HARVARD | BUSINESS | SCHOOL
WORKING KNOWLEDGE

RESEARCH & IDEAS

Innovative Ways to Encourage Personal Savings

Q&A with: Peter Tufano
Published: June 23, 2008
Author: Martha Lagace

*Saving money doesn't need to be so difficult. According to HBS professor **Peter Tufano**, "The most interesting ideas—indeed the oldest—try to make savings a fun or satisfying experience." As Tufano describes in this Q&A, different solutions appeal to different people. Here's what government policy, the private sector, and nonprofits can do. Key concepts include:*

- *A variety of levers can be used to support people who want to save (not to force someone to save who doesn't want to).*
- *Some levers are simple changes that make the process of savings easier.*
- *Other levers involve providing various incentives, be they financial or sociological.*
- *The oldest and most interesting ideas try to make savings a fun or satisfying experience.*

Putting together the money for everything from a short-term emergency to retirement is hard enough, a challenge that low- and moderate-income families endure every day. Yet as HBS professor Peter Tufano describes, new and old products targeted at people who haven't saved in the past and who don't have much money to begin with can make savings more feasible or more fun, or both.

Given the diversity of financial conditions, social settings, and personal circumstances of families, and against the backdrop of consumerism in the United States, there is no one-size-fits-all savings solution to support every low- to moderate-income family, says Tufano. Beyond valuable programs like Social Security, tax breaks for savers, or auto-enrollment initiatives, there are more innovative and exciting projects: Prize-linked savings accounts like the United Kingdom's Premium Bond program, for example, award prizes as part of the savings product's return. Rotating Savings and Credit Associations, known as ROSCAs, draw impetus from the spirit of communities and social networks.

The varied solutions that Tufano and colleagues have set out in a stream of coauthored papers alter the conditions that make savings difficult by changing the savings decision-making process, the time and place for savings, or the cost-benefit of savings itself. Such ideas could help low- to moderate-income households, and anyone else, build assets and put aside more money for their needs and desires.

"A lot of the work that I've done over the course of the last 10 years has been field-based, working in conjunction with HBS student teams, partners in business and the nonprofit sector, and especially through the nonprofit that I founded, Doorways to Dreams Fund or D2D (D2DFund.org)," explains Tufano.

"My colleagues and I try to keep our connections in the communities we serve by talking with people. We come away from these encounters with a sense of optimism. Low- and moderate-income individuals, by and large, want to take care of their families. Government policy, the private sector, and nonprofits can do more to support these sets of well-meaning folks who are trying to do the right thing."

Tufano was invited to describe his work for *HBS Working Knowledge*.

Martha Lagace: How did you get interested in studying different vehicles for savings?

Peter Tufano: One day I received a phone call from one of my college roommates who worked in South Central Los Angeles as a community organizer. He was bemoaning the lack of financial services to people who lived there. As a result, I became very interested in what we might call "consumer" or "household" finance. This brand of finance was quite different in many ways from the type of finance researched and taught at business schools. I explored how financial services were practiced in a place like South Central, focusing in particular on the opportunities to leverage social organizations to deliver a broad range of financial services. An article about this work was published in the *Harvard Business Review*.

My colleagues and I looked at a full range of financial services that were—and were not—available in South Central and communities like it, including payment services, savings, credit, and insurance. For a variety of reasons I began to focus on savings, because few organizations seemed interested in savings by the poor. Credit was fairly well available in their communities, and payment services (such as check cashing, money orders, and debit cards), while costly, were also available. Savings was the "missing market."

Q: There are structural barriers to a lack of savings. What other barriers make saving money difficult?

A: One of our papers, "Using Financial Innovation to Support Savers: From Coercion to Excitement," [PDF] is an attempt to explore the various reasons why people don't save. The most obvious barrier is that they simply have too little income. In addition, there is a whole host of reasons why people put off savings, especially in the context of an economy where consumerism is common.

A variety of levers can be used to support people who *want* to save (not to force someone to save who doesn't want to). Some of these levers are simple changes in what I call the plumbing, making the process of savings easier. Others involve providing various incentives, be they financial or sociological. The most interesting ideas—indeed the oldest—try to make savings a fun or satisfying experience. Taken together, these approaches run the gamut. There is no one solution, but different solutions will appeal to different people.

Q: Let's talk about prize-linked savings. What are these savings vehicles? Why are they so difficult to introduce in the United States?

A: Prize- or lottery-linked savings programs have been in existence since 1694 and are currently in use in a host of countries around the world. They blend elements of lotteries and savings programs. In particular, these products offer savers protection against principal loss and liquidity, but instead of paying interest proportional to savings balances, they essentially "raffle off" the interest pot each period. Savers give up a large chance of a small return for a small chance of a large, life-changing return. I have studied these programs in England, where they have been run for over 50 years, as well as in South Africa. They channel some of the demand for lotteries into a demand for savings. These so-called prize-linked products have been extraordinarily effective in generating savings over many centuries, and one wonders how successful they could be in the United States.

We have worked with one innovator in Clarksville, Indiana, and have written about the subject in a paper, "Consumer Demand for Prize-Linked Savings: A Preliminary Analysis" [PDF].

In the Clarksville survey, there were four characteristics that define people who were most interested in the product:

- They have no plan to save and no regular savings plans.
- They have almost no savings.
- They play the lottery heavily.
- They are optimistic about their future.

That characterized more than half of the folks in the survey.

I have observed use of the products elsewhere, and wrote a case study about one in South Africa called the Million-a-Month Account, known as MaMA. MaMA was remarkably successful, generating 750,000 accounts over two years. Unfortunately, this past spring the highest court in South Africa ruled it an illegal lottery and shut it down. In South Africa as in America, the state has a monopoly on what can be considered a lottery. A lottery is used as a source of public revenues. I'd be happy to have a debate about whether it's healthier for families to play the lottery or to save in lottery-linked savings programs. In one case, the losers have worthless bits of paper; in the other, they have their savings.

In the United States, if you were to roll out such a product exactly as it exists in other countries, you would likely be in violation of both state lottery laws and federal banking regulations. Fortunately, one can test the structure under sweepstakes laws. Preliminary results for the market research in Indiana show remarkably strong interest in the product. We can't say there is a *demand* at this point, but there is interest in the product from low- to moderate-income households.

I don't know if more than half of Americans or even half of low-income Americans would find this product of interest—but I am heartened by the fact that it has generated strong interest in South Africa, the United Kingdom, northern European countries, Middle Eastern countries, developing countries, and Central and Latin America. Given all those experiences as well as our market research, I'd be surprised if at least there wasn't a strong demand in the United States. Yet to roll out lottery-linked products in an efficient way, we need to address the legal and regulatory barriers.

Q: Can these ideas for savings vehicles be extended to households with higher incomes too?

A: The work that I do deals with low- to moderate-income households. That said, all the things I write about in these papers are applicable to a large range of Americans. Programs such as automatic defaults and 401(k) defaults, as embodied in proposals like the auto-IRA and AutoSave, are effective and would appeal to people in the workforce in a stable job, typically with a large employer.

Having said that, there are even more ways to appeal to American would-be savers. These initiatives could go to the place where they have their money to save, whether it is the workforce or tax refund sites; create a social angle to savings; and create a psychological angle to help savings, whether it is in prize-linked or collectible savings.

On the sociological end, our research with U.S. savings bonds has been eye-opening. It reveals an old-fashioned impulse lives on: to save on behalf of others. Savings bonds help children get started on the route of savings. It is not the same as giving them money to spend, nor is it the same as the traditional economic bequest motive: to save so that when you die you can give money to people. Savings bonds actually give people savings. We've had a lot of success in sales of U.S. savings bonds because they tap into a very old and traditional reason to want to save. In some sense, I think people may give up hope for themselves and may despair that it's too late—but it's not too late for a child if he or she can get started in the right direction. Again, there is nothing about that impulse that is particularly low income.

Q: What are you working on next?

A: First, I hope to work on prize-linked projects more over the coming years. I want to learn about the demand for these products and, more importantly, find out whether they create new savings or simply substitute for existing savings.

Second, in the policy arena, our field research over the past three years on U.S. savings bonds convinces me that relatively small changes in U.S. Treasury policy would make savings easier for families. In particular, our research suggests that letting refund recipients check off a box on their tax form 8888 to buy bonds might be effective. (Form 8888 allows refund recipients to send refunds to up to three destinations, a policy initiative partly spurred by my and D2D's work.)

Third, the concept of gifting savings and buying savings is very exciting. I've developed some projects out in the field where we can learn whether those concepts have legs—and whether they generate new savings.

On the credit side, I think the presentation of information to credit card borrowers may influence the way they use their credit. We are currently working on a field experiment to see if providing information to consumers in a different way on a credit card statement or on a financial dashboard would change the way they manage their money. Such information as currently presented minimizes the appearance of debt burden that families are building. New types of credit card statements might be more effective in helping borrowers understand the consequences and likely future implications of their current decisions.

Finally, my colleagues at D2D Fund are very excited about financial education initiatives where we are working with commercial video game developers to embed financial literacy training in commercial-quality games. We want to test whether these tools change the way people make decisions about their financial lives. We hope the markets would include young adults (not just teenagers), members of the military and their families, and low- to moderate-income families. When you hear about video games you might immediately think of violent shoot-outs. However, there is a host of video games in the casual game segment where shooting is not involved, and the players are more likely to be quite different from the stereotypical gamer.

The above research projects, in conjunction with casewriting for my new MBA elective, Consumer Finance, are keeping me very busy. I'm very excited about the possibility that new research and teaching can help us accomplish the HBS mission of making a difference. WK

About the author

Martha Lagace is the senior editor of *HBS Working Knowledge*.

