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FACTORS AFFECTING FINANCIAL CONSUMERS' PRIVATE PENSION PLAN DECISIONS: A LITERATURE REVIEW AND A CONCEPTUAL FRAMEWORK PROPOSAL

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Abstract

The objective of this study is to propose a framework related to financial consumers' private pension plan decisions. Specifically, we review the factors affecting consumers' participation, contribution and asset allocation decisions regarding private pensions. The factors discussed include situational and dispositional factors, personality, motivation, financial literacy, and external influences. Based on this survey of literature, we develop a number of propositions, which are expected to benefit individual retirement planners and pension institutions in gaining a better understanding of retirement saving decisions.

Keywords: Private pension plan, retirement, financial consumers, financial planning, conceptual framework

JEL Codes: D11, D14, J32

FİNANSAL TÜKETİCİLERİN BİREYSEL EMEKLİLİK KARARLARINI ETKİLEYEN FAKTÖRLER: BİR LİTERATÜR TARAMASI VE KAVRAMSAL ÇERÇEVE ÖNERİSİ

Öz

Bu çalışmanın amacı finansal tüketicilerin bireysel emeklilik planları ile ilgili kararlarına yönelik bir çerçeve sunmaktır. Özellikle, tüketicilerin bireysel emeklilik sistemine katılım kararı, yatırılan miktar ve varlıkların dağılımı ile ilgili kararlarını etkileyen faktörler gözden geçirilmiştir. Bahsedilen faktörler durumsal ve ruhsal faktörleri, kişilik özelliklerini, motivasyonu, finansal okuryazarlığı ve dış etmenleri içermektedir. Bu literatür taraması temel alınarak bireysel emeklilik danışmanları ve kurumlara emeklilik birikimlerini daha iyi anlamada yarar sağlaması beklenen bazı önermeler geliştirilmiştir.

Anahtar kelimeler: Bireysel emeklilik planı, emeklilik, finansal tüketiciler, finansal planlama, kavramsal çerçeve

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1. Introduction

Retirement saving decision has gained growing emphasis in recent years due to the aging population around the globe and its impact on macroeconomic conditions. This is even more important considering the fact that in recent years, there has been a shift of responsibility to plan for retirement from governments and corporations to individuals. Therefore, understanding the factors which might have an effect on private pension plan decisions is of utmost significance for both financial consumers and pension institutions to acquire valuable information with which to influence consumer behavior in this area (Rickwood & White, 2009).

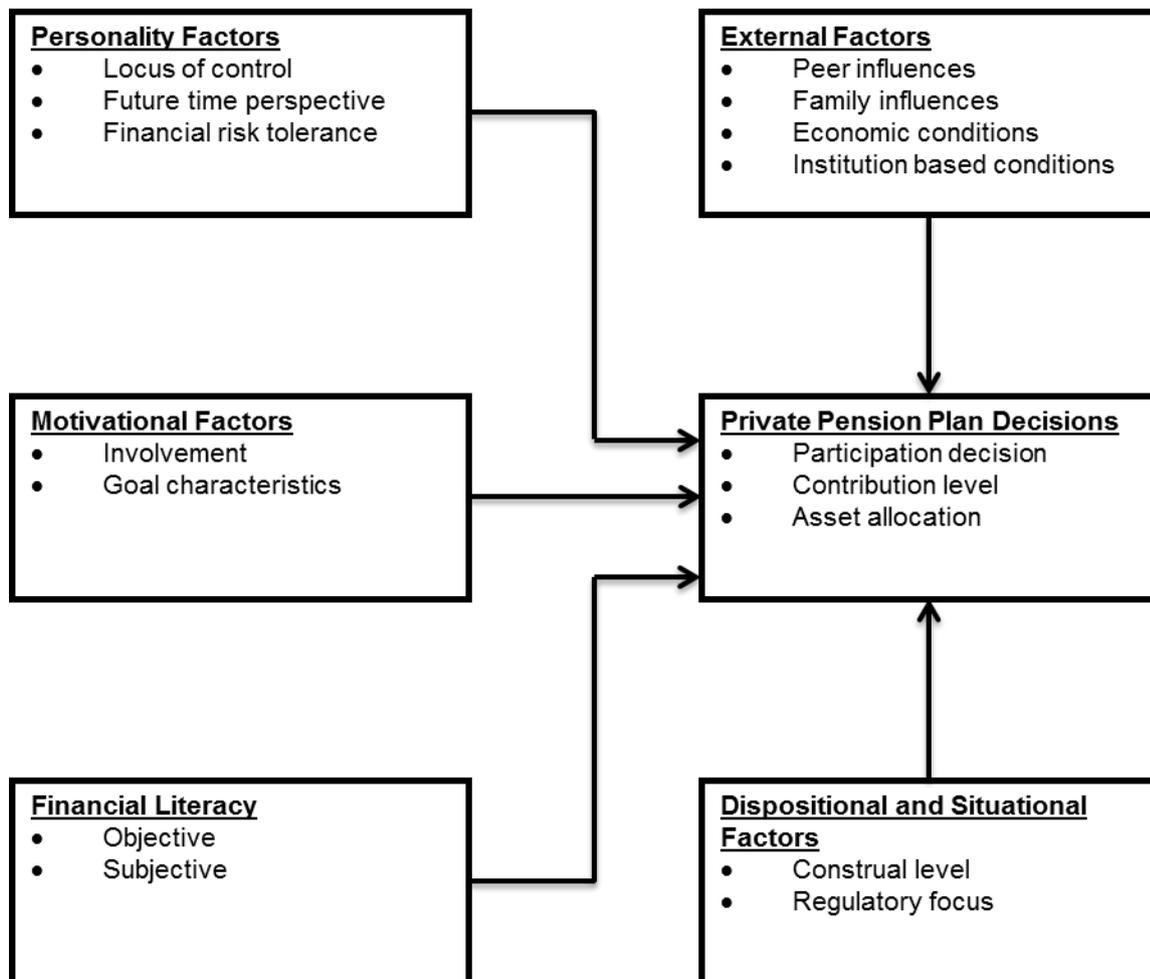
The objective of this study is to propose a framework related to consumers' private pension plan decisions. The key decision is whether consumers are willing to participate in a plan or not. Once the participation decision has been made, the next important choice is how much to contribute. Another plan feature that is chosen by participants is the allocation of assets within the individual's account. Some individuals might prefer riskier options with volatile returns such as stocks, while others might opt for fixed income securities. The factors affecting these three essential decisions will be the focus of this study.

In prior works, several factors affecting consumer decision making in the purchase of financial services in general, and retirement saving decisions in particular, have been investigated in isolation. However, comprehensive reviews including a large set of factors that are likely to have an impact on participants' private pension plan decisions are scarce. This paper contributes to the literature by proposing a framework which fits together several elements, some of which did not receive adequate attention in prior studies. The relation of demographic factors such as age, income, education and gender to retirement saving practices has been well established in the literature. In this paper, we rather focus on the role of personality, motivation, financial literacy, situational and dispositional factors, and external influences in explaining private pension plan decisions among financial consumers.

The framework proposed in this paper is depicted on Figure 1 that follows. Among personality factors, we discuss the role of locus of control, future time perspective and financial risk tolerance in explaining private pension plan decisions. Motivational factors comprise of involvement and the characteristics of goals such as the number of goals, goal clarity, specificity and priority. Besides, we examine the role of both objective and subjective financial literacy of consumers in determining decisions related to private pension plans. The next set of factors includes regulatory focus and mental construal which have both situational

and dispositional features. Finally, we elaborate on external factors including family and peer influences, economic conditions and institution based conditions.

Figure 1. Conceptual Framework Of The Factors That Influence Private Pension Plan Decisions



2. Personality Factors

2.1. Locus of Control

Locus of control (LOC) is a personality factor that explains differences in individuals' perception of control over the course of their lives (Rotter, 1966). Based on their locus of control, individuals can be grouped as internals, who attribute occurring events to their own actions, and consider themselves in control of their lives, and externals, who believe life events may happen independently of one's own action, and consider forces outside themselves may control their lives.

The LOC concept has been investigated within finance domain to demonstrate

differences between internals and externals in their money attitudes, saving behavior, and financial preparedness. Overall, the studies suggest that internals believe in controlling their own fates and therefore take responsibility of their finances; whereas externals rely on other forces than themselves in determining the course of their lives; hence don't take responsibility of their finances (Lim et al., 2003; Perry and Morris, 2005). In particular, it is established that internals manage their money more carefully (Tang, 1995) and save more than others (Sakalaki et al., 2005) since they believe in controlling their own financial state and have a higher sense of responsibility for their success in life. Furthermore, it has been revealed that individuals with internal LOC orientation have an increased tendency to engage in financial preparation processes due to the fact that their likelihood to defer gratification is greater than those of individuals with external LOC orientation (Morgan & Eckert, 2004; Plunkett & Buehner 2007).

We summarize the above in our first two propositions:

Proposition 1a. Internals are more likely to participate in private pension plans than externals.

Proposition 1b. Internals are more likely to make larger contributions to their private pension plans than externals.

2.2. Future Time Perspective

Future time perspective (FTP) is a psychological trait that determines individuals' tendency to think about future events (Koposko & Hershey, 2014) and the degree to which they consider future states when making decisions about their lives (Van Dalen et al., 2010). It has been shown that individuals with increased future orientation have high levels of conscientiousness, which is related to being organized and efficient (Hershey & Mowen, 2000) and have fewer tendencies to procrastinate, i.e. they prefer acting now rather than delaying activities for future (Gupta et al., 2012).

The relationship between time orientation and saving for retirement is well established (Jacobs-Lawson and Hershey, 2005; Hershey et al., 2008; Earl et al. 2015). It is demonstrated that those who have a future orientation are more prone to save for the retirement years (Van Dalen et al., 2010). FTP is found to be related positively with self-accounted financial readiness for retirement (Hershey & Mowen, 2000), and a higher amount of retirement saving contributions (Jacobs-Lawson & Hershey, 2005).

Thus, we propose the following;

Proposition 2a. Future oriented individuals are more likely to participate in private pension plans than present oriented individuals.

Proposition 2b. Future oriented individuals are more likely to make larger contributions to their private pension plans than present oriented individuals.

2.3. Financial Risk Tolerance

Financial risk tolerance is the extent of ambiguity an individual is comfortable with while making a decision regarding the finances (Grable, 2000). The level of financial risk tolerance is determined by various factors such as gender, age, ethnicity, marital status, occupation, education, wealth and income (Hallahan et al., 2004; van Heijnsbergen, 2010).

Financial risk tolerance is found to be influential in strategies for retirement investment (Grable & Joo, 1997). For instance, it is seen that individuals with high levels of financial risk tolerance prefer stocks rather than bonds and certificates of deposit in their retirement funds (Hariharan et al., 2000). Van Rooij et al. (2007) investigated risk attitudes towards general matters, financial matters and pension matters and found that for the decisions regarding the pension, individuals acted in the most risk-averse manner choosing the most conservative portfolios of funds. Deaves et al. (2007) reported that individuals who had greater inclination to plan are more risk tolerant and make larger pension contributions.

Based on the above we propose the following:

Proposition 3a. Risk averse individuals are more likely to participate in private pension plans than risk takers.

Proposition 3b. Risk averse individuals are more likely to make larger contributions to their private pension plans than risk takers.

Proposition 3c. Risk averse individuals are more likely to prefer private pension plans with conservative asset allocations than risk takers.

3. Motivational Factors

3.1. Involvement

Involvement is basically defined as individual's perceived pertinence of an item based on their innate needs, values, and interests (Zaichkowsky, 1985). As a central construct in decision-making, it influences the extent of the search for and evaluation of information. It is generally suggested that a positive relation exists between consumers' level of involvement and their likelihood of purchasing a product (Mittal, 1989).

Within the retirement and financial preparedness domain, the role of involvement in decisions has been studied extensively. These studies mostly report that as the level of involvement increases so does financial preparedness for retirement (Morgan & Eckert, 2004; Segel-Karpas & Werner, 2014). Contrary to that, another study demonstrated that affective involvement to retirement planning is not related to the extent of financial preparation of individuals, whereas cognitive involvement is negatively correlated (Hershey & Mowen, 2000). The authors interpreted this finding as an indication of concern by these individuals who are not prepared financially for their future and hence becoming more interested in retirement planning. Furthermore, it is noted that as individuals engage in more financial planning activities such as information seeking from various sources, their perceived pension savings adequacy improves (Van Dalen et al., 2010).

The studies examining the impact of varying degrees of involvement on the likelihood planning for retirement and participating to a pension plan are few in number. For instance one study found no significant difference between level of involvement of individuals who bought and who did not buy a pension product (Pallister et al., 2007). However, it is generally indicated that individuals that are vastly involved with a product are frequent buyers (Laurent & Kapferer, 1985). In accordance with this, Wills & Ross (2002) found that involvement in retirement decisions has a positive impact on the likelihood of savings for retirement.

Consequently, we propose the following:

Proposition 4a. Individuals, who are involved in retirement planning, are more likely to make larger contributions to their private pension plans than less involved individuals.

Proposition 4b. Individuals, who are involved in retirement planning, are more likely to participate in private pension plans than less involved individuals.

3.2. Goal Characteristics

Goals, which are defined as “intentions to realize a desired state” (Antonides and Van Raaij, 1998, p.175) govern behaviors, information search and decision-making processes towards achieving these goals (Austin and Vancouver 1996). Goals are essential in planning for retirement as they aid individuals to contemplate their future and prepare both mentally and financially (Stawski et al., 2007). Moreover, it is suggested that goals help individuals to set a scale to assess saving performance (Koposko & Hershey, 2014).

Research on saving and retirement planning focused on several distinct goal characteristics. The numbers of goals individuals have is one factor that influences their saving behavior. When individuals possess multiple goals, conflicts arise in the allocation of

mental resources (Loibl, 2009). It is suggested that having only one goal results in higher saving intentions than having numerous goals since individuals with one goal are more action oriented whereas those with numerous goals tend to compare the goals for significance and urgency and are therefore are more deliberation oriented (Soman & Zhao, 2011). Another prominent characteristic that has been investigated is goal clarity, which is related to having a clear vision of retirement and setting distinct objectives about quality of life in retirement (Stawski et al., 2007). It is stated that retirement goal clarity influences retirement savings indirectly through planning activities (Hershey et al., 2007; Stawski et al., 2007).

Another characteristic, goal specificity, measures the degree of certainty in the level of desired accomplishment (Wright & Kacmar, 1994). Within retirement planning context, goal specificity refers to either determining a specific amount for retirement or saving the utmost amount without a particular target. Even though prior studies have not investigated the impact of goal specificity for retirement planning domain, it is stated that level of goal commitment increases with goal specificity (Wright & Kacmar, 1994). Consequently, it is expected that as goals for retirement become more specific, individuals' commitment to these goals increase, hence the level of their contribution to their retirement plans. Finally, it is indicated that the level of priority of goals increase the level of savings for retirement (Glass & Kilpatrick, 1998).

Based on the above, we propose the following:

Proposition 5a. Individuals, who have goals that are few in number and more clear, are more likely to participate in private pension plans than those, who have goals that are high in number and less clear.

Proposition 5b. Individuals, who have specific goals for retirement and attach more priority to them, are more likely to make larger contributions to their private pension plans than those who have less specific goals for retirement and attach less priority to them.

4. Financial Literacy

Financial literacy -or financial knowledge- can be defined as understanding key financial terms and concepts needed to function daily in a society (Bowen, 2002). Some other definitions of financial literacy in the literature include “the ability to read, analyze, manage and communicate about the personal financial conditions that affect material well-being” (Vitt et al., 2000, p.2), “a basic knowledge that people need in order to survive in a modern society” (Kim, 2001, p.1), “a person's ability to understand and make use of financial concepts” (Servon & Kaestner, 2008, p.273). There is no standardized instrument to measure

the construct of financial literacy, mainly due to lack of agreement on its conceptualization and definition (Huston, 2010). Both performance tests and self-report methods have been used in previous literature. This discrepancy led to two dimensions of financial literacy: objective and subjective.

4.1. Objective Financial Literacy

Objective financial literacy is measured by performance tests, which are knowledge based and attempt to measure the extent to which individuals are aware of basic finance concepts. Findings suggest that there is a strong correlation between objective and subjective financial literacy (Goldsmith & Goldsmith, 1997) and that both objective and subjective financial knowledge influence financial behavior in general (Roob & Woodyard, 2011). Within the context of retirement decisions, Lusardi & Mitchell (2007) analyzed retired households, indicating that greater objective finance knowledge was associated with planning and succeeding in retirement planning, as well as investing in complex assets such as stocks. The authors also indicated that more knowledgeable consumers thought more about retirement. In accordance with this, individuals with higher objective financial literacy levels have been found to be more likely to save (Grable & Lytton, 1997) and more likely to participate in private pension system (Agnew et al., 2009; Fornero & Menticone, 2011; Zanghieri, 2013).

4.2. Subjective Financial Literacy

Subjective financial literacy or perceived knowledge can be defined as confidence in knowledge, i.e., how much respondents think they know. It is assessed with self-reports. Courchane (2005) indicated that self-assessed financial knowledge was one of the most significant factors in determining saving decisions. The finding that higher levels of subjective finance knowledge were associated with better retirement preparedness was also confirmed by Hershey et al. (2007).

Based on the above, we propose the following:

Proposition 6a. Both objective and subjective financial literacy have a positive effect on private pension plan participation decision.

Proposition 6b. Both objective and subjective financial literacy have a positive effect on private pension plan contribution levels.

Proposition 6c. Both objective and subjective financial literacy have a positive effect on the likelihood of preferring complex assets for the private pension plan.

5. Dispositional and Situational Factors

5.1. Mental Construal

Construal level influences the way an individual mentally represents objects/events; hence has an impact on perception, evaluation and decision processes (Trope & Liberman, 2010). High level construal is associated with an abstract mindset, which focuses on primary (core) features, positive aspects and desirability concerns of objects/events, low level construal is associated with a concrete mindset, which focuses on secondary (peripheral) features, negative aspects and feasibility concerns (Dhar & Kim, 2007; Eyal et al., 2004; Freitas et al., 2004; Kray, 2000; Liviatan et al., 2008; Todorov et al., 2007).

Construal level can be studied as both an individual difference variable and a contextual variable. Firstly, individuals have a disposition to construe objects/events in a more abstract (high level) or more concrete (low level) manner. Additionally, situational influences might activate abstract or concrete mindsets with individuals as well. For instance, as temporal distance to objects/events increases, they will be construed at a higher level in an abstract way and as temporal distance to objects/events decreases, they will be construed at a lower level in a concrete way (Liberman & Trope, 1998; Khan et al., 2011). Van Schie et al. (2013) demonstrated that construal level influences planned retirement age based on both chronic and situational construal levels.

Construal level theory is used to explain the reasons of procrastination in retirement planning. For instance, it is revealed that as individuals get older, their temporal distance to retirement decreases and they have an increased tendency to postpone retirement due to increased number of feasibility concerns. However, for younger individuals retirement is in distant future and attention is on desirability aspects of retirement, so they plan for retirement ages that they cannot afford (Van Schie et al., 2013). Overall, it is suggested that retirement is perceived as a distant future activity hence construed in an abstract way with a focus on the desirability. Yet, the contributions one needs to make to the pension plans are present, near future activities therefore construed in a concrete way with a focus on the feasibility. Consequently, it is seen that people are not willing to undertake concrete costs to realize abstract gains and delay the planning for retirement (Van Heijnsbergen, 2010). To break the cycle of postponement Thaler and Benartzi (2004) developed the SMarT (Save More Tomorrow) program which enabled participants to assign beforehand some percentage of

their prospective salary raises to their retirement plans. The success of SMarT program is mainly explained by the fact that, as participants are required to start contributing in the future, their temporal distance increase and construe retirement planning in an abstract manner, which emphasizes the positive aspects of the plans (Lynch & Zauberman, 2006).

We summarize the above discussion in the following two propositions:

Proposition 7a. Individuals, who situationally construe retirement at a higher level (abstractly), are more likely to participate in private pensions than those who situationally construe retirement at a lower level (concretely).

Proposition 7b. Individuals, who dispositionally have high level construal, are more likely to participate in private pensions than those who have low level construal.

5.2. Regulatory Focus

Regulatory Focus Theory (RFT) examines the impact of motivational orientation on goal attainment. According to RFT, two types of motivational regulation can be distinguished; namely promotion and prevention focus (Forster et al., 1998). Promotion focus implicates a focus on achieving aspirational and idealistic goals whereas prevention focus implicates a focus on achieving goals related to duties and responsibilities (Shah and Higgins, 1997). Individuals' motivational regulation change based on their predisposition and situational factors. Situational factors can induce a promotion or prevention focus momentarily, and when they align with chronic tendencies both motivation and performance improve (Shah et al., 1998). In relation to RFT, regulatory fit concept has been developed to describe the fit between individuals' goal orientation and the means for attaining that goal. It is suggested that regulatory fit enhances the value ascribed to the final outcome (Avnet & Higgins, 2006; Higgins, 2000).

Within the financial domain, various studies examined the impact of regulatory focus and regulatory fit on financial decisions and behavior. For instance, it is suggested that regulatory orientation influences individuals' preferences for various investment instruments such that promotion focused individuals were more attentive to gains and preferred stocks and trading accounts, while prevention focused individuals were more attentive to losses and preferred mutual fund or Individual Retirement Account (IRA) investments (Zhou and Pham, 2004). Additionally, it is determined that the attitudes of individuals with a promotion focus are more favorable towards saving for retirement than those of individuals with a prevention focus. Further, it was found that the likelihood of saving for retirement is higher for those who experience a regulatory fit their regulatory focus and saving goals. For a promotion orientated

individual a promotion saving goal like “saving to enjoy life” increased the likelihood of saving for retirement. Similarly, for a prevention oriented individual, a prevention saving goal like “saving for rainy days” improved the likelihood of saving for retirement (Cho et al., 2014).

Thus we propose the following:

Proposition 8a. Individuals, who situationally experience a regulatory fit, are more likely to participate in private pensions than those who do not.

Proposition 8b. Individuals, who are dispositionally promotion focused, are more likely to participate in private pensions than those who are dispositionally prevention focused.

Proposition 8c. Individuals, who are dispositionally promotion focused, prefer riskier assets for the private pension plans than those who are dispositionally prevention focused.

6. External Factors

6.1. Family Influences

Current literature identifies family as the primary agent for financial socialization (Sohn et al., 2012). Parents are important role models in money management behaviors, determining financial goals and saving. Therefore, the individuals’ willingness to adopt parental financial role modeling should be positively related to their financial attitudes and behaviors. For instance, young people who discuss financial issues with their parents use credit more frequently (Allen et al., 2007). Rickwood and White (2009) note that familial influence has the biggest impact on the extent to which participants prepare for retirement. Advice from family members, especially parents, was found to be the most respected personal source of retirement savings information. Even in cases where participants considered their parents unprepared for retirement, parents were still influential because the individual did not want to experience the same poor retirement lifestyle. For individuals with successful siblings, the siblings were also a significant influence on retirement decisions. Prior research also showed that discussing financial issues with parents had a positive influence on likelihood of saving for retirement among young people (Hancock et al., 2013; Jorgensen and Savla, 2010; Mandell, 2009; Sabri et al. 2010).

Based on the above we propose the following:

Proposition 9. Individuals, who are more influenced by their family, are more likely to participate in private pension plans than those who are less influenced.

6.2. Peer Influences

Studies in the literature have shown that peers are also an important financial socialization agent. An individual may mimic peers because their behaviour might reflect relevant private information or in a desire to conform to social norms (Beshears et al., 2013). It might also be the case that individuals derive utility from their consumption relative to their peers (Abel, 1990). There is a growing empirical literature on how social interactions can affect financial decisions. Studies have shown that parents have a greater influence on individuals at a younger age while peers become more influential as the individual gets older (Brown et al., 1993; Clarke, et al., 2005; Harris, 1995; John, 1999). Duflo and Saez (2003) demonstrated that peers are an important influence in 401(k) plan participation decisions. The authors further found that individuals who were exposed to colleagues who were motivated to enroll in a retirement plan were themselves more likely to enroll. In a more recent study, Beshears et al. (2015) investigated how receiving information about coworkers' behavior affects retirement savings choices and found that peer information increased savings of non-unionized recipients.

Thus we propose the following:

Proposition 10a. Individuals, who are more influenced by their peers, are more likely to participate in private pension plans than those who are less influenced.

Proposition 10b. Individuals, who are more influenced by their peers, are more likely to make larger contributions to their private pension plans than those who are less influenced.

6.3. Economic Conditions

Based on economic theory, when stock market crashes or the economy enters into a recession, we would expect to see declines in participation because workers may be reluctant to commit to saving. For workers who continue to participate we would expect to see a decline in contributions because workers may be pessimistic, feel uncertain about their future wages or job prospects, or because their spouses may have lost their jobs in the recession (Butrica & Smith, 2016). This has also been demonstrated empirically in several studies. For example, Muller and Turner (2011) used the Panel Study of Income Dynamics and found that 401(k) participation is influenced by the performance of the stock market and that fewer individuals participated in private retirement plans during crisis periods. Utkus and Young (2009) investigated the impact of the 2008 crisis on retirement plans and found that a significant portion of participants shifted their asset allocation from stocks to fixed income

instruments. A study by Smith et al. (2004) found that key life events, such as the birth of a child and the purchase of a home, influence contributions in defined contribution plans. In a more recent study, Butrica and Smith (2016) controlled for earnings, job changes, and other household factors, and found that workers reduce their 401(k) participation and contributions during recessions, suggesting that they may be responding to changes in their expectations about the economy and stock market. The role of economic conditions in shaping retirement saving decisions is even more important for financial consumers in emerging markets with a history of economic instability and crises because participants might lack necessary confidence in the private pension system (Cole et al., 2011).

Therefore, we propose the following:

Proposition 11a. Individuals, who experience favorable economic conditions, are more likely to participate in private pension plans than those who experience poor economic conditions.

Proposition 11b. Individuals, who experience favorable economic conditions, are more likely to make larger contributions to their private pension plans than those who experience poor economic conditions.

Proposition 11c. Individuals, who experience favorable economic conditions, are more likely to prefer stocks in their private pension plans than those who experience poor economic conditions.

6.4. Institution Based Conditions

One of the most important influences on retirement plan participation decisions seems to be trust in institutions. Generally, it has been shown that a distrust of financial institutions influences financial behavior (Agnew et al., 2009). Usually, individuals who distrust financial institutions including pension funds avoid doing business with them (Bertrand et al., 2006; Szykman et al., 2005). Similarly, Van Dalen et al. (2010) reported that higher levels of trust in government, pension funds, banks and insurance companies were associated with higher perceived savings adequacy for retirement. Studies have also shown that there is a positive correlation between participation level and employer matching rate (Andrews, 1992; Bassett et al., 1998; Papke, 1995, Papke & Poterba, 1995). However, the relationship is not linear: increasing matching rate from low to medium levels has a large effect but increasing the rate from medium to high has a small or insignificant effect on participation rates (Kusko et al., 1998). The existence of employer match has been found to have a positive effect not only on

participation rate but also on total contribution levels (Benartzi, 2001). The retirement plan's flexibility features such as the option to borrow or the ability to retire early have also a positive effect on participation and contribution rates (Holden & Vanderhei, 2005)

Based on the above, we propose the following:

Proposition 12a. Trust in institutions, the amount of matching provided by these institutions and the flexibility offered have a positive effect on private pension plan participation decision.

Proposition 12b. Trust in institutions, the amount of matching provided by these institutions and the flexibility offered have a positive effect on private pension plan contribution levels.

7. Conclusion

This paper reviewed the factors affecting consumers' private pension plan decisions. The factors discussed included situational and dispositional factors, personality, motivation, financial literacy, and external influences. Based on this survey of literature, we developed a number of propositions, which address the relationship between these factors and private pension plan decisions including participation, contribution rate, and asset allocation. Both individual retirement planners and pension institutions might improve their insight on private pension plan decisions based on this proposed framework.

Evidence suggests that in many countries individuals lack adequate savings for their retirement period (Koposko & Hershey, 2014). An inclusive understanding of the factors influencing private pension plan decisions will allow managers to be better equipped to propose adequate plan features and develop more fitting strategies to attract consumers. This will benefit not only consumers in increasing their personal welfare and being more financially prepared for their post-employment years but also the economic system by increasing saving rates and reducing the burden on governments.

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