Making Group Decisions the Behavioral Finance Way

By Michael Liersh, PhD, and Anil Suri

Investment success can rest on tailoring an approach to meet an investor’s unique financial goals. But what should be done when an investor is not acting alone but is part of a couple, family, committee, or board with diverging opinions and goals?

Groups of affiliated investors—couples, families, and investment committees or boards—often recognize that good communication can lead to better investment decisions. However, facilitating constructive dialogue can be challenging. Fortunately for portfolios large and small, behavioral finance offers numerous insights—and suggests several approaches for reconciling the dissimilar financial perspectives that sometimes arise within groups.

Start by (re)establishing the group’s investment purpose. When guided by common goals, times of significant change in the markets can present an ideal opportunity to air out feelings about risk and return—and re-assess the desired trade-off between them.

Pinpoint areas of agreement and disagreement. Facilitating an environment where every group member’s viewpoint is taken into account can lead to a structured discussion in which differences are narrowed and all parties are heard. The dialogue alone can go a long way toward achieving unity of purpose and, ultimately, successful investment outcomes.

Structured approaches can help. For example, formal questionnaires that elicit each group member’s risk preferences, preferred approach to making and implementing investment decisions, and desired intent for the investment dollars can be aggregated and played back to the group in a nonjudgmental discussion format. By discussing the results as a group, action steps can be identified to enable the investment process to progress constructively.

Individuals vs. Groups

When couples, families, and investment boards or committees make decisions, a common question arises: How can we reconcile multiple perspectives and goals to make wise investment decisions for the group and avoid unwise ones?

Insight can be found by asking a related question that has plagued academic researchers for many decades: Who makes better decisions—an individual or a group?1 As with many questions, the answer depends on a variety of factors. For example, researchers Christoph Gort and Anke Gerber found that when making asset allocation choices, individuals’ and groups’ risk-return trade-off choices were, on average, surprisingly similar.2 However, upon further examination, the researchers discovered that certain groups made better risk-return trade-offs relative to individuals and other groups made worse trade-offs. The element that seemed to drive group out- or underperformance was the level of communication, or information exchange (see table 1). Among other factors, higher-performing groups spent more time discussing the problem to be solved and generated more problem-solving suggestions.

Many people believe that simply coming together in groups and verbally sharing ideas automatically will lead to good decisions. This can be true, but unstructured communication can result in severe obstacles to information exchange. For example, in group settings it is not uncommon for an individual—who is often the most experienced investor or primary decision-maker—to lead the discussion by first expressing a personal opinion.

This can cause others to go along with that view even when they may not actually share it. To highlight this point, let’s walk

<table>
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<tr>
<th>Table 1: Factors That Can Affect Risk-Return Trade-Offs Groups Make</th>
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<tr>
<td>High Information Exchange Groups</td>
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<tr>
<td>23 minutes</td>
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<tr>
<td>Low Information Exchange Groups</td>
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Source: Adapted from Gort and Gerber (2008)
Most individuals agree that C matches the Target—line A, B, or C? So, would it surprise you that in a test, please closely examine Figure 1. Which line matches the “Target”—line A, B, or C?

For this experiment, an unknowing individual was placed in small groups with others who were in on the prank. The pranksters purposefully provided wrong answers in order to examine what the unknowing participant would do. Shockingly, about 75 percent of individuals went along with the pranksters and provided incorrect responses to the vision tests at least once.3

People might conform to a group for many reasons. Individuals may begin to question their own assessments of the correct answer, and this uncertainty leads to embracing the group’s decision. Or an individual may not want to be contrarian and experience the discomfort of going against the majority perspective.

Whatever the cause, a breakdown of communication can inhibit good group decision-making—and may exacerbate other group decision-making issues such as “groupthink” (individuals generate reasons to support the group’s decision rather than actively considering alternatives; see Esser 1998) or “relationship conflict” (individuals focus on personal differences rather than solving the task at hand).4

Facilitating Constructive Dialogue

In different variations of Asch’s experiment, certain procedures significantly diminished the influence of the group. For example, if the unknowing participants wrote down their answers rather than shared them with the group verbally, they were much less likely to conform (i.e., they were more likely to provide correct responses).

Additionally, if there was one other individual who did not conform to the group, this also increased correct responses.

Define the group’s purpose. A shared vision of what the group is trying to accomplish can be critical to making good decisions (Van Ginkel and Van Knippenberg 2008). For a couple, the common purpose might be ensuring enough resources to maintain the couple’s lifestyle in retirement; for a family, it might be managing a foundation intended to exist in perpetuity; and for an investment committee or board it might be following guidelines outlined in an investment policy statement (IPS) for the benefit of others.

Establish an information-sharing methodology. A structured process to collect the viewpoints of all individuals in the group—and then aggregate those views for group discussion—can facilitate constructive, actionable dialogue. For the group discussion, setting communication guidelines in advance increases the likelihood that each individual’s thoughts, no matter how contrarian, are heard and that the information-sharing process is fair. Indeed, feelings of fairness can go a long way toward creating a positive group dynamic.5

Facilitate a discussion with a beginning, middle, and end. During the group discussion, it can be critical first to reiterate the group’s investment purpose and then to keep the conversation focused on the decisions that need to be made—rather than on any one individual’s viewpoint. In this way, ideas, opinions, or thoughts can be evaluated in the context of the problem to be solved, thus sidestepping any potential personal conflicts or the pressure to conform. Finally, setting a predetermined end time can help increase the group’s focus on achieving the meeting’s objectives.

Taking Action

To facilitate group decision-making, it can be critical to establish a structured method to help couples, families, and investment committees or boards share perspectives (Liersch and Suri 2011). Once each individual’s perspective is established, a financial advisor can help highlight key similarities and differences by aggregating and comparing each individual’s views.

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Figure 1: Which Line Matches the Target—Line A, B, or C?

Figure 2: How to Enhance Effective Group Communication

Define the group’s purpose
Establish an information-sharing methodology
Facilitate a discussion with a beginning, middle, and end
**Case Study: A Couple**

Consider a couple in their mid-fifties with two children who are in college. They are interested in understanding whether they are on track to meet their goals and asked their financial advisor to help. Their advisor sent them formal questions (separately) on nine key topic areas (see table 2). Once the questions were answered, the advisor identified key similarities and differences, and set up a conversation with the couple to discuss their perspectives—so they could identify how to most productively invest to achieve their desired outcomes.

**Preparing for the Discussion: Key Similarities**

In preparing for the meeting, it was clear to the advisor that the couple was confident that investing could help them achieve their desired outcomes. However, both spouses also acknowledged that they may not be able to adapt to rapidly changing portfolio performance during periods of market uncertainty and volatility. As a consequence, the couple could unnecessarily exit their investment strategy at exactly the wrong time (e.g., during a market low). The advisor made a note to be sure to highlight this potential reaction and to facilitate the discussion of methods that could increase comfort with the investment risk the couple would like to take—especially during challenging times. For example, the couple could set aside cash to cover essential expenses for a year or two, employ option (or other alternative) strategies to smooth the investment journey, take a more conservative approach to investing, or simply re-focus on the goals they are trying to accomplish.

With respect to their preferred approach to making and implementing investment decisions, the couple appeared to share the view that having a moderate degree of access to their investment dollars was best. Specifically, they wanted the flexibility to change their investment approach if needed—or to draw on some of their investment principal if an unforeseen issue arose. That said, both spouses were looking to their financial advisor to design a long-term investment approach that would help them achieve their desired outcomes in the most comfortable way, which was reflected in their low desire to be actively involved in tactical investment decision-making—instead, the couple was focused on having quarterly check-ins and a more extensive review once a year.

Finally, both spouses articulated a need to focus on their personal lifestyle spending goals to ensure that they accumulated enough financial assets and did not run out of money during their lifetimes. The advisor made a note to be sure to identify current spending patterns and future needs, which would be an initial step in addressing this concern, because the couple could then make any appropriate adjustments, such as investing more, spending less, or exploring income-based investment strategies (e.g., dividend- or yield-generating investments) or solutions (e.g., annuities). Philanthropy, though not an urgent priority—it was important for the couple; they highlighted that, after they addressed their more pressing needs, they would like to explore a family foundation or donor-advised funds.

**Going Deeper: Key Differences**

The spouses had divergent perspectives in three areas: perceptions of their own level of investment experience, desires for explicit protection of their investment portfolio, and focus on family members as the intended recipients of investment dollars.

The advisor thought that discussion of the varied perspectives, though potentially challenging, would be productive. In this case, as for many spouses, it was the first time the couple had engaged in a structured conversation to identify key issues with respect to investment decision-making. The advisor decided that rather than make any suggestions or highlight any potential decisions, the discussion of differences would be focused on active listening with the goal of understanding where each spouse was coming from.

Indeed, our firm’s research suggests that of the nine topical areas of questioning described here, the average number of differences per couple is more than four, with the typical couple having five areas where key differences arise (see figure 3).6 It may or may not be surprising that—like the couple in our case study—perceived levels of investment experience, desire for portfolio protection, and money matters with respect to family constitute the most common differences, with 50 percent or more of spouses showing potentially disparate views for each of these three elements.

Ways to address these differences are discussed below.

When experience is different for couples—and for families (e.g., younger generations, by nature, typically have less experience than older ones) and investment boards or committees (e.g., members have different skill sets and levels of investment knowledge)—it can be useful to have an open dialogue about what is not understood. Allowing those with less experience to ask questions can open the door to conversations that highlight gaps or flaws in logic for both less and more experienced individuals.7 Furthermore, financial advisors and investors can work together to understand the right levels of investment complexity so that investment dialogue can be tailored to meet everyone’s needs. If desired, education can be provided to ensure the group has the right tools to jointly consider investment options and make decisions.

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**Table 2: The Couple’s Areas of Agreement and Disagreement**

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<tr>
<th>Agreement</th>
<th>Disagreement</th>
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<tr>
<td>Confidence in the future of markets</td>
<td>Perceived level of investment experience</td>
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<tr>
<td>Adaptability to short-term market fluctuations</td>
<td>Portfolio protection</td>
</tr>
<tr>
<td>Access to investment dollars</td>
<td>Support, and giving, to family</td>
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<tr>
<td>Activity level</td>
<td>Community-based giving</td>
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Lack of portfolio protection can be a large source of anxiety for those who desire it. Recognizing this potential source of concern—even if not all group members fear investment loss—may identify ways in which the desire for protection can be accommodated. By feeling more protected, individuals may be able to stay the course with investments during sharp downturns, when selling investments can be especially damaging to a portfolio. This can be accomplished by working with a financial advisor to pre-experience what potential losses may look like under different scenarios (e.g., an economic downturn) and making appropriate adjustments in advance to mitigate those losses (e.g., increasing asset diversification, investing more conservatively, or setting aside more cash to avoid liquidity crises). Additionally, considering investment solutions that can explicitly offer principal protection (e.g., annuities, market-linked investments) or employing alternative strategies that intentionally attempt to capture less of the downside when markets decline can enhance levels of portfolio protection.

No matter what differences arise among members of a group, it can often be useful to refocus a group on the stated investment purpose. In this case, the couple agrees on solving for their own lifestyle spending needs and their philanthropic interests, but not on family. Why? One spouse may feel it’s important for the couple to take care of themselves before investing for children, grandchildren, or older parents; and the other may feel that educational accounts, trusts, long-term care, and supplementing family members’ income should be incorporated in the design of the investment approach. A good starting point for resolution might be to identify the excess resources available to the couple after they have solved for their own lifestyle needs. Once that amount is established, the couple can work together to select a course of action for their additional, non-essential investment dollars.

The Way Forward
Investing is not like buying a car. Instead, many investments, rather than one investment alone, can make up the right investment approach for a couple, family, or investment board or committee. This means that many different investment approaches can be combined to resolve key differences in investment perspectives (see figure 4). The right overall approach can be reached by:

**Group consensus.** Consensus for couples may equate to compromise. For example, a spouse who is not interested in downside portfolio protection might agree to protect some of the portfolio to accommodate the spouse who is anxious about potential investment loss. For a family and investment committee or board, consensus may mean establishing a “majority rules” format to resolve differences or that 100 percent of group members need to agree to the investment approach.

**Agreeing to disagree.** For couples and families, choosing to invest separately may be the preferred way forward, where everyone invests according to their own preferences and goals. For investment committees or boards, this approach may be less viable, so re-focusing discussion away from individual perspectives—and toward the IPS or mission—can help resolve disagreement.

**Following the primary decision-maker.** Giving an individual in the group decision-making authority—whether it be a spouse, adult child, parent, or chief investment officer—is a common path to implementing an investment approach. In some cases, it may be valuable to document the reasons for the investment choices, and why the primary decision-maker either took or declined to
Can goals be prioritized to emphasize commonalities and de-emphasize differences? Can the financial strengths and weaknesses of each member of a group be identified, so that different members shape various elements of a comprehensive financial strategy according to their strengths?

Taking a group's view into account. Doing so can allow for easier decision-making transitions in the event the primary decision-maker is no longer available to make investment choices.

Combining decision-making methods. Taking an approach where some of the investment decisions are made by consensus (e.g., for joint resources), some are made by individuals (e.g., for separate resources), and others are made by the primary decision-maker (e.g., for trusts) is also a common strategy.

Fortunately, there is not an all-or-none approach to establishing good decision-making processes, so many combinations—or other procedures not mentioned here—can work. For example, families can invest and give together via a family foundation but still invest individually to meet individual goals and aspirations.

Concluding Thoughts and Actions
Ascertaining an individual investor’s unique financial goals—and helping him or her to navigate the complexities of reaching them—can prove a challenge in the best of circumstances. But the challenge can become more formidable when the investor is two or more people who have differing risk preferences, approaches to making and implementing investment decisions, and desires for their investment dollars. When financial goals diverge, investors and their financial advisors can look to behavioral finance to help negotiate a path forward. Can goals be prioritized to emphasize commonalities and de-emphasize differences? Can the financial strengths and weaknesses of each member of a group be identified, so that different members shape various elements of a comprehensive financial strategy according to their strengths? Are certain decision-making approaches better suited than others for resolving different areas of disagreement among members of a group? A financial advisor and other trusted investment professionals can offer numerous approaches for reconciling such differences.

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Endnotes
1. For a review of research that examines group decisions and performance, see Hackman and Katz (2010).
2. See Gort and Gerber (2008). Performance was determined by the Sharpe ratio, which measures the benefit of excess return above the risk-free rate—relative to risk, or standard deviation.
3. See Asch (1951, 1955, 1956). Many videos are available online that explain Asch’s experiment and demonstrate the procedure.
4. For a perspective on the benefits of keeping task and relationship (e.g., personal) conflict distinct, see De Wit et al. (2011).
5. In fact, when procedures are not perceived as fair, people can be more likely to attribute negative outcomes to the authority figure; see Brockner et al. (2007).
6. Data represent investment personality survey data from 40 affluent, high-net-worth, and ultra-high-net-worth couples in 2012; ages ranged from 20s to 80s; differences in topic areas measured on a three-point scale of low, moderate, or high.
7. For an example of what experts and non-experts can bring to the table when making decisions, see McKenzie et al. (2008).
8. For example, investors can be exceptionally loss averse in retirement; see AARP and American Council of Life Insurers (2007).

References