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The power of habits for improving financial wellness

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Much of our financial wellness is based on our actions and behaviors. We might want a better credit score or more savings, but we don't take the actions required to accomplish those goals. Our desire to change doesn't always lead to action.

Many unsuccessful change seekers cycle through similar steps. In the beginning, we expend lots of energy as we tap into our willpower. We attempt to commit to the new behavior by raising the cost of failure (e.g., purchase a gym membership thinking the payment will inspire us to go or announce our new savings plan on social media). For a while that works, but we begin to lose steam. We don't like feeling denied and can become preoccupied with what we perceive we're missing. Who wants to stick to their budget when they see their friends' brunch photos posted on social media? Eventually, we start making excuses to rationalize not sticking with our plan ("I'll just have a small meal at brunch") and revert to previous behaviors to stop the internal conflict. We blame our lack of willpower for the perceived failure.

The ability to exert willpower is one of our brain's executive control functions. Executive control functions are the cognitive skills we use to make decisions, control impulses and progress toward goals. Executive control functions expend mental resources and can be compromised when we're low on energy or consumed with competing decisions and day-to-day survival. For example, someone who's worried about what they'll eat each day has less available mental resources for long-term planning and willpower exertion.

How can we leverage that understanding of human cognition to improve our financial wellness? We can work with our brains to leverage the power of habits.

Habits are a form of automaticity—meaning the ability to rapidly carry out actions or tasks without relying on our brain's executive control functions. Research shows that nearly half our daily behaviors are habitual. And that's not necessarily a bad thing! Could you imagine if it took significant conscious effort to weigh the pros and cons of dental hygiene before remembering how to put toothpaste on your toothbrush?

Habits are automatic actions that don't rely on the brain's executive control.

Why are habits so important for financial wellness? Consider how many habits are financial in nature or have financial implications. Whether it's our daily trip to a favorite coffee shop or celebrating occasions with fancy meals or shopping sprees, our habits impact our pockets. Unbeneficial financial habits can impede our ability to meet obligations, which can result in the need to take out loans. For many, these aren't large loans; some people resort to payday loans and are charged more in fees than the amount they needed to borrow. According to the Pew Charitable Trusts, on average each year, a payday loan borrower takes out eight loans of $375 each to pay recurring expenses—and pays an average of $520 in fees.

Habits have consequences. So how do we replace bad habits with good ones or build new good habits to yield positive results in our financial state?

Building habits requires effort and patience—that's the idea at the heart of the common saying "it takes 21 days to make a habit." If we accept that as truth, we might wonder why we're still struggling to keep our New Year's gym commitment in the last week of January. The reality is quite complex. It's likely the 21-day habit statement arose from a 1960s book in which a plastic surgeon, Dr. Maxwell Maltz, noticed that it takes about 21 days for patients to become accustomed to their post-surgery bodies. Dr. Maltz generalized this experience to other events, like moving to a new home. Eventually, it morphed into a target timeframe for habit success.

Recent research shows it actually takes about 66 days or longer to form habits. We can automate simple actions faster than complex ones. And we're prone to habit slips, because old habits aren't forgotten. Instead, we need to form new habits the brain will favor over established patterns.

According to Dr. Wendy Wood, a psychologist who has studied habits for more than two decades and author of *Good Habits Bad Habits*, habit formation hinges on three basic components: *context*, *repetition*, and *reward*.

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Context refers to our environment, which provides cues that trigger our behaviors. These cues are the promoting and restraining factors that either increase or decrease the likelihood we'll take a particular action. For example, being asked "would you like fries with that?" in a fast-food restaurant boosts the likelihood we'll spend (and eat) more. Keeping cookies and chips in the house increases the likelihood of late-night snacking—and having them in our bedroom further promotes night snacking.

Context includes social influences, the ways our culture and relationships impact our behavior. If our friend group goes to brunch every week, we're more likely to go—even if we're low in funds. Identity economics describes how we place ourselves into social categories that determine how we behave and influence the economic decisions we make. Thus, part of context is introspectively reviewing our ascribed norms and determining if they match with our financial well-being goals.

Our norms are often intertwined in our cultural identities, e.g., America has a culture of spending. Our cultural associations may encourage us to shell out large sums on country club memberships, extravagant nail appointments, the latest sneakers or vacations. Many of us think we're not vulnerable to external influences, such as marketing and social norms, but research debunks that assertion.

When aiming to build good financial habits, context matters.

Think: *how can I create an environment whereby a desired action is easier to accomplish?* Ask yourself: *do my financial habits align with my values, or am I acting on unconscious cultural influences?* Without addressing context, we'll be fighting our environment and using more of our executive control resources, which are finite.

> Context: one of the best predictors of economic upward mobility is being friends with someone who is more financially secure than you.

Factoring in community. Humans are a social species. We thrive when we're active and welcome in our communities. Healthy and supportive relationships are associated with longer and higher-quality lives. Because we influence each other and are prone to follow the crowd, the benefits of community can translate to our financial lives. Surrounding ourselves with others who share similar financial goals can improve our ability to stick with our new behaviors. In fact, one of the best predictors of economic upward mobility is being friends with someone who is more financially secure than you. When building community around a goal or idea, each person reinforces the other's behaviors, helping build positive habits.

Repetition, in the context of habits, refers to continuously performing an action until it becomes automatic. This component of habit building is most effective when we establish a routine of doing the same things in the same way each time. The amount of time it takes for the action to become automatic depends on how well we address the restraining and driving forces in our environment (i.e., our context).

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Someone looking to develop a new gym habit is more likely to be able to repeat the behavior if the gym is close to their home. A long drive can be a restraining force that can make the behavior more difficult to build into a habit. The automatic transfers available through electronic banking systems are examples of easier repeated savings. Less-frequent routines can also be established and their effectiveness enhanced when the routine is tied to something external—again, we're back to the importance of context. For example, reviewing your free annual credit report every New Year's Day or changing your financial and banking passwords whenever we "spring forward" or "fall back."

Being ready to rebound. Life is full of challenges, and we all make mistakes. We should create space for imperfection by becoming masters of the rebound. Daily routines are powerful, but all is not lost if we miss a day or two. Winning a basketball game doesn't depend on the ability of the players to score with every single shot.

Rewards: our brains are built to seek them—and the bigger and more unexpected, the better. When creating new habits, it's vital for the brain to associate the behavior with the dopamine release that comes with rewards. Meaning the dopamine release must occur with or right after the behavior to teach our brains to favor the action. This could be why it's so difficult for young people to start saving for retirement. The reward is too far away to motivate continued action and create the habit of saving. To start, we must establish what kinds of experiences are viewed as rewards.

Gamification has been used in many contexts to stimulate engagement through the offer of rewarding experiences. For example, since the brain favors uncertain rewards, financial apps could be designed with the user as a character. Each time users save, review a financial resource, or hit a milestone, they would receive credits toward in-app character upgrades like armor or clothing. The key takeaway is that the journey toward a goal needs to be rewarding, not just the destination. Once the habit is formed, the habit will continue—even when the reward is removed.

You may be thinking, "this all sounds great in theory, but what does it look like in practice?"

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Story time

I worked with a single client who wanted to reduce impulse spending to increase savings and reduce debt. At the time, the client had two checking accounts and one savings account in a local bank—and primarily used their debit card for spending.

We established a new primary account in an online bank and chose not to request a debit card. The client's payroll direct deposit was updated to the new online account, the one from which bills would be paid. This account was connected to the local checking account so transfers could be made between the two. Next, we downloaded information about the client's spending for the previous six months to get a picture of existing spending habits. After documenting income and expenses, we set a "frivolous spending" budget—i.e., the amount of money each month that could be spent freely. After each payday, the frivolous spending portion is transferred to the local account. We also set up recurring savings from online checking to a high-yield online savings account. Meanwhile, the local savings account was funded with an amount to cover potential emergencies.

Context: To gain access to a large sum, the client would need to initiate a transfer that would take up to three days. This external condition reduced the likelihood of unchecked spending, because the funds became more difficult to access.

Reward: Freely spending was a rewarding experience for the client. If we totally removed this ability, we likely would've created an internal conflict that the client's brain would have tried to resolve by reverting to old behaviors. Establishing a budget for frivolous spending allowed the client to feel its reward—on a sustainable budget. Plus, seeing debt go down and savings grow provide ongoing rewards.

Repetition: The automated transfers allowed for the money transactions to occur every two weeks, in alignment with payday. That regular schedule encouraged the client to review progress toward paying off debt and increasing savings—which increased the client's financial mindfulness and provided ongoing motivation to maintain new habits.

Summary

Financial wellness is influenced by a wide array of societal, cultural and relational factors.

On an individual level, tapping into the power of habits can support sustainable changes that will improve financial health over time. Organizations looking to support financial wellness for individuals should consider creating systems and programs that address the components of habit formation to fuel client success.

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