Hey! What’s New? 2024-114

Using Behavioral Science in a Financial-Planning Practice

A recent article in the *Journal of Accountancy*, written by Dave Strausfeld, J.D., notes that behavioral finance is a field focusing on the sometimes irrational ways people make financial decisions and how to improve their decision making. This article discusses some ideas for financial-planning practices to consider. They come from a presentation at the AICPA & CIMA ENGAGE conference in June given by Michael E. Kitces on how to use behavioral finance in a financial-planning practice.

One study that Kitces summarized in his presentation suggests that overly lengthy client meetings can hinder clients' ability to arrive at a decision. “The researchers found, in another context, that a criminal parole board was more likely to grant parole if the parole hearing was held first thing in the morning rather than at 11 a.m. after other hearings. Why? By 11 a.m., the strain and effort of the morning's previous hearings had caused the parole board members to become mentally drained, hindering their ability to make deliberate decisions,” Kitces said.

An implication of this study, Kitces observed, is that after a 1½-hour meeting with a financial adviser, clients may think, "My brain is freaking tired. You ain't getting no decision from me at this point."

For similar reasons, Kitces suggested that advisers should be careful not to overwhelm clients with the number of decisions they must make simultaneously, because this can impede decision making too. Instead, after a broader discussion, consider focusing on achieving one or two goals at a time, he recommended.

Another worthwhile technique, Kitces observed, is to have clients write down their priorities and set a written deadline for achieving them. This may help spur them to complete the tasks, because people are wired to feel socially obligated to follow through on written commitments, he said.

Kitces also discussed "choice architecture," which examines how the framing of choices influences people's decisions. “The difference between opting in versus opting out is especially important and has implications for financial planners' fee structures,” Kitces noted. Financial planners designing their fee structures should consider this insight into people's natural tendency towards inertia, he stressed.

In some financial-planning fee models, clients keep paying for the services unless they opt out, meaning the default option is to continue using the services. In contrast, with hourly billing, clients must make a fresh opt-in decision each time they have a new financial question to ask the adviser for which they'll be billed. The easiest choice is to forgo asking the question, saying, "I'm just going to not deal with it right now," Kitces said. Advisers should at least be aware of this behavioral difference.

A related notion applies to business decisions about whether to bundle services together, Kitces noted. For instance, if a firm strongly prefers working with highly motivated clients (and isn't worried about having enough of them), it might consider charging for a service separately.

Clients who overcome inertia to make an affirmative choice to spend money on the service will be more likely to follow through with it, compared to those who receive it bundled in, he said.

Kitces mentioned that his former firm began asking clients for permission to take a headshot photo when they were in the office and put it in their customer relationship management (CRM) record. That way, all members of the team, including back-office employees who might not meet with clients at all, weren't "just looking at a bunch of numbers in the CRM," Kitces explained. The photos humanized the clients.

In addition, Kitces noted that his former firm began posting one-to-two-minute videos of its advisers introducing themselves. Using videos rather than merely photos led to a rise in website-driven inquiries from potential clients, who "bonded with and picked their adviser" from the short video introductions. The videos humanized the advisers and led to an increase in business, he indicated.

In sum, behavioral science can be a powerful tool for working with clients more effectively and operating a financial-planning practice better. But, Kitces stressed, "Please use 'The Force' for good and not for evil."

Learn more at [Using behavioral science in a financial-planning practice (journalofaccountancy.com)](journalofaccountancy.com).