Study: Too many choices impair 401(k) decisions

When individuals are faced with too many options they become paralyzed and don't make the best decisions -- even when it comes to 401(k) options, according to a new study co-authored by Columbia Business School and University of Chicago Booth School of Business.

The study released on June 30 by Columbia Business School Professor Sheena Iyengar and University of Chicago Associate Professor of Economics Emir Kamenica examines this paradox of choice, which found that the more fund options an employee has to choose from, the more it deters a person from enrolling in a plan.

Too many options, the researchers found, can impair a person's ability to make reasoned choices.

In the first study, one group was asked to pick a gamble from the menu of 11 gambles, which included ten risky options and one less lucrative, and less risky, gamble of five dollars. Another group was offered three gambles, which included the less lucrative gamble of five dollars. The researchers found that many more subjects chose the simple option from the set with 11 options than from the set with three.

In another study, this one related to 401(k) plans, the researchers tested whether the number of funds offered influences asset allocation. Using data from the Vanguard Center for Retirement Research, the researchers analyzed the investment decisions of over 500,000 employees in 638 firms. The study found that with every additional ten funds in a plan, allocation to equity funds decreased by 3.28 percentage points. Meanwhile, for every ten additional funds, there was a 2.87 percentage point increase in the probability that participants will allocate nothing to equity funds.

"As revealed in the first two studies, the presence of complicated choices caused decision-makers to choose the simpler options, even if they were not as lucrative," the study reported.

"In addition, the data revealed that employees under 30 years of age are as likely as others to allocate no money at all to equity funds and their participation in equities is just as sensitive to the number of funds as that of older employees," the study found. "The findings are of particular economic significance, as non-participation in the stock market, especially for younger employees, is likely to be detrimental to one's retirement income."