Peer Effects and Financial Decisionmaking in Brazil

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Sector(s): Finance

Sample: 150 pairs of investors

Outcome of interest: Empowerment

Intervention type: Information Social networks

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Research Papers: Understanding Mechanisms Underlying Peer Effects: Evidence From a Field Experim...

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The channels by which peer effects influence financial decisions are not well understood. Researchers tested the independent impact of two of these channels, social learning (when someone purchases an asset after a peer expresses a desire to purchase the same asset) and social utility (when someone feels he can gain more from an asset because his peer owns it), on financial decisions in Brazil. Both social learning and social utility had significant effects on decisions to invest in a newly designed real estate asset.

Policy issue

In many cases, peer effects—the result of comparing oneself with friends, family members, or other peers, on an individual's choices[1]—may drive financial decisions, rather than careful consideration of the products being offered. While researchers have shown that peer effects play an important role in financial decisions, the channels through which peer effects influence financial decisions is less understood. There are two potential channels by which this can occur: social learning, or learning from a peer's choice to purchase an object; and social utility, or influence through a peer's possession of an asset. Researchers have found it difficult to disentangle the effect of social learning from social utility—if a peer chooses to purchase an asset, it usually implies that he also possesses the asset. In this evaluation, researchers created an experimental setting that decoupled the decision to purchase an asset from actually owning it in order to understand the independent effects of social learning and social utility on financial decisions.

Context of the evaluation

Between 2006 and 2011, the "banked" population in Brazil increased from 50 percent of the total population to 62 percent.[2] As more and more people enter the formal banking sector, it is increasingly important to understand the factors the drive their financial decisions. To investigate the mechanisms through which peer effects drive financial decision making in Brazil,

researchers worked with a large financial brokerage in 2012 to design a new financial asset to independently test some of the peer effects channels which might influence financial decision making.

Woman talks to friend while sharing content on tablet in Brazil.

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Details of the intervention

Researchers conducted an evaluation to test the impact of social learning and social utility on financial decisions. Researchers partnered with a large financial brokerage in Brazil to offer a new financial asset to 150 pairs of clients with a close social relationship (family members or friends). The investment was designed to be risky: minimum investments were 2,000 Brazilian real (over US$1,000), around 50 percent of the median investor's monthly income in the sample.

Within each pair of investors, one member was randomly assigned the role of Investor One and the other the role of Investor Two. Investor One was first given the chance to invest in the asset with no mention of the peer, and Investor Two was given the chance to invest in the asset after receiving different types of information regarding their peer’s decision and ability to purchase the asset.

Researchers randomized both whether Investor One was allowed to purchase the asset and whether Investor Two was informed of Investor One’s choice to invest and of their ownership of the asset. The brokerage first called Investor One to give him the chance to purchase it, with the understanding that the asset was in limited supply. If Investor One decided to purchase the asset, a computerized lottery determined whether he was able to make the investment.

After the call to Investor One but on the same day, the brokerage called Investor Two and shared the same information about the asset as before. A second lottery determined whether Investor Two received no information about Investor One’s choice or

complete information about the choice, including, if Investor One had chosen to purchase the asset, whether he had actually acquired ownership.

Of the pairs where Investor One expressed a desire to purchase the asset (78 out of 150), two-thirds of Investor Twos received information regarding their peer's investment decisions. Within this group, approximately half learned that the decision was rejected (learning without utility), and the other half learned that the peer was able to purchase the asset (learning with utility). This design enabled researchers to disentangle decisions based on social learning from those based on social utility.

Results and policy lessons

Results showed that both social learning and social utility matter for financial decisions and that social learning effects were greatest among investors who were less financially sophisticated.

Social learning: Knowing that Investor One had a desire to purchase an asset led to a 30 percentage point increase in the desire to purchase this new asset among Investor Twos, from a base of 42 percent take up among those who were given no information about the peer's decision. Follow up surveys revealed that there were large and significant effects for social learning when Investor One was financially sophisticated (with insignificant effects when Investor One was financially unsophisticated), or when Investor Two was financially unsophisticated (with small insignificant effects when Investor two was financially sophisticated).

Social learning plus social utility: Knowing that Investor One decided to purchase the asset and was also able to purchase it had a significant effect on Investor Two's decision to purchase the new asset. Ninety-three percent of this group decided to purchase the asset, compared to 42 percent when Investor Two had no information and 71 percent when Investor Two knew that the peer desired to purchase the asset but the purchase was not authorized.

Social utility: The difference between the effects of social leaning plus social utility and the effects of social learning alone indicates that social utility has a large and significant effect over and above social learning. Moreover, in a follow-up survey, 60 percent of respondents reported that wanting to earn the same financial return as their peer was a significant factor in their decision, and 32 percent reported that the fear of not having a return that their peer could have was a significant factor in their decision. Forty-four percent reported that a significant factor in their purchase decision was that they could talk with their peer about the asset.

These findings can provide important evidence that greater information for financial decision making might help mitigate herding behavior in financial markets or identify the channels through which peer effects work in other settings such as marketing, technology adoption, or health seeking behavior.

Bursztyn, Leonardo, Florian Ederer, Bruno Ferman, and Noam Yuchtman. 2014. ‰ÛÏUnderstanding Mechanisms Underlying Peer Effects: Evidence from a Field Experiment on Financial Decisions.‰Û Econometrica 82(4): 1273-1301.

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1. James, Russell, "Peer Effects," <http://www.slideshare.net/rnja8c/peer-effects>.

2. Nakane, Márcio and Bruno de Paula Rocha, "Policy Innovations to Improve Access to Financial Services: The Case of Brazil," February 2012, <http://www.cgdev.org/doc/LRS_case_studies/Nakane_PaulaRocha_Brazil_r1.pdf>.