There Is Light At the End of the Tunnel: Helping Consumers Avoid Financial Decision Making Biases By Inducing Broad Bracketing

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Many financial decision-making biases arise from consumers’ tendency to consider decisions in isolation. To induce consumers to spontaneously bracket multiple decisions together, we asked them to identify all the choices that a person makes in a short duration. The manipulation reduced risk aversion, loss aversion, ambiguity aversion, and inter-temporal impulsivity.

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EXTENDED ABSTRACT

Narrow choice bracketing is a pervasive problem in consumer decision making: people often consider decisions in isolation rather than simultaneously assessing the consequences of a series of decisions. One of the reasons postulated for narrow bracketing is cognitive inertia—people’s tendency to “deal with problems as they are presented to them” (Read et al., 1999, p. 188). Cognitive inertia implies that consumers fail to realize that each individual choice is one of a much larger series of choices. In the present research, we developed a manipulation to encourage consumers to broadly bracket their decisions by making them realize that choices are sequential, repetitive, and pervasive.

To induced broad bracketing, we showed participants a 6-minute video in which an actor performed various everyday actions in an apartment (e.g., eating candy, opening mail, listening to a music CD, etc.). In the choice bracketing condition, participants were asked to press a button whenever the actor made a choice, whereas in the control condition, they were asked to make a non-choice judgment, such as to press a button whenever the actor touched an object with his hands. Participants in both condition identified 39 actions on average.

Study 1 examined how the choice bracketing manipulation influenced financial decision making in the domain of risk aversion. After the manipulation, participants were asked to make 20 choices between pairs of high-risk and low-risk gambles of equal expected value (e.g., 20% chance of winning $10.00 vs. 80% chance of winning $2.50). Whereas participants in the control condition were risk averse, choosing risky gambles in only 25% of the trials, participants in the choice bracketing condition were risk neutral, choosing risky gambles on 49% of the trials, consistent with the idea that participants in the choice condition were broadly bracketing their decisions and thus were more tolerant of risk.

In Study 2, following the manipulation, participants were asked to choose between pairs of gambles with ambiguous and unambiguous probabilities of winning (e.g., 40% chance of winning $20 vs. 30-50% chance of winning $21). The ambiguous gambles offered a 5% premium over the unambiguous gambles, with probability of winning in a 20% range about that of the unambiguous option. We found that participants in the choice bracketing condition were significantly less ambiguity averse, choosing the ambiguous gambles in 60% of the trials, compared to those in the control condition, who chose ambiguous gambles in 45% of the trials.

In Study 3, participants were asked to make 36 choices between pairs of immediate vs. delayed payoffs in which we varied the hyperbolic discount rate that the delayed option offered over the immediate option. We hypothesized that participants in the choice bracketing condition would be less impulsive overall and would be more sensitive to the temporal discount rate. We found a condition X discount rate interaction, such that at lower discount rates, where impatience is less costly, participants in both conditions were equally impatient, but at higher discount rates, where impatience is more costly, participants in the choice bracketing condition were significantly more patient than those in the control condition.

Study 4 explicitly tested whether the choice manipulation induced broader bracketing. Previous research has found that people are less loss averse when they have to make many decisions simultaneously rather than one decision at a time (Gneezy & Potters, 1997; Thaler, Tversky, Kahneman, & Schwartz, 1997). While participants in the control condition would be expected show this difference, if the choice condition spontaneously puts participants in a broad bracketing mindset, then we would hypothesize that those making individual decisions would be just as loss aversion as those making simultaneous decisions.

To test this hypothesis, we used a 2 (choice bracketing vs. control) X 2 (individual vs. simultaneous decisions) design. In each of 9 trials, participants could invest a portion of 100 cents in a lottery. They had a 67% chance of losing their investment and a 33% chance of gaining multiplying their investment by 3.5 times. This lottery has a positive expected return of 16.67%. In the individual decisions condition, participants decided how much to invest in one lottery at a time and saw the result of each lottery immediately after their decision. In the simultaneous decisions condition, participants had to decide how much to invest in 3 lotteries at a time, and were thus compelled to broadly bracket their decisions.

We found that while control participants invested a larger amount in the individual decisions condition than in the simultaneous decisions condition, those in the choice bracketing condition invested the same amount irrespective of whether they were asked to make decisions individually or simultaneously. In other words, the choice manipulation made participants in the individual decisions condition just like those in the simultaneous decisions condition.

Finally, Study 5 replicated and extended the finding of Study 4 using a different lottery structure. We also found that whereas the outcome on one trial (i.e., whether participants won or lost the lottery) influenced participants’ decision on the next trial in the control condition, there was no such effect in the choice bracketing condition, again consistent with the broad bracketing mechanism—if people are considering many decisions simultaneously, then they should not be affected by the ups and downs of individual outcomes.

These converging findings suggest realizing that choices are sequential, repetitive, and pervasive can improve consumers’ cognitive myopia in financial decision making—after seeing an actor in a video make a large number of choices, participants appear to no longer “deal with problems as they are presented to them,” but instead re-construe presented problems with a portfolio mindset rather than an individual-decisions mindset. Notably, our manipulation induced broad bracketing by changing consumers’ construal of their decisions instead of changing the structure of the choice task. Future research can attempt to develop educational interventions to mitigate the dark side of consumers’ financial decision making in important real life decisions.

REFERENCES

