2.3 Rational choice, behavioural economics and business objectives

Name: _____ Class: _____ Date: _____ **Total: 26 marks**

KEY WORDS rational consumer choice • bounded rationality • anchoring • default choice • nudge • satisficing

Objective

Build the skills to answer exam questions on **rational consumer choice**, its limits from **behavioural economics**, **nudges**, and the objectives of firms.

You must be able to:

- outline the assumptions of rational consumer choice
- explain bounded rationality, self-control and selfishness, and common biases
- explain choice architecture and nudges, with examples
- compare profit maximization with other business objectives

1 Key knowledge and worked examples

■ Rational choice and behavioural economics

Rational consumer choice assumes that consumers have **consistent preferences**, **perfect information**, and always choose to **maximize utility** (satisfaction). Firms are assumed to **maximize profit**.

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Behavioural economics uses psychology to show where real people differ:

idea	meaning	example
bounded rationality	limited time and information, so people make "good enough" choices	choosing a phone plan after reading two offers
bounded self-control	people find it hard to stick to plans	planning to save but spending the money
bounded selfishness	people care about others and fairness	giving to charity, tipping
rule of thumb (heuristic)	a mental shortcut	always buying the same brand
anchoring	relying too much on the first number seen	"was $200, now $120"
framing	the way a choice is presented changes it	"90% fat-free" vs "10% fat"
availability	judging risk by examples that come to mind easily	fearing flying after a crash in the news

Choice architecture is the way choices are presented. **Nudges** change behaviour without banning options or changing prices much:

- **default choice:** an option that applies unless people opt out (automatic enrolment in a pension; organ donation opt-out);
- **restricted choice:** fewer options so the choice is easier;
- **mandated choice:** people must make a decision (e.g. state yes or no to organ donation when renewing a licence).

Firms also use behavioural ideas (free trials that roll into payments, "limited time" offers, product placement).

Business objectives: firms may not only maximize profit. Alternatives: **corporate social responsibility** (CSR: ethical and environmental aims), **market share** (lower prices to grow), **satisficing** (making "enough" profit to keep shareholders happy while pursuing other aims), **revenue** or **growth** maximization.

Answer shapes: name the bias or nudge → apply it to the case → evaluate (does it work, is it ethical, is it enough?).

2 Practice

2.1 State **two** assumptions of rational consumer choice. [2]

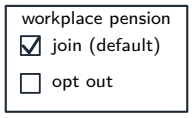


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2.2 Explain what is meant by **bounded self-control**, with an example. [2]



2.3 A government changes workplace pensions so that workers are enrolled automatically and must opt out if they do not want to save. Explain why this is likely to increase saving. [4]



2.4 An online shop lists a jacket as "Was $250 – now $150". Explain how this uses anchoring, and how it could lead to a choice that is not rational. [3]



2.5 A family-owned company accepts lower profits so that it can pay suppliers fairly and cut its emissions. Explain **two** objectives other than profit maximization that it may be following. [3]



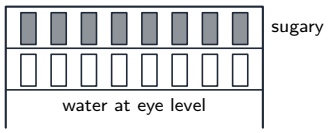
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3 Exam-style questions

3.1 A government wants to reduce the consumption of sugary drinks by young people.

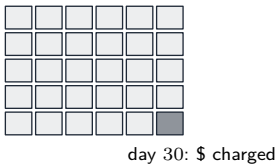
(a) Define **choice architecture**. [2]

(b) Evaluate the use of nudges to reduce the consumption of sugary drinks. [6]



3.2 A streaming service offers a free 30-day trial that turns into a paid monthly plan unless the customer cancels.

Explain how the firm uses behavioural economics, and why a government might regulate this practice. [4]



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