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Does self-control predict financial behavior and financial well-being?



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ABSTRACT

To improve our understanding of how people make financial decisions, it is important to investigate what psychological characteristics influence individuals' positive financial behavior and financial well-being. In this study, we explore the effect of individual differences in self-control and other non-cognitive factors on financial behavior and financial well-being. A survey containing measures of financial behavior, subjective financial well-being, self-control, optimism, deliberative thinking and demographic variables was sent to a representative sample ($n = 2063$) of the Swedish population. Our findings extend the application of the behavioral lifecycle hypothesis beyond savings behavior, to include general financial behavior. People with good self-control are more likely to save money from every pay-check, have better general financial behavior, feel less anxious about financial matters, and feel more secure in their current and future financial situation.

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1. Introduction

People make bad financial decisions. We save too little for retirement (Lusardi, 1999), we overspend (Sotiropoulos and d'Astous, 2013), we do not pay our bills on time, and we sometimes buy things we regret (Abendroth and Diehl, 2006). However, we do not make bad financial decisions all the time and some of us are more or less inclined to make bad financial decisions. Moreover, some of us are more or less susceptible to feeling anxiety as a consequence of our financial behavior. This behavioral heterogeneity is a challenge to one-model-fits-all theories of economic behavior and as a consequence recent research has been concerned with understanding the role of individual differences in financial behavior and financial well-being. However, previous research has mostly focused on the influence of cognitive factors such as financial literacy (Fernandes et al., 2014; Lusardi and Mitchell, 2007) and numeric skills (Lusardi, 2012) on financial behavior. Less research has

focused on the influence of non-cognitive factors related to self-control and other similar constructs such as deliberativeness.¹ In this study, we explore the influence of such factors on both financial behavior and financial well-being in a large scale diverse sample of the Swedish population, while controlling for financial literacy and demographic factors.

1.1. Individual differences and financial behavior

Self-control is typically manifested as our ability to break bad habits, resist temptations and overcome first impulses (Baumeister, 2002; Fujita et al., 2006). One way to define self-control is that it constitutes the ability of our future selves to control our current self. When self-control failure occurs, people act in a non-optimal way and they might, for example, procrastinate work even though

¹ Borghans et al. (2008) pointed out that the usage of the words 'cognitive and non-cognitive factors' can be confusing since few abilities are devoid of cognition. Cognitive abilities are often measured using IQ or numeracy tests (Parise and Peijnenburg, 2017). In this paper cognitive factors are factors measured by some kind of knowledge or performance test, while non-cognitive factors are self-reported measures of personal preferences, personality, behavior, thoughts or feelings.

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they know that they would be better off spreading the work-load over time (Ariely and Wertenbroch, 2002; Fudenberg and Levine, 2006). Such explanations of self-control failure are in line with the behavioral life-cycle (BLC) hypothesis formalized by Shefrin and Thaler (1988). According to the BLC hypothesis people act as if there within every person is an ongoing conflict between a “planner” who thinks about the long-run and a “doer” who is more concerned about the current situation. The BLC hypothesis further states that people’s financial behavior over the course of life is determined by their ability to control impulses and the costs connected to exercising such self-control. Depending on our mental accounts and how we categorize money, it is more or less costly for us to save for the future. For example, monthly income is easier to spend and, therefore, costlier to save than money set aside for retirement. The BLC hypothesis is an extension of the traditional life-cycle model which assumes that people perceive money as completely fungible and that the farsighted individual rationally plans his or her life-time consumption (Modigliani and Brumberg, 1954). Although the BLC hypothesis has been influential in understanding savings behavior, research is currently lacking regarding to what extent it is applicable for other types of financial behavior that extend beyond savings behavior.

The ability to control impulses is undoubtedly a key factor for long-term success in many areas of life. In the seminal work on self-control by Mischel et al. (1972) pre-school children were presented with the simple marshmallow test, in which they could either eat a small snack right away or wait 15 min and get a larger snack. Around 67% of the children in the original study failed to resist temptation and ate the small snack, indicating a lower level of self-control. Mischel followed the children in the original sample for more than five decades tracking how the ability to exercise self-control at an early age was correlated with various life outcomes as the children grew into adults. The results were striking. Children who were successful in resisting temptation and delayed gratification were more successful in almost every outcome measured. They had higher SAT scores, educational attainment, sense of self-worthiness and ability to cope with stress. Additionally, they were less likely to be addicted to drugs and had lower body mass index (Mischel et al., 1989). Similarly, Moffitt et al. (2011) measured nine different aspects of self-control, including impulsive aggression and hyperactivity, among children in New Zealand. At the age of 32 people who had shown good self-control as children had better physical health, higher socioeconomic status, were more likely to be homeowners and have retirement plans and were less likely to have committed a crime. Duckworth and Seligman (2005) performed a longitudinal study where eight-grade students either had to self-report their self-control or perform an IQ-test. Self-control was a better predictor than IQ when predicting final grades, high school selection, school attendance and hours spent doing homework.

Studies that have explored the link between self-control and financial behavior have focused on specific financial decisions, such as retirement planning or credit use. Achtziger et al. (2015) found that people with low self-reported self-control are more likely to engage in compulsive shopping while Gathergood (2012) found that people with self-control problems in the financial domain are more likely to suffer from credit withdrawals and unforeseen expenses on durables leading to over-indebtedness. It has also been shown that people’s savings behavior is affected by their self-control. According to Biljanovska and Palligkinis (2015), households with self-control problems due to lack of planning, monitoring or commitment, have lower wealth accumulation. Choi et al. (2011) found that people with low self-control are less likely to save enough money for retirement. Rha et al. (2006) used data from a survey of a representative American sample in order to test how self-control mechanisms, such as saving goals,

foreseeable expenses and saving rules, affect households’ savings behavior. They found that households with saving rules are more likely to save than households without such rules and also that specific saving goals generally increase the probability of saving. On the contrary, Ballinger et al. (2011) found in experiments that neither self-control nor four different kinds of measured impulsive behavior affect savings behavior when taking cognitive abilities, such as working memory, into account. Thus, the relationship between self-control and financial behavior is still inconclusive.

Few studies have explored the link between self-control and broader, more general, measures of financial behavior. One of few studies that have investigated a more general set of financial behaviors is Miotto and Parente (2015). They used qualitative as well as quantitative methods to investigate how personal characteristics, including self-control and propensity to plan for the future, affect low-middle class households’ financial management. According to their study, individuals with higher self-control and tendencies to plan for the future also manage their finances better. However, their sample contained only 165 lower-middle class female consumers of a retail company in São Paulo. Thus, there is a need for large scale surveys covering more general samples.

1.2. Individual differences and financial well-being

A related topic that has been underexplored in the previous literature is how the ability to control impulses links to feelings of anxiety regarding one’s own financial situation. Financial well-being is often treated as an objective measure where certain financial decisions are defining features of what constitutes financial well-being. However, an equally important aspect of financial well-being is how people subjectively feel about their financial situation. To what extent do people feel anxiety concerning the many decisions and uncertainties involved in financial decision making? Moreover do people with self-control problems feel more anxiety concerning their own financial behavior irrespective of their own financial situation? To our knowledge, no previous research has been done to examine the effect of self-control on financial well-being.

In addition to self-control, two other psychological constructs that might influence financial behavior and financial well-being are optimism and the tendency to think deliberatively. People who are optimistic are more likely to save, work harder and retire later. However, extremely optimistic people demonstrate deficient financial behavior (Puri and Robinson, 2007). Optimism has also been shown to be associated with general well-being and may be an important aspect of financial well-being. Depressed individuals are more prone to pessimistic thoughts about the future and suffer to a greater extent from pessimism bias than non-depressed individuals (Strunk et al., 2006). Not only optimism, but also intuitive thinking, which can be seen as the opposite of deliberative thinking, has been associated with behavioral biases in decision making. Klaczynski et al. (1997) showed that faith in intuition was significantly related to heuristic judgments as described by Kahneman et al. (1982). Furthermore, Thoma et al. (2015) found that professional financial traders tend to engage in deliberative thinking to a greater extent than non-financial traders, and also that they use fewer heuristics in decision-making. Thus it is interesting to also explore to what extent these psychological constructs, which are related to self-control, are linked to financial behavior and financial well-being.

1.3. Aim of the present research

The main aim of this study is to investigate if self-control predicts financial behavior and financial well-being. Following the BLC hypothesis we predict that self-control will be positively

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