The Next Discipline:
Applying Behavioral Economics to Drive Growth and Profitability[i]

For years, Gallup has been researching how behavioral economics affects customers, employers, growth and profitability. The results of their research are filled with facts and implications that can revolutionize the way we do business. The following is a summary of their findings.

Introducing Behavioral Economics

For years business leaders have struggled to comprehend the apparent irrationality of employee and customer behavior and the impact it has on business performance. Fortunately, there is an emerging management discipline based on principles of behavioral economics that can help business leaders and executives make sense of the economic behavior of people and serve as a platform for effective management solutions. Gallup research revealed that *a study group of 10 companies that applied these principles outperformed peers by 85% in sales growth and more than 25% in gross margin during a recent one-year period*.

For the past 30 years, behavioral economics has challenged the central premise of classical economic theory — that individuals will always behave rationally to achieve the best possible outcome. In fact, some have suggested that economic decision making is up to 70% emotional and 30% rational. Our emotional, cognitive, and perceptual processes place limits on how rationally we can view the world around us. These limits have a profound effect on the decisions we make — and subsequently on the way organizations need to think about how their employees and customers make decisions and ultimately behave.

Summary of Key Research Conclusions

1. Customer behavior is influenced more by emotion than reason, and these emotional dimensions can be measured and managed.
2. Employees have a tremendous impact on customers' emotional *engagement*, for good or ill.
3. Employee behavior is influenced more by emotion than reason, and these emotional dimensions can be measured and managed.
4. The ability to *engage* employees depends on identifying the unique strengths they bring to their roles, selecting and positioning them for success by ensuring their strengths fit their roles, and providing them with an engaging workplace and an engaging manager.

The Top Line

Emotionally satisfied customers deliver significantly enhanced value to an organization by buying more products, spending more for those products, returning more often, and staying longer with the business. *Customers who have a strong emotional connection to the organization represent an average 23% premium in terms of share of wallet, profitability, revenue, and relationship growth over the average customer*.

In stark contrast, those customers whose emotional connection to the organization is weak or absent represent a 13% *discount*. At a local business unit level, those whose levels of customer engagement place them in the top 25% of comparable units within an organization tend to outperform all other units on measures of profit contribution, sales, and growth by a factor of two to one. Clearly, engaging customers on an emotional level has a significant financial benefit.

Just as *engaged* customers are among an organization's most profitable patrons and passionate advocates, *engaged* employees are an organization's most productive and efficient workers. Teams of *emotionally engaged* employees deliver significantly better growth (productivity, profitability, and customer) and cost-reduction (turnover, absenteeism, theft, and safety) outcomes than disengaged work teams. Similarly, organizations that *engage* their employees grow their earnings more than 2½ times faster than organizations that do not.

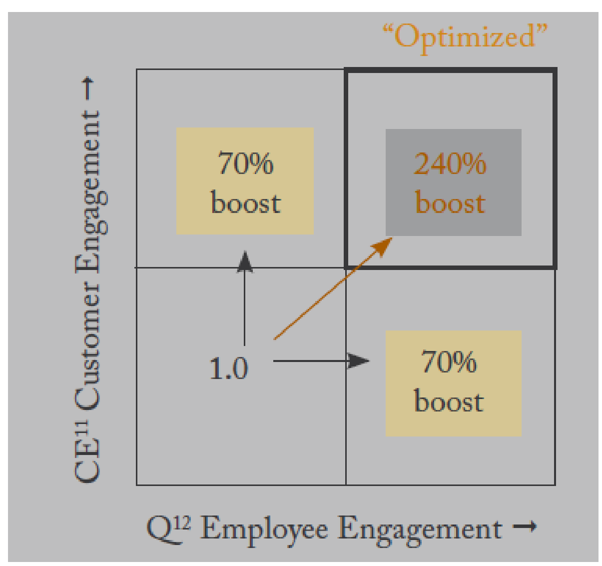
Unlocking Potential Profit

From a behavioral economics perspective, high performance organizations recognize the need to understand every individual's unique set of characteristics, strengths, and weaknesses at the individual level, person by person, and to leverage it to drive performance. For new employees, this means deploying a disciplined selection process to match prospective employees' strengths to the demands of their roles. For existing employees, a manager's goal should be to use each person's unique strengths for maximum effect, rather than trying to change the things that are difficult or even impossible to change. Employees whose supervisors focus on their strengths during performance reviews are more than 2½ times as likely to be *engaged* as those whose supervisors focus on their weaknesses.

The Bottom Line

Organizations that improve *emotional engagement* with employees and customers realize significant financial returns for their efforts. *In fact, "optimized" teams within an organization — those that are in the top 50% of teams on both employee and customer engagement — generate a 240% boost in financial performance compared with teams that fail to engage their employees and their customers*. As Figure 1 shows, optimized teams also significantly outperform those that scored high on one but not the other of these metrics. Contrary to popular wisdom, our emotional traits are in fact quite predictable, and it is this long-ignored aspect of employee-customer relations that holds the key to superior performance and long-term growth.

**Figure 1:
Performance Optimization Quadrants**



[1] Gallup Consulting. "The Next Discipline: Applying Behavioral Economics to Drive Growth and Profitability." http://www.gallup.com/consulting/122906/next-discipline.aspx (2009). "CE11" and "Q12" are Gallup Trademarks.