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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 5

Discussion

Discussion

Financial inertia is a complex construct and is defined and operationalized in different ways across the literature (e.g., Cui et al., 2021). It has been described as a behavior, an outcome, a state, and a unidimensional or multidimensional tendency (Bawa, 1990; Bozzo, 2002; Gray et al., 2016; McMullan & Gilmore, 2003; Schweidel et al., 2011), with one common factor being its passive nature. Thus, financial inertia can be seen as an umbrella term that is used to refer to passive behaviors or tendencies of inaction in a financial context (e.g., Cui et al., 2021; Pande, 2013; Pendleton & Robinson, 2018; Seth et al., 2020). Aside from general agreement that financial inertia involves an element of passivity, there is little consensus in the academic literature on its formal definition. Relatedly, it is unclear what the characteristic features of financial inertia are.

In this dissertation, we addressed three aims in three chapters, comprising eleven consecutive studies. First, we aimed to clarify the concept of financial inertia by investigating what laypeople perceive as its most characteristic features. Second, we aimed to identify the underlying dimensions of these features and develop an instrument that can measure individual differences in financial inertia across various financial domains (i.e., pension, healthcare, banking, and utilities). Third, we aimed to identify how individual differences in financial inertia are related to retrospective and prospective financial decision-making in the pension domain.

Summary of Main Findings

What is Financial Inertia? A Prototype Approach to Assess Laypeople's Views

In this dissertation, we approached financial inertia as a trait. To identify the most representative features of financial inertia, we conducted a prototype analysis in Chapter 2. A prototype analysis is an extensive empirical bottom-up method that assesses laypeople's connotations with financial inertia and identifies features that are most representative of the construct (e.g., Cantor & Mischel, 1977; Fehr & Russell, 1984; Hepper et al., 2012). The prototype analysis started by soliciting associations of laypeople regarding financial decision-making and coding these associations into categories (Study 2.1). These categories were subsequently ranked by their representativeness of financial inertia (Study 2.2). Follow up studies showed that central (i.e., more

representative) features were more accessible in memory than peripheral (i.e., less representative) features. Central features were more often correctly and falsely recognized and recalled as features of financial inertia (Study 2.3), and were more often and more quickly judged as being related to financial inertia (Study 2.4). The results also showed that central and peripheral features were more descriptive of a recalled financial inertia situation than an ordinary situation, even though central features were not considered significantly more descriptive of the recalled financial inertia situation than peripheral features (Study 2.5). Taken together, the findings from the prototype analysis uncovered the 30 most representative features of financial inertia and provided evidence that financial inertia adheres to a prototype structure.

Based on the findings from the prototype analysis in Chapter 2, we found that financial inertia is a multifaceted construct. Laypeople indicated that the majority of its 30 most representative features were related to:

- postponement or avoidance (e.g., procrastination, decision avoidance, intention-behavior gap),
- experiencing negative emotions associated with decision-making (e.g., feeling overwhelmed, feeling anxious or worried about the possible negative effects of making a decision or changing something),
- a lack of motivation (e.g., lazy, tired, reactive, unproductive),
- a disinterest in finances and financial decision-making (e.g., no concern with current financial situation, no considerations about saving money, no considerations about future financial needs, no desire to understand, no general considerations about the features), and
- the absence of goal-directed behavior (e.g., inaction, status quo, not exploring options, not doing research, not comparing, considering and discussing options).

The 30 most central features that emerged from the prototype analysis partly connect to topics that have also been addressed in the literature of financial inertia but also add to this literature. For example, procrastination and avoidance of financial decision-making, the two features with the highest representativeness scores, are also often mentioned in the literature (e.g., Berstein et al., 2013; Shin et al., 2019; White & Yanamandram, 2004; Zhao et al., 2012). This also applies to features related to a lack of motivation or interest to consider options, make financial decisions, or act upon those decisions (e.g., “apathy” in Colgate & Lang 2001; McMullan & Gilmore, 2003; Solomon,

1994; Wu, 2011b). These features are commonly reported in the literature and have intuitive appeal as a justification for passive behavior (i.e., that people who do not look at their finances and do not make financial decisions are just lazy). These features taken together, however, may not be sufficient to fully explain the passive behaviors that are associated with financial inertia.

In addition to the current literature, the prototype analysis indicated that negative emotions may be a prevalent feature when it comes to financial inertia. Negative emotions in relation to financial decision-making are a less central topic in the literature (e.g., Gounaris & Stathakopoulos, 2004; Huang & Yu, 1999; Rahantoknam et al., 2017), but were prevalent in laypeople's associations with general financial decision-making (Study 2.1), and had high representativeness scores for financial inertia specifically (Study 2.2). Thus, even though some literature approaches financial inertia as a construct with little emotional involvement, our research indicates that specifically negative emotions such as worry or anxiety were seen by laypeople as highly representative of financial inertia. This indicates that the role of negative emotions related to financial decision-making may be larger than was previously thought. This also suggests that we should not attribute a lack of financial decision-making to people simply being lazy or unwilling to engage in financial decision-making. A portion of people may experience negative emotions which impede decision-making and facilitate financial inertia.

Development and Validation of the Financial Inertia Scale

Building upon the most characteristic features of financial inertia from the perspective of laypeople (Chapter 2), we developed and validated a 12-item Financial Inertia Scale (Chapter 3). This instrument measures individual differences in financial inertia. We also created a 4-item Financial Inertia Short-Scale for situations where brevity is required. The Financial Inertia Scale was developed in a three-wave longitudinal study with a representative US sample (Study 3.1) and validated in a UK sample (Study 3.2) and US sample (Study 3.3). Across waves and samples, we found that the Financial Inertia Scale displayed good fit measures, good temporal stability, good internal consistency, and strong measurement invariance between waves, sex, and age.

The scale development process identified four underlying dimensions in the central features from Chapter 2:

- financial procrastination (e.g., I tend to procrastinate),

- financial anxiety (e.g., I often feel overwhelmed),
- disinterest in financial options (e.g., I typically do not compare costs or prices), and
- disinterest in finances (e.g., I am really not that interested).

These four dimensions are interrelated and can be represented by an overarching construct that we refer to as trait financial inertia (Study 3.1). Each of the four dimensions consists of three items and the mean of all items represents the trait financial inertia score. The scale validation process established convergent and divergent validity (Study 3.2) and established the relationship between financial inertia and retrospective behavior across various financial domains (Study 3.3).

The convergent and divergent validity of financial inertia with various other constructs related to inaction or financial decision-making were examined (Study 3.2). The main findings indicated that financial inertia was part of a “passivity” cluster that consisted of constructs such as procrastination, indecisiveness, worry, and uncertainty avoidance. While financial inertia was close to those constructs, it did not overlap. Thus, financial inertia was positioned as a related but separate construct among other passive constructs. This provided evidence for the convergent validity of the Financial Inertia Scale. In addition, financial inertia was distinct from constructs such as general risk propensity, curiosity, numeracy, maximization, and need for cognition, which also provided evidence for the divergent validity of the Financial Inertia Scale. Thus, our findings indicate that financial inertia is a stand-alone construct that seems to capture a different type of passivity than a variety of pre-existing constructs related to financial decision-making.

As a first step to establish predictive validity of the Financial Inertia Scale, we examined whether higher financial inertia was associated with less action taken across various financial domains that employ financial service contracts (Study 3.3). The main findings indicated that generally an increase in financial inertia was associated with a decrease in actions taken in the past 12 months. Specifically, people with higher financial inertia scores were less likely to have looked into their pension, banking, healthcare, and utility services. It was also associated with less changes made in these domains, with the exception of healthcare services where it appeared that age and sex may play a more important role in predicting change-making behavior. These findings provide support for the predictive validity of the Financial Inertia Scale with

regard to retrospective financial behavior. Taken together, the research presented in this chapter support the notion that financial inertia can be described as a trait because we found that there are individual differences in the tendency to make financial decisions that are stable over time and are related to a lack of decision-making across financial domains.

The Role of Trait Financial Inertia in Pension Engagement

Building upon the findings of Chapter 3 regarding the predictive validity of financial inertia on various general retrospective behaviors across financial domains (i.e., logging in and making changes), we further investigated the relationship between financial inertia and specific pension-related behaviors in Chapter 4. We examined various pension-related behaviors, such as information gathering (e.g., logging in to one's pension account, checking one's pension settings) and making changes (e.g., changing a pension setting, changing one's pension saving amount). We collected administrative data from a field study at a large Dutch pension provider (Study 4.1) and self-report data in two online studies with a sample from the UK (Study 4.2) and from the Netherlands (Study 4.3).

The main findings indicated that, across all three samples, higher financial inertia was associated with less retrospective information gathering behavior. Participants higher in financial inertia were less likely to have logged into their pension accounts in the period before taking part in the survey (Study 4.1). They were also less likely to have looked into the choices that they could make with respect to their pension settings and less likely to have looked at how much they saved for their pension in the past twelve months (Study 4.2 and 4.3). In contrast to the consistent findings regarding the relationship between financial inertia and retrospective information gathering behavior, there were mixed findings regarding the relationship between financial inertia and retrospective changes. More specifically, higher financial inertia was related to less changes to risk settings in Study 4.1, but an increase in financial inertia was only significantly related to less changes made to pension settings and pension saving amount in Study 4.2 but not in Study 4.3. Finally, we consistently found that higher financial inertia was associated with lower intentions to gather information in the future but not with lower intentions to make changes (Studies 4.2 and 4.3). In line with these intentions, the findings from the administrative behavioral data collected in the period after the

financial inertia survey showed that people with higher financial inertia also gathered information less often (i.e., logged in) but did not change their risk setting less often (Study 4.1) than people with lower financial inertia. Taken together, the findings of Chapter 4 indicate that trait financial inertia is consistently related to information gathering intentions, past behavior, and future behavior but that the relationship between financial inertia and making changes is less consistent or absent.

In the discussion of Chapter 4, we proposed multiple explanations for the finding that trait financial inertia was related to information gathering behaviors but not to making changes. For example, people might not be able to make changes to their pension, or may feel like they cannot make changes. People who have a workplace pension through a collective pension fund may not be able to make any changes to the way their pension is managed. When they fill out the financial inertia survey, they may not have thought about other options to make changes to their pension such as increase their monthly contribution to that pension fund, take out an annuity policy, increase their personal savings, or manage a stock portfolio. This would imply that a change to the wording of the questions in the survey might yield different results. We provide additional examples in the discussion of Chapter 4.

Implications and Directions for Future Research

Building upon the findings of this dissertation, we identify several implications and directions for future research. The prototype analysis reported in Chapter 2 revealed that financial inertia adheres to a prototype structure. Financial inertia is a broad and multi-faceted concept where not all features have to be present at all times to activate the prototype. The analysis identified central features that were found to be most representative of financial inertia. Specifically, the central features identified in the prototype analysis demonstrate that financial inertia is more than just being lazy or unmotivated, although that appears to be part of it. A lack of financial decision-making was also related to procrastination or avoidance, a variety of negative emotions associated with financial decision-making such as worry or anxiety, and a lack of goal-oriented behavior. This increased understanding of what laypeople see as the most representative features of financial inertia can serve to supplement the existing definitions in the literature and allow researchers and practitioners to scrutinize their theoretical definitions and practical

operationalizations of financial inertia to ensure that their view of the concept reflects how laypeople perceive and experience financial inertia in their daily lives.

The development of the Financial Inertia Scale in Chapter 3 yielded a concise questionnaire, consisting of 12 items that can measure individual differences in financial inertia. In this process, we identified four underlying dimensions: financial procrastination, financial anxiety, disinterest in finances, and disinterest in financial decision-making. Taken together, these dimensions represent trait financial inertia, which we conceptualized as the tendency not to make financial decisions. The overarching implication of this development process is that the four dimensions represent the most prominent and consistent factors that are related to a lack of financial decision-making. In turn, the identification of these four dimensions provides a basis for the development of interventions that could be aimed at reducing people's tendency to not make financial decisions by reducing financial procrastination, financial anxiety, and/or their disinterest in finances and options.

Organizations can utilize the Financial Inertia Scale to enrich information about their customer base by linking financial inertia subscale scores to subgroups with similar demographic profiles (e.g., married men in their thirties). This would create an organization-specific index that identifies which barriers to financial decision-making are most strongly experienced by each easily identifiable subgroup. In turn, policy makers can employ interventions that are targeted at reducing a specific dimension of financial inertia in a specific subgroup (e.g., financial anxiety, such as worrying about making the wrong decision). This process can utilize an experimental setup such as A/B testing to evaluate the effectiveness of an intervention in reducing inaction in specific subgroups. In time, organizations can build an organization specific repository that contains interventions aimed at reducing dimensions of financial inertia in specific subgroups that were found to be effective for decreasing inaction.

In addition to the four dimensions that were identified in the scale development process, Chapter 4 also reported a cluster analysis which revealed that people can be reasonably well represented by five different financial inertia profiles (see Study 4.2 for the analyses and group profiles). The findings from these profiles indicate that, although people have an individual

level of trait financial inertia and the scale development showed that all dimensions are related, a high (or low) score of financial procrastination commonly occurred with corresponding high (or low) financial anxiety. This co-occurrence was also found for disinterest in finances and disinterest in financial options. This implies that there are different types of consumers, and that organizations may benefit from designing interventions that specifically target hurdles that people in specific financial inertia profile groups face. For example, an intervention that is aimed at decreasing financial procrastination and financial anxiety might inform people about their options, the consequences of these options, and a clear path to make desired changes or ask for help in making these decisions. Such an intervention is probably more effective in reducing barriers to financial decision-making in people who are high in financial procrastination and financial anxiety (e.g., The Anxious Procrastinators) compared to people who are low (e.g., The Interested and Determined). Similarly, an intervention that is aimed at informing people about the pros and cons of certain financial products is probably unlikely to increase financial decision-making for people who are disinterested in comparing options (e.g., The Indifferent). That intervention, however, might be effective at increasing financial decision-making for people who are interested in financial products and comparing those options (e.g., The Interested and Determined) because they may value the information and use it in their subsequent decision-making process. Tailoring interventions based on specific characteristics of financial inertia subgroups that came out of the cluster analysis offers an alternative direction for interventions to decrease financial inertia by targeting barriers that are specific to the characteristics of these subgroups.

Studies 4.2 and 4.3 took a broad range of sociodemographic factors into account. The findings indicated that only a few sociodemographic factors were consistently related to pension engagement intentions or behaviors (e.g., type of pension plan). The majority of sociodemographic factors were not significant predictors of pension engagement behaviors or were related to one or more specific pension engagement behaviors (e.g., sex; see Studies 4.2 and 4.3). For example, in Study 4.2 males more often changed a pension setting and how much they were saving for their pension but did not differ from females in how often they looked into choices they could make, looked into current pension settings, and how much they had saved for their pension. They also did

not differ in any of the five intentions for those behaviors. There are similar patterns for infrequently significant predictors such as age, employment status, education, and household size. In contrast, financial inertia was a stable predictor in predicting three information gathering behaviors and three intentions to gather information in both Study 4.2 and 4.3 (and also predicted change making behavior in Study 4.2). This finding implies that, when it comes to studying factors that are related to pension engagement behaviors, it may be fruitful to further examine the predictive value of trait financial inertia and its four underlying dimensions on financial inaction rather mapping the effect of individual sociodemographic factors.

The stable relationship between trait financial inertia and retrospective inaction across various financial domains may also point towards the added value of studying the impact of individual differences in constructs that are specifically designed to be applied in a financial context. This opens up avenues for further research that examines the effects of financial inertia on financial inaction in comparison to other constructs, such as those that were studied to assess convergent and divergent validity in Study 3.2 (e.g., indecisiveness or uncertainty avoidance). This could be a next step in identifying potential other working mechanisms at an individual level that could be responsible for a large part of the inhibition and hurdles that people experience when making financial decisions.

Strengths and Limitations

The research described in this dissertation started by clarifying laypeople's associations of a difficult to define construct by employing a prototype analysis. In the prototype analysis, we opted to add features from the academic literature to the associations of laypeople to create an extended list of features, which were subsequently rated on their representability of the financial inertia construct. This combination of top-down and bottom-up features can be considered a strength because this yielded a broader and more inclusive overview of features than either approach would have achieved alone. This approach further ensured that the scale development process had a solid foundation of features that could serve as the basis for candidate items for the Financial Inertia Scale. Utilizing the findings from a prototype analysis as part of the candidate item generation step also allows researchers to examine whether the underlying dimensions of a scale adequately represent

the construct (e.g., as in Seuntjens et al., 2015b). Our findings revealed that negative emotions were prevalent associations with financial decision-making during the prototype analyses and this was confirmed as a defining underlying dimension in the scale creation process.

The methodological rigor used in the scale development and validation process can be considered another strength of this dissertation. The scale development process utilized longitudinal data from a large representative sample with low attrition rates. This yielded a 12-item Financial Inertia Scale that can measure individual differences in financial inertia. The scale displayed good fit measures, good temporal stability, good internal consistency, and can utilize mean or sum scoring (see Chapter 3 for extended evaluation of the scale development process). The scale validation process established measurement invariance between timepoints of the longitudinal study, between age groups, and sex, and between the three studies that employed samples from both the UK and the USA. The Financial Inertia Scale demonstrated convergent validity with other constructs related to inaction (e.g., indecision) and divergent validity with constructs related to financial decision-making (e.g., numeracy; see Chapter 3.2). Furthermore, the relationship between financial inertia and inaction in financial contexts across studies provide early support for its predictive validity, although that relationship appears to be dependent on financial context and occurs more often for information gathering behaviors (e.g., log-ins) than for behaviors related to changes (e.g., changing one's risk profile) and thus warrants further investigation (see Chapter 3.3 and Chapter 4).

Despite finding a relationship between trait financial inertia and retrospective behavior for general behaviors across financial domains (i.e., login and change making; Chapter 3) and for general and specific pension-related behaviors (e.g., looking into pension settings; Chapter 4), there were some specific contexts where financial inertia was not significantly related to retrospective behavior. These were adjustments made in healthcare in a US sample (Chapter 3.3) and specific pension changes in the Dutch sample (Chapter 4.3). In addition, the relationship between financial inertia and prospective behavior was found for log-ins but not for changes made to risk profiles when utilizing administrative data (see Chapter 4.1). This illustrates that, although we find a consistent relationship across the vast majority of contexts, one should be cautious when generalizing the findings of this

dissertation to new financial contexts or when using financial inertia to predict future behavior in unstudied contexts.

When it comes to predicting financial behavior, it appears that the specific financial context can be highly influential. This is reflected in the findings of Chapter 4 that illustrated that sociodemographic variables were not consistently associated with financial behavior (i.e., much less consistent than trait financial inertia was). Predicting financial behavior appears to be a difficult task. Even though the findings presented in this dissertation support the idea that financial inertia is predictive of financial behavior, future research should establish this association in a specific context for specific behaviors and not assume that it generalizes to all situations. In addition, we note that the findings presented in this dissertation were based on data collected through online surveys with US and UK samples (and one from NL). While the findings across studies with different samples were comparable (i.e., higher trait financial inertia was related to less action taken in the financial domain) and although these countries have significant differences in some of their financial systems (e.g., the pension schemes and healthcare structures vary from country to country), we would recommend caution when generalizing these findings to other countries, particularly to countries where financial contexts differ markedly from the contexts of the studies that were presented in this dissertation.

A limitation of concurrently examining financial inertia and prospective behavior in the same sample without a control condition is that the act of participating in a survey that contains the Financial Inertia Scale could act as a trigger that increases the likelihood of financial behavior after the study. Filling in the Financial Inertia Scale could make participants think about their own financial behavior and may lead them to consider whether action is warranted. The dataset of the field study at the pension provider (Chapter 4) did not contain information about the pension behaviors of customers that did not participate in the study. As a result, we examined the relationship between trait financial inertia and prospective pension behavior for a group of participants that might have an increased (or decreased, or similar) likelihood to take action because they filled in the Financial Inertia Short-Scale. In addition, people who are more likely to act when it comes to financial matters may be overrepresented in the sample because they are demonstrably more active when it comes to their pension (i.e., they read emails from their pension provider and participate in a

survey about financial behavior). While this does not necessarily influence the relationship between trait financial inertia and financial behavior, it is worth examining further. This limitation could be addressed in future studies by comparing the relationship of financial inertia and pension behavior between groups that did, and did not, participate in the (same) survey, or by comparing groups that fill out the Financial Inertia Scale before or after providing information about their financial behaviors.

Conclusion

Financial inertia, the tendency not to make financial decisions, is a complex construct that consists of many features and adheres to a prototype structure. Laypeople generated and identified the most characteristic features of financial inertia. We found that the underlying dimensions of these features were financial procrastination, financial anxiety, disinterest in financial options, and disinterest in financial decision making. We developed and validated the Financial Inertia Scale, an instrument that can measure individual differences in financial inertia. These individual differences in financial inertia were related to inaction across various financial domains and for various financial behaviors. We found support for a consistent relationship between trait financial inertia and retrospective financial behavior. Predicting future behavior based on trait financial inertia is less consistent. This remains an important avenue to examine in future studies. Based on the studies presented in this dissertation, we conclude that people's tendency not to make financial decisions is not merely a lack of motivation or just a result of laziness. Rather, it encompasses a large number of features that are likely context dependent, where negative emotions may play a larger role than previously suggested. It is our hope that identifying the underlying dimensions of trait financial inertia and creating the Financial Inertia Scale provides other researchers and practitioners a well-founded starting point for the development of interventions aimed at helping people overcome barriers to financial decision-making.

