Read the Selling CFLs at Wal-Mart Case before class** ▪ **Submit case writing assignment before class**		
Week 7 03/20/24 (W)	Application to Organizations Making Decisions (Part 1)		
Readings:	▪ Thinking, Ch.23 and 24		
Application to Organizations Making Decisions (Part 2)			
Readings:	Jon Krakauer (1996): [Into Thin Air Case](#) *Outside Magazine (online)*		
To – Do:	▪ **Read the Into Thin Air article** ▪ **Submit the writing assignment before class**		
Week 8 03/28/24 (W)	Consumer Financial Decision-Making		
Readings:	Misbehaving, Ch, 21		
Guest Speaker (TBA)			
Week 9 04/03/24 (W)	Experts vs. Novices (Part 1)		
Readings:	▪ Thinking, Ch. 21, 22		
Experts vs. Novices (Part 2)			
Readings:	▪ [Google Prediction Markets](#) (GPM) Case (online)		
To – Do:	▪ **Read GPM Case** ▪ **Submit writing assignment before class**		
	Defaults and Choice		

Week 10 04/10/24 (W)	Architecture (Part 1)		
Readings:	▪ [Elements of Choice Chapter 1](#) (online), Misbehaving, Chapter 32		
Defaults and Choice Architecture (Part 2)			
Readings:	▪ [Behavioral Insights (A)](#) Case (online)		
To – Do	▪ **Read Behavioral Insights (A) Case** ▪ **Submit writing assignment before class** ▪ **Submit two final exam questions**		
Week 11 04/17/24 (W)	Happiness (Part 1)		
Readings:	▪ Thinking, Ch. 35, 37 and 38		
Happiness (Part 2)			
Week 12 04/24/24 (W)	Behavioral Game Theory: How People Really Think Strategically		
Readings:	▪ Misbehaving, Ch.15, pp. 301-305		
Course Wrap and Review			
Readings:	▪ Misbehaving, Conclusion (pp.347-358)		
Final Exam In class on4/24			

WRITING ASSIGNMENT QUESTIONS

Below are the questions/topics you will be asked to respond to for the writing assignments listed in the Course Roadmap.

1. **JC Penney**
   a. Using principles from mental accounting, explain why Johnson's pricing strategy may not have worked as intended.
   b. Do you think the pricing problem was a strategy or execution problem? Did Johnson just need more time?

    c. If you were hired to replace Ullman (as Johnson was), what would be your plan for pricing? If you had to switch from a high-low format, what would you do differently from Johnson? Would you do anything the same?

2. **Coca-Cola Vending Machine (A)**
   a. What did Coca-Cola do right? What did it do wrong?
   b. What do you think of Ivester's comments? What would you have said if you were Ivester?
   c. Using principles of mental accounting, how would you introduce a paradigm shift or increase the price?
   d. How would you change the public's perceptions of fairness/ethicality related to Coca-Cola's potential decision to introduce dynamic-pricing vending machines?

3. **Toro S'no Risk Program**
   a. The Toro No S'no case raises issues that involve many of the concepts we have studied during the course. Write a memo to Pollick giving him some insights on what Toro should do the following year and why.

4. **Selling CFLs at Wal-Mart Case**
   a. Why does Wal-Mart care about CFLs? Why do consumers care about CFLs?
   b. What is the diagnosis? Why has public reception been so lousy? You should be able to tie in several concepts we have discussed already.
   c. Identify potential solutions for the problems/issues you identify in the preceding question. In other words, how could the problems be addressed or overcome?
   d. What about LED bulbs? Will they face the same problems?

5. **Into Thin Air Article**
   a. Why are the climbers up there? Consider the motivation and incentives facing each participant. What are the implications for potential decision biases and corrective measures?
   b. What are the defining characteristics of the decision-making environment on Mt. Everest? Setting aside the extreme physiological conditions, what are the biggest challenges for good decision-making?
   c. Describe the decision process used by Hall and Fischer. What mistakes did the guides or members of the climbing teams make during the climb to the summit? Why were these mistakes made? How do these mistakes relate to concepts we have discussed in the course so far?
   d. If you were advising a friend interested in organizing an expedition to the top of Mt. Everest (or some other large but potentially dangerous mountain), what advice would you give to him/her based on the concepts of this course?

6. **Google Prediction Markets**
   a. Is it a good idea to encourage <u>all</u> employees to trade in these markets? Should insiders and/or highly uninformed people be allowed to trade? Do they help the market or hurt it?
   b. What kind of decisions are prediction markets useful for?
   c. Will most managers welcome prediction markets within their companies? Why or why not? Will they welcome a prediction market about a project or outcome that they're responsible for?

        d. How would you get managers to use the prediction markets in their decision-making?

7. **Behavioral Insights Case**
        a. Do the assignment listed at the end of the case: using principles of behavioral economics, develop the best possible letter to send to delinquent taxpayers. In a postscript of no more than a couple of paragraphs, please explain the letter.

METHOD OF EVALUATION

1. **Participation (25%).** In a course like this, the adage "garbage-in-garbage-out" is especially true. You will only get out of this course as much as you are willing to put in, and lively class discussion is essential for learning this material. It is therefore very important that you take an active role in classroom activities and discussions and come fully prepared. If you are distracting from the class or contributing in an inappropriate/irrelevant manner, you will not receive participation credit for such comments (in fact, you could end up receiving negative points!).
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2. **Writing Assignments (40%).** To reinforce the learning process, you are required to do <u>**five**</u> written case assignments to receive a passing grade for the course. You may also do a sixth or seventh assignment. If you do a sixth assignment, I will drop the lowest score. If you do a seventh, I will give you one extra credit point. Of the writing assignments listed in the course roadmap, you can choose which five you would like to turn in. Assignments should be done on an individual basis. You may discuss the case and assignment with other students in the class, but **each person must submit their own paper with original work**. The writing assignments should be contextualized in the case at hand and should draw on information from the readings and lectures to support your analysis.

All of the writing assignments will be case-based and **must be turned in prior to the start of class**, since we will be discussing and analyzing the case together in class. **Late assignments will not be accepted,** and any cases submitted after five minutes into class will not be graded.

Here are some **general guidelines** for preparing effective write-ups:

1. Be concise and to the point. Provide a strong, logical flow in your analysis. Above all, do not spend time rehashing or paraphrasing the details of the case, as I have read the cases and know these details already.
2. Make your assumptions explicit whenever necessary and defend them.
3. Your analysis should be thorough, be carried out correctly, and should draw whenever relevant on material presented in class or assigned in the readings.
4. Focus any specific recommendations on the important issues in the case. Recommendations should be practical, cost-effective, and appropriate to the timing (short-term or long-term) of the problem at hand.

Formatting requirements:

Writing assignments have a **strict four-page limit but brevity when accompanied by completeness will be rewarded**. All papers should be **double-spaced** with 1" margins and **12-point font**. Please write a cohesive paper (do not submit numbered or bulleted lists summarizing your thoughts). **Failure to follow formatting guidelines will result in a one-point reduction**. Please submit assignments using Canvas.

3. **Final Exam (35%).** The final exam is composed by the students. By Wednesday, April 5th, everyone must submit two exam questions via Canvas suitable for use in an all-essay, in-class exam. The submission of these questions counts towards your participation grade. The best of these questions will be compiled and posted on Canvas by the end of the day Wednesday April 12th. Expect to receive an initial list of approximately 20 potential exam questions. The final exam will consist of six of these questions and you will have to answer four of them. **The exam will be 90 minutes and will be held as a take home exam (Starting Wednesday, April 20th).**

Grading System

All case assignments will be graded by the TA using a seven-point system. All grading will be done blindly. The grades can be interpreted as follows:

1-2	Incomplete assignment. Some questions are not addressed and/or little evidence of reading.
3	Some evidence of reading, but little understanding of the psychology or how it works. Minimal application of course concepts to the actual question that was asked.
4	An attempt at applying the course material, but with little or no depth of analysis (possibly just repeating ideas from the reading).
5	A solid application of the course material, with some good points but few creative insights. **The majority of papers will receive this grade**.
6	A deeper level of thinking than the obvious answer. Clearly written with creative examples.
7	An exceptional paper with an original insight and clear analysis. Such papers make us say, "I wish I had thought of that!" **Very few of these grades are given**.

The final exam will be out of 40 points and will be graded blindly. Graded exams will not be returned unless specifically requested by the student (though individual grades and a histogram of the grades for each section will be posted on Canvas).

Other Resources

- Richard H. Thaler and Cass R, Sunstein (2021). Nudge: The Final Edition. New York: Penguin Group.

- James Surowiecki (2005). The Wisdom of Crowds. New York: Anchor Books.

- Michael Lewis (2004). Moneyball: The Art of Winning an Unfair Game. New York: W.W. Norton & Company.

- Jon Krakauer (1999). Into Thin Air: A Personal Account of the Mt. Everest Disaster. New York: Anchor Books.

- Nate Silver (2012). The Signal and the Noise: Why So Many Predictions Fail—but Some Don't. New York: The Penguin Press.

- Robert B. Cialdini (2006). Influence: The Psychology of Persuasion (revised edition). New York: William Morrow & Company.

- Nassim Nicholas Taleb (2010). The Black Swan: The Impact of the Highly Improbably (2nd edition). New York: Random House.

- Laszlo Bock (2015). Work Rules!: Insights from Inside Google That Will Transform How You Live and Lead. New York: Hachette Book Group.

- Michael Lewis (2017). The Undoing Project: A Friendship That Changed Our Minds. New York: W.W. Norton & Company, Inc.

- Eric J. Johnson (2021) The Elements of Choice: Why How We Decides Matters. New York: Riverhead, an imprint of Penguin-Random House.