2020... The start of a new decade

FEBRUARY 2020

FA NEWS

FINANCIAL & ADVISORY NEWS

Global bond investments getting riskier

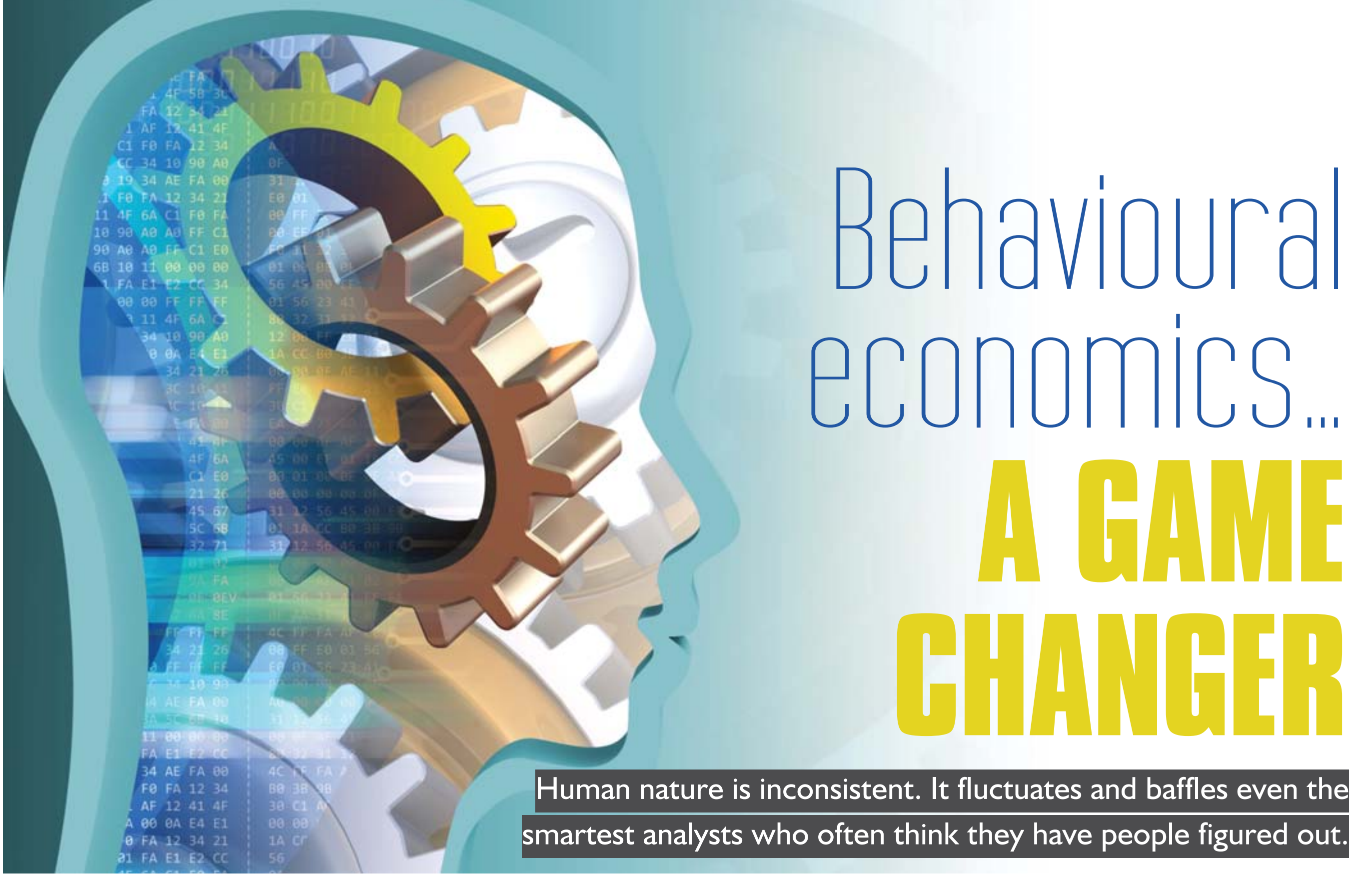
Updates to the insurance regulatory framework

Risk trends and their interconnections

Anticipate unprecedented types of claims

Ignorance is no longer an excuse

DIGITAL TRANSFORMATION IN HEALTHCARE



Behavioural economics... A GAME CHANGER

Human nature is inconsistent. It fluctuates and baffles even the smartest analysts who often think they have people figured out.

Its ever-changing nature is particularly interesting when businesses get involved and try to understand what goes into the decision-making and purchasing processes of their customers.

Factors affecting purchasing decisions

Previously, economists attempted to rationalise consumer actions, but by studying the psychological, cognitive, emotional, cultural and social factors that affect purchasing decisions, they have come to recognise that most purchasing decisions are deeply irrational.

Instead, people use quick subconscious heuristics to aid them in their decision-making process. One of the more prevalent of these is the tendency to default to the market leaders. When people do not know much about a certain topic or product, they go for the biggest brand.

This, along with aspects such as artificial scarcity and the recency bias, causes people to place disproportional trust in their most recent memories. The prodigious exposure of big brands therefore means that they are always top of mind, even when better alternatives exist.

Why behavioural economics is crucial

This is especially true of the financial services industry. Conversely, people are quick to spend their hard-earned money on things they do not need in the heat of the moment, but when it comes to investing this money, the decision is often delayed.

One of the reasons for this is hyperbolic discounting, the tendency to opt for a smaller, immediate reward rather than a larger reward at a later stage. This is particularly evident in the pension funds space where most people are either saving too little or not at all.

Behavioural economists recognise that consumers do not see their future selves as a part of them, but rather as strangers, and subsequently do not care about what happens to that future self. People tend to see their monthly salaries as money due to them, and any portion saved towards retirement is seen as a loss.

This subconscious application of personal biases underlines why behavioural economics is crucial in understanding consumer behaviour.

Two main drivers of choice

This understanding is particularly important in the retirement fund space, where there is also an ethical obligation to assist people in securing their futures. A good example of this is the *Save More Tomorrow* programme pioneered by American behavioural economists, which has helped approximately 15 million Americans to significantly boost their savings rate.

The program makes setting aside money for retirement a default option when employees start at a company and, instead of asking them whether they would like to save, asks them whether they would like to opt out of saving money. By slightly changing the question, the number of people choosing to invest on their employment forms more than tripled.

Default and opt-out options are key behavioural economic principles and two main drivers of choice architecture. The newly implemented retirement default regulations require retirement funds to adopt a set of default options when it comes to how savings are invested, what happens to their savings if they leave their employer's service before retirement, and to offer members a pension at retirement. Basically, should members not select a fund option, one will be selected for them by default.

Knowledge of behavioural economics places providers at a massive advantage because it taps into the subconscious purchasing decisions of the clients they wish to target. It therefore places a substantial moral obligation on service providers to harness this power to ensure that the purchasing decisions of clients contribute towards long term financial benefits.

Tim Allemann
CMO
Fedgroup