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AXA Report

The Psychological Forces and Barriers that influence people's financial management

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redefining / standards

Contents

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INTRODUCTION

It is widely acknowledged that for most individuals, managing our personal finance sits near the bottom of our list of priorities. The thought of sorting out money matters often inspires feelings of fear, anxiety or at best, boredom among the vast majority of consumers.

Fact; More than one in four said they found the idea of managing their finances 'a terrifying idea' and one in six were put off because their finances were just 'too much of a mess'. [extract from research findings – see page 10].*

But why is this? Are we pre-programmed to feel like this, or is this learned behaviour? Are we driven by the same emotional triggers when managing our money as in other areas of our lives?

This Report explores the psychological barriers to financial change. Written and researched by Professor Karen Pine, author of Sheconomics, and Ben (C) Fletcher, Head of Psychology at the University of Hertfordshire, the study was commissioned by AXA, as part of its ongoing **My Budget Day*** campaign.

The Report paints a picture of British consumers mired by *'the three i's'*; inertia, ignorance and immediate gratification. It identifies around 20 barriers to financial management and the psychology behind them and contains some of the findings (shown in *italics*) from an extensive consumer survey designed to get to the nub of *why* people struggle to take charge of their money.

Arguably, the study raises as many questions as it answers and clearly highlights the ongoing challenge for the financial services industry as to how it can help consumers to overcome their apparent aversion to financial planning. Identifying and understanding what holds people back is only half the battle; the Report offers tips to creating a different mindset that will help galvanise individuals into being proactive; replacing reluctance and negativity with enthusiasm and positivity when managing their money. The overriding message to consumers must surely be to *Do Something* as being proactive is empowering in its self.

PSYCHOLOGICAL FORCES AND BARRIERS TO CHANGE

For many years now psychologists have been trying to explain one puzzling human characteristic; that is, people's tendency to engage in behaviour that is potentially harmful. For example, despite being aware of the damaging consequences of over-consumption of junk food, more than half the people in the UK are overweight. Smoking is a life-threatening activity, yet millions of people every year continue to light up. And despite the UK having sunk into economic decline, most of us continue to remain reluctant to take control of our financial future. To understand why people resist change we will consider the psychological evidence under three categories, the *three i's*:

- inertia
- ignorance
- immediate gratification

INERTIA

People have a preference to stick with what they know and a strong inclination to leave things as they are. From failing to join the company pension scheme or move a poorly-performing investment, to leaving credit card statements unopened, it's what people *don't* do that gets them into financial trouble, rather than what they *do*. Psychologists often call this the '**status quo bias**'. Making changes requires effort, decision and action. Opting for the status quo, by contrast, is effortless, easy and undemanding. In addition people generally want to avoid the pain of negative outcomes, and decisions to act – to change the status quo - impose upon them a higher level of responsibility than decisions to leave things as they are. Human beings are naturally averse to sticking their necks out and facing the possibility of feelings of regret. No wonder *more than a quarter of people surveyed said that, when it comes to their finances, they'd rather not think about it.*

Even when default rules are changed, humans stay with their preference to leave things as they are. For example economists Madrian and Shea, in a paper in 2001, described low take-up of pension plans under an opt-in scheme. This was barely 20% after 3 months of employment rising to just 65% after 3 years. But when joining the scheme was made the default and employees had to opt-*out*, 90% of employees joined immediately and this rose to 98% in 3 years. **Inertia** or the status quo bias, rather than choice, was their biggest barrier to change.

Professor Ben (C) Fletcher, of the University of Hertfordshire, has described the human brain as '**a habit machine**', explaining why people can become trapped in a cycle of repetitive behaviour. The brain seeks out known patterns and pathways, choosing familiar ones over new routes to save energy and mental capacity, something referred to as the brain's **efficiency trap**. People also rationalise their failure to act by saying they are happy with the way things are. This rationalisation may reflect a **psychological bias**, identified by US psychologists, whereby humans are known to **over-value** what they have themselves, relative to the value they would attach to the same situation or possession if it belonged to another person. This is related to a tendency for **unrealistic optimism**, the belief that things will turn out better in the end, despite the evidence to the contrary. Inertia and habitual behaviour are also associated with **decision paralysis**. Psychologists from Princeton University in the US showed that the more choices people have in life, the more likely they are to do nothing. They also showed that the longer a person hesitates for, the less likely they are to ever make a decision. Needless to say, when it comes to financial decisions, like starting a pension or choosing the best investment or mortgage, such delays can be costly. Nonetheless, *more than half the people in the survey agreed that, in relation to managing their finances, it was something they 'should get round to'.*

The emotional basis of both inertia and decision paralysis, in many cases, is **fear**. People prefer the devil they know to one they don't and this is played out in their financial behaviour. Professor Karen Pine, author of *Sheconomics*, noted that in the face of fear over money problems people often feel powerless. Fear of making the wrong decision may mean they leave managing their finances to someone else (e.g. a partner or parent), or simply do nothing at all. In the survey, *more than one in four of the respondents said they found the idea of managing their finances 'a terrifying idea' and one in six were put off because their finances were just'too much of a mess'*.
Fear can be contagious too, it is the emotion that the human brain recognises faster than all others and this can lead to a 'herding' tendency. People aren't motivated to go against the crowd and this can be a barrier to change, to being different. Being seen as part of the group is an important human characteristic.

IGNORANCE

We mentioned above that sometimes the more choices people have, the harder they find it to make a decision. The same can be said of **information**; the more people are bombarded with facts, figures, statistics and information, paradoxically the less well-informed they feel. This is because people only have the mental capacity to process a certain amount of information at any one time. *More than two-thirds of people surveyed said they would manage their finances more 'if there was one simple thing I could do now that would make a difference'*.

Jargon too contributes to people's feelings of ignorance and makes people feel excluded from a domain of knowledge. The financial sector can be prone to using too much technical jargon that most people simply don't understand. **Financial illiteracy** is still surprisingly commonplace, even though many people feel too embarrassed to admit they do not know their assets from their ISA, and *more than half the people surveyed said they would be more likely to manage their finances if they understood the terms and jargon.*

Even the current global economic crisis does not seem to have enlightened people about the financial world or motivated them to re-evaluate their own financial situation. *Sixty-four per cent of the people surveyed said that media coverage of financial events had not encouraged them to manage their finances more*. Despite the fact that most people's assets have fallen in value, the price of credit has risen and more jobs are at risk, more than a third of people surveyed thought they had no reason to 'change the way things are financially'.

Financial literacy isn't taught at school and people not only have difficulty with financial language, many **struggle with numbers** too, which adds to their **perceived inaptitude** when dealing with apparently complicated financial matters. For example, charges on a pension may sound very low (e.g. 1.5%) yet few people comprehend that these may reduce the value of their pension by up to 25%.

Furthermore, when struggling with feelings of ignorance, it is not always clear to people where they should go for financial advice. The bank manager's office has become more of a virtual than actual space in modern society and automated phone systems mean a human advisor can be hard to track down. This changing landscape of the financial world has left many people feeling **ignorant or helpless about where to go**, with *59% of people saying they would manage their finances if they could 'get advice from someone I* *trusted'*, also indicating that many are also **sceptical** about whether they can trust those proffering advice. *Half of the people in the survey said that even if they were faced with large debt problems they would not seek professional advice.* However, *more than half said they would go to a body like the Citizens Advice Bureau or the Consumer Credit Counselling Service*. These organisations are perhaps perceived as **more approachable or trustworthy than financial advisors**. *One in ten men, for example, would rather have a minor operation than see a financial advisor and one in seven people would prefer a visit to the dentist.*

People can also be **ignorant about their abilities** when it comes to money. In recent years psychologists have demonstrated the ubiquitous nature of human **over-confidence** and one impact of this is that people **believe they are in better financial shape than they are**. It is therefore perhaps unsurprising that *63% of people in the survey felt confident in their ability to manage their finances.*

Professor Gilovitch, a US psychologist, points out that, given that two-thirds of new businesses fail in the first four years, if people *weren't* overconfident not many would start new businesses. People tend to believe they can overcome obstacles that are put in their way but research shows they will be likely to **over-estimate their abilities**.

IMMEDIATE GRATIFICATION

Many decisions to change, and financial ones particularly, involve weighing up the benefits of a small reward now against a larger one in the future. This is the concept of **immediate versus delayed gratification**. Unsurprisingly, *63% of people surveyed said that there were nicer things to do than manage their finances and 42% would rather do something else with their time*.

In experiments looking at what happens in the brain when a person buys something, psychologists from Stanford University found that a kind of **cerebral struggle** takes place, between the immediate pleasure of acquisition and the equally immediate pain of paying. Therefore, if people can have the pleasure of acquisition now and delay the pain of paying, with credit for example, financial decisions become less of a struggle. Of course, the painful part of the decision is not eliminated but merely postponed. However, this does explain why people aren't motivated to save for the future. Many would rather have their pleasure now than wait years for it. And, under many circumstances, putting off financial decisions does not have immediate, perceptible painful consequences. *This is why even when faced with the prospect of large debt, one in ten people in the survey said they would do nothing.*

A **tendency to live in the present** and believe the future will take care of itself is a significant barrier to improving financial management. This is a natural and adaptive human characteristic (being firmly rooted in the present would have kept our evolutionary ancestors safe from predators) however in modern society it may also reflect an individual's **immaturity**. Children are notoriously bad at delaying gratification. In psychological experiments where young children are offered the choice of a sweet today or the whole packet tomorrow, many chose to have one sweet now. **Peter Pan syndrome** is a term used to describe adults' reluctance to act maturely. This can be seen in people who believe life is for living now, for having fun and not worrying about what's round the corner. Asked to choose from a variety of situations that would encourage them to save, *many Peter Pans in the survey said they would save for a holiday, new house or new car rather than the threat of redundancy.*

More than *half the people in the survey agreed that, in relation to managing their finances*, it was something they 'should get round to' yet often people never get round to dealing with financial problems because they believe that, somehow, things will sort themselves out. In the survey 1 in 6 people indicated a reluctance to think about the future, believing that if they were faced with large debt 'it was OK and would work out later'. **Perceived helplessness** may be underlying this belief, the inability to believe one can have any effect, since *two-thirds of respondents said they would manage their finances if they thought 'anything I did could make a difference now' and one in five had no confidence in their ability to do anything that would make any difference.*

CONCLUSION

By creating a detailed psychological picture of *why* people feel the way they do about money management, and the obstacles that stand between them and better financial planning, the financial services industry can address consumers' needs and wants in a more reassuring and user-friendly way.

We know that **jargon** contributes to people's feelings of ignorance, makes them feel excluded and lowers self esteem; in line with this, AXA has already addressed the issue of clearer and simpler communication – using less jargon – to inspire trust and reassurance among consumers often bombarded with complex information they are unable to process.

The Report reinforces that **too much choice** results in no action at all being taken and AXA believes that simplification should be across the board, and that the exhaustive choice of products to consumers should be reduced to help aid consumers' decision making.

These may be small steps relative to the scale of the problem but by understanding and responding sympathetically to individuals' needs, the financial services industry can help to demystify financial planning and reduce the fear factor.

Psychologists' Tips for creating a more positive mindset

- **Take the first step**
  Visualise your goal. Have a clear sense of where you want to be. Break down how you are going to get there into small steps. Then take one small step towards your goal today.

- **Make it known**
  Own up to a fear or problem and share it with someone you trust. Enlist the help of a supportive buddy. Once you've put it out into the world there's more chance of a solution.

- **Get outside yourself**
  If you're trapped by inertia and indecision, ask yourself 'What would X do?' Think of someone who you believe has it right financially - then put it into action.

- **The law of opposites**
  You can trick your brain by behaving in the opposite way to how you feel. So acting as if you are the person you want to be will conquer some of the barriers you've been putting up.

- **Reframe**
  Putting a different spin on problems can lead to a fresh approach. If the idea of a pension bores you, for example, reframing it as a gift to your future self could shift your mindset.

ENDS

For more information on the report please contact AXA on mybudgetday.uk@axa-uk.co.uk

KEY RESEARCH FINDINGS

- More than a quarter of people surveyed said that, when it comes to their finances, they'd 'rather not think about it'.
- More than half agreed that, in relation to managing their finances, it was something they 'should get round to'.
- More than one in four said they found the idea of managing their finances 'a terrifying idea' and one in six were put off because their finances were just 'too much of a mess'.
- More than two-thirds of people surveyed said they would manage their finances more 'if there was one simple thing I could do now that would make a difference'.
- More than half said they would be more likely to manage their finances if they understood the terms and jargon.
- Sixty-four per cent of respondents said that media coverage of financial events had not encouraged them to manage their finances more.
- More than a third of people thought they had no reason to 'change the way things are financially'.
- Fifty-nine per cent said they would manage their finances if they could 'get advice from someone I trusted'.
- Half of the people in the survey said that even if they were faced with large debt problems they would not seek professional advice. However, more than half said they would go to a body like the Citizens Advice Bureau or the Consumer Credit Counselling Service.
- One in ten men would rather have a minor operation than see a financial advisor and one in seven people would prefer a visit to the dentist.

- Sixty-three per cent of people felt confident in their ability to manage their finances.

- Sixty-three per cent of people surveyed said that there were nicer things to do than manage their finances and 42% would rather do something else with their time.

- When faced with the prospect of large debt, one in ten people said they would do nothing.

- One in six indicated a reluctance to think about the future, believing that if they were faced with large debt 'it was OK and would work out later'.

- Two-thirds of respondents said they would manage their finances if they thought 'anything I did could make a difference now' and one in five had no confidence in their ability to do anything that would make any difference.

Research was carried out among a sample of 2,110 adults (aged 18 and over) by YouGov, during October 2009.

31 Kahneman. D & Tversky A. (1979), Prospect theory: an analysis of decision under risk, Econometrica 47, 263 -291