Understanding decision-making

Thinking socially

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The problem with economic theory is that it often paints individuals as autonomous decision-makers. In some schools of thought our financial actions are seen as purely self-serving, with wealth maximisation being the overriding driver. It's assumed that 'economic man' does what he does for the money. A focus on material incentives, material rewards and material outcomes is thought of as inevitable.

As the World Bank study highlights, there are 'other-regarding' preferences[2] at work in all societies. These are concepts such as the innate human desire for social status; our need to identify with one group while potentially rejecting another group; our willingness to cooperate with others who are seen as cooperating; our tendencies in some instances to behave altruistically; and our willingness to engage either in instrumental reciprocity, responding to kindness with kindness for some long-term gain or intrinsic reciprocity, where an individual will be prepared to either reward or punish the behaviour of others even if it is at a cost to oneself or the community.

Understanding where these counter-intuitive drivers of decision-making come from demands that we understand how our broader group behaves and cooperates, and identifies which decisions are in the best interest of the group. Financial decision-making by an individual is more heavily influenced by the requirements of the broader group than it is by self-interest.

On the one hand, this influence from the group helps explain phenomena such as the 'third force' of human drive, alluded to by Daniel Pink in his book Drive. Pink describes how human beings can also be driven, to greater or lesser degrees, by the intrinsic rewards that come from believing you are enhancing the world around you. This contrasts dramatically with the kind of explicit rewards provided by simply meeting basic needs or achieving certain performance goals.

Conversely, understanding the role of social influence by way of social context and social history also helps explain how entire societies can get stuck in dysfunctional behaviours such as corruption, over-indebtedness and xenophobia.

Through social context we derive social norms, those powerful sets of shared beliefs that dictate how community members should behave to maintain group dynamics, or how and with whom individuals should interact in their social networks. The net outcome has the potential to be profoundly destructive to a population.

Failure to understand the importance of social influences on financial decisionmaking has been the undoing of many financial wellness and financial literacy programmes. As the World Bank study cautions us, policymakers often underestimate how critical this social component is in influencing changes in our financial capability.

But if we can get down to the heart of those social norms, come to grips with the context in which they were formed, and identify how a group's social network influences both the formation of those norms and individual decision-making, we can begin to identify what types of interactions have the greatest potential for creating the kind of new behaviours required to better serve the long term interests of the group.

Understanding who (what type of person) carries influence and why, means we can determine what kind of group role model could change the 'mental models' the group employs while making specific decisions. We can target specific individuals to lead and amplify change.

Let's try to explore this dynamic more fully.

The power of the people

The tendency of the financial services industry is to 'tell' people what would be the preferred behaviours they should follow if they want to improve their financial decisionmaking. Our advisory process is often one where our clients share with us their financial concerns and we, in turn, tell them what they must do.

Consider why this might be problematic. If this advisory framework exists outside of the social context, once the individual returns to that context, it's just a matter of time until the pre-existing social norms prevail. 'Tell' an individual that if they want to sort out their retirement shortfall they shouldn't buy that new car on credit and they will likely revert back to their original plan or, more drastically, change financial advisers. The issue isn't lack of fortitude or financial savvy. The issue is that there are greater influences at play than you, the adviser.

As an industry, we owe it to our clients to better understand the social context that they operate within – irrespective of what socio-economic grouping they may fall into. The research is alerting us to the fact that unless we develop ways to help clients grapple with potentially dysfunctional pockets of influence, financial advice will fail to make any impact on an individual's financial capability.

There is a good news/bad news story here. We are beginning to understand better that people will do the right thing to enhance their financial well-being, but only if they perceive other people as doing the right thing. That means that people often behave as 'conditional cooperators'. It also means that under the right conditions, social pressure can provide a powerful impetus for change[3]. The implication is that we should be spending considerably more time as an industry and as policymakers in determining how we can leverage the power of group coercion and group support to change dysfunctional financial behaviours. Our current model depends almost entirely on convincing the individual directly. But encouraging the right financial behaviour has been shown to be far more effective if it is reinforced by social norms that correlate with the behaviours being promoted.

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South Africa: A case study

Case study/lesson

Why does it seem as though no one is listening? The fact is it is at odds with what most of the population sees as the South African success story, post apartheid.

In many highly visible success stories, it sometimes appears as though the real way to success and wealth is through the patronage, nepotism and corruption either afforded by some of our transformation strategies or the prevailing tender processes employed by businesses. The term 'tenderpreneur' is probably far more applicable in accounting for the rapid rise of South Africa's own unique '1%' than indeed the term 'entrepreneur' (and this is hardly the exclusive domain of the Black Diamonds[4]).

In spite of the disheartening results from the Institute of Race Relations' that 85% of the black South African population has not benefited from the BEE initiatives that have been in place for almost two decades now[5], the 'mental model' persists that this is a critical element for transformation. "Saving more" is not the primary factor in explaining the extraordinary pockets of wealth creation that we have seen post apartheid. Nor is "spending less".

A greater factor in the creation of an aspirational black middle class over the years since apartheid has been the role of the government. It facilitated the introduction of two critical ingredients for transformation: the economic legitimacy of employment (albeit for the public sector) for previously disenfranchised South Africans; and unfettered access to unsecured credit to a population that had been previously excluded from any financial levers (such as credit) for building wealth and assets.

As Deborah James points out in her book *Money from Nothing*, "A newly liberalised capitalism combined with pronounced state patronage was superimposed on what existed before... Whereas the official system of earlier (apartheid era) classification used race as a means to categorise the population, this has been replaced by a market system emphasising lifestyle, consumption, and consumer choice: the living standards measures, or LSMs".

"Across all these strata, people have found themselves, to different degrees, exposed to new pressures to consume and have been readily offered the wherewithal to do so. Credit and debt are what make it possible for people to buy more than they can afford. Countering the apparent homogeneity – 'everyone is now middle class' – one of the things that varies widely is whether individuals borrow, from whom, how much, what for, and what do they do about repayment." These are the new class differentiators, the factors shaping the various status groups and how distinctively different they may be from one another in solving financial problems.

James's short summary of her thinking in her book fleshes out some of the conflicts South Africans face in the context of wealth creation or even financial security that have led to some dysfunctional behaviour around money and wealth creation.

> **"Save more", "Save for retirement", "Make a budget", "Protect your families and loved ones" – this is the general litany of the advice world. Why does this fall on deaf ears?**

MONEY FROM NOTHING: ASPIRATION AND INDEBTEDNESS IN SOUTH AFRICA

Case study/lesson

Socially necessary expenses[6]

People – both middle class and aspiring to be so – got heavily into debt during the 1990s. This had to do with the swiftness of political transition in 1994, and the desire for economic well-being that accompanied it. It would be hard to imagine how the burgeoning aspirations for a better life could have been met in the post-apartheid era were it not for the ability to borrow. Had there been no debt – or access to credit, to use the version that sounds more palatable – very little transformation would have occurred in South Africa. There would not be nearly as many black people driving decent cars instead of skedonks and living in decent homes rather than shacks and sending their children to good schools and universities. Many in the 'new' middle class might have barely finished high school themselves, yet were expected to educate several children to tertiary level (though this could be a matter for disagreement within households). Often the only way to do so, even by those who hated the idea of borrowing, was 'on tick'[7] – and it was often the schools and universities that found themselves becoming de facto creditors. A Sowetan family has two parents working for a parastatal transport company. The mother, a frugal person, decries all forms of borrowing, especially buying food at Woolworths by 'swiping the card'. However, she is in disagreement with her husband about whether their daughter ought to have gone out to work or attended university. The result is that the university – here reluctantly turned lender – must wait until the mother gets her 13th cheque before the fees are paid.

In sum, if there is dissatisfaction with the rate of transformation, the levels of grievance, had there been no credit, would have been much greater, but the results have often been far from straightforward. In this case the daughter got a good job, but that does not always follow.

The situation is neatly summarised by Jonny Steinberg in his 2008 book *Thin Blue: The Unwritten Rules of Policing South Africa,* when he describes the dilemmas faced by one such member of the new middle class. "To ensure that your children attend a good school, you must buy a house in the suburbs. You have no reserves of cash, no investments, and so your entire house is bought with borrowed cash; the Reserve Bank governor's quarterly decisions on interest rates, which once meant so little that you were barely aware of them, can now destroy your precarious monthly budget overnight[8]."

People, then, borrow to fulfil their own and their dependants' expectations, but the net result, taken overall, has been levels of debt that many decry as unsustainable. To speak of such borrowing as 'irrational', as financial advisers and economists often do, is to miss an important aspect of the social underpinnings of debt. The reasons for debt have less to do with meeting immediate material aspirations than striving for longterm goals like education, housing, or investing in socially valuable and prestigious connections such as marriage. Exacerbating the levels of dependency on credit, shrinking levels of employment for the majority have been accompanied by entry into – or the consolidation of – secure employment for the few: especially in civil service jobs or those involving government tenders. People with jobs are expected to support their relatives who are unemployed, and may borrow to meet these expectations. Here, the fulfilling of socially valued norms – like paying for the upkeep and education of members of the extended family – can have negative effects.

Debt advisers have recognised, and many of their clients already know, that only by strategically withdrawing from such obligations can a more individually-viable middle-class existence become possible. There are "kind and well-meaning people", says Phumelelo Ndumo, author of a book on the subject, who have been "taken advantage of by those they love". Rather than being a 'cash cow', she advises people to partner up in a nuclear family and focus on the future achievements and needs of their own children[9]. Yet such advice can be difficult to follow since it goes against the grain of valued social norms. Those who were well served by the new dispensation, finding that they're required to provide security and education for those who benefited less, have thus found themselves faced with a seemingly insoluble dilemma: to act 'rationally' is to undercut the even more forceful value entailed in social expectation and obligation.

Some members of the new middle class, in the grip of the status anxiety and competition that are well known in cases of class mobility, spend money on expensive items. "Neighbours compete and feel under pressure to show that they are living in the correct way," one young lecturer told me. "If you take three neighbouring houses in Orange Farm …all the consumer items like DVD players and washing machines are exactly the same as each other." So, competing for status does not necessarily mean striving for difference: it can be more like keeping up with the Khumalos than trying to surpass them. Others will spend money on ceremonies considered socially mandatory like expensive weddings. But many, keen to act more frugally, have become hesitant to marry. Not only lavish ceremonies and receptions, but bridewealth or lobola, are costly and can necessitate debt. The cost in the case of the same young lecturer, given her education, would be estimated at R50 000, and the wedding itself would cost around R250 000. While she understands that her parents would want to demand this payment from any prospective son-in-law, Bongile also feels that the huge debt with which he would be saddled to carry forward into the future would make the arrangement unsustainable. She won't be getting married any time soon, she told me.

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The formal and the informal: uneven combinations

Policymakers and financial analysts often make incorrect assumptions. For example, they see people as gradually moving from more 'traditional' ways of conducting their financial affairs (like investing in savings clubs or stokvels) to more 'modern' ones, like saving money in banks. To facilitate more modern (read 'rational') behaviour, they advocate the banking of the unbanked. In fact, though, many people have developed strategies that have been called 'portfolios', which include savings and credit from all of these, in uneven combinations. A group of salaried teachers made a conscious decision to avoid the formal sector and use a savings club, because they felt they had been treated with discourtesy and even criminal neglect by those in that sector: specifically the notorious retailers that sell appliances on hire purchase, one of whom had wrongly issued a garnishee order on the club's founder member founder for an alleged missed payment, and proved unresponsive to all communications. So the founders still use the bank to store their money but use the savings club to generate interest.

Likewise, many policymakers view the indebted as victims of nefarious loan sharks (mashonisas) and consider that they would be better served by the formal banks. This may have a measure of truth, but there is another side to the story. Those not in receipt of a regular salary are unable to borrow from the banks: for them, the mashonisa represents a preferable (often the only) option for getting hold of money in a hurry, even if they do charge 50% per month. Besides, to see the mashonisa as a demonic figure can be a misrepresentation. Many lenders are also borrowers – and vice versa. Savings clubs or stokvels like the one mentioned above, for example, not only encourage members to save money, they also make it compulsory for them to lend that money out at interest (typically, 30% per month), to make it 'grow'. Informal moneylending, to give another example, is a tactic used not just by baseball bat-wielding loan sharks: it is also resorted to by grannies, pensioners, neighbours, and people who want to supplement their income. In some cases this is because they lack other, more steady, jobs. But it also owes itself to the fact that even those with salaries need more than they earn. The ubiquitous emphasis on 'becoming an entrepreneur' can lead to grief. People struggling to run small businesses often fail to get credit at reasonable rates, because they 'lack connections'. All too often, as in the case of one Sowetan I know, they turn to money lending as an alternative. If more sustainable and productive forms of employment were more readily available, there might be less recourse to 'making money from nothing' by lending it out at extortionate rates of interest.

Ways forward
So do we advocate the survival of the fittest, sink or swim? Or is the answer the complete avoidance of debt?

Although it is true, as stated above, that there are blurred areas where lenders and borrowers are difficult to distinguish from each other, it is still necessary to decide whether the weaker and more vulnerable in society need more protection than the rich and powerful. If they do, how can such protection be put in place without undermining the stability of the financial system? The tendency in societies which advocate the free market has increasingly been – often by giving financial advice and attempting to teach 'self-discipline' – to make borrowers carry the can. And this may be necessary, but it can work only if it's combined with other measures. It needs to be accompanied by an attempt to tackle South Africa's infamous 'advantage to creditor' culture, by offering debt defaulters a way to start on a new page, and by challenging the general attitude among many lenders (and the magistrates' clerks that enable them to issue garnishee orders with impunity) that 'anything goes' because none of them will ever be called to account. At the same time, borrowers will need to recognise the social entanglements in which they are caught, and start to take the kinds of advice offered by advisers who understand these contexts, even if doing so might put certain social relationships and dependencies at risk.

Solutions that help us shape the social context

As the World Bank study highlights, "social norms are rarely chosen by the people who are subject to them. They come from either historical circumstances or accumulated precedence." Breaking a social norm can create shame and stigma, which is why such issues as openly discussing your debt situation can be hugely problematic. The challenge is to determine how we can design policies or programmes that can bypass the influence of negative social norms on financial wellness.

To start with, creating the perception that there are more 'acceptable' norms may be a particularly effective way of stimulating more desirable behaviours.

Take for example the recent South African Revenue Service (SARS) TV ad series that provided an array of amusing skits on tax evasion. The key to the success of these skits was that tax payers were portrayed as attractive young black couples and tax evaders were portrayed as despicable 'lowlifes', often Caucasian. The ad campaign was effective in getting people to perceive tax evasion as something much more than just breaking the law – attractive, socially acceptable people simply wouldn't dream of it in these scenes. The point is that, when people understand how others think about a given behaviour, this can be a catalyst for changing social norms.

Traditional advertising techniques also will use 'norm entrepreneurs' (high status game changers) as another way of reducing the perceived cost of violating an existing norm and increasing the perceived benefits of the new behaviour. If Trevor Noah turned around and told The Daily Show producers: "I believe my acute sense of wit and comedic timing owes much to growing up in the cultural hotpot that is South Africa, and as such, half my pay should go back to the South African people in some way", that would send a powerful message out about success, status, and our obligations to a broader social context.

As Wilkinson and Pickett highlighted in their study on the impact of inequality on societies, two factors are key to creating a dysfunctional outcome:

- The perception that success was just a function of being in the right place at the right time (inadvertent access to a BEE deal) and not the product of superhuman contributions of intellect or labour.
- An escalating inequality of wealth, perpetuated by the fact that only a small minority had access to these opportunities and they went on to become significantly wealthier than everyone else.

The net effect is that money plays a particularly dysfunctional role under these conditions[10].

With these conditions in place, our decision-making around money becomes toxic. Not only does the society in question show a sharp increase in crime, teenage pregnancies, mental and physical illness and so on, but money is considered essential for improving your perceived status through buying aspirational goods.

Social cooperators and influencers could provide a catalyst for changing the quality of financial decision-making in South Africa, but only if we find a way to change the script that's used by those influencers. We know that there are better scripts out there that appear to be making a difference.

To some extent, then, we need to get individuals and communities to write a new script themselves that would be based on an emerging consciousness of how their actions impinge on their financial well-being. This is not a script that the current financial services industry can write for them with any degree of credibility.

Additionally, we know that social networks can be a distinctive form of economic coordination in themselves with their own inherent logic. As such, they can both aid and undermine goal-seeking. We need to be clear on how this social fabric is constructed to ensure that concepts we promote don't end up undermining something critical in an individual's life.

For example, as a financial services company, we might see commitment devices as a way to get people to save more reflexively or to resist the temptation to divest themselves of essential insurance protections. On the positive side, this provides an individual some protection from social demands for financial assistance from family members. But commitment devices could also have the opposite effect by weakening broader sharing conventions like helping out extended families or groups or friends during hard times.

What this all suggests is that, as an industry, we need to reflect more on the potential for broader, unintended consequences behind our financial planning recommendations. We need to, as the World Bank study urges us, keep digging deeper to understand the root cause of any issue relating to an individual's financial well-being and take great care to understand those decisions and their implications within the broader social context.

Concluding thoughts

Not all social norms are beneficial to a society – as such, norm change may well be a necessary component of long term social change (reluctance to save, eliminating corruption).

Without first addressing the need to change those prevailing social norms that are problematic to the broader society, our efforts to try to elicit change by simply encouraging the individual to change their own personal behaviours will invariably fail.

But, and this is a big but, while it is highly unlikely that the financial services industry will provide the catalyst for such mental model changes, a concerted campaign that is driven by both the public and private sector might just succeed.

References

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Article tags

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