Strategic Planning for Financial Service Providers: A Family Life Cycle Profile of Competitive Market Segments

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Financial services providers face a marketplace redefined by a myriad of changes including deregulation, tax reform and heightened competition. Questions that must be answered if a provider is to recognize competitive threats in a timely manner include: "What business are we in?", "Who is our competition?" [6]. The differences in customer needs, combined with competitive pressures to segment the financial services market make strategic planning critical for profitable operations. Because financial planning services are typically viewed as commodies by consumers, financial planning providers tend to take a commodity marketing approach. The commodity marketing approach focuses attention on short-term profitability which can lead to a less profitable long-term position and a lost competitive edge. This study uses family life cycle stages combined with consumers' self reports of willingness to accept risk and invest monetary assets to study ways financial providers can develop both short-term and long-term focuses on profitability.

Defining Financial Planning Markets

Criteria used to define the financial planning market should reflect not only the current profitability of the segment, but also the future profitability and competitive advantages offered by the financial planners should not rely solely on household income as a good indicator of segment potential because income alone is not a reliable predictor of the long-term strategic profitability of a customer segment. For example, younger households represent segments with a strong future benefit, but will have lower current household incomes than other segments. Age and marital status also create different financial planning needs. The presence of children in a household can create different financial requirements than households of the same age, income and marital status without children present. These demographic factors can be combines to meaningfully divide the marker for financial products and services based on near and long term profitability by utilizing family life cycle stages [6]. Family life cycle stages involve a combination of factors including age, income, marital status and the presence of children in the household [10, 16]. Combinations of these factors define tight family life cycle stages (Table 1).

Table 1
Typical Stages in a Family Life Cycle

Head of household less than 45:
Stage 1 Not married, no children
Stage 2. Married, no children
Stage 3. Married or unmarried, children under 18 at home

Head of household between 45 and 65:
Stage 4. Married or unmarried, children under 18 at home
Stage 5. Married, no children under 18 at home
Stage 6. Unmarried, no children under 18 at home

Head of Household over 65:
Stage 7. Married, no children under 18 at home
Stage 8. Unmarried, no children under 18 at home

By clustering households according to these factors, the life stages reveal differences in financial decisions — due in part to marital status or the presence of young children [7, 8, 16]. Life experiences, household circumstances and personality factors affect attitudes toward risk and liquidity, and the choices of financial planning services.

Client Needs and the Financial Planner

Since different needs motivate households, financial services providers must be responsive to the impact of these needs on the financial services purchases of each segment. Client objective/constraint profiles that reflect investment goals should be formulated for the individual household segment and market limitations. Such a profile has the benefit of providing a basis for evaluating the needs and risk/return options for the consumer client. Such a profile should reflect: (1) the clien'ts need for current income; (2) their inflation protection needs; (3) their ability to tolerate a loss of principle; (4) their ability to tolerate volatility in income; (5) their liquidity requirements; (6) their particular tax bracket and situation; (7) any legal constraints; (8) the length of the planning time or horizon; and (9) any other unique needs of the client.

Orchestrating a system of financial product/service offerings around these needs as reflected in life stages would give an organization a competitive advantage. By following a household through the various stages, this approach moves a provider into a "financial consultant" role.

Strategy in the Financial Planning Industry

From a strategic standpoint, no single segment will continue to offer the same profitability over time. Though in the near term younger households may be less profitable than older households, access to the segment can be gained by establishing an early financial planning relationship. This may be the most cost effective way to ensure future profitability for the company. While profitable markets can be won away from competitors, stealing market share may be less cost effective than nuturing share. Current customers can be reached at lower costs, and their needs, as determined by their life cycle groups, are also more readily known.

Thus, "growing" a "future benefits" segment is clearly a strategic move in a competitive marketplace. Since these "future benefits" segments may not be highly profitable today, financial planning firms must attract business from segments that can bridge the present and future profitability. All segments may not offer the same potential, but competitive advantage lies in the fit between segment needs and a financial services provider's offerings.

Methodology

Evaluation of Market Segment Potential

To assess the strategic possibilities of segmenting the client market for financial service providers, the authors evaluated household data included in the most recent "Survey of Consumer Finances" [4]. Conducted jointly by the Survey Research Center of the University of Michigan and the Federal Reserve Board, this data was collected from 3,824 households and included extensive information on the financial assets households owned, risk and liquidity attitudes and use of financial service providers.

Responses to questions relating to the composition and ages of household members were used to classify households into the eight stages identified in Table 1. Using these stages, it was possible to define market segments according to the societal pressures prevalent to particular consuer groupings. Table 2 summarizes the key characteristics of each stage.

The value of total assets was greatest for consumers in stage five (married households, with the head of the household between 45 and 65 years old, with no children living at home). This segment also owned the greatest proportion of financial assets. Stage three households, either married or not with children, represented the largest group of the eight segments, followed next by stage five households. While not as willing to accept financial risk as some segments, stage five households were willing to invest their money for longer periods of time. These characteristics suggest that the stage five life cycle segment represents the short-term to intermediate-term profitability target for financial service providers.

When ranked by value of financial assets held, stages three and four (household heads under 45 and between 45 and 65 years old with children under 18 at home) fall next in potential. The younger of these two stages (stage 3) may be of greater potential benefit since this stage includes nearly one third of all represented households. While desiring some liquidity, they are willing to take more financial risks than other segments. Also, the proportion of this group owning financial assets, as well as the dollar amount of those assets, is projected to grow in the future. This group may offer greater intermediate and future benefit flows for financial planners.

Of the married households, many were dual career/dual earner households. Stages composed soley of unmarried households, which included surviving spouses, divoreced and never married person, consistently owned lower proportions of financial assets. In the unmarried household stages, the absence of an additional wage earner had a negative impact on the accumulation of financial assets.

Table 2
Financial Asset Holding By Family Life Cycle Stages

Lifecycle Stage	% of Total House-holds	% of Segment Owning Assets	Median Value of Financial Assets Owned[1]	Acceptance of: Risk[2]	Liquidity[3]
Household Head <45:					
Stage 1. Unmarried, no children	11.8	81	2,898	M	M
Stage 2. Married, no children	7.6	90	20,350	A	M
Stage 3. Married or Unmarried, children	31.4	84	23,750	M	A
Household Head 45-65:					
Stage 4. Married or Unmarried, children	8.9	86	31,850	L	A
Stage 5. Married, no children	13.9	94	37,100	A	M
Stage 6. Unmarried, no children	8.3	75	12,850	L	A
Household Head >65:					
Stage 7. Married, no children	8.0	82	31,625	L	A
Stage 8. Unmarried, no children	9.3	73	8,713	L	L

1 Financial assets used were: equity in the home, real estate, checking accounts, money market accounts, mutual funds, savings accounts, brokerage accounts, certificates of deposit, IRAs, Keogh accounts, cash value of life insurance, All Saver certificates, U.S. savings bonds, Treasury bills and bonds, state and corporate bonds, publicly traded stock, trust accounts and investments in precious metals and collectibles.

2 M, A, L = More, average or less willing to take financial risks.

3 M, A, L = More, average or less willing to invest money.

Financial planners should not automatically assume, however, that consumers within each group are homegeneous units. In married households, for example, husbands and wives have been shown to have very different patterns of responses to the household's financial behavior (4). Other studies suggest there is little agreement between husbands and wives on savings practices and priorities (4, 5).

Family structure has also been shown to affect a household's financial behavior. A 1986 study found that households containing young children were more likely to own financial assets such as IRA accounts and college funds than those households without young children. Older households were more focused on financial assets that would generate retirement income. This study confirmed that the ownership of financial assets reflects not only the individual needs of the households, but also the needs resulting from societal pressures (15).

Consumer Usage Patterns of Financial Planning Services

These differing financial and life cycle stages needs were also found to influence a household's choice of financial planning service. As shown in Table 3, the "Survey of Consumer Finances" provided data on the use of five financial planning services: accountants, bankers, brokers, lawyers and tax advisers. Differences were apparent in the choice of financial service provider preferred by the various life stages.

Table 3
Use of Financial Planning Sources by Family Life Cycle Stages[1]

	Financial Planning Service Used				
Lifecycle Stage	Acct.	Banker	Broker	Lawyer	Tax Advisor
Household Head <45:					
Stage 1.					
Unmarried, no children	217[2]	97	167	90	73
Stage 2.					
Married, no children	283	92	114	120	82
Stage 3.					
Married or Unmarried, children	117	111	124	160	173
Household Head 45-65:					
Stage 4.					
Married or Unmarried, children	92	122	143	195	118
Stage 5.					
Married, no children	142	130	133	125	173
Stage 6.					
Unmarried, no children	67	124	114	100	118
Household Head >65:					
Stage 7.					
Married, no children	42	173	110	80	73
Stage 8.					
Unmarried, no children	67	168	90	115	64

1 Index numbers were based on the percent of households in a stage using a source compared to the percent of all households using that source.

2 This index number means Stage 1 households were more than twice as likely as all households to use accountants for financial planning

A pattern in use of financial planning sources by life cycle stage was evident. To test whether these differences were statistically significant, the authors performed the SAS procedure CATMOD. This categorical modeling program derived a model that would indicate the probability of a particular consumer stage selecting a specific financial planning service (11). The ability of the eight life cycle stages to predict the use of the five sources of financial advice over another source of advice was supported. Therefore by knowing the life cycle stage of a consumer, it is possible to predict the choice of financial planning advice the consumer in this stage would prefer to use. The impact of the stage was significant with a Chi^2 of = 81.12, with 28 degrees of freedom where $p < 0.0001$.

The index numbers reported in Table 3 allow financial planners to identify major user segments. Index numbers over 100 indicate a greater than average use of service provider. Heavier overall usage of planning service is evident in stages three and five. The level of financial asset ownership by households in stage five (Table 2) suggests this is likely to be a highly sought after segment. Heavy use of planning advice may reflect not only the financial motivations of the segment, but also the efforts of providers to attract these customers.

Younger households (stages one and two) were more than twice as likely to use accountants for financial planning. Older households (stages seven and eight) were more likely to consult bankers for financial advice, as were stage six households. Brokers were preferred by young, unmarried households (stage one). Lawyers were more preferred for financial planning purposes by households with children (in stages three and four). Tax advisors were more used by households with young children (stage three) or no children (stage five).

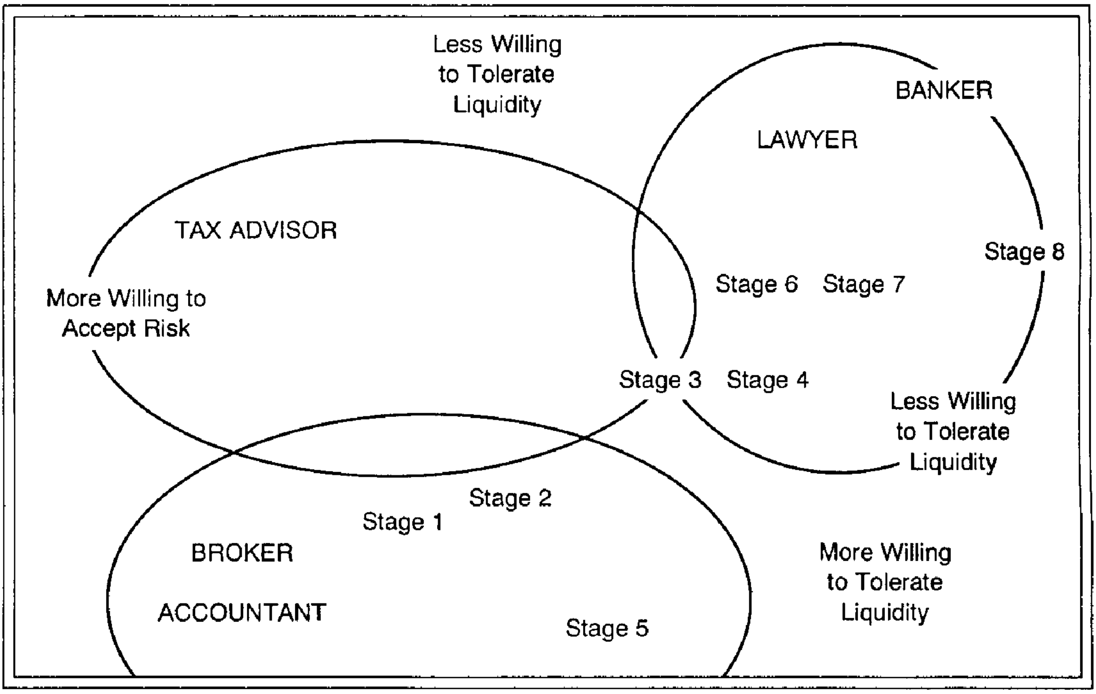
Although overall use of accountants for financial planning advice was relatively low, all households using accountants did not report the use of any other advice source. Also, less than five percent of the consumers using bankers for financial planning purposes reported using additional sources. In contrast, nearly a quarter of those using brokers as financial planners also used other professional advisors; for tax advisors and lawyers this proportion was almost fifty percent.

Households with children (stages three and four) and middle aged married households (stage five) were <u>most</u> likely to use several sources of professional financial planning advice. Older households (stages six, seven, and eight) were <u>least</u> likely to use more than one source of financial advice. In terms of absolute usage, bankers were more likely to be the source of financial planning advice for any life cycle stage. This indicates that bankers who establish an early contact with consumers can more than likely sustain this relationship over time.

Strategic Planning for Financial Services Providers

Figure 1 indicates the relationship of risk and liquidity attitudes to the choices of financial service provider by the eight life cycle stages. Life stages are positioned on Figure 1 by the risk and liquidity attitudes of the households while financial service providers are positioned according to the risk and liquidity attitudes of their clients. Three competitive groupings, as represented by the circled areas, were defined by the position of the five sources of financial advice relative to the risk and liquidity attitudes of their customers segments.

Figure 1
The Three Competitive Groupings in the Financial Service Provider Marketplace[1]



[1] Life Stages are positioned by the risk and liquidity attitudes of those households; financial service providers are positioned according to the risk and liquidity attitudes of their clients. The three circles enclose the groupings most likely to use that grouping's financial service provider.

Strategic Planning for Bankers and Lawyers

Risk averse consumers who desire liquidity characterized the banker/lawyers grouping. The use of bankers as financial planners depended more on avoiding risk than on customer's attitudes toward investing money for long periods of time. The use of lawyers as financial planners, in contrast, depended more of the preferences for liquidity than the desire of the consumer to avoid financial risk. This banker/lawyer grouping attracted two types of customers: those with the fewest and lowest value financial assets (stages six and seven); and those with the highest value of asset ownership (stages four and seven). The banker/lawyer group would have both present and intermediate-term markets well covered. Future profitabiltiy is a strategic concern for this group. Tax advisors offer the greatest peripheral competitive challenge, while accountants and brokers attract a different customer base and are not a major threat to the banker/lawyer planning group.

Strategic Planning for Brokers and Accountants

A willingness to take financial risks and invest money for longer time periods characterizes this competitive group. Use of brokers and accountants, was greater among younger segments (in stages one and two). These segments represents a unique competitive situation, since these households selecting accountants usually use accounting services for all their financial planning needs. Broker users demonstrate a different pattern as the households using broker services also use several other service providers. This broker/ accountant niche has growth potential with consumers in stages one and two. Near and intermediate-term profitability depends on the degree to which stage five households use these service providers. Because stage five households use multiple financial service providers, brokers and accountants face intense competition for these unfocused customers, particularly from tax advisors.

Strategic Planning for Tax Advisors

The third grouping represented consumers who were somewhat willing to accept risk but less willing to invest assets. This group relied on tax advisors for their planning needs. While tax advisors face no direct competition within the segment, they attracted a smaller customer base. Future profitability for this segment can be attained by attracting and retaining the stage three customer base. Near and intermediate term profitability is primarily from households in stages five and six.

Summary

Competitive consideration are suggested by the three grouping of financial service providers (as shown in Figure 1). Although there are other factors which can influence the choice of an advisor, risk/liquidity attitudes are dominant motivations. Bankers and lawyers tended to attract, within a certain range (Stage 8), clients with similar risk/liquidity attitudes. Within this stage, the two providers tended to be in greater direct competition.

While tax advisors, brokers and accountants each attracted consumers willing to accept risk, the clients of tax advisors preferred a more liquid position. Though their customers are likely to use multiple sources for financial services. tax advisors have a customer base most capable of delivering near, intermediate and future profitability.

Brokers and accountants appeared to be in more direct competition for clients. However, households selecting accountants as advisors tended to use no other source of planning advice. Broker users, in contrast, were much more likely to use multiple sources for planning advice.

Managerial Implications

This study has numeroud implications for the strategies of financial service providers. In broad terms the implications concern both the competitive marketing of financial planning services and products and the strategy for building near, intermediate, and long-term profitability.

Since the future, intermediate, and current benefits groups have distinctly different risk/liquidity profiles, it may be not be cost effective for financial planners to target their services to all households in all three groupings. Instead, establishing a firm relationship with households within their particular strategic niche and offering some products and services to key households in neighboring groupings offers a better opportunity for long-term growth and profitability. After first establishing a strong base in the grouping it dominates, a financial services provider can develop a secondary strength among customers outside its major competitive area.

Areas for Possible Future Research

The financial planning market continues to be affected by numerous changes in both the economic and the financial environment. Further research into the household life cycle profiles (that would identify even more demographic and attitudinal variables) would help to further refine market segments for financial planners. Additional clarification of the competitive differences facing financial service providers would greatly improve the successful strategic planning of service providers competing in this complex industry.

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