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Financial Wellness Essay Collection

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Fighting Procrastination for Financial Wellness:
Harness the Power of Inertia

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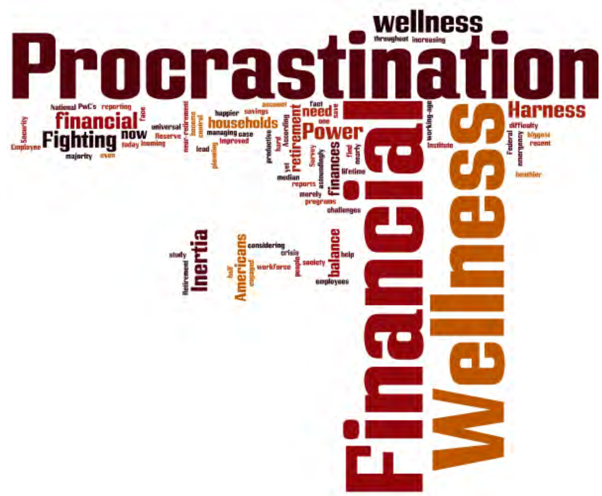
Figure 1 Procrastination: Sword of Damocles Hanging Over Financial Wellness



"The secret of getting ahead is getting started."

—Mark Twain

The need to save for financial wellness is universal, yet planning for it is hard. According to a 2016 PricewaterhouseCoopers survey,[1] 52% of employees report difficulty managing their personal finances. A majority of Americans today face a looming retirement crisis considering the fact that the median retirement account balance is only $2,500 for all working-age households and $14,500 for near-retirement households.[2] More astoundingly, a recent Federal Reserve study[3] reports that nearly half of Americans do not even have $400 in savings in case of an emergency.

Financial wellness has become one of the biggest challenges in our society. There is an increasing need for financial wellness programs to help more people find balance and control over their personal finances. Improved financial wellness will lead to a more engaged and productive workforce, and healthier and happier society.

Aside from economic and external factors that cannot be controlled, perhaps the biggest roadblock to financial wellness is procrastination. While traditional economic theory posits people are always rational, behavior finance shows the opposite. People often make irrational decisions due to various cognitive errors and behavior biases. When people procrastinate, they depart from economically rational decisions that are in their best interests. Throughout different age groups and cultures, procrastination has been identified as the major source of suboptimal retirement planning.[4] As the word cloud art shows in Figure 1,[5] procrastination is often like the sword of Damocles hanging over people's financial wellness.

People procrastinate for a variety of reasons and situations. Sometime we clearly know we're procrastinating but just cannot resist it; sometime we

1 PricewaterhouseCoopers, "Employee Financial Wellness Survey: 2016 Results," April 2016, *https://www.pwc.com/us/en/private-company-services/publications/assets/pwc-2016-employee-wellness-survey.pdf.*

2 Nari Rhee and Ilana Boivie, "The Continuing Retirement Savings Crisis," National Institute on Retirement Security research report, March 2015.

3 Board of Governors of the Federal Reserve System, "Report on the Economic Well-Being of U.S. Households in 2015," May 2016, *https://www.federalreserve.gov/2015-report-economic-well-being-us-households-201605.pdf.*

4 See, for example, Ted O'Donoghue and Matthew Rabin, "Procrastination in Preparing for Retirement," paper (1998), *http://www.wiwi.uni-bonn.de/kraehmer/Lehre/Beh_Econ/Papiere/ODonoghue-Rabin-retire.pdf;* Eunyoung Baek and Sharon A. DeVaney, "Assessing the Baby Boomers' Financial Wellness Using Financial Ratios and a Subjective Measure," *Family and Consumer Sciences Research Journal* 32, no. 4 (2004): 321–48, *doi:10.1177/1077727X04263826*; and Gary D. Brooks, "Exploring Themes of Procrastination in Retirement Planning Behaviors of Generation X" (doctoral dissertation, University of Phoenix, 2011).

5 This word cloud art is inspired by Kalian Shang, "Visualization of Social Network Data," Society of Actuaries, *Data Visualization: 2016 Call for Essays*, and is made by online tools Wordle (*http://www.wordle.net*).

Figure 2 Typical Causes of Procrastination and Strategies Against It

CAUSES

Initiation Difficulty
- Lack of financial literacy
- Fear of embarrassment
- Choice overload
- Hand-to-mouth middle class or richer
- Those wasted windfalls
- Small reckless purchases
- What you need vs. what you want
- Trade-off anxiety
- The psychology of the credit card

Lousy Implementation
- Default effect
- Overly relying on rule of thumb

Stagnant Maintenance Mode
- Status quo

STRATEGIES

Incentivizing Initiation
- Financial literacy education breaks the ice
- Financial counseling ease the embarrassment
- Limited choices make choosing easier
- Adjusting reference point can help you save
- Use mental accounting to your advantage
- Break big goals into achievable steps
- Small incentives can go a long way
- Make a precommitment to future
- Track your spending for goal attainment

Better Implementation
- Use default options cleverly
- Step forward from the rule

Dynamic Maintenance Mode
- Introduce automatic rebalancing and lifecycle funds
- Reward the good behavior

don't even realize we are doing it. In this essay, we will outline various behavioral and psychological factors of procrastination at different stages of the savings lifecycle. Furthermore, we will discuss strategies that could harness the power of inertia to achieve financial wellness. Figure 2 summarizes the typical causes of procrastination and strategies against it.

Typical Causes of Procrastination for Financial Wellness

Getting started or keeping going, there are many points to falter over on the road to financial wellness. Many cognitive and behavior biases are natural to human nature but could have significant negative impact on one's financial position.

INITIATION DIFFICULTY

The first step is often the hardest. If a good start is half the battle, a halted start is losing the battle. Some people already give up on their financial wellness plan simply because they never really get started.

- **Lack of financial literacy: "I don't really understand it."** According to analysis of a Financial Industry Regulatory Authority survey,[6] 63% of Americans are financially illiterate and lack the basic skills to reconcile their current budget and plan for the future. As a result, people often avoid discussing their personal finances due to lack of knowledge or lack of understanding.
- **Fear of embarrassment: "I feel so embarrassed talking about it."** Sometimes people already know they have financial problems but feel too embarrassed to admit it or to seek help. In addition, they may have no idea where to go if they do need help in figuring out how bad those problems are and how to fix them.
- **Choices overload: "I don't know which one to choose."** When faced with too many options, people may freeze and not make a decision. For instance, presenting too many investment fund choices can cause confusion and hence inaction.

6 Madeline Farber, "Nearly Two-Thirds of Americans Can't Pass a Basic Test of Financial Literacy," *Fortune*, July 12, 2016, *http://fortune.com/2016/07/12/financial-literacy/*.

- **Hand-to-mouth middle class or richer: "I have no extra money to save."** National Bureau of Economic Research analysis[7] shows that about a third of Americans households are living paycheck to paycheck; two-thirds of that group are middle class or richer—the "wealthy-hand-to-mouth." A quarter of that group earns over $100,000 annually. These people may believe they have no disposable money. This is more likely because of impulse spending than low income.

- **Those wasted windfalls: "A gift card is not for saving."** Mental accounting underlies people's tendency to value some dollars less than others and thus to waste them. Study has long shown that when people get financial windfalls such as a bonus, tax refund or gift card, they are more likely to spend it than to save it.[8]

- **Small reckless purchases: "It is just a Starbucks' latte."** Many people don't consider themselves reckless spenders and are cost-conscious on large financial decisions such as a house or car. However, mental accounting discipline is relaxed when making small purchases, such as a daily Starbucks' latte.

- **What you need vs. what you want: "But I really want it."** People often spend impulsively on things they want but don't really need out of immediate emotions. When we're in a good mood, we would spend out of pleasure. When we're in a bad mood, we would spend to make us feel better.

- **Trade-off anxiety: "Live in the present, at the cost of tomorrow."** Saving for retirement involves a trade-off between now and the future. Dollars assigned to future mental accounts are often devalued, which leads us to pursue small but immediate gains and hence spend more easily and more foolishly in the present.

- **The psychology of the credit card: "Just put it on the card."** People tend to spend more when they use credit cards than when they use cash because credit card spending desensitizes people from the pain of spending.[9] Moreover, many people have savings in their bank accounts and at the same time revolving balances on their high interest credit cards.

LOUSY IMPLEMENTATION

Procrastination is still here even when you get started. A financial wellness plan is often like a new year's resolution. Many people make it; less people achieve it. We already recognize that we need to make some change in life. Procrastination is the thief of that change in our life.

- **Default effect: "I will stick to the default."** When procrastinators do make decisions, they often simply pick the default choices. For example, many employer-sponsored saving plans require active elections on the part of employees. Consequently, many employees will not be enrolled by default.[10] In addition, study also finds that the majority of employees participating in a 401(k) plan tended to stick to the default contribution rate of 3% or less.[11]

- **Overly relying on a rule of thumb: "According to the rule."** Many procrastinators can't or won't make time to examine their own financial needs and choose to take the easy way out by overly relying on some rule of thumb for making financial decisions. While rules of thumb are useful as general

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7 Greg Kaplan, Giovanni Violante, and Justin Weidner, "The Wealthy Hand-to-Mouth," National Bureau of Economic Research working paper, no. w20073 (April 2014).

8 See, for example, Hal R. Arkes, Cynthia A. Joyner, Mark V. Pezzo, Jane Gradwohl Nash, Karen Siegel-Jacobs, and Eric Stone, "The Psychology of Windfall Gains," *Organizational Behavior and Human Decision Processes* 59, no. 3 (1994): 331–47, *doi:10.1006/obhd.1994.1063*.

9 Drazen Prelec and Duncan Simester, "Always Leave Home Without It: A Further Investigation of the Credit-Card Effect on Willingness to Pay," *Marketing Letters* 12, no. 1 (2001): 5–12.

10 John Beshears, James J. Choi, David Laibson, and Brigitte C. Madrian, "The Importance of Default Options for Retirement Saving Outcomes: Evidence from the United States," in *Social Security Policy in a Changing Environment,* eds. Jeffrey Brown, Jeffrey Liebman, and David A. Wise (Chicago: University of Chicago Press, 2009), 167–95.

11 James J. Choi, David Laibson, Brigitte C. Madrian, and Andrew Metrick, "For Better or For Worse: Default Effects and 401(k) Savings Behavior," in *Perspectives on the Economics of Aging,* ed. David A. Wise (Chicago: University of Chicago Press, 2004), 81–126.

guidelines, they often oversimplify complex issues in ways that can fail individuals' long-term financial prospects.

STAGNANT MAINTENANCE MODE

Procrastination persists years after you get started. Many people prefer sticking with a financial wellness decision made a long time ago and fall into the trap of status quo bias by doing nothing. In the face of dynamic changes in our life and in the market, making no decision could actually be a bad decision.

- **Status quo: "I will just keep it that way."** Once the financial decision is made, many procrastinators do nothing and just leave it unchanged. For example, an early study shows that more than half of TIAA-CREF plan participants had never changed their initial chosen asset allocation over their lifetimes.[12]

Harness the Power of Inertia for Incentivizing Savings

Employers and advisers can adapt their programs to ease people into better financial wellness. We underscore some strategies and tools to equip people to effectively initiate and manage their financial wellness plans.

INCENTIVIZING INITIATION

A journey of a thousand miles begins with a single step. Employers and advisers can incentivize and promote positive behaviors that help one make the first step toward a successful financial wellness plan.

- **Financial literacy education breaks the ice.** Financial wellness programs can offer basic financial literacy workshops with interactions, humor and games. For instance, a Monopoly-based game can walk people through different life stages such as buying a house or having a child and encourage participants to engage in "savings missions." Evidence shows that most workshop participants will take positive actions to improve their financial well-being.[13]

- **Financial counseling eases the embarrassment.** Money issues can be overwhelming and confusing. Many employers offer financial counseling services as part of financial wellness program. Talking to a knowledgeable and trustable professional can help ease the embarrassment and get people help with their personal finances.

- **Limited choices make choosing easier.** The more funds offered, the less the participation rate. Consolidated options and personalized recommendations could solve the problem of choice overload.[14]

- **Adjusting your reference point can help you save.** A hand-to-mouth person may find it too difficult to save because of current financial needs. By adjusting expectations to a lower reference point such as hypothetically imagining a salary cut or tax increase, an individual may realize he or she can actually adapt to a smaller paycheck and save for retirement.

- **Use mental accounting to your advantage.** By funneling money into a pension fund or savings account directly from your paycheck, people usually mentally count it as savings and thus less are likely to spend it. Similarly, by allocating debt payments such as a mortgage, student loan or credit card balance through direct deposit, people will mentally subtract the money from income and therefore are more likely to pay down their debts.

- **Break big goals into achievable steps.** Small steps are the secret to big success. Just a few dollars a day can add up to significant savings over time. It helps people recognize that saving may not be as daunting as it seems. For example, a person may easily save the cost of a Starbucks' latte—$5

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12 William Samuelson and Richard Zeckhauser, "Status Quo Bias in Decision Making," *Journal of Risk and Uncertainty* 1, no. 1 (1988): 7–59, *doi:10.1007/BF00055564*.

13 Lewis Mandell and Linda Schmid Klein, "The Impact of Financial Literacy Education on Subsequent Financial Behavior," *Journal of Financial Counseling and Planning* 20, no. 1 (2009).

14 Sheena Sethi-Iyengar, Gur Huberman, and Wei Jiang, "How Much Choice is Too Much? Contributions to 401(k) Retirement Plans," in *Pension Design and Structure: New Lessons From Behavioral Finance*, eds. Olivia S. Mitchell and Stephen P. Utkus (Oxford: Oxford University Press, 2004), 83–95.

per day—and put away $1,825 a year, or $73,000 in 40 years, even without taking the interest rate into consideration.

- **Small immediate incentives can go a long way.** A small immediate incentive can encourage people to reach large long-term savings goals. For instance, employers can offer a $100 wellness incentive to employees who complete a financial fitness check with a retirement vendor.
- **Make a precommitment to the future.** The budget indicates the priority. People can employ precommitment strategies to help them accomplish their long-term goals. For instance, retirement accounts are such precommitment devices as they discourage impulsive behavior through penalties on early withdrawal.
- **Track your spending for goal attainment.** When people track their expenditures, they are often shocked to discover how much money is overspent or gets used for things they really don't need. Most people have a strong tendency to avoid losses, and tracking spending can help people stop unnecessary purchases and head in the right direction regarding their financial goals.

BETTER IMPLEMENTATION

For people interested in improving their financial wellness, there is always room for further improvement through better implementation. Financial wellness programs sponsored by employers and advisers can help people get access to financial education and guidance to more effective management of their personal finances.

- **Use of default options cleverly.** Empirical evidence shows that default options—such as employees are entered into an automatic savings plan by default and must take action to opt out—have tremendous impact on savings and participation rates. While less than 10% of individuals eligible for IRAs participate in a self-initiated plan, employer-sponsored retirement plans such as a 401(k) with automatic enrollment boast participation rates in excess of 90%.[15]
- **Step forward from the rule.** We can use the rule of thumb as the starting point but must adjust it based on an individual's situation. For instance, one can use the commonly cited "100 minus your age" rule to understand the basic principle of gradually reducing risk over time but select lifecycle funds to professionally determine proper investment mixes tailored to meet investment objectives based on various time horizons.

DYNAMIC MAINTENANCE MODE

Just like driving a car, you have to make adjustments along the way. A successful financial wellness program should be interactive and dynamic, such as rewarding people for making wise decisions and navigating them through different life stages for their financial wellness plans.

- **Introduce automatic rebalancing and lifecycle funds.** This strategy exploits an individual's tendency to stick with the status quo, at the same time dynamically adjusting their portfolios to meet investment objectives. For instance, retirement management firms can suggest or make it as default that retirement portfolios are automatically rebalanced on participants' birthdays. People can also select lifecycle funds that are automatically adjusted and balanced during the course of the fund's time horizon as the investor ages toward retirement.
- **Reward the good behavior.** We all like a treat for our good behaviors. Small rewards for good saving behaviors help reduce the stress and negative emotions associated with following a planned budget.

Summary

Financial wellness has increasingly become a key component of individuals' overall healthiness, happiness and productivity, yet many Americans are considerably less prepared for their personal finances due to procrastination. In this essay, we

15 J. Mark Iwry and John A. Turner, "Automatic Annuitization: New Behavioral Strategies for Expanding Lifetime Income in 401(k)s," The Retirement Security Project, no. 2009-2 (July 2009), *https://www.brookings.edu/wp-content/uploads/2016/06/07_annuitization_iwry.pdf.*

discussed various causes and negative implications of procrastination, and also different strategies to harness the power of inertia to aid individuals in their pursuit of future financial well-being. It is our hope that this work will serve to further increase public awareness about how procrastination may limit the degree of financial wellness and provide insights to help people make positive changes around financial wellness.

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