LEVERAGING BEHAVIORAL ECONOMICS IN HUMAN RESOURCES MANAGEMENT

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Agenda

- Intro to Behavioral Economics
- Business Case for Changing Employee Behaviors
- Models for Understanding Behavior Change
- Key Insights from Behavioral Economics
- Sample Employer Strategies
- For More Information on Behavior Change…
What Is Behavioral Economics?

Traditional Economics

What rationale people *should* do

Behavioral Economics

What sometimes irrational people *actually* do
CRUMPs vs SIRPs

Behavioral Economics in the Workplace

**Completely Rational Utility Maximizing Person**

- Incentives
- Information
- Capabilities / Resources

**Sometimes Irrational Real Person**

- Nudges
- Guardrails
- Habit Cues
Behavioral Economics: Top 10 Insights for HR Professionals

1. Insights from Behavioral Economics can help impact an organization's success in a variety of ways, from culture, to talent development to comp & benefit costs

2. HR is in an ideal position to leverage Behavioral Economics within an organization

3. Benevolent persuasion (nudging employees to do what’s good for them, and the organization) is viewed by many as a completely ethical business practice

4. Employees must believe that the employer is concerned about their best interests

5. Behavior tends to change along a predictable pathway, driven by specific processes

6. Habits impact behavior more than conscious choice or motivation

7. People tend to make cognitive errors in a predictable manner

8. To sustain change, employees need motivation (intrinsic and extrinsic) and ability (skills and environment); employers can help on each of these

9. Extrinsic rewards can kill intrinsic motivation

10. It’s often best to make the Right Choice the Easy Choice (and/or the Fun Choice)
Business Case for Changing Employee Behaviors
Continued Rise in Healthcare Costs

Exhibit 1.11 - Average Annual Premiums for Single and Family Coverage, 1999-2014

* Estimate is statistically different from estimate for the previous year shown (p<.05).

# Estimated Cost of Poor Health to US Economy—$576 Billion

<table>
<thead>
<tr>
<th>Category</th>
<th>Annual Cost (Billions)</th>
<th>Percent of Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Wage Replacement</strong></td>
<td>$117</td>
<td>20.3%</td>
</tr>
<tr>
<td>Incidental absence due to illness, workers’ compensation, short-term disability, long-term disability</td>
<td>$117</td>
<td>20.3%</td>
</tr>
<tr>
<td><strong>Medical and Pharmacy</strong></td>
<td>$232</td>
<td>40.3%</td>
</tr>
<tr>
<td>Workers’ compensation, employee group health medical treatments, employee group health pharmacy treatments</td>
<td>$232</td>
<td>40.3%</td>
</tr>
<tr>
<td><strong>Lost Productivity</strong></td>
<td>$227</td>
<td>39.4%</td>
</tr>
<tr>
<td>Absence due to illness, presenteeism</td>
<td>$227</td>
<td>39.4%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$576</td>
<td>100%</td>
</tr>
</tbody>
</table>

Source: Integrated Benefits Institute 2012 Analysis
Increasing Obesity Rates in US (CDC Data)

1990 OBESITY RATES

2000 OBESITY RATES

2010 OBESITY RATES

Legend:
- No Data
- <10%
- 10%-14%
- 15%-19%
- 20%-24%
- 25%-29%
- ≥30%

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American’s Are Not Saving for Retirement

➢ 31% of non-retired Americans reported having no retirement savings or pension
  • Alarmingly, among those ages 55 to 64, the number is 19%

➢ Almost half of adults were not actively thinking about financial planning for retirement
  • 24% had given only a little thought to financial planning for their retirement
  • 25% had done no planning at all
  • Of those who have given at least some thought to retirement planning, 25% didn't know how they will pay their expenses in retirement

➢ The Great Recession pushed back the planned date of retirement for two-fifths of those ages 45 and over who had not yet retired

51% of US employers with 50+ employees have a wellness program

Among employers offering wellness programs:

- 80% screen employees for health risks
- 77% offer lifestyle management interventions; among these:
  - 79% provide nutrition/weight management programs
  - 77% offer smoking cessation
  - 72% provide fitness resources
  - 52% offer stress management programs
- 56% provide Disease Management programs; among these:
  - 85% target diabetes
  - 60% focus on asthma
  - 59% target coronary artery disease
  - 54% focus on heart failure
- 44% regularly evaluate wellness program; only 2% measure financial impact

Source: Rand Corporation – 2013 Workplace Wellness Programs Study
Despite Employer Efforts
Limited Engagement

Participation Rates for Employees Identified through Screenings or Claims Data

- Disease Management: 16%
- Weight / Obesity: 10%
- Smoking Cessation: 7%
- Fitness: 21%

Source: Rand Corporation – 2013 Workplace Wellness Programs Study
Behavior change is tough, particularly sustained change.
Typical Employers Frustrations

1. “We offer great wellness programs and a generous 401(k) match —people just don’t participate”

2. “People went back to their old ways after completing the wellness initiative”

3. “We can’t force people to change—they have to want to do it”
Models for Understanding Behavior Change
Some Behavior Change Models…

- Behaviorism
- Transtheoretical model
- Theory of planned behavior
- Protection motivation theory
- Self-determination theory
Enter Behavioral Economics…

➢ “Behavioral economics is the study of how real people actually make financial choices; it draws on insights from both psychology and economics.”¹

➢ Research based critique of rational decision theory

➢ The science of trying to understand how and why individuals make suboptimal and optimal consumer choices

# Heuristics and Choice Architecture

<table>
<thead>
<tr>
<th>Heuristics</th>
<th>Workplace Examples</th>
</tr>
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<tbody>
<tr>
<td>Endowment Effect</td>
<td>“I don’t want to drop the PPO plan, even if the HSA plan costs less”</td>
</tr>
<tr>
<td>Loss Aversion</td>
<td>“I’m not willing to risk losing my retirement savings in mutual funds”</td>
</tr>
<tr>
<td>Status Quo Bias</td>
<td>“I’ve never been one to exercise much; why start now?”</td>
</tr>
<tr>
<td>Clue Seeking Bias</td>
<td>“The PPO plan is listed 1st in the Enrollment Guide; it must be the best plan”</td>
</tr>
<tr>
<td>Preference for Now</td>
<td>“Saving for retirement doesn’t make sense for me; I need the money now”</td>
</tr>
<tr>
<td>Optimism Bias</td>
<td>“I’m generally healthy; I don’t really need to do a health screening”</td>
</tr>
</tbody>
</table>

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<tr>
<th>Choice Architecture</th>
<th>Workplace Examples</th>
</tr>
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<tbody>
<tr>
<td>Framing</td>
<td>Communicate “what you lose” by not getting the free health screening done</td>
</tr>
<tr>
<td>Naming</td>
<td>Renaming the “High Deductible Plan” the “Healthy Saver Plan”</td>
</tr>
<tr>
<td>Ordering</td>
<td>Listing the optimal plan (e.g., Healthy Saver Plan) first in Enrollment Guide</td>
</tr>
<tr>
<td>Default Options</td>
<td>Auto-enrolling employees in Target Date Funds in 401(k) plan</td>
</tr>
<tr>
<td>Pre-Commitment</td>
<td>Commit to doing the Health Risk Assessment (HRA) in the next 30 days to enter a drawing for $500 (forfeit the chance to win if you don’t actually do HRA)</td>
</tr>
<tr>
<td>Priming</td>
<td>As employees are making an election decision regarding the 401(k) plan, have them think about what they’ll be doing in retirement</td>
</tr>
</tbody>
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1 **Heuristics** are mental shortcuts that influence employees’ decisions, often in irrational ways.

2 Through **Choice Architecture** (Thaler, Sunstein), employers can nudge employees to make better decisions.
Why Is Behavior Change So Tough?
*Understanding Two Systems at Work in Our Brain*

**System 1: Fast**
- Automatic; requires little effort
- Examples:
  - *Eat the doughnut in front of you*
  - *Answer that text that just arrived*

**System 2: Slow**
- Reflective; involves choice and concentration
- Examples:
  - *Determine the benefits of quitting smoking*
  - *Make a plan to exercise more, or to get more sleep*

* Thinking, Fast and Slow by Daniel Kahneman, 2011
Potential Strategies to Target the Two Systems

System 1 (Automatic)

- Make the **healthy** choice the **easy** choice
- Leverage the power of **habit**

System 2 (Reflective)

Provide the **knowledge, motivation** and **resources** to sustain healthy behaviors
### Application in the Workplace: 
What’s Driving Specific Health Behaviors?

<table>
<thead>
<tr>
<th>Behavior</th>
<th>Habit-Driven (Fast System)</th>
<th>Intention-Driven (Slow System)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nutrition</td>
<td>Bringing lunch from home</td>
<td>Enrolling in nutrition class</td>
</tr>
<tr>
<td>Physical Activity</td>
<td>Taking the Steps</td>
<td>Joining a gym</td>
</tr>
<tr>
<td>Tobacco</td>
<td>Spending more time with non-smoking friends</td>
<td>Registration for smoking cessation class</td>
</tr>
<tr>
<td>Sleep</td>
<td>Consistent sleep schedule</td>
<td>Buying new window shades</td>
</tr>
<tr>
<td>Stress</td>
<td>Practicing mindfulness</td>
<td>Enrolling in yoga class</td>
</tr>
<tr>
<td>Prevention</td>
<td>Routine self-examination</td>
<td>Visiting one’s PCP</td>
</tr>
</tbody>
</table>

**ROI / Sustained Health Improvement**

**Traditional Employer Focus**
Achieving Sustained Behavior Change

Extrinsic

Intrinsic

Habit
Habitual behaviors, or routines, are driven by the basal ganglia, the oldest part of the human brain.

Brain-damaged patients can continue to demonstrate old habits, and form new ones, even after near complete memory loss.

Our ability to execute daily habits has been essential to our survival as a species.
### Make a Habit, Break a Habit…

#### Make a Habit
- Repeat desired behavior in a stable context (time, location, process, associated people)
- Be mindful of cues
- Occasional misses are OK

#### Break a Habit
- Notice cues (time, location, process, associated people)
- Disrupt, or remove, cues
- Replace, or at least modify, undesired behavior
Employers’ Role in Shaping Health Habits

Enabling Bad Habits

- Physical Activity
- Nutrition
- Sleep >9:00PM
- Stress

Building Good Habits

- Physical Activity
- Nutrition
- Sleep >9:00PM
- Stress

FREE

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Helping Employees
Build Healthy Habits

Drivers

Motivation

Intrinsic

Ability

Skills

Extrinsic

Environment

Goals

Participate in Healthy Events

Sustain Healthy Habits

1 Includes periodic events such as Health Risk Assessments, Screenings, Coaching, Education and Competitions

2 Reflects sustained improvements in Nutrition, Physical Activity, Sleep, Stress Management and Avoiding Risking Behaviors (e.g., tobacco use or excessive alcohol use)