NON-TECHNICAL SUMMARY

“Fear on Financial Decision Making”
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Although the role of emotions in financial decision making has often been acknowledged, especially in the popular press, systematic attempts to test the causal impact of a specific emotional experience on financial decisions are still scant in the literature. In this research, we focus on the impact of fear on financial decision making.

It is well established that fearful people tend to be more pessimistic (Lerner & Keltner, 2001) and to choose a risk averse option (Raghunathan & Pham, 1999). Also, individuals have a tendency to believe that others are likely to think and feel like them (Van Boven & Loewenstein, 2003). Taken together, these two pieces of evidence lead us to hypothesize that in a stock market-type of environment, a fearful investor (relative to an investor in a neutral state condition) will expect other investors to become more risk-averse. As a result, she will sell her assets earlier. We term this process fear-based social projection, as one’s fear is projected into one’s expectation of others’ behaviors, which ends up influencing one’s decisions.

The Xlab is used to experimentally test this hypothesis and to provide direct evidence of causality. Following the social psychology and consumer research approach, participants’ emotions are orthogonally manipulated via exposure to fearful versus neutral stimuli (i.e., watch horror movie vs. documentary clips)—see Andrade and Ariely 2009 for similar approach. Then, in a purportedly independent second study, participants face a financial decision making task. We have created a “Cash Out” game, which mimics a liquid asset selling situation. Participants start the game with a given asset which actually represents part of their own participation fee. Similar to a stock market, the value of the asset varies overtime (across multiple rounds). In each round, the participant has to decide on whether to stay in the game or to “cash out”—i.e., sell the asset. The main dependent variable is represented by the number of rounds each participant stays in the game.

We have conducted the first experiment in the Xlab and the results have been quite promising. After being exposed to fearful (vs. neutral) stimuli in a purportedly independent study, participants were given the opportunity to play the Cash Out game. Moreover, two formats of the game were created in order to test for social-projection biases. In the non-social projection condition, participants were told that $ amount in any given round was randomly determined by the computer. In the high-social projection condition, participants were told that the $ amount in any given round is determined in part by everybody’s decision in the room—asset value going up if no one cashes out in a given round and asset value going down if at least one person cashes out in a given round. We hypothesized that if fear influences one’s decision to cash out based on social projection, its impact should emerge in a condition where people are (vs. not) led to think about what other will do.

The results showed that fearful people do cash out earlier. As important, the effect emerged only in the high-social projection condition—that is, when participants were thinking of what others would do while making their decision. In the non-social projection condition, there was no difference between the two conditions. These results shine initial light into the underlying psychological processes that might lead fear to influence financial decision making.

Several additional studies have been planned, as it will be detailed in the following pages. This research represents a joint collaboration between a junior faculty member (Eduardo B. Andrade) and a 3rd year doctoral student (Chan Jean Lee). Given the costs associated with programming (i.e., the Cash Out game) and data collection (i.e., according to Xlab policy, participants must make on average $15 45 minute session), we hope to obtain financial support so that additional studies can be conducted.