



Predictably Irrational: The Hidden Forces That Shape Our Decisions

By Dan Ariely

INTRODUCTION

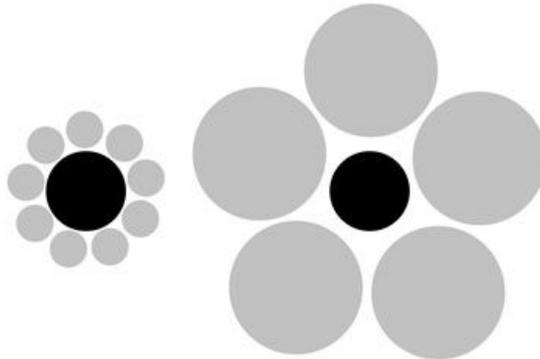
- This is a journey into the many ways we are all irrational. But there are ways in which we are predictably irrational.
- My goal, by the end of this book, is to help you fundamentally rethink what makes you and the people around you tick.

1: THE TRUTH ABOUT RELATIVITY

Why everything is relative...even when it shouldn't be

- Humans rarely choose things in absolute terms. We don't have an internal value meter that tells us how much things are worth. Rather, we focus on the relative advantage of one thing over another and estimate value accordingly. (For instance, we don't know how much a six-cylinder car is worth, but we can assume it's more expensive than the four-cylinder model.)
- Let me start with a fundamental observation: most people don't know what they want unless they see it in context.
- We don't know what kind of racing bike we want— until we see a champ in the Tour de France ratcheting the gears on a particular model.
- We don't know what kind of speaker system we like— until we hear a set of speakers that sounds better than the previous one.
- We don't even know what we want to do with our lives— until we find a relative or a friend who is doing just what we think we should be doing.
- Everything is relative, and that's the point. Like an airplane pilot landing in the dark, we want runway lights on either side of us, guiding us to the place where we can touch down our wheels.
- Which one would you choose? In this case, Sam knows that customers find it difficult to compute the value of different options. (Who really knows if the Panasonic at \$ 690 is a better deal than the Philips at \$ 1,480?) But Sam also knows that given three choices, most people will take the middle choice (as in landing your plane between the runway lights). So guess which television Sam prices as the middle option? That's right— the one he wants to sell!

- Visual representation of relativity. The black circle is the same size:



- RELATIVITY IS (RELATIVELY) easy to understand. But there's one aspect of relativity that consistently trips us up. It's this: We not only tend to compare things with one another but also tend to focus on comparing things that are easily comparable—and avoid comparing things that cannot be compared easily.
- The “Decoy Effect”
 - Three options: A, A+, and B
 - We don't know anything about A or B. We only know that A+ is better than A. So A is a decoy, we throw B out, and go with A+ because we don't know much, but we know that A+ is at least better than A.
- CAN WE DO anything about this problem of relativity? The good news is that we can sometimes control the “circles” around us, moving toward smaller circles that boost our relative happiness. If we are at our class reunion, and there's a “big circle” in the middle of the room with a drink in his hand, boasting of his big salary, we can consciously take several steps away and talk with someone else. If we are thinking of buying a new house, we can be selective about the open houses we go to, skipping the houses that are above our means. If we are thinking about buying a new car, we can focus on the models that we can afford, and so on.
- Example. Buying a nice pen. It is \$50, but across town it is on sale for \$25. Do you drive 15 minutes to save \$25? Many people would. What if you were buying a \$500 suit? Would you travel 15 minutes to buy one for \$475? Probably not. Is your 15 minutes' worth \$25 or not? The \$475 to \$25 purchase should be irrelevant.
- For sure, James has made a lot of money, and he sees even more money all around him. One of his good friends, in fact, is a founder of PayPal and is worth tens of millions. But Hong knows how to make the circles of comparison in his life smaller, not larger. In his case, he started by selling his Porsche Boxster and buying a Toyota Prius in its place. 4 “I don't want to live the life of a Boxster,” he told the New York Times, “because when you get a Boxster you wish you had a



911, and you know what people who have 911s wish they had? They wish they had a Ferrari.” That’s a lesson we can all learn: the more we have, the more we want. And the only cure is to break the cycle of relativity.

- Negative decoy effect. When I took this job, I wished and dreamed that in one year I would be making \$100K. Now I am making \$300K, but the person next to me who has similar characteristics is making \$325K, so I am not happy.
- Meet someone in a foreign country...you two are the only ones alike. Have a bond. Get back to home country, no bond because now everyone is like you two. That is relativity working.

2: THE FALLACY OF SUPPLY AND DEMAND

Why the price of pearls...and everything else...is up in the air

- The price of pearls
 - Tahitian Black Pearls were new to the market and not well received until they were put into the window of a 5th avenue store with an outrageously high price tag.
 - “In order make a man covet a thing, it is only necessary to make the thing difficult to attain.”--Mark Twain
 - Imprinting. Named after goslings, after the breakout of their eggs, become attached to the first moving object they encounter. They make initial decisions based on what’s available in their environment and then stick with that decision once it has been made.
 - The human brain can often take first impressions and decisions and become “imprinted”.
 - When we encounter a new product, we can associate the first price that is associated with it, and it can affect our long term willingness of what we will pay for the product from that moment on.
 - The initial price becomes an “anchor”.
 - The black pearls were “anchored” to the finest gems in the world, and the prices flowed forever after.
- Social Security Number Experiment
 - Take the last two digits of your SS# and ask yourself would you pay this amount for various items? This experiment was done on MBA students at MIT.
 - Arbitrary Coherence. The concept that although initial prices are arbitrary, once those prices are established in our minds, they will not only shape present prices but also future prices. Thus making them “coherent”. Does thinking about one’s SS# be enough to create an “anchor”. Would the initial anchor have long term influence?



- The SS#s did serve as anchors. The students with higher numbers ended up paying 200-300% higher for objects than everyone else. Not rational, but we are like the goslings. Attached to the SS# as an anchor.
- Once someone was willing to pay X for one product, they were more willing to pay X for a product in the similar category (computer products). That is “arbitrary coherence”.
- We might see a 57-inch LCD high-definition television on sale for \$ 3,000, for instance. The price tag is not the anchor. But if we decide to buy it (or seriously contemplate buying it) at that price, then the decision becomes our anchor henceforth in terms of LCD television sets. That’s our peg in the ground, and from then on— whether we shop for another set or merely have a conversation at a backyard cookout— all other high-definition televisions are judged relative to that price.
 - To “pull up your anchor” you must acclimate to a new environment.
- It is important to understand the process by which our first decisions translate into long term habits.
- “Herding”. To illustrate this process, consider this example. You’re walking past a restaurant, and you see two people standing in line, waiting to get in. “This must be a good restaurant,” you think to yourself. “People are standing in line.” So you stand behind these people. Another person walks by. He sees three people standing in line and thinks, “This must be a fantastic restaurant,” and joins the line. Others join. We call this type of behavior herding. It happens when we assume that something is good (or bad) based on other people’s previous behavior, and our own actions follow suit.
- But there’s also another kind of herding, one that we call self-herding. This happens when we believe something is good (or bad) based on our own previous behavior. Essentially, once we become the first person in line at the restaurant, we begin to line up behind ourselves in subsequent experiences.
- Does that make sense? Let me explain. Recall your first introduction to Starbucks, perhaps several years ago. (I assume that nearly everyone has had this experience, since Starbucks sits on every corner in America.) You are sleepy and in desperate need of a liquid energy boost as you embark on an errand one afternoon. You glance through the windows at Starbucks and walk in. The prices of the coffee are a shock— you’ve been blissfully drinking the brew at Dunkin’ Donuts for years. But since you have walked in and are now curious about what coffee at this price might taste like, you surprise yourself: you buy a small coffee, enjoy its taste and its effect on you, and walk out. The following week you walk by Starbucks again. Should you go in? The ideal decision-making process should take into account the quality of the coffee (Starbucks versus Dunkin’ Donuts); the prices at the two places; and, of course, the cost (or value) of walking a few more blocks to get to Dunkin’ Donuts. This is a complex computation— so instead, you resort to the simple approach: “I went to Starbucks before, and I enjoyed myself and the coffee, so this must be a good decision for me.” So you walk in and get



another small cup of coffee. In doing so, you just became the second person in line, standing behind yourself. A few days later, you again walk by Starbucks and this time, you vividly remember your past decisions and act on them again—voilà! You become the third person in line, standing behind yourself. As the weeks pass, you enter again and again and every time, you feel more strongly that you are acting based on your preferences. Buying coffee at Starbucks has become a habit with you.

- How Starbucks moved the anchor
 - HOWEVER, THERE IS something odd in this story. If anchoring is based on our initial decisions, how did Starbucks manage to become an initial decision in the first place? In other words, if we were previously anchored to the prices at Dunkin' Donuts, how did we move our anchor to Starbucks? This is where it gets really interesting. When Howard Shultz created Starbucks, he was as intuitive a businessman as Salvador Assael. He worked diligently to separate Starbucks from other coffee shops, not through price but through ambience. Accordingly, he designed Starbucks from the very beginning to feel like a continental coffeehouse. The early shops were fragrant with the smell of roasted beans (and better-quality roasted beans than those at Dunkin' Donuts). They sold fancy French coffee presses. The showcases presented alluring snacks— almond croissants, biscotti, raspberry custard pastries, and others. Whereas Dunkin' Donuts had small, medium, and large coffees, Starbucks offered Short, Tall, Grande, and Venti, as well as drinks with high-pedigree names like Caffè Americano, Caffè Misto, Macchiato, and Frappuccino. Starbucks did everything in its power, in other words, to make the experience feel different— so different that we would not use the prices at Dunkin' Donuts as an anchor, but instead would be open to the new anchor that Starbucks was preparing for us. And that, to a great extent, is how Starbucks succeeded.
- Of course, Mark Twain came to the same conclusions: “If Tom had been a great and wise philosopher, like the writer of this book, he would now have comprehended that work consists of whatever a body is obliged to do, and that play consists of whatever a body is not obliged to do.” Mark Twain further observed: “There are wealthy gentlemen in England who drive four-horse passenger-coaches twenty or thirty miles on a daily line in the summer because the privilege costs them considerable money; but if they were offered wages for the service, that would turn it into work, and then they would resign.”*
- These questions may be tough nuts to crack, but in terms of our personal lives, we can actively improve on our irrational behaviors. We can start by becoming aware of our vulnerabilities. Suppose you're planning to buy a cutting-edge cell phone (the one with the three-megapixel, 8 × zoom digital camera), or even a daily \$ 4 cup of gourmet coffee. You might begin by questioning that habit. How did it begin? Second, ask yourself what amount of pleasure you will be getting



out of it. Is the pleasure as much as you thought you would get? Could you cut back a little and better spend the remaining money on something else? With everything you do, in fact, you should train yourself to question your repeated behaviors. In the case of the cell phone, could you take a step back from the cutting edge, reduce your outlay, and use some of the money for something else? And as for the coffee— rather than asking which blend of coffee you will have today, ask yourself whether you should even be having that habitual cup of expensive coffee at all.*

3: THE COST OF ZERO COST

Why we often pay too much when we pay nothing

- Getting something for free feels good.
- Zero, “Free”, are emotional hot buttons. A source of irrational excitement. Things you would never desire, suddenly become desirable when they are free.
- The two chocolates.
 - Hershey Kiss and Lindt Chocolate (fine), both on a table for free. The prices were next to each one. 73% chose the Lindt. Price of Lindt-15 cents, Kiss was 1 cent.
 - Then offered Kiss for free and Lindt for 14 cents. Only lowered price by 1 cent. 69% chose Kiss, and 31% took the Lindt.
 - Even though Lindt was a great deal, still went with free Kiss.
- When something is free, there is really no downside. When there is a choice between a free item and another item, that can lead us to a bad decision. When something is free, we are so afraid of loss, that we feel like we need to take it.
- THE CONCEPT OF zero also applies to time. Time spent on one activity, after all, is time taken away from another. So if we spend 45 minutes in a line waiting for our turn to get a FREE! taste of ice cream, or if we spend half an hour filling out a long form for a tiny rebate, there is something else that we are not doing with our time.

4: THE COST OF SOCIAL NORMS

Why we are happy to do things, but not when we are paid to do them

- As Margaret Clark, Judson Mills, and Alan Fiske suggested a long time ago, the answer is that we live simultaneously in two different worlds— one where social norms prevail, and the other where market norms make the rules. The social norms include the friendly requests that people make of one another. Could you



help me move this couch? Could you help me change this tire? Social norms are wrapped up in our social nature and our need for community. They are usually warm and fuzzy. Instant paybacks are not required: you may help move your neighbor's couch, but this doesn't mean he has to come right over and move yours. It's like opening a door for someone: it provides pleasure for both of you, and reciprocity is not immediately required. The second world, the one governed by market norms, is very different. There's nothing warm and fuzzy about it. The exchanges are sharp-edged: wages, prices, rents, interest, and costs-and-benefits. Such market relationships are not necessarily evil or mean— in fact, they also include self-reliance, inventiveness, and individualism— but they do imply comparable benefits and prompt payments. When you are in the domain of market norms, you get what you pay for— that's just the way it is.

- When we keep social norms and market norms on their separate paths, life hums along pretty well. Take sex, for instance. We may have it free in the social context, where it is, we hope, warm and emotionally nourishing. But there's also market sex, sex that is on demand and that costs money. This seems pretty straightforward. We don't have husbands (or wives) coming home asking for a \$50 trick; nor do we have prostitutes hoping for everlasting love. When social and market norms collide, trouble sets in. Take sex again. A guy takes a girl out for dinner and a movie, and he pays the bills. They go out again, and he pays the bills once more. They go out a third time, and he's still springing for the meal and the entertainment. At this point, he's hoping for at least a passionate kiss at the front door. His wallet is getting perilously thin, but worse is what's going on in his head: he's having trouble reconciling the social norm (courtship) with the market norm (money for sex). On the fourth date he casually mentions how much this romance is costing him. Now he's crossed the line. Violation! She calls him a beast and storms off. He should have known that one can't mix social and market norms— especially in this case— without implying that the lady is a tramp. He should also have remembered the immortal words of Woody Allen: "The most expensive sex is free sex."
- Experiment
 - Paid one group more to do a task, paid another group less, and the third group they asked them to do it as a favor.
 - The group that was paid more outperformed the group that was paid less, but the ones doing for a favor, outperformed both.
 - There are many examples to show that people will work more for a cause than for cash. A few years ago, for instance, the AARP asked some lawyers if they would offer less expensive services to needy retirees, at something like \$ 30 an hour. The lawyers said no. Then the program manager from AARP had a brilliant idea: he asked the lawyers if they would offer free services to needy retirees. Overwhelmingly, the lawyers said yes.



- Because once market norms enter our considerations, the social norms depart.
- What if you offer gifts? Where do those fall in market norms versus social norms?
 - The conclusion: no one is offended by a small gift, because even small gifts keep us in the social exchange world and away from market norms.
- This experiment illustrates an unfortunate fact: when a social norm collides with a market norm, the social norm goes away for a long time. In other words, social relationships are not easy to reestablish.
- For example, what happens when a customer's check bounces? If the relationship is based on market norms, the bank charges a fee, and the customer shakes it off. Business is business. While the fee is annoying, it's nonetheless acceptable. In a social relationship, however, a hefty late fee— rather than a friendly call from the manager or an automatic fee waiver— is not only a relationship-killer; it's a stab in the back. Consumers will take personal offense. They'll leave the bank angry and spend hours complaining to their friends about this awful bank. After all, this was a relationship framed as a social exchange. No matter how many cookies, slogans, and tokens of friendship a bank provides, one violation of the social exchange means that the consumer is back to the market exchange. It can happen that quickly. What's the upshot? If you're a company, my advice is to remember that you can't have it both ways. You can't treat your customers like family one moment and then treat them impersonally— or, even worse, as a nuisance or a competitor— a moment later when this becomes more convenient or profitable.
- Of course, a gift is a symbolic gesture. And to be sure, no one is going to work for gifts rather than a salary. For that matter, no one is going to work for nothing. But if you look at companies like Google, which offers a wide variety of benefits for employees (including free gourmet lunches), you can see how much goodwill is created by emphasizing the social side of the company-worker relationship. It's remarkable how much work companies (particularly start-ups) can get out of people when social norms (such as the excitement of building something together) are stronger than market norms (such as salaries stepping up with each promotion). If corporations started thinking in terms of social norms, they would realize that these norms build loyalty and— more important— make people want to extend themselves to the degree that corporations need today: to be flexible, concerned, and willing to pitch in. That's what a social relationship delivers.
- MONEY, AS IT turns out, is very often the most expensive way to motivate people. Social norms are not only cheaper, but often more effective as well.



5: THE POWER OF A FREE COOKIE

How free can make us less selfish

- When a Vera Wang gown is reduced from \$10,000 to \$ 249, the excitement (“demand,” in economic-speak) over the gown dramatically increases. More precisely, demand increases for two reasons. According to the first law of demand, it increases because more women are now in the market for designer gowns (they can now afford them). And according to the second law of demand, it increases because at these prices, women might buy multiple units. This second law is less relevant for wedding gowns, where women presumably need just one, but central in cases where we need multiple units (cookies, sweaters, etc.). Still, even in the case of wedding dresses, multiple women have been sighted leaving Filene’s Basement with more than one gown. These two laws are the nuts and bolts of the standard economic rule of demand. (Admittedly, the Filene’s event isn’t just any occurrence of “increased demand.” It’s more like an all-out bridal battlefield.)
- The basic lesson, then, is that when we offer people a financial payment in a situation that is governed by social norms, the added payment could actually reduce their motivation to engage and help out. But what if the situation was reversed and we asked people to pay us for something? Would the effect of social norms work in the same way? This was the question that Uri Gneezy (a professor at the University of California at San Diego), Ernan Haruvy (a professor at the University of Texas at Dallas), and I wanted to explore: the effect of mixing social and market norms on demand.
- When the Starbursts cost a cent apiece, the average number of candies per customer was 3.5, but when the price went down to zero, the average went down to 1.1 per customer. The students limited themselves to a large degree when the candy was free. In fact, almost all the students applied a very simple social-norm rule in this situation— they politely took one and only one Starburst. This, of course, is the opposite of the second law of demand. And how did these two forces of demand work together? In total, the increase due to the greater number of people that stopped by and the decrease due to the reduction in the number of candies that each person took resulted in students collectively taking fewer Starbursts as the price decreased from 1 ¢ to free. What these results mean is that when price is not a part of the exchange, we become less selfish maximizers and start caring more about the welfare of others.
- What these results mean is that the theory of demand is a solid one— except when we’re dealing with the price of zero. Whenever the price is not part of the exchange, social norms become entangled. These social norms get people to consider the welfare of others and, therefore, limit consumption to a level that does not place too much of a burden on the available resource. In essence,



when prices are zero and social norms are a part of the equation, people look at the world as a communal good. The important lesson from all of this? Not mentioning prices ushers in social norms, and with those social norms, we start caring more about others.

- Ask yourself whether market norms or social norms will produce the best result.

6: THE INFLUENCE OF AROUSAL

Why hot is much hotter than we realize

- When we are aroused, we make decisions differently.
- Our emotional states affect our decisions greatly.
- Make decisions before you are in that state. Don't rely on your judgment when you are in that state.

7: THE PROBLEM OF PROCRASTINATION AND SELF CONTROL

Why we can't make ourselves do what we want to do

- IN CHAPTER 6, we discussed how emotions grab hold of us and make us view the world from a different perspective. Procrastination (from the Latin pro, meaning for; and cras, meaning tomorrow) is rooted in the same kind of problem. When we promise to save our money, we are in a cool state. When we promise to exercise and watch our diet, again we're cool. But then the lava flow of hot emotion comes rushing in just when we promise to save, we see a new car, a mountain bike, or a pair of shoes that we must have. Just when we plan to exercise regularly, we find a reason to sit all day in front of the television. And as for the diet? I'll take that slice of chocolate cake and begin the diet in earnest tomorrow. Giving up on our long-term goals for immediate gratification, my friends, is procrastination.
- What do these results suggest? First, that students do procrastinate (big news); and second, that tightly restricting their freedom (equally spaced deadlines, imposed from above) is the best cure for procrastination. But the biggest revelation is that simply offering the students a tool by which they could precommit to deadlines helped them achieve better grades.
- Interestingly, these results suggest that although almost everyone has problems with procrastination, those who recognize and admit their weakness are in a better position to utilize available tools for precommitment and by doing so, help themselves overcome it.



8: THE HIGH PRICE OF OWNERSHIP

Why we overvalue what we have

- On the basis of Jack Knetsch, Dick Thaler, and Daniel Kahneman's research on the "endowment effect," we predicted that when we own something— whether it's a car or a violin, a cat or a basketball ticket— we begin to value it more than other people do.
- Experiment
 - Duke basketball tickets
 - Those who had them were asked a price, and those who wanted them were asked what they would pay. Those who had them were 14x higher than those who did not have them.
- Quirks
 - #1: The first quirk, as we saw in the case of the basketball tickets, is that we fall in love with what we already have.
 - #2: The second quirk is that we focus on what we may lose, rather than what we may gain.
 - #3: The third quirk is that we assume other people will see the transaction from the same perspective as we do.
- For one, the more work you put into something, the more ownership you begin to feel for it.
- Also, we can begin to feel ownership before we even own something.
- My own approach is to try to view all transactions (particularly large ones) as if I were a nonowner, putting some distance between myself and the item of interest. In this attempt, I'm not certain if I have achieved the uninterest in material things that is espoused by the Hindu sannyasi, but at least I try to be as Zen as I can about it.
- But home ownership is even more interesting and complex than, say, the regular case of owning a coffee mug or a pair of baseball tickets— because we invest so much in our houses.

9: KEEPING DOORS OPEN

Why options distract us from our main objective

- In the context of today's world, we work just as feverishly to keep all our options open. We buy the expandable computer system just in case we need all those high-tech bells and whistles.
- We might not always be aware of it, but in every case we give something up for those options. We end up with a computer that has more functions than we need,



or a stereo with an unnecessarily expensive warranty. And in the case of our kids, we give up their time and ours— and the chance that they could become really good at one activity— in trying to give them some experience in a large range of activities. In running back and forth among the things that might be important, we forget to spend enough time on what really is important. It's a fool's game, and one that we are remarkably adept at playing.

- We have an irrational compulsion to keep doors open. It's just the way we're wired. But that doesn't mean we shouldn't try to close them. Think about a fictional episode: Rhett Butler leaving Scarlett O'Hara in *Gone with the Wind*, in the scene when Scarlett clings to him and begs him, "Where shall I go? What shall I do?" Rhett, after enduring too much from Scarlett, and finally having his fill of it, says, "Frankly, my dear, I don't give a damn." It's not by chance that this line has been voted the most memorable in cinematographic history. It's the emphatic closing of a door that gives it widespread appeal. And it should be a reminder to all of us that we have doors— little and big ones— which we ought to shut.
- We need to drop out of committees that are a waste of our time and stop sending holiday cards to people who have moved on to other lives and friends. We need to determine whether we really have time to watch basketball and play both golf and squash and keep our family together; perhaps we should put some of these sports behind us. We ought to shut them because they draw energy and commitment away from the doors that should be left open— and because they drive us crazy.

10: THE EFFECT OF EXPECTATIONS

Why the mind gets what it expects

- WHEN WE BELIEVE beforehand that something will be good, therefore, it generally will be good— and when we think it will be bad, it will bad.
- Atmosphere...if it looks good, we think it will be good, and it is better.
- Words you describe something can affect expectation.
- Presentation affects presentation.
- Ariely, Dan. *Predictably Irrational, Revised and Expanded Edition: The Hidden Forces That Shape Our Decisions* (pp. 204-205). HarperCollins. Kindle Edition.
- EXPECTATIONS ALSO SHAPE stereotypes. A stereotype, after all, is a way of categorizing information, in the hope of predicting experiences. The brain cannot start from scratch at every new situation. It must build on what it has seen before. For that reason, stereotypes are not intrinsically malevolent. They provide shortcuts in our never-ending attempt to make sense of complicated surroundings. This is why we have the expectation that an elderly person will need help using a computer or that a student at Harvard will be intelligent.* But because a stereotype provides us with specific expectations about members of a



group, it can also unfavorably influence both our perceptions and our behavior. Expectations enable us to make sense of a conversation in a noisy room, despite the loss of a word here and there, and likewise, to be able to read text messages on our cell phones, despite the fact that some of the words are scrambled. And although expectations can make us look foolish from time to time, they are also very powerful and useful.

- THE BRILLIANT SATIRIST Alexander Pope once wrote: “Blessed is he who expects nothing, for he shall never be disappointed.” To me, it seems that Pope’s advice is the best way to live an objective life. Clearly, it is also very helpful in eliminating the effects of negative expectations. But what about positive expectations? If I listen to Joshua Bell with no expectations, the experience is not going to be nearly as satisfying or pleasurable as if I listen to him and say to myself, “My god, how lucky I am to be listening to Joshua Bell play live in front of me.” My knowledge that Bell is one of the best players in the world contributes immeasurably to my pleasure. As it turns out, positive expectations allow us to enjoy things more and improve our perception of the world around us. The danger of expecting nothing is that, in the end, it might be all we’ll get.

11: THE POWER OF PRICE

Why a 50-cent aspirin can do what a penny aspirin can’t

- Most important, I want to probe an aspect of placebos that is not yet fully understood. It is the role that price plays in this phenomenon. Does a pricey medicine make us feel better than a cheap medicine? Can it actually make us physiologically better than a cheaper brand? What about expensive procedures, and new-generation apparatuses, such as digital pacemakers and high-tech stents? Does their price influence their efficacy? And if so, does this mean that the bill for health care in America will continue to soar? Well, let’s start at the beginning.
- Placebos work for two reasons:
 - #1: Confidence or faith in the drug
 - #2: Conditioning. Pavlov. Expectation of something good
- ON THE BASIS of price alone, it is easy to imagine that a \$ 4,000 couch will be more comfortable than a \$ 400 couch; that a pair of designer jeans will be better stitched and more comfortable than a pair from Wal-Mart; that a high-grade electric sander will work better than a low-grade sander; and that the roast duck at the Imperial Dynasty (for \$ 19.95) is substantially better than the roast duck at Wong’s Noodle Shop (for \$ 10.95). But can such implied difference in quality influence the actual experience, and can such influence also apply to objective experiences such as our reactions to pharmaceuticals?



12: THE CYCLE OF DISTRUST

Why we don't believe what marketers tell us

- Trust, like money, is a crucial lubricant for the economy. When people trust other people, a merchant, or a company, they are more likely to buy, lend, and extend credit. In the old days, business was conducted on a gentleman's handshake. But when the handshake results in a swindle, trust disappears and all subsequent transactions— whether between cheaters or the genuinely good-hearted— become more difficult.
- Tragedy of the commons issue. When a group can use a resource at a rate slower than what it takes to replenish, everything is good. When an individual thinks they can do better for themselves by taking more, throwing off the balance, they do, and it kills the whole thing. But happens all the time.
- Nevertheless, it did set a powerful example of how transparency and sacrifice can serve to restore public trust and help a firm set itself on the right path.
- Another promising way for companies to create trust is by proactively addressing consumers' complaints.
- A more extreme version of this idea is for companies to make themselves transparent and vulnerable.
- The boy who cried wolf lessons:
 - #1: The first is that people are willing to forgive a bit of lying.
 - #2: But the second, more important moral— one that we are just beginning to understand— is that trust, once eroded, is very hard to restore.
- Nevertheless, by coming to understand trust as an important, tangible public resource to be protected and cared for, organizations could do a great deal to restore it. A few are beginning to take great care to create and maintain trust and do what they can to prevent its possible deteriorations. In the end, I believe that companies that want to be successful will heed the example of Timberland and realize that honesty, transparency, conscientiousness, and fair dealing should be bedrock corporate principles.

13: THE CONTEXT OF OUR CHARACTER...PART I

Why we are dishonest, and what we can do about it

- After some discussion we decided that there might be two types of dishonesty. One is the type of dishonesty that evokes the image of a pair of crooks circling a gas station. Then there is the second type of dishonesty. This is the kind committed by people who generally consider themselves honest— the men and



- women (please stand) who have “borrowed” a pen from a conference site, taken an extra splash of soda from the soft drink dispenser, exaggerated the cost of their television on their property loss report, or falsely reported a meal with Aunt Enid as a business expense (well, she did inquire about how work was going).
- Experiment on cheating on an exam:
 - #1: The first conclusion, is that when given the opportunity, many honest people will cheat.
 - #2: The second, and more counterintuitive, result was even more impressive: once tempted to cheat, the participants didn't seem to be as influenced by the risk of being caught as one might think. When the students were given the opportunity to cheat without being able to shred their papers, they increased their correct answers from 32.6 to 36.2. But when they were offered the chance to shred their papers— hiding their little crime completely— they didn't push their dishonesty farther.
 - We care about honesty and we want to be honest. The problem is that our internal honesty monitor is active only when we contemplate big transgressions, like grabbing an entire box of pens from the conference hall. For the little transgressions, like taking a single pen or two pens, we don't even consider how these actions would reflect on our honesty and so our superego stays asleep. Without the superego's help, monitoring, and managing of our honesty, the only defense we have against this kind of transgression is a rational cost-benefit analysis. But who is going to consciously weigh the benefits of taking a towel from a hotel room versus the cost of being caught? Who is going to consider the costs and benefits of adding a few receipts to a tax statement? As we saw in the experiment at Harvard, the cost-benefit analysis, and the probability of getting caught, does not seem to have much influence on dishonesty.
 - WHAT TO DO? Suppose that, rather than invoking the Ten Commandments, we got into the habit of signing our name to some secular statement— similar to a professional oath— that would remind us of our commitment to honesty. Would a simple oath make a difference, in the way that we saw the Ten Commandments make a difference? We needed to find out— hence our next experiment.
 - So we learned that people cheat when they have a chance to do so, but they don't cheat as much as they could. Moreover, once they begin thinking about honesty— whether by recalling the Ten Commandments or by signing a simple statement— they stop cheating completely.

14: THE CONTEXT OF OUR CHARACTER...PART II

Why dealing with cash makes us more honest

- Left cokes in a refrigerator...they were gone in 72 hours. Left six one-dollar bills in refrigerator and they were all still there in 72 hours. People felt different about taking cash.



- This means that when given a chance to cheat under ordinary circumstances, the students cheated, on average, by 2.7 questions. But when they were given the same chance to cheat with nonmonetary currency, their cheating increased to 5.9— more than doubling in magnitude.
- As the author and journalist Upton Sinclair once noted, “It is difficult to get a man to understand something when his salary depends upon his not understanding it.” We can now add the following thought: it is even more difficult to get a man to understand something when he is dealing with nonmonetary currencies.
- But look at the latitude we have with nonmonetary exchanges. There’s always a convenient rationale. We can take a pencil from work, a Coke from the fridge— we can even backdate our stock options— and find a story to explain it all. We can be dishonest without thinking of ourselves as dishonest. We can steal while our conscience is apparently fast asleep.

15: BEER AND FREE LUNCHES

What is behavioral economics, and where are the free lunches?

- What happened? We found that when people order out loud in sequence, they choose differently from when they order in private. When ordering sequentially (publicly), they order more types of beer per table— in essence opting for variety. A basic way to understand this is by thinking about the Summer Wheat Ale. This brew was not very attractive to most people. But when the other beers were “taken,” our participants felt that they had to choose something different— perhaps to show that they had a mind of their own and weren’t trying to copy the others— and so they chose a different beer, one that they may not have initially wanted, but one that conveyed their individuality.
- What about their enjoyment of the beer? It stands to reason that if people choose beer that nobody has chosen just to convey uniqueness, they will probably end up with a beer that they don’t really want or like. And indeed, this was the case. Overall, those who made their choices out loud, in the standard way that food is ordered at restaurants, were not as happy with their selections as those who made their choices privately, without taking others’ opinions into consideration. There was, however, one very important exception: the first person to order beer in the group that made its decisions out loud was de facto in the same condition as the people who expressed their opinion privately, since he or she was unencumbered, in choosing, by other people’s choices. Accordingly, we found that the first person to order beer in the sequential group was the happiest of his or her group and just as happy as those who chose their beers in private.
- What these results show is that people are sometimes willing to sacrifice the pleasure they get from a particular consumption experience in order to project a certain image to others. When people order food and drinks, they seem to have two goals: to order what they will enjoy most and to portray themselves in a



positive light in the eyes of their friends. The problem is that once they order, say, the food, they may be stuck with a dish they don't like— a situation they often regret.

- In essence, people, particularly those with a high need for uniqueness, may sacrifice personal utility in order to gain reputational utility.
- IF I WERE to distill one main lesson from the research described in this book, it is that we are pawns in a game whose forces we largely fail to comprehend. We usually think of ourselves as sitting in the driver's seat, with ultimate control over the decisions we make and the direction our life takes; but, alas, this perception has more to do with our desires— with how we want to view ourselves— than with reality. Each of the chapters in this book describes a force (emotions, relativity, social norms, etc.) that influences our behavior. And while these influences exert a lot of power over our behavior, our natural tendency is to vastly underestimate or completely ignore this power. These influences have an effect on us not because we lack knowledge, lack practice, or are weak-minded. On the contrary, they repeatedly affect experts as well as novices in systematic and predictable ways. The resulting mistakes are simply how we go about our lives, how we “do business.” They are a part of us.
- A second main lesson is that although irrationality is commonplace, it does not necessarily mean that we are helpless. Once we understand when and where we may make erroneous decisions, we can try to be more vigilant, force ourselves to think differently about these decisions, or use technology to overcome our inherent shortcomings. This is also where businesses and policy makers could revise their thinking and consider how to design their policies and products to provide free lunches.