

My talk will focus on an entity that is wholly responsible for the way that financial decisions are made

- even responsible for every financial crisis experienced.

Not the banking institution -financial sector-- stock market - the former government or even the current one...

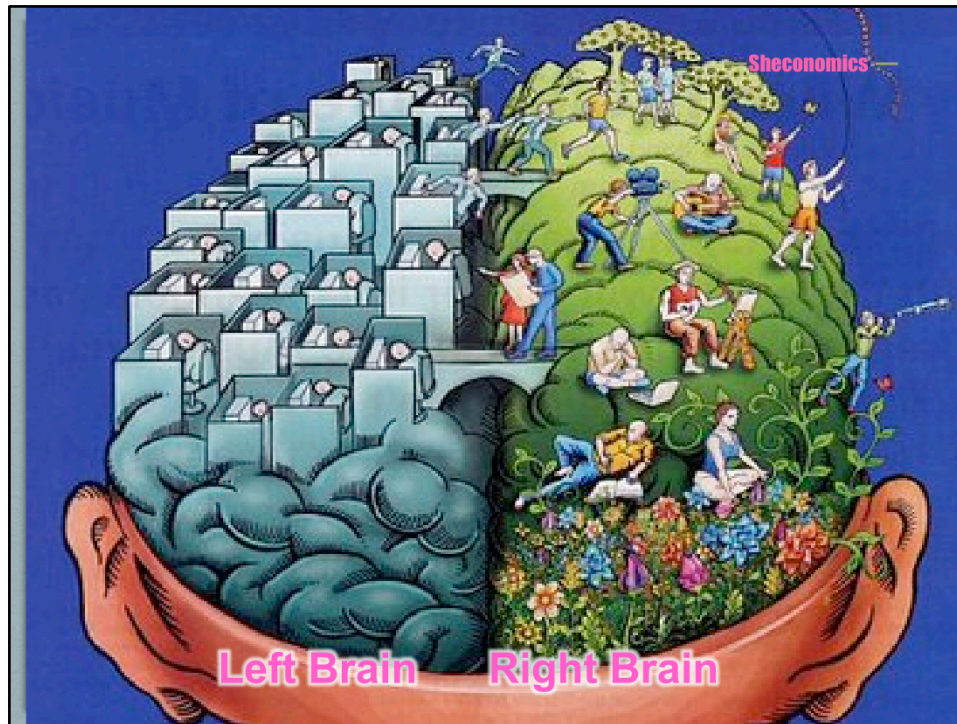
-It's the human brain.

Financial decisions are not made by computers using logistical algorithms, they are made by humans. And although humans are thinking, rational beings they are also often emotional irrational and completely illogical.

Message

It is an erroneous assumption that human financial behaviour is underpinned by rational, reasoned, logical decision-making processes. **Many decisions involve flawed thinking, are fraught with cognitive bias and overloaded with emotion.** The human brain is efficient *and* error-prone and the flaws affect both men and women but not always in the same ways.

MUCH HUMAN FINANCIAL BEHAVIOUR IS NOT predicted by normative economic theory



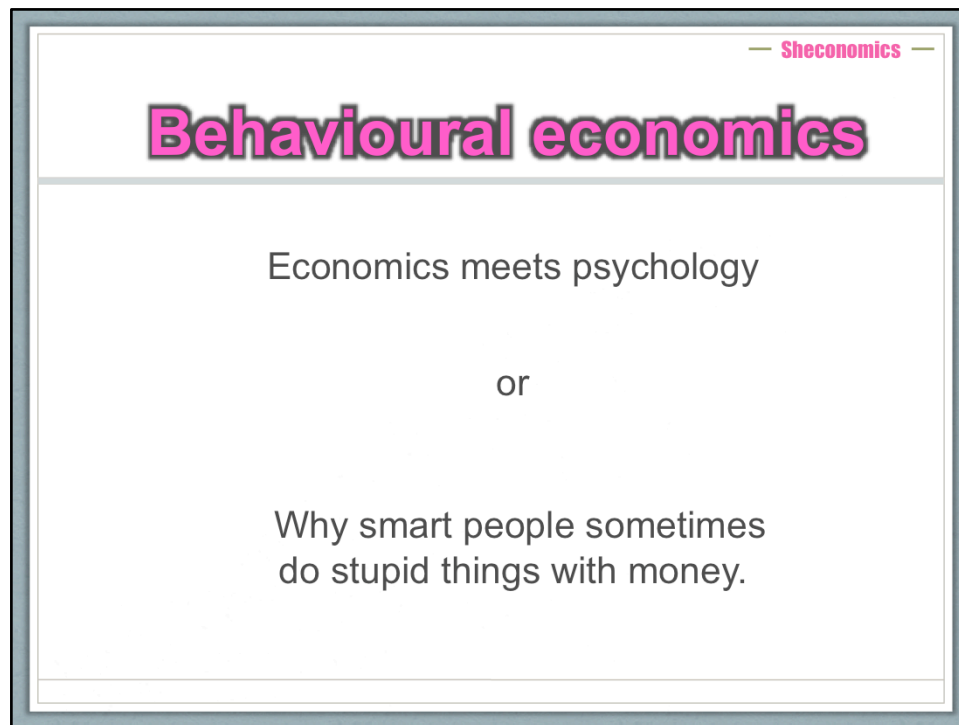
MANY FINANCIAL DECISIONS ARE A TUG OF WAR BETWEEN THE TWO SIDES OF THE BRAIN

System 1 – LEFT SIDE -the slow deliberate RATIONAL logical processes

ACCOUNTANTS –COMPUTER SCIENTISTS - BANKERS

System 2 – the fast efficient intuitive CREATIVE processes

ARTISTS –POETS- MUSICIANS- LOVERS OF SMALL FURRY CREATURES



Relatively new field of academic study

Economics meets psychology or

Why smart people sometimes do stupid things with money

Sheconomics is behavioural economics for women

1. Financial decisions are not always rational
2. Money is emotional
3. Men and women are different

1. Financial decisions are not always rational

uncertainty attached to financial decisions

-we assume individuals will engage in some **careful planning, weigh up the pros and cons**, look at the **immediate and future benefits, compare providers fairly** and reach a conclusion.

-**WRONG** : We fall foul of a number of cognitive biases that act against self-interest and can cost us money.

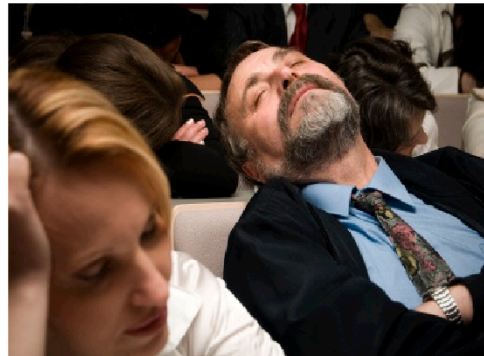
2. Money is emotional

Many financial decisions are emotional, laden with moral and value judgments and this has both pros and cons

3. Men and women are different

Men's and women's brains differ and they are socialised differently and this impacts on their financial behaviour. Neither sex is better they are just different.

Sunk cost trap



When future decisions are based on past spending.

People would travel thru dangerous snow storm if paid for ticket, stay at home if given it for free

The money's spent – sunk cost fallacy

Affects people on personal, social and political level

Explains why stay in wrong jobs/wrong relationships

Why people **over value** what they have and **under-value** what they could have

Why people **don't sell failing investments and hang on to** poor endowment policies

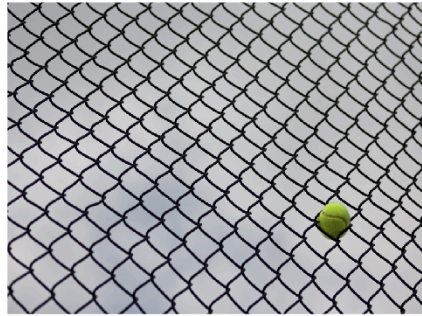
WHY financial decisions made based on previous ones –turn down offer on house cos less than price paid, may have overpaid

Why government spending decisions often based on how much has already been spent (throwing good money after bad)

2000s - Many less well-off families took out mortgages at cheap interest rates not realising repayments would shoot up to unaffordable levels a few years later.

-it was too easy for borrowers to make choices that were against their long-term interest –less so now

Status quo bias



A preference for keeping things the way they are and over-valuing the present.

Brain operates on the **efficiency principle** – has a strong preference for inertia.

Creating new solutions/behaviours uses energy. We revert to old ways.

New Coke never caught on because people preferred what they know.

The status quo bias is a preference for keeping things the way they are – and over-valuing the present and what has gone before.

Explains why PEOPLE TAKE OUT a low-interest introductory rate then don't switch when the price increases.

WHY Employees don't join company pension schemes.

WHY People set up direct debits and forget to cancel them or monitor them.

WHY people stay loyal to banks that they're dissatisfied with.

Sheconomics research 2010 first direct: a third of all the over 55s still with the same bank they opened an account with on leaving school.

banks make money out of people's inertia

-PEOPLE NOT CHANGING BANKS: Not **just laziness** that stops people from **switching** - but **loyalty**.

Women big on loyalty-form strong bonds with friends and stay loyal but when it comes to their finances. Loyalty costs them money.

HOW HUMANS ARE NOT ALWAYS RATIONAL

When offering finance products -assume people skilfully select the best product for their self-interests, despite the complexity of the task.

This is a flawed assumption – underpinned the recent sub-prime disaster -people made irrational borrowing decisions

Intuitive Reasoning

A notepad and pen together cost £1.10.
The notepad costs £1 more than the pen.
How much does the pen cost?



The use of mental shortcuts and basing decisions on feeling not thinking.

BEHAVIOURAL ECONOMICS HAS REVEALED A NUMBER OF COGNITIVE BIASES WHICH RESULT FROM THE BRAIN'S TENDENCY TO USE MENTAL SHORTCUTS

Intuitive reasoning (automatic vs controlled)

LEFT BRAIN **hijacked by** RIGHT BRAIN

Notepad and pen **FROM COGNITIVE REFLECTION TEST** 500 PEOPLE study via **First direct**

6 OUT OF 10 got it WRONG

WRONG ANSWER PREDICTS FINANCIAL BEHAVIOUR

wrong answer were more likely to have:

FEWER SAVING, MORE C/C DEBT, STILL WITH SAME BANK

Intuitive reasoning works fast and under the radar- sometimes it serves us well (knowing whether to trust someone or not) other times we would be better off stopping and reflecting.

Money is emotional



Have revealed some cognitive – or thinking – biases

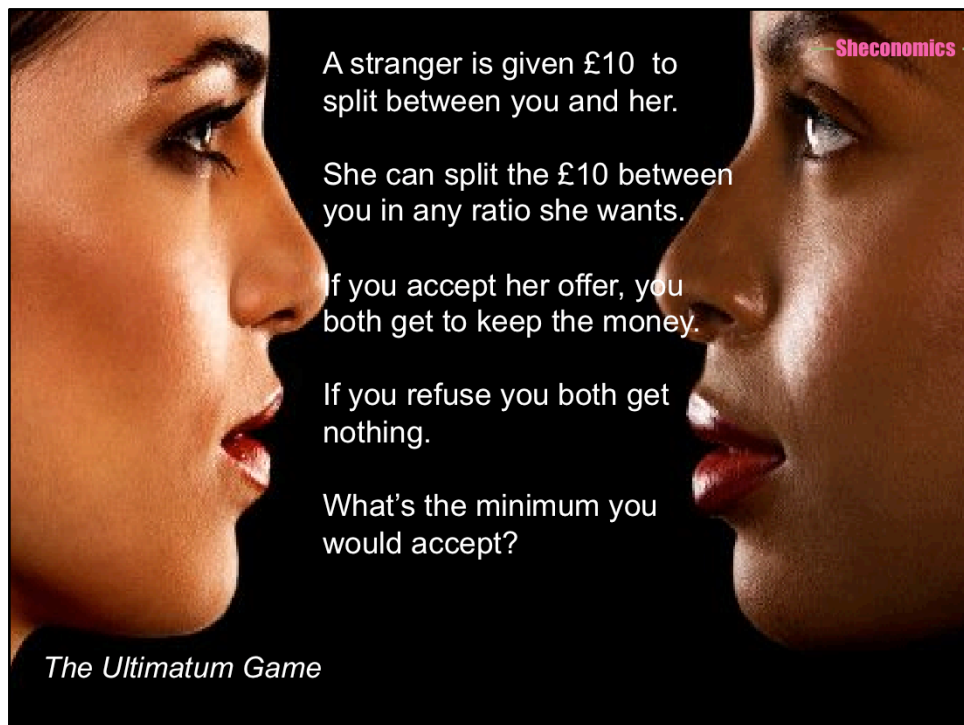
NOT **EVERYONE** AFFECTED, THESE ARE SOME PATTERNS OF THOUGHT THAT LEAD MANY PEOPLE TO GET LESS OUT OF THEIR FINANCIAL CHOICES THAN THEY SHOULD.

But we tend to default to one side of the brain rather than the other and there are times when it is useful to deploy both types of thinking.

Sometimes we're not even aware that these are skewing our judgment

-they operate outside of conscious awareness.

Other times we are taken over by emotions: **Ultimatum game**



Half of all people will turn down less than £2.50

Turn down a good deal if they feel someone else is profiting from it **never underestimate people's wish for fairness and social co-operation.**

1970's Kunz & Woodcott xmas cards to strangers - most people sent one back. MORE women.

WOMEN like to see fair play - evolved to place a high value on social cooperation, the survival of our evolutionary ancestors may have depended on it – **OUR BRAINS SHAPED BY EVOLUTION** for Fairness, justice, spite, social co-operation
FINANCIAL BEHAVIOUR: ANOTHER BIAS=THE EGO TRAP

People accept less from a man than from a woman

Women offer men more

Solnick 2007/*economic inquiry* – impact on salary negotiations

Attractive people were offered more but more was demanded of them Solnick 1999

- MEN MORE COMPETITIVE INVEST MORE OF THEIR EGO IN A DEAL
- WOMEN LESS LIKELY TO BE IN IT FOR THE THRILL

The broker's dilemma

You've been searching for weeks for a rare model of a car you love. Your brother-in-law tracks one down through a dealer friend of his. It's exactly what you want, if a little over-priced. As you are about to buy it the dealer lets slip that your brother-in-law is getting a significant sum for brokering the deal. Do you buy the car?

- a) Yes, at least I get the car I want
- b) No, I'll find one without his help somewhere else

46% of women and 38% of men chose b)

Source: SHECONOMICS financial dilemmas survey 2009

Financial dilemmas –broker's dilemma –here **women were more emotional.**

REMEMBER in a negotiating situation the broker may think the client is bothered about the rate of interest, the client may be more bothered about the commission the broker is getting. They may make what seems like an irrational decision because of emotional factors.

The inheritance dilemma

Your great-aunt has left £22,000 in her will to you and your brothers. You haven't spoken to your brothers for years after a huge family row. Great-aunt was very fond of your brothers and wrongly held you responsible for the rift.

She leaves your brothers £10,000 each, and you £2,000. The only proviso is you have to accept this split. If you refuse then each of you gets nothing and the whole £22k goes to the cats' home. What do you do?

- a) Accept the money and let your brothers get their inheritance
- b) Refuse the money so you go without - but so do they

25% of women and 30% of men chose b)

Source: SHECONOMICS financial dilemmas survey 2009

People will turn down free money, when they let their emotions take over.

Here **men were more emotional than women**.


Economic theory fails to take into account the fact that people will turn down free money, that their financial choices and decisions may be driven by hidden emotional factors

— Sheconomics —

Sheconomics in practice

- Men are twice as likely as women to feel happy about asking for money
- More than eight out of ten women don't like asking for money
- Nine out of ten women find asking for money embarrassing (compared to 6 out of 10 men)

Source: SHECONOMICS Asking for Money survey 2010



MONEY IS EMOTIONAL –

SHECONOMICS LOOKS AT THESE EMOTIONS

ONE IS **FEAR**

FINDINGS: Men are twice as likely as women to feel happy about asking for money
 More than eight out of ten women don't like asking for money
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****EXPLAINS WHY****

MANY FEMALE START-UP BUSINESSES ARE UNDERFUNDED

WOMEN ARE RISK AVERSE AND FEAR DEBT MORE THAN MEN

WOMEN USE BANK FINANCE MORE - a WETF survey found no evidence that banks discriminate against women

men use a wider variety of sources inc private investors (angels) and ask for more money.

OPPOSITE OF FEAR IS FEARLESSNESS WHICH CAN LEAD TO MALE OVERCONFIDENCE

—

research from the **UK SMALL AND MEDIUM ENTERPRISE FINANCE SURVEY** shows:

men's business plans are likely to be less adequate than women's

Men more likely to **FAIL TO MAKE REPAYMENTS** and

over-rate their chances of success

WOMEN worry more than men, more **risk averse**- - financial illiteracy – BUT MAKES THEM **BETTER PLANNERS, SAFER RISKS**

WHEN WOMEN REPRESENT 30% OF A COMPANY'S BOARD OF DIRECTORS PROFITABILITY INCREASES THREE FOLD.



Thank you

www.karenpine.com www.sheconomics.com

MESSAGE: It is an erroneous assumption that human financial behaviour is underpinned by rational, reasoned, logical decision-making processes. **Many decisions involve flawed thinking, are fraught with cognitive bias and overloaded with emotion.** The human brain is efficient *and* error-prone and the flaws affect both men and women but not always in the same ways.

Many decisions involve flawed thinking, are fraught with cognitive bias and overloaded with emotion –NOT TAKEN A/C OF in **FINANCIAL PRESS/info/ and affects men and women differently.**

THERE MAY BE LOTS OF BARRIERS TO BORROWING – LET’S NOT FORGET THE ONES THAT ARE IN OUR OWN HEADS