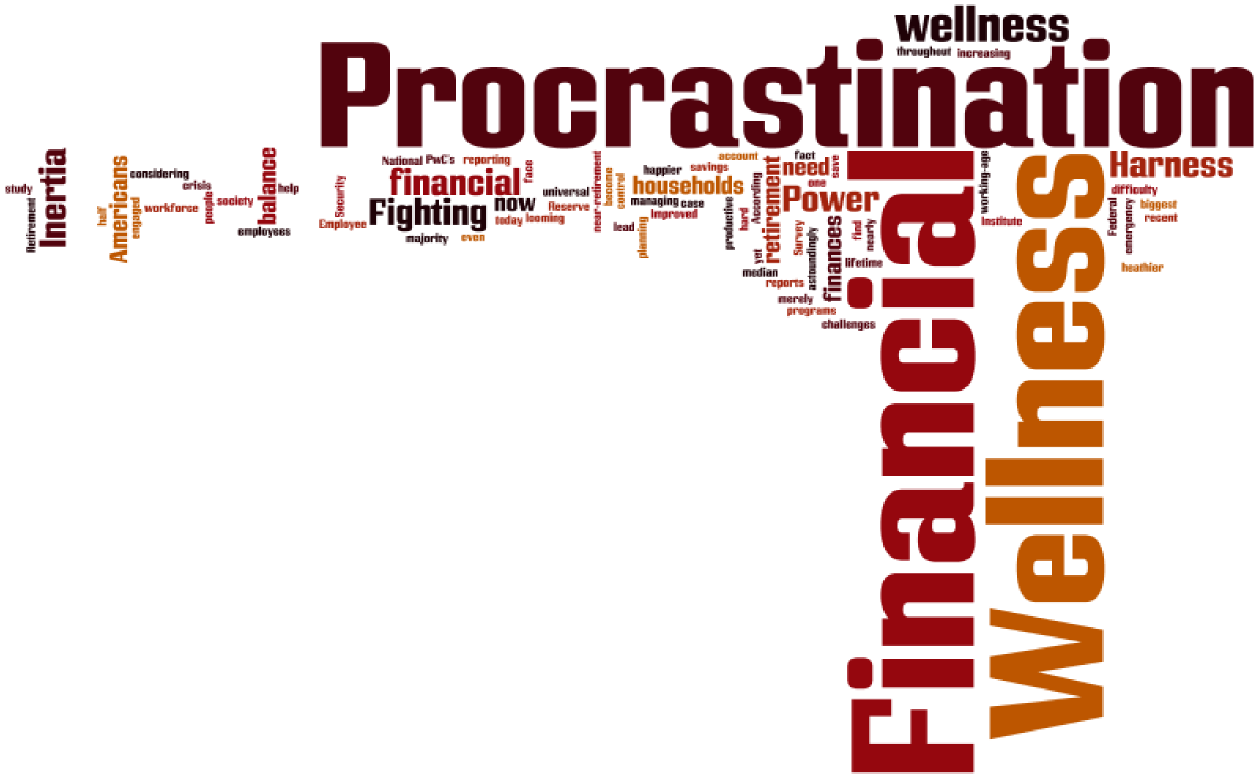

Fighting Procrastination for Financial Wellness

– Harness the Power of Inertia

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The Secret of Getting Ahead Is Getting Started. - Mark Twain

Introduction

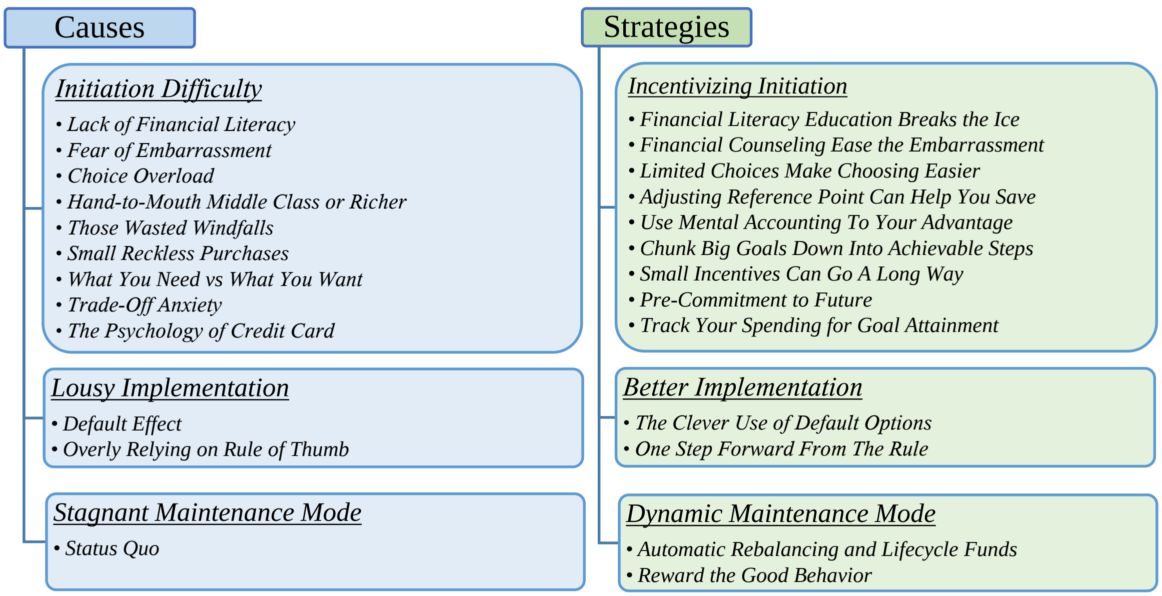
The need to save for financial wellness is universal, yet planning for it is hard. According to PwC's 2016 Employee Financial Wellness Survey, 52% of employees reporting difficulty managing their personal finances. A majority of Americans today face a looming retirement crisis considering the fact that the median retirement account balance is only $2,500 for all working-age households and $14,500 for near-retirement households (National Institute on Retirement Security 2015). More astoundingly, a recent Federal Reserve study (Dodini 2016) 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 now. There are increasing need of 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 heathier and happier society.

Aside from economic and external factors that cannot be controlled, perhaps the biggest internal roadblock that hinder many people down the road to financial wellness is procrastination. While traditional economic theory posits that people are always rational, behavior finance shows the opposite. People often consistently make irrational decisions due to various cognitive errors and behavior biases. When people procrastinate, they departure from economically rational decisions that are in their best interests. Prevailing throughout different age groups and cultures, procrastination has been identified as the major source of suboptimal retirement planning (c.f. O'Donoghue and Rabin 1998; Baek and DeVaney 2004; Brooks 2011).

People procrastinate for a variety of reasons and situations. Sometime we clearly know that we're procrastinating but just cannot resist it; sometime we don't even realize that we are doing it. In this essay, we will outline various behavioral and psychological factors of procrastination at different stages of savings lifecycle. Furthermore, we will discuss different strategies that could harness the power of inertia in order to achieve financial wellness. Figure 1 summarizes the typical causes of procrastination and strategies against it.

Figure 1. Typical Causes of Procrastination and Strategies Against it



Typical Causes of Procrastination for Financial Wellness

- ***Initiation Difficulty: The First Step Is Often The Hardest.***
  - *"I don't really understand it."* (Lack of Financial Literacy). According to the Financial Industry Regulatory Authority, 63% of Americans are financially illiterate and lack of 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.
  - *"I feel so embarrassed talking about it."* (Fear of Embarrassment). 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.
  - *"I don't know which one to choose."* (Choices Overload). 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.
  - *"I have no extra money to save."* (Hand-to-Mouth Middle Class or Richer). National Bureau of Economic Research (Kaplan et al. 2014) shows that about a third of Americans

households are living paycheck to paycheck, including about two-thirds middle class or richer as the "wealthy-hand-to-mouth", and about 25% of those making over $100,000. These people may feel that they have no disposable money, but more likely because of impulse spending instead of low income.

- *"Gift card is not for saving."* (Those Wasted Windfalls). Mental accounting underlies people's tendency to value some dollars less than the others and thus to waste them. Study has long shown that when people get some financial windfalls such as bonus, tax refund or gift card, they are more likely to spend it than to save it (e.g. Arkes et al. 1994).
- *"It is just a cup of Starbucks Latte, per day."* (Small Reckless Purchases Add Up). Many people don't consider themselves as reckless spenders and are cost-conscious on large financial decisions such as house or car. However, mental accounting relaxes their disciplines when making small purchases, such as a Starbucks latte a day.
- *"But I really want it."* (What You Need *vs* What You Want). 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.
- *"Live in the present, at the cost of tomorrow."* (Trade-Off Anxiety). Saving for retirement involves a trade-off between now and future. Dollars assigned to the future mental accounts are often devalued, which leads us to pursuit small but immediate gains and hence spend more easily and more foolishly at present.
- *"Just put it on the card."* (The Psychology of Credit 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 (Prelec and Simester 2001). 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.***

- *"I will stick to the default."* (Default Effect). 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 (Beshears et al. 2009). In addition, study also finds that majority of employees participating in a 401(k) plan tended to stick to the default contribution rate of 3% or less (Choi et al. 2004).

- *"According to the rule."* (Overly Relying on Rule of Thumb). 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 thumbs are useful as general 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.***
  - *"I will just keep it that way."* (Status Quo). Once the financial decision is made, many procrastinators tend to 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 (Samuelson and Zeckhauser 1988).

Harness the Power of Inertia for Incentivizing Savings

- ***Incentivizing Initiation: A Journey Of A Thousand Miles Begins With A Single Step.***
  - *Financial Literacy Education Breaks The Ice.* Financial wellness program can offer basic financial literacy workshops with interactions, humors 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 wellbeing (Mandell and Klein 2009).
  - *Financial Counseling Ease 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 (Sethi-Iyengar et al. 2004).
  - *Adjusting 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 that 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 account it as savings and thus less likely to spend it. Similarly, by allocating debt payment such as mortgage, student loan or credit card balance through direct deposit, people will mentally subtract the money from income and therefore more likely be able to pay down their debts.
- *Chunk Big Goals Down Into Achievable Steps*. Small step is 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 cup of Starbucks Latte for $5 per day, and achieve an annual saving of $1,825 a year, or $73,000 in 40 years even without taking 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.
- *Pre-Commitment to Future*. Budget indicates the priority. People can employ pre-commitment strategies to help them to accomplish their long-term goals. For instance, retirement accounts is such pre-commitment devices as they discourage impulsive behavior through penalties on early withdrawal.
- *Track Your Spending for Goal Attainment*. When people track their spending, they are often shocked to discover how much money gets used for things they really don’t need, or gets overspent than planned. As most people have the strong tendency to avoid losses, tracking spending can help people feel the urge to stop the unnecessary spending and head towards the right direction of their financial goals.

- ***Better Implementation: The Difference Between What You Want and What You are is How You Do it.***
  - *The Clever Use of Default Options.* Empirical evidence shows that default options have tremendous impact on savings rates and participation rates. For instance, employees enter into an automatic savings plan by default and must take action to opt out. While only less

than 10% of individuals who are eligible for IRAs participate in a self-initiated plans, employer-sponsored retirement plans such as 401(k) with automatic enrollment boast participation rates in excess of 90% (Iwry and John 2009).

- *One Step Forward From The Rule.* We can use the rule of thumb as the starting point but adjust it based on 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 that are tailored to meet investment objectives based on various time horizons.

- ***Dynamic Maintenance Mode: Just Like Driving A Car, You Have To Make Adjustments All Along The Way.***
  - *Automatic Rebalancing and Lifecycle Funds.* This strategy exploits individuals' tendency to stick with the status quo and 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 automatic rebalanced on participants' birthday. People can also select lifecycle funds that is automatically adjusted and balanced during the course of the fund's time horizon as the investor ages towards 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 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 wellbeing. 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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Bio - Tianyang Wang

Tianyang Wang (Tian) is an assistant professor in the Department of Finance and Real Estate at Colorado State University.

Tian earned his Ph.D. from the University of Texas at Austin. He is an *Associate of the Society of Actuaries (ASA)* and a *Financial Risk Manager (FRM)* — Certified by the Global Association of Risk Professionals (GARP).

Tian's research passion is to make fundamental new discoveries about *how to model risks, how to analyze risk, how to price risks, how to manage risks, and how people behave under risks*. His research spans both theoretical developments and empirical applications and are presented at many national and international conferences in risk management, insurance, finance, and management sciences.

As of the Summer of 2016, Tian has 11 articles published in leading academic journals, such as *Operations Research* (listed on UT Dallas 24 leading business journals and the Financial Times “FT45” list of influential business journals); *Journal of Risk and Insurance* (the premier journal for risk management and insurance); and *Financial Review* (the flagship journal of financial economics by the Eastern Finance Association).

Tian’s research has been sponsored by grants from several government and professional societies, including the *Society of Actuaries* (SOA), the *U.S. Department of Energy* and the *Lawrence Livermore National Laboratory*, and the *National Science Foundation of China*. He is very grateful for being awarded various honors and for being a finalist in multiple best paper competitions.

Tian is actively engaged in the academic and professional societies. He has served as a reviewer for 21 international prestigious academic journals; as an invited speaker, session chair and discussant in international conferences sponsored by major academic and professional societies, including the SOA and the *American Risk and Insurance Association* (ARIA); as a member of multiple important committees for the *ARIA* and for *SOA Project Oversight Group* (POG).