Retirement Planning of Younger Baby-boomers: Who Wants Financial Advice?

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Abstract

This paper uses a recent wave of a nationally representative survey to determine the predictors of financial planning services utilization among younger baby boomers. The results suggest that cognitive factors and factors related to human capital, such as IQ and educational attainment, are positively associated with use of financial planning services in this group. The study also shows that participation in a tax-advantaged account and higher net worth increase the probability that a person will seek professional financial advice. The paper provides useful information for financial planning practitioners, economists, and policy makers.

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1. Introduction

The number of individuals approaching retirement age is increasing rapidly as younger baby boomers, born between 1956 and 1964, form a sizable cohort (Wellner, 2003). Over the next 20 years, more than 78 million Americans will turn 65 (Paul, 2001). Historically, retirees have received retirement benefits that paid out as an annuity for their lifetime through a defined benefit plan. However, because of the escalating costs of offering such plans, most employers have replaced them with participant-directed, defined contribution plans such as 401(k) plans, wherein the responsibility for wealth accumulation and contribution rests on participants, rather than their employers (Bassett & Rodrigues, 1998). The growing market of personal financial advice helps to fill the gap between the skills of most individuals and the skills required to maximize financial security in retirement. The availability of these services enables even the average household with limited financial skills to plan effectively for retirement. Past research on household use of financial advice has found that the portfolio allocations of individuals who access investment advice are more rational and more consistent with economic theory than the allocations of those who manage their own wealth (Bodie & Crane, 1997). Bae and Sandager (1997) used the CFP Board Survey of Trends in Financial Planning to find that, among available resources, households primarily used the services of financial planners for retirement planning, investment planning, and tax planning. In addition, complex economic situations, changes in tax laws, and new investment alternatives were associated with households' decisions to hire financial planners. Using the Survey of Consumer Finances, Chang (2005) found that, while wealthier households were more likely to seek professional financial advice, lower income households consulted their social networks, including friends and family, for investment and wealth-management decisions. Using a data set of German investors, Bluethgen, Gintschel, Hackethal, and Muller (2008) found that wealthier and older individuals and women were more likely to seek financial advice than were others.

The purposes of this study are to examine the determinants of financial and retirement planning services use among younger baby boomers, to discuss possible opportunities for the financial services industry, and to make recommendations for the industry and public policy makers to improve both the means of and access to resources for effective financial planning.

2. Data and Methodology

This paper uses data from the latest wave (2006) of the National Longitudinal Survey of Youth (NLSY79). NLSY79, a comprehensive, nationally representative data set comprising 12,686 respondents residing in the United States, is managed by the Center for Human Resource Research at Ohio State University (Zagorsky, 2007). The NLSY79 contains information on socioeconomic, demographic, and health-related factors of respondents, including a special section with a random sample of 1,000 respondents born between 1957 and 1964 who answered questions on the retirement expectations of younger baby boomers. We use these data to examine the respondents' willingness to plan for retirement and their use of various kinds of financial planning services as they approach retirement. The data enable us to study the effect of

cognitive abilities and human capital attainment on the willingness to plan for retirement and to understand the market for financial advice among younger baby boomers.

Model

Our primary analysis estimates the marginal effects of the determinants of financial planning service use. Because the participation outcome is binary, we use probit methodology to estimate the coefficients and compute their test statistics. In the first specification, we test for utilization of any financial planning services—a financial planner, financial planning software, retirement seminars, or books on retirement. The second specification determines the unique predictors of separately utilizing the services of a financial planner. The final specification examines the predictors of retirement plan preparation through self-study only. For example, the variable is coded as 1 if a household prepared for retirement by using computer software, by attending retirement seminars, or by reading books on retirement, and zero otherwise. In addition, we also examine whether households with children are less likely to plan for their retirement, as the presence of children might place constraints on their planning horizon and financial resources that they may have otherwise devoted to retirement savings.

Independent variables are factors related to income and resources, behavior and cognition, and demographics. For the income- and resource-related factors, the model controls for income (the log form of income is used in the analysis) and net worth (NLSY's calculated net worth from 2004 is inflated to reflect 2006 dollars). Participation in defined contribution plans is also included among the income and resource variables. Defined contribution plans are tax-advantaged retirement accounts for which individuals are responsible for the contribution and allocation of assets in their portfolios. The behavioral and cognitive variables comprise IQ, educational attainment, risk tolerance, and self-reported health. IQ is calculated from the Armed Forces Qualification Test scores included in the NLSY79 data set using the method suggested by Zagorsky (2007). Risk tolerance is measured from the income gamble-related questions included in the data set, using the method suggested by Barsky, Juster, Kimball, and Shapiro (1997). The responses to the following set of questions developed by Barsky et al. (1997) are provided in the data set for estimation of the self-reported risk tolerance of respondents:

> *"Suppose that you are the only income earner in the family, and you have a good job guaranteed to give you your current income every year for life. You are given the opportunity to take a new and equally good job, with a 50-50 chance it will double your income and a 50-50 chance that it will cut your income by (1) 33% (2) 50%, or (3) 20%. Would you take the new job?"*

If the respondent answers "yes" to the first question, then the second follow-up question (50% income cut) is asked. If the respondent says "no" to the first question, then the third follow-up question (20% income cut) is asked. The risk tolerance measure in NLSY coincides with the risk tolerance measure created by Lusardi (1998) for the Health and Retirement Study (HRS) data set. Educational attainment variables compare attainment of high school, some college, college, or graduate school to the reference group of individuals who did not complete 12 years of education. The health status of the respondents is included as a control variable in the model. The health status measure is based on a question in the NLSY that asks the respondents to self-report an assessment of their general health on a scale of 1-5 with excellent health=1 and poor health=5.

This variable was reverse coded for estimation in our model. Finally, marital status, family size and children, and age are controlled as demographic variables in the model. Age squared is also included to control for the quadratic effect of age (Wooldridge, 2006). The inclusion of the age squared variable helps estimate whether there exists a significant difference between older and younger respondents in the cohort.

The binary dependent variables used in our study are analyzed using probit models, summarized as follows:

$$P_i^* = \alpha_\tau + \beta_\tau C_i + \delta_\tau Y_i + \gamma_\tau W_i, + \Phi_\tau T_i + \varepsilon ,$$
$$\text{where } P_i=1 \text{ if } P^*_i>0$$
$$\text{and } P_i=0 \text{ if otherwise for } i= \{1,2,\ldots,I\} \qquad (1).$$

In the first model, P_i is a discrete dependent variable equal to 1 for the i^{th} participant using a financial planning service, and zero otherwise. Pi is determined, in this case, by P_i^*, which is a latent continuous variable indicating whether the marginal benefit of using a financial planning service is greater than the marginal cost of doing so. The error term ε is distributed normally with mean zero and variance 1. C_i is the vector of the income- and resource-related variables, Y_i is the vector for the cognitive and behavioral variables, and T_i is the vector for the demographic variables controlled in our model.

Similarly, in the next part of this study, two more probit models are used. One model estimates the predictors of consulting a financial planner. A second model estimates the predictors of financial planning on one's own by reading books, attending seminars, or using financial planning software. Each model controls for the same set of variables as the first model.

3. Results

3A. Descriptive Statistics

The descriptive statistics from Table 1 show that the average age of the respondents in the 2006 survey was 45, the average family income was $73,628, and the average net worth in 2006 dollars was $224,850. The 2006 wave of NLSY79 does not contain information on individual net worth; the net worth from 2004 was inflated, assuming a normal inflation rate of 3.5%, to approximate the individual net worth value for 2006. The inflation rate of 3.5% was calculated from the consumer price index (CPI) data provided by the Bureau of Labor Statistics.[1] The average IQ of the respondents was calculated at 96, whereas the highest percentage of respondents had graduated from high school (46%). The largest percentage of respondents in the sample was in the most risk-averse category of the risk tolerance scale (54%). While 10% of respondents had not planned or calculated their retirement, the highest percentage who claimed to have planned for their retirement had used the "do-it-yourself" approach of reading books on retirement planning (38%), and 21% had consulted a financial planner. Only 13% of the respondents had utilized software programs on their computers or programs available online to prepare their financial plans. Nineteen percent of the respondents had attended retirement seminars.

[1] U.S. Department of Labor (2009), *BLS Handbook of Methods*, Bulletin 2490, U.S. Government Printing Office.

The test results in Table 2 show the differences between respondents who used the services of a financial planner and those who self-prepared their retirement plans by reading books, attending seminars, and using software programs. The results show the importance of cognitive ability and human capital attainment on an individual's decision to access the services of a financial planner. Furthermore, respondents who used the services of a financial planner had significantly higher income, net worth, and educational attainment. They also had higher IQs and better health status.

Determinants of planning for retirement

The results of the probit analysis (Table 3) show that income, net worth, and having a defined contribution plan are positively associated with planning for retirement. Among cognitive and behavioral factors, IQ, educational attainment, and health are positively associated with planning for retirement. These findings are consistent with the findings of previous studies, which have shown a positive relationship between human capital and financial services utilization (Miller & Montalto, 2001; Soberon-Ferrer & Dardis, 1991). Among the demographic variables, women are more likely than men to plan for their retirement, and white households are more likely than others to plan for retirement. Having children is negatively associated with seeking financial advice and retirement planning. These findings are similar to those of the Miller and Montalto (2001) study on utilization of financial planners. It is likely that the presence of dependent children reduces the availability of financial resources and time for households to plan effectively for their retirement. In a previous study, Zagorsky (2005) found that having children is a negative predictor of net worth because the presence of children increases the current consumption of households while reducing the availability of resources for savings and future consumption.

3B. Determinants of utilizing financial planning services

Table 4 shows the probit models that examine the predictors of the younger baby boomers' utilization of the services of a financial planner (columns 1, 2, 3, 4) and self-preparation of retirement plans (columns 5, 6, 7, 8). Household income and net worth are positively associated with both consulting a financial planner and self-preparation of retirement plans. In addition, those who have a defined contribution plan are more likely to use the services of a financial planner. Among the cognitive factors, IQ and attainment of a college degree or higher are positively associated with utilization of a financial planner and self-preparation of retirement plans. Good health is also positively associated with consulting a financial planner. In addition, the results show that age squared is positively associated with seeking the services of a financial planner. Women are less likely than men to self-prepare their retirement plans and instead are more likely to consult a financial planner for their retirement planning needs. Respondents who are white are more likely than others to consult a financial planner, while married respondents are more likely than the control group to consult a financial planner and self-prepare their retirement plans.

4. Conclusion

This research empirically tests the determinants of utilizing financial planning services among younger baby boomers. The results provide a particularly interesting perspective on the role of

cognitive ability on utilization of financial planning services within this group. The association between factors related to human capital and utilization of financial advice to plan for retirement is worth further examination. The results suggest that a very high percentage of young boomers have not yet planned for their retirement or have self-prepared their retirement without necessarily having the sophisticated financial skills required for such tasks. Therefore, it is clear that, as members of this cohort approach retirement, their attitudes about retirement planning will pose both a challenge and an opportunity for the financial services industry and public policy makers; these groups will need to act fast to develop products, services, and policies to increase participation by this cohort in saving and preparing for their retirement.

The broader implications of our research suggest that those best capable of making financial planning decisions choose to access financial planning services. Related studies indicate that portfolio allocations of individuals who access investment advice are more rational and more consistent with economic theory than the allocations of those who manage their own wealth (Bodie & Crane, 1997). American workers are increasingly responsible for securing their own retirement savings as employers continue to transfer the risk and responsibility of saving for retirement to their employees. However, only a minority of American households feels "confident" about the adequacy of their retirement savings, and one third of adults in their 50s say they have failed to develop any kind of retirement saving plan at all (Lusardi 1999, 2003; Yakoboski & Dickemper, 1997).

One reason people fail to plan for retirement, or do so unsuccessfully, is because very few are financially well informed (Lusardi, 2003). Many fail to appreciate the role of (or may not be competent at solving problems with) compound interest, inflation, and risk. A clear way to address this issue is through the use of the professional services of a financial planner. Our findings indicate that currently the wealthier, more educated households are the biggest users of these professional services, though they perhaps have fewer barriers to independent investment. Those who need professional financial planning advice the most are least able to access these services because of the challenges of paying for them and locating credible professional providers.

Throughout the 1990s, there was an explosion of products and programs in financial services, along with several government programs and workplace financial education seminars, geared toward employees (Lusardi, 2004). Some researchers, including Lusardi (2004), contend that these programs have only minimal effects on savings. We suggest that a more efficient and effective approach is to provide incentives for consumers, particularly less educated and lower income consumers, that will defray their costs and increase their access to financial planning services. Specifically, this research can inform public policy decisions regarding programs that make credible, professional financial planning services available to those who need them most. In addition, the financial services industry must introduce additional retirement savings products that help reduce the complexity of investment decisions for households, provide some degree of protection against market volatility, and mitigate some of the individual longevity risk for the long run. Increasing the availability of low-cost, annuity-type products might serve such a purpose. Making these products available to the retail investor through tax-advantaged accounts and regular channels might go a long way in providing an opportunity for asset building and financial security for households that currently do not have the means to access the services of a

financial planner. Public investment in educating consumers directly may be more appropriately channeled to another model that provides greater access to consumers who do not currently avail themselves of financial planning services. In this paper, we identify the characteristics of soon-retiring baby boomers who do use financial planning services. These results and further research can help financial planners and policy makers target potential customers based on age, occupation, income, marital status, and similar factors to determine consumers who are not currently using these services. Departing from the current strategy of focusing only on increasing the financial literacy of consumers, both the public policy makers and the professional services industry need to direct more effort toward developing a streamlined environment for increasing access to and growing the utilization of financial planning services among those who currently cannot access such services but need them the most.

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Table 1: Descriptive Statistics

	Variables		All
N=1000			
Demographic	Age	Continuous	45
	Female	Equal to 1 if yes; 0 otherwise	54%
	Married	Equal to 1 if yes; 0 otherwise	64%
	Family Size	Continuous	3.1
	Have Children	Equal to 1 if yes; 0 otherwise	83.00%
	Race		
	White	Equal to 1 if yes; 0 otherwise	48%
Income & Resources	Family Income	Continuous	$73,628
	Net worth		$224,850
	Pension Plan		
	Defined Benefit	Equal to 1 if yes; 0 otherwise	35%
	Defined Contribution	Equal to 1 if yes; 0 otherwise	65%
Cognitive & Behavioral	IQ	Continuous	96.00
	Education		
	< 12 years	Equal to 1 if yes; 0 otherwise	6%
	12 years	Equal to 1 if yes; 0 otherwise	46%
	13-15 years	Equal to 1 if yes; 0 otherwise	24%
	16 years	Equal to 1 if yes; 0 otherwise	13%
	>16 years	Equal to 1 if yes; 0 otherwise	11%
	Risk Tolerance		
	1=Most Risk averse		54%
	2		12%
	3		18%
	4= Most Risk taking		16%
Retirement Preparedness	Planned for retirement		
	Use Financial Planner	Equal to 1 if yes; 0 otherwise	21%
	Attend Seminar	Equal to 1 if yes; 0 otherwise	18%
	Read Books	Equal to 1 if yes; 0 otherwise	38%
	Use Software	Equal to 1 if yes; 0 otherwise	13%
	Not planned for retirement	Equal to 1 if yes; 0 otherwise	10%

Table 2: Demand for Financial Planning services

	Retirement Planning	
	Use Financial Planner	Self preparation
Income	$125,165***	$77,689
Net worth	$578296***	$186,786
Years of education	15*	14
IQ	103*	101
Health status	4.06***	3.03

*$p < .10$, **$p < .05$, ***$p < .01$.

Table 3: Probit Analysis of Demand for Retirement Planning

Variable Type	Variables	Coef.	St. Error	Marginal effects
Income & Resources	Log Income	0.816***	0.152	0.296
	Log Networth	0.695***	0.093	0.219
	Defined Contribution	0.738*	0.350	0.249
Cognitive & Behavioral	IQ	0.004***	0.000	0.008
	Education			
	High School	0.197	0.101	0.154
	Some college	0.295	0.131	0.143
	College	0.542**	0.121	0.171
	Grad school	0.544**	0.141	0.194
	Risk Tolerance	0.085	0.063	0.026
	Health	0.122***	0.000	0.001
Demographic	Age	-1.594	2.061	-0.253
	Age square	0.017	0.022	0.002
	Female	0.324*	0.151	0.094
	Married	0.282	0.289	0.056
	Family size	0.043	0.089	0.018
	Children	-0.817**	0.221	-0.111
	White	0.119***	0.014	0.235
	Intercept	0.471	0.083	

*$p < .10$, **$p < .05$, ***$p < .01$.

Table 4: Probit analysis of predictors of financial planning services utilization

		Consult Financial Planner				Self preparation of retirement plans			
N=1000		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Variable type	Variables	Coeff	St. Error	Marginal effect	Sig	Coeff	St. Error	Marginal effect	Sig
Income & Resources	Log Income	0.154	0.027	0.033	**	0.152	0.021	0.031	**
	Log Net worth	0.243	0.053	0.057	***	0.107	0.049	0.039	**
	DC plan	0.349	0.143	0.096	**	0.191	0.169	0.068	
Cognitive & Behavioral	IQ	0.006	0.003	0.001	*	0.021	0.004	0.011	***
	High school	0.232	0.357	0.056		0.342	0.360	0.113	
	Some college	0.510	0.367	0.135		0.440	0.355	0.172	
	College	0.579	0.098	0.164	***	0.786	0.364	0.306	**
	Grad. School	0.549	0.143	0.156	***	0.936	0.455	0.356	**
	Risk tolerance	0.069	0.053	0.018		0.266	0.217	0.081	
	Health	0.396	0.065	0.504	***	-0.223	0.186	-0.072	
Demographic	Age	-2.364	1.633	-0.671		-0.410	1.525	-0.101	
	Age square	0.032	0.016	0.007	**	0.006	0.014	-0.001	
	Female	0.143	0.023	0.031	***	-0.068	0.022	-0.026	*
	Married	0.151	0.067	0.035	**	0.555	0.151	0.131	***
	Family size	0.231	0.210	0.052		-0.088	0.283	-0.036	
	Children	-0.306	0.226	-0.064		-0.113	0.214	-0.040	
	White	0.110	0.018	0.025	**	0.117	0.152	0.049	
	Intercept	69.422	3.290		***	22.978	4.333		***
	Pseudo R^2	0.234				0.247			

*p < .10, **p < .05, ***p < .01.