Nudge Theory

Idea In Short

Defaults quietly govern most decisions. Design them deliberately, coach clients to architect choices, and put your strongest recommendation first because the status quo option almost always wins.

The Economist Who Made Economics Human

Richard Thaler, a professor at the University of Chicago Booth School of Business, won the Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel in 2017. The Royal Swedish Academy of Sciences honored him for incorporating psychologically realistic assumptions into analyses of economic decision-making. His work explored three traits that systematically shape choices, namely limited rationality, perceptions of fairness and lack of self-control. 1

Most people know Thaler for writing the 2008 bestseller Nudge with Cass Sunstein. The book reveals how many so-called decisions are actually default choices, illusions and mental rules of thumb. We are educated to believe that people behave rationally all the time. In reality, we blaze through the workday making hundreds of non-decisions. Thaler's central insight, as the Nobel committee put it, was that he made economics more human. 2

Idealized Versus Human Decision-Making

An idealized thought process looks linear and orderly. The decisions are measured and distinct. Depending on the probabilities and payoffs, you can choose among options A, B, C, D and E. This is classic Master of Business Administration (MBA) thinking, elegant on a whiteboard.

What actually happens is far messier. We often see only one option because of our preconceived notions, laziness or eagerness to fit in. A myopia creeps into decision-making because, frankly, we are human. The debate between rational economics and behavioral economics continues, but Thaler's research tipped the balance toward realism.

Choice Architecture and Neutral Design

Nudge argues that people can be steered toward better decisions through more thoughtful choice architecture. The way choices are displayed and the default options selected heavily influence the outcome. This is not a radical concept. Paco Underhill's Why We Buy showed years ago that science and psychology drive product placement in retail stores. The best-marketed products sit at eye level and on aisle end-caps. Consumer product companies pay millions in slotting fees for prime shelf space.

Thaler and Sunstein contend that no design is neutral. Something must appear on the front of a menu. Something must sit at eye level in the grocery store. Something must be the default shipping preference on Amazon. If any configuration carries a slant or bias, the logical step is to do the homework and present choices so people tend to pick the better one. 3

Why Policy Makers Love Nudges

You can see why this idea attracts broad support. It respects libertarian ideals of choice and individual responsibility while suggesting that governments and institutions can subtly tilt people toward better decisions. It is a rare solution with appeal across the political spectrum. Policy makers in many countries have adopted nudge units and behavioral insights teams to apply these principles.

Thaler's work has had real impact on retirement savings. Automatic enrollment in 401(k) plans, a direct application of default choice theory, has helped create billions of dollars in retirement wealth for ordinary people. The Nobel committee noted this concrete contribution alongside his theoretical advances.

The Power of Default Choice

There are dozens of reasons we show faulty judgment, but one deserves special attention. Default choice is the option selected if you do nothing. The concept is simple, yet its consequences are staggering.

Consider the trivial case. The number one ringtone is the default one provided by Verizon, AT&T and Sprint. It is not the prettiest sound, but people cannot be bothered to change it. It is a small, trivial thing with no real value, and the default works fine.

The pattern turns serious with retirement plans. People do the same thing with their 401(k) and 403(b) accounts. Thirty to forty years of stashing money from every paycheck is certainly not trivial. Yet a non-decision here can cost hundreds of thousands of dollars. CALPERS, the giant pension fund for California state teachers, found that the average number of times teachers changed their asset allocation during their careers was zero. More than half the participants never adjusted their mix of stocks, bonds and cash. They started teaching at 25 with a generic allocation and stuck with it for decades.

Even Nobel Laureates Default

It is easy to mock those California teachers, except that Harry Markowitz did the exact same thing. Markowitz is a co-founder of modern portfolio theory, which proves that asset allocation is critically important for optimizing risk-adjusted returns. He is a Nobel Prize winner and a name etched into finance history.

How did Markowitz allocate his own retirement funds? He said he should have computed the historical covariances of asset classes and drawn the efficient frontier. Instead, he split his contributions fifty-fifty between bonds and equities. The man who invented the mathematics of optimal diversification fell back on a simple default. That reveals how deeply defaults shape behavior, even among experts.

Organ Donation and the Opt-Out Effect

A study from 2003 showed that the percentage of the population who donated organs was highly correlated to the default option on the driver's license. When the default was yes, more than 85 percent of people donated their organs at death. When the default was no, most people did not donate. The distribution was bi-modal, driven entirely by the default choice.

Talk about non-thinking humans. The same person, facing the same moral question, behaves completely differently based on which box is pre-checked on a form. This is the nudge in its purest form, and it carries life-or-death stakes.

What This Means for Consultants

All this business-book theory is fine, but what does it mean for consultants and their clients? The applications are practical and immediate.

First, coach your clients on default choices. For those focused on sales and marketing projects, coach customers to think through the choice architecture. The options clients show their end customers matter. Google understood this deeply and paid Mozilla to keep Google as the default search engine in Firefox. Google argued to regulators that other search engines were only one click away, but people do not take that extra step.

Second, put your best recommendation first. When you storyboard recommendations and present options, the order matters. Do not bury your best thought in the middle of the deck. Put your best foot forward.

Third, expect resistance to change. Your client's organization has a default choice too. The status quo option for them is to ignore you. It is easier to do nothing, take the default and dismiss the changes you recommend. Logic alone will not carry the day. You must provide the passion that motivates action and the tools that make implementation easy to repeat. Persuade using head, heart and hand.

Beware the Defaults You Cannot See

As a consultant, much of your job involves seeing past the default choices that a client's organization has convinced itself of over decades. They carry oral history, precedents and institutional memory. You will hear refrains like "we tried that before" or "the vice president will never agree" or "we have never done that type of project."

Once you open your eyes to it, you will see default choices everywhere. The consultant who recognizes them, names them and replaces them with better architecture delivers value that outlasts the engagement. Thaler joked that he would spend his prize money as irrationally as possible. The rest of us should spend our attention far more rationally, designing defaults that serve the people who rely on them.

- 1Nobel Prize popular science background
- 2BBC News coverage of Thaler's Nobel Prize

- 3UBS Nobel Perspectives profile of Richard Thaler

Summary

Nudge theory shows that no design is neutral. Consultants who master choice architecture can steer clients toward better outcomes, anticipate resistance to change, and expose the hidden defaults that block progress. The status quo is powerful, but it is not inevitable.