Peer Advice on Financial Decisions: A Case of the Blind Leading the Blind?

Sandro Ambuehl,
University of Toronto and CESifo
Douglas Bernheim,
Stanford University
Fulya Ersoy,
Stanford University
Donna Harris
University of Oxford

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Motivation

People often consult non-expert advice for financial decisions (Lusardi, 2003, 2008; van Rooij et al., 2011; Lusardi and Mitchell, 2014; Bernheim, 1998)

Social interaction affects personal financial decision making (Beshears et al., 2015; Brown et al., 2014; Bursztyn et al., 2014; Cai et al., 2015; Duflo and Saez, 2003; Hvide and Ostberg, 2014; Hong et al., 2004, 2005; Kast et al., 2016; Ivkovic and Weisbenner, 2007)
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Are the effects beneficial / harmful?
Breaking taboo: Ask your friends and family for financial advice

by J.D. Roth

Updated on October 6th, 2016

INVESTOR TOOLKIT

FA HUB | ADVISOR INSIGHT | FA PLAYBOOK | INVESTMENT STRATEGIES | INVESTOR TOOL

Beware of bad financial advice from friends and family

Deborah Nason | @dnason

16 Hours Ago
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- Even carefully designed, professional communication can fail to improve decision making (Ambuehl, Bernheim, Lusardi, 2016), so why would the average peer to succeed?
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Case of the blind leading the blind? (Bernheim, 1998)
  - Even carefully designed, professional communication can fail to improve decision making (Ambuehl, Bernheim, Lusardi, 2016), so why would the average peer to succeed?
  - “Two heads are better than one”?
    - Often decision making is better in groups (Charness and Sutter, 2012)
Research Questions

Does face-to-face communication with a randomly chosen peer improve decision making quality in settings where best choice depends on preferences?

Context: A laboratory experiment in the UK, decisions involving both preferences and the concept of compound interest.
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**Mechanisms:**

- Do subjects merely mimic others’ choices? Do they acquire skills they can apply to new problems?
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Spillovers:
- Can we use communication to leverage financial education?
Experimental choices

Each subject makes each choice twice, in two frames. Example:

- **Complex framing:** What amount £\(v^{\text{complex}}\) today is as good as receiving £5, invested at 1%, compounded daily, after 72 days?

- **Simple framing:** What amount £\(v^{\text{simple}}\) today is as good as receiving £10 in 72 days?
Timeline

Stage 1

Stage 2

Choice Problems
Timeline

Stage 1
Choice Problems

Stage 2

Communication: Discussion
Timeline

Stage 1
Choice Problems

Stage 2

Communication:
Discussion

Solitary:
Contemplation
Timeline

Stage 1
- Choice Problems

Stage 2
- Choice Problems
  - Discussed
  - Novel

Communication:
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Timeline

Stage 0: Choice Problems

Stage 1: Choice Problems
- Discussed
- Novel

Stage 2: Choice Problems

Communication: Discussion

Solitary: Contemplation
Timeline

Stage 0
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Stage 1
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Stage 2
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Communication: Documentary Discussion
Solitary: Documentary Contemplation
Timeline

Stage 0

Choice Problems

Stage 1

Choice Problems

- Discussed
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Stage 2

Choice Problems

Communication: Documentary

Discussion

Solitary: Documentary

Contemplation

Comm. with Educ. Documentary

Discussion

(Education for partner)
Data

- 263 subjects
- University of Birmingham, UK, Fall 2015-Spring 2016
- Mean completion time: 123.75 minutes (s.d. 20.01 minutes)
- Mean payment: £26.55

Dependent Variable

- Financial competence $-|v^{\text{complex}} - v^{\text{simple}}|$ 
- Normalized as if each future value was £1
Does communication help or hurt decision making quality?

Averaged across discussed and novel tasks. Slopes: Solitary: 0.016 (s.e. 0.018). Communication: 0.088*** (s.e. 0.017). Diff-in-diff: 0.072*** (s.e. 0.027). OLS, s.e. clustered by subject.
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Conceptual learning or choice mimicry?

Slopes: solitary-discussed: 0.022 (s.e. 0.022), solitary-novel: 0.009 (s.e. 0.022), communication-discussed: 0.096*** (s.e. 0.019), communication-novel 0.081*** (s.e. 0.018). Diff-in-diff: discussed: 0.073** (s.e. 0.030), novel 0.071** (s.e. 0.029). OLS, s.e. clustered by subject.
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Who benefits most from communication?

Hypothesis 1

Information flows from those who have it to those who do not (e.g. Jackson & Bruegman, 2009)

- Improve more the better the partner

4 kinds of pairs
Classify using stage 0 decisions (to avoid regression to the mean)

- Self in better / worse half
- Partner in better / worse half

Skill transmission more effective between people of similar skills who can address concerns at appropriate level and pace (e.g. Booij, et al., 2016, Feld & Zolitz, 2016, and Haliassos et al., 2017)

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Difference in slope Communication to Solitary: Self worse, partner worse: 16.4%*** (s.e. 2.2), Self worse, partner better: 8.29%*** (s.e. 2.13), Self better, partner worse: 0.48% (s.e. 2.47), Self better, partner better: -2.15% (s.e. 2.5). Difference in better vs. worse partner: Self worse: -8.06%*** (s.e. 2.18), Self better: -2.6% (s.e. 2.12). OLS, s.e. clustered by subject.
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Variables

- Highlight similarities e.g. “I’m bad at this too, let’s see whether we can help each other out”
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**Variables**

- **Highlight similarities** e.g. “I’m bad at this too, let’s see whether we can help each other out”
- **Small talk topics**: Country of origin, college major, years of study
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Slopes: Diff-in-diff communication with educated / not educated: 0.042, \( p = 0.016 \).

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Most beneficial between people with similar skill levels, as transmission requires “common language”

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▶ Can we use communication to leverage financial education?
Not really since education indirectly helps through choice mimicry, but not through conceptual learning.
Conclusion

Policy implications
Financial decision making may be improved by encouraging communication even in environments involving preference heterogeneity

▶ Will be most effective if (e.g. in financial education interventions) people of similar skill level are paired
▶ By contrast, educating part of population and relying on diffusion may be ineffective
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Further questions

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  - Our experiment: Ability and confidence highly correlated
  - Maybe less so in other contexts (e.g. Linnainmaa et al., 2016)
- Would effects be similar in less / more educated subject pools?
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