

Information overload

Over the years, employers have taken many steps to improve 401(k) plans, to make them more attractive to participants and to encourage higher participation rates. One of those steps was to increase the number of investment choices available, so that each participant would be more likely to find an investment alternative exactly to his or her taste.

Here's the anomaly: The more investment choices that a plan offers, the lower the participation rate tends to be. Exactly the reverse of what was hoped for.

An experiment done in 1995 may shed some light on this result. The study was conducted by Professor Sheena Iyengar, who is the author of "The Art of Choosing," published in March, 2010.

In the study a sample booth was set up in a gourmet food store, offering patrons samples of jam. Sometimes there were six flavors of jam to choose from, sometimes there were 24 choices on display. At all times, anyone who tried a sample received a coupon for \$1 off for a purchase of a jar of jam. The coupons were tracked, some results were unexpected.

- The larger flavor assortment drew many more shoppers to try a sample, a 50% increase in samplers.

- On average the shopper tried two flavors of jam, whether presented with a large or small number of choices.

- Shoppers presented with fewer choices were far more likely to use the coupon to buy jam. Of those who selected their samples from the array of 24 flavors, just 3% purchased jam. For those presented with only six alternatives, a whopping 30% decided to buy!

Although the result may seem surprising at first, a logical explanation is possible. Busy shoppers typically don't have time to try more than two samples, no matter how many they have to choose from. When one samples two of six choices, one has tried one-third of the possibilities, and so may have a higher confidence level about making the "best" choice. On the other hand, with the larger array one leaves 22 jams untasted, and so could easily decide that more investigation is warranted before making an unplanned purchase.

How much more difficult—and important—is the choice faced by 401(k) investors? Investors generally, who are managing their taxable portfolios, have still more choice and still more information to filter and analyze.

Perhaps that's why some 401(k) plan sponsors are considering offering investment advice to participants, and it's why more and more affluent individuals are turning to professionals for investment help.

(March 2010)