Why Do So Few Individuals Seek Professional Financial Advice?

by Maher H. Alyousif and Charlene M. Kalenkoski, 5/8/17

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Although 76% of respondents to FINRA's 2012 national financial capability study reported not being satisfied with their personal financial situation, very few sought financial advice, with 9% seeking debt counseling and 30% seeking insurance advice. This discrepancy motivated our research paper titled "Who Seeks Financial Advice?" This article summarizes the key findings from that research.

Understanding the factors that influence the demand for financial advice provides the industry with information that can help identify potential new clients and deliver a critically needed financial service. Our research focused on women, the young (aged 18-44) and the financially illiterate because of the characteristics that distinguish and affect the financial behaviors of these groups.

The empirical literature on gender differences shows that females score lower than males in financial knowledge tests, are less likely to be satisfied with their personal financial situation, and are less confident in their financial skills. Young adults exhibit a weak understanding of basic financial knowledge, which negatively affects the quality of their financial decisions and leads them to commit financial mistakes. Additionally, individuals who are not financially literate are less likely to own stocks and to prepare for retirement.

The results of our research can be summarized into five main findings and implications for financial advisors:

1. Income and the subjective assessment of risk tolerance are the key consistent factors across all groups that have been found to influence the decision to seek different types of financial advice. As income increases, respondents become more sophisticated and show a greater tendency to request the services of financial professionals due to the benefits to be gained from relying on financial experts in managing their investments and financial affairs. Because an important feature of financial services is the agency problem[1], individual investors lack a mechanism to monitor their financial advisors and risk tolerance might indicate individuals' willingness to tolerate outcome uncertainty.
2. Financial literacy has been found to affect the demand for financial advice positively. The five financial literacy questions asked in the FINRA study measured respondents' understanding of compound interest, inflation, bond prices, mortgage interest and risk-return trade-off. When consumers recognize the complexity of managing their investments and the benefit of using an expert's advice, they are more likely to seek professional financial advice.
3. The subjective assessment of financial knowledge, which could be a proxy for self-confidence, affects the demand for financial advice. Consumers who have low self-confidence are less likely to seek financial advice because they lack the ability to monitor this agency relationship and to evaluate financial products.
4. Financial fragility has a negative effect on the demand for financial advice. There were six signs of financial difficulties were reported by respondents. This variable is defined in our paper as a tendency to experience overspending, have difficulty covering expenses, lacking an emergency fund, being unable to come up with $2000 in the next month, not having any retirement plan, and reporting a high level of debt.
5. Education consistently positively affects the seeking of all types of financial advice by all types of individuals.

These findings raised five implications for financial advisors:

1. High-income clients are more likely to seek financial advice than low-income clients. Perhaps this is because the latter clients don't meet planners' client selection criteria due to the size of their investable assets. If planners are uninterested in these clients, these lower-income clients may turn (and, indeed, some may have turned already) to "robo" advisors. Only 20% of consumers currently are aware of such "robo" advisors according to A.T. Kearney's 2015 robo-

advisory services study, but could increase as individuals become more familiar with these services. Consumers' subjective risk tolerance represents another challenge because such attitudes are difficult to quantify and appear to influence the demand for financial advice. By raising people's understanding of the broader meaning of risk beyond the volatility of financial securities, advisors can demonstrate the benefits of financial advice that is centered on providing customized solutions. Individuals might not realize other aspects of risk such as inflation and the need to protect their future purchasing power.

2. Respondents' difficulty in understanding the risk-return trade-off in buying a single stock versus a mutual fund and the relation between bond prices and interest rates in the financial literacy questions suggest the value of financial decision-making literacy over numeracy and general math skills. Financial literacy programs should equip consumers with the knowledge about when to seek help, where to find it, how to screen advisors and how to assess outcomes. Demystifying the financial advice process reduces consumers' uncertainty and encourages them to seek the services of financial professionals rather than to rely on their informal networks for financial information.
3. Although one might think that consumers' subjective assessment of their own financial knowledge should relate to their performance in financial literacy questions, it does not. Of our respondents, 73% perceived their financial knowledge to be high, but only 16% could answer all five basic literacy questions. Ideally, we would like consumers to have a basic understanding of personal finance and to be confident enough to establish a relationship with financial professionals without fear of opportunistic behavior.
4. We found that the effects of five types of financial advice, including debt counseling, savings and investment, mortgages and loans, insurance, and tax planning, vary. For example, financial literacy increases the demand for all types of financial advice except debt counseling, while financial fragility increases the demand for debt counseling and decreases the demand for other types of advice. Therefore, the marketing of financial advisory services should target specific segments for which a type of advice is directly relevant and likely to have a bigger impact.
5. The current expansion of personal financial planning programs across college campuses is a positive trend that provides the industry with great opportunities. It brings the topics of personal finance to students who are preparing to join the workforce, which can improve their financial decisions. Additionally, the partnership between advisory firms and financial planning programs provides those firms with exposure to market their services and a chance to attract talent to their practice.

In addition to the key variables that we examined in our paper, understanding the demand for financial advice requires an investigation of the effect of salient and hidden fees on consumers' decisions to hire financial professionals. Furthermore, examining the determinants of trust in services, such as financial advice, is critical because consumers lack the ability to evaluate the service quality and assess the viability of advisors' financial recommendations.

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[1] The interests of the investor and the financial advisor are not necessarily aligned.

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