

## **Alternative views of consumer behaviour**

*Detailed notes for Edexcel Economics A, unit 1.2.10: Alternative views of consumer behaviour*

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### **Reasons why consumers may not behave rationally**

In economics we often assume that consumers are rational. This means that consumers make decisions that maximise their utility.

Another way to think about rationality is that every choice made by a particular consumer must be logically consistent. For example, if a consumer prefers apples over bananas and bananas over cherries, they should prefer apples to cherries.

However there are many reasons why, in the real world, consumers may not actually be rational.

For the Edexcel course, there are three key reasons why consumers may not be rational:

#### **1. Influence of others' behaviour.**

Consumers may be influenced by the actions of others.

For example, consumers may be more likely to buy something because it is perceived as trendy, or to fit in with others. In other words, consumers may be subject to 'social norms' or even peer pressure to buy certain products.

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Examples include:

- Consumers may choose clothing brands based on what their friends or social media influencers wear.
- Individual buying shares of the same company on the stock market despite a lack of knowledge about the company.
- Going to busier restaurants rather than empty restaurants.
- Changes in social media apps consumers use based on what others are using.

This means that goods subject to social norms, demand may be higher than it would be for a rational consumer.

## 2. Habits

Consumers may form a habit of buying a particular good each time. This can become irrational when the good has become more expensive, fallen in quality or substitutes have improved.

Some examples of habit formation include:

- Everyday items at the supermarket. For example, consumers may buy the same brands of foods or cosmetic products each time they visit the supermarket. This could be buying Weetabix on every supermarket visit for example.
- Habit formation can also apply to addictive goods such as cigarettes or alcohol.
- Another example is consumers may forget to cancel monthly subscriptions that they no longer use. This could include subscriptions for music or video streaming services such as Spotify and Netflix.

Demand for goods consumed because habit would increase compared to the rational level of demand.

Demand could also become more price-inelastic, as the habit means demand may not respond as much to price changes.

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### 3. Consumer weakness at computation

Consumers may not be able to calculate discounts correctly or add up items.

This explains why some companies such as Netflix advertise monthly prices to consumers rather than annual prices. The monthly price seems cheaper to consumers, even though twelve times the monthly price would be the same as the annual price.

This increases demand for services selling monthly subscriptions, such as Netflix and gyms.

Other examples of consumer weakness at computation include:

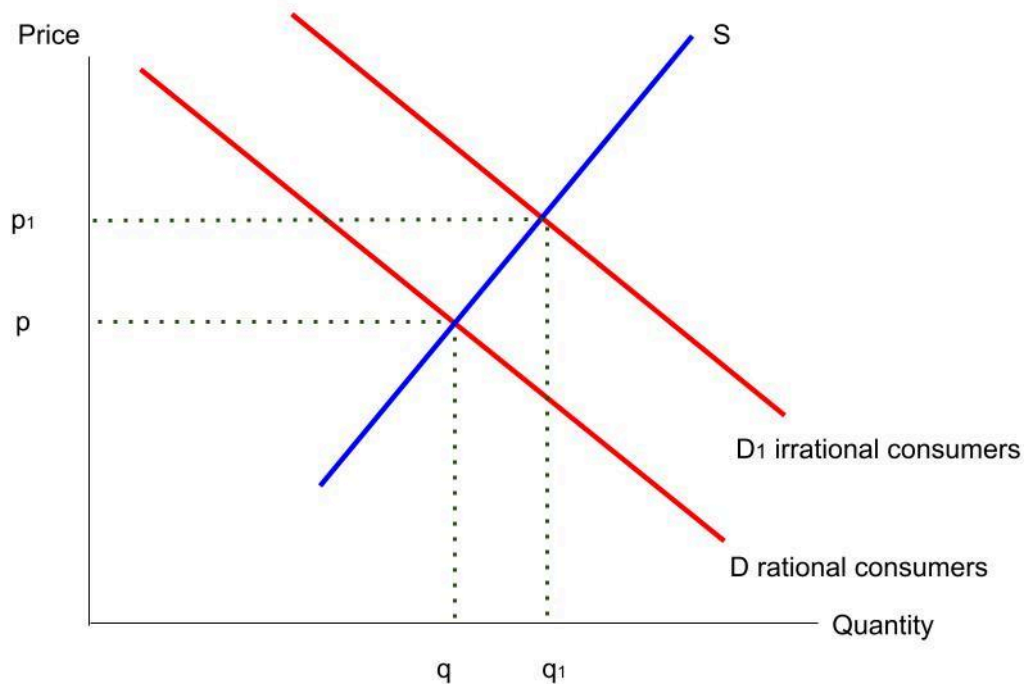
- Consumers may be overwhelmed by the number of choices available, making it difficult to calculate and compare the benefits and prices of each alternative.
  - This may apply to options for pensions and products on supermarket shelves.
- Consumers may buy too much food at the supermarket, particularly when there are discounts from buying in bulk. However the food may expire at home as a result.
- Opportunity cost:
  - Imagine two scenarios in which a consumer can decide whether to travel for a discount.
  - Scenario A. A consumer can travel to the other side of town to save £10 on a £30 item.
  - Scenario B. A consumer can travel to the other side of town to save £10 on a £300 item.
  - In both scenarios, consumers would save the same amount, £10, from travelling.
  - However in practice consumers are more likely to travel in the case of scenario A compared to scenario B.
- More generally, consumers may struggle with calculations involving uncertainty, losses versus gains (insurance) and compound interest (investing over time).

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### Diagram for irrational consumers



When a consumer is irrational, their demand curve may be different to the demand curve under rationality. For example, demand under rational behaviour may lie at demand curve D. However demand may be higher at D1 under irrational behaviour for some products. This could include goods bought because of social norms such as popular clothing brands.

This increases the equilibrium quantity (from  $q$  to  $q_1$ ) and equilibrium price (from  $p$  to  $p_1$ ) in this particular case.

However, the reasons for consumers not behaving rationally could have the opposite effect in some cases. For example, pensions may be underconsumed relative to the rational level. This could lead to lower demand for pensions compared to the rational level of demand.

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## **Evaluation points for reasons for consumer irrationality**

Are there reasons why these “reasons for irrationality” could be perceived as rational?

For the influence of others’ behaviour:

- A restaurant being busier could be a sign of the high quality of the food.
- Someone choosing a social media app which their friends use makes it easier to communicate with their friends.
- Trying to “fit in” with a social group could be a rational behaviour. There could be a utility gain from social acceptance or avoiding rejection from a group.

Regarding consumer habits:

- Habit formation could simply be because the consumer likes that good the most and that’s why they keep buying it
- Consumers may buy every new Apple iPhone, possibly because they perceive it as high quality and still the best smartphone on the market.
- It can take time and prove difficult for consumers to switch to a different firm for say energy or banking. Even cancelling a gym membership could take time in some cases. To save time and effort for the consumer, it could therefore be rational to stick to a default option.

To evaluate consumer weakness at computation:

- It may be rational for consumers to pay on a monthly basis rather than a year upfront, particularly where they can cancel part-way through the year.
- We may need to consider the time cost to consumers of travelling to and from supermarkets to avoid food waste.
- Also, food waste may come from the sizes of containers offered by supermarkets. If food can only be purchased in large containers, this may increase food waste without it being due to consumer weakness at computation.

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## **Practice question on alternative views on consumer behaviour**

This practice question is written in the style of A Level Economics Edexcel A.

It features a short extract, followed by a practice question.

**Extract:** *The Competition and Markets Authority (CMA) has looked into subscriptions for services such as video and music streaming services, such as Netflix, Disney Plus, YouTube Premium, Apple Music and Spotify. The CMA was worried that such subscriptions, which often start as free trials, could force consumers to keep using services that they do not use or want anymore. The CMA calls this a “subscription trap” and estimates are that nearly 10 million out of 155 million active subscriptions in the UK are not wanted. The total cost to consumers of subscription traps is £1.6 billion a year.*

*However the automatic renewal of subscriptions may save time for consumers who already know they would like a renewal. Consumers can benefit from free trials, which enable consumers to try before they buy.*

*Businesses may design subscriptions in ways to increase uptake. This includes stating monthly prices of subscriptions rather than annual prices, as well as providing inferior options to make one choice appear most beneficial.*

Source: [gov.uk](https://www.gov.uk)

**Question:** Assess **two** possible reasons why consumers may not behave rationally in the case of subscription purchases. (12 marks)

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## **Related resources**

Edexcel Economics A notes, model answers and practice questions:

<https://tfurber.com/edexcel-economics>

Edexcel Economics A Theme 1 notes, model answers and practice questions:

<https://tfurber.com/theme-1-edexcel-economics/>

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