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When and why people do not make financial decisions: definition, measurement, and implications of financial inertia

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Chapter 1

Introduction

Introduction

Financial inertia is an umbrella term that is used to describe passive behaviors or tendencies of inaction when it comes to financial matters (e.g., Cui et al., 2021; Pande, 2013; Pendleton & Robinson, 2018; Seth et al., 2020). Most people will recognize the tendency to stay inactive when it comes to making certain financial decisions. Sometimes, it makes sense to not take action, for example, when you already know the available options and have concluded that these are inferior to your current state. But sometimes people also stay inactive when better options are available, because they tend to procrastinate, avoid the decision out of fear that they might make the wrong decision, or simply are not interested in their finances. In these instances, staying inert could be risky, incur costs, or lead to missed benefits.

Financial inertia can be observed in different financial contexts and varies in importance and complexity. For example, people are often passive when it comes to their pension (Choi et al., 2002; Krijnen et al., 2022), even though they might be unsure whether their pension will be sufficient to live comfortably after retirement (Börsch-Supan et al. 2020; Helman et al., 2010). People save too little (Piotrowska, 2019), might have little knowledge about their pension (e.g., Mayhew, 2003; Mitchell, 1988; Van Els et al., 2011; Van Schie et al., 2012), and do a poor job at investing for their retirement (e.g., O'Donoghue & Rabin, 1999). This might explain why 59.3% of working-age Americans lack retirement account assets while they are not covered by a defined benefit pension and why 76.6% fall short of conservative retirement savings targets (Brown et al., 2018). Also in the Netherlands, a country where 89% of employees have a defined benefit pension (OECD, 2023), about one in five people is expected to fall short of estimated minimal expenditures after retirement (De Bresser & Knoef, 2015). It seems that many people have a tendency to be financially inert when it comes to their pension which can negatively impact financial well-being after retirement (e.g., Brügggen et al., 2017; Eberhardt et al., 2021).

The tendency to remain inactive and not make financial decisions is not exclusive to the pension domain. It is also observed in financial domains such as healthcare plans, utility services, and banking. For example, people often do not optimize their healthcare plans and/or do not switch to providers that offer cheaper healthcare plans (e.g., ACM, 2024; Douven et al., 2017; Heiss et al., 2013; Zhou & Zhang, 2012), they do not switch to cheaper utility services (ACM,

2018; Deller et al., 2021; Schleich et al., 2019), and only 3% of people in the UK and the Netherlands switch to a different bank in a given year despite possibilities for higher interest rates or lower service costs (Competition and Markets Authority, 2016; GfK, 2014).

Financial inertia has thus been documented across financial domains. This evidence notwithstanding, the field has not yet converged to a widely accepted and context-independent definition of financial inertia. The current diversity in definitions and operationalization of financial inertia makes it challenging to disentangle the most characteristic features of financial inertia from features that are related to financial inertia but do not represent the core of the concept. This lack of conceptual clarity makes it difficult to identify factors that might explain why some people are more likely to be financially inert than others. Pinpointing the core characteristics of financial inertia allows for a more nuanced classification of people's likelihood to be financially inert. A more nuanced classification addresses an existing need of researchers and practitioners to differentiate between people who are more or less likely to be, or stay, financially inert. Assessing financial inertia's core features is an important first step in developing methods that can identify those at risk of financial inertia. Being able to recognize those who are prone to financial inertia also offers avenues for the creation of interventions that can be tailored to prevent future problems that stem from inaction, by assisting people to overcome the obstacles that are associated with financial inertia. For example, identifying people who have a tendency to avoid financial decisions and who might, in turn, save too little for their pension could be a first step in helping them to act now and avoid financial risk (see for default effects in 401(k) savings behavior, Choi et al., 2004).

Defining and Measuring Individual Differences in Financial Inertia

Research into financial inertia, and inertia more generally, often examined outcomes of inaction such as not switch to a cheaper utility provider (e.g., Hortaçsu et al., 2017), or the continuance of behavior such as the repeat purchase of a product (e.g., Bozzo, 2002). This binary classification strategy, whereby people are labeled as financially inert based on a lack of (change in) observable behavior over a certain time period, is commonly used as a representation of financial inertia. This binary classification, however, does not allow researchers and practitioners to distinguish between individuals who

exhibit the same behavior (active or not) but have different levels of trait financial inertia. Additionally, it does not allow for a more in-depth assessment of people's reluctance to make financial decisions. This is especially relevant in financial contexts where action or behavioral change is infrequent, such as pension saving or switching banks. In these contexts, labeling a large portion of people as financially inert does not distinguish between people who are more or less likely to act in the future. For example, people who have compared options and are actively preparing to make a switch are likely to be different from people who have not even considered switching in the first place.

In this dissertation, we present an alternative approach by examining financial inertia as a trait. This approach implies that some people are generally more likely to be inert than others and that this tendency to be inert is a stable trait across different financial contexts. Examining financial inertia as a trait facilitates a more nuanced classification of people's propensity to take action in the financial domain. This addresses an existing need of researchers and practitioners to more accurately identify people who are likely to be financially inert, without the restriction of having to classify financial inertia based solely on previous behavior. This approach provides the opportunity to more closely examine what the characteristic features of financial inertia are in order to more comprehensively assess individual differences in people's reluctance to make financial decisions.

Previous research has approached the concept of financial inertia in many ways. For example, it has been defined as a unidimensional (e.g., "... brand purchase increases the probability that it will be purchased on the next occasion"; Bawa, 1990, p. 263) or multidimensional tendency (e.g., involves confusion, competitor attraction, habit or passivity, switching costs, customer ambivalence, and time constraints; Gray et al., 2016). It has also been defined as a state (e.g., "inertia can be defined as a particular state for industrial customers developing regular and stable buying behavior without any real strong positive feelings"; Bozzo, 2002, p. 4), a behavior (e.g., maintain a telecommunications portfolio without considering change; cf. Schweidel et al., 2011), or an outcome (e.g., the repeat purchase of a product or staying with a service contract in combination with a positive, negative or neutral attitude towards the product or service; McMullan & Gilmore, 2003). Even though these approaches differ in their characterization of financial inertia with regard to its

dimensionality, assumed stability, and expression, all descriptions include a notion of passiveness.

Much research has been devoted to explaining why people are passive, tend not to make decisions, or not take action. Constructs that have been related to financial inaction are for example, habit, inertia, repeat purchase behavior, resistance to change, routinized behavior, spurious loyalty, and status quo (Bawa, 1990; Carter et al., 2016; Gal, 2006; Godkin & Allcorn, 2008; Gounaris & Stathakopoulos, 2004; Huang & Yu, 1999; Huff et al., 1992; Lee & Neale, 2012; Leventhal et al., 2006; Oliver, 1999; Pitta et al., 2006; Polites & Karahanna, 2012; Roy et al., 1996; Samuelson & Zeckhauser, 1988; Solomon, 1994; White & Yanamandram, 2004; Wu, 2012; Ye, 2005). These constructs, however, are often aimed at general decision-making and/or contexts that are not specifically related to financial decision-making. By positioning financial inertia as a trait and identifying its characteristic features within the specific context of financial decision-making, we add to the literature on financial inertia by offering an alternative approach that focuses on individual differences in the tendency to make financial decisions.

When it comes to individual differences in not taking action, there are many general traits that may be relevant. For example, some people differ in their tendency to delay or defer decision-making. This has been conceptualized in the literature as a trait such as procrastination (i.e., irrational delay; Steel, 2010) or decision attitude (i.e., the propensity to make or avoid making decisions; Beattie et al., 1994). People might also be less inclined to make financial decisions because they have more difficulties with making decisions, have a stronger tendency to avoid uncertainty, tend to worry more, are more likely to experience regret, or tend to resist change. These traits have been operationalized with measurement instruments that are context independent (i.e., Indecisiveness scale, Frost & Shows, 1993; Uncertainty Avoidance Scale, Jung & Kellaris, 2004; Penn State Worry Questionnaire, Meyer et al., 1990; Regret Scale; Schwartz et al., 2002; Resistance to Change Scale; Oreg et al., 2008). Financial inertia, when viewed as a trait, appears to be conceptually related to these more general traits. As financial inertia is specifically concerned with a lack of decision-making in the financial domain, it should also be distinguishable from general traits by including an element that is specifically related to a financial context.

Outline and Objectives of this Dissertation

This dissertation has three objectives. First, it aims to clarify what financial inertia is by investigating what laypeople see as the most characteristic features of financial inertia. Second, it aims to identify the underlying dimensions of these central features and develop a measure that can capture individual differences in these dimensions across various financial domains. Third, it aims to examine how individual differences in financial inertia are related to retrospective and prospective financial decision-making in the pension domain. The following three empirical chapters discuss how these objectives are addressed. This dissertation is written using the “we” form, instead of the “I” form, because the research reported in the empirical chapters was conducted in collaboration with my supervisors.

Chapter 2: What Do We Mean by Financial Inertia? A Prototype Approach to Assess Laypeople’s Views

For the first objective, we start by noting that the academic literature on financial inertia does not converge to a single conceptual definition of financial inertia and that operationalizations of the construct are often binary measures of behavior that are context dependent. To supplement the existing top-down conceptual definitions of financial inertia, we conducted a prototype analysis, a bottom-up method that provides insight into what laypeople see as characteristic features of financial inertia. Laypeople have first-hand experience with financial inertia and can identify what they believe are the most descriptive characteristics, without being influenced by preexisting theories. A prototype analysis yields an overview of the most central aspects of financial inertia and provides insight into the complex, multidimensional nature of financial inertia (for more information on prototype structures and prototype analyses see for example, Cantor & Mischel, 1977; Fehr & Russell, 1984; Hepper et al., 2012).

The procedure to identify the prototypical structure of financial inertia consisted of five studies. Study 2.1 solicited associations of laypeople with financial decision-making which were subsequently coded into categories. Study 2.2 asked participants to rate the representativeness of all categories in relation to financial inertia and divided the features into characteristic, central features and less characteristic, peripheral features. Studies 2.3 through 2.5 examined whether central features were also more accessible in memory than

peripheral features. We examined the difference in memory accessibility with a recall and recognition task in Study 2.3, a classification task in Study 2.4, and an autobiographical recall task in Study 2.5. The prototype analysis yielded 30 categories that were most representative of the financial inertia construct. It further showed that these 30 central features were more accessible in memory than less representative features (i.e., peripheral features).

Chapter 3: Development and Validation of the Financial Inertia Scale

For the second objective, we examined the underlying dimensions of the central features of financial inertia that were identified in Chapter 2 to develop an instrument that can measure individual differences in the tendency to make financial decisions. Study 3.1 consisted of three identical waves in which participants were asked to indicate how strongly they agreed or disagreed with statements that were directly based on the central features from the prototype analysis. We examined the underlying dimensions, suitability of the factor structure, temporal stability, measurement invariance, and internal consistency to create the Financial Inertia Scale as a measure of trait financial inertia. Study 3.2 examined the relationship between trait financial inertia and constructs that are related to inaction. We examined convergent and divergent validity of the scale and created a visual nomological network to examine how trait financial inertia is positioned compared to the other constructs. Study 3.3 examined whether participants with higher trait financial inertia were less likely to have taken action in the past on the various measures of inaction related to financial service contracts.

Chapter 4: The Role of Trait Financial Inertia in Pension Engagement

For the third objective, we examined how individual differences in financial inertia are related to retrospective and prospective financial decision-making, by looking at various forms of pension engagement. Study 4.1 was a field study in collaboration with a large pension provider in the Netherlands. Customers were asked to fill in the Financial Inertia Short-Scale and these data were combined with administrative data about customer activity on pension accounts before and after the survey. We examined whether people who were higher in financial inertia were less likely to log in to their pension account and whether they were less likely to reconfirm or change their pension settings. We utilized the behavioral data to study this relationship before and after partaking

in the survey. Study 4.2 examined whether people higher in financial inertia were less likely to inform themselves about their pension and make changes to their pension in the past twelve months and whether they had less intentions to perform these behaviors in the coming twelve months. We also examined whether we could identify homogeneous subgroups of people based on the four dimensions of Financial Inertia Scale. Study 4.3 was a replication of Study 4.2 with a Dutch sample where we also examined the previous forms of pension engagement in relation to the new pension system that will be implemented in the Netherlands, and we examined the influence of financial knowledge in pension engagement.

Chapter 5: Discussion

To conclude, Chapter 5 offers an overview of the main findings for each of the three aims for this dissertation. This chapter also discusses theoretical and practical implications, directions for future research, strengths and limitations, and ends with a conclusion.