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The Alpha Edison Perspective
Managing Customer Uncertainty

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Managing Customer Uncertainty

The mental, physical, and emotional strains of 2020 have left many people feeling at least one thing in common: uncertainty. Over half of Americans expect their lives will remain changed in major ways by the pandemic[1], but of course the most interesting question is how. Not only might the COVID-19 pandemic impact consumers' ability to earn a living, educate their children, and care for elderly parents, but the Black Lives Matter protests, millions of acres of burning forest, and the stewardship of our country also hang in the balance. With so much in flux, corporate leaders are being called upon to reinforce core values that will remain constant through any unexpected turn of events, while altering just about everything in how they operate on a day-to-day basis. It is no easy task.

Here, we draw upon behavioral models of risk-preferences (introduced alongside other predictive models of behavior change in a prior issue of this newsletter) to understand how the various apprehensions among customers manifest as business risk that can be more deliberately and effectively managed. As corporate leaders navigate the unknown, they are making difficult decisions that test the edge cases of even the best laid contingency plans. The pandemic responses we've observed serve as a useful reminder of what we look for - and try to foster - in businesses that excel at helping their customers navigate uncertainty. The three principles we describe are reducing the most important risks to human health and safety, putting customers in control of the other risks they wish to take or avoid, and making the upside of uncertain choices more salient.

Principle #1: Put a stake in the ground about the risks you will minimize

The risk of contracting COVID-19 is the most prominent concern for many people right now, which means that every company (whether consumer-facing or not) ought to be addressing it head on. While most agree that human wellbeing is a "sacred value" that cannot be compromised, this can be operationalized in different ways, with some companies arguing they provide an essential service that warrants face-to-face interactions if handled with appropriate caution, and others shutting down entirely until further notice. Whichever path is chosen, managers do not have the luxury of assuming that everyone is on the same page, especially as many consumers suffer from information overload in attempting to interpret incongruent policies and recommendations from disparate sources. Rather, communicating clearly and openly about risk reduction priorities serves as a commitment device - and makes the promise more credible to customers - that their vulnerability will not be taken for granted.

1 ://www.pewresearch.org/fact-tank/2020/09/17/about-half-of-americans-say-their-lives-will-remain-changed-in-major-ways-when-the-pandemic-is-over/

Looking beyond the COVID-19 risk that is top of mind at present, there are other low probability, high impact risks lurking below our purview all of the time. Whether a company operates amusement park rides that need regular maintenance, or develops software that processes users' sensitive personal information, its customers want reassurance that the risks of "black swan" events are given due consideration and that mitigation efforts are being taken. Indeed, the erosion of trust due to inadequate safety precautions is perhaps the greatest threat to a company's long-term success. Just as reliability distinguishes a trustworthy person, consistently putting people first - whether or not risks to their wellbeing are as front and center as they are for COVID-19 - is the hallmark of a trustworthy brand that earns customer loyalty.

Application of Principle #1

Companies that have most successfully reduced the risk of COVID-19 have done so by making that objective explicit in their daily operations. On the Masters of Scale podcast, Panera CEO Niren Chaudhary described how he has put the wellbeing of people at the forefront of the fast-casual restaurant chain's long-term strategy, and how this has naturally shaped their pandemic response. Long before the onset of COVID-19, he had invested in a customer-centric e-commerce platform, employee support structures, and relationships with the broader business community. As the virus spread, these pre-existing frameworks facilitated the rapid rollout of curbside pickup at over 1,000 locations, partnerships with CVS and Walmart to employ furloughed staff, and a pledge to serve 500,000 meals to people impacted by the pandemic.

Principle #2: Give customers more control over less consequential risks

Vigilance about maintaining health, safety, and livelihood has left many consumers in a state of "ego-depletion" with scant self-regulatory resources to cope with uncertainty in other domains of their lives.[2] As a result, many people are also experiencing heightened sensitivity and aversion to other, less tangible risks such as shifts in their own consumption preferences. After all, it's hard to say if it will be appealing to resume activities like attending sporting events and concerts in a few months time, and buying tickets in advance could mean throwing money down the drain if the answer turns out to be "no". Unlike risks to human health, the worst case scenario (wasting money, in this example) is much less consequential, but it may nonetheless cause customer indecision and inertia. The corresponding risk to a company is not simply a lost sale, but also lower accuracy in forecasting demand, and thereby their own needs for capital and operational inputs.

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One approach to bolstering consumers' confidence despite this inherent uncertainty is giving them a greater sense of control over their own experience[3], sometimes referred to as "psychological safety"[4]. This could mean letting them decide which risks they want to pay to avoid (e.g., offering insurance against a change of plans) or giving them some benefit for taking on risk (e.g., discounting the unit price on subscription orders that lock them into future purchases). For example, we see this in the shipping options of many companies, with a predetermined delivery date costing more, or alternatively, a bonus such as Amazon digital credits provided for willingness to wait, sometimes indefinitely. Ultimately, giving customers greater flexibility and agency can enable more efficient allocations of each type of risk to the party - in some cases, the business itself - with the highest tolerance.

2 Unger, A., & Stahlberg, D. (2011). Ego-depletion and risk behavior. Social Psychology.

3 Horswill, M. S., & McKenna, F. P. (1999). The Effect of Perceived Control on Risk Taking. Journal of Applied Social Psychology, 29(2), 377-391.

4 Edmondson, A. C., & Lei, Z. (2014). Psychological safety: The history, renaissance, and future of an interpersonal construct. Annu. Rev. Organ. Psychol. Organ. Behav., 1(1), 23-43.

Application of Principle #2

The purported elimination of change fees by airlines is one reflection of magnified consumer desire for optionality. Because this new policy doesn't apply to cheaper "basic" economy fares for many airlines,[5] it enables further price discrimination between leisure travelers who want the least expensive fare and those who - like business travelers - are willing to pay more for loss mitigation in the event that plans need to be altered. Of course, the change fee will be rolled into main cabin fares at a time when prices are already suppressed so the de facto increase is more palatable. While not as purely altruistic as the airlines' PR teams would have you believe, the new division of fare classes does give consumers greater choice about how much they value hedging against unpredictable shifts in external conditions or personal preferences. JetBlue, long considered an airline industry leader in customer service, has specifically made "flexibility" a theme to guide customer offerings.

Principle #3: Make the upside salient

Against a backdrop of profound uncertainty, with much collective will directed at avoiding catastrophe, human beings are still able to thrive on the hope of forward progress, as they always have. In fact, the disruption of pre-pandemic behavioral patterns (as discussed in our introduction to AE's behavioral modeling approach) has inspired many people to take a step back and reevaluate various aspects of their lives, and even ponder ways to enhance their own identity through self-actualization and self-expression. This openness to experimentation - not to mention pent up "variety-seeking" due to restrictions on activity - are a boon to growth stage companies whose very survival depends on new customer acquisition. On the flip side of that, the primary risk to these businesses is that the reluctance of consumers to take a chance on their product or service will translate into flatter growth and failure to reach "escape velocity".

The challenge for business leaders is to strike the right balance between acknowledging the gravity of our current situation, while still authentically inviting people to picture themselves in a more favorable light, under more favorable conditions, using their product or service to solve at least one major pain point. This is not to imply that all brands should strive to project a fun, carefree personality, but nearly universally, businesses should aspire to make customer experiences uplifting. One study even showed that cueing goals to promote positive outcomes (rather than prevent negative outcomes) enhanced creative problem-solving[6], which could entail more vivid imagination about product benefits. By making the upside potential more concrete and plausible - and, thus, salient in consumers' decision processes - positive framing is a powerful strategy for growing companies to encourage trial and adoption among uncertain consumers.

Application of Principle #3

Helping people delight in novel forms of consumption is a key objective for several emerging companies in our portfolio. For instance, Olive & June has seen skyrocketing sales of their at-home manicure kits in recent months, driven in part by pandemic tailwinds of closed nail salons, but also appealing to the optimism of consumers who wish to pamper themselves - or in a small way reinvent themselves - in the midst of the tumult. The company has crafted their brand to be both personal and aspirational, with founder Sarah Gibson Tuttle as the face of the target consumer's "BFF" who shares curated nail polish colors and insider tips. Just as the degree to which one likes another person is a determinant of trust at the early stages of a relationship[7], affinity for a brand can also form the basis for consumers to take a leap of faith with an unfamiliar product or service.

5 https://nymag.com/intelligencer/2020/09/why-airlines-ending-change-fees.html

6 Friedman, R. S., & Förster, J. (2001). The effects of promotion and prevention cues on creativity. Journal of personality and social psychology, 81(6), 1001.

7 Nicholson, C. Y., Compeau, L. D., & Sethi, R. (2001). The role of interpersonal liking in building trust in long-term channel relationships. Journal of the Academy of Marketing Science, 29(1), 3.

Investing in Uncertain Times

One of our primary considerations before investing in a company is whether it will be adaptive and resilient to volatility of the "six-sigma" variety we are witnessing at present. We look for founders who are guided by strong, unwavering values to prioritize the most important risks to human wellbeing, even in times of relative calm when those risks are less obvious. As for other types of risk, such as consumers' uncertainty about future preferences or ambiguity about the benefits of trying new products, there are inevitably tradeoffs to be made between minimizing downside and maximizing upside potential. As businesses test a range of strategies to strike the right balance for their customers, this improves their ability to forecast more accurately and sustain rapid growth, which in turn improves the investment's risk-return profile