3 Behavioral Phenomena That Impact Your Finances

Don’t let these challenges prevent you from saving for retirement.

If you aren't careful, a single purchase could lead to many others.

Humans are emotional creatures. We're often drawn to negative behaviors, even when we know we should be doing something else. A large part of becoming better and more efficient with managing your personal finances is to work to reduce that emotional behavior.

The first step in that process is understanding your blind spots and recognizing tendencies that could be working against you. There are several behavioral phenomena that you should be aware of so you can better control your actions and protect yourself from those who might try to exploit you. Here's how to overcome the challenges that might be preventing you from preparing for your financial future.

The Diderot effect. Have you ever noticed that when you buy a new house you immediately feel the need to buy more furniture and update the window treatments? Even items as minor as towel bars and matching toilet paper holders become a priority because your old goods don't seem to measure up anymore. The same thing can occur when you buy a new shirt or blouse and the immediate urge to buy shoes and accessories that make the outfit creeps into your mind. This phenomenon has a name: the Diderot effect. The introduction of a new possession can result in a process of spiraling consumption.

Planning opportunity: Develop a responsible plan to pay yourself first and save for emergencies and retirement. If you create a healthy environment of "forced scarcity" where you focus on financial independence and building memories through travel and experiences over accumulating items for the sake of having more, you will be on firmer ground for financial fulfillment.

Also, resist the temptation to immediately spend any windfall of money you receive. If you inherit a large sum of cash, take life slow and don't make too many quick and rash decisions.

The Zeigarnik effect. Ever wake up in the middle of the night and realize that you never called a client or family member back? This ties into the Zeigarnik effect, a psychological tendency to dwell on an uncompleted task rather than a completed one.

The Zeigarnik effect can be tied into your financial life. There are many financial issues that we all know we need to address, but many people fail to set up a basic financial plan. As a result, a tremendous level of stress can build to the point of waking you up at night and paralyzing you into inactivity.

Planning opportunity: As unpleasant as addressing these uncomfortable issues with loved ones can be, the relief and sound sleep that comes from peace of mind can be worth it. But it does take effort to address basic but critical financial issues proactively. Focus on building a financial foundation, such as building an emergency reserve account containing three to six months of living expenses, filling out estate documents including wills and health care directives and saving 15 to 20 percent of your gross income for retirement.

The Pareto principle. The Pareto principle is also known as the 80/20 rule, in which about 20 percent of things are vital and 80 percent are trivial. For example, 80 percent of a company's revenue may be coming from its top 20 percent of customers. It can relate to many areas of your personal and financial life, too.

Planning opportunity: Think about how you apply your energy and financial resources. The typical individual could set themselves up for a successful retirement if they can allocate 20 percent of their income to saving for the future as early as possible.

Also, think about how you spend your time growing your career and expanding your income opportunities. Use this principle to remind yourself to focus on the 20 percent that really matters. Don't let the minutiae of life (the 80 percent) keep you from moving your financial household forward.

Your emotions can hinder your ability to build wealth for the future. However, you can also offset them with strong planning and preparation for the future. Use these strategies to resist the urge to spend money you could be using to secure your long-term financial goals.

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