The Demand for Financial Planning Services[1]

Sherman D. Hanna, Ohio State University
Professor, Consumer Sciences Department
Ohio State University
1787 Neil Avenue
Columbus, OH 43210-1290
Phone: 614-292-4584
FAX: 614-688-8133
E-mail: hanna.1@osu.edu or sdhanna@gmail.com

Abstract

I analyze a combination of the 1998 to 2007 Survey of Consumer Finances datasets, and find that the proportion of households reporting use of a financial planner increased from 21% in 1998 to 25% in 2007. Multivariate analysis shows that the likelihood of using a financial planner is strongly related to risk tolerance, with those with low risk tolerance the least likely, and those with above average risk tolerance the most likely to use a financial planner, even after controlling for income, net worth, age, and other factors. However, those with substantial risk tolerance have significantly lower likelihood of using a financial planner than those with above average risk tolerance. Black households are more likely but Hispanic and Other/Asian households are less likely than comparable White households to use a financial planner. The likelihood of using a financial planner increases with net worth for ranges above zero, but also increases as net worth decreases below zero.

The proportion of households using financial planners has increased, but is at a relatively low level, even at high levels of income and net worth. What factors are related to use of financial planners? Which types of households seem to be underserved by financial planners? This

[1] This research was supported in part by a 2009 CFP Board Financial Planning Grant to Texas Tech University for "Estimating the Value of Comprehensive Financial Planning."

paper uses a combination of the 1998 to 2007 Survey of Consumer Finances datasets to analyze the effects of household characteristics and risk tolerance on the use of financial planners.

Literature Review

Warschauer (2008) discussed the benefits of financial planning advice. Hanna and Lindamood (2009) discussed the theoretical benefits of using a financial planner based on expected utility analysis. One of the striking results of their analysis is that all other things equal, those with low risk tolerance should place a higher value on comprehensive financial planning advice than those with high risk tolerance. However, studies analyzing empirical patterns on use of financial planners have not focused on the theoretical relationship between the value of financial planning advice and risk tolerance.

Elmerick, Montalto, and Fox (2002) used the 1998 Survey of Consumer Finances (SCF) dataset to analyze the types of households that reported using a financial planner for comprehensive advice, advice on savings and investment, or advice on credit. They reported that 21% of households used a financial planner for some type of advice. In their multivariate analysis, those under 35 were more likely to use a financial planner than those 35 and older, use of financial planners increased with education, Blacks were more likely and Hispanics less likely than Whites to use financial planners, unmarried female households were more likely than married households to use financial planners, use of financial planners increased with income to the $50,000 to $74,999 range and then was roughly the same above that level, and the use of financial planners increased with net worth and also with the level of financial assets.

Chang (2005) also used the 1998 SCF, and reported that of households who saved or invested, about 36% reported consulting a paid financial professional for advice and 27% reported consulting a banker (which Chang assumed was not directly paid for advice). The most common source of advice was friends or relatives, mentioned by 41% of those who reported saving or investing. Chang's multivariate analysis showed that use of financial planners increased with education and liquid asset level but decreased with income, was higher for single female head households than for married couples, higher for Black households than for White households, but lower for Other (presumably Hispanic and Other/Asian combined) than for White households, and increased with risk tolerance.

Theory

Given that financial planners are paid by commissions or fees or a combination of methods, it makes sense that a household's resources, including income and assets, would affect its demand for financial planning services. I will focus on the use of financial planners, and ignore the interaction between the demand for financial planning services and the demand for financial advice from others such as bankers and brokers, but including the demand for other types of advice would be an obvious extension to our research.

The need for financial planning services may be related to the ability of the household to do its own planning, which is presumably related to the complexity of its financial situation. Warschauer (2008) discussed some major issues in financial planning, and obviously the simpler types of households, e.g., a young one person household with no savings or discretionary income, might have low need for financial planning services, whereas an older household with higher income and assets might have higher needs. The ability of a household, in terms of experience with its financial management, might be related to age and cognitive ability, as well as formal learning. Education is related to cognitive ability. However, even though a person with high cognitive ability may be more likely to be able to manage his or her own financial planning tasks, such a person might also be more likely to recognize the need.

Methods

Data and Variables

I use a combination of the 1998, 2001, 2004, and 2007 SCF datasets to study the demand for financial planners. For more information about the SCF datasets and methodological issues, see Lindamood, Hanna, and Bi (2007) and Hanna, Lindamood and Huston (2009). The SCF dataset contains five implicates. I use the repeated-imputation inference (RII) method to correct for underestimation of variances due to imputation of missing data (Montalto & Sung, 1996). The descriptive results in Table 1 are weighted to represent the population proportions of households, with the SCF population weights adjusted so that the apparent sample size was equal to the actual sample size. In general, I follow methods suggested by Lindamood, et al. (2007).

The explanatory variables included in the study are age of the head, education, health status, risk tolerance, household income, presence of children aged under 19, homeownership, and

household type, as well as the racial/ethnic self-identification of the respondent. Table 1 shows the distribution of variables and the rates of using a financial planner by categories. The possibility of nonlinear effects for age makes it reasonable to include both age and age squared to account for non-linear effects of age in our multivariate analysis, but in our descriptive analyses (Table 1) I classify age using six categories: under age 30, age 30-39, age 40-49, age 50-59, age 60-69, and age 70 and over. Education may have an impact on the financial knowledge of the household, and therefore its choices. For non-couple households, education is based on the highest education attained by the head, but for couple households, it is based on the partner with the higher level of education. For instance, if a husband's highest education is a high school diploma and the wife has a bachelor degree, I coded the education of the household is coded as bachelor degree. Job status is based on the head for non-couple households, and for couple households I use the status of both the head and the partner/spouse based on the following: if one or both are self-employed I count the household status as self-employed, if neither is self-employed but at least one is an employee I count the household status as employee, if neither is employed or self-employed but neither is of retirement age I count the household status as no work, and if neither is employed or self-employed but at least one is of retirement age I count the household status as retired. Couples may make different choices than and generally may have more potential resources than single people. Having a dependent child under the age of 19 may make the investment horizon shorter and also reduce the amount available for investing.

The income and wealth-related factors include household income, net worth, homeownership, The household income and net worth are measured using natural logs to capture the possible non-linearity of the relationship, although for our descriptive results in Table 1, I present results using categories of income and net worth. For values of income and net worth equal to zero, the log of 0.01 is used. Net worth is specified as a piecewise (Suits, Mason, & Chan, 1978) log variable to allow for different effects for positive and for negative net worth. Households with negative net worth are different from household with low net worth (Chen & Finke, 1996) so I allow for separate effects of net worth in the negative range versus in the positive range of net worth. For positive values of net worth, the log of net worth is used, and otherwise that variable is computed as the log of 0.01. A separate variable is computed for negative values of net worth, the log of the absolute value of net worth, and for non-negative values of net worth, that variable is computed as the log of 0.01.

Statistical Analysis

Logistic regression is an appropriate technique for a multivariate analysis of a dependent variable

with a small number of levels (Allison, 1999). As suggested by Montalto and Sung (1996), this study uses the repeated-imputation inference (RII) method to correct for underestimation of variances due to imputation of missing data. Deaton (1997) suggested that weighting regression procedures using endogenous weights might result in biased estimates, so I did not weight the logistic regression.

Results

Descriptive Results

About 22% of the households reported that they used a financial planner. Table 1 contains means tests of using a financial planner by categories of independent variables. (For income and net worth, I used mean rates by categories for the descriptive table, even though I use continuous variables in the logistic regression.) There are significant differences in the likelihood of using a financial planner by most of characteristics used in this study.

The likelihood of using a financial planner was roughly the same for 1998, 2001, and 2004, then increased significantly in 2007 to 25%. Only 11% of those who said they were unwilling to take any risks with investments used a financial planner, with the other levels of risk tolerance having higher rates, with the peak rate of 33% being for "above average", and the "substantial" level having a significantly lower rate (29%) than the rate for "above average".

The proportion using a financial planner increases with age, from 18% for the less than 30 category to 27% for the 50 to 59 category, then decreases to 16% for the 70 and older category. Married households are the most likely to use a financial planner (25%), while other types of households are roughly five percentage points lower. Only 12% of households with Hispanic respondents use a financial planner, compared to 24% of those with White respondents, 21% of those with Black respondents, and 18% of households with respondents choosing an "other" racial/ethnic category.

The likelihood of using a financial planner increases steadily with education, from 7% for those with less than a high school degree to 35% of those with a post-bachelor degree. Having a child under 19 in the household is related to a slightly higher rate of using a financial planner. Households with a self-employed head or spouse have the highest rate of using a financial planner, 28%, compared to 23% for households with an employee, 16% for retired households, and 13% for those otherwise not employed. Homeowners are more likely to use a financial planner than renters.

The likelihood of using a financial planner increases with income, from 23% of households with annual incomes under $23,654 to 39% of households with incomes over $135,242. Over 7% of households have negative net worth. The likelihood of using a financial planner is higher for those households (16%) than is the likelihood for households with net worth of zero to $14,000 (11%) and is about the same as the rate for households with net worth of $14,001 to $102,753. The rate steadily increases net worth increases, with almost 40% of those with net worth over $822,717 using a financial planner.

Multivariate Results

The logistic regression shows the effects of independent variables on the likelihood of using a financial planner (Table 2). Most of the effects are similar to the descriptive patterns shown in Table 1. As with the descriptive results, the highest likelihood of using a financial planner is for those with above average risk tolerance, although those with average risk tolerance are not significantly different. Those having substantial risk tolerance are significantly less likely to use a financial planner than those with above risk tolerance. The likelihood of using a financial planner increases strongly with net worth as net worth increases from zero, but it also increases strongly as net worth becomes more and more negative.

There are five groups of variables that have different effects in the multivariate analysis than in the descriptive results. The combined effect of age and age squared implies that the likelihood of using a financial planner increases until age 42, then decreases, which is lower than the peak age range in the descriptive results, 50-59. Controlling for income, age, and other characteristics, single headed female households are significantly more likely than married couple and single headed male households to use a financial planner. Households with a Black respondent are more likely than households with a White, Hispanic, or Other/Asian respondent to use a financial planner. Households with Hispanic respondent and households with Other/Asian respondents are less likely than households with White respondent to use a financial planner. Households with a child under 19 are less likely to use a financial planner than those without a child under 19. Homeowners are not significantly different from renters in the likelihood of using a financial planner. Households with employee job status are not significantly different from those categorized as self-employed, retired, or not working.

Implications

The substantial increase in the use of financial planners in 2007 may provide optimism for the financial planning industry, but some of the patterns suggest underserved market

segments. The result that even after controlling for income, age, and net worth, those with low risk tolerance (unwilling to take investment risks) are less likely to use a financial planner than those with higher net worth may seem reasonable in terms of the idea of financial planning as portfolio management, but in terms of the theoretical results demonstrated by Hanna and Lindamood (2009), those with low risk tolerance but high net worth or income should benefit substantially from the risk management aspects of comprehensive financial planning. Single male headed households also seem to be an underserved segment, although this pattern may be related to the reluctance of some men to seek help.

The result that households with Hispanic and with Other/Asian respondents are significantly less likely to use financial planners than those with White or Black respondents suggests that populations with substantial proportions of immigrants are underserved by financial planners. Obviously, lack of familiarity with financial planning in the United States may be a factor, but increased marketing to these segments may be beneficial.

The strong effect of education on the likelihood of using a financial planner, even after controlling for income and net worth, is understandable, but it also suggests that less educated affluent households may be underserved by financial planners.

References

Bae, S. C. & Sandager, J. P. (1997). What consumers look for in financial planners. *Financial Counseling and Planning*, *8*(2), 9-16.

Bucks, B. K., Kennickell, A. B., Mach, T. L., & Moore, K. B. (2009). Changes in U.S. family finances from 2004 to 2007: Evidence from the Survey of Consumer Finances. *Federal Reserve Bulletin*, 95, A1-A55.

Chang, M. L. (2005). With a little help from my friends (and my financial planner). *Social Forces*, 83 (4), 1469-1498.

Chen, P. & Finke, M. S. (1996). Negative net worth and the life cycle hypothesis. *Financial Counseling and Planning*, 87-95

Elmerick, S. A., Montalto, C. P., & Fox, J. J. (2002). Use of financial planners by U.S. households. *Financial Services Review*, *11*(3), 217-213.

FPA and Ameriprise Value of Financial Planning Study (2008). FPA Press. Retrieved June 30, 2009 from www. fpaforfinancialplanning.org/ WhatisFinancialPlanning/ FinancialPlanningWeek.

Hanna, S. D. & Lindamood, S. (2010). Quantifying the economic benefits of personal financial planning. *Financial ServicesReview,* in press.

Schulaka, C. (2009). What is the value of financial planning? *Journal of Financial Planning*, *22* (3), 14.

Suits, D. B., Andrew Mason, and Louis Chan, Spline functions fitted by standard regression methods. *Review of Economics and Statistics*, *60* (1978), 132-139.

Warschauer, T. (2008). The economic benefits of personal financial planning. *Proceedings of the Academy of Financial Services*

TABLE 1. Using a Financial Planner by Various Characteristics, Bivariate Analysis, Combined 1998-2007 Datasets (Means Test)

Variable	Category	% in category (n=17,684)	***Using a Financial Planner*** 22.0	sig. level[1]
Survey year	year 1998	24.3	21.1	.000
	year 2001	25.1	20.0	.000
	year 2004	25.6	21.7	.000
	year 2007	25.0	25.2	
Risk tolerance	no risk	40.7	10.8	.000
	average	38.1	28.2	.000
	above average	17.2	33.2	
	substantial	4.0	28.7	.000
Age	**less than 30**	13.5	17.6	
	30-39	19.1	23.7	.000
	40-49	22.2	22.9	.000
	50-59	17.8	26.9	.000
	60-69	12.0	23.8	.000
	70 and over	15.7	15.7	.000
Marital status	**married**	50.0	24.6	.000
	single male	14.5	19.4	
	single female	27.2	19.5	.842
	partner	7.3	18.8	.261
Racial/ethnic status of respondent	**White**	75.4	23.6	
	Black	12.8	20.8	.000
	Hispanic	8.4	11.6	.000
	Other/Asian	3.4	17.7	.000
Education	**< high school**	11.1	7.2	
	high school	28.2	15.2	.000
	some college	26.5	23.5	.000
	bachelor degree	20.1	28.7	.000
	post-bachelor degree	14.1	35.1	.000
Child<age 19	yes	43.6	22.4	.006
	no	56.4	21.6	

Variable	Category	% in category (n=17,684)	***Using a Financial Planner***	
			22.0	sig. level[1]
Employment status	**employee**	61.4	23.1	
	self-employed	14.0	28.0	.000
	retired	21.4	16.3	.000
	not employed	3.2	12.9	.000
Homeowner	yes	67.9	15.5	.000
	no	32.1	25.1	
Income	**< 23,654**	24.9	11.3	
	23,654-46,250	25.3	17.4	.000
	46,251-82,966	24.8	24.6	.000
	82,967-135,242	15.0	31.7	.000
	>135,242	10.0	39.2	.000
Net worth	< 0	7.4	16.2	.000
	0-14,000	17.6	10.7	
	14,001-102,753	25.0	17.3	.000
	102,754-333,200	25.0	23.1	.000
	333,201-822,716	14.9	31.6	.000
	> 822,717	10.1	39.5	.000

[1]Significance test is for mean difference from reference category for each variable. Bold is the reference category; Weighted data; RII technique is used.

TABLE 2. Using a Financial Planner, Multivariate Logistic Analysis.

Variable[2]	(n=17,684)	Using a Financial Planner			
		Coefficient[3]	p-value [1]	s.e.	Odds ratio
Intercept		-3.0562	.000	0.2459	
Survey year	(1998)				
year 2001		-0.0742	.155	0.0522	0.928
year 2004		0.0532	.302	0.0515	1.055
year 2007		0.3506	.000	0.0505	1.420
Risk tolerance	(above average)				
no risk		-0.8803	.000	0.0611	0.467
average		-0.0767	.078	0.0436	1.009
substantial		-0.2624	.001	0.0797	0.899
Age		0.0278	.000	0.0077	1.028
Age squared		-0.0003	.000	0.0001	1.000
Marital status	(married)				
single male		-0.1841	.004	0.0635	0.832
single female		0.2107	.000	0.0555	1.234
partner		-0.0879	.292	0.0835	0.916
Racial/ethnic status	(White)				
Black		0.3013	.000	0.0695	1.352
Hispanic		-0.2360	.014	0.0958	0.790
Other/Asian		-0.3529	.001	0.1068	0.703
Education	(<high school)				
high school degree		0.3383	.003	0.1149	1.403
some college		0.6038	.000	0.1152	1.829
bachelor's degree		0.7017	.000	0.1177	2.017
post-bachelor degree		0.8276	.000	0.1196	2.288
Presence of a child under age 19		-0.1564	.000	0.0421	0.855
Employment status	(employee)				
self employed		-0.0649	.159	0.0461	0.937
no work but not retired		-0.2429	.082	0.1396	0.784
retired		0.0487	.471	0.0676	1.050
Income (log) [if ≤ 0, log(.01)]		0.0261	.033	0.1225	1.026
Net worth (log) [if ≤ 0, log(.01)]		0.1015	.000	0.0111	1.107
-Net worth (log) [if ≥ 0, log(.01)]		0.0950	.000	0.0135	1.100

Variable[2] (n=17,684)	Using a Financial Planner			
	Coefficient[3]	p-value [1]	s.e.	Odds ratio
Homeowner	0.1004	.089	0.0590	1.106
Concordance (mean)	70.2%			

[1] Significance level and standard error based on RII technique.

[2]Reference category in parentheses.

[3]Unweighted analysis combining all five implicates.