11. New strategies to affect behavioral change in wealth management, interview with Sille Krukow

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Behavioral design principles are based on the idea that humans often deviate from the principles of economic rationality. Research suggests that human behavioral biases in financial decision making occur both consistently and in recognizable patterns. This means that we can design incentives to correct the biases. Sille Krukow talks with us about how behavioral design principles can help wealth managers enhance client loyalty by helping their clients make better decisions.

Redesigning Financial Services (RFS): Behavioral design is based on insights from behavioral economics. Can you explain this relationship?

Sille Krukow (SK): Yes, sure. Behavioral economics is based on the idea that we humans do not always act as rationally as economic models may predict. For example, we tend to excessively discount the future, making us value impulsive purchases like a new iPhone today over making less urgent but necessary contributions to a retirement plan. Such deviations from rationality are referred to as cognitive biases, and they generally occur when our feelings override what may be considered rational thinking. Behavioral design principles help us use these biases to our advantage, rather than to our detriment.

RFS: Can you share some examples?

SK: Of course. In healthcare and wellness, behavioral design applications are already helping people improve health-related behaviors like diet and exercise. For example, the app Pact uses behavioral weakness and turns them into strengths. Users make a weekly pact, choosing how often they intend to exercise and even bet money on their commitment. Users, who fail to honor their pact, forfeit the money they put in. The forfeited money is then pooled and distributed to those, who did exercise. This has proven to be a big motivator by making the impulse to laze around today less attractive than invest in a better health in the future.

Another exciting example from another industry is Opower – a company that helps utility companies nudge consumer behavior by applying the motivating power of social norms. The company designs personalized energy bills informing consumers how their energy use compares to that of other efficient households. This simple intervention has delivered considerable savings, and is far more cost-effective than traditional marketing or economic incentives.

RFS: Can you explain the cognitive processes behind the success of such examples?

SK: Very broadly speaking, it is important to understand that human behavior is controlled by two systems of thinking: reflective and automatic thinking. Reflective thinking is conscious and rational thinking, and it is best activated when one is in a calm and collected state – a cold state of mind. Reflective thinking helps us navigate a complex world as reasoning critical thinkers. Unfortunately, reflective thinking is very energy-intensive, even causing our blood sugar level to fall. Perhaps you can recall how hungry one gets when studying for hours on end.

Different to reflective thinking, automatic thinking is fast, energy-efficient and unconscious. Automatic thinking essentially boils down to what we would call habits or even instincts in colloquial language. They are influenced by our previous experiences, cognitive short-cuts and of course by our immediate surroundings. And since automatic thinking is so much more efficient than reflective thinking, our biological "default" is to be in a state of automatic thinking for 90% of the time, preserving energy and only drawing on the energy-demanding reflective processes when absolutely necessary.

The examples I mentioned before all typically employ design to make the "right" decisions the easy ones – or the ones favored by the automatic thinking system.

RFS: What does all this mean for designing customer experiences in wealth management?

SK: Let me begin a little bit more broadly. On an evolutionary level, this means that we as humans are best suited to live and interact with very simple environments – environments that allow our automatic thinking to inform the majority of our decisions. This is typically an environment that minimizes complexity and uncertainty – essentially anything that would activate reflective thinking unnecessarily.

From a wealth manager's perspective, the impact is clear. We need to design both online and offline client journeys that are uncluttered with too many distractions, and that allow our clients to rely on their more efficient automatic thinking systems during the decision-making process. Concretely, this means focusing less on rational incentive structures – like legal information or pricing structures – and paying greater attention to how we design the surroundings in which our clients make their choices – both online and offline. In other words, we need to design better "choice architecture".

RFS: What is choice architecture?

SK: Very broadly, choice architecture explores the impact the design of an environment can have on the choices being made in it. Most essentially, it is a targeted design process that facilitates behaviors among clients that correspond with their values, needs and aspirations, such as for example staying within budget limits, saving for the future, etc. The key here is to empower consumers in a way that their every-day automatic actions correspond with their long-term ambitions.

It is important to note that choice architecture already exists in our current surroundings. However, most existing paradigms engage the client in very rational, information-driven ways, and thus also fail to predict and prevent human errors in the process. Done in the right way, choice architecture can limit the probability of mental errors compromising our ambitions. This can be done in a number of ways, like by anchoring financial incentives, defining the right defaults, framing communication, and by optimizing feedback loops.

RFS: Today, robo-advisory is en vogue offering the potential to automate much of the investment process. Does this minimize the relevance of choice architecture?

SK: I do not think so. Even if some financial decisions are made well by robo-advisors, the emotions connected to human decisions will still play a key part in the investment process. For example, what will keep investors from selling in panic during a drop in the market? Or what will prevent investors from investing during times when everyone is jumping into the market? I think we can find part of the answer to these questions in the potential of intelligently designed choice architecture that makes the "right" decision the easy one. In fact, many big robo-advisors like Vanguard are already integrating behavioral design insights into their interfaces to nudge clients to save (and invest) more for retirement.

RFS: How important is it for wealth managers to deliver a great customer experience? And what role can choice architecture and behavioral design principles play in this context?

SK: I think it is clear that many of the products wealth managers will deliver to clients in the coming years are already at risk of being commoditized. It is in this environment that the value of a fruitful client experience gains in importance. Looking ahead, I think players that are able to deliver a fabulous client experience are likely to thrive, while those who are not, are likely to fall behind. And today's customers are increasingly looking for convenience, authenticity and exclusivity rather than just competitive prices. Choice architecture that corresponds with client values can be a key ingredient to the delivery of the positive, long-term client experience that will help incumbents thrive in the future.

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