

# Financial Advice: Who Pays

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*Using a cost-benefit framework for financial planning services and proprietary data collected in the summer of 2008, the client characteristics that are associated with the likelihood of paying for professional financial advice, as well as the type of financial services purchased, are identified. Results indicate that respondents who pay for financial advice are more likely to be female, relatively older, wealthier, and college educated but do not have a high level of self-reported knowledge about financial issues. Of the respondents who purchase financial advice, those who are comprehensively-managed are more likely to be under 65, wealthy, and have high self-reported knowledge about financial issues. This study reveals important differences between the decision to pay for financial advice and the type of financial services purchased.*

*Key Words: financial advice, financial services, professional advice*

## Introduction

Making efficient and appropriate financial decisions requires significant knowledge of increasingly complex financial markets. Rather than investing scarce resources to acquire the financial knowledge needed to plan effectively, relying on the assistance of a professional may be more efficient (Chang, 2005). This study examined the demand for paid financial advice and, among those who purchase, which client characteristics differentiate between those who pay for limited services versus those who use financial planners that provide a comprehensive financial plan.<sup>1</sup>

The shift from defined benefit to defined contribution retirement plans, increasingly complex and rapidly changing tax laws, greater household personal wealth within cohorts, along with a broad array of financial products available to transfer resources across the life cycle, have been both a burden and an opportunity for many households (Benartzi & Thaler, 2002; Hilber & Turner, 2010; Lusardi & Mitchell, 2007b). The burden is that a failure to understand the financial planning process (i.e., determining financial goals, managing and protecting resources, etc.) may lead to significant welfare loss. Increasing choice and complexity also can also benefit those with sufficient in-

formation and ability by providing additional options that may be better suited to unique household preferences and objectives.

Financial decision making that aligns behavior with individual preferences either requires a significant investment in expertise or the use of a professional to provide financial guidance. Akerlof and Shiller (2009) suggested that uninformed financial decisions by individuals contributed to the 2008 global financial crisis. Because many complex borrowing and investing decisions are not well understood by the average household, Akerlof and Shiller recommended that public sector incentives be considered to encourage more people to seek financial advice.

Unlike other professions that provide expert advice, there are relatively few studies that have explored the willingness to pay for financial planning services. Grable, Cantrell, and Maddux (2004) contended that little is known about those who choose professional providers other than that they typically exhibit higher financial well-being or net worth. This was unsurprising since the significant fixed costs of financial advice would only be worth paying for among those with greater income and wealth.

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Public data sets such as the Survey of Consumer Finances (Chang, 2005; Elmerick, Montalto, & Fox, 2002; Finke, Huston, & Waller, 2009) and the Retirement Confidence Survey (Joo & Grable, 2001), as well as proprietary data surveying Internet users (Grable et al., 2004) and university faculty and staff (Grable & Joo, 2001), have been used to identify characteristics of those who seek financial planning assistance. These studies found that over one fifth of households used financial planners, but the majority of households relied on nonprofessionals due to cost and trust factors (Grable et al., 2004). The decision to use a financial planner varies by the demographic characteristics of the household and by whether advice is sought regarding credit and borrowing, saving and investing, or comprehensive advice (Elmerick et al., 2002). The likelihood of seeking help outside one's social network tends to increase as the degree of complexity or the need for specialized knowledge increases (Chang, 2005). Larson (1993) found the top reason to hire a financial planner, tax accountant, or lawyer was that these professionals were more knowledgeable than the client.

Hiring an expert is an acknowledgment that the expected benefit of informed choice exceeds that of uninformed choice or of increasing one's own knowledge through time and effort. Bluethgen, Gintschel, Hackenthal, and Muller (2008) found that individuals who face a high cost of information production were more likely to seek financial planning advice. The self-employed, who may have more complex estate, tax, and investment planning decisions, were also more likely to use a financial planner (Miller & Montalto, 2001). Joo and Grable (2001) found that those with lower self-reported financial knowledge were more likely to seek financial planning advice. It is also possible that young (and male) investors may be more subject to overconfidence and therefore less likely to seek financial planning advice (Barber & Odean, 2001).

This research used a large proprietary data set of moderate- and higher-wealth respondents to investigate the determinants of purchasing financial advice as well as the use of a comprehensive financial planner among those who used financial professionals. Demand for financial services was modeled as a cost/benefit analysis, where the cost of obtaining advice from a paid professional was weighed against the expected benefit from improved financial decision making. Results suggested that the decision to choose a planner is often a rational one, and the characteristics

that impact the choice of a comprehensive plan differ from those related to hiring a financial professional.

### ***Reasons to Hire a Financial Planner***

Hiring a financial professional involves using scarce resources to hire a decision making agent endowed with greater knowledge and ability; in this case, personal finance-specific human capital. The principal (client) pays either fees, a percentage of assets, commissions, or some combination of these to purchase the human capital service flows of a financial professional if the expected benefit from this expert advice exceeds the costs.

Financial planning information and skill can be used to create a more optimal investment portfolio, improve borrowing and saving behaviors, decrease tax payments, enhance estate planning, and maximize other financial resource allocation decisions. Informed choice increases expected utility from consumption in future periods by improving allocation of resources (Finke et al., 2009). Motivation to hire the services and expertise of a financial planner is based on the perceived benefits and costs of paying for financial advice. The costs of financial planning include commissions on financial products, fees paid for the preparation of financial plans, and recurring fees that are often levied as a proportion of assets managed by the adviser. The benefits relate to the anticipated improvements in welfare from employing an expert to assist with complex financial decisions. For example, improved investment decision making should increase the expected net return on a household portfolio for a given level of risk. Better risk management decisions will result in the use of products that provide a more appropriate level of protection against unanticipated wealth shocks. In each of these domains, informed decisions may provide an increase in welfare that exceeds the cost of the advice. Factors that influence either the costs or expected benefits of advice will affect the decision to hire a financial planner.

Purchasing the services of a skilled expert also involves potential agency costs. Agents seeking to maximize their own utility may provide recommendations that are not perfectly aligned with those of their client. Higher agency costs will reduce the expected increase in informed consumption. Likewise, higher perceived monitoring and bonding costs will reduce the expected benefit from using a financial professional.

### ***Client Characteristics***

Client characteristics that are hypothesized to influence perceived costs and benefits of hiring a financial professional include:

**Age:** Younger individuals may be viewed as having a greater need for financial advice since they generally have less knowledge and experience, higher present values of expected future earnings, and more years to benefit from advice (Agarwal, Driscoll, Gabaix, & Laibson, 2009). However, with age comes increasing complexity of taxation, dependents, and higher income and financial wealth, which also impact the need and ability to pay for financial advice.

**Education:** Education level is often used to proxy an individual's rate of time preference. Individuals with higher levels of formal education, representing lower rates of time preference (Joireman, Sprott, & Spangenberg, 2005), are hypothesized to be more likely to understand and be willing to forgo present consumption to pay for financial planning activities that have future expected benefit.

**Financial Knowledge:** The degree to which an individual understands financial issues may lead to an awareness of the complexity and potential tradeoffs of not hiring a financial professional, or may lead to an increased desire to manage one's own personal finances (Lusardi & Mitchell, 2007b; Perry & Morris, 2005).

**Income:** At higher income levels, the cost of the time commitment to acquire or use the human capital necessary for personal financial planning makes it more effective to outsource some (or all) of the burden to a financial professional. Higher income is also associated with greater benefits from tax planning advice (Finke & Huston, 2003).

**Wealth:** Higher wealth individuals have relatively more to lose by making poor financial decisions; thus, those with high net worth are generally thought to be more likely to experience greater benefit from purchasing financial assistance (Hanna & Lindamood, 2009). Also, wealthier investors are likely to have more complex tax and estate planning issues.

**Cultural Influences:** Race and gender are important cultural influences that tend to impact help-seeking behavior. Minorities may have a bias to be less trusting of an expert and/or have less financial planning experience (Perry & Morris, 2005; Yao & Hanna, 2005). Chang (2005) found that minorities often have less investment experience and are less likely to have received information from family or peers. They may also be less willing to trust the advice of

an expert and incur higher agency costs. Similarly, women have been found to have less financial experience and lower levels of confidence in their ability to manage their own finances (Barber & Odean, 2001; Estes & Hosseini, 1988).

**Self-employed:** Self-employed individuals may tend to have more complex tax, estate, and investment issues compared to non-self employed persons (Moskowitz & Vissing-Jorgensen, 2002). Thus, self-employed respondents are hypothesized to have a greater expected benefit from making more tax efficient choices and improving portfolio composition than by hiring financial professionals than those who are not self-employed.

### **Method**

This study used proprietary data co-sponsored by a large independent financial services company and a professional association serving the financial planning community. Data were obtained in the summer of 2008 by a third party data collection company. The survey was designed to provide data that described consumer attitudes in a changing economy among a population with moderate to higher incomes and/or wealth. To be eligible to be included in the study, respondents had to meet a threshold of having at least \$50,000 in annual income or a minimum of \$50,000 of investable assets. The sample included data for 3,022 respondents. All data were individual-level except income and investable assets which were household-level variables.

Because the sample represented a higher income and/or wealth population, the incidence of financial advice purchased was higher than is typically found in a nationally representative sample. This afforded the opportunity for a better analysis of the financial advice purchasers within this targeted population; however, it did present some limitations in terms of generalizing results from the analysis. Descriptive information about the sample can be found in Table 1.

### **Analysis**

The analysis is presented in two parts. The first analysis examined the decision to purchase financial services and a logistic regression was used to estimate the likelihood of paying for financial advice. The second analysis was limited to only those who purchase financial advice and examined the factors that explain variation in whether the type of advice purchased was piecemeal (advice-supported) or holistic (comprehensively managed). These analyses were viewed as two separate decisions.

**Table 1. Summary Descriptive Statistics**

	All (N = 3,022)	Self-directed (n = 1,515)	Advice-supported (n = 754)	Comprehensively-managed (n = 753)
	%	%	%	%
Variables				
Age				
Less than 35	15	21	8	9
35 - 44	14	15	12	13
45 - 54	22	22	18	24
55 - 64	33	29	37	40
65 +	16	14	24	14
Education				
≤ High school	5	5	4	4
Some post-secondary	18	21	16	12
Associate's degree	5	7	5	3
College degree	36	35	37	37
Graduate/professional degree	36	32	38	43
Financial human capital				
Understand financial issues	31	30	27	39
Race				
White	86	87	85	85
Black	2	2	2	2
Hispanic	3	3	3	4
Asian	4	3	6	5
Other	4	4	5	4
Gender				
Male	58	60	56	58
Female	42	40	44	42
Income				
< \$75,000	20	26	16	10
\$75,000 - \$99,999	16	17	15	13
\$100,000 - \$124,999	13	13	13	12
\$125,000 - \$149,999	13	13	12	13
\$150,000 - \$249,999	21	17	24	27
\$250,000 and over	18	15	20	25
Wealth				
< \$10,000	13	23	5	4
\$10,000 - \$49,999	12	18	8	6
\$50,000 - \$99,999	9	11	7	6
\$100,000 - \$249,999	12	13	13	10
\$250,000 - \$499,999	11	10	13	11
\$500,000 - \$999,999	17	10	23	23
1 million and over	26	15	31	40
Employment status				
Self employed	6	4	8	8

### ***Dependent Variables***

To construct the dependent variables for the logistic regression analyses, respondents were first classified into one of three categories:

1. *Self-directed*: Respondents who did not pay for financial services.
2. *Advice-supported*: Respondents who consulted with paid professional(s) but did not have a comprehensive written financial plan and/or have an on-going relationship with their advisor.
3. *Comprehensively-managed*: Respondents who were actively engaged in the financial planning process, had an ongoing relationship with a paid professional, and have comprehensive written financial plans which included multiple aspects that were reviewed and evaluated regularly.

For the first regression, the dependent variable was coded as 1 if the respondent paid for financial advice and 0 if the respondent did not pay for financial advice (i.e., self-directed). For the second regression, paying respondents were coded as 1 if they were comprehensively-managed and 0 for those who paid for non-comprehensive advice (i.e., were considered to be advice-supported).

### ***Independent Variables***

The demographic characteristics of age, education, gender, and race were included as predictor variables in both regression models. Age was measured categorically: less than 35, 35 - 44, 45 - 54, 55 - 64, and 65 and over (omitted category). Binary variables were created to capture respondent education level (college or more = 1, less than college = 0), gender (male = 1, female = 0), and race (White = 1, all other race categories = 0).

Indicators of economic status included income, wealth, and working status (self-employed = 1, 0 otherwise). Income was measured through six categories: less than \$75,000 (reference category), \$75,000 - \$99,999, \$100,000 - \$124,999, \$125,000 - \$149,999, \$150,000 - \$249,999, and \$250,000 and over. Similarly, wealth was captured through seven categories ranging from less than \$10,000 (reference category), \$10,000 - \$49,999, \$50,000 - \$99,999, \$100,000 - \$249,999, \$250,000 - \$499,000, \$500,000 - \$999,999, to 1 million and over in investable assets.

Financial knowledge was measured with the following item: “*I understand financial-related issues.*” The knowledge variable was coded 1 for those who answered yes,

otherwise coded 0 if no. The knowledge variable was used to proxy human capital specific to personal finance.

## **Results**

### ***Descriptive Results***

The dependent variable for the first regression equation captured whether the respondent paid for financial advice. Half of the sample was self-directed, meaning they chose not to pay for professional advice. The dependent variable for the second regression model focused on the remaining half of the sample that did pay for professional financial advice. This sub-sample was evenly split between those respondents who were comprehensively-managed (25% of total sample) and those who were advice-supported (25% of total sample).

The first column of results presented in Table 1 reported frequencies for all of the independent variables included in the regression models. Over half of the sample respondents were between the ages of 45 and 64. Nearly three quarters of respondents (72%) had completed college. The majority were White (86%), and over half of the respondents (58%) were male. Approximately two out of five respondents reported household income of \$150,000 or more. About one fourth (25%) of the respondents were millionaires in terms of investable assets. Most respondents were not self-employed (94%). The remaining columns of Table 1 provided the frequencies of these same variables by financial advice type. The results were similar except for potential differences in age, income, and wealth distributions.

### ***Logistic Regression Results***

Logistic regression results are shown in Table 2. The first column reports results for the decision to purchase expert advice (includes both comprehensively-managed and advice-supported respondents) versus those who chose not to purchase financial services (i.e., self-directed). Among the demographic characteristics, all of the variables included in the model show significant results. In terms of age, the youngest respondents (less than 35 years old) were about a third less likely to purchase financial advice compared with the oldest respondents (65 and over). The results indicate a positive relationship between education and paying for financial advice. Both White and male respondents were less likely to pay for financial advice compared to respondents of other races and females, respectively.

While significant results were indicated for at least one category within all of the economic variables, wealth had more impact on the likelihood of paying for financial advice than income, especially in the highest wealth category.

**Table 2. Logistic Regression Results**

	Pay vs. not pay (N = 3,022)	Among those who pay comprehensive vs. advice-supported (n = 1,507)
	%	%
Variable		
Age (65 and over omitted)		
Less than 35	-32**	153***
35 - 44		133***
45 - 54		157***
55 - 64		111***
Income (omitted < \$75,000)		
\$75,000 - \$99,999		
\$100,000 - \$124,999		
\$125,000 - \$149,999		50*
\$150,000 - \$249,999	53**	
\$250,000 and over		
College or more (vs. less than college)	37***	
Financial human capital – understand issues	-21**	70***
White (vs. all other races)	-30**	
Male (vs. female)	-25***	
Wealth (omitted less than \$10,000)		
\$10,000 - \$49,999	53**	
\$50,000 - \$99,999	124***	
\$100,000 - \$249,999	197***	
\$250,000 - \$499,999	343***	
\$500,000 - \$999,999	715***	76**
1 million and over	736***	104***
Self employed	47*	
Max-rescaled R <sup>2</sup>	0.23	0.08

\* $p < .05$ . \*\* $p < .01$ . \*\*\* $p < .001$ .

ries. Respondents with half a million dollars or more in investable assets were about seven times more likely to purchase financial advice compared to respondents with the lowest level of wealth (less than \$10,000). Self-employed respondents were approximately 50% more likely to purchase financial advice compared to their non-self employed counterparts. Those who reported having the highest understanding of financial issues were less likely to pay for professional financial advice.

The second column of results in Table 2 is censored to the group of respondents that purchased financial advice. The dependent variable compared those who selected comprehensive management to those who were advice-supported. Among the demographic characteristics, the only variable with statistically significant results was age. Compared with the oldest age group (65 and older), younger respondents were roughly between two to two and a half times more likely to be comprehensively-managed. There was no



evidence to suggest that race or gender had an impact on the decision between being comprehensively-managed or advice-supported. Although there was no evidence to suggest that formal education had an impact on the choice of comprehensive management, reporting an understanding of financial issues was positively associated with purchasing comprehensive financial advice, as opposed to being advice-supported.

Among the economic variables, there was some statistical support to suggest that respondents with the highest reported levels of investable assets were more likely to choose comprehensive management compared to the least wealthy respondents who pay for financial advice. There was no evidence to suggest that employment status had an impact on the type of financial advice purchased.

## Discussion

Using a sample of over 3,000 respondents with an annual income and/or investable assets greater than \$50,000, this study examines who pays for financial advice and whether the financial services purchased are partial or comprehensive. Descriptive comparisons show that a greater proportion of college-educated respondents select professional, and in particular comprehensive, advice that includes a complete, written financial plan. Likewise, a higher proportion of the most financially knowledgeable respondents opt for comprehensive services and a smaller proportion chooses to direct their own finances. The very young tend to be self-directed, the middle-aged comprehensively-managed, and the oldest are advice-supported regarding their financial planning. A far greater proportion of the highest wealth and income respondents choose to purchase comprehensive financial planning advice.

In a multivariate analysis, wealth is shown to be, by far, the strongest predictor in the decision to pay for financial advice. Income, however, is only significant (and positive) for those in the second-highest income category. These results suggest that the benefits from improved financial decision making increased with wealth. As wealth increases, the expected benefit from improved asset allocation, tax efficiency, estate planning, and wealth preservation all increase to the extent that the expected benefit outweighs the cost of preparing and maintaining a financial plan. However, once wealth is accounted for, the impact of income is less consistent. This may suggest that financial advice is seen as most valuable to those with the most accumulated assets, rather than the most human capital. Clients with greater wealth may also be more attractive to financial ad-

visers who are compensated based on a percentage of managed assets.

Results also suggest that those with at least a college degree are more likely to hire an expert to assist with financial decisions; however, those who believe they have a better grasp of financial issues are less likely to pay for financial advice. Better educated households are more likely to see their income and financial resources increase in the future, leading to a greater expected improvement from professional financial advice in the present. On the other hand, respondents who feel that they already have greater financial knowledge are likely to see a smaller anticipated gain from relying on the financial advice of an expert. The self-employed have financial issues that are more complex than the average employee, so it is not surprising that they are also more likely to pay for financial advice.

Among only those who pay for financial planning advice, high income and wealth are associated with a positive likelihood of choosing a comprehensive financial planner rather than an advice-supported planner. The oldest respondents are far less likely to choose a comprehensive planner compared with their younger counterparts. Greater financial knowledge is found to be negatively associated in the decision to pay for financial advice, but positively associated with paying for comprehensive management as opposed to being advice-supported.

These results suggest important differences between the choice to purchase professional financial planning and the type of professional advice chosen. Those with greater wealth and income, and those who are more knowledgeable about financial issues, prefer to purchase comprehensive management versus being advice-supported. In many cases, advice-supported planning is provided by financial professionals who may not have a fiduciary relationship with their client. For example, brokers who are regulated by the Securities Exchange Act of 1934 are only required to sell financial products that are suitable to investors while investment advisers, who are regulated by the Securities and Exchange Commission according to the Investment Advisers Act of 1940, must recommend products that are in the client's best interests. This lack of a fiduciary relationship among brokers may increase the potential for high agency costs among advice-supported clients. If the more financially-knowledgeable and/or the wealthy are better able to estimate agency costs of different financial advising agents, this may explain the preference for comprehensive financial planning services over a piecemeal

approach. A much lower preference for comprehensive advice among those 65 or older is also consistent with evidence that financial decision making ability declines with advanced age (Agarwal et al., 2009).

This study also highlights possible resistance to financial counseling or planning services among men. This may not be surprising if men are more likely to be overconfident of their ability to direct their own financial decisions. In addition, the finding that education is positively associated with paying for financial advice is counterintuitive, but may also suggest that some level of knowledge is needed to increase recognition of the benefits from hiring an expert to provide financial assistance. It is possible that many who have less formal education and less exposure to finance-related coursework are underserved due to an inability to assess whether the potential benefits of advice outweigh the cost.

Results from this study provide greater insight into the demand for professional financial advice as well as the demand for comprehensive financial planning services. Unlike prior studies that emphasize the desire to seek financial assistance in general, this study explores both who pays for financial advice and who has chosen advice that includes a written, comprehensive financial plan. Results indicate that the wealthy are most likely to receive professional assistance when making financial decisions. While this result is not surprising, since those with greater resources have the most to gain from this advice, it highlights the need for professional advice among lower-wealth households who may be among the most vulnerable to making poor financial decisions. The use of a written, comprehensive financial plan appears to be related to both higher socioeconomic status and to variables that indicate increased financial sophistication. This may reflect confusion among consumers unable to differentiate between advisers who provide comprehensive planning services and those who provide more limited, product-based financial advice.

The primary limitation of this study is that the sample includes only those with greater than \$50,000 in investible assets or a \$50,000 income, which are both above the median for American households. Even these income and wealth thresholds may not be large enough to attract the services of a professional financial advisor since likelihood of receiving professional financial advice increases sharply with wealth. This leaves the majority of Americans, with assets or income too low to attract an advisor, without the help they need to make more effective choices in an

increasingly complex financial marketplace. The recent housing crisis is evidence that uninformed decisions can create economic instability among households and within the economic system. This negative externality provides a justification for some public support of financial counselors who are able to help average households make better financial decisions.

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## Endnote:

<sup>1</sup> For the purposes of this study, comprehensively-managed clients are defined as respondents who are actively engaged in the financial planning process, have an ongoing relationship with a paid professional, and have comprehensive, written financial plans which include multiple aspects that are reviewed and evaluated regularly. The authors would like to thank the Financial Planning Association (FPA) and Ameriprise Financial for sharing the data used in this study (used with permission). The Financial Planning Association and Ameriprise Value of Financial Planning Study: Consumer Attitudes and Behaviors in a Changing Economy, was conducted online within the United States by Harris Interactive on behalf of the Financial Planning Association and Ameriprise Financial Services, Inc., between June 27 and July 18, 2008 among 3,022 adults with greater than \$50,000 in annual income or investable assets.