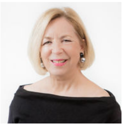
Financial Well-being

Understanding decision-making

South Africa | 06 February 2015 | Insight

Authors and contributers



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Can understanding how we make financial decisions lead to better outcomes?

Perhaps the most powerful aspect of the financial well-being model is that it helps us cope with some of the most problematic contradictions in the literature around financial decision-making. On the one hand, the research cautions us that unless we can make a distinct link to what matters to individuals (their values), we are unlikely to successfully translate financial knowledge into an effective engagement with the financial decision. On the other hand, there are any number of studies that highlight just how bad we human beings are at making financial decisions.

The financial well-being model recognises the validity of both those points and provides us with a means for navigating our way through the potential minefield. At the heart of the process, we must recognise that there are distinct filters by which an individual processes financial decisions: automatic thinking, social context, mental models and mindsets about money are cases in point. The job of the financial consultant, financial coach or financial therapist is to understand how these filters may be creating a blockage to an individual's ability to secure what matters to them. This next section provides an in-depth description of some of these blockages. An important insight is that concepts such as automatic thinking, social context, mental models and mindsets about money are not simply blockages. They also hold the key to how to positively link decisions to values.

Changing how we think about the problem

How could we go about improving the financial decision-making and financial capability of an individual? There are any number of how-to books that profess various formulas for success. But as David Brooks, the New York Times's pre-eminent pundit on social and political issues, explains in his book The Social Animal, these formulas are typically derived from "the surface level of life": what knowledge needs to be acquired and what physical steps need to be taken. Getting to the heart of financial decision-making demands we go one step deeper. As Brooks points out:

"We are living in the middle of a revolution in consciousness. Over the past few years, geneticists, neuroscientists, psychologists, sociologists, economists, anthropologists, and others have made great strides in understanding the building blocks of human flourishing.[1]"

The critical insight: our conscious, deliberative thinking capacity plays a relatively minor role in the outcome.

Earlier this year, the World Bank published their annual World Development Report with a review of why development projects tend to fail in emerging economies. We saw the paper as providing a superb template for getting to the heart of any change management issues. The study argues along the same lines as David Brooks: to understand what informs financial decisionmaking, we need an approach that goes significantly beyond financial or economic analysis to meaningfully integrate elements of behavioural finance, anthropology, development economics, psychology and even historical context. Specifically we need to understand:

- When it is that our brains are using automatic thinking to make decisions and when they are using deliberative, knowledge-based thinking in making decisions
- The role that social context plays in decision-making
- The critical role of mental models in both dysfunctional and constructive outcomes.

While the intent of their study is to use these insights to better inform how policymakers, development specialists and service providers could create more effective outcomes for communities and societies, we will take each in turn to illustrate how these insights are equally valuable in the world of financial advice and financial empowerment. In addition, we will look at how people's mindsets about money affect their interaction with it. This examines how our psychological disposition towards money influences decision-making.

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References

1 Brooks (2012)

Article tags

AUTOMATIC THINKING | DELIBERATIVE THINKING | SOCIAL CONTEXT | FINANCIAL DECISION-MAKING | MENTAL MODELS | MONEY MINDSETS