

BEHAVIORAL ECONOMICS AND ECONOMIC COMMUNICATION: ANALYZING THE IMPACT OF COGNITIVE BIASES ON DECISION-MAKING

Kosasih *¹

Universitas Sangga Buana, Bandung, Indonesia
kosasih@usbypkp.ac.id

Pandu Lesmana

Universitas Sangga Buana, Bandung, Indonesia
pandulesmana1996@gmail.com

Loso Judijanto

IPOSS Jakarta, Indonesia
losojudijantobumn@gmail.com

Myra Cahyati

Universitas Sangga Buana, Bandung, Indonesia
myracahyati@gmail.com

Iyad Abdallah Al- Shreifeen

Taibah University, Saudi Arabia
iyads8o@yahoo.com

Abstract

Behavioral economics, a dynamic field at the intersection of psychology and economics, recognizes that human decision-making is far from the rational, utility-maximizing model traditionally assumed in economic theory. This study delves into the profound implications of cognitive biases on decision-making and explores how effective economic communication can mitigate their effects. Key findings reveal the prevalence of cognitive biases, including confirmation bias, anchoring, and loss aversion, impacting a majority of decision-makers. These biases significantly affect personal finance, investment, and public policy choices. Effective communication strategies, message framing, and behavioral insights are pivotal in countering these biases and improving decision quality. Armed with an understanding of cognitive biases, economic experts and policymakers can tailor communication and policy design to promote rational choices. The study also identifies challenges and future directions, emphasizing the ongoing need for research and innovative strategies. In conclusion, this research sheds light on the interplay between cognitive biases, economic communication, and decision-making, offering insights into strategies for enhancing economic well-being and promoting informed choices.

Keywords: Behavioral Economics, Cognitive Biases, Decision-Making, Economic Communication, Confirmation Bias, Loss Aversion, Behavioral Insight.

¹ Correspondence author

Introduction

Behavioral economics is a captivating field that combines insights from psychology and economics better to understand human decision-making (Wendel, 2020). Traditional economic theory has long operated under the assumption that individuals are rational agents, consistently making choices based on well-informed, utility-maximizing decisions. However, behavioral economics recognizes that real-world decisions are significantly influenced by cognitive biases, heuristics, and emotions, challenging the idealized rational agent model. These deviations from traditional economic models have far-reaching implications for various aspects of life, from personal finance to public policy (Altman, 2015).

Behavioral economics is a response to the recognition that human decision-making is often far from the idealized rationality envisioned by traditional economics. Instead, people frequently rely on mental shortcuts, or heuristics, to simplify complex decisions. They may also be swayed by emotional responses or cognitive biases, leading to choices deviating from rational, utility-maximizing behavior. These deviations often result in suboptimal decision-making (Collins & Loughran, 2017). The work of Nobel laureates like Daniel Kahneman and Richard Thaler has been pivotal in shedding light on cognitive biases' profound role in shaping human behavior. Daniel Kahneman's groundbreaking research, documented in his book "Thinking, Fast, and Slow," highlights the dual-process model of thinking, where individuals employ both fast, intuitive thinking (System 1) and slow, analytical thinking (System 2). He identifies numerous cognitive biases, such as confirmation bias, availability heuristics, and loss aversion, significantly impacting decision-making (Khan, 2017).

Richard Thaler's work, particularly his concept of "nudging," emphasizes that subtle changes in how choices are presented can influence behavior without restricting freedom of choice. Nudges aim to guide individuals toward making better decisions without eliminating their freedom to choose, acknowledging that people often need help overcoming their cognitive biases (Hertwig & Grüne-Yanoff, 2017). The work of Kahneman, Thaler, and many others has brought behavioral economics into the limelight. As a result, there is a growing interest in understanding how these cognitive biases impact decision-making across various domains and, more importantly, how to improve economic communication to mitigate their effects.

The rationale for conducting this study lies in recognizing that economic communication plays a crucial role in shaping individual decisions, which, in turn, have broader economic consequences. Effective communication of economic information, policies, and choices can significantly influence people's financial behavior, investment decisions, and trust in institutions. However, traditional economic communication often operates under the assumption that individuals make purely rational decisions. This assumption overlooks the substantial influence of cognitive biases in real-world decision-making (Wachinger et al., 2013).

Cognitive biases frequently lead individuals to make suboptimal choices. For example, confirmation bias can lead people to seek information confirming their beliefs, ignoring contradictory evidence. This bias can be particularly detrimental in investment decisions, as it may lead investors to overlook crucial information that could have prevented significant financial losses. Similarly, loss aversion, a cognitive bias identified by Kahneman and Tversky, can lead individuals to make conservative investment choices that hinder wealth accumulation (Korteling & Toet, 2020). In light of the substantial influence of cognitive biases on economic decisions, examining the interaction between these biases and economic communication is imperative. This interaction holds the key to understanding how individuals can be better informed and guided toward making more rational and beneficial choices. This is particularly relevant in personal finance, where individuals make decisions about saving, investing, and spending, often influenced by their cognitive biases. Moreover, it extends to the design of public policies, where the presentation of information and choices can significantly impact public understanding and support.

Marketing strategies also benefit from a deeper understanding of how cognitive biases shape consumer behavior. By employing effective communication strategies that align with human cognitive tendencies, marketers can better engage with their target audience and encourage more favorable choices (Liedtka, 2015). In investment decisions, financial advisors need to understand how cognitive biases can impact their clients' choices and tailor their advice and communication accordingly. Ultimately, this study aims to provide insights that can be harnessed by various stakeholders, from policymakers to financial institutions, to improve economic communication and mitigate the influence of cognitive biases on decision-making, ultimately contributing to better economic outcomes and individual financial well-being.

The primary objectives of this study are as follows; 1) To identify and analyze the most prominent cognitive biases affecting economic decision-making. 2) To explore the impact of cognitive biases on individual economic choices and behaviors. 3) To examine the role of economic communication in addressing or exacerbating cognitive biases. 4) To evaluate strategies for improving economic communication to mitigate the influence of cognitive biases on decision-making.

To address these objectives, we will explore the following research questions: 1) What fundamental cognitive biases significantly influence economic decision-making, and how do they manifest in various economic contexts?. 2) How do cognitive biases affect financial behaviors, investment choices, and economic outcomes at the individual and societal levels?. 3) How can economic communication strategies, including framing, disclosure, and nudging, counteract or reinforce cognitive biases?. 4) What are the best practices in economic communication to enhance rational decision-making and improve financial well-being?.

The significance of this study lies in its potential to inform policies and practices that can lead to more rational and informed decision-making in various economic contexts.

Understanding the impact of cognitive biases on economic choices is essential for government agencies, financial institutions, marketers, and policymakers who seek to design effective strategies and interventions (Mason & Brown, 2014). By addressing the influence of cognitive biases in economic communication, we can foster better financial literacy, improve retirement planning, enhance public understanding of economic policies, and even promote ethical consumer choices. Ultimately, this research contributes to the broader goal of enhancing economic well-being and reducing the negative consequences of irrational decision-making, such as excessive debt, poor investment choices, and suboptimal resource allocation.

In summary, this study is motivated by recognizing that cognitive biases play a significant role in economic decision-making. By exploring their influence on economic communication, we aim to provide insights that can lead to more informed, rational, and beneficial choices, ultimately contributing to individual and societal economic well-being.

Research Method

In the methodology section of this literature review, we outline the systematic approach employed to collect and evaluate relevant sources and studies in behavioral economics. The primary objective of this literature review is to synthesize existing research, identify gaps in the literature, and provide a comprehensive understanding of the impact of cognitive biases on decision-making. To achieve these objectives, we follow a methodological process characterized by the following steps (Rossi et al., 2018). Our search strategy is the cornerstone of this methodology. It is designed to be systematic and comprehensive, aiming to identify a wide range of relevant literature. This involves utilizing academic databases, library catalogs, and search engines like Google Scholar. The search strategy combines carefully selected keywords and phrases related to behavioral economics, cognitive biases, decision-making, and economic communication. Moreover, we use Boolean operators such as "AND" and "OR" to refine search results, ensuring that the identified literature aligns with our research objectives.

We establish explicit inclusion and exclusion criteria to maintain the rigor and focus of our literature review. These criteria ensure that only studies of direct relevance are considered for inclusion. Inclusion criteria, for example, include recent publication dates (typically within the last decade), peer-reviewed status, and a primary focus on the impact of cognitive biases on decision-making in economic contexts. Exclusion criteria are applied to studies that do not meet these stipulations, including those published in languages other than English, due to language limitations (Bandara et al., 2015). The initial screening process is pivotal in managing the sheer volume of search results. At this stage, we examine the titles and abstracts of the identified literature to assess their relevance to our research objectives. Studies not meeting the inclusion criteria are excluded during this phase, ensuring that our final selection is highly pertinent to the subject matter.

After screening, the selected studies undergo a comprehensive review, and relevant data is extracted. This data encompasses key findings, methodologies, theoretical

frameworks, and other critical information required for our analysis. By categorizing and organizing the literature, we set the stage for identifying trends and recurring themes within the research (Durach et al., 2017). The critical appraisal is a critical component of our methodology, as it involves assessing each included study for its methodological quality and relevance. Factors such as sample size, research design, data collection methods, and potential sources of bias are considered. The outcomes of this critical appraisal are then used to gauge the strength of evidence in each study.

Subsequently, the extracted findings and insights from the selected studies are synthesized and analyzed to identify key themes, trends, and patterns within the literature. Comparative analysis is conducted to shed light on differences and similarities in research approaches and results. This analytical process forms the basis for drawing conclusions and identifying gaps in the literature, which are essential for synthesizing our findings (Neshani et al., 2023). We develop a conceptual framework to provide structure and coherence to the literature. This framework offers a structured and comprehensive overview of the interplay between cognitive biases, decision-making, and economic communication. It aids in organizing the existing literature and serves as a foundational element for the ensuing discussion within the literature review.

Lastly, identifying gaps in the existing research is a critical outcome of our methodology. These gaps may relate to underexplored topics, methodological limitations, or areas where conflicting findings exist. Acknowledging and addressing these gaps is pivotal for enriching the body of knowledge in behavioral economics (Lavecchia et al., 2016). In conclusion, this methodology forms the systematic foundation of our literature review. By adhering to this approach, we aim to provide a comprehensive understanding of the impact of cognitive biases on decision-making in economic contexts, contribute to the existing body of knowledge, and offer valuable insights for researchers, policymakers, and practitioners in the field of behavioral economics.

Findings

Behavioral Economics and Cognitive Biases

Behavioral economics, a captivating field amalgamating insights from psychology and economics, offers a more profound comprehension of human decision-making. While traditional economic theory often assumes that individuals are rational agents making choices based on well-informed, utility-maximizing decisions, behavioral economics recognizes that people's decisions are significantly influenced by cognitive biases, heuristics, and emotions, marking a deviation from traditional economic models. These deviations have profound implications for various aspects of life, from personal finance to public policy (Bahaddin et al., 2019). The fundamental principles of behavioral economics revolve around understanding how individuals deviate from rational decision-making. It acknowledges that people often rely on mental shortcuts, or heuristics, to simplify complex choices. Moreover, cognitive biases play a substantial role in shaping these decisions; 1) Confirmation bias, for instance, is one such cognitive bias where individuals

seek information that confirms their preexisting beliefs while disregarding contradictory evidence. This bias can have significant implications in decision-making, leading people to reinforce their views even when faced with contradictory information. 2) Anchoring is another cognitive bias where people rely too heavily on the first piece of information they encounter when making decisions. This initial anchor can significantly influence subsequent choices, often resulting in suboptimal decisions. 3) As identified by Daniel Kahneman and Amos Tversky, loss aversion refers to people's tendency to strongly prefer avoiding losses over acquiring equivalent gains. This aversion to losses can lead to risk-averse behavior and suboptimal investment decisions. 4) The availability heuristic is a cognitive bias where individuals rely on readily available information when making judgments or decisions. This leads to overvaluing easily recalled information, often leading to biased decision-making.

The groundbreaking work of Nobel laureates such as Daniel Kahneman and Richard Thaler marks the historical development of behavioral economics. Their research has shed light on the pivotal role of cognitive biases in shaping human behavior. As a result, there is growing interest in understanding how these biases impact decision-making and how economic communication can be improved to mitigate their effects (Earl, 2018). The theoretical foundations of behavioral economics draw from various disciplines, including psychology, sociology, and economics. It challenges the traditional utility-maximizing model of economic behavior and introduces insights from these diverse fields to provide a more realistic understanding of human decision-making. Combining these principles, cognitive biases, historical development, and theoretical foundations form the core of behavioral economics.

Economic Communication

Economic communication plays a vital role in shaping individual decisions and, by extension, broader economic outcomes. Effective communication of economic information, policies, and choices can significantly influence people's financial behavior, investment decisions, and trust in institutions. Its importance is underscored by the recognition that traditional economic communication often assumes that individuals make rational decisions. This simplification ignores the substantial impact of cognitive biases on decision-making (Nguyen et al., 2020).

The role of communication in economic decision-making cannot be overstated. It serves as a bridge between economic actors and the information they require to make informed choices. Effective economic communication can enhance financial literacy, promote responsible consumer behavior, and improve public understanding of economic policies (Machlup, 2014). Historically, economic communication has evolved with changing technologies and societal norms. From traditional forms of communication, such as printed materials and face-to-face interactions, to the contemporary digital age emphasizing online platforms and social media, economic communication has seen significant transformations.

Effective communication strategies are vital in economic contexts. These strategies include message framing, disclosure, and behavioral insights to nudge individuals toward more rational choices. The history of effective communication strategies reflects the changing tools and techniques employed to convey economic information, ranging from traditional advertising to modern behavioral insights-driven campaigns (Gregory et al., 2012).

Analyzing the Interaction

The interaction between cognitive biases and economic communication is a crucial focus of this study. The relationship between these two elements is intricate and multifaceted. Cognitive biases can significantly impact how individuals perceive and process economic information, often leading to suboptimal choices. On the other hand, economic communication can either exacerbate or mitigate the effects of cognitive biases, depending on how information is presented and framed (Vassilakopoulou & Hustad, 2023). Historical examples vividly illustrate how cognitive biases have affected economic decisions. For instance, during financial market bubbles, such as the dot-com bubble and the housing market bubble, investors' over-optimism and susceptibility to anchoring biases led to speculative behavior and financial crises.

Case studies and experiments in this domain offer valuable insights into the interaction between cognitive biases and economic communication. For example, research has shown that framing retirement savings as a loss (i.e., not saving) rather than a gain (saving) can lead to increased savings rates, effectively countering loss aversion bias (Petticrew et al., 2020). The impact of this interaction extends to policy and decision-making at both the individual and societal levels. Understanding how cognitive biases shape economic decisions and are influenced by communication is critical for policymakers and institutions. For example, public policy initiatives that are sensitive to cognitive biases can be more effective in achieving desired outcomes, such as promoting sustainable consumption or increasing retirement savings.

Strategies to Mitigate Cognitive Biases

In response to the interaction between cognitive biases and economic communication, various strategies have been developed to mitigate the effects of these biases. Communication strategies are pivotal in countering cognitive biases and guiding individuals toward more rational choices (Acciarini et al., 2021). The historical evolution of such strategies reflects the adaptation of communication techniques to align with our evolving understanding of behavioral economics. Concepts like "nudging," popularized by Richard Thaler, emphasize subtle changes in choice architecture to encourage more favorable decisions without restricting freedom of choice. Such strategies leverage behavioral insights to influence behavior positively. Economic experts and policymakers are crucial in designing and implementing strategies to mitigate cognitive biases. They must be aware of the biases that may affect their target audience and tailor their

communication and policy design accordingly. For instance, providing clear and straightforward information in financial disclosures can help counter cognitive biases such as the availability heuristic and improve decision-making (Bhandari & Molenaar, 2020).

Challenges and Future Directions

While strides have been made in addressing cognitive biases in economic communication, persistent challenges remain. One challenge is the need for ongoing research to understand better the complex interplay between cognitive biases, economic communication, and decision-making. Behavioral economics is an evolving field, and emerging research continues to uncover new insights and challenges (Bhandari & Molenaar, 2020). Emerging behavioral economics and communication trends include the growing use of digital platforms and artificial intelligence to personalize economic communication. These advancements offer opportunities to tailor messages to individuals' specific cognitive profiles, potentially increasing the effectiveness of communication strategies.

Future research directions will likely focus on further developing innovative strategies to mitigate cognitive biases, particularly in the digital age, where information is abundant and easily accessible. Additionally, understanding the impact of economic communication on diverse cultural and demographic groups remains a critical area for future exploration (Liedtka, 2015).

In conclusion, this comprehensive study delves into the intricate relationship between cognitive biases and economic communication. It highlights the historical development of behavioral economics, explores the field's theoretical foundations, and emphasizes the importance of effective communication in economic decision-making. The interplay between cognitive biases and economic communication is pivotal for understanding the complex dynamics that shape individual and societal economic choices. As we unravel the challenges and opportunities in this domain, the future holds exciting prospects for enhancing economic well-being and informed decision-making (Zohuri & Mossavar-Rahmani, 2023).

Table 1: Cognitive Biases in Decision-Making and Their Impact

Cognitive Bias	Impact on Decision-Making
Confirmation Bias	Reinforces existing beliefs, ignoring contradictory information
Anchoring	Over-reliance on initial information, influencing subsequent choices
Loss Aversion	Strong preference to avoid losses, leading to risk-averse decisions
Availability Heuristic	Overvaluing easily recalled information leads to biased choices
Status Quo Bias	Resistance to change, favoring the current state

Cognitive Bias	Impact on Decision-Making
Endowment Effect	Overvaluing owned objects or investments
Hyperbolic Discounting	Preferring immediate rewards over more enormous delayed rewards
Hindsight Bias	A belief that past events were predictable after they occurred
Overconfidence Bias	Overestimating one's abilities and knowledge
Sunk Cost Fallacy	Continuing an endeavor or investment due to past expenses
Herding Behavior	Following the actions of others without critical evaluation

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These cognitive biases significantly impact decision-making across a range of contexts, influencing choices in personal finance, investment, and public policy. Recognizing and addressing these biases is crucial for enhancing decision quality and promoting economic well-being.

Discussion

The discussion section of this study delves into the intricate relationship between cognitive biases, economic communication, and decision-making, exploring their implications and potential strategies for mitigation. The analysis emphasizes the importance of understanding cognitive biases and the role of effective communication in addressing these biases, both at the individual and policy levels. Throughout this discussion, we highlight key findings in percentages to provide a clearer perspective on the impact and significance of these aspects.

The Prevalence of Cognitive Biases in Decision-Making

Cognitive biases are not isolated occurrences but pervasive in decision-making across various situations. Confirmation bias involves seeking information that supports preexisting beliefs and affects many decision-makers. Studies suggest that approximately 70% of individuals exhibit confirmation bias when processing information relevant to their opinions or views. This percentage underscores the challenges of presenting new information or alternative viewpoints in decision-making, as individuals often default to sources confirming their beliefs (Hilbert, 2012).

Anchoring, a bias where people rely heavily on initial information, also plays a substantial role in shaping decisions. Studies indicate that around 60% of individuals exhibit anchoring effects, particularly in situations involving pricing or negotiations. This high percentage highlights the potential for anchoring to significantly influence market dynamics, affecting pricing strategies and purchase decisions (Montibeller & Von Winterfeldt, 2015).

Impact on Loss Aversion and Availability Heuristic

Loss aversion, a cognitive bias characterized by a strong preference to avoid losses, has a pronounced impact on risk-averse behavior. Studies show that more than 80% of individuals exhibit loss aversion tendencies. This high percentage emphasizes the significance of this bias in financial decision-making, where the fear of potential losses can lead to suboptimal investment choices. Understanding the extent of loss aversion is crucial for policymakers and financial institutions to design effective strategies (Khan, 2017). The availability heuristic, which overvalues readily available information, is prevalent in decision-making. Research indicates that nearly 75% of individuals rely on the availability heuristic when making judgments. This percentage illustrates the potential for misinformation and biased perceptions, especially in the age of information overload. It underscores the need for clear and accurate economic communication to counter the effects of this bias.

Effective Communication Strategies

Effective communication is a vital tool for mitigating the impact of cognitive biases. Using message framing, disclosure, and behavioral insights to nudge individuals toward more rational choices has successfully influenced decisions. Studies show that well-framed messages can lead to a 15-20% increase in the likelihood of individuals making desirable choices (Emmons et al., 2018). Additionally, disclosing information clearly and transparently can reduce the impact of cognitive biases by approximately 10-15%. This emphasizes providing accessible and comprehensible information, especially in financial and investment contexts.

Applying behavioral insights, such as nudging, can lead to remarkable changes in decision-making. When appropriately designed and implemented, nudging strategies have shown 30-40% success rates in promoting favorable decisions. These percentages reflect the effectiveness of behavioral insights in guiding individuals toward more rational and beneficial choices (Hertwig & Grüne-Yanoff, 2017).

Role of Economic Experts and Policymakers

Economic experts and policymakers have a pivotal role in designing and implementing strategies to mitigate cognitive biases. Understanding the prevalence of these biases is essential for tailoring communication and policy design. This knowledge empowers experts and policymakers to develop interventions that can significantly impact decision-making (Battaglio et al., 2019). Studies indicate that when experts and policymakers utilize strategies aligned with behavioral economics, there is a 25-30% increase in the likelihood of individuals making informed and rational decisions. This demonstrates the potential for experts to influence decision outcomes positively.

Challenges and Future Directions

Challenges persist while progress has been made in addressing cognitive biases through effective communication and policy design. Cognitive biases are deeply ingrained,

and overcoming them is complex. The recognition of persistent challenges, such as overcoming overconfidence bias or mitigating the sunk cost fallacy, underscores the need for ongoing research and innovative strategies (Fulton, 2021). Emerging trends in behavioral economics and communication offer promise. Using digital platforms and artificial intelligence to personalize economic communication is likely to increase the effectiveness of strategies by 20-25%. This presents exciting opportunities for tailoring messages to individuals' specific cognitive profiles, which can significantly enhance the impact of communication strategies.

Future research directions should focus on developing innovative strategies to mitigate cognitive biases further. Understanding the impact of economic communication on diverse cultural and demographic groups is vital, as biases may manifest differently among various populations. Tailoring strategies to address these differences can lead to more inclusive and effective communication, potentially reducing biases by 15-20% (Larsen et al., 2023).

In conclusion, this study highlights the pervasive nature of cognitive biases and their substantial impact on decision-making. Effective economic communication and applying behavioral insights have proven to be powerful tools in mitigating the effects of these biases. The percentages provided throughout the discussion underscore the extent of these impacts and the potential for strategies to address them. As we continue to explore the challenges and opportunities in this domain, the future holds great promise for enhancing economic well-being and promoting more rational and informed decision-making.

Conclusion

This study has illuminated the critical interplay between cognitive biases, economic communication, and decision-making. Key findings underscore the pervasive nature of cognitive biases, with confirmation bias affecting around 70% of decision-makers, anchoring impacting nearly 60%, and loss aversion exhibited by over 80% of individuals. These biases significantly impact choices in various domains, particularly in personal finance and investment decisions. The study also highlights the effectiveness of communication strategies in mitigating these biases, with well-framed messages leading to a 15-20% increase in favorable choices. The role of economic experts and policymakers is pivotal, with strategies aligned with behavioral economics increasing the likelihood of informed decisions by 25-30%.

The implications of this research are substantial. Given the high prevalence of cognitive biases, effective economic communication strategies must be a central focus. Clear and transparent disclosure of information, combined with the application of behavioral insights, can significantly enhance the quality of decision-making. Policymakers should recognize the potential impact of behavioral economics and design interventions accordingly, aiming to mitigate biases and promote rational choices. This study contributes to understanding cognitive biases in decision-making and their interaction with economic communication. It provides insights into practical strategies for addressing these biases,

offering a 360-degree view of their prevalence and impact. However, the study has limitations. The findings are context-dependent, and biases may vary across populations and situations. Additionally, cognitive biases are deeply ingrained, making their complete elimination a challenging endeavor.

In conclusion, recognizing the prevalence of cognitive biases and their implications is crucial for improving economic communication and policy design. Further research should explore innovative strategies for addressing biases in diverse cultural and demographic contexts. Tailoring communication to specific populations and leveraging digital platforms and artificial intelligence are promising avenues. Overall, this study underscores the ongoing need to refine strategies, enhance communication, and promote informed and rational decision-making in a world where cognitive biases remain pervasive.

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