The Marketer's Guide

to Your Customers' IRRATIONAL MINDS

PepperGroup

Behavioral economics is not only incredibly interesting; it provides highly valuable insights for strategic marketers.

In this collection, we've pulled together seven short but powerful nuggets. Each considers a way we think as human beings and how we, as marketers, can use these insights to improve our effectiveness. As a bonus, we've also included a collection of our all-time favorite books related to behavioral economics.

In this guide:

- » Anchoring, and the Four Ways it Impacts Marketing and Sales
- » Why "The Curse of Knowledge" Can Screw Up Your Marketing Communications
- » The Status Quo Trap and Five Ways Out
- » One Behavioral Insight That Can Keep You From Losing Sales
- » How to Apply Game Theory to Help Drive Better Outcomes
- » Six Principles for Making Your Message Sticky
- » Yes, You Can Sell $1.00 for More than A Dollar, Plus How It Relates to Competitive Strategy
- » The Best Behavioral Economics Books For Marketers

This is the kind of strategic thinking that we at Pepper Group bring to the table for our clients. Are you getting strategic marketing advice from your current agency partner? If not, maybe we should talk.

Call us at 847-963-0333 or email us at pepper@peppergroup.com.

220 N. Smith St. | Suite 406 | Palatine, IL 60067 | tel: 847.963.0333 | fax: 847.963.0888 | peppergroup.com

© 2013 Copyright Pepper Group, All rights reserved.

PepperGroup

Four Ways that Anchoring Impacts Marketing & Sales

Anchoring is an interesting human cognitive bias that is very relatable to marketing and sales. In short, anchoring refers to how an initial number or concept powerfully affects one's final analysis.

For example, ask twenty people for an average gas price forecast on this date next year. But before you do, tell half of them that you saw gas in downtown Chicago going for almost $5.00 a gallon recently. Tell the other half that you recently bought gas for $3.50 in rural Indiana.

Variations of this experiment time and again show that the second group of people will forecast a lower price than the first group. Why? The original number acted as an anchor from which they adjusted their estimate.

What's even more interesting is that the anchor doesn't even have to be related to the topic. In another experiment, participants were asked to first write down the last two digits of their social security numbers. Then they were asked to bid on various items. The people with the highest two-digit numbers bid around twice as much for the same items as those with the lowest numbers.

So what does this mean for business?

» PRICING

Conventional wisdom says that you can always lower your original price, but it's tough to go up! Your original price acts as an anchor.

» NEGOTIATIONS

Anchors can serve as the reference point for the negotiation from which concessions are granted and can dramatically affect the final outcome.

» BUDGETING

When forecasting, we often choose a natural anchor, like last year's number, and adjust from there. To make better decisions, don't let the original anchor exert too strong a hold. Instead, use other scenarios and benchmarks as well.

» COMPETITIVE STRATEGY

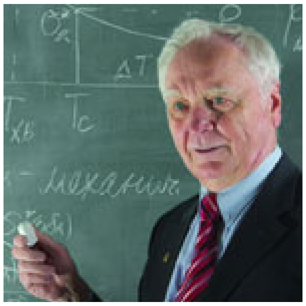
Anchoring is not only numerical. Often, when a firm surprises the industry with a new product, the competition starts thinking of ways they can respond with something incrementally better. A better approach is to focus on the real need that this new product is solving rather than anchoring all thoughts on the product itself.

There are many other scenarios as well; if you look for it, you'll see this mental bias at work everywhere.

© 2013 Copyright Pepper Group, All rights reserved.

Why the "Curse of Knowledge" Can Screw Up Your Marketing Communications

Ever sat down to read about a company's services and come away with, "huh?" Especially in BtoB marketing, many communications are often difficult to actually understand. You might blame it on the jargon and acronyms, but the culprit is much more substantial.



You didn't understand what you read because the communicator was suffering from an insidious affliction. For years, we at Pepper Group have called it "being too close to the subject matter." But in their great book, *Made to Stick*, Chip Heath and Dan Heath have identified a better name for it: The Curse of Knowledge. In short, it's the fact that once you know something, it's impossible to go back mentally to a point before you had that knowledge. It seems obvious to you. As a result, your communications are often a lot less clear to your audience than you think.

Want some proof? Tap out a song by knocking on the desk. I'm not suggesting you go for a Lady Gaga melody; just try the alphabet song or the Star Spangled Banner. Then, ask someone to guess what you're tapping. Sounds easy, right? Try it. You'll get very frustrated. While you're tapping, you'll be hearing the tune in your head and the answer will seem perfectly obvious. At the same time, your listener is just hearing meaningless knocking. That tune in your head is the equivalent of the Curse of Knowledge.

You may have heard about our award-winning Follett eBooks campaign a few years ago. It's a solid example of overcoming this curse. At the campaign's core was the basic insight that the audience didn't truly understand what eBooks were or how their school could benefit from them. By focusing on ensuring understanding among our various audiences, the campaign tripled monthly sales over a period of only six months.

Even if you're aware of it, the curse is very difficult to overcome. It's one reason that it usually pays to hire outside help. Regardless of how you address The Curse of Knowledge, though, the next time you are about to communicate something, pause for a moment and consider if there's maybe a tune playing in your head that your audience is just not going to hear. It may save you a lot of unproductive tapping.

© 2013 Copyright Pepper Group, All rights reserved.

The Status Quo Trap & Five Ways Out

Don't let a fear of change cloud your decisions. One of the common psychological biases that gets in the way of better decision making, and is particularly relevant to marketing, is the Status Quo Trap.

The fact is that most of us have a strong bias towards alternatives that perpetuate the current situation. Not changing is often the most comfortable option, isn't it?

In one interesting experiment, a group of people was randomly given one of two gifts. Half received a decorated mug; the other half got a large Swiss chocolate bar. They were then told that they could effortlessly exchange the gift they received for the other gift. One would expect that about half of the people would exchange, but only one in ten actually did. The status quo exerted incredible influence, even though it was arbitrarily established only minutes before!

So, how do you avoid this trap? Above all, it is important to evaluate each option based on its own merits. In any given decision, be aware that you may unconsciously give some options extra weight just because they more closely perpetuate the status quo.

Here are some techniques to help avoid this trap, as published in the book *Smart Choices*:

- » Always remind yourself of your objectives and examine how they would be served by the status quo.
- » Ask yourself whether you would choose the status quo alternative if, in fact, it weren't the status quo.
- » Never think of the status quo as your only alternative. Weigh the pluses and minuses of all options.
- » If several alternatives are clearly superior to the status quo, don't default to the status quo
  just because you have a hard time picking the best one.
- » Avoid exaggerating the effort and cost involved in switching from the status quo.

So, whether you're evaluating an aggressive marketing tactic, a risqué new campaign, a website redo or maybe even an upgraded graphic identity, change can sometimes be a very good thing.

Finally, as a marketer, it's very important to remember that your prospects have the same bias. Your offer is not the status quo for them. Make sure you're helping them get out of this trap as well.

© 2013 Copyright Pepper Group, All rights reserved.

One Behavioral Insight That Can Keep You From Losing Sales

As human beings, losses loom larger to us than gains. It’s one of those proven quirks in the way we think. Understanding this concept, however, can help you enhance your marketing effectiveness.

THE RESEARCH:

Losing $100 is painful and finding $100 is good, but losing $100 is more painful than finding $100 is good.

WHAT IT MEANS:

Say you’re selling a cost-savings solution. “You could save $10,000/month” might not be as motivating as “You’re losing $10,000 every month.”

THE RESEARCH:

The way losses and gains are framed makes a huge difference in our perception of them. For example, paying a surcharge feels a lot worse than missing out on a discount, even if the price difference is exactly the same. Think about it. Would you rather get a “cash discount” or pay a “credit card surcharge?”

WHAT IT MEANS:

Is your pricing structure optimized? As an example, are you charging a lower base price with added fees, or are you offering discounts off a higher base price instead?

THE RESEARCH:

Once you own an object, it becomes much more valuable to you. In one experiment, 50% of the people in a room were randomly given a coffee mug. The average mug owner wanted about $6 to give it up, but people who weren’t given the mug were only willing to pay about $3 to acquire it.

WHAT IT MEANS:

Free trials can be very powerful. If you can get your customers to experience what you deliver and feel as if they own it—even for a short period of time—they’ll likely assign a lot more value to it.

The endowment effect, prospect theory, reciprocity, anchoring, scarcity, social proof, relativity, authority, commitment and consistency, the power of “free” and many other behavioral economics principles can provide powerful insights that can help enhance your marketing effectiveness. First and foremost, of course, you must have something good to sell. This is persuasion, not trickery. Assuming this foundation, understanding the psychology of persuasion and then combining high-impact creative with incredibly efficient execution is the surest way to marketing success.

PepperGroup

220 N. Smith St. | Suite 406 | Palatine, IL 60067 | tel: 847.963.0333 | fax: 847.963.0888 | peppergroup.com

© 2013 Copyright Pepper Group, All rights reserved.

How to Apply Game Theory to Help Drive Better Outcomes

Typically, marketing communications are targeted at prospective and current customers. Targeting prospective and current employees is also legitimate. But a marketing message targeted at competition? Why?

There actually could be a strategic reason to communicate messages aimed at your competitors, especially if only two or three of you dominate a given market.

Consider "The Prisoner's Dilemma," a popular example of Game Theory. Here's a typical description of the setup:

Two men are arrested, but the police do not have enough evidence for a conviction, so they offer both a similar deal: if one testifies against (betrays) his partner, and the other remains silent, the betrayer goes free and the other guy gets a year in jail. If both remain silent, both are sentenced to only one month in jail for a minor charge. If each 'rats out' the other, each receives a three-month sentence. Each prisoner must choose either to betray or remain silent. What should he do?

The best outcome for Prisoner A is if he rats out his partner and his partner stays silent, because then Prisoner A will go free. But that's also the best choice for Prisoner B. So even though the best outcome for both of them is for both of them to keep quiet, they'll end up ratting out each other. In business, this is basically what competitors do all the time.

Now why would you want to communicate a message to your competitor? Take a look at this example from a UK game show. Here, they've set up a "prisoner's dilemma" of sorts as part of the game. One of the contestants sees how to ensure the best outcome. Watch how he commits to a decision that will ensure that they both don't end up with nothing.

PepperGroup
220 N. Smith St. | Suite 406 | Palatine, IL 60067 | tel: 847.963.0333 | fax: 847.963.0888 | peppergroup.com
© 2013 Copyright Pepper Group, All rights reserved.

How to Apply Game Theory to Help Drive Better Outcomes

Want more? In "A Beautiful Mind," John Nash has an epiphany at a bar that leads him to develop a Nobel Prize winning concept around Game Theory called the Nash Equilibrium. This time it's not about money, but girls. Technically the description in the movie isn't perfect, but it is an incredibly good scene:

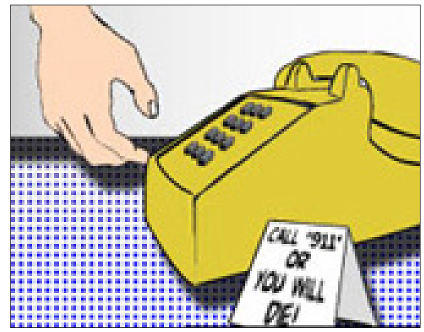
So, think about it. Is there anything you can strategically communicate to your competitors that will help ensure the best outcome?

PS. Please keep in mind that actual collusion is still illegal. Also, just to be sure we've covered all the disclaimers…"don't try this at home," "actual results may vary" and "professional driver on a closed course."

© 2013 Copyright Pepper Group, All rights reserved.

Six Principles for Making Your Message Sticky

Why do some messages just stick with you, while others are quickly forgotten?



For example, why do we remember precisely what happened to that guy who was approached by a beautiful woman in a hotel bar and woke up in a bathtub missing a kidney, yet we can't recall that new corporate strategy that was announced last month?

This is the question explored in a book by Chip and Dan Heath called *Made to Stick: Why Some Ideas Survive and Others Die*.

This idea of stickiness has always been important to marketers to help ensure our target audience remembers our message. But creating sticky messages is now more important than ever. Social media has turbocharged old fashioned word-of-mouth. Create a good message and it can spread like wildfire, bringing a benefit that is potentially worth millions in traditional advertising dollars. And, unlike a lot of traditional advertising, it will also have a lasting effect on your audience.

So what did the research uncover? Here are six principles the Heaths identified that contribute to making a message stick:

- » **Simplicity—The core message is both simple and profound**
- » **Unexpectedness—It generates interest and curiosity by overturning expectations**
- » **Concreteness—The message is put in terms of sensory information and human actions**
- » **Credibility—The details of the message have to be believable**
- » **Emotions—It should tap people's feelings**
- » **Stories—The message makes use of a short, coherent story or stories**

The more of these qualities the message shares, the more likely it is that it will be remembered and be influential. These apply whether the message is a political platform, public relations effort, corporate communication, B2B marketing or a consumer advertising campaign.

Compared to other disciplines, marketers have always been the most attuned to how a message is communicated and delivered. It's why creativity is so important.

220 N. Smith St. | Suite 406 | Palatine, IL 60067 | tel: 847.963.0333 | fax: 847.963.0888 | peppergroup.com
© 2013 Copyright Pepper Group, All rights reserved.

Yes, You Can Sell $1.00 for More than A Dollar, Plus How It Relates to Competitive Strategy

One of the fundamentals of strategic marketing is thinking forward and reasoning backward. The dollar auction is a great example.

So, how do you sell a dollar for more than a $1.00? Take a group of people and offer to auction off your dollar in 5-cent bid increments. The high bidder wins, but the second highest bidder, the loser, has to give up their losing bid. You'll almost always get more than $1.00 for your dollar—guaranteed.

How? Let's say that you were one of the bidders and you just bid outbid Mary's 50¢ with a bid of 55¢. Great deal for a buck, right? Well, if Mary's not thinking forward and reasoning backward, she's just thinking about her next move—which is, of course, to outbid you and offer 60¢. She's better off buying a dollar for 60¢ than she is losing 50¢. So, good move right?

Well, what's your next move? You're going to use the same logic and bid 65¢. She'll then bid 70¢, and so on. You can see how this will continue.

Here's where it gets really fun. Now let's say you just bid $1.00 for the dollar, outbidding Mary's 95¢. Does Mary stop? Is it better for her to bid $1.05 for the dollar (and lose 5¢), or give up and lose 95¢? Suddenly, you and Mary are bidding more than $1.00 for that dollar. Until someone comes to their senses, the bidding will keep going.

LET'S SAY YOU WERE PLAYING THIS GAME. HERE ARE A FEW POSSIBLE OBJECTIVES AND STRATEGIES:

Objective: **You want to make money**

Strategy: In this game, there is no way to make money simply by playing it straight. The only way is to convince your competition, or better yet somehow commit to yourself, that no matter what happens you're going to keep going until you "win." If your opponent feels that you're not going to bid rationally, they'll realize that they're better off not bidding against you at all. But why commit yourself? It guarantees that you're not bluffing.

Objective: **You want to "win" the dollar**

Strategy: Immediately bid $1.00 for it, or if your opponent opens with 5¢, bid $1.05. You need to give him no incentive to outbid you. However, you must be pretty confident that he's not going to act irrationally and be willing to lose a lot more money in order to "win" that dollar.

PepperGroup

220 N. Smith St. | Suite 406 | Palatine, IL 60067 | tel: 847.963.0333 | fax: 847.963.0888 | peppergroup.com
© 2013 Copyright Pepper Group, All rights reserved.

Yes, You Can Sell $1.00 for More than A Dollar, Plus How it Relates to Competitive Strategy

Objective: **You want to bankrupt your opponent**

Strategy: If you just want to destroy the other guy, and you have more money, just keep bidding until he runs out. Just make sure that you actually do have more money and that you are totally committed!

While this is a simplified model, it does relate to marketing and sales. Say you're in a competition for a contract and the more time/money you spend on the proposal, the more likely it is that you'll win. But if you lose, anything you put into the proposal is lost. How should you proceed? Will you get sucked into a bidding war where you're investing more to win the business than it's worth?

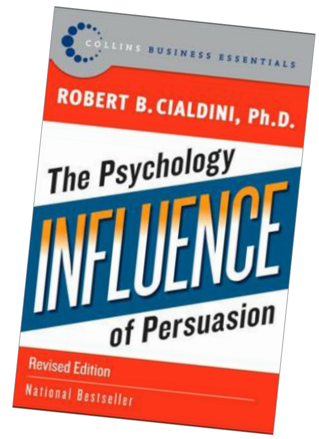
Or, say you're the biggest player in your industry, and have the deepest pockets. If your competitors truly believe that you'll pursue something at all costs, even if you lose money and are totally irrational about it, they might not even play against you for it.

There are many situations where you can apply this insight. The key is to think forward and reason backward. Identify your desired outcome, or objective. Anticipate what moves your competition will make. Think about the ways in which it might end. Then reason backward to what you should do now.

PepperGroup

220 N. Smith St. | Suite 406 | Palatine, IL 60067 | tel: 847.963.0333 | fax: 847.963.0888 | peppergroup.com
© 2013 Copyright Pepper Group, All rights reserved.

The Best Behavioral Economics Books for Marketers



Staying at the top of your marketing game is critical in this fast-moving world. Indeed, in order to be a Pepper, one has to be a continuing education fanatic. As we are avid readers, there are many books that have become highly valued at Pepper Group.

Here is a list of our favorite books around the subject of behavioral economics as it relates to marketing strategy:

Influence, the Psychology of Persuasion by Robert Cialdini

This is one of the most important books ever written on the science of persuasion and should be required reading for a marketing degree. If you like this, I'd also recommend *Predictably Irrational* and *Decision Traps*, later in this list.

Made to Stick and *Switch* by Chip Heath/Dan Heath

Take the best ideas and research from the *Tipping Point, Blink, Influence* and the *Happiness Hypothesis*—all great books—and combine them with fascinating behavioral economics wisdom, concrete examples and clever insights, and you have these two highly entertaining and practical books.

Predictably Irrational by Dan Ariely

After 20 years of researching behavioral economics, Dan Ariely has identified how "we all behave irrationally in a predictable fashion." It might just change your thinking about whether markets really know best or not. It will also help you understand common biases and help you avoid mistakes that you often make yourself.

Selling the Invisible by Harry Beckwith

If your business sells services, then you are selling the "invisible" and this book is a must-read. Written in 1997, it's still amazingly relevant. It's the first book we give new hires who will be involved in client strategy here at Pepper Group.

Decision Traps by Edward Russo and Paul Schoemaker

A classic. Written almost 25 years ago, this book outlines the ten barriers to brilliant decision-making, and shares fascinating examples of the cognitive biases and irrational thinking prevalent in all of us.

PepperGroup
220 N. Smith St. | Suite 406 | Palatine, IL 60067 | tel: 847.963.0333 | fax: 847.963.0888 | peppergroup.com
© 2013 Copyright Pepper Group, All rights reserved.