Chapter 14
Nudge Theory and Decision Making:
Enabling People to Make Better Choices

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ABSTRACT

This chapter examines the theoretical underpinnings of nudge theory and makes a case for incorporating nudging into the decision-making process in corporate contexts. Nudging and more broadly behavioural economics have become buzzwords on account of the seminal work that has been done by economists and highly publicized interventions employed by governments to support national priorities. Firms are not to be left behind, however. What follows is extensive documentation of such firms that have successfully employed nudging techniques. The examples are segmented by the nudge recipient, namely - managers, employees, and consumers. Firms can guide managers to become better leaders, employees to become more productive, and consumers to stay loyal. However, nudging is not without its pitfalls. It can be used towards nefarious ends and be notoriously difficult to implement and execute. Therefore, nudges should be rigorously tested via experimentation and should be ethically sound.

INTRODUCTION

Decision-making is an integral part of modern management. It involves the selection of a course of action from two or more possible alternatives to arrive at a solution for a given problem. These decisions affect people and are implicitly geared towards altering people's choices or courses of action. However, the success of such decisions would crucially depend on the behavioral response of the affected individuals. Behavioral economics, which explicitly models how people will behave when one relaxes the classical assumption of rationality, could provide a sound theoretical base for assessing and evaluating such behavioral response. In fact while pioneered by policymakers to support national priorities, behavioural economics (and 'nudging' in particular) has been attracting significant interest from business leaders, for quite some time now, who wish to take their decision-making to the next level.

DOI: 10.4018/978-1-7998-2216-5.ch014

Contrary to popular notion, behavioral economics is a fairly old genre of economic theory. One could say that the field originated with the publication of *Theory of Moral Sentiments'* by Adam Smith in 1759 (which predates *Wealth of Nations* published in 1776) since Smith argues in the former that human beings' actions are influenced by the interplay of 'passions' and the 'impartial spectator' (Ashraf, Camerer & Loewenstein, 2005)[1]. This was a far cry from the rational '*homo economicus'* that featured prominently in his later work and would subsequently serve as the bedrock of classical economic theory.

It is unclear why the *Theory of Moral Sentiments* did not catch on with the general academic discourse. Nonetheless, behavioral economics received a major fillip during the 1970s when psychologists Amos Tversky and Daniel Kahneman published a series of iconoclastic papers that formalized something that was fairly obvious in actual practice - human beings are not rational and their decision making is influenced by a multitude of biases, mental short-cuts and emotions. Since then, the field has become a highly influential one with prominent economists such as Matthew Rabin, Andrei Shleifer, Richard Thaler, Cass Sunstein and Dan Ariely making landmark contributions and making the field accessible to the general public through popular novels such as '*Thinking Fast and Slow'* and '*Predictably Irrational'*[2]

However, the one behavioral economics book which has arguably had the most profound impact on public policy and the corporate world is '*Nudge: Improving Decisions About Health, Wealth and Happiness*' ('Nudge') - written by Richard Thaler and Cass R. Sunstein. As explained by Thaler, 'nudges' refer to small, discreet changes that affect an individual's choice-making process without his knowledge and without interfering with his options. Stated differently, a 'nudge' is a technique that inconspicuously alters the choice architecture of consumers such that an individual ends up choosing the option which is the most suitable or beneficial to him without his knowledge.

Sunstein and Thaler's book outlined multiple examples drawn from the fields of finance, health and public policy where nudge type interventions had been administered and provided policy directions that governments could follow for more effective governance. Crucial to the moral justification for using nudges is the concept of 'libertarian paternalism'. People do not always make the most rational choices as per societal norms or by keeping in mind what is best for them. The choice architect however can subliminally guide the individual to take that decision that works best for them[3]. In other words, people can be made to choose something without actually robbing them of their agency to refuse such choice. Another key point worth highlighting is that the logical base for nudges lies in the dual system framework propounded by Kahneman and Tversky[4]. Essentially, there are two systems in the human mind - 'System 1' which makes fast, automatic decisions subject to influences and 'System 2' which makes slow, reflective and goal-oriented decisions. Thaler and Sunstein believe that with the proper nudge it is possible to take advantage of the System 1's decision-making skills to ultimately make the right choice[5]

Nudging has taken over major industries, especially the marketing world, where nudges are incorporated to induce a consumer to buy the product. However, it was first pioneered by institutions and governments, notably in the UK and the USA. Prominent proponents of nudging include former US President Barack Obama who exhorted government departments to adopt behavioural economics to support national priorities, such as enabling Americans to find better jobs or lead healthier lives (Legett, 2014). Other countries such as Germany, Australia and United Kingdom have also set up dedicated nudge units within their governments. In fact, the recent Economic Survey of India of 2019 talks about the power of nudges to promote gender equity and cleanliness and advocates the setting up of a nudge unit for India as well (Department of Economic Affairs, 2019). When applied to organisations, nudges can be used as a powerful tool to build the leadership muscle and trigger productivity boosts through change initiatives. Major Silicon Valley companies are applying the novel concept of 'Nudge Manage-

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