

Setting carefully

expectations

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We all base certain our decisions on expectations. We buy new products because we expect that they carry certain quality, we vote for certain candidates because we expect they will do a “good job”, etc. However, recent research suggests that our expectations affect not only decisions. They also affect the level of enjoyment we derive from taking these decisions (or from experiencing their consequences). In economic terms it means that level of utility derived from the consumption of a product is affected by the expectations of the consumer. Even more technically, we say that people possess expectation-based reference-dependent preferences.

Consider a situation where a decision maker has to make an action. The level of the satisfaction that she will extract from this action (denote this value by x) is not perfectly known to her before the action is taken. This level of satisfaction is realized afterwards. However, a decision-maker has an expectation of what that level might be before making the decision (denote this value by y). A simple interpretation of the theory suggests then that mismatch between x and y will affect the actual satisfaction derived from the action. In particular, if $y-x < 0$, which means that realized satisfaction exceeded expectations then consumer gets an extra boost in satisfaction level and ultimate level of satisfaction is in fact above x . However, if consumer gets disappointed ($y-x > 0$) his satisfaction will be lower than x .

How these satisfaction-affecting expectations are formed is another matter. In this respect we can imagine certain number of opportunities given to the decision-maker to decide on the final expectation that he will base his decision on. What

complicates the calculation of the final impression is that early impressions actually affect the later ones. Therefore, more opportunities there are to form the impression harder it is to detect the actual pattern of expectation formation.

Experimental evidence supporting the principles underlying expectation-based reference-dependent preferences is mounting as this entry is being written ([Crawford and Meng, 2011](#); [Pope and Schweitzer, 2011](#); [Gill and Prowse, 2012](#)). I have discussed certain business and economic implications of these principles in a [recent OFCE working paper](#). For example, the mechanism implies that advertising campaigns can get wasteful not only from social, but also from individual producer's point of view as they may scare off potential customers instead of attracting them.

What is interesting is the fact that this principle seems to have been known for advertisers, media strategists and business practitioners for some time now ([Parasuraman et al., 1991](#); [Dixon et al., 2010](#)). In fact, we can even speculate that this principle is known for certain politicians (or at least members of their staff).

Take a look at the current US presidential campaign. More precisely at the three debates held between the two presidential candidates (Democrat incumbent Barak Obama and Republican challenger Mitt Romney) that were held on October 3rd, 16th and 22nd. President Obama is known to have lost the first debate and won the third one, while the second debate was called a draw. Now, what is important to understand is that there is no actual score. These "scores" were simply based on the feelings of the electorate surveyed after each debate. These debates can be seen as opportunities to the voters to form their expectations based on which they will cast their votes on November 6.

Sequencing in results has been clearly beneficial for Mr Obama for few different reasons. For example, psychologists have a memory “bin” model of impression formation where the last piece of information received is the most relevant piece in determining the decision ([Wyer and Srull, 1989](#); [Babutsidze, 2012](#)). Another reason why the sequencing favors the incumbent is that voters usually prefer voting for candidates that are on a winning streak to voting for those on a losing streak.

However, what expectation-based reference-dependent preferences can offer is the insight into the judgment of voters on the outcome of single debates. The theory implies that voters would give higher appraisal to the positive performance of the candidate when they expect him not to do well compared to when they expect him to perform well. This means voters would judge President Obama’s performance to be poorer hadn’t they been “primed” by the results of the first two debates.

Presidential candidates might not know about this theory, but Mr Obama tried to use the principle (consciously or unconsciously) by saying that: [“Governor Romney, he’s a good debater. I’m just okay”](#) just before the first debate. The fact is that the strategy to set voter expectations low has not been sufficient to convince enough voters that his poor performance was satisfactory. Perhaps this was the case because it indeed was very hard to set expectations lower than those set by Mr Romney who has provided meaty [gaffe](#) after [gaffe](#) throughout the campaign.

However, the lost first debate might actually benefit President Obama. Somewhat counter-intuitive suggestion of the theory is that had he performed well during the first debate, he’d have *a higher likelihood of losing elections*.

