Behavioral Economics and Motivation

Motivating Clients to Success in IDAs and Beyond

This session will focus on providing you with both information about this topic as well as new ideas and activities for making this topic engaging.

Specifically, as a result of this session, you will be able to:

- Define behavioral economics.
- Explain the relationship of behavioral economics in the context of financial education and getting people to save.
- Explain the relationship of behavioral economics to motivation.
- Differentiate internal versus external motivation.
- Differentiate positive versus negative motivation.
- Explain factors that influence internal and external motivation.

Is “motivation” an important topic to address in financial education for AFI Participants?
YES NO

What are some reasons for or against including this topic your financial education program?

What other ideas do you have for providing this information to participants in a way that is effective and engaging?

Motivation

Trainings for staff of IDA programs frequently include discussions of attrition among account holders and the methodologies that staff can enact to ensure that enough people are enrolled and precious grant dollars are utilized. But what if there was a conversation about ensuring the success of each and every IDA participant who initially enrolls?

This section begins with a review of theories that observe consumers in the marketplace and continues with the factors that affect individual client motivation. It concludes with opportunities for staff of IDA programs to identify the forces that motivate their individual clients and develop tactics to incorporate them into effective program design.

The Theory of Behavioral Economics

Behavioral Economics is a theory of economics that attempts to explain consumers' decisions as those of rational actors looking out for their self-interest given the sometimes inefficient nature of the financial market. One of behavioral economics' primary observations is that people make decisions on imprecise impressions and beliefs rather than rational analysis.

A second observation states that the way a question or problem is framed to a consumer will influence the decision he/she ultimately makes. These two observations largely explain financial market inefficiencies; that is, behavioral economics holds that markets are sometimes inefficient because people are not mathematical equations.[17]

Behavioral Economics and "Pre-Commitments"

In 1979, psychologists Daniel Kahneman, LL.D. '04, of Princeton and Amos Tversky of Stanford argued that the ways in which alternatives are framed—not simply their relative value—heavily influence the decisions people make. This was a seminal paper in behavioral economics.

Behavioral economist David Laibson states, "There's a fundamental tension, in humans and other animals, between seizing available rewards in the present, and being patient for rewards in the future…People very robustly want instant gratification right now, and want to be patient in the future. If you ask people, 'Which do you want right now, fruit or chocolate?' they say, 'Chocolate!' But if you ask, 'Which one a week from now?' they will say, 'Fruit.' Now we want chocolate, cigarettes, and a trashy movie. In the future, we want to eat fruit, to quit smoking, and to watch Bergman films."

Pre-commitments of this sort are one way of getting around not only the lure of temptation, but our tendency to procrastinate on matters that have an immediate cost but a future payoff, like dieting, exercise, and cleaning your office. Take 401(k) retirement plans, which not only let

[17] (2010). Retrieved May 14, 2010, from The Free Dictionary: http://financial-dictionary.thefreedictionary.com/Behavioral+Economics

workers save and invest for retirement on a tax-deferred basis, but in many cases amount to a bonanza of free money...That's because many firms will match employees' contributions to such plans, so one dollar becomes two dollars. "It's a lot of free money," says Laibson, who has published many papers on 401(k)s and may be the world's foremost authority on enrollment in such plans. "Someone making $50,000 a year who has a company that matches up to 6 percent of his contributions could receive an additional $3,000 per year."

The rational model of economics unequivocally predicts that people will certainly snap up such an opportunity. But they don't—not even workers aged 591/2 or older, who can withdraw sums from their 401(k) plans without penalty. (Younger people are even more unlikely to contribute, but they face a penalty for early withdrawal.) "It turns out that about half of U.S. workers in this [above 59 1/2] age group, who have this good deal available, are not contributing," says Laibson. "There's no downside and a huge upside. Still, individuals are procrastinating—they plan to enroll soon, year after year, but don't do it." In a typical American firm, it takes a new employee a median time of two to three years to enroll. But because Americans change jobs frequently—say, every five years—that delay could mean losing half of one's career opportunity for these retirement savings.

Laibson has run educational interventions with employees at companies, walking them through the calculations, showing them what they are doing wrong. "Almost all of them still don't invest," Laibson says. "People find these kinds of financial transactions unpleasant and confusing, and they are happier with the idea of doing it tomorrow."

It's not that [consumers] are utterly helpless against procrastination. Laibson worked with a firm that forced its employees to make active decisions about 401(k) plans, insisting on a yes or no answer within 30 days. This is far different from giving people a toll-free phone number to call whenever they decide to enroll. During the 30-dayperiod, the company also sent frequent e-mail reminders, pressuring the staff to make their decisions. Under the active-decision plan, enrollment jumped from 40 to 70 percent. "People want to be prudent, they just don't want to do it right now," Laibson says. "You've got to compel action. Or enroll people automatically."

When he was U.S. Treasury Secretary, Lawrence Summers applied this insight. "We pushed very hard for hard for companies to choose opt-out [automatic enrollment] 401(k)s rather than opt-in [self-enrollment] 401(k)s," he says. "In classical economics, it doesn't matter. But large amounts of empirical evidence show that defaults do matter, that people are inertial, and whatever the baseline settings are, they tend to persist."

"We tend to think people are driven by purposeful choices," explains Sendhil Mullainathan, who received a MacArthur Fellowship in 2002. "We think big things drive big behaviors: if people don't go to school, we think they don't like school. Instead, most behaviors are driven by the moment. They aren't purposeful, thought-out choices. That's an illusion we have about others. We can talk abstractions of risk and return, but when the person is physically checking off the box on that investment form, all the things going on at that moment will disproportionately influence the decision they make. That's the temptation element—in real time, the moment can be very tempting. The main thing is to define what is in your mind at the moment of choice."[18]

"Save More Tomorrow"

Another approach to increase saving is to give people the opportunity to control their desires for instant gratification. One intriguing possibility is the "Save More Tomorrow" program proposed by economist Richard Thaler. The essence of this program is that people commit in advance to putting a portion of their future salary increases into a retirement savings account. When a worker signs up, he or she makes no sacrifice of lower consumption today but, instead, commits to reducing consumption growth in the future.

When this plan was implemented in several firms, it had a large impact. A high proportion (78 percent) of those offered the plan joined. In addition, of those enrolled, the vast majority (80 percent) stayed with the program through at least the fourth annual pay raise. The average saving rates for those in the program increased from 3.5 percent to 13.6 percent over the course of 40 months.[19]

We see from this research is that consumers are willing to make good decisions for themselves when it pertains to future behavior, but are less willing to apply those choices to decisions made today. Research in the IDA field has revealed that options such as direct deposit lead to higher savings rates since the client is making the decision today to commit to saving in the future.

There is No One-Size-Fits-All When Preparing to Save for the Future

In Annamaria Lusardi, Punam Anand Keller, and Adam Keller's report to the National Endowment for Financial Education, they found in focus groups and interviews that many employees stated that the process of beginning and participating in a retirement plan such as a typical 401(k) plan can be very overwhelming. The initial process often is perceived as confusing, long and tedious. Many individuals do not feel comfortable making financial decisions like how to manage their money within a 401(k).

Barbara Roper, director of investor protection at the Consumer Federation of America said that the majority of people have difficulty with this task. She explained that, in general, people want to be told how to manage their money since they do not feel prepared to make these important decisions nor do they read prospectuses or other investor materials. Roper also stated that many people do not understand how small their savings for retirement actually are.

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[18] Lambert, C. (2006, March-April). The Marketplace of Perceptions. *Harvard Magazine* , pp. 50-57, 93-95.

[19] Mankiw, G. (2006, June 28). *Behavioral Economics*. Retrieved May 19, 2010, from Greg Mankiw's Blog: Random Observations for Students of Economics: http://gregmankiw.blogspot.com

In fact, according to one survey released by the Consumer Federation of America (CFA) and Financial Planning Association (FPA), 21% of Americans think that winning the lottery is the most practical way to accumulate several hundred thousands of dollars (rather than saving it). Younger employees are less likely to save for retirement than older employees. In one study, only 26% of those 30 years old or younger participated in their Supplementary Retirement Account versus 58% of those who were 60 years and had at least ten years on the job. One reason is that many younger workers feel like retirement is very far away and put off saving for retirement in order to pay for current expenses. Hewitt Associates reported that most people put priority on saving for a house, saving for their children's education or paying for their children's needs rather than retirement.

In their study, Lusardi and her colleagues presented recommendations for tactics in motivating individuals to save for retirement vary by age group. For the would-be retirees – the older age group – recommendations include:

- Hosting seminars on asset allocation and asset management where they could see if their money is in the right place
- Providing personalized financial advisors who can strategize with them individually and work hand-in-hand with them till their retirement

For the younger age group recommendations include:

- Using the existing network of peer groups to communicate the virtues of saving in order to make it top priority – training small groups of the target segment and using them to further train others
- Having financially knowledgeable people in this age group display the benefits of long-term planning and tools used for it [20]

What we learn from this study is that the unique circumstances of younger versus older workers affects how they view saving for the future, with the older workers feeling confused while the younger workers feeling as if this topic did not apply to them. The researchers found that different tactics were effective with the different age groups.
In an IDA program that serves clients who differ in terms of age, race, level of educational attainment, family makeup, etc. – as many programs do – providing a menu of financial education services may result in higher levels of attainment among individual account holders.

[20] Lusardi, A., Keller, P. A., & Keller, A. (2009). *Increasing the Effectiveness of Retirement Saving Programs for Females and Low Income Employees: A Marketing Approach.* Denver: National Endowment for Financial Education.

The Theory of Motivation

In general, motivation refers to the start, the direction, the intensity and the persistence of behavior. Motivation means having the passion and the will to undertake some action. Motivation may be internal (intrinsic) or external (extrinsic):

> **Internal motivation** is seen when a person undertakes an activity for its
> own sake without any sort of external reward, such as a hobby. Internal -
> motivation can result from feelings (e.g., happiness, anger, and -
> sadness), thoughts (e.g., "I better finish the report before the deadline -
> tonight."), values and goals. -
>
> **External motivation** is evident when someone behaves in a particular -
> way for reasons external to the person, such as money or coercion. -
> External motivation may come from parents, a boss, coworkers, friends, -
> and siblings. It is most frequently thought of in terms of salary (i.e., -
> money), promotions, grades, praise and punishment. -

A second dimension of motivation has to do with the underlying intention of the motivation. It occurs on a spectrum ranging from negative to positive:

> **Positive motivation** is seen when people engage in an activity that has -
> a virtuous end, such as volunteering, athletics, or art. -
>
> **Negative motivation** is evident when individuals act in a manner that is unethical or has a destructive end, such as judging others, physical altercations or vandalism. Negative motivation also occurs when individuals use destructive emotions, such as guilt and shame, to coerce others into acting.

Positive internal motivation begins with a sense of purpose, knowing why one is doing what he or she is doing. Having a clear idea of one's personal core values helps immensely in answering the question "Why am I doing this?" The advantage of knowing one's values is that the person will experience clarity and focus with which to make wise choices and take decisive action. The main reason for becoming aware of one's top values is to improve performance in the areas that are most meaningful to that person. [21]

Schinnerer's explanation of motivation provides the rationale behind why many financial literacy curriculums include an early section on values and how they relate to clients' views on money. Fostering and identifying positive internal motivation among clients can help them to achieve their personal goals, in their lives as a whole as well as within the IDA program.

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[21] Schinnerer, J. L. (2007). *The Power of Postive Internal Motivation.* Retrieved May 20, 2010, from Psych Central: http://psychcentral.com

Internal versus External and Negative versus Positive Motivations[22]

	Negative	Positive
Internal (Intrinsic) Motivation	One's own feelings of guilt, shame, embarrassment, or fear Perfectionism Destructive anger Debilitating stress Need for power Need to please others Worry Low self-esteem	Acting in accordance with personal values Satisfaction Sensory pleasure Sense of competence Enjoyment Praise from self Self-respect Fulfillment of aspirations/dreams Sense of achievement Highly engaged in activity Constructive anger or stress Job satisfaction Goal setting Pursuing one's natural tendency towards self-development Need for affiliation with others Perception that what one is doing is morally significant
External (Extrinsic) Motivation	Yelling at a person Shaming a person Threatening a person's job security or social status Punishment Withdrawal of love or friendship Aggressive show of strength from another, coercion Expectations of others	Money (only lasts a short period) Rewards Public recognition Empowerment from others Promotion Praise from others Respect from others Pleasant work environment Challenging work

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[22] Schinnerer, J. L. (2007). *The Power of Postive Internal Motivation.* Retrieved May 20, 2010, from Psych Central: http://psychcentral.com

		Some autonomy and input into decisions Appropriate responsibility Fringe benefits Friendships at work

Table Talk – Factors that Affect Motivation
With the other participants at your table, discuss the unique reasons why clients in your IDA program may not achieve certain benchmarks. Consider internal as well as external impediments to motivation.

Negative Internal Motivation	Negative External Motivation

Small Group Work – Turning Negative Motivation into Positive Motivation

Working with your table, use the factors impeding motivation from the previous activity to come up with tactics that can be used to enhance motivation among your participants. Be sure to consider both individual as well as group approaches. Be prepared to present your findings to the larger group.

Negative Internal Motivation		Positive Internal Motivation
______________________	→	______________________
______________________	→	______________________
______________________	→	______________________
______________________	→	______________________
______________________	→	______________________

Negative External Motivation		Positive External Motivation
______________________	→	______________________
______________________	→	______________________
______________________	→	______________________
______________________	→	______________________

Small Group Work – Doing More with Less

It is well understood that many human service ventures (including IDA programs) do not have the abundant financial resources needed to do all that they are mandated to accomplish. Staff at programs like these must be creative with their limited resources in order to produce their desired outcomes.

With the participants at your table and using the information that you gleaned from the previous two exercises, think about specific ways that you can creatively provide services that will enhance the motivation of your IDA participants. Remember that different approaches are needed to address differing impediments to motivation. You are encouraged to think outside the box!

Achieving the Vision Questions for Reflection and Action

How does this section of information on *behavioral economics and motivation* help you build next level financial education for your clients? Specifically, how does it help you help them to potentially:

- **Achieve or retain economic security**

Building the Bridge

In the first financial education training of trainers, you learned about building the bridge for clients with financial education. How does this section of information help you build a **financial education bridge** for your clients? Specifically, how does it help you:

- **Choose topics**
- **Develop an approach**
- **Provide support**
- **Create an environment that helps clients succeed**