

Psychology of saving

When we understand our responses to money, we can put measures in place to help us make the right decisions.

Over the last few years a new science has developed called behavioural finance that aims to understand why people react the way they do to money.

Behavioural psychologist Merle Friedman of the PeoplesTree Group says research has shown that there are three main reasons why people do not save: too much choice, a preference to maintain status quo and an inability to delay gratification.

1. Too much choice makes it hard to reach a decision

When people are faced with too many choices they find it difficult to make a decision. Economists and companies have always assumed that the more information and choice we have, the better decisions we will make but the opposite is often true. There is only so much information our brain can process before it effectively shuts down and we cannot make a decision.

Are South African investors simply faced with too much choice, considering the diverse range of investment products out there, from endowments to retirement annuities to unit linked investments? Even within one investment category such as unit trusts, there are over 800 investments to choose from. While people may want to save, the choice may be so overwhelming that it is difficult for them to even know where to begin and spending the money becomes the easiest choice.

2. It is difficult to change our spending and saving habits

Having so much choice establishes what Friedman calls the *status quo bias* or *adopting the default position*. It is easier to keep on doing what you are doing than to make a change. The effort of making a choice, filling in forms and dealing with the administration of an investment means we are less likely to do so. Regulations like FICA which require even more paper work can also discourage saving. Financial advisers can help their clients to overcome this inertia and make a positive change towards saving.

3. We struggle to delay gratification

Most people struggle to delay gratification. Friedman says focus groups have shown that when people are asked if they would like to receive R2000 today or R2500 in a year's time, they will choose the smaller amount immediately. This is because most people struggle to visualise what their future looks like. They can see immediately what they would do with the R2000 today but do not have a clear picture of what R2500 will mean to them in the future.

Financial advisers and investment companies play a key role in explaining the benefits of delaying consumption. By maintaining a relationship with their clients, they can reinforce these benefits during the client's financial journey.

Making saving easier: the role of financial institutions

Defined contribution pension schemes have increased the need for individuals to take an active role in their financial future. In the late 1990s, many companies moved from defined benefit pension funds, which guaranteed employees a certain level of income on retirement, to the defined contributions system which effectively handed over the financial responsibility of retirement to employees. However this was often done without any education or access to financial advice. As a result many members did not fully understand the financial risk they were taking on until the market crashes of 2000 and 2008. The amount of choices available to employees, especially without assistance, often led to poor investment decisions. This contributed to the breakdown of people's trust in the financial industry and investment products.

Financial institutions of the future will enter into partnerships with their clients to ensure that their needs are being met and that sound investment decisions are made. Products have become more transparent, enabling costs to be fully understood and these companies have provided tools and advice to assist clients in selecting the correct solutions for their needs.

How Liberty is helping customers own their financial future

The new branding of our products has helped to create solutions in line with the investment strategies of our customers so that although there will be choice, it will not be overwhelming. Clients will be able to choose solutions that grow their investments without jeopardising their capital. Product documents have been simplified so that they are easy to understand and products are being renamed so that the names reflect what the product offers.

In partnership with Liberty, customers can take ownership of their financial plans, identify their goals and work with their financial advisers to identify the correct solution for their financial needs.

Liberty is working on simplified products and choices as well as transparency and customers can now embrace the vision of a healthy financial future and work with their financial advisers to reach their goals.