

## Why do financially constrained people waste money on discretionary spending?

Mechanisms that reduce the adverse impact of discretionary consumption are critical. Thus, plans like the “Save More Tomorrow Program” that enrolls people in a pension scheme with small contributions could immensely benefit them, studies show



Why do financially constrained people waste money on discretionary spending?

Experience of financial scarcity is a universal problem. In March 2021, the revolving debt, which is mostly the revolving credit card debt, increased by 7.9 per cent to about \$980 billion in the US. Ideally, individuals with scarce financial resources, such as those with high amounts of debt, should manage their money efficiently. However, even consumers who have high consumer debt, engage in discretionary consumption.

For example, the amount of credit card debt in the US was higher in 2019 than in the period of the 2008 financial crisis, and according to a recent poll, 32 per cent of the adults who said they had credit card debt, identified discretionary spending as the primary contributor to that debt, while only 23 per cent of necessary purchases contributed to their credit card debt, which suggests that these people need to have a clear understanding of their living expenses (i.e., nondiscretionary and discretionary expenditures) for a good successful financial future.

In our “Journal of the Academy of Marketing Science” article, we demonstrate that individuals with greater financial scarcity can perceive the future to be more optimistic, resulting in more discretionary expenditures (i.e., spending, borrowing, and investing). We test and find support for this finding in three large-scale studies, including a survey, two longitudinal archival studies, and two preregistered online experiments. In our studies, we investigate both subjective and objective perceptions of financial scarcity using different samples (i.e., samples from India, Italy, Germany, and the US). The results of the studies consistently show that consumers with scarce financial resources have more discretionary expenditures, and theoretically, their optimistic future perceptions explain why these individuals with scarce financial resources have more discretionary expenditures.

Discretionary expenditures for people with financial scarcity lead to serious consequences. For example, financial debts for people with financial scarcity lead to severe mental health issues, including finishing one’s life, which suggests that public policymakers urgently need to tackle this growing problem with appropriate interventions. We suggest that these findings can be used by public policymakers by nudging consumers and using persuasive communication in different ways.

One way that public policymakers can urge these people to save or enroll in a pension scheme rather than spend, borrow, or invest in discretionary investing is by using choice architecture and message framing. Choice architecture can be used by bringing the future desired option temporarily closer to the present and making the desired future behavior an opt-out option. This approach is similar to the “Save More Tomorrow Program”, in which there is a default choice of enrolling people in a pension scheme with the added provision that they only start off making small contributions.

Rather than urging consumers with scarce financial resources to start saving and enrolling in the pension schemes at the present when they are only focused on their financial scarcity, a default option of saving and enrolling in the pension scheme starting in a year would be better for these consumers. This approach will bring the future temporarily closer to these consumers. Moreover, rather than making this choice an opt-in option, it can be presented as an opt-out option. This type of choice architecture, where the future temporarily is closer to the present and in which saving and enrolling in the pension scheme in a year is the opt-out option, could be better for the well-being of these consumers with scarcer financial resources.

Relatedly, social trust is used extensively in nudging, and public policymakers can show examples of people who have benefited from these types of schemes, in which consumers start to save and enroll in pension schemes in a year when financially scarce, which can also help these individuals with scarcer financial resources.

From a managerial perspective, while targeting people with financial scarcity to sell discretionary goods would be profitable but unethical, inducing more consumption of nondiscretionary products would be a win-win situation for companies and consumers. In fact, the latter approach would make people spend on things that are truly necessary for them in their daily lives.

In summary, given the severe consequences of discretionary consumption for people with financial scarcity, both policymakers and managers should develop mechanisms that reduce the severe consequences of discretionary consumption.



Prof. Gopal Das, Faculty in the Marketing Area at IIM Bangalore

Disclaimer: Views expressed are the authors' own, and Outlook Money does not necessarily subscribe to them. Outlook Money shall not be responsible for any damage caused to any person/organisation directly or indirectly.