

## Chapter 9

# Understanding Actual Socio– Economic Behavior as a Source of Competitive Advantage: The Role of Experimental–Behavioral Economics in Innovation

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### **ABSTRACT**

*This chapter illustrates the potentiality of the application of experimental-behavioral methods to gain global competitive advantages based in the anticipated measurement of how consumers and citizens would behave when exposed to specific innovation actions to be implemented by an organization. To this end, the chapter presents a brief background of the experimental-behavioral economics approach as an application of the experimental-scientific paradigm to study socio-economic behavior, highlighting its main differential features (use of economic monetary incentives, non-deception, and anonymity). After a discussion of the internal and external validity of this methodology and its ethical implications, the chapter presents specific examples of its application in both industry (framing management and measurement of the added value generated by alternative designs of an innovative product) and government (optimal design of new public programs and policies).*

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*Don't rely on what people tell you. Rely on what they actually do.*  
(Ariely, 2008, pp. 341-361)

## **INTRODUCTION**

Innovation is a critical challenge for both advanced and developing economies to increase their global competitiveness. Without innovation, economic activity cannot take advantage of the global technological and managerial developments, and is constrained to the generation and commercialization of standardized products and services applying always the same standard methods and processes. Nations and regions that do not participate in this global innovation race, face an important risk of getting excluded from the global marketplace losing even their local markets, which would shift from local-produced to global-produced and more competitive goods.

In these last years, a conjunction of social, technological and scientific developments has made possible new ways of innovation supported by in a deeper exploration and a more effective management of socio-economic behavior. In this framework, innovation based in such new understanding of the behavior of consumers and citizens arises as a critical source of competitive advantages in the private and public sector. The main features of such a new understanding of consumer behavior could be considered as contradictory at a first glance, but they can be easily interpreted in the framework of the dual models of thought presented by Kahneman (2011). According to this model, citizens and consumers - as human beings - employ two fundamentally different modes of thought, named as System 1 and System 2. Roughly speaking, System 1 is fast, intuitive, associative, metaphorical, automatic, and impressionistic, and it cannot be switched off. Its operations involve no sense of intentional control, but it is the secret author of many of the choices and judgments made by consumers and citizens. System 2 is slow, deliberate and effort-

ful. Its operations require attention. System 2 is slothful, and gets tired easily - a process called *ego depletion* - accepting what System 1 tells it. As explained by Kahneman (2011), one way to conceptualize these systems is to think of the processes involved in driving a car: the novice needs to rely on controlled processing, requiring focused concentration on a sequence of operations that require mental effort and are easily disrupted by any distractions. In contrast, the well-practiced driver, relying on automatic processes, can carry out the same task efficiently while engaged in other activities such as chatting with a passenger or tuning in to a radio station. Of course, he or she can always switch to more deliberative processing when necessary, such as conditions of extreme weather, heavy traffic or mechanical failure. In terms of decision-making, the description of System 2 bears a close resemblance to the rational, general-purpose processor presupposed by standard economic theory. Although these economic models have provided a strong and unifying foundation for the development of theory about decision-making, several decades of research on these topics have produced a wealth of evidence demonstrating that, in practice, these models considering only System 1 do not provide a satisfactory description of actual human behavior and need to be complemented by considerations regarding System 2. This duality is present in any situation in which human being make decision, specifically in the purchase decision-making that determined consumer behavior.

In this framework, socio-economic behavior supported by system 2 plays a critical role in the arise of what is known as the *new consumer* (Lewis, 2001). Such *new consumers* are smarter, more empowered, and more demanding than previous generations of shoppers. They make full use of online tools to connect with others and score the right buys, look for their peers for guidance and support. They trust more customer reviews than firm's publicity, looking for a stronger sense of community and belonging. They are more inde-

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