



Five preconditions of effective consumer engagement – a conceptual framework

Product information, consumer choice and market engagement

Lauren Solomon &
Ben Martin-Hobbs



Behavioural economics - 101



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Rational Choice Theory

Homo economicus – ‘economic man’ (obviously!)
maximises his utility.

- selfish, rational and has stable preferences

Assumptions:

- **Perfect rationality**
- **Perfect information**
- (Perfect competition)



*"Yes, the planet got destroyed. But for a beautiful moment
in time we created a lot of value for shareholders."*

Behavioural approach to economics

- Rational choice theory
 - How ***should/will*** people respond to incentives – according to rational choice theory **assumptions** (normative)
- Behavioural economics has a different emphasis and approach :
 - ***How*** do people respond to incentives or make risky choices?
- Necessarily means **trials (evidence based policy)**

Breaking down perfect rationality...

- ***Bounded rationality*** – limited time, available information and cognitive bandwidth (Herbert Simon)
 - Decision-making sometimes results in errors
- “What you see is all there is” (Kahneman)
 - our view of the world is limited by the information that is available at a given moment

Breaking down perfect rationality...

Utility theory (rational choice)

- “the utility theory is assessed by comparing the utilities of two **states of wealth**”
- Gaining \$500 has the same utility as loosing \$500
 - Start with \$1000 + \$500 = \$1500
 - Start with \$1500 - \$500 = \$1000

Breaking down perfect rationality...

‘Prospect theory’ – Tversky and Kahneman

Problem 1 – which would you choose?

- A) Get \$900 for sure
- B) 90% chance to get \$1000

Problem 2 – which do you choose?

- A) Lose \$900 for sure
- B) 90% chance to lose \$1000

Breaking down perfect rationality...

‘Prospect theory’ – Tversky and Kahneman

Problem 3 – you (personally!) have been given \$1000
Which would you choose?

- A) 50% chance to win a further \$1000
- B) Get \$500 for sure

Problem 4 – you (personally!) have been given \$2000
Which would you choose?

- C) 50% chance to lose \$1000
- D) Lose \$500 for sure

Breaking down perfect rationality...

- '**Prospect theory**' – Tversky and Kahneman

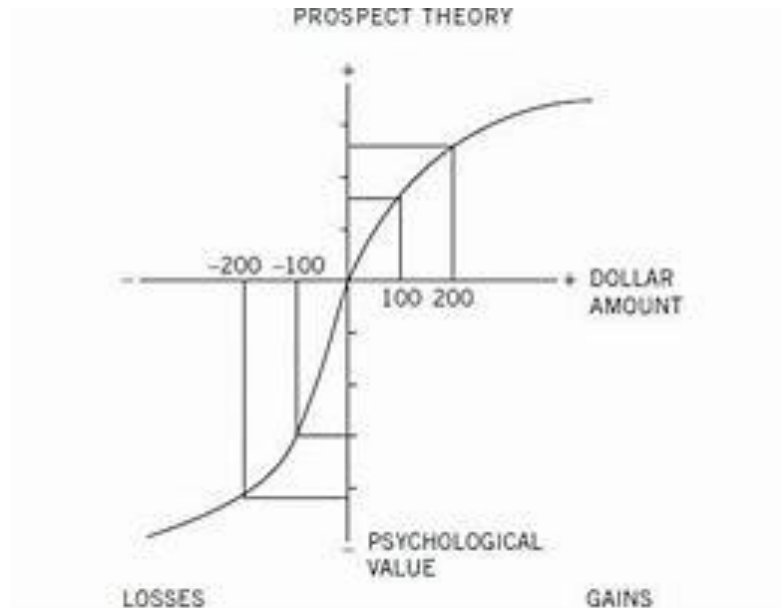
Do you take the gamble? A 50/50 coin toss where you:

- Win \$130 or
 - Loose \$100
-
- What is the smallest gain needed to balance an equal chance to loose \$100?

Breaking down perfect rationality...

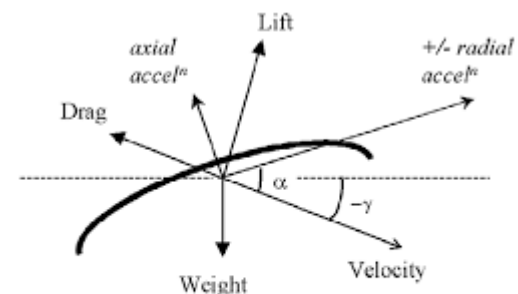
‘Prospect theory’ – Tversky and Kahneman

- Evaluation of choices is relative to a reference point
- Diminishing sensitivity when evaluating wealth - \$10 to \$20 compared with \$90 to \$100 (\$10 diff in both)
- Loss aversion – “losses loom larger than gains”



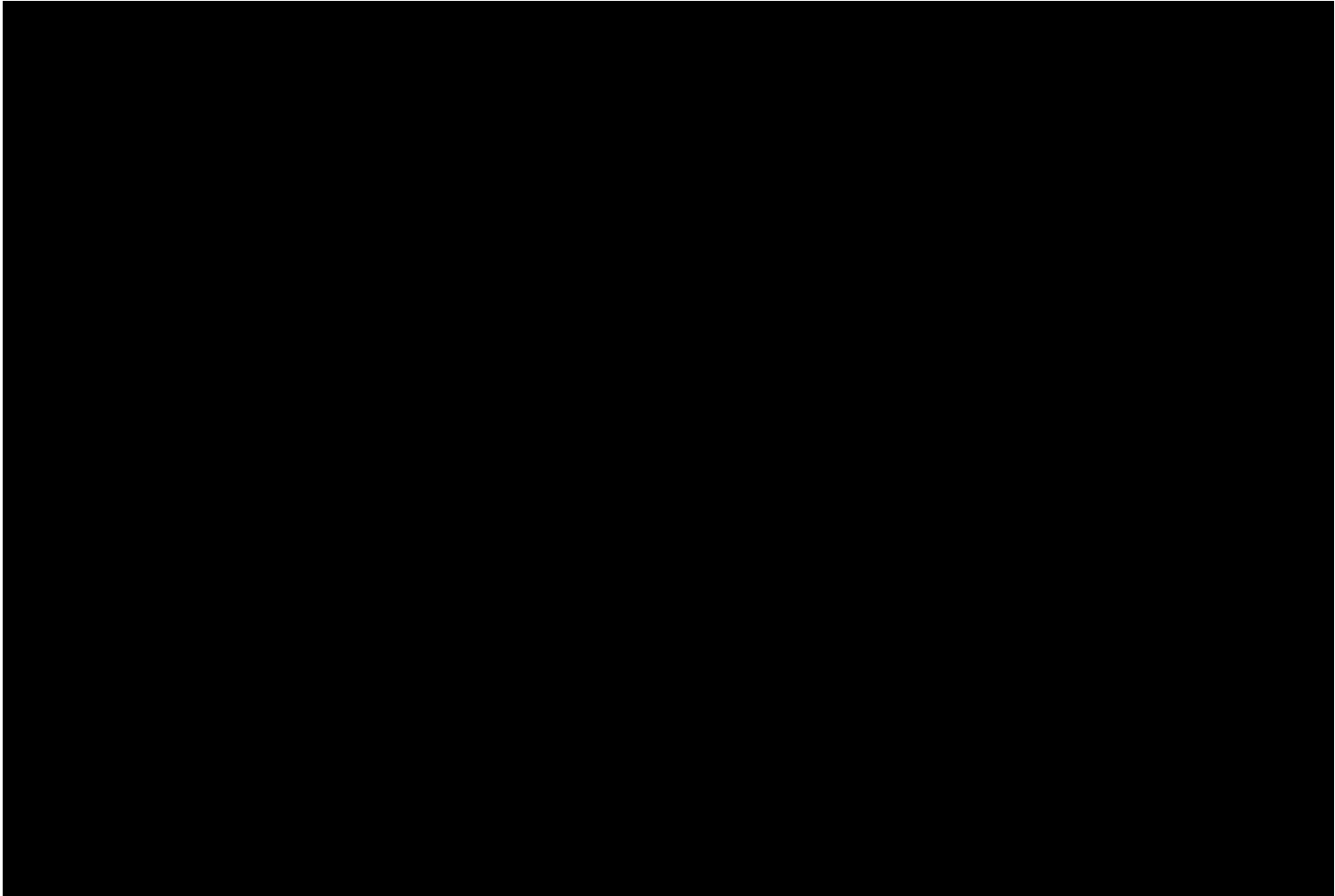
Thinking Fast, Slow - Kahneman

- **System one** – our primary mode of thinking, quick, automatic, intuitive thinking, drawing on *heuristics* and/or experience
 - effortless and *not really conscious*
 - catching a Frisbee - relies on *heuristics*
- **System two** – slow, calculating, deliberative thinking, requires effort and a sense of agency – what “I” do
 - Calculating your tax



α = Angle of Attack
 γ = Flight Path Angle

Attention availability



Required effort

- **“Law of least effort”** – we prefer easier ways to resolve problems – reverting to System 1 when we should use system two
 - Thinking is hard! And system 2 is “lazy”
- **Choice overload** – can cause decision-making errors applies to system 2 as well as system 1

Mental shortcuts or rules of thumb – “*Heuristics*”

- **Anchoring and discounting**
 - What is a jacket from Brand XX worth?
 - \$300 50% off sale
 - \$370 60% off sale
 - Particularly problematic with partitioned pricing – which exploits limited attention availability
- **Satisficing** – we make choices based on what is ‘good enough’, rather than optimal – particularly when faced with complexity and uncertainty

Cognitive biases

When our heuristics fail to produce a correct judgment, this may result in a cognitive bias – a tendency to draw an incorrect conclusion in a certain circumstance based on cognitive factors

- **Present Bias** – today/tomorrow matter, next year not so much
- **Optimistic bias** – 90% of drivers think they are above average
 - Confident but confounded (Harrison)
- **Loss aversion and framing**
- **Status quo/inertia**

Uncertainty and *heuristics* – (Gigerenza)

- Should we ever rely on heuristics?
- Decision-making under **risk** – we can calculate probabilities/likely outcomes – requires statistical thinking (system 2?)
- Decision-making under **uncertainty** – we can't calculate probabilities/likely outcomes – requires smart rules of thumb (*heuristics*) and intuition (system 1?)
 - Could/Would you run a cost-benefit analysis of a prospective partner?

Nudge: Improving Decisions about Health, Wealth, and Happiness - Thaler

- “Libertarian paternalism”- preferred as compared with bans/mandates
- Choice architecture is everywhere
- Leveraging defaults – every choice has an implicit default (i.e. where no choice made)

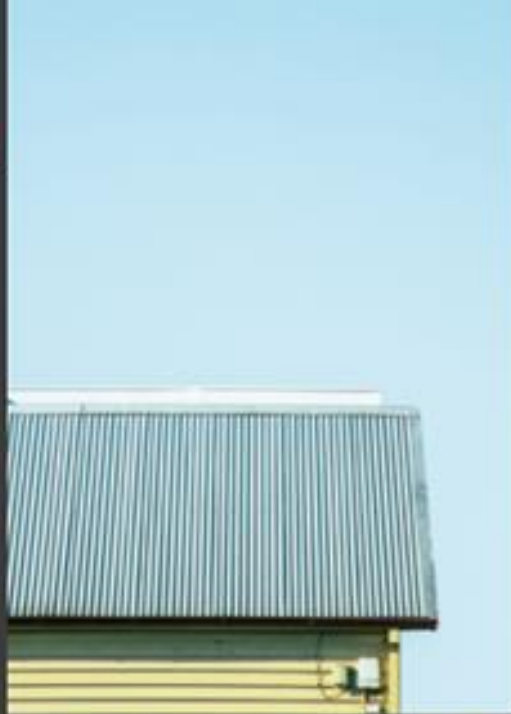
- Nudges are a *tool*, much like a ban or mandate they are neutral

Examples of *nudges*

- Electricity conservation – [Social norms](#)
- Prompts – repaying overdue bills - [hand written notes on envelopes](#) (novelty bias?)
- Reframing - [comparing last year's premium with the forthcoming year at renewal](#)
- Leveraging defaults
 - Organ donation (from *Nudge*)
 - [Swedish social security](#)

Examples of *nudges* - energy switching

- Small Scale Database trial – Ofgem & BIT
 - Increased switching from 6% to 13%, however participant retailer had a price rise mid-trial
- Cheapest letter offer – Ofgem & BIT
 - Increased switching from 1% to 3% - low cost, but demonstrates the issue of scalability
- Basic Plan Information Document – AER & BIT
 - Found medium confidence – but little improvement in comprehension
- Benefit Change Notice Letter – AER & BIT
 - Use of loss aversion – “you will lose your discount”



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Policy environment

Increasing policy & regulatory intervention in deregulated markets

- Royal Commission into Misconduct in the Banking, Superannuation & Financial Services Industries
- Independent Review of Electricity & Gas Markets in Victoria
- ACCC Retail Electricity Pricing Inquiry
- ESC review of hardship programs
- ACCC Monitoring Broadband Australia market study

Technological advancement & data

- Greater focus on data, who owns it, how is it being used
- Productivity Commission Data Availability & Use – sector-specific discussions to follow
- ACCC Data Analytics Unit
- Online marketplace driving disruption
- Push towards personalisation

Stagnant wages growth

- Low wages growth and underemployment placing pressure on household budgets

Declining trust

- In all major institutions – companies, governments, religious and media organisations

Current issues raised across a range of markets

People are disengaged! *Can mean:*

- People are experiencing barriers to engaged due to *reduced capacity*;
- People aren't engaged due to *perceived costs > perceived benefits*.
- People aren't engaging because they have a product that suits needs.

It's complex! *Can mean:*

- Language & jargon too complex for comprehension;
- Product features too numerous or onerous to enable comparison;
- Product info is presented in a way which is too complicated.

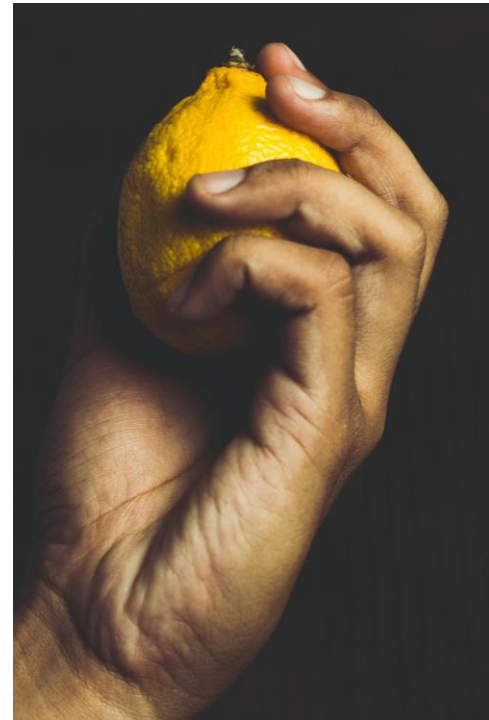
People don't switch! *Can mean:*

- Customers have a product that meets preferences;
- Perceived search/comparison costs exceed benefits;
- Switching process is costly (time or financial).

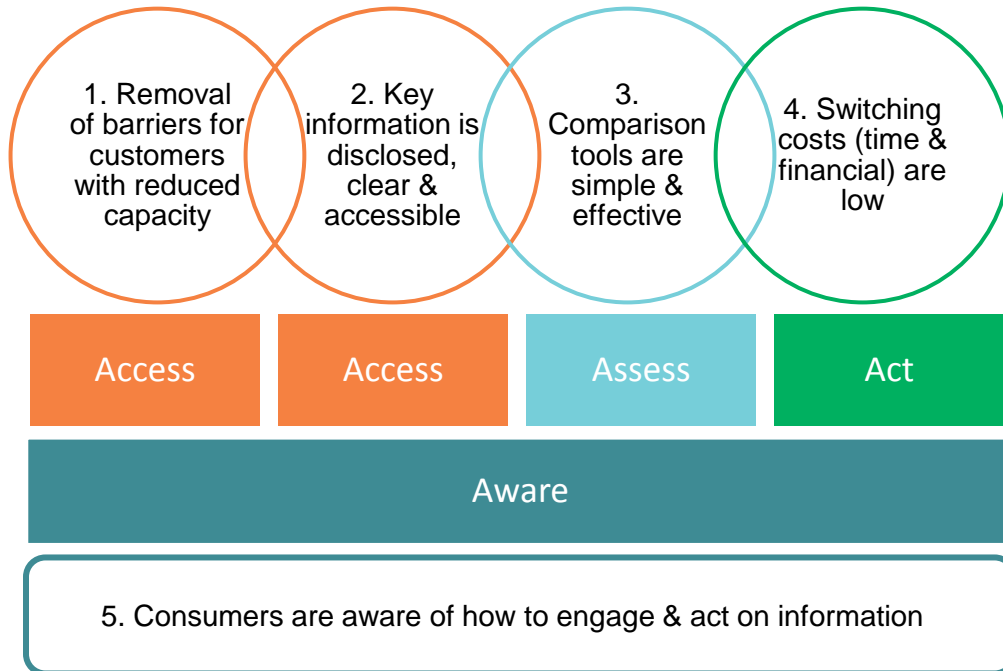
Assumptions of neoclassical microeconomics & consumer choice

Perfect information

- George Akerlof's seminal paper - *The Market for "Lemons"*
- Primary focus of regulators and policymakers to since then – provide more information to consumers and they'll then make a rational choice reflective of preferences.
- Emerging view - information alone while a *necessary* precondition, is not *sufficient* to improve decision-making.



CPRC Conceptual Framework – Five Preconditions



Reflecting a shift towards a more integrated approach to policy & regulatory intervention.

Acknowledging engagement is both about information *AND* behaviour.

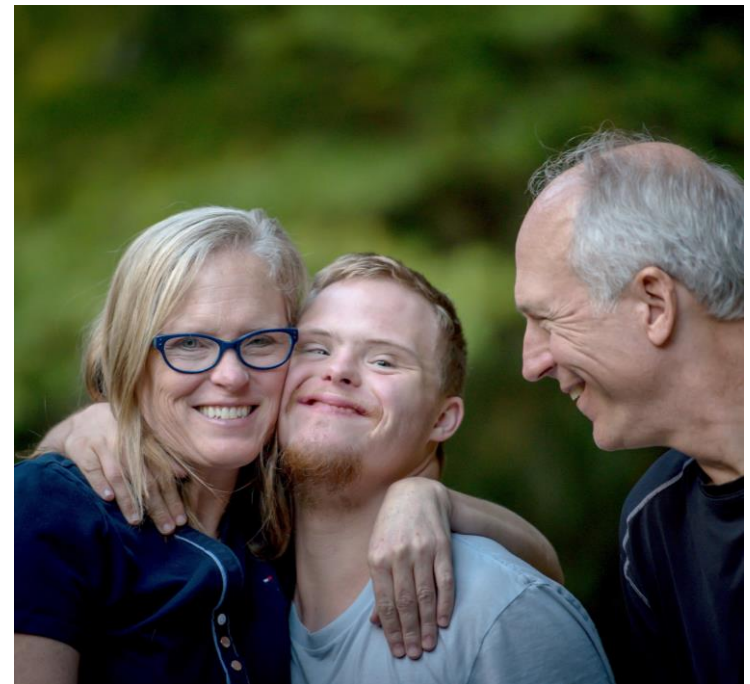
Precondition 1 - Barriers to access for consumers with reduced capacity or vulnerability are removed

Ensure consumers experiencing reduced capacity to engage, compare and switch providers can obtain a fair product that meets their needs. Barriers may include:

- Belonging to culturally and linguistically diverse (CALD) backgrounds;
- Temporary trauma or crisis associated with domestic violence, health or an accident;
- Digital exclusion – that is, without access to the internet or digital devices;
- Permanent mental health or learning disability;
- Significant financial distress or a poor credit history



Access



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Precondition 1 - Barriers to access for consumers with reduced capacity or vulnerability are removed

Requires drawing on strengths of different institutions for integrated delivery.

Effective interventions *may* include:

- Guaranteed low/ no fee products for vulnerable consumers
- Default simple, low-cost products for individuals with reduced capacity
 - MySuper
- Fast-tracked debt relief support for individuals experiencing domestic violence across sector
 - WEstJustice Restoring Financial Safety Project
- Outreach programs
- Support for community orgs assisting customers navigate market
 - QCOS/AGL *Switched on communities program*



Access



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Precondition 2 - Key product information is disclosed in a relevant, clear and comprehensible manner



Access

Consumer can comprehend the information and understand whether the product or service meets their preferences.

Key information may include:

- Price and other costs
- Quality and Features
- Terms and conditions, jargon and language

Comprehension testing should be conducted to ensure consumers understand the information presented or that tools developed improve decision-making.

Prices <small>(GST exclusive so that you can compare with your bill)</small>				
	Summer: 1 Dec - 28 Feb		Other: 1 March - 30 Nov	
Off Peak	10pm-7am Mon-Fri Sat Sun	21.34 cents per kWh	10pm-7am Mon-Fri Sat Sun	21.34 cents per kWh
Semi-peak	9am-5pm Mon-Fri 8pm-10pm Mon-Fri	37.147 cents per kWh	9am-5pm Mon-Fri 8pm-10pm Mon-Fri	33.24 cents per kWh
Peak	7am-9am Mon-Fri 5pm-8pm Mon-Fri	38.588 cents per kWh	7am-9am Mon-Fri 5pm-8pm Mon-Fri	35.147 cents per kWh
Separate meter 1	8pm-8am - 16.61 cents per kWh		8pm-8am - 16.1 cents per kWh	
Separate meter 2	11pm-5am - 22.572 cents per kWh		11pm-5am - 23.572 cents per kWh	
Supply charge	84 cents per day		84 cents per day	



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Precondition 2 - Key product information is disclosed in a relevant, clear and comprehensible manner



Access

Effective interventions *may* include:

Price and other costs:

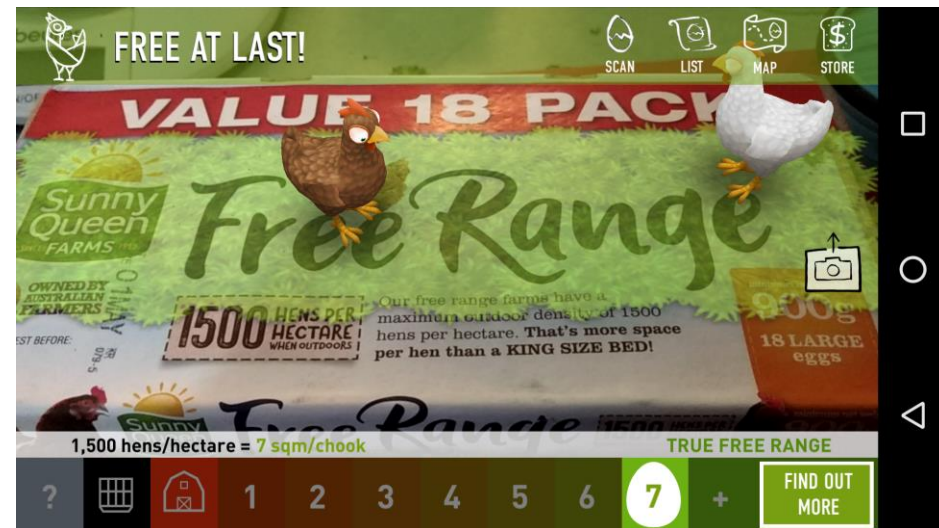
- unit pricing, online price tracking tools, reference prices based aggregate use.

Quality and features:

- Accredited business ratings, measures of customer service quality, technical service quality or feature presentation informed by behavioural insights (e.g. traffic lights for food).

Terms of service, jargon and language:

- cartoons and visual representations of contracts (where possible), digital tools to assist comprehension.



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Precondition 3 - Comparison tools are accurate, simple and effective

Enable consumers to assess and compare products and identify one that suits their preferences.

Information summaries - price fact sheets, critical information summaries & disclosure statements

- Simple, understandable and comparable (Harrison *et al*, 2016)
- Part of consumers' decision-making journey



Assess



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Precondition 3 - Comparison tools are accurate, simple and effective



Assess

Comparator websites and digital tools

- Require consistent information across comparison sites/digital tools
- A platform neutral approach to reform
- CMA principles: Clear, Accurate, Responsible, Easy to use
- Accreditation, direct regulation, or the potential for enforcement
- Awareness

Consumer data availability and transferability

- Improve consumers' access to their data
- Facilitate data portability and innovative comparison services.
 - E.g. mobile phone number porting
- Privacy and consent essential



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Precondition 4 - Switching costs (financial and non-financial) are low

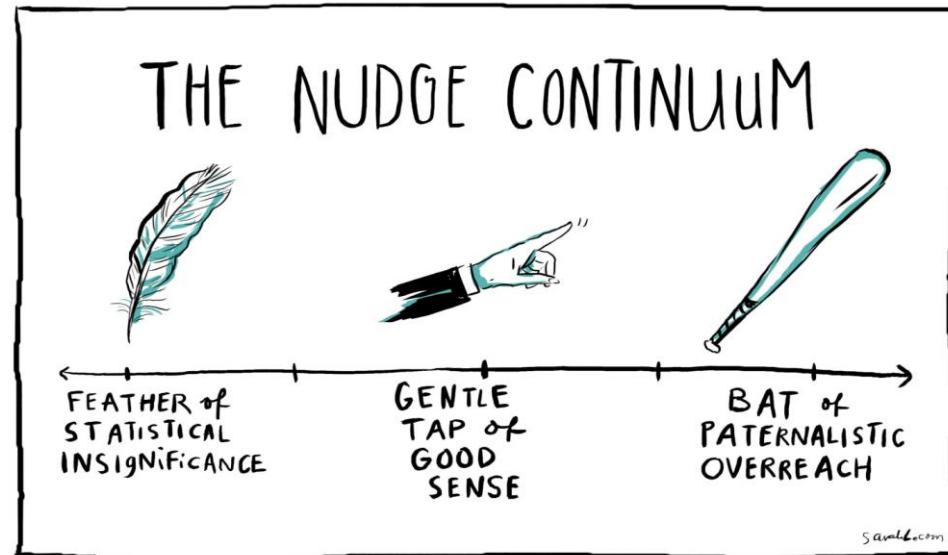


Act

Consumers can switch providers easily, with minimal financial and non-financial barriers (*thinking costs*).

Barriers include:

- Switching costs – financial costs like exit fees for a service provider. These directly diminish the value of switching to an alternative provider
- *Thinking costs* – perception that switching is difficult



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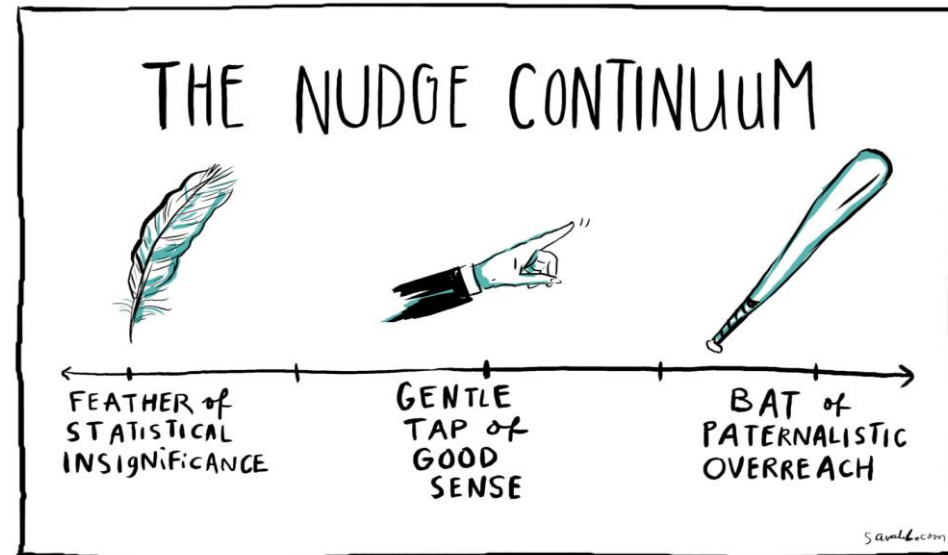
Precondition 4 - Switching costs (financial and non-financial) are low



Act

Effective interventions *may* include:

- Improving comparator switching processes
 - Information-only sites
 - Lead generation sites
 - End-to-end sites
- Encouragement of third-party brokers and collective switching
 - Flipper
- *Nudges*
 - Provide premium from previous year and forthcoming year on renewal notice.



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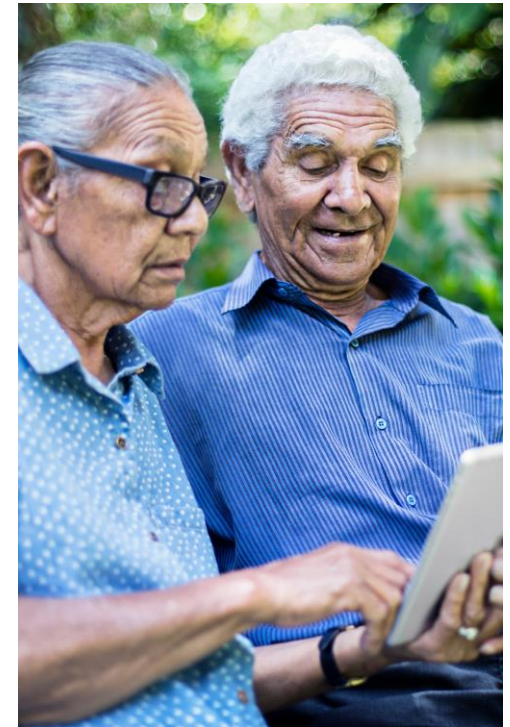
Precondition 5 - Consumers are aware of how to access, assess and act on information



Aware

Consumers need to be sufficiently aware how they can:

- access assistance and fair products when they have reduced capacity;
- access key information about competing products and services;
- assess which product or service offering best meets their preferences;
- act on information that enables switching to a product where that service offering better meets preferences



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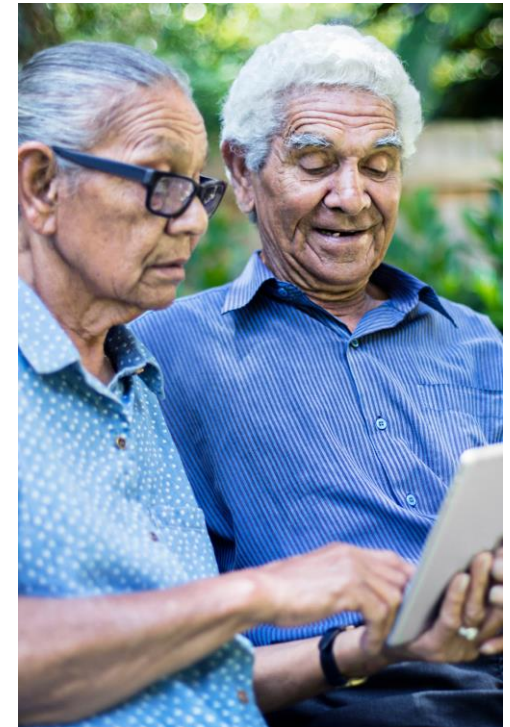
Precondition 5 - Consumers are aware of how to access, assess and act on information



Aware

Effective interventions *may* include:

- Government awareness campaigns
 - Swedish privatisation of social security
- Support and training for frontline staff
 - “Train the trainer”
- Nudges
 - Handwritten notes on overdue bills



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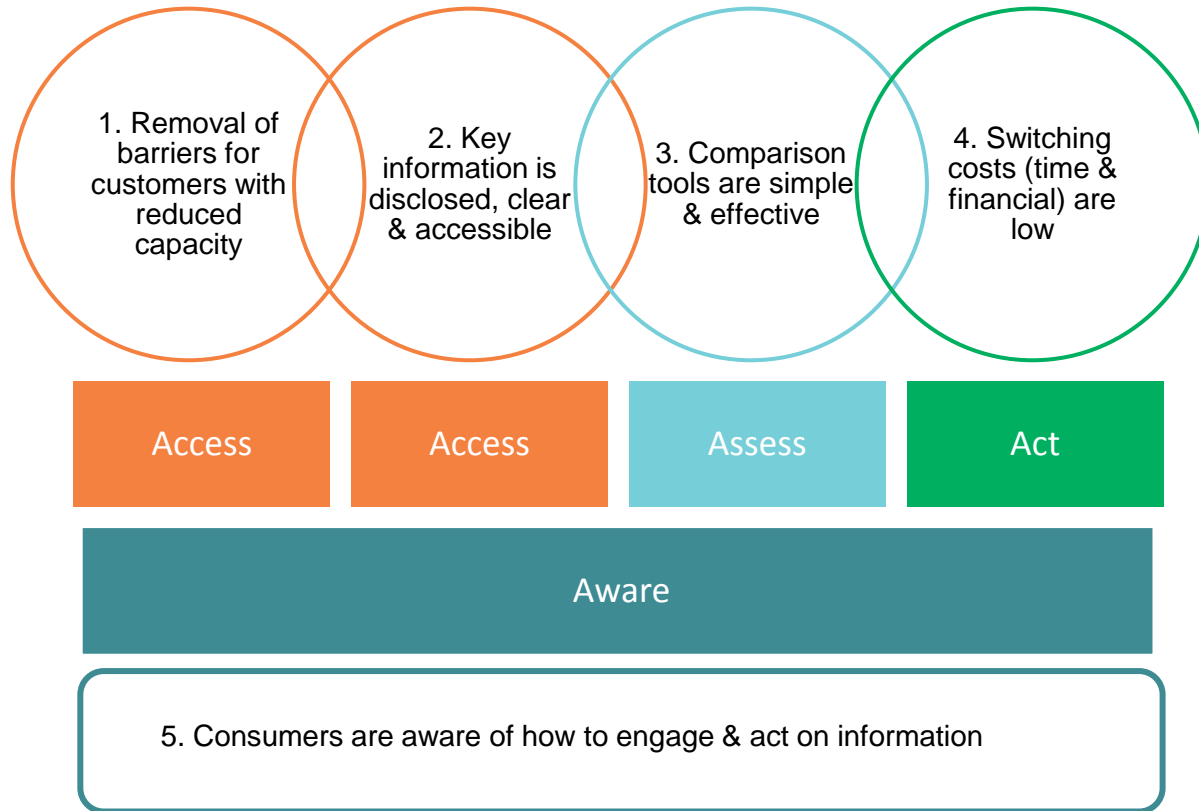
Trialling and implementing interventions

Successful interventions work end-to-end and are reflective of the customer decision-making journey.

Critical to designing effective interventions are:

- Customer journey-mapping of the existing decision-making process for consumers – interventions targeted at key problem areas;
- Baseline data of the awareness across different segments of the community about how to engage, compare & obtain products that suit preferences;
- Trialling interventions to understand the impact on the behaviour change that was being targeted.
- Measuring outcomes – collecting more data on the experience for consumers of accessing, assessing, acting on and awareness of available information & tools.

CPRC Conceptual Framework – Five Preconditions – views?



Hear from our eminent speakers:



Mr. Rod Sims, Chair
Australian Competition and
Consumer Commission



Mr. Ed Santow, Commissioner
Australian Human Rights Commission



Dr Katharine Kemp
Lecturer
Faculty of Law
UNSW Sydney



**Professor James
Arvanitakis**
Pro Vice Chancellor
(Research and Graduate
Studies)
Western Sydney University



Dr Suelette Dreyfus
Lecturer
Department of Computing
and Information Systems
**The University of
Melbourne**



Dr Monique Mann
Vice Chancellor's Research
Fellow
Faculty of Law
**Queensland University of
Technology**



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