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Money Madness – Those Irrational Money Behaviors

Behavioral finance is one of the hot topics of the day. It's all about why people make poor financial decisions. Before you consider it all "bunk" and ignore the conversation, take a look at how marketers are putting that same knowledge to work.

1. Why wine menus always have a few mega buck bottles.

The expensive bottle makes the mid-tier bottles seem cheaper in comparison. Much the same happens in auto sales, appliances, home sales, etc. If your purchase is framed by more expensive options, it seems more reasonably priced, even if it is far more than we intended to pay. By anchoring our expectations of price with the higher option, the lower amount no longer seems too much to spend.

2. Thinking it isn't really a loss until it's final.

Loss aversion makes us reluctant to sell a bad position in hopes that it will go back up. It makes us keep an expensive gadget that we don't use or clothing that no longer fits. It's why we don't cancel memberships we don't use because we view that sunk cost as still potentially redeemable. Health clubs are well aware that once they get that initial membership payment, it's hard for people to cancel their unused memberships.

3. Placing a high value on FREE.

Have you ordered one more item than you wanted on Amazon to get free shipping or bought a product to get the free gift set? We tend to be suckers for "free," not looking at how much we spend just to get something for free. Has a hotel chain called you recently to let you know you have been awarded a "free" stay. That free stay is far from free by the time you factor in travel, food and entertainment costs, to say nothing of potentially sitting through a time share pitch. But it's hard to turn down the idea of a freebie theoretically worth a couple hundred dollars.

4. Present wants are more important than future needs.

Yeah, yeah, we know we need to put money aside for retirement, that we should have an emergency fund and that unless we accumulate a down payment that new home will never be ours. But that's far away and we have a "good use" for the money now. Marketing plays on our desire for immediate gratification and our unconscious feeling that now matters more than later.

5. Overestimating the possibility of unlikely things occurring.

Lotteries love promotion of big winners. If we can think of examples of people who have won the lottery, hit it big in Las Vegas, made the ultimate stock trade, or started a hot company, we think the same is more likely to happen to us, regardless of the odds against that occurring. In the gambler's fallacy, people believe that something is "due" to happen simply because it hasn't for quite some time.

Before you dismiss behavioral finance as something that doesn't apply to you, it pays to think about the money choices we make and why we make irrational choices. If an investment turns sour, the logical decision is to sell it and invest the money in a more likely prospect. As much as you might like to win the lottery, counting on winning to fund your retirement is not logical. You are not more likely to make a lucky bet just because you have lost your money up to that point. Understanding why we make irrational decisions really does help reset our brains to make more rational decisions and that can add up to real money!

TOP

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