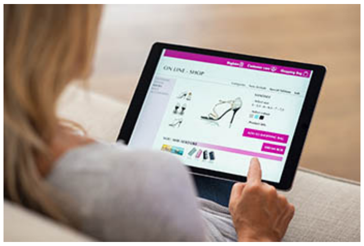

Behavioral Economics Can Give You an Edge with SMBs

small business business customers customer service

Summary: Behavioral economics, the study of how we make decisions, is used by many FIs in various ways. We look at three areas of your business where understanding behavioral economics can help you better serve your customers.

If you have ever purchased an item on Amazon that popped up in the "Customers who bought this also bought" feature, you are not alone. Together with its other recommendation features, it is responsible for 35% of Amazon's revenue. At the heart of this strategy is a sophisticated algorithm coupled with behavioral economics.

What is behavioral economics?

Born as an alternative to classical economic theory, behavioral economics is the study of how various factors — social, psychological, emotional, and cultural — influence the way we make decisions. Essentially, it seeks to explain why humans behave the way they do, rather than how they rationally should, and suggests actions that might alter that behavior in line with people's long-term interests. Such actions are known as "nudges."

What are some behavioral economics applications?

Behavioral economics has been successfully adopted in many industries for a range of purposes, from boosting marketing efforts to improving employee well-being and motivation. Governments have also made use of it in designing their policies. The following are striking examples of the effectiveness of applied behavioral economics:

- In a 2005 trial, General Electric found that financially incentivizing employees to quit smoking led to 3x the success rate of their traditional smoking cessation policies. GE subsequently extended the program to its 152K employees.
- Behavioral economics is also at the heart of the stark difference in organ donation rates between countries where donation is set by default (90%) and those where it is not (10%). This is explained by the "status quo bias," a preference to keep things as they are.
- The British government's "Nudge Unit" successfully employed behavioral economics to increase tax collection by simply reminding people by letter that paying on time is the socially acceptable norm.

How can behavioral economics support CFIs with business customers?

Understanding how small- and medium-sized businesses (SMBs) make decisions can help community financial institutions (CFIs) identify strategies to serve them better. Here are **three areas in which behavioral economics can make a difference:**

1. Savings. There are a number of factors, or biases, that contribute to a gross savings rate of 17.8% in the US. Although we know the benefits of saving for the future, we tend to put aside less than we should. CFIs can use behavioral economics to encourage SMBs to focus on saving.

One such strategy is to create subaccounts to break savings down into smaller, more achievable, short-term goals, such as the purchase of a new piece of equipment. Subaccounts can help identify the true capacity for saving, incentivize it — either financially or with other forms of recognition — and provide regular feedback on customers' milestones or those of their peers. Also, providing information on projected operating costs can help business customers recognize the importance of planning for the future.

2. Loans. Barriers to lending are not confined to poor collateral or insufficient cash flow. Lack of borrowing can often be traced to behavioral influences — such as limited time to address complex issues, perceived risk, and loss aversion — which CFIs can address to improve lending outcomes.

Anticipating lending needs is key. Financial and behavioral data, layered with analytics, allow CFIs to offer personalized products at the right time. Uptake can be increased by configuring the loan to overcome some of the relevant behavioral biases. The loan application process should be made as easy as possible, with minimal friction to avoid losing the customer along the way. Sharing success stories from other SMB loans can have a positive impact by increasing trust in the process. Finally, the use of nudges or incentives can encourage timely repayment.

3. Money management. While SMBs may be experts in their field or product, financial management may not be a core skill — and yet it is essential to the smooth operation of the business. By leveraging behavioral economics, CFIs can support SMBs with their financial wellness in a number of ways.

To begin with, they should be a source of financial information and advice that they can personalize to customers' specific needs. Nudges can be used to remind customers to take action such as making a payment, alerting them when they are about to be overdrawn, or offering advice and solutions. Finally, CFIs can offer incentives to reward customers for healthy financial practices.

SMBs are typically pressed for time and resources, and they value additional support from their financial institution in making sound and sustainable financial decisions. CFIs, with their long-standing relationships and customer knowledge, are well-positioned to support SMBs with better financial management. By applying behavioral economics, CFIs can design strategies that will benefit their customers and their institution.

PCBB IS A CERTIFIED FEDNOW® SERVICE PROVIDER

ECONOMY & RATES

Rates As Of: 10/03/2023 09:49AM (GMT-0700)

Treasury	Yields	MTD Chg	YTD Chg
3M	5.62	0.07	1.20
6M	5.58	0.05	0.82
1Y	5.47	0.03	0.76
2Y	5.14	0.10	0.72
5Y	4.79	0.17	0.78
10Y	4.78	0.21	0.91

30Y	4.91	0.21	0.95

FF Market	**FF Disc**	**IORB**
5.33	5.50	5.40
SOFR	**Prime**	**OBFR**
5.32	8.50	5.32