FINANCIAL EDUCATION VERSUS SUSTAINABLE SPENDING

At Zero-credit, we are not big fans of the concepts of Financial Literacy, or Financial Capability, as it is now more fashionably called. You may very well question our wisdom, given that we ourselves publish creditfree living tips and are entering the field of financial education. However, with the growing trend for money management, we find that simply focusing on the sums isolates far too many of us. Who wants to be labelled illiterate or incapable after all?

The value of money is relative: it is what we do with the money we earn, save, or find that excites us, and the regrets we may feel when a sum is lost. There is nothing intrinsically motivating in money, so managing it demands more than an understanding of its numerical values. Most of all in the 21st Century, we are surrounded by messages encouraging us to spend, so we need to decode the promotions to find the key to focusing on what we need and want.

Zero-credit has always respected our individual differences. Some thrive on Spartan anti-consumerism, whilst others tend towards the comforts of opulence and luxury. Those with children have different needs to those without, whereas younger people invariably seek adventure and to explore. What interests Zero-credit most, other than circumstances that change our capacity to earn, is that which prevents us from retaining our wealth.

‘Sustainable Spending’ is our first attempt at drawing together the work of leading psychologists in the fields of spending, payments and borrowing and we are fortunate that several have expressed an interest in working with us in the future. We should particularly like to thank Professor Priya Raghubir at NYU Stern, Jashim Khan, lecturer at the AUT Business School and Professor Stephen Lea, at the University of Exeter for their kind contributions of information and advice, as well as their enthusiasm for our work to date.

We expect to update this e-book every couple of years, for ours is an ongoing battle between consumer and marketer: they need us to spend, whereas we need only to spend how we want. The first in a series of creditfree e-books, ‘Sustainable Spending’ is exclusive to Zero-credit Members and Subscribers and not for resale or redistribution to others. If you want to share its ethos and ideas, simply ask your friends, family, neighbours, colleagues or associates to join our cooperative! We very much look forward to involving you in the development of future e-books, but for now, this one is ours.

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The Language of Money Management

Whether our focus is living within our means, getting and staying out of debt, or simply to ensure future savings, there is a whole host of terms used to describe our financial circumstances and approaches to managing them.

We cannot ignore our own prejudices, when implied low levels of financial literacy or capability encourage us to hide painful experiences and outcomes, no matter how unconnected to our actions and responsibilities these money worries may be.

Prospect Theory\(^1\) suggests that the perceived pain of a loss is greater than the joy of a gain, meaning that the pain of working for a goal may be greater than the joy experienced on achieving it. When we use credit, the pain of paying takes place after we have received the item we are buying, but what happens if that item loses its appeal, or does not last? Is the pain of working for a goal is greater before or after achieving it?

In our November 2010 Comparison of Debtors and Savers, Zero-credit found that whilst 11% of people said that they had not used any credit in the last three years, 57% said that they had not borrowed any money within that time. Perceptions of the two are clearly very different.

Where it may be ‘clever’ to use credit for consumption smoothing - spreading the costs of what we buy - this only applies when we succeed in balancing our books at the end of an agreed term. Meanwhile, the ‘future discounting’ of borrowing is only an investment worth celebrating when the value of any assets meets or surpasses their cost. Get it wrong, by misdemeanour, miscalculation or misfortune and the outcome is the same: we are in debt.

\(^1\) Prospect Theory was developed by Daniel Kahneman, professor at Princeton University's Department of Psychology, and Amos Tversky in 1979. It helps to describe how people make choices in situations where they have to decide between alternatives that involve risk, for example, in financial decisions.

Percentage of people who stated that within the last three years they:

- did not use credit: 11%
- did not borrow: 57%

Zero-credit Ltd: Borrowing a Comparison of Debtors and Savers. December 2010

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Debt

The Oxford Dictionary defines debt as:

- a sum of money that is owed or due
- the state of owing money
- a feeling of gratitude for a service or favour

Others extend the emotional aspects of debt yet further to feelings of obligation, duty and a liability to pay or do something. This may be appropriate and honourable in a relationship of mutual respect or trust, but what happens when we feel obliged to pay for something we no longer possess or value, or the obligation is beyond our means?

If we can feel inadequate as children, lovers and parents even, how much less forgiving is our relationship with a creditor whom we could have chosen to avoid. Experiencing an error of judgement as ours alone, we increase the risk of reduced motivation and the potential to ignore debt until it has spiralled out of control.

To repay any debt requires us to place another’s interests before our own. However, research has found that self-control is a limited resource. After a prolonged period of controlling ourselves, we can become more likely to give in to temptation. Psychologists call this ‘ego-depletion’ and it can result in the ‘What the hell effect’, a detrimental excess that sets our best efforts back.

Whilst it is true to say that tackling unmanageable borrowing or spending early invariably has better outcomes in the longer term, it is important to recognise when we are at our weakest and our self-control is low. If we feel a sense of inadequacy about a situation, words like debt, which prompt sentiments of liability and obligation, may not help us to achieve our long-term goals.

2 Vohs KD and Heatherton TF. (2000). ‘Self-regulatory failure: a resource-depletion approach’: ‘As hypothesised, exerting self-control during the first task led to decrements in self-control on a subsequent task. Moreover, these effects were not due to changes in affective state and occurred only when self-control was required in the first task.’

Encompassing a range of assessment types, from vague estimates to specified amounts of money, definitions of the word budget are fraught with contradiction:

- an estimate of income and expenditure for a set period of time
- the amount of money needed or available for a purpose

Estimates are, of course, only as reliable as the information on which we base them, so to predict future spending from past recollections is a recipe for miscalculation. Of course, money management experts recommend we record every transaction, but is this practical or realistic in every case? Let us not forget that the gap between that which we should, and that which we do, provides ever more scope for feelings of inadequacy when self-control is low.

Research\(^4\) suggests that when we ask people to give an account of frequent behaviour:

- They tend to estimate, rather than recall and count each individual experience.
- The more mundane the activity, the more likely they are to estimate.
- Extreme experiences are often recalled in detail, especially if they are negative.
- People often exaggerate or embellish their accounts of extreme experiences.

The same applies to our recollections of spending, so an awareness of bias is the first step to addressing this. However, simply recognising a tendency to underestimate spending leads us to overcompensate for this in future estimates. This is not going to help if we 'make a budget and stick to it' based on an overestimate for spending on items that we are trying to cut back: magazines, alcohol or shoes for instance.

Decomposition is an estimating technique used during research into spending recall\(^5\) that encourages us to explore anchors to adjust our estimates. For instance, if we eat out regularly, trying to remember the restaurants visited, the company kept, or the types of cuisine we have eaten will provide us with greater accuracy in recalling and therefore counting individual episodes.

The anchors that lead us to the greatest accuracy have little to do with the amount spent until we recall the associations and context of our spending. They also make us far more likely to identify patterns in our behaviour that encourage us to spend despite our convictions to resist temptation. In short, we may become able to recognise triggers that lead us off track and to eliminate or avoid circumstances in which we have less control.


COST-CUTTING

Cost-cutting has entered our money management vocabulary alongside new trends, which equate household spending with running a business. Its promise of increased efficiency and, above all, profitability is what appeals. However, the difficulty with applying commercial principles to a household is that for many of us, the people we live with are more than cost centres to be rounded and trimmed at every management review.

Whilst there is merit in teaching a child deferred gratification, the temptation is to cut costs on anything and everything that constitutes fun: we cannot afford to go bowling, to the cinema, or on holiday next year. Countless media reports that Brits will spend less on leisure or are downshifting to affordable, unbranded goods in recession affirm our resolve. We feel a part of the trend, when we commit to it.

However, in our rush to cut the costs of perceived excesses and to exercise self-control over anything more than our most rudimentary needs, we deny ourselves significant pleasures that nurture our independence and originality. Without these anchors to recall, there are no peaks and troughs of joy or pain. Thus, we lose our capacity to differentiate experiences, to question what is valuable to us and to solve problems to address this. Moreover, as we learn from the ‘What the Hell effect’, prolonged self-control runs against our nature and is not sustainable. Too often, we pay the price for our thrift when we rebel, leaving us no better off than when we started, often less so.

Economies are not efficient unless they are effective. No business cuts costs where there is a return on investment: multiple and family households, in particular, are investors in people. These households can economise most effectively by reviewing the items they consider least; frequent and mundane spending that we are most likely to ignore or miscalculate. Specifically positioned to solve our problems conveniently, budget brands aim to keep us spending. Our challenge is to consider what is cut at our expense.

In as much as we hold different views about what governments could and should cut in public spending, our own spending requires the command of our own opinions if it is to be most effective. We can only be truly satisfied in our spending when it reflects what we have consciously chosen to reflect our personal needs and wants.

6 The Stanford marshmallow experiment was a study on deferred gratification, conducted in 1972 by psychologist Walter Mischel of Stanford University. In the study, a marshmallow was offered to each child. If the child could resist eating the marshmallow, he was promised two instead of one. The scientists analyzed how long each child resisted the temptation of eating the marshmallow, and whether or not doing so had an effect on their future success. The results provided researchers with great insight on the psychology of self control and evidence that good impulse control might be psychologically important for academic achievement and for success in adult life.

KEY POINTS

Running a household is not like running a business

Denying ourselves rewards and pleasures is not sustainable in the long-term

Frequent spending requires more rigorous review than occasional treats

We need to make our own, informed choices that fit our values and lifestyles
MONEY-SAVING VERSUS CREDITFREE

The Oxford Advanced Learners Dictionary defines comparative newcomer, money-saving, as ‘something that helps you spend less money’.

This combination of language is a clever ploy because despite using the word saving, which ordinarily means money set aside for a future purpose, implicit in the term money-saving is the assumption that we will spend. Examples include receiving cashback after you have spent, discounts and deals that commit you to buying, buying one to get one free, or three for two offers to entice you into trying or indulging in more than you expect.

Money-saving is so new a term that its definition depends on references to many forms of economizing, but these too present us with an array of choice. Alongside the compromise and hard graft of scrimping for instance, it is easy to perceive quicker and greater returns from an investment in vouchers or better still, freebies. Remember from Prospect Theory how the perceived pain of a loss (hard work) is greater than the joy of a gain (obtaining our goal).

We shall explore some of the psychology of pricing later in this e-book, but for now, it is enough to recognise that we are highly likely to be confused when our clutch of money-saving bargains results in our spending more than we had originally intended. Indeed, we can easily feel stupid for not saving money with money-saving tools and most certainly, if that is how we do feel, anything labelled money-saving is best avoided.

Creditfree is a term coined by Zero-credit founder, Emma Bryn-Jones, to describe the acquisition of products, services or experiences that do not require borrowing. It may also include circumstances that do not require us to spend money. Emma was particularly keen to avoid the stigma associated with the word debt and to shift perceptions of credit, to make it less appealing. It is more common to find the term debt free than creditfree for instance, yet the former implies a release or relief from burden.

Our intention is to disrupt the widespread acceptance of credit compared to the rejection of debt. Many of our Members, Subscribers, followers and fans have started to use creditfree to replace words like budget, cost-cutting and money-saving whilst others continue to qualify the word creditfree with one of these. For this reason, it is difficult to assess the impact of using the word creditfree and it will be interesting to see how it develops as our cooperative grows.
SPENDING

Throughout history, society has attempted to control consumption, initially to protect the trade in expensive goods. In the past, sumptuary laws were an effective tool for differentiating social rank and class, often leading to discrimination also. Laws to regulate social hierarchies through restrictions on clothing and luxury items were set out in long lists, specifying the colours, materials and places of manufacture even. For example, an English Law of 1363 restricted the wearing of gold or purple silk to women of the royal family only. Such laws were well known and the penalties for breaking them, severe. In Britain, sumptuary laws fell out of use during the 17th Century, although the continuation of class systems ensured the symbolism of conspicuous consumption flourished.

Coined by the American economist and sociologist, Thorstein Veblen, in 1899, conspicuous consumption seems even more relevant to our spending today than it did over a hundred years ago. Despite efforts to reform social mobility, consumption has evolved to become a means of self-realization and identification, in that we no longer merely acquire products and services: we consume their symbolic meaning and image also. Within fashions for sumptuary laws, three common themes are still prominent today: physicality, exclusivity and variety. Whereas once, we valued obesity as a physical demonstration of wealth, we now use cosmetic enhancements and we have replaced the exclusivity of jewel-encrusted robes with designer labels. Indeed, it is easy to see how we adopt events and occasions, fueling demand for an increasing variety of consumption and how quickly trends switch to anti-trends to support this.

Armed with this brief history of connotations, we are better equipped to rationalise the messages of any marketing mix and to identify which subliminal techniques encourage us to spend. The emergence of Brand Loyalty and Identity are particularly relevant because they call to atavistic desires to absorb products and services, in an attempt to reflect status as an intrinsic worth. The personification of Access credit cards as our ‘flexible friend’ was a prime example of this and led the trend for cartoon based money products.

In ‘Psychology Meets Economics: Why Consumers Can’t Count Their Money Correctly’, Priya Raghubir sets out some of the variation in perceptions of value to demonstrate how marketers use psychology. For instance, Prospect theory is behind promotions in which gifts, discounts and bundles present a combination that seems preferable to the sum of its parts. Two 10% discount vouchers appear more valuable than one 20% voucher, yet they may well lead us to spend twice. In a similar vein, Weber’s Law, which uses visual reference points to inform choice, suggests that non-comparable product forms will make it harder to compare products in relation to price, thus the value of pizza served as slices, rounds and squares can remain hidden. The same applies to bags of fruit containing five or six pieces. It is difficult to compare the price per kilogram, so we give up trying.

9 The term “marketing mix” was coined in 1953 by Neil Borden, although this was actually a reformulation of an earlier idea by his associate, James Culliton, who in 1948 described the role of marketing manager as a “mixer of ingredients”. E. Jerome McCarthy, proposed a Four P classification in 1960: Product, Promotion, Place and Price.
11 Ernst Heinrich Weber (1795–1878) was one of the first people to approach the study of the human response to a physical stimulus in a quantitative fashion. Gustav Theodor Fechner (1801–1887) later offered an elaborate theoretical interpretation of Weber's findings, which he called simply Weber's law. This attempts to describe the relationship between the physical magnitudes of stimuli and the perceived intensity of the stimuli.
PAYMENTS

As part of ongoing research into the impact of cashless transactions, in 2009, Jashim Khan and Margaret Craig-Lees12 reported evidence that the volume, value and type of products purchased increase when a credit card is used. In short, the changing physicality of cashless transactions may be removing significant anchors or reference points, which help us to control our spending. Currency can have historical or political contexts, or we may experience emotional associations with certain notes and coins, which are lost as payment methods change. Indeed, the perceived value of any currency within money-based transactions opens a wide range of discussions across academic disciplines.

Our immediate concern is to understand payments psychology techniques in order to inform and control our spending. Common money illusions include visual, numerical and face value biases: for instance, assuming that notes, which are larger than coins are more valuable, then spending more in small change than when using a note to pay, or spending live ten pound notes with ease, yet refusing to break into a fifty-pound note! Why do we often spend more on holiday overseas? Without our usual reference points, it is harder to make value judgements about currencies with which we are not familiar.

There is also evidence to suggest that we are more likely to spend currency that is more colourful and appears less serious. We can begin to see why cards have replaced gift vouchers and there are choices of credit and debit cards, decorated with personalised and personified images, especially in markets aimed at young people and children.

In addition to our social and cultural perceptions of money, the physical tangibility of a currency creates a strong psychological influence in how we spend it. When we exchange a tangible payment token for a product or service, the pain of loss is closely associated with the joy of a gain. To some extent, credit separates these experiences, yet interestingly, there is also evidence to suggest that payment by debit card is even less painful than payment by credit card. Perhaps we are lulled into a false sense of security by the assumption that we are drawing on funds that we have? This is particularly worth noting in relation to spending recall.

Colourful money tokens, such as decorated credit cards encourage us to spend more.


SUMMING UP FOR SUSTAINABLE SPENDING

We hope that this short overview of some of the psychology behind money management techniques leaves you better informed to handle your own finances. At Zero-credit, we believe that spending needs to be a personal and informed choice if it is to sustain saving, borrowing or simply maintain our capacity to live within our means. This is why we emphasize sustainable spending over financial education.

Whilst low levels of numeracy continue to plague our capacity to manage money, UK education statistics13 point to relatively little change in numeracy levels over the past twenty years. UK debt statistics on the other hand do not. Behavioural economists14 are increasingly looking to the cost efficiencies of automatic enrolment on pensions and savings plans over widespread public information to encourage the take up of behaviours where we might otherwise procrastinate and postpone our intended actions.

Perhaps the greatest key to dodging the pitfalls of our increasingly complex and global society is to recognise that in the face of information growth we are all likely to become selective about when and where we are attentive. However much we may dislike the inequalities of certain marketing strategies, the phenomenon of inattentive and unaware behaviours will invariably create opportunities for those who observe situations carefully. At Zero-credit, our aim is simple: to outmanoeuvre the Personal Finance sector and place consumers back at the heart of decision making, because ultimately, we are market forces!

**KEY POINTS**

- We spend on credit and debit cards more easily than when using cash
- We part with five £10 notes more readily than we break into a £50 note
- We find it easier to spend when using an unfamiliar currency
- Colourful money tokens, such as decorated credit cards encourage us to spend more

13 The Sheffield report - The levels of attainment in literacy and numeracy of 13- to 19-year-olds in England, 1948-2009 - says the latest evidence shows that 22 per cent of 16- to 19-year-olds are functionally innumerate. Professor Greg Brooks, one of the study’s authors, said this had remained at around the same level for at least 20 years. Sheffield University researchers synthesised more than 60 years of evidence on numeracy and literacy and concluded that standards have generally risen in England, with the highest skills among the best in the world.