



Behavioral Economics

<b>Name of the Faculty:</b>	<b>Prof. Ritwik Banerjee</b>
<b>Designation/Affiliation:</b>	<b>Associate Professor, IIM Bangalore</b>
<b>Teaching Area:</b> (such as Finance & Accounting; Marketing; Production & Operations Management; Strategy)	<b>Economics</b>
<b>This course may be offered to:</b>	<b>SNOC MBA level</b>
<b>Total Credits (No. of hours):</b>	<b>3 credits (35 hours)</b>
<b>Specify the Year and Month:</b>	<b>Jan 2024 - Mar 2024 (SNOC)</b>
<b>Course Type:</b>	<b>Elective</b>
<b>Grading Norms</b>	<b>Quantitative</b>



## Course Summary

The purpose of this course is to inform future managers, analysts and consultants of the deeper psychological processes which underlie decision making. The course will enable the students to incorporate the insights into marketing, human resource practices, finance and business strategies.

How a woman (or a man) fares in life depends to a large extent on a series of decisions that she takes. However, the process of how we arrive at decisions is often very complex. To keep things simple, economists assumed away much of the complexity and developed a rather simplistic framework for analyzing human behavior. The framework came to be known as the Rational Actor Model, where human beings were assumed to have many super human power. Let's call them *homo economicus* or simply, *Econs*. *Econs* are willful, selfish and have perfect foresight while also possessing extraordinary abilities to make complex calculation at very short period of time. Behavioral Economics was born as an antithesis to the Rational Actor Model. In this alternative paradigm, human beings were assumed to be less selfish and smart, prone to mistakes and procrastinations and often times myopic. Let's call them *homo behavioralis* or *Humans*. Do Humans sound more like you and me or for that matter, your neighbor next door?

Consider the following: ask the person on your left the answer to the following:  $1 \times 2 \times 3 \times 4 \times 5 \times 6 \times 6 \times 7 \times 8 \times 9 = ?$  To the one on your right:  $9 \times 8 \times 7 \times 6 \times 5 \times 4 \times 3 \times 2 \times 1 = ?$  Chances are that the one on your right will quote a higher number. The reason is they are *Humans*. If they were all *Econs*, the answer they would give would all be the same and it would indeed be the correct answer.

Each topic covered in this course will have two facets. First, students will get a broad overview of important results from behavioral economics and psychological aspects of economic decision making. Second, the students will see applications corresponding to these results. The course will also introduce the students the idea of experimentation - the methodological tool in which one thing is changed at a time which in turn makes causal inference possible. Finally, the course will draw heavily from the Indian cultural context, thereby giving the students a flavor of the cultural specificity and norm of an emerging economy such as India. Overall, the participants will have a better understanding of people and how they make decisions, which in turn will allow them to take effective managerial decisions.

Prerequisites: Completion of first year core courses in an MBA curriculum is preferred.

## Learning Objectives / Outcomes

The objective of this course is to deliver:

- Conceptual fundamentals governing how decisions are made.
- Ample business applications of important results and principles of behavioral economics.

This course will enable students to have a better understanding of people and how they take decisions, which in turn will lead to effective decision making in the context of management. The course will also aim to sensitize students to the behavioral specificities and cultural norms of emerging economics like India.



Knowledge of such local cultural norms will help students have a better understanding of the Indian context which in turn will help them negotiate the unique challenges of conducting business in the global South.

## Pedagogy

A variety of approaches will be used – lectures will contain short cases or caselets, presented in the form of Business Applications and newspaper articles. In class exercises in the form of Demonstration Problems and Examples will also be used. The lecture slides will contain the essential elements needed for the course. Readings and handouts will be given throughout the course.

The following are the textbooks for the course:

1. *Thinking Fast and Slow* by Daniel Kahneman
2. *Misbehaving* by Richard Thaler

The following are some of the suggested readings:

3. *Judgement in Managerial Decision Making* by Max. H Bazerman and Don A. Moore
4. *Nudge* by Richard Thaler
5. *Personnel Economics* by Peter Kuhn
6. *Personnel Economics in Practice* by Edward Lazear and Michael Gibbs
7. World Development Report 2013

## Course Evaluation & Grading

The grading will be qualitative (Excellent / Good / Satisfactory / Failure). However, quantitative grade points may also be provided if needed from any of the participating schools. The final grades will be determined on the following:

Component	Unit	Weight
Quiz	Individual	40%
Project Presentation	Group	60%

The quiz will be closed book.



## Session-wise plan

Total Contact Hours: 35

Lecture	Topic
1	<p>Introduction to Behavioral Economics</p> <p><i>In class experiment</i></p> <p>Econs and Humans</p> <p>Reading: “Humans and Econs” Chapter 1, Nudge</p>
2-3	<p>Heuristics, Biases and Emotions</p> <p><i>In class experiment</i></p> <p>How do consumers use heuristics to make decisions? What are the biases in their decision-making process?</p> <p>Reading: “Part II: Heuristics and Biases” Chapter 10-13, Thinking Fast and Slow</p>
3-4	<p>Overconfidence and Exponential Growth Bias</p> <p><i>In class experiment</i></p> <p>What is exponential growth bias?</p> <p>Application: personal finance</p> <p>Application: COVID-19</p>
5-6	<p>Loss Aversion</p> <p>Why are losses more painful than gains pleasurable?</p> <p>Applications of loss aversion</p> <p>Reading: Chapter 26 and 27, Thinking Fast and Slow</p> <p>Case: Why Consumers Don’t Buy: The Psychology of New Product Adoption (HBR) (Gourville, 2003)</p>

7	<p>Mental Accounting</p> <p>How do we partition payment streams and set prices?</p> <p>Reading: Part II – Mental Accounting, Misbehaving, Richard Thaler</p>
8	<p>Perceptions of Risk, Confidence and Consistency</p> <p>Why do people buy lotteries when they are not worth it?</p> <p>Why do people not buy insurance when they are worth it?</p> <p>Reading: Chapter 19, 30, 31, Thinking Fast and Slow</p>
9-10	<p>Impatience and self-control</p> <p>How people really discount the future?</p> <p>Why do we buy alarm clocks when we actually prefer to sleep in the morning?</p> <p>Reading: Chapter 11 and 12, Misbehaving</p>
11-12	<p>Strategic Thinking among Humans</p> <p>Level-k thinking</p> <p>How strategic do strategic people think others are</p> <p>Reading: Lecture Slides, Ch 21, Misbehaving</p>
13	<p>Perceptions of fairness</p> <p>Is UBER's surge pricing fair?</p> <p>Is it fair for a hospital to charge surge pricing in times of dengue?</p> <p>Reading: Chapter 8, Judgement in Managerial Decision Making</p>
14	<p>Social Preferences and Fairness Concerns</p> <p>Peer effects, charitable contribution, cooperation, social norm</p> <p>How does Apple leverage social preferences to push the sale of iPhones?</p>

	<p>Reading: Chapter 8, Judgement and Managerial Decision Making</p> <p>In class experiment</p>
15-16	<p>Discrimination</p> <p>Why does a Black/Dalit/Muslim/Female get paid less than an equally able White/Upper caste/Hindu/Male worker?</p> <p>Explicit and Implicit biases among managers</p> <p>Gender differences in self-confidence, competition, risk preference, leadership</p> <p>Reading: Chapter 16 Personnel Economics</p>
16-17	<p>Economics of Gender</p> <p>Gender and self confidence</p> <p>Gender and competition</p> <p>Gender and low-promotability jobs</p> <p>Reading: HBR article on low-promotability jobs</p>
18	<p>Nudges and Public Policy: Defaults and Choice Architecture</p> <p>How do we design lunchrooms so that children opt for healthier food?</p> <p>How do we make people save more without changing the interest rates?</p> <p>Reading: Chapter 4, 5 and 16, Nudge</p>
19	<p>Economics of Scarcity</p> <p>How do we behave when we are under time scarcity?</p> <p>How do we behave when we are under resource scarcity?</p> <p>Effect of scarcity on human cognition</p>



20	Happiness Economics  What makes us happy? How good are we at predicting what will make us happy? Does money make us happy?  Reading: Chapters 35, 37, and 38, Thinking Fast and Slow
Additional session	Student presentations on the team-based activity

Class Schedule:

First Lecture: 8<sup>th</sup> Jan (Wed): 2:30 PM to 4:00 PM (IST)

Second Lecture: 9<sup>th</sup> Jan (Thu): 2:30 PM to 4:00 PM (IST)

Every Wed and Thu the same time.

**No lectures on 14<sup>th</sup> and 15<sup>th</sup> Feb.**

Project presentation: 27<sup>th</sup> March 2-5 PM and 28<sup>th</sup> March 2-4 PM

Presentation hours: 5

Total contact hours: 35

Profile of Faculty:

<http://www.ritwikbanerjee.in/>

<https://www.iimb.ac.in/user/53/ritwik-banerjee>