Surprising Ways to Boost Your Finances

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Don't put a dollar figure on your financial goals. Beware multiple savings accounts. Ignore the minimum balance figure on your credit card statement. And if you think paying off your smallest debt will motivate you to tackle the larger ones, think again.

Those were just a few of the surprising research findings presented last week at the Conference on Consumer Financial Decision Making, sponsored by the Leeds School of Business at the University of Colorado in Boulder.

Framing Savings Decisions

Conventional wisdom suggests the best way to save money is to put a time frame and dollar figure on a financial goal and work backward; so if you want to save $500 for a vacation in 10 weeks, you divide 500 by 10 and save $50 a week to reach the goal. But depending on how a consumer thinks about a goal, that approach may be counterproductive, according to four studies conducted by Gülden Ülkümen at the University of Southern California and Amar Cheema at the University of Virginia.

"There are beneficial effects of specifying," says Ülkümen. "You know how much effort you have to put into the goal and clear rules are more likely to be followed. But sometimes specific goals appear to be more difficult and lead to disengagement."

Consumers typically frame goals two ways: They either focus on *why* they want to pursue a particular goal (known as high-level construal) or they're detailed types who spend more time on *how* to get there (known as low-level construal).

In one experiment, participants were asked to list an occasion they would like to save for in the next six months; one group stated the dollar amount and another did not. Then researchers surveyed the group using a scale that measures how they construe goals, and contacted them a month later to see how much they saved.

Among the high-level construers -- those focused on the "why" -- people who put a specific dollar figure on their goal saved more. Among the low-level construers -- those focused on the "how" -- people who put a specific dollar figure on their goal ended up saving less.

"High-level construers perceive goals as more important, anticipate higher success, and have greater actual success" when they set specific dollar amounts, says Ülkümen. "Specific goals hurt low-level construers; they perceive the goals as more difficult, become discouraged, have lower anticipated success and less actual saving."

The takeaway:If you think about goals in a big-picture way -- such as why it's important to save for retirement -- put a timeframe and a number on your goal. If thinking about retirement prompts you to look at details, such as how your company's 401(k) plan works, then join immediately, start contributing a percentage you can afford, increase it by 1 percent every time you get a raise -- and don't look at the end goal. You're less likely to get discouraged by a huge target.

No Safety in Numbers

Meanwhile, if you're someone who maintains a separate account for every savings goal, it's time to consolidate. Three researchers at the University of Utah found that consumers who use multiple accounts spend more money than those with a single account.

"Some people may want multiple accounts because they feel each serves a separate function," says researcher Jessica Rixom, who conducted the studies with Himanshu and Arul Mishra. "It shouldn't matter how many accounts someone has, but it does."

In this experiment, one set of participants had a single account and a second group had multiple accounts. They were assigned to complete a task, and if they were successful, they earned money and had to deposit their earnings. Then they were asked if they wanted to buy an item -- a T-shirt, Blockbuster gift card, etc. They could say yes or no, and pay for it from their account(s). Participants were told that a drawing would be held at the end of the experiment and the winner could keep all the items they purchased as well as the money left in their account(s).

Participants repeated the process five times. They could earn a total of $100 and spend up to $40.

The multiple-account participants spent 20 percent of the money they earned, compared to 12.7 percent for single-account participants. Moreover, people with multiple accounts were more apt to justify their spending decisions. "They would say things like, 'It was good to know I still have money here, so I could spend more from over here,'" Rixom says.

The takeaway: Maintain a single account for your paycheck and spending, and use online budgeting software to do the mental accounting for you -- a free tool such as Mint.com, which is supported by advertising, or an ad-free subscription tool such as Mvelopes.com. (Full disclosure: I use the latter tool myself and write a paid column for its site.)

Manage Credit Card Debt the Smart Way

When you've got multiple credit cards to pay off, the smartest financial approach is to pay off the card with the highest-interest rate first and work your way down to the lowest-rate card. But some personal finance gurus suggest that closing the smallest balance first will provide the momentum to tackle the rest. That's wrong, according to a working paper by Shahar Ayal, Moty Amar, and Dan Ariely of Duke University; Scott Rick of the University of Michigan; and Cynthia Cryder of Carnegie Mellon.

People tend to break a large goal into smaller, more manageable parts. But research finds that attaining sub-goals can distract someone from their ultimate goal; they win the battle but lose the war. People who focus on the sub-goal of paying off the smallest debt first distance themselves from the big-picture goal and end up worse off than they would otherwise be.

The researchers developed a computerized debt-management game in which participants were saddled with multiple debts and given cash at different intervals to pay down the debts. Some participants were allowed to keep some cash in a checking account, while others had to allocate all the cash they receive to pay down debt. Participants could clearly see the interest rates of each debt.

No one consistently allocated their cash to pay off the loan with the highest interest rate debt, the study found, and many participants in the cash condition kept available cash in their checking account.

The researchers then repeated the experiment -- but in this case told the participants they would not have enough cash to close any of the accounts. This group in this experiment ended up with less debt than people in the previous one.

Finally, researchers ran the same experiment but integrated several of the smaller debts into one larger debt with a slightly higher interest rate, putting these players in a worse financial situation. Despite this, they ended the game in a better financial situation than the control participants. They didn't pay down the debts any more rationally than the other players. But because the smaller debt was closer in size to the others, they had no motivation to try to close it out first.

Bottom line: If you don't have the discipline to list your credit cards in interest-rate order from highest to lowest and pay them off that way, try an online tool such as DebtGoals.com (about $15/month) that literally tells you what to pay off first to minimize your overall debt. Or contact the National Foundation for Credit Counseling (nfcc.org) for debt counseling. Don't choose debt settlement (see this recent story for an idea of the damage it can cause).

As for that minimum payment on your credit card: Ignore it and pay more. Boston College researchers Linda Court Salisbury and Katherine Lemon are studying the new disclosure information on credit card statements, looking at what motivates consumers to shed debt more quickly. They ran an experiment that asked people to pay a hypothetical credit card bill -- and discovered they actually paid more when the minimum required payment was not stated on the bill.

"The minimum required payment is an anchoring effect bringing down payment," says Salisbury. What should you pay attention to? Look at the box that tells you the total amount you'll pay over time if you only make the minimum payment. "(Displaying) future cost led to greater repayment," Salisbury says.

Bottom line: Try to pay off as much as you can, or aim for ten percent of the balance each month.