Consumer Financial Behavior

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Consumer Financial Behavior

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Abstract

Consumer financial behavior is a domain between micro-economics, behavioral finance, and marketing. It is based on insights and behavioral theories from cognitive, economic, and social psychology (biases, heuristics, social influences), in the context of and sometimes in conflict with micro-economic theories of consumers, investors, and markets. Behavioral finance has a descriptive approach, how people make financial decisions. Not always rational, but often in a systematic irrational way. Consumer financial behavior is also a basis and starting point for the marketing management of financial products and services, as well as for consumer education and protection policy. This monograph is on the determinants/drivers and consequences of spending, saving, borrowing, insuring, and investing. Ultimately, this monograph is on the financial requirements for financial inclusion, and participation in present society with its myriad of products and services, experiences, social media, information (overload), and the pursuit of meaning, satisfaction, happiness, and wellbeing.

Contents

1

Introduction

Financial behavior of consumers is very relevant for government policy, for marketing management of companies on the consumer market, and, last but not least, for consumers themselves and consumer protection.

Many consumers lack sufficient knowledge (literacy) about budgeting, financial products, and financial planning. Due to this, they make suboptimal decisions, take too much credit, pay too high interest rates, do not save enough for their retirement and pension plan, are over- or underinsured, and make costly mistakes in their investments. Financial education could possibly help them to make better financial decisions (Mandell, 2001; Lusardi and Mitchell, 2014), but some researchers such as Willis (2011) conclude that financial education increases people's confidence but not their financial ability. An alternative to financial education is assistance and advice of experts and systems that work in the consumer interest. People make use of heuristics (quick and easy decision rules) rather than using a slow and difficult economic approach. Gigerenzer (2007) argues that these heuristics are not inferior ways of information processing and decision making but are evolutionary functional in a complex world to make quick, often even unconscious (intuition), evaluations and decisions.

Consumer organizations and market authorities need to know how consumers spend, save, borrow, insure, invest, and save for their pension. From a *consumer protection* perspective, this information may provide ways where and how to protect consumers against unscrupulous sellers and against themselves as illiterate and imperfect decision makers. How should people best manage their financial affairs? And how should they avoid the risk of mistakes and losses they cannot bear?

Financial products are bought on the *market*. Banks, insurance, and credit-card companies develop and sell new products and services, communicate about these products and services, and advice consumers what to buy. Banks, insurance, and credit-card companies, and other financial institutions should become more customer-centric. Products should be offered that people need and want in the short-term and in the long-term, and products that are safe under various economic conditions such as a recession. The duty of care of sellers includes protecting consumers against severe mistakes and risk of losses they cannot bear. Financial products and services may look profitable and attractive in the short term, but could be 'dangerous' for consumers in the long term under different economic conditions.

Consumer spending, saving, borrowing, investing, and tax compliance also have implications for *macro-economic policy* of a country. Katona (1975) was one of the first to recognize that consumers have power with their discretionary spending and saving. The economy of a country may stagnate if consumers have a low level of confidence and delay and curtail their spending. Consumer confidence has been low in many countries during the economic recession of 2008–2013. Consumer spending was low and saving was high during this period and this had severe consequences for the sales of products and services and the economy as a whole.

Objectives

This monograph is about financial behavior, products, and services at the generic and domain-specific level: choice and expenditure within a product category or between product variants. It is not focused on the specific level of brand choice (Van Raaij and Verhallen, 1994). The objective of this monograph is to bring together the scientific knowledge of consumer financial behavior in a systematic way in order to improve the understanding and insights of this behavior. Target groups of readers of this monograph are:

1. Teachers and students of marketing, finance, and management (university level).
2. Financial advisors and planners.
3. Consumer educators.
4. Communicators and consumer advisors of financial institutions.
5. Consumer policy makers.
6. Consumers themselves (for a better understanding of their own behavior).

Structure of the monograph

This monograph contains sections on (2) money management, spending, and budgeting, (3) saving behavior, (4) credit behavior and debt problems, (5) insurance behavior, (6) pension plans and old-age provisions, (7) investment behavior, (8) tax behavior, compliance, and evasion, and (9) responsible financial behavior.

Section 2: *Money management, spending, and budgeting* focusses on how people handle their money in daily transactions and payments, and how people try to 'make ends meet' by budgeting their expenses.

Section 3: *Saving behavior*, saving motives and goals. Consumers save to have a financial buffer, save for specific transactions, for 'rainy days', their children and for old age. A long time horizon is needed to refrain from immediate spending but save for 'later.'

Section 4: C*redit behavior and debt problems*. Although credit is an attractive way to buy now rather than after saving, consumers may become over-indebted on their credit cards and personal loans. Impulsive behavior and lack of overview and self-control are psychological factors that explain why some people get into financial problems.

Section 5: *Insurance behavior* is on the avoidance of potential financial losses. People are often under- or over-insured, not knowing the coverage of their insurance policies. Important home insurance against natural disasters is often lacking, whereas less relevant insurances such as warranty extensions, have been bought.

Section 6: Most people agree that *pension plans and old-age provisions* are of great importance, but nevertheless many people spend little time on this topic and do not save enough for their retirement. How can this situation be improved in the consumers' and societal interest?

Section 7: *Investment behavior* is often risky and full of biases and heuristics guiding private investor's behavior. Risk propensity and attitude are thus the major concepts and explanations of investment behavior.

Section 8: *Tax behavior, compliance and evasion* is important for people and the tax authority. Traditionally, tax payers and tax authority played the 'cops & robbers' game of mistrust and control. A modern approach is the 'clients & services' approach, in which there is more trust between parties and the tax authority provides an already filled-out tax declaration and other services to the tax payers (Kirchler, 2007).

Section 9: *Responsible financial behavior* is an ultimate goal for consumer financial behavior. The financial literacy of most people is low and is a cause of many mistakes and lack of appropriate actions, for instance to save for retirement. Financial education might be a solution, but other ways to get around the illiteracy problem of consumers are financial planning and advice. Even with a high level of financial literacy, financial behavior is often not responsible and sustainable.

Not all financial behaviors of consumers and private investors have been included in this monograph. Missing areas are: (1) gambling and betting in casinos and on the internet, (2) participation in lotteries, (3) 'unlawful' behavior and paying fines for traffic and other law violations, and (4) fraud, theft, pyramid games for investors, and other criminal financial behaviors, except for insurance fraud (Section 5) and tax evasion (Section 8).

What will be included?

Many factors and variables may be included in describing financial behavior and its determinants and consequences. The list is almost endless. To restrict this number to manageable proportions, the structure

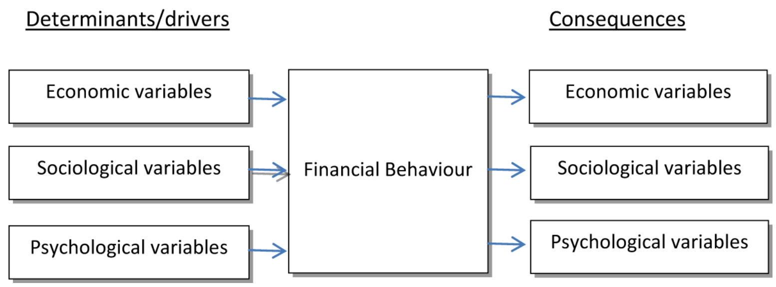

Fig. 1.1 Structure of variables.

of Figure 1.1 has been used with a maximum van five types of variables in each box.

The content of the boxes of Figure 1.1 consists of:

Financial behavior:

1. Specific acts, such as buying a product or putting money on a savings account.
2. Categories of acts, such as spending, saving, and borrowing.
3. Financial skills such as budgeting, financial planning, decision making, and using heuristics such as mental accounting.

Economic variables:

1. Income and wealth of households and individuals.
2. Interest rate, inflation rate.
3. Supply and prices of financial products and services.
4. Business cycle: recession and upswing.
5. Financial risk and uncertainty.

Sociological variables:

1. Socio-demographic characteristics of people.
2. Household, family life-cycle.
3. Life events such as marriage, divorce, birth of children, moving, and job change.
4. Social reference and comparison.
5. Norms and values.

Psychological variables:

1. Perception of gains and losses.
2. Risk preference and tolerance for uncertainty.
3. Confidence in the economy and trust in financial institutions.
4. Self-control, impulse control, pre-commitment, conscientiousness, and need for cognition (Cacioppo and Petty, 1982).
5. Time preference (present *versus* future).

Note that some economic and sociological variables, such as interest and inflation rate and family life-cycle, can only be determinants and not consequences of financial behavior (Figure 1.1).

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