

A BEHAVIORAL FINANCE APPROACH TO RETAIL MARKETING DECISIONS: APPLICATION OF HEURISTIC THEORY

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ABSTRACT

This paper analyses the application of theory on heuristics. When you make judgments and decisions about the market, you like to think that you are objective, logical, and capable of taking in and evaluating all the information that is available to you. Unfortunately, the biases sometimes trip us up, leading to poor decisions and bad judgments. This paper tries to give a theoretical base for taking decision-based on available data which is may be misleading and biased.

KEYWORDS: *Heuristics, Biased, Amazon, Retail Marketing*

INTRODUCTION

The retail business' success depends on the how long they can keep their customers active. There are two types of customers viz., Active and Inactive customers. As Gerd Gigerenzer rightly pointed out if a customer has not made a purchase for nine months or longer, classify him or her as inactive, otherwise active. The habit of retailers is sending the special offers and catalogues to all customers without validating whether they are active or inactive which annoys the inactive latter with no further interest in the product. This group later may turn up to those who give negative comments in the online reviews. Hence, the retailers should classify their customers into Active and Inactive which will give a positive result in their marketing efforts. When the retailer avoids such information which is already available, it is known as the rule of Heuristics. In this rule, we will be checking whether the customer is active or not, and the other part like how much bought, how frequently so on and so forth is ignored.

The theory of Heuristics has been explained the mental shortcut that allows people to solve problems and make judgments quickly and efficiently. These rule-of-thumb strategies shorten decision-making time and allow people to function without constantly stopping to think about their next course of action. When we live in a world full of information, the human brain can process only a certain amount and may not be able to analyze each and every single aspect of every situation. This may lead to wrong decisions or time lag in taking right decisions. The various theories of Heuristics as proposed by Psychologists have the following advantages

Effort reduction: According to this theory, people utilize heuristics as a type of cognitive laziness. Heuristics reduce the mental effort required to make choices and decisions.

Attribute substitution: Other theories suggest people substitute simpler but related questions in place of more complex and difficult questions.

Fast and frugal: Still other theories argue that heuristics are actually more accurate than they are biased. In other words, we use heuristics because they are fast and usually correct.

Behavioral finance uses this theory of Heuristics to explain the process of decision making among investors and those who are related to financial sectors. Some common heuristics include the availability heuristic and the representativeness heuristic.

The Availability Heuristic involves making decisions based upon how easy it is to bring something to mind. When you are trying to make a decision, you might quickly remember a number of relevant examples. Since these are more readily available in your memory, you will likely judge these outcomes as being more common or frequently-occurring. For example, if you are thinking of flying and suddenly think of a number of recent airline accidents, you might feel like air travel is too dangerous and decide to travel by car instead. Because those examples of air disasters came to mind so easily, the availability heuristic leads you to think that plane crashes are more common than they really are.

The Representativeness Heuristic involves making a decision by comparing the present situation to the most representative mental prototype. When you are trying to decide if someone is trustworthy, you might compare aspects of the individual to other mental examples you hold. A sweet older woman might remind you of your grandmother, so you might immediately assume that she is kind, gentle and trustworthy. If you meet someone who is into yoga, spiritual healing and aromatherapy you might immediately assume that she works as a holistic healer rather than something like a school teacher or nurse. Because her traits match up to your mental prototype of a holistic healer, the representativeness heuristic causes you to classify her as more likely to work in that profession.

The Affect Heuristic involves making choices that are strongly influenced by the emotions that an individual is experiencing at that moment. For example, research has shown that people are more likely to see decisions as having higher benefits and lower risks when they are in a positive mood. Negative emotions, on the other hand, lead people to focus on the potential downsides of a decision rather than the possible benefits.

As per the behavioral Economics Guide 2016, Markus Wübben and Florian von Wangenheim, two professors of business administration, empirically tested both the hiatus rule and the Pareto/NBD model. Taking an airline, an apparel retailer, and an online CD retailer, they studied how many times the Pareto/NBD model and the hiatus heuristic correctly predicted which previous customers will make purchases in the future. For the airline, the hiatus rule predicted 77% of customers correctly, whereas the complex model got only 74% right. For the apparel retailer, the difference was even larger, 83% versus 75%. Finally, for the online CD retailer, whose managers used a 6-month hiatus, the number of correct predictions tied. More data, more analysis, and more estimation did not lead to better predictions on average, the simple heuristic that managers used came out first. More recently, a dozen other companies were tested, with the same result.

Anwar Ahmed Henry Bwisa and Romanus Otieno (2014) in their paper say that many researchers have also classified the theories as either rational or non-rational (Gigerenzer, 2001; Hansson, 2005; Oliveira, 2007). In differentiating the two, Gigerenzer (2001) identified four attributes for rational theories as Optimization, normative, omniscience and internal consistency. In the same vein, non-rational theories are identifiable to possess attributes such as non-optimization, descriptive,

search, ecological rationality and cognitive building blocks like emotions, imitation, and social norms.

Kees van den Bos in his book *Fairness Heuristic theory* (2007) points out that when the most relevant information is not available, people use other information to assess what is fair and how to react to the situation at hand. In this way, less relevant but available information may be used as a heuristic substitute for more relevant yet missing information.

Joachim I. Krueger (2014) critically analyzed the application of Heuristic game theory in selecting the best project with the available information. He has evaluated the validity of various theories which leads to the selection of the best from various available alternatives.

ElkeKurz-Milcke and GerdGigerenzer (2017) focus his analysis of heuristic theory on two questions, the first descriptive, the second normative: What are the heuristics in the adaptive toolbox? In which environments does a given heuristic succeed, and in which does it fail?

Nowadays we analyze the performance based on the trend of searches of these companies by customers. Google trends data for Amazon from 2004 to 2018 has been analyzed and figured out the role of heuristic theory in decision-making.

The figure 1 given below shows the google trend in searches of Amazon

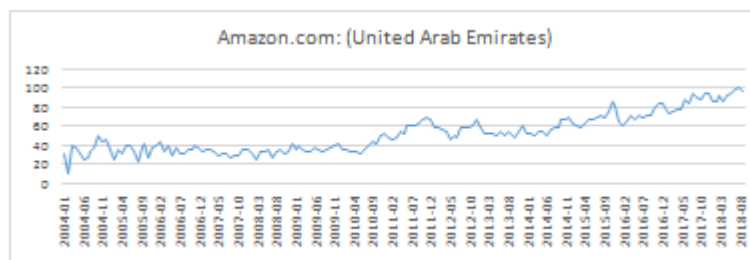


Figure 1

The conventional theories of customer behavior say that when there is a boom in the online search on their products there will be an automatic pressure on sales, but the theory of Heuristics says the analysis should be based on the active and passive customers. Every day some people randomly checking the sites as time pass or just curiosity, that doesn't mean that they are really interested in the product. Those customers should be identified as passive customers and not to be informed of the products and plans. The data may be biased. The forecasted results are given below.

The data on Amazon internet searches by Google trend has been projected and given in the following figure 2.

It shows that there will be a similar trend in the coming years for Amazon. That may be misleading if we take the actual number of active searches and passive searches. A clear idea on the market behavior can only be studied from clubbing the customers into Active and inactive or passive by analyzing the various other factors

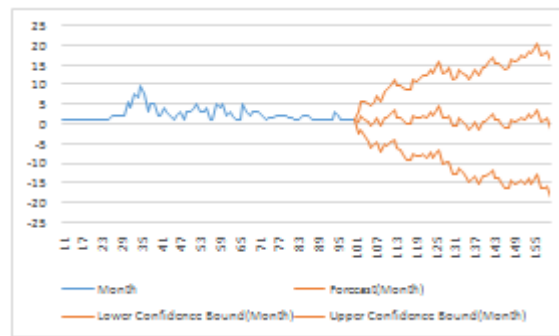


Figure 2

If you are dealing with a situation of risk, in which all consequences and probabilities are known and where the future is like the past, then look for fine-tuned solutions such as complex optimization techniques. If, however, you are dealing with situations of uncertainty, then look for sufficiently robust solutions, including simple heuristics. Take heuristics seriously, take uncertainty seriously, and beware of the bias (Gigerenzer, 2012).

To conclude sometimes less is more. One of the most challenging recent questions on the minds of researchers, consultants, and practitioners relates to how the abundance of data generated in our information society can be used to generate insights.

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