Behavioral Economics
Field Guide
for Financial Services
People make a tremendous number of monetary decisions every day. We decide whether we should buy coffee, what kind of coffee to get, if we should use a Groupon, and many other things. We make so many decisions about money, we might start to think we’re good at making them.

However, the reality is that financial decisions are incredibly complex. Consider, for example, the simple case of buying a cup of coffee for $2.50. To carry out this decision properly, we need to quantify not only the pleasure that we will get from the cup of coffee but also the opportunity cost — what we will give up for the pleasure of the coffee. Only if the expected pleasure of the coffee is larger than the opportunity cost should we spend the money.

So, how do we make (seemingly simple) financial decisions? The results from multiple experiments show that people rely on rules of thumb — heuristics — to help us solve these complex problems. These heuristics can get us into trouble. For example, people generally don’t consider the short-term good of the purchase relative to the long-term good of saving the money, and instead they simply repeat their past behavior. Another shortcut people make is to copy their friends’ and neighbors’ behavior. These trouble these heuristics can cause is amplified when the decisions are about loans, retirement savings, and mortgages.

This document focuses on some main heuristics and points to the myriad psychological booby traps of financial decision-making.

This Field Guide was developed to help financial service providers understand how people think about money. This guide will serve as a resource throughout the MetLife project.

Funded By:

MetLife Foundation
For each Behavioral Economics Principle we have provided you with the following information:

<table>
<thead>
<tr>
<th>Key Question</th>
<th>Behavioral Economics Principle</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Making the connection</strong></td>
<td>When and where will financial service providers see have seen this behavior with clients?</td>
</tr>
</tbody>
</table>

**Research background**

What do we know about the behavior?

**Using this finding**

How can financial service providers apply the research?
# How to Use This Field Guide

This field guide is organized by key behavioral economics principles. Look for the question that most closely matches the behaviors you observe and then go to the corresponding page. There, you will find research findings, tips, and more about the behavior.

<table>
<thead>
<tr>
<th>Question</th>
<th>Go to:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Do people do what is best, or do they do what is easiest?</td>
<td>Default Bias Page 7</td>
</tr>
<tr>
<td>Why can’t people make a choice when they’ve been given so many options?</td>
<td>Decision Paralysis Page 8</td>
</tr>
<tr>
<td>Why do people keep doing what they’ve always done?</td>
<td>Status Quo Bias Page 9</td>
</tr>
<tr>
<td>Why don’t people remember important details of their decisions?</td>
<td>Limited Attention Page 10</td>
</tr>
<tr>
<td>What do people consider when making a decision?</td>
<td>Availability Bias Page 11</td>
</tr>
</tbody>
</table>

## Choice Architecture

<table>
<thead>
<tr>
<th>Question</th>
<th>Go to:</th>
</tr>
</thead>
<tbody>
<tr>
<td>If people say they want to save for the future, why don’t they?</td>
<td>Hyperbolic Discounting Page 13</td>
</tr>
<tr>
<td>Why can’t people do what they say they want to do?</td>
<td>Lack of Self-Control Page 14</td>
</tr>
<tr>
<td>When are people most vulnerable to making a bad decision?</td>
<td>Ego Depletion Page 15</td>
</tr>
<tr>
<td>Why can’t people plan ahead enough to prevent the emergencies they encounter?</td>
<td>Tunneling Page 16</td>
</tr>
<tr>
<td>Why do people repeatedly set unrealistic goals and expectations?</td>
<td>Planning Fallacy Page 17</td>
</tr>
<tr>
<td>Why do people just give up after a few little setbacks?</td>
<td>The What-The-Hell Effect Page 18</td>
</tr>
<tr>
<td>Why do people say they want to do something but never seem to get around to it?</td>
<td>Procrastination Page 19</td>
</tr>
<tr>
<td>Question</td>
<td>Go to:</td>
</tr>
<tr>
<td>-------------------------------------------------------------------------</td>
<td>----------------------------</td>
</tr>
<tr>
<td><strong>The Psychology of Money</strong></td>
<td></td>
</tr>
<tr>
<td>Why don’t people treat all dollars equally?</td>
<td>Mental Accounting</td>
</tr>
<tr>
<td></td>
<td>Page 21</td>
</tr>
<tr>
<td>How do people choose what to buy and what not to?</td>
<td>Opportunity Cost Neglect</td>
</tr>
<tr>
<td></td>
<td>Page 22</td>
</tr>
<tr>
<td>How does poverty affect people and their decisions?</td>
<td>Scarcity</td>
</tr>
<tr>
<td></td>
<td>Page 23</td>
</tr>
<tr>
<td>How do people get attached to irrelevant facts and figures?</td>
<td>Anchoring</td>
</tr>
<tr>
<td></td>
<td>Page 24</td>
</tr>
<tr>
<td>How can I get people to take up a product or service?</td>
<td>The Power of Free</td>
</tr>
<tr>
<td></td>
<td>Page 25</td>
</tr>
<tr>
<td>Do people only care about what other people think of them?</td>
<td>Self-Signaling</td>
</tr>
<tr>
<td></td>
<td>Page 26</td>
</tr>
<tr>
<td>Why don’t people appreciate and value my services?</td>
<td>Payment for Effort</td>
</tr>
<tr>
<td></td>
<td>Page 27</td>
</tr>
<tr>
<td>Why does it sometimes feel emotionally easy to spend money and other times really hard?</td>
<td>Pain of Payment</td>
</tr>
<tr>
<td></td>
<td>Page 28</td>
</tr>
<tr>
<td><strong>Motivations</strong></td>
<td></td>
</tr>
<tr>
<td>Why do people seem more motivated by threats than promises?</td>
<td>Loss Aversion</td>
</tr>
<tr>
<td></td>
<td>Page 30</td>
</tr>
<tr>
<td>What happens when people think about what might have been?</td>
<td>Regret and Counterfactuals</td>
</tr>
<tr>
<td></td>
<td>Page 31</td>
</tr>
<tr>
<td>Is it okay if people do the right thing for the wrong reason?</td>
<td>Reward Substitution</td>
</tr>
<tr>
<td></td>
<td>Page 32</td>
</tr>
<tr>
<td>Why do people put in more effort as they get closer to reaching their goal?</td>
<td>Goal Gradient Theory</td>
</tr>
<tr>
<td></td>
<td>Page 33</td>
</tr>
<tr>
<td>Why do people follow the herd, even if the herd leads them astray?</td>
<td>Herding</td>
</tr>
<tr>
<td></td>
<td>Page 34</td>
</tr>
<tr>
<td>Should I be all-business with people, or should I try to establish a social relationship with them?</td>
<td>Reciprocity</td>
</tr>
<tr>
<td></td>
<td>Page 35</td>
</tr>
<tr>
<td>How can people resist things that tempt them?</td>
<td>Pre-commitment</td>
</tr>
<tr>
<td></td>
<td>Page 36</td>
</tr>
<tr>
<td><strong>Additional Resources</strong></td>
<td></td>
</tr>
</tbody>
</table>
Choice Architecture
Do people do what is best or what is easiest?

**Default Bias**

*People tend to make the easiest possible choice — often by not doing anything.*

---

**Making the connection**

Your clients might end up with a savings or loan product that seems easy or familiar to them instead of the product that is right for them.

---

**Research background**

If people were rational, giving them more choices would allow them to make better decisions. They would be able to select something that met their needs and preferences. Perfectly rational people would always choose their favorite option among other choices.

But real people often choose an easy option that they barely even like. If something is easy to choose — that is, if it is the default — people tend to choose it.

One demonstration of this behavior involves organ donation in European countries. In countries where people had to check a box in order to be organ donors, the rates were low. In countries where people had to check a box to not be organ donors, the rates were high.

Allowing people to select something can increase buy-in. However, too many choices can often have negative consequences, pushing people to resort to default options regardless of whether they are good options.

---

**Using this finding**

Make the right choice the easiest choice. Smooth the pathway to desired behavior. Eliminate extra steps and excess choices, and reduce the required effort as much as possible.

When clients sign up for a savings account or a loan product, default them into automatic savings deposits or automatic bill pay.
Decision Paralysis

When given too many choices, people often don’t choose at all.

Making the connection

The plethora of little decisions while getting set up for financial services could lead to your clients to inaction.

Having too many options can also lead your clients to choose the easiest one or to decide to think it over, deferring the decision.

Research background

For perfectly rational people, having more choices is better because they are more likely to get exactly what they want.

But when real people have too many options, they struggle and are less likely to choose anything at all.

Researchers in California showed that consumers who were presented with only 6 jam flavors to sample were 10 times more likely to buy than consumers presented with 24 flavors.

Decision paralysis is related to ego depletion and default bias. One reason is that people’s brains get overwhelmed, so they just do what is easiest — not choose anything at all.

Another reason is that when people are presented with many choices, they feel that they are likely to make the “wrong” decision and regret any choice.

Using this finding

Don’t overwhelm your client with too many options and decisions. Present smaller choice sets and make a recommendation.
When faced with options, decision makers often stick to the status quo. They just keep doing what they’ve been doing.

The status quo bias has been observed in laboratory and field settings. Two field studies looked at Harvard University employees’ health care and retirement investment choices. Employees stayed with the same plan year after year, no matter how good or bad a fit their current plan was.

This bias often seems related to inattention or inertia.

Help clients look at their spending and savings with fresh eyes. They may have ongoing expenses or that no longer make sense but have become a habit.

Make it as easy as possible for them to choose a better alternative.

Avoid assuming that repeated choices are your clients’ best option or their preference.
Why don’t people remember important details of their decisions?

Limited Attention

People often miss important details because they can only process a limited amount of information at a time.

Making the connection

Your clients might not remember the details of important decisions because there is just too much information or too many other things going on.

For example, a client might forget about the day of the month their first loan payment is due because the due date is buried in twenty pages of paperwork, or because they were juggling an important task at work.

Research background

People are only able to concentrate on a limited number of things. This means that people are generally bad at multitasking. Similarly, people can receive an information overload, which makes it difficult to retain it.

In one study, participants were asked to watch a short film of people playing basketball and count the number of passes one team made. During this task, half the participants did not notice a gorilla walking through the court. Why? Participants were so preoccupied with the task at hand, that it affected their ability to perceive and remember significant details.

Using this finding

Help client stay attentive to the elements of discussion by breaking information into smaller segments.

Have clients make more important decisions first.

Use ‘rules of thumb’ to condense the information you provide. Focus on the essentials and give reminders.

Separate information into “Actions / Things you need to do” and “Information / Things you should know.”
What do people consider when making a decision?

Availability Bias

People tend to focus on what easily comes to mind, which usually are vivid or recent events.

Making the connection

Your clients' memories may keep them from making the decisions that are best for them. For example, your clients might have had a bad experience with a financial institution in the past. The memory of that will continue to affect their financial decisions and trust of other financial institutions.

On the other hand, a client may be think a financial product is more promising or important than it is, just because they’ve heard about it recently.

Research background

Rational people would make a decision using the information that’s most relevant to the question.

Most people tend to consider the information that’s most vivid to them. For example, people use the information that first comes to mind, such as recent or dramatic experiences.

Availability bias was demonstrated in a study where researchers asked married couples to estimate their personal contribution to household chores. The combined estimates from the couple generally added up to more than 100%. It’s much easier for people to remember when they last did the dishes than it is for them to remember instances when someone else did.

Using this finding

Ask your clients to talk about their experiences and share positive stories to balance any negative ones.

Do not assume that if a client wanted a savings account, he or she would ask for one or open one. Also sometimes just a suggestion of the best behavior will help people adopt it.
Now Versus Later
If people say they want to save for the future, why don’t they?

Hyperbolic Discounting

People put an unrealistically high value on the here and now and an unrealistically low value on the future.

Making the connection

Clients might spend money on what they want and need today, forgoing the benefits of saving for the future. If clients have money readily available, they will find it hard to set some aside for future needs.

Research background

People have an impulsive side that drives them to make decisions that satisfy them in the present. People also have a deliberative side that pushes them to account for long-term needs and goals. For better or worse, people are willing to doom their future selves to more-difficult-than-necessary circumstances.

For example, people were asked if they would prefer one dollar today or three dollars tomorrow, and most of them wanted the dollar today. But when they were asked whether they would prefer one dollar in a year or three dollars in a year and a day, most people chose to receive the three dollars.

When the delay is in the distant future, people do not demonstrate hyperbolic discounting. This suggests that the time frame for gains or losses will change what people want.

Using this finding

Work with your clients to set a plan in motion for saving before they feel the pain of parting with that money. For example, offer to set up an IDA account when your clients has just received their tax returns.

Encourage your clients to imagine detailed future projections of their savings behaviors to help them better empathize with their future self.

Ask your clients to commit to a savings or loan repayment plan with a delayed start.
Lack of Self-Control
This is the tension between doing what’s good for us in the long term and what feels good right now.

Making the connection
Clients are tempted to spend their money on things they want now instead of saving for the future or repaying debts.

Research background
Rational people would not behave in a way that’s inconsistent with their goals.

The reality is that, despite their best intentions, people sometimes give into temptations that get in the way of their goals. People procrastinate, break their diets, and make impulse purchases.

The good news is that getting people to pre-commit to a goal can help with self-control.

In one study, students were given the opportunity to create their own deadlines for coursework. The students could pre-commit to deadlines that spread out their workload or they could turn in all coursework at the end of the semester. The students who recognized they might procrastinate and leave all the coursework to the last day of class got higher grades.

Using this finding
Have your clients pre-commit to spending limits and savings goals.

Design interventions that get people to make the right decision at the exact moment they are making the decision.
The energy people use to make decisions is the same as the energy they use for self-control — and for many other things. That means that when people get tired or when they have made a long series of decisions, it is harder for them to delay their present desires to reach future goals.

Having more on your mind is linked to giving in to instinctive desires. In an experiment, people with greater cognitive load (e.g., a longer number to remember) made less self-controlled and less nutritious food choices.

Because of decision fatigue, judges in Israel give parole to some people at the start of the day, based on real decisions. After that, the possibility of granting parole gets lower as the judges make more decisions and gradually results to the default option — until the judges break for a snack.

A financial service provider can recommend a course of action, like splitting a direct deposit. But the clients make the final decisions about their finances. This adds up to a lot of information and decisions to process. Your clients might end up worn out and unable to make good decisions.

For example, at a new job, an employee could be overwhelmed by all the forms and decisions. As a result, the employee might not make the best decision and avoid signing up to split their direct deposit at all.

Stagger the decisions your clients must make to minimize their decision fatigue.

Present important choices first. Don’t require your clients to make an intensive series of important decisions.

Make good practices as automatic as possible, requiring as little mental effort as possible.

For decisions that require a lot of mental effort, make sure the client isn’t tired or hungry. We often make the best decisions earlier in the day and earlier in the week.
Why can’t people plan ahead enough to prevent the emergencies they encounter?

TUNNELING

If it’s an emergency, people can only think about the emergency.

Making the connection

Your clients might make decisions that are detrimental in the long run in order to address current, pressing issues.

For example, clients might decide to take out a high-interest loan to cover past due bills, without realizing that the interest rate puts them in more debt in the long run and more likely to be unable to pay next month’s bills.

Research background

When under a lot of stress, in a crisis, or up against a deadline, people focus all of their attention on the task at hand and may neglect or exclude everything else.

Tunneling is often associated with the scarcity mindset. When faced with a financial crisis, other responsibilities (such as taking medications, studying for school, job performance, or raising children) fall off the radar because cognitive resources are devoted to solving the crisis.

Research shows that tunneling can be useful. When against a project deadline, people become more productive because of the heightened focus. But it can also be counter-productive and undermine creative problem solving, like a skydiver who single-mindedly keeps pulling the tangled rip cord, rather than think critically and untangle it.

Using this finding

Do not require that clients take on additional responsibilities or additional actions when they are dealing with a crisis.

Make good decisions easy and automatic, so that if and when a crisis arises, the good decisions are already locked in.

If you can alleviate the crisis, you may also be able to get them to commit to an action that will prevent the same thing in the future. While they still remember their emotions, you could discuss a small-dollar emergency loan that requires a higher payment but starts building a savings account.
Why do people repeatedly set unrealistic goals and expectations?

**Planning Fallacy**

People tend to be too optimistic about their future plans, even when previous plans didn’t work out.

**Making the connection**

Your clients might set unlikely financial goals because people envision best-case scenarios and fail to envision roadblocks.

For example, a client may set a goal of depositing ¼ of their monthly earnings into a savings account, forgetting the need to build some slack into their budget for the unexpected expenses that inevitably arise.

**Research background**

People tend to make plans based on unrealistic, best-case scenarios, while not considering past experiences with similar plans.

For example, research shows that students complete their term theses much later than their specified plans.

Time and again, people believe everything will run smoothly, even when there is significant evidence that there will be hiccups in the process. People also fail to account for unexpected expenses when making budgets, even though they have incurred such expenses in previous months.

**Using this finding**

Help your clients set more obtainable financial goals by having them look at spending in previous months.

As part of the goal setting process, have clients think of everything that could go wrong and build a contingency plan.
THE WHAT-THE-HELL EFFECT

People tend to lose self control once they have deviated from their original plan a few times.

Making the connection

Once your clients have broken their own rules to a certain extent, or their plans change due to a setback, they are much more likely to abandon future attempts to stick to their plan.

Research background

Rational people would continue with their plan, even after making mistakes.

In reality, people lose self control and are more likely to succumb to temptation when they deviate from their standards.

For example, pretend you’ve promised yourself you won’t eat any chocolate for a month. After a few days, you succumb to temptation and eat one chocolate. The next day, you eat a couple pieces of chocolate. Soon, you are eating chocolate every day—and not even worrying about moderation. Rather than thinking of yourself as a dieter who makes mistakes, you no longer think of yourself as a dieter.

Using this finding

Keep client motivated by replacing inhibitional goals with acquisitional goals. For example, instead of having them say “I won’t spend $100 on extravagances,” have them say “I want to save $100 this month.”

Build in wiggle room. Instead of having clients prohibit themselves from spending any money on restaurant meals, have them limit it to twice a month.

Build in opportunities to reset that allow clients to recommit when they get off track.
Why do people say they want to do something but never seem to get around to it?

Research background

In an ideal world, everyone would follow through on their intentions. They would recognize the value of a product or service and, if the benefit was higher than any costs of completing the tasks, they would take action immediately.

However, in the real world, people are extremely present-biased and often put off impending tasks until the last possible moment, which can be counterproductive and have negative consequences.

In a study with University students at MIT, researchers found that evenly spaced deadlines helped students complete their homework assignments AND improved the quality of those assignments.

However, there is also evidence that deadlines are less effective for lengthy tasks, such as losing weight. This principle is related to self-control, tunneling, and hyperbolic discounting.

Procrastination

People generally do not manage their time well and constantly wait until the last possible moment to do anything.

Making the connection

Clients might fully intend to enroll in direct deposit or open up a savings account but may fail to take the steps until it is absolutely necessary or very convenient.

Using this finding

Create deadlines to get clients to focus on the task. Ideally, those deadlines are real and costly if missed.

Encourage clients to reserve time on their schedule to complete these tasks.
Psychology of Money
Why don’t people treat all dollars equally?

## Mental Accounting

People categorize and treat money differently depending on where it came from and where it is going.

### Making the connection

Your clients probably don’t treat all dollars equally. For example, they might spend their tax return dollars on something fun — something that they wouldn’t buy with everyday salary dollars — even though a tax return is just deferred salary. Similarly, a bonus or cash gifts are likely to be thought of (and spent) differently than earned salary.

### Research background

Rational people would make financial decisions based on how the decision affects their overall wealth.

The reality is that people organize their wealth into mental accounts, which adversely impacts their ability to assign utility values.

For instance, when research subjects were asked to imagine they lost a $10 theater ticket before entering the theater, only 46% said they would purchase another theater ticket. Alternatively, when research subjects were told that they arrived at the theater to buy the ticket and discovered they had lost a $10 bill, 88% responded that they would still buy a theater ticket.

### Using this finding

Ask your clients what they would do if they got the money a different way.

Leverage the fact that money is treated differently and get them to designate bonuses or tax returns as money to save.

Help your client create different mental accounts for spending and saving, and encourage them to set up actual accounts in the same way.
How do people choose what to buy and what not to?

Opportunity Cost Neglect

People tend to ignore what they give up when they make a choice.

Making the connection

Clients might fail to recognize what they’re giving up when they make decisions about spending. They focus instead on what they are getting now, not what they are giving up. This can lead to decisions about money that aren’t good in the long term.

Research background

In economics, all costs are opportunity costs. For the rational person, the cost of a new car today isn’t just the price paid. It’s also whatever enjoyment a person could have gotten from spending the money on something else or saving it for the future.

But people rarely consider opportunity costs. They generally rely on habits, defaults, social cues or marketing ploys when making purchasing decisions, rather than weighing the cost of coffee for a week against a night at the movies.

Studies consistently show that when explicitly presented with purchasing options, people do consider opportunity costs and generally spend less money. Even without specific options, people still generally spend less money just by changing the “do not buy” option to “keep money for other purchases.”

Researchers believe that opportunity cost neglect happens because people tend to make judgments and have preferences using only the information that is either right in front of them or in easy reach.

Using this finding

Have your client think about tradeoffs.

Instead of talking about the dollar cost of a potential purchase, talk about the tradeoff. E.g. “Putting an addition on the house this year will cost you three summer beach trips.”
Making the connection

Clients managing tight budgets have fewer cognitive resources available to make strategic decisions about their finances.

Research background

Poverty exaggerates anyone’s tendency to prioritize the present and to focus on the scarce resource (money) – to the detriment of strategic decision-making.

People who are preoccupied by money scarcity are more aware of the value of money, but at a cost: They narrow their cognitive bandwidth, which affects how they make their decisions.

For example, field research in India showed that farmers had significantly lower IQ scores in pre-harvest times when money was scarce than in post-harvest times when money was abundant.

In fact, even thinking about money trouble has an effect similar to losing a night of sleep.

Scarcity heightens limited attention and tunneling (see pages 10 & 16).

Using this finding

Align tough decisions (such as saving decisions) with times of abundance (such as when payday happens).

Make the decisions as easy and automatic as possible, thereby requiring fewer cognitive resources.
Making the connection

Your clients might be overly attached to facts and figures that aren’t accurate or relevant but are salient.

For example, they are likely to anchor on to the maximum pre-approval amount for a mortgage and end up purchasing a home that is a dangerous financial stretch.

Research background

The anchoring effect is one of the most common and enduring biases, and it’s even stronger when people already have other things on their mind.

In negotiating or haggling, completely rational people wouldn’t be influenced by a seller’s asking price. They would independently determine how much they are willing to pay for the item.

But real people make everything relative to an anchor number, which is often the first number suggested, and their counter offer varies based on how high or low that first number was.

Research shows that anchoring happens everywhere, not just in markets. For example, when guessing the height of the tallest redwood, people who were primed with a high number guessed much higher than people primed with a low number.

Using this finding

Eliminate the anchor.

If you want the client to save more, set the anchor higher. If you want to client to spend less or take on less debt, set the anchor lower.

Be very careful about providing estimates. Estimates could become more concrete to your clients than you intend.
**The Power of Free**

*A price of zero is psychologically much different — and much more attractive — than any other price, no matter how low.*

**Making the connection**

Your clients might stop using your financial services if you begin to charge for them, such as free checking or free tax-preparation, if they can get those services for free elsewhere.

Potential clients might also pay to use a bank or tax preparer, if they believe they are getting something else for free by using this particular provider.

---

**Research background**

Rational people would consider the risks and non-monetary costs that come with taking something. But in reality, most people demonstrate a very strong attraction to products that are offered for free.

In one experiment, people were asked to choose between a Lindt Chocolate and a Hershey’s Kiss. When both sweets cost money (but different prices), more people selected the Lindt Chocolate. But even with the same price difference, people selected the Hershey’s Kiss when it was free.

Understanding the power of free does not always lead to the same strategies for products. Businesses sometimes attempt to introduce new products by offering them free to consumers, then starting to require payment at a later time. This strategy is likely to backfire if people can get a similar product for free.

At the same time, in a field experiment, Kenyan women who received free bed nets were willing to buy bed nets in the future. In fact, they were more willing to purchase bed nets than women who had not received bed nets for free. In this case, the power of free led to initial uptake, an appreciation for bed nets, and a willingness to invest in them.

---

**Using this finding**

If your primary concern is that a product or service be taken and used, then you should try to make it free.

If a competitor offers a service or product for free, even if it is inferior, it will be difficult to get clients to pay for yours.

You can make a product more attractive by including a free gift.

You can motivate clients around a threshold if you offer something free if they pass the threshold. This only works if clients are close to attaining it.
Do people only care about what other people think of them?

**Research background**

Most people believe that attitudes, beliefs, and goals drive behavior. But sometimes it is the other way around. People observe their own behavior as a way to build their own identity and reinforce who they want to be.

Studies show that people will even go extreme lengths to create or preserve their self identity. In one study, students held their arm in ice water for an unbearably long time because they believed that higher tolerance correlated with having lower risk for a heart defect.

This is particularly powerful for people’s self-perception of being good and fair. Many studies show that people will even act against their own self-interest to preserve their self-image.

**Using this finding**

Use positive identity traits to motivate people to take action, such as: “Good parents open Child Savings Accounts" or “Adults who think about the future save part of their tax refund.”

**Self-Signaling**

People behave in ways that reinforce the type of person they believe themselves to be.

**Making the connection**

Clients who believe that they are good savers, and build that into their identity, will be more successful at saving when presented with the opportunity.
Why don’t people value and appreciate my services?

**Payment for Effort**

People place greater value on services and products where they can see the amount of effort put into providing them.

**Making the connection**

If clients do not see the backend work that is put into preparing taxes or providing financial services, they may not appreciate or value the service or the providers.

By demonstrating the effort and that the provider is doing, especially what the client cannot see, will increase the perceived value of the service, even if it is a free service.

**Research background**

A rational person would be willing to pay a certain amount based on service or product they received, regardless of what went into creating that service or product.

However, research shows that people are willing to pay more when they can see the effort that goes into offering that service. This is related to a sense of fairness and reciprocity.

Researchers presented students with two websites, one that just had them stare at a gradually filling progress bar before being presented flight options and the other that said “searching” and displayed an animation of the fares being added as they were “found.” The group with the “searching” site valued the site higher than the progress bar site. This is also called the labor illusion.

**Using this finding**

Tell clients about the backend work that is going on to provide the service.

Make your effort more visible to clients.

For tax preparation, let clients know how much time preparers spend in trainings, studying, and taking exams in order to prepare their taxes.

Tell clients, “This is a particularly tricky case, let’s try to work this out.”

Update clients on work that is going on and progressing, even if the client doesn’t need to do anything.
Why does it sometimes feel emotionally easy to spend money and other times really hard?

**Research background**

For a rational person, money is money and it should not matter when or how it is spent; all that matters is the amount. But for most people, the very timing and method of payment impacts how much we spend and how we feel about spending it.

Studies show that when people buy groceries with cash, they spend less money than if they are buying groceries with a credit or debit card.

Similarly, researchers have found that the more transparent a payment is, the more painful it is. And when payments are painful, consumers will try to avoid them (generally by buying less).

**PAIN OF PAYING**

Some purchases are more painful than others, and people will try to avoid those types of purchases (incremental, cash, separated as a fee, and frequent).

**Making the connection**

Clients will feel less pain paying fees or high interest rates if they are rolled into their normal payment, rather than charged individually.

Clients may also feel better about using services if they have already paid for them, rather than being charged for them later.

**Using this finding**

Make payments that you DON’T want clients to make as uncomfortable as possible: only accept cash payments, have it be a separate line on a bill, etc.

Make payments that you WANT clients to make as easy as possible: roll the fee into a regular payment, have a delayed charge, etc.
Motivations
In a world of rational people, a dollar would feel like a dollar, whether it was lost or gained. In fact, people hate to lose about twice as much as they like to gain.

This means that when there is something to be lost, people are more likely to take risks to prevent that loss; and when there are gains to be made, people tend to avoid risks. Therefore, people are easily motivated by the prospect of losing.

People also consider their current state to be the reference point for determining whether something is a gain or a loss. If a change could mean losing or giving up something they currently have (even if that something is a free coffee mug they were given minutes prior), people are far less willing to give it up. This is called the endowment effect.

Your clients might prioritize paying down loans rather than building savings, even if the loan has a lower interest rate than a return on a savings investment.

Similarly, your clients might want to pay down all debts before even starting to build emergency savings because debts can feel like losses.

Assume your clients are more sensitive to loss than they think.

Show the amount your clients stand not to have if they don’t build their savings, instead of showing them how much they will have if they do save.

Show savings goals as being in the red and deposits get them closer to being in the black.

With financial incentives, try to get your client to feel like they already have a reward, but they will lose it if they don’t act.
What happens when people think about what might have been?

**Regret and Counterfactuals**

People’s satisfaction depends both on outcomes and on ideas about what could have happened.

**Making the connection**

Your clients might be motivated to make tough financial decisions because of fear of missing out on something. When they think about the regret they’ll feel if they miss an opportunity, they act as if it were a loss to be avoided. Savings lotteries are good examples of such incentives.

**Research background**

Rational people would regret only bad final outcomes, but most people regret what could have been. Regret can compound the pain of loss and increase the motivation to avoid it.

One study looked at images of Olympic medal winners and found that bronze medal winners seem happier than silver medal winners. Why? The silver medal winners were comparing their situation to the most salient alternative outcome: winning the gold. But the bronze medal winners were considering how close they had come to not winning a medal at all.

Your clients don’t want to feel regret and be reminded that they made a bad decision or that they could have done better by repurchasing a rising stock — even when they stand to benefit from the repurchase.

Regret can be a powerful motivating force, especially when it is tied to concrete steps that were not taken.

**Using this finding**

Help clients imagine the regret they would feel if they had an emergency but didn’t have the savings to cover it.

If there are incentive associated with a positive behavior, make the regret of not getting those incentives more salient.
Making the connection

It is difficult for people to stay motivated if the goal is too far off into the future. People respond better to small rewards. These rewards can be designed to guide someone to achieve long-term goals.

Clients may be more motivated to make savings deposits if they can ‘level up’ to being a Super Saver and then a Gold Saver and then a Platinum Saver based on the consistency of deposits.

Research background

Think of a large box. When you’re up close, it looks very big. As you move farther away from the large box, it begins to look smaller. Long term goals may be harder to adhere and achieve because people have trouble staying motivated for something so far into the future.

Reward substitution is a way of breaking this long distance down into shorter distances and rewarding a person who stays on that path. In a person’s mind, these appealing short-term goals can replace the not-so-motivating real goal.

Using this finding

Help your clients by reframing their goals through short term incentives.

Create goals with levels and points accumulation for targeted behaviors.

Reward your clients for each positive step taken toward a larger goal, such as marking deposits with stickers or smiley faces.

Track and display progress toward goals in a visually pleasing and engaging way.

Be sure that any rewards or points given are directly related to an action that the client has full control over.
Why do people put in more effort as they reach their goal?

People tend to put in more effort at the very beginning and as they get closer to reaching their goal. This is true even if they simply feel closer to finishing, even though the number of steps have not changed.

In one study, researchers found that mice in a maze ran faster as soon as they spotted the cheese. Why? When the distance to achieving a goal shrinks in proportion to the original distance, people are more likely to want to complete it.

In another study, customers were given a punch card that specified that if they got 10 cups of coffee, they would get one for free. Researchers found that as customers got closer to the free cup, they bought coffee more frequently. They also found that if they told customers that they needed 12 punches but started them off with 2 free punches, they completed the punch card faster than those with the traditional 10-punch card.

Goal Gradient Theory

People will work harder to achieve a goal as the distance to reaching the goal shrinks.

Making the connection

People don’t work steadily towards a goal. The closer one is to reaching his or her goal, the more effort they’ll exert.

For example, as clients approach their savings goal, they may make larger or more frequent deposits.

Research background

Using this finding

Help you clients visualize how much closer they are to achieving their financial goals.

Instead of telling clients how much they’ve put into their savings plan in dollar amount, once they’re over 50%, tell the percentage of the total goal they’ve reached.
Rational people would make a decision based on information relevant to their circumstances. Many people, however, make decisions based on what the crowd is doing.

The power of the desire to conform was strongly demonstrated by Solomon Asch in the 1950s. The participants in the study did not know the other people in the room were confederates (non-participant actors that researchers have planted and prepared to act a certain way).

When the confederates started to incorrectly answer questions addressed to the room, the participant answered incorrectly — even when the confederate was unquestionably wrong. Many people question their own perceptions when everyone around them says something else.

Actions and advice of other people might lead your clients to make bad financial decisions, such as taking out a high-interest loan.

Show your client the ‘herd’ that is doing the desired behavior.

Ask your clients to reflect on why they are doing what they are doing and propose alternate options.
Making the connection

Clients who feel that you have helped them may be more likely to go out of their way to cooperate with you.

Clients who feel that they have been wronged may act against their best interests to retaliate against you, the financial institution, or other things associated with it. For example, they may choose not to pay back a loan.

Research background

If people were always rational actors, they would try to further their own agenda and always act in their own self interest.

However, research in social psychology shows that when a stranger does something nice for another person, the recipient is much nicer and much more cooperative than the rational actor theory would predict.

When someone receives a small favor, they feel obligated to return a larger favor, even when they don’t know the person or didn’t ask for the favor.

However, this can also work in the reverse, as retaliation. If someone feels slighted by another person, they will reciprocate the hostile actions in a more nasty and even brutal way.

Using this finding

Always be nice and trustworthy to clients!

Give tokens of appreciation or do favors for clients before asking them to do something in return.

Maintain a social relationship that makes use of reciprocity for the client’s own good.
How can people resist things that tempt them?

**Research background**

Classic economic theory predicts that if the costs outweigh the benefits of any action, the rational person will not undergo that action. However, the real world shows that people are constantly tempted and rarely have the self-control to withstand all of those temptation.

But research shows that people often understand that they will be tempted and unable to exert self-control. About 30% of people offered a commitment savings product in the Philippines opened the account and saved, on average, 81% more than clients not offered the commitment savings product.

In a study in the US, 78% of people offered the option to pre-commit to increasing their contributions to retirement savings when their income went up enrolled in the program. The participants average savings contributions increased by 10 percentage points over 3 years.

This principle is related to self-control and hyperbolic discounting.

**Using this finding**

Help people recognize their need for self-control mechanisms.

Create products with a commitment device (48-hour wait period for withdrawals, loan products that force savings).

When possible, have clients sign-up for a service/product BEFORE it begins and they feel tempted not to do it.

**Making the connection**

Clients might recognize that they will be tempted to make withdrawals from a savings account, so they may be open to signing up for an account with restrictions to keep them from succumbing to temptation.
Additional Resources

Intro Guides
• Behavioral Economics for Kids by Neil Bendle (available as a free eBook at neilbendle.com)
• EAST: Four Simple Ways to Apply Behavioral Insights by the Behavioural Insights Team (available for download at behaviouralinsights.co.uk)

Websites
• Center for Advanced Hindsight – www.advanced-hindsight.com
• Ideas42 – www.ideas42.org
• Innovations for Poverty Action – www.poverty-action.org
• Behavioural Design Lab – www.behaviouraldesignlab.org

Blogs
• Dan Ariely – danariely.com
• Ethics of Nudge – ethicsofnudge.com
• Nudge Blog – nudges.org
• CFED BE Blog – cfed.org/bog/tags/behavioral_economics

Books
• Predictably Irrational: The Hidden Forces That Shape Our Decisions by Dan Ariely
• The Upside of Irrationality: The Unexpected Benefits of Defying Logic at Work and at Home by Dan Ariely
• The Honest Truth about Dishonesty: How We Lie to Everyone – Especially Ourselves by Dan Ariely
• Scarcity: Why Having Too Little Means So Much by Sendhil Mullainathan and Eldar Shafir
• Thinking Fast and Thinking Slow by Daniel Kahneman
**Default Bias**


**Decision Paralysis**


**Status Quo Bias**


**Limited Attention**


**Availability Bias**


**Hyperbolic Discounting**


**Lack of Self-Control**

Ego-Depletion

Tunneling

Planning Fallacy

What-the-Hell Effect
Procrastination

Mental Accounting

Opportunity Cost Neglect

Scarcity

Anchoring
Power of Free


Self-Signaling

Payment for Effort

Pain of Payment


Loss Aversion


Regret and Counterfactuals


Reward Substitution


Goal Gradient Theory


Goal Gradient Theory Continued


Herding


Reciprocity

Pre-Commitment