

## Decision making behavior

- Why do people make the choices they do?
- Reason-based choice
- Regret theory
- Effort-accuracy
- Choice and judgment heuristics

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## Where are we so far?

- Economics predicts rational choices
  - Obey the law of contradiction
- People's choices are not always optimal.
- That does not mean choices are bad.
  - Psychologists have set up particular circumstances in which people make poor choices
  - Helps to illustrate processes people use.
- We will examine models of choice behavior.
  - Many different processes are used to make choices.

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## Prospect Theory

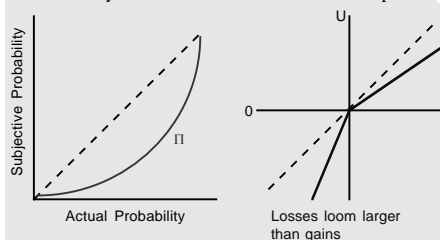
- A model that is like economic models.

$$P = \sum (\pi * u_i)$$

P is subjective probability

u is the utility of each option

Utility is evaluated relative to a reference point.



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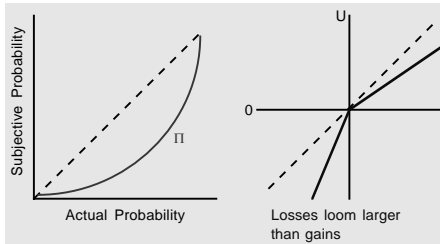
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## Prospect Theory

- Big difference between certainty and uncertainty
- Utility function explains framing effects.




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## Reason-based choice

- People want to be able to justify their choices
  - May make decisions that are easiest to justify.
  - Shafir, Simonson, & Tversky

Imagine you just finished a particularly difficult final exam, and you are walking home. You will not find out whether you passed the exam until tomorrow afternoon. A travel agent has a sign for an inexpensive trip to Acapulco. The offer expires that afternoon, but you can pay \$5.00 to hold a reservation until tomorrow. Do you sign up to take the trip or pay the \$5.00 fee?

A majority of people given this scenario pay the \$5.00.

Two other groups are run

One group told they passed the exam: Most choose to go

One group told they failed the exam: Most choose to go

People are paying for information that will not affect their choice...

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## Reason-based choice (cont.)

- People want a reason to go on the trip.
  - If they get a passing grade: Celebration
  - If they get a failing grade: Consolation
- Other reason-based effects
  - The attraction effect (discussed last class)
  - Effect is stronger if people have to justify their choice.
- Justification is not always good
  - People tend to use less information and to rely on single dimensions when forced to justify a choice.
  - It is easier to come up with these simpler justifications.

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## Regret Theory

- People may make choices to avoid regret
- Status quo bias
  - People would prefer not to make a change
  - If a change is made, and it goes badly, there is regret.

Imagine you come to class and are given a ticket for a drawing to win a prize. You are given the option to trade your ticket with your neighbor before the drawing takes place. Will you trade?

This is an even trade, but most people elect to keep their ticket.

They would experience regret if the ticket they traded away eventually won the drawing.

May also explain certainty effects. Regret if a 1/24 chance occurs.

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## Effort Accuracy framework

- People attempt to make accurate choices
  - People want to minimize effort
- Some methods for making choices are highly accurate
  - They involve considering a lot of information
  - Calculating expected utility is a high effort-high accuracy way of making a choice.
- Some methods are simpler
  - They involve considering less information.
  - We will now look at some simpler decision heuristics.

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## Satisficing

- Choose the first option that is satisfactory
  - Will find an option that satisfies the goal
  - Does not guarantee finding the best option
- Imagine you are a manager at a supermarket
  - You need someone to bag groceries
  - You get 100 applications
  - The cost of hiring a sub-optimal person is low
  - Take the first person who looks like they can do the job.

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## Elimination By Aspects

- Start with the most important attribute
  - Eliminate all options that are not satisfactory with respect to that attribute
- Then go to the next most important attribute
  - Repeat this process until there is one option left



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## Lexicographic Semiorder

- Like Elimination By Aspects
- Look at the most important attribute
  - Select the option that has the best value on that attribute



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## Mental accounting

- Utility theory is a common currency theory
- All options are evaluated with respect to utility
- But all gains and losses are not viewed as the same.
  - People seem to have a variety of mental accounts.

Imagine you are shopping for a calculator and a jacket, and you find them both at the same department store. The calculator costs \$25, and the jacket costs \$120. You are told that a store across town has both items, but the calculator is \$15 cheaper at that store. Do you buy the items at that store or do you go across town.

Most people say yes.

If the jacket is \$15 cheaper, most people say no.

In each case, they have spent the same amount of money.

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## Mental Accounting

- The idea is that people are creating separate mental accounts for different goals.
  - Money for necessities
  - Money for entertainment
  - Spending money from one account does not affect others.

Imagine you have gone to the movies to see a show. You got to the front of the line and realized you lost \$10, do you still go to the movie?

Most people say yes

Imagine you have gone to the movies to see a show. The ticket costs \$10. You buy the ticket early in the day. When you get to the theater, you realize you lost the ticket. Do you buy another one?

Most people say no.

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## The House Money effects

- Another example of Mental Accounting

You go to a casino and put a quarter in a slot machine. You win \$100. How is your gambling behavior affected?

People are often more willing to gamble in this situation.

Not any windfall increase in money works.

You are just about to go into a casino, when you see a newspaper. You own 100 shares of a stock and find out that it went up \$1.00 that day. How is your gambling behavior affected?

Most people's gambling behavior is unaffected by this news.

In the first case, people feel as if they are gambling with the house's money. In the second case, it feels like their own money.

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## Summary

- Prospect theory
- Reason-based choice
- Regret theory
- Heuristics and biases
- Mental accounting

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