Review of Financial Planning Research in the US: 1995-2005

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Introduction

While the concept and practice of family and personal finances are not new, the field of financial planning as an academic discipline is relatively new. The increasing significance of financial literacy due to the complexity of the financial marketplace and growing individual responsibility of their financial future are key factors that have made financial planning discipline grow.

In practice, financial planning industry has only about 30 years of history (FPA, n.d.). The term financial planning used to form the association of the field (Financial Planning Association) in 1970. Since then the financial planning industry has become one of the most growing fields with financial planners being one of the highest ranked jobs in the U.S. Formal education for financial planning has been growing during the past 20 years. In the U.S. there are approximately 200 higher education programs that offer Certified Financial Planners Board of Standard registered curriculum for bachelor, master's and doctoral degrees or corresponding certificates.

Overall, financial planning, as an academic discipline and as a field of practice, has exhibited dramatic growth in the past 30 years. Experiencing this evolution, it is worthwhile to review the research development of the field to examine the past, current, and future of financial planning research. To examine the financial planning research in the U.S., this paper overviewed past 11 years of selected academic publications in personal financial planning field.

Terminology

To help understand the field, the term financial planning needs to be explained first. “Financial Planning” more specifically “Personal Financial Planning” has been defined as a “process” of meeting life goals through proper management of personal finances (CFP Board., n.d.). It encompasses various and complex areas of personal finances, such as budgeting, cash management, debt management, credit management, risk management, retirement planning, college planning, tax planning, and estate planning. The Certified Financial Planners Board of Standards specifies 101 topics in personal finances that are pertinent to the profession and the practice of financial planning. While the financial planning itself refers the “process” of managing personal finances, the areas covered by financial planning are very broad. In academic field of finance, however, personal finance and corporate finance have been clearly distinguished and the personal financial planning deals with “personal” side of finances.

Even though I specified financial planning as “personal” side of finances, it is not clear, sometimes, whether the unit of analysis is “individual” “family” or “household.” It seems that in the literature, individual, family, and household have been interchangeably used as a subject of personal financial planning. In this paper, financial planning refers personal financial planning and personal financial planning includes family and household financial planning.

Brief Review

To overview the past and present and anticipate the future research direction of personal financial planning, the literature review process focused on reviewing the most popular manuscript outlets in the field. Journals were limited to the ones that published peer-reviewed

academic financial planning research manuscripts. While each of the topic areas has its own journals that publish academic research (for example, there are insurance journals, specific law journals, and mutual fund journals, etc), the scope of this review is limited to the holistic and comprehensive view rather than technical or specific ones. Even though this review is limited in its scope, I hope it will depict the overall direction of the financial planning research.

In the process, I selected four major academic journals: *Financial Services Review, Financial Counseling and Planning, Journal of Consumer Affairs, and Journal of Personal Finance*. The *Financial Services Review* is the official journal of the Academy of Financial Services which is published quarterly showcasing financial planning research in the field since 1991. *Financial Counseling and Planning* is the official journal of the Association for Financial Counseling and Planning Education which is published bi-annually including manuscripts in financial planning, education, and counseling since 1990. The *Journal of Consumer Affairs* is the official journal of the American Council on Consumer Interests, which is published bi annually with manuscripts in consumer protection, consumer interests, and personal finances. The *Journal of Consumer Affairs* started its first volume in 1966 and has been one of the key sources for consumer research. The *Journal of Personal Finance* is the official journal of the International Association for Financial Consultant and is relatively new. The *Journal of Personal Finance* published its first issue in 2002 and it is quarterly.

The following tables summarize published articles in each of the four journals according to specific financial planning topics. As shown in Table 1, *Financial Services Review* published the most number of articles in the area of investment. The second most published topic is retirement followed by financial planning education (the journal had a special issue on financial education in 1999). The widely and most frequently published investment manuscripts could be

even more dominant with the fact that numerous articles in retirement also deal with investment strategies. These outnumbered manuscripts in investment topic are not surprising though because the majority of the membership and the readership of the journal belong to finance department in higher education institutes. One of the interesting topics from this journal is its focus on financial planning profession and education, especially the CFP® exam. This journal is the only journal that published manuscripts that discussed Certified Financial Planners™ and their certification process, exam, and education. Another aspect that is interesting about this journal is the inclusion of sociology and psychology in financial planning. While there were only two manuscripts that focused the discussion in sociology and psychology of financial planning, many other manuscripts included theoretical background of sociology, psychology, and behavioral finances.

Table 2 summarizes *Financial Counseling and Planning* articles by their topics. The topics for this journal were more diverse and less concentrated than *Financial Services Review*. While, the most frequently published topic was retirement, other topics, such as investment, credit and debt, and financial behavior were also popular. Rather unique topics for this journal include financial counseling and survey. Considering the audience and membership of this journal, financial counseling topics are on target. Financial counseling manuscripts present information on the counseling profession, specific needs, and strategies for diverse population (e.g., Kerkmann, 1998; Klingander, 2000; Lown & Ju, 2000; McGregor & Berry, 1997). The journal also published articles about the Survey of Consumer Finances on its imputation and methodology.

Table 1. *Financial Services Review* (1995-2005) articles by topic

Topic	Number of Articles
Investment	
General Investment (including Asset Allocation)	51
Bond	6
CD (Money Market)	4
Mutual Funds	14
Stock	31
Retirement	35
Financial Planning Education	14
Cash Management (banking, Saving, Cash flow, Emergency Fund)	8
Mortgage and Real Estate	8
Financial Planning Industry/Profession	8
Financial Planning	7
Credit and Debt	6
Risk Tolerance	5
Insurance	3
Financial Literacy	3
College Planning	2
Sociology or psychology of financial planning	2
Tax	1
Employee Benefit	1
Small Business	1
Bankruptcy	1
Total	**211**

Table 2. *Financial Counseling and Planning* (1995-2005) articles by topic

Topic	Number of Articles
Retirement	28
Investment	18
Credit and Debt	18
Financial behavior	17
Financial Planning Education	14
Cash Management (banking, Saving, Cash flow, Emergency Fund)	13
Financial Wellbeing	12
Risk Tolerance	10
Consumer Decision Making	8
Mortgage and Real Estate	5
Financial Counseling	5
Insurance	4
Human Capital	4
Financial Planning	3
Small Business	3
Survey	3
College Planning	2
Financial Planning Industry/Profession	2
Financial Literacy	2
Employee Benefit	1
Total	**172**

For the *Journal of Consumer Affairs*, the review included articles for the past 6 years (1999-2005). Out of 109 total research articles, only 35 (32%) manuscripts directly focused on financial planning issues. As shown in Table 3, the most frequently published topic was credit card issues. As an outlet that promotes consumer interests (including consumer protection), the

manuscripts for this journal discuss issues related to consumer education and specific population (e.g., college students credit card practices).

Table 3 *Journal of Consumer Affairs* (1999-2005) article by topic

Topic	Number of Articles
Credit Card	7
Personal Finance Education	5
Investment and Wealth	4
Savings and Budgeting	3
Retirement	3
Health Care	3
Home Buying	1
Debt Management	1
Total	**35 (109)**

The *Journal of Personal Finances* is in its beginning stage in the field. Even though it has four years of history, this journal has received some attention from the professionals and researchers. As shown in table 4, this journal published various topics in core financial planning. The journal had a special issue on risk tolerance and is noticed with the largest number of manuscripts in risk tolerance topic.

Discussion

From the overview of the manuscripts' topics in the journals in financial planning field, several insights were drawn: (1) manuscripts in investment area are dominant; (2) retirement issue has shown its significance; (3) as a specific topic, risk tolerance has captured researchers'

attention; (4) theoretical advancement is necessary; and (5) methodological challenges remain. I like to discuss theses points one by one below.

Table 4 *Journal of Personal Finance* (2002-2005) articles by topic

Topic	Number of Articles
Risk Tolerance	9
Investment	7
Financial Planning Education	7
Retirement	6
Insurance	2
Financial Wellbeing	2
Financial Planning Theory	1
Financial Counseling	1
Total	**35**

Outnumbered Publication in Investment Topic

As shown in the previous section, investment topic has been most frequently published in financial planning journals. There are several possible answers to this phenomenon. First, investment area itself is very diverse and extensive. It encompasses specific investment vehicles (e.g., stock, bond, options, future, and mutual funds), investment strategies, asset allocation, and different investment theories. Second, there are relatively more available datasets in investment area. Some areas in financial planning require micro level (household, family, or individual) data with psychological and behavioral questions and sometime these types of data are only available through primary data gathering process. Third, it is possible that there are more researchers examine investment topic than any other areas of personal financial planning.

Significance of Retirement Topic

Retirement issue has been in the nexus of financial planning in the US for the past couple of decades. This year the first baby boomers have started to turn age 60. As the society gets older, the phenomenon and characteristics of retirement confront a huge change. Retirement is no longer the end of working age, it is another beginning. As longevity increases, retirement period is getting longer. Therefore, planning for retirement is one of the financial planning necessity and focal point for the most US households. The pure meaning and scope of social supports for retirees are changing also. Many people anticipate pessimistic future of the Social Security system.

Specific issues in retirement research include: baby boomer and their characteristics, baby boomer's retirement planning, baby boomers special needs for retirement, diminishing defined benefit issue, increasing significance and specific strategies for defined contribution, investment choices for retirement planning, comparison of various Individual Retirement Accounts (IRAs) (e.g., IRA, Roth IRA, Non-deductible IRA, educational IRA, etc), retirement planning behavior, savings behavior relating to retirement planning, attitudes for retirement, meaning of retirement, various investment strategies comparisons, retirement confidence, asset and retirement decision, targeted retirement age, retirement needs analysis, activity in retirement, and issues with Social Security.

Providing a slightly different perspective, retirement research key words include the following: age, retirement needs, saving/dissaving during retirement, effect of changing jobs on pension, retirement expenses, retirement income, long-term care, retirement planning, retirement savings, retirement wealth adequacy, retirement and college cost, and retirement and employees.

Risk Tolerance Popularity

The significance of risk tolerance has been reconfirmed during the past 10 years in research and practice. Risk tolerance is generally defined as a person's willingness to take financial loss due to the uncertain market situation. In practice as a mandatory part of fiduciary responsibility, planners and financial professionals are encouraged to gauge individual investor's risk tolerance.

In research, one of the issues in risk tolerance is its measurement. Measuring risk tolerance is difficult. As a psychological trait, risk tolerance is not only stable but also variable. It is relatively consistent as an individual attitudinal trait however; it is influenced by environmental situation (e.g., stock market index, economic shock, life cycle changes) thus variable over time. In the measurement issues, the type and number of questions that possibly gauge individual financial risk tolerance has been one of the main research topics. Some researchers used single item measurement (e.g., Survey of Consumer Finances has one question that represents individual investor's risk tolerance), while some researchers developed multiple-item measurement (e.g., Grable & Lytton, 1999). In industry, risk tolerance has been measured with firm specific questions and there are companies that specialize in risk profiling (e.g., Finametrica in Australia).

Another issue in risk tolerance measurement includes its joint trait. As a household member, individual's risk tolerance, sometimes, is influenced by his/her spouse's risk tolerance (Gilliam & Bagwell, 2005; Roszkowski, Delaney, & Cordell, 2004). Risk tolerance is also gauged indirectly by objective financial portfolio. Some researchers (e.g., Chang, DeVaney & Chiremba, 2004; Hanna & Chen, 1997) used the ratio of equity to overall financial asset as a proxy for risk tolerance. Researchers and practitioners also used rule of thumb heuristics as

proxies for risk tolerance. For example, gender (women have lower levels of risk tolerance than men), age (older people have lower risk tolerance than men), income (lower income people have lower levels of risk tolerance than upper level income people), and education have been used in various research.

Risk tolerance research also includes identifying the factors affecting risk tolerance. As explained above, demographic factors have been used as proxies for risk tolerance and researchers have studied these factors in various points of view. Researchers studies psychological and emotional variables as well as demographic and socioeconomic variables. One recent study hypothesized possible relationship between risk tolerance and other psychological traits of sensation seeking, type A personality, and locus of control (Grable & Joo, 2004).

Theoretical background of risk tolerance is also worth mentioning. Risk tolerance research includes two distinctly different perspectives. Some includes behavioral finance frameworks, such as prospect theory or regret theory, which assumes not so rational human behaviors. Others utilize expected utility theory with rational human behavior.

The Necessity of Theoretical Advancement

In financial planning research, unique theoretical background is not yet established. This is one of the challenges for building financial planning as an independent academic field. Financial planning researchers used macro, micro, family, consumer, and consumption economics theories, such as utility theory, cost-benefit analysis, life cycle theory, systems theory, theory of aging, human capital theory, and other income theories. Researchers also used finance theory such as mean-variance theory and Sharpe analyses. Marketing theory (such as theory of

learned behavior) and education theory (e.g., cognitive development theory) are also used in financial planning research.

Life cycle theory (as proposed by Modigliani and Brumberg in 1954 and developed by Ando and Modigliani in 1963) and is one of the most utilized theories in financial planning research especially in research focused on consumer behavior such as savings or retirement planning. Life cycle theory sometimes has been used in risk tolerance and investment research.

One recent development in financial planning research is the adaptation of sociology and psychology theories. For example one study in *Financial Services Review* discussed sociological meaning of "time" (Poole, 2000) and another study explained sociology of personal finances focusing on the meaning of money, rationality, and characteristics of money (Robinson & McGown, 1998).

Methodological Challenges

Data availability and methodological challenges are another issue that is present in financial planning research. While there are abundant data in some areas of financial planning topics (e.g., industry data in investment and insurance), psychological or behavioral data are hard to gather due to time and money constraints. As mentioned earlier, investment related data are available through private company, government agencies, and research generating firms. However, usually psychological and behavioral variables are not included in finance-based investment data. For examples, despite its significance and popularity of risk tolerance, due to the difficulty of data gathering, risk tolerance is not part of investment data. Another aspect that is specific to investment data is that generally these data is gathered at macro level. Therefore, individual or household level questions are hard to be included in the data gathering process. The

most comprehensive thus frequently used household level data is the Federal Reserve Board's Survey of Consumer Finances.

In terms of methodology, several advancements are noticeable. Even though the development of Monte Carlo analysis was started in 1950s, in financial planning research, it has been widely used in the past 10 years. Its easy to understand output is one of the factors that made Monte Carlo simulation's wide usages in financial planning research.

More recently, non-parametric analyses (especially with classification tree methodology) were used in financial planning research. Classification tree methodology has been used in some of the financial planning industry (e.g., insurance and credit industry have used classification tree to segment their clients), its academic utilization in financial planning research has been relatively limited.

Several Examples of Hot Topic Research

So far, I briefly reviewed financial planning research for the past 11 years and discussed specific insights from the review. In this section, as a showcase of financial planning research, I like to present several examples of research in hot topics.

Investment: Multiple Horizon Asset Allocation Approach

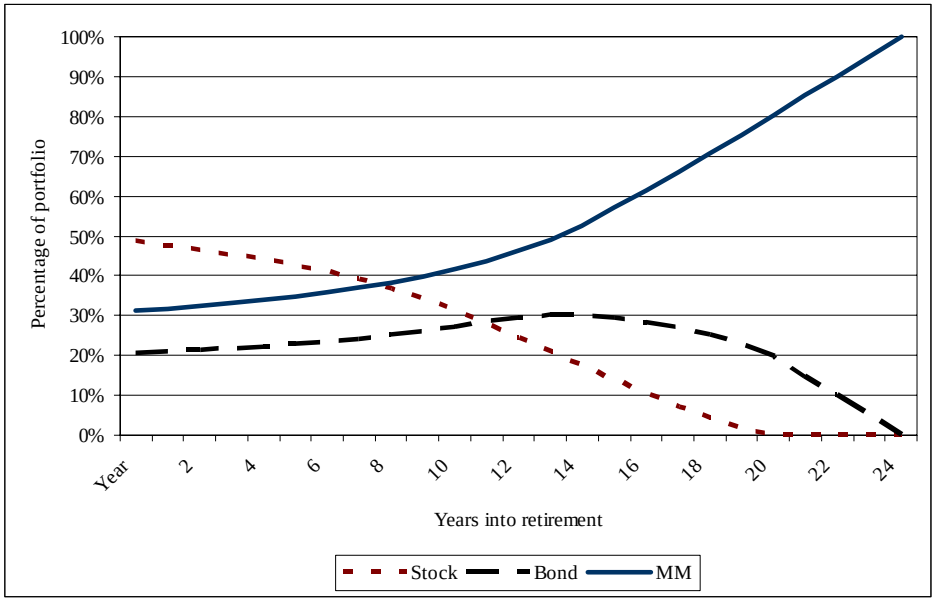
Recently, Zhu, Cordell, & Joo (in press) introduced multiple horizon asset allocation (MHAA) approach in investment. Originally, the concept is introduced by Cordell (2005). Zhu and her associates summarized that in practice asset allocation (especially retirement asset allocation) does not based on sound scientific theory. Practitioners often use rules of thumb in formulating asset allocation or even ignore the needs for long-term retirement planning and

annual capital withdrawals. Those rules of thumb include 100 minus age strategy or 1/n strategy. The 100-age strategy suggests that individuals invest 100-age percentage of portfolio in stock (equity). The 1/n simply means that individuals spread their asset into n different investment category by 1/n amount. By using such simplistic rules to manage investors' retirement portfolios, practitioners simplify the decision making process but often produce sub-optimal portfolio outcomes due to ignorance of individualities of clients.

To accommodate lack of theoretical background, Zhu (in press) reviewed retirement planning and investment, short-term investment versus long-term investment, financial risk tolerance, human capital, life cycle investment, and life expectancy to develop theoretical background of MHAA. One of the key strengths of MHAA is that it considers individual's risk tolerance level and life expectancy.

Simply, MHAA basic concept is that investors are facing the periodic maturity of numerous portfolios with different investment horizons. For example for a 64-year-old person (one year from retirement), if this person's life expectancy is 25 years, planners will hypothetically need 25 different portfolios (with different investment horizons) due to the different withdrawal needs for each year (i.e., the first portfolio will withdraw the annual retirement need in the beginning of year 1 (at age of retirement); the second portfolio will withdraw the annualized retirement need in the beginning of year 2; and so on). Therefore, each portfolio is consisted with different emphasis in liquidity.

Zhu and her associates specified MHAA concept with mathematical expression and developed asset allocation strategies using spreadsheet analyses for different level of risk tolerance. For example the following table shows asset allocation strategy for an investor with moderate risk tolerance.



Source: (Zhu, Cordell, & Joo (in press)).

However, to be practically feasible, MHAA approach requires development of an advanced rebalancing software and one of the weaknesses is the high transaction costs for each portfolio management.

Risk Tolerance: Introduction of Psychological Variables

As explained above, identifying risk tolerance factors is not easy. One recent study by Grable and Joo (2004) categorized risk tolerance factors into socioeconomic and psychological domains and examined possible significant relationships between and among the variables. One notable contribution of their research is the examination of psychological factors in risk tolerance.

What accounts for an individual's choice of action when faced with a risky financial situation? They summarized that a person's biological makeup, demographic and socioeconomic

profile, and psychological factors are of primary importance when answering this question. Among psychological factors, some examples of risk tolerance factors include personality (e.g., Type A characteristics have been found to be associated with the need to maximize achievement and the desire to take extended personal risks) and birth order (the firstborn and the only child tend to be less willing to take risks than later born children in the family). Risk tolerance research is multidisciplinary. Grable and Joo (2004) suggested that future research devoted to the investigation of the effects of factors related to risk tolerance should use a combination of demographic, socioeconomic, social development, psychosocial, and family situation factors.

In their study, Grable and Joo (2004) analyzed a survey with two universities' employees. Among the socioeconomic (age, education, gender, marital status, financial satisfaction, net worth, home ownership, household income, race/ethnicity, and financial knowledge) and psychological variables (birth order, self-esteem, type A personality, and sensation seeking), their analyses found education, marital status, net worth, household income, financial knowledge, and self-esteem to be significant factors related to financial risk tolerance. Specifically, those who had a bachelor's degree and higher level of education, compared to the lower education group, and those who had a higher level of net worth, household income, financial knowledge, and self-esteem showed higher levels of financial risk tolerance. Married respondents tended to exhibit lower levels of financial risk tolerance.

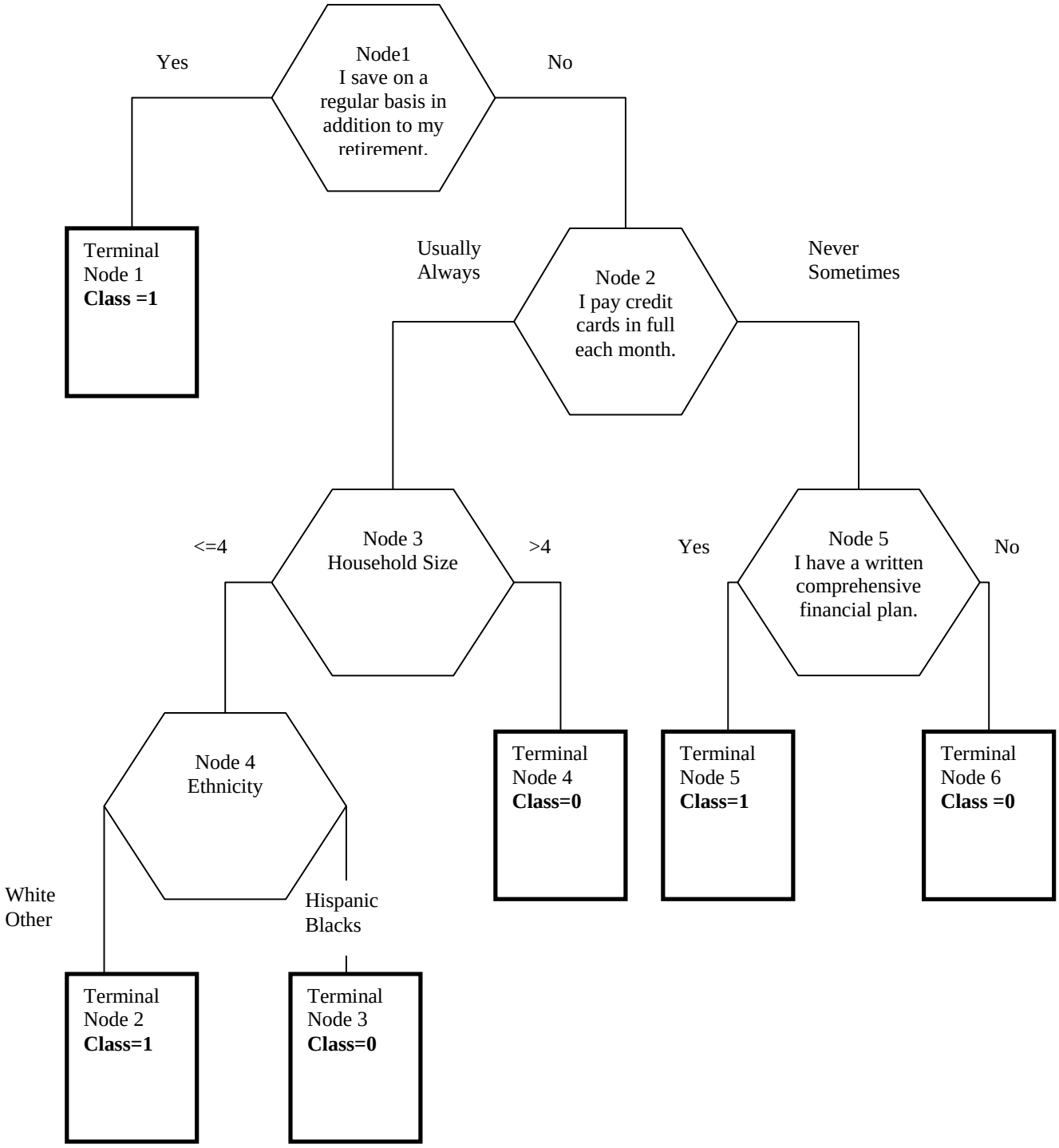
Although there appears to show supports for the relationships between and among socioeconomic and psychological factors and risk tolerance, much research is still needed clarify these relationships.

Classification Tree for an Emergency Fund Adequacy

In this section, I like to introduce a study that utilized different analytical tool. A study by Joo and Grable (in press) used classification tree to study emergency fund adequacy. Their findings have several implications for financial professionals, researchers, and policy makers. First, the classification tree methodology gives an easy to understand outcome to financial consultants. Using classification tree findings, financial consultants can segment their clients into profile groups. By segmenting clients, professionals can develop targeted strategies designed to improve their clients' financial wellness. Second, through the use of classification tree analyses in personal finance research, researchers can examine more complicated data without restrictions on variable distribution. Third, policy makers will appreciate the classification tree methodology because of its prescriptive categorization ability, which can lead to ways to improve family well-being.

Classification tree analysis is a nonparametric method. It does not require any model or functional forms of relationships. Classification tree consist of a root node, internal nodes, and terminal nodes. Except the terminal nodes, all nodes have two daughter nodes. Classification tree have been used as a data mining technique.

Joo and Grable (in press) used CART® software by Salford Systems. The use of classification tree is the easiest to be presented with a tree output. The following figure is an output of Joo and Grable (in press) study.



Note: Class = 0 (those who do not meet the three month guideline) Class= 1 (those who meet the rule)

Concluding Remarks

The needs for financial planning and its research are greater now than any other time in the past. As a process of helping people to reach their life goals, financial planning will be a key in personal finances in the future. As such, as an academic discipline, financial planning is emerging. In this review, I overviewed past 11 years of financial planning research in selected journals. This review exhibited several insights about the field. Significant topics and specific challenges have been identified. I believe the expansion of practical implications of financial planning research findings is the key responsibility of researchers in the field. The future of financial planning research should poster identification of the individual needs (hot issue) into practical applications for professionals.

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