

Nudge: Improving Decisions about Health, Wealth and Happiness

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Nudge: Improving Decisions about Health, Wealth and Happiness is an eminently readable book on behavioural economics. The book talks about how people always go for the path of least resistance when it comes to making decisions. In order to help lazy decision makers pick the right choice, it is important to create nudges that help make them decisions that are beneficial.

The book is co-written by two authors. Richard H Thaler is an American economist who won the Nobel Prize in 2017. Cass R Sunstein is an American law expert and professor who was part of the Obama administration.

This handcrafted summary of Nudge will help you understand how people make decisions and how most of these decisions are not taken in a rational manner. In this context, it is important for nudges to guide people towards the right choices. This summary also helps you understand the various types of bias that seep into our decisions

Nudge is a fascinating book that simplifies concepts of behavioral economics and helps you understand the power of nudge using examples from the world of economics, finance, marketing, and even day to day life.

Are you free to choose?

Having a choice, gives a sense of freedom - The Freedom to Choose. While we like to believe that we are free to make our own choices, there is an influence that plays a role in making our choices.

These influences can be biases, recommendations, or even structured external 'interferences'. For a very long time, economists believed that people could make rational choices, **until behavioural economists proved that, more often than not, people do not make rational choices.**

Another fallacy about human behaviour is that people like to have more choices. **The more, the better.** However, the reality is that too many options or choices make it difficult to make up our mind. This happens because humans take decisions based on the two distinct systems.

Thinking, fast and slow

The human brain operates in ways that we do not yet understand completely. However, what we know is that our brain helps us make decisions in two ways or two systems:

The **automatic system** or the intuitive system provides emotional responses or automatic actions. If you know how to cycle, then getting on cycle and pedalling away is an **automatic decision**, because you are habituated to cycling.

The **reflective system**, on the other hand, is more deliberative and thinking oriented. If you do not know how to cycle, then learning to cycle is where the reflective system of the brain helps you. You put in all your focus and attention in learning the new skill, i.e. cycling. Once it becomes a habit, however, it then becomes a decision that is taken by the **automatic system**.

The reflective system is slow and thinking oriented (conscious thought), while the automatic system is quick and habit or instinct oriented (gut reaction).

It is too much of an effort

It takes a lot of effort to ask the **reflective system** to take a decision, so we naturally gravitate towards the **automatic system**,

which does not require a lot of thinking or effort.

One 'hack' to take decisions on not-so-simple choices without making too much effort on the reflective system, is to use **thumb rules**. While rules of thumb help make quick decisions, they also carry biases that cloud decision making.

The biases that creep in

One such bias is **anchoring**. In anchoring, you use a familiar fact, or a 'reference point', to arrive at a decision, which might turn out to be a flawed decision. For example, a charity might ask you to donate one of the four amounts: \$50, \$75, \$100, or \$150. Your chosen donation amount will be one of these four options.

However, if the same charity asks you to pick a donation amount from options of \$100, \$250, \$1000, or \$5000; there is a higher probability that you will pay more than what you paid in the earlier options. This is because, in the second set of options, your choice was **anchored** to the higher amounts.

Similarly, there is the **availability** bias, where your choice of taking insurance against a natural disaster like an earthquake increases if you have experienced an earthquake.

The third bias is known as **representativeness** bias, where people judge a situation and make choices based on how similar that situation is to past experiences.

Another inherent bias in humans is **overconfidence** in one's ability. Similarly, many companies make money from the **status quo bias**, where you continue subscribing to a magazine or service, long after you have last used, just because you have not made an effort to look up and unsubscribe the service.

Context affects choices

People are busy, with limited attention span. We rely on thumb rules to make decisions, and thereby get into the biases trap, and end up, in most scenarios, making a flawed decision.

The choices we make, therefore, are and can be, influenced.

These influences are **nudges** that guide us towards a particular choice, from a set of options. When someone places a bowl of cashew nuts before you, you eat the cashews till the bowl is empty. If someone refills the bowl, you eat some more. However, if the bowl is not refilled, then you do not eat any more cashews.

This *mindless behaviour* is based on **inertia**, where the automatic system takes over, and you do not pay attention to what you are doing.

Framing is another way where you can be **nudged** into choosing different options in different scenarios. If you are told that surgery leads to the death of 10 out of 100 people, you will be worried about choosing the surgery option.

But if you are told that 90 out of 100 people survive the surgery, you are more likely to choose the surgery option.

Social influences also act as a **nudge**, when it comes to making a choice. Marketing folks have used this as a way to sell their products for a long time.

A lack of self-control, combined with mindless choosing, can lead to poor choices.

Why is making a choice so difficult?

What are the scenarios in which people need a **nudge** to make the right choice? There are various choice environments that make choosing the right option difficult for people.

One scenario is the - **Benefits Now - Costs Later** scenario. There are **investment goods, like exercising**, where the current cost regarding effort is very high, and the benefits are delayed in the future. Similarly, there are **sinful goods, like smoking**, where the current benefits are high, but the costs or consequences in future are dangerous.

Degrees of difficulty is yet another choice architecture scenario where making the right choice is difficult. Some choices, like deciding on a mortgage or a loan, are infinitely more difficult than deciding on which bread to buy.

This brings us to the **frequency** parameter in choice architecture. Choosing which bread to buy is a daily choice, so if you make the wrong choice, then you can always go back to your earlier choice the next time you buy bread.

Once-in-a-life difficult decisions

However, choosing a mortgage is an infrequent decision, maybe not more than two or three times in your life. The low frequency of choice and subsequent cost of the wrong choice makes choosing difficult in case of **once-in-a-life decisions**.

Lack of feedback, or delayed feedback, also makes choosing difficult. Similarly, the human brain processes choices differently as compared to experiences.

This is similar to being explained the choices of food in a menu, in a language that you are not familiar with. Choosing options from such a menu is difficult unless you experience what the chosen dish tastes like.

What is the choice architecture?

Choice architecture is about creating **nudges** that are most likely to benefit people and least likely to harm them. As a choice architect, you design the choice environments, and then design **nudges** that subtly, or not so subtly, nudge you towards the choice that is good for you.

A **nudge** needs to help make you the right choice when making a choice is difficult for most people. In order to do so, a choice architect needs to have a good understanding of how people behave.

Humans make mistakes and commit errors all the time. A choice architect needs to keep in mind this fact and ensure that **nudges** are built to help people avoid making such mistakes.

The alarm in cars that indicate that you are not belted when the car is in motion is an example of a nudge that prevents people from forgetting to snap on their seat belts.

The power of 'default option.'

A good choice architect can unleash the power of the default option. If we go back to the brain's **automatic system**, we recollect that people tend to be lazy and try and make choices using the automatic system instead of the **reflective system**.

This can lead to making the wrong choice. We tend to be comfortable with whatever default option that our computers or household goods come with. The path of least resistance is what people look for; default options, therefore, need to help make the better choice.

Other types of nudge

Providing immediate feedback is a good nudge. In the case of digital cameras, the ability of the camera to show what you just clicked is an example of immediate feedback nudging the user to make a better choice; in this case, a better image.

Explaining options so that they are understood in practical usage terms is another way to nudge people towards the right choice. This is called **mapping**. Continuing with our digital camera example, megapixels is a popular way to sell digital cameras.

Higher megapixels means better image resolution, but what it also means is more space as high megapixel images are heavier. Could the size of the image be a better way to explain megapixels option to the consumers, as the usage of an image is mostly regarding its size, and not resolution?

Incentives as a nudge

When we looked at biases at the beginning of this book summary, we saw that rules of thumb help simplify complex decisions.

A paint shop is an example of a **complex choice structure**. There are thousands of colour combinations that are possible by mixing shades. Using linear list based shade card will make choosing the right shade an extremely exhaustive exercise.

By clubbing colours in similar groups, the choice process becomes simpler as you first choose the main colour group and from thereon you move to specific shades within that colour group. This simplifies a complex choice structure.

Incentives are the most powerful nudge to get people to make a particular choice. A simple heuristic that can be used while designing an incentive as a **nudge** is:

1. Who uses?
2. Who chooses?
3. Who pays?
4. Who profits?

Nudges that help in saving money

When it comes to money, just like in other cases, humans do not make a rational choice. People end up making wrong choices, whether it is experimenting with bread or deciding to save money for a rainy day.

Can a **nudge** help people do a better job in choosing options in **saving, investing, and borrowing**?

The economic theory of saving for retirement is a simple concept but built with complex tools. The concept is that in the future when you retire, you need to have enough money to continue having the same lifestyle as you did when you had a salary coming in every month.

However, the tools required to calculate how much money you need to save for retirement include complex words like time value of money, inflation, and rate of return and so on.

One of the most helpful **nudges** in helping people save money is the **default opt-in option** in pension plans. By making 'default enrolment' in pension plans, savings moves from a reflective system decision to an automatic system decision. Furthermore, reducing the number of 'plan options' within the mandatory pension schemes makes it even simpler for people to choose the most effective plan.

Nudges that help in investment choices

In investment decisions, poor choices lead to wrong investments at the wrong time. The tendency to follow others leads to investing in over-valued stocks and joining a rally at the wrong time. Another choice where investors err is the debt-equity ratio of their investment portfolio. When to invest and where to invest are complex choice systems and the need for the right **nudge** becomes critical. Offering investment plans that are labelled aggressive, moderate and conservative regarding returns and risk, is a good **contextual nudge**.

Using the **RECAP** (Record, Evaluate, and Compare Alternative Prices) framework is a good nudge to help people reverse their errors made at the time of investment. By giving complete transparency of how the investment is performing, and periodically sharing options to the current choice, is what RECAP is all about.

Similarly, using the incentive heuristic of **Who uses? /Who chooses? /Who pays? /Who profits?** helps ensure that the incentive nudge is designed to help the investor and not the seller alone.

Nudges that help in managing loans

Regarding borrowing, mortgages, and credit card loans being the most common, choices are becoming complex with fixed and variable rates of lending, interest-only loans, teaser rate mortgages and many more. The borrowing (or lending) industry has the most predatory practices, which fleece or penalise customers for making the wrong choice.

The industry says that people should read all documents and clauses before signing up, which as we know, is a reflective system decision, something that humans do not want to make. Generating transparent interest reports is a much-needed nudge in this industry.

One way credit card companies use a nudge in a negative manner is enabling only the minimum amount due as an auto-payment option. Extending full credit amount auto-payment will be a positive nudge for those who can clear off their credit amount in one go.

Doctors as choice architects

Choices play an important role in health. Along with choices comes the inherent biases that make us choose the least resistance route. In the case of health related choices and decisions, **doctors play the role of choice architects**.

For example, the chances of self-examination in breast cancer detection increases when the risks of non-examination are highlighted rather than the lower risk on regular examination.

In the case of government-sponsored or funded programs, a critical error in the choice architecture of these programs is the overload of choices that are offered to those who sign up.

Offering too many choices for complex decisions related to health coverage, that too in the future, makes it a complex structured choice, leading to poor choices, and therefore lower subsequent sign-ups. A large-scale US government Medicare program had the default option of non-enrolment!

Similarly, most state-funded Medicare programs do not offer the RECAP nudge to enable people to correct their earlier wrong choices. These are major design flaws regarding choice architecture, and influence the poor response of some of these programs.

Nudge for organ donation

Another health-related challenge is the massive gap between demand and supply of organs for transplantation. It is believed that in the US, there are 12000-15000 potential organ donors. Each eligible (brain dead) donor can donate three organs, which means that the number of lives that can be saved by organ donation is three times the number of donors.

However, less than half of the eligible potential donors, become actual donors. One key reason for this gap is the need for

explicit consent of the surviving family members of the potential donor.

In a study in the US, it was found that 97% of the respondents were 'willing to be organ donors' if such a situation arose. However, the organ donation process requires the explicit consent of the surviving family members, unless the 'organ donation consent box was 'ticked' in their driving license.

Can make default opt-in for organ donation in the driving license check-box help in increasing number of actual organ donors? A milder variant of this 'choice' can be the mandated choice where the driving license holder has to necessarily decide yes or no for organ donation.

Nudges that will help the environment

The choices for health become more complex when it comes to the impact of environmental changes on our health. The reason for this is the extremely long time gap between the stimulus (now) versus impact (later, regarding global warming and so on).

Nudges should be created in such a way that people can visualise how their choices today will impact the environment for the generations to come.

Nudge you towards school

When it comes to schools, especially in the context of the American education system, do more choices help? Before answering this, it is important to understand that the current way of choosing schools is fairly simple- the parent decides the school for the child, and it is usually the default choice of the neighbourhood school.

By publishing information about the school's performance regarding test scores, quality of facilities and so on, schools can help parents make a more than default choice. Enabling parents to visit schools and meet teachers before their children join the school is also a good nudge to help the parents choose a better school.

In San Marcos, Texas, the school administration designed an effective nudge to get school students to join college. The school administration made it a mandatory requirement for graduating students from the San Marcos school to complete an application to a nearby college.

The nearby college, Austin Community College, required a high school degree and just a record of having taken a standardised test, of admission. By filling just the college form, the San Marcos school students were eligible to join college.

This nudge helped San Marcos school increase its student's college acceptance rate from 34 per cent to 45 per cent.

Where do you stop nudging?

In the case of cigarettes, the nudge that began with education on the harmful effects of tobacco is today a screaming warning on the cigarette pack with heavy taxation.

Just like with cigarettes, will we move from a nudge to an aggressive position against usage and consumption? The answer lies not in stopping nudges altogether but in doing something, and subsequently deciding whether the nudge needs to continue or should it move to become a screaming warning.

Similarly, there can always be a risk of **bad nudges**, especially as we saw in the case of predatory practices in the lending and borrowing industry. The rules of engagement and transparency should help us understand whether the nudge is a good nudge or a bad nudge.

An extreme view might be that in a free society, **people have the right to be wrong**, and that, at times, it is better to learn from mistakes. However, this approach can lead to wrongful inclusion, where the poor might end up choosing something that further pushes him into poverty, while the incentive structure benefits the seller.

It is possible to for choice architects to preserve freedom of choice and continue to nudge people in a direction that helps them live better.

Inarguably, small nudges in the right direction can help you stay on track to achieving your goals. From that perspective, systematic investment plans (SIPs) in mutual fund can act as a great nudge. SIPs allow you to invest a small or large amount of money, on a periodic basis, in a mutual fund scheme of your choice. This means that you can invest a fixed amount of money fortnightly, monthly or even quarterly. The SIP acts as a periodic nudge that enables you to continue investing, consistently over a period of time. Since you are making a commitment to invest, SIPs also help in reducing behavioural biases and maximising potential returns.

