
DETERMINANTS OF COMPENSATION FOR FINANCIAL PLANNERS

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ABSTRACT

Remuneration acts as an incentive. While it is the reward of undertaking current risk in the labor market, it incentivizes workers to higher productivity in the hopes of increasing future wages. Limited research exists regarding the determining factors of total annual compensation within the financial planning industry. This work examines the nature of factors of annual compensation gathered from survey research and their impact among financial planning professionals. Data for the study are from a survey instrument developed and administered in 2008. Findings of this study indicate that gender, having a Certified Financial Planner (CFP) designation, ownership in a financial planning firm, as well as individual planner perceptions of success and compensation are significant determinants of financial planner total annual compensation. **JEL Classification:** J31

INTRODUCTION

Financial reward is a fundamental component of the workplace. Compensation is not just payment for services rendered. Workers value the relative wage as they respond to the incentive function of compensation. A given dollar amount of remuneration may be satisfactory for living standards, but if it is below a competing worker's absolute amount, the total value of the remuneration decreases as perceived by the employee. He or she may view the lower relative amount as a signal to compete and will strive to increase productivity, and thus, future compensation. The employee could also view the wage difference as unfair and reduce productivity in response, believing the workplace does not appreciate current effort. Thus, perception of remuneration is an important component of career success. Employment within the financial planning industry is segmented. Professionals may work for financial planning firms, other types of financial institutions, or own their own firms. Educational differences also exist. Some professionals may have little to no college while other professionals have advanced degrees. While the CFP designation is

increasing in importance, it is not required to practice. Additionally, the CFP designation may not have much value for employees within large financial institutions who do not need an external verification quality. The fractured employment situation obfuscates the assessment of determinants of financial planner total annual compensation.

The existing empirical research investigating remuneration within financial planning is limited, has been open to definitional interpretation, and is without empirical regard. This empirical research is among the first to examine the importance of key determinant and their respective impact on total annual compensation of the individuals working as financial planners.

The organization of this study is divided into four sections. The first section provides an overview and background of the literature relevant to the study. The second section offers a discussion of the data and methodology utilized to conduct the study. The next section offers a discussion of the empirical results. The final section puts forth a summary and conclusion.

BACKGROUND

Social psychologist Fritz Heider developed attribution theory, a cognitive theory associated with success and interpersonal relationships. Attribution theory explores individual awareness of cause and effect scenarios and how the outcomes of such scenarios affect the individual's perception of usefulness. Heider proposed that people endeavor for prediction and understanding of daily events in order to give their lives stability and predictability (Heider, 1958).

Fullin and Mills (1995) apply attribution theory to sports, analyzing how athletes adjust performance output to awareness of cause and effect scenarios. External attribution assigns causality to an outside factor, such as to pay or promotion as in this study, or to competition in the sports analogy. Internal attribution assigns causality to factors such as independence or ability. Financial planners engage attribution theory when measuring and comparing themselves to others. After comparison, the individual may attribute the differences to internal or external deficiencies, to which the individual can adjust. Athletes can adjust ability, effort, and tasks. Like a football quarterback, the financial planner moderates the plays of financial life around the key planning areas, making strategic adjustments (Mittra, Potts, and LaBrecque, 2005).

General Career Success Dimensions

While defining career success can be nebulous, individuals with career and professional aspirations have an interest in the contributors to success and compensation (Hall, 1976, 2002). Hughes (1937, 1958) divided career success into objective and subjective characteristics. Objective elements are observable, measurable, and verifiable by a third party. Examples include pay, promotion, status, rank and affiliation. Subjective elements are an individual's responses to experiences within the career path. Examples include work/life balance, sense of meaning and purpose within the profession, personal growth, creativity, variety, and independence.

While objective criteria has dominated much of the overall career success literature, studies involving subjective criteria have increased as more people adopt and customize the criteria within career research. Heslin (2005) argues four inherent assumptions are prevalent in the current career success literature. First, objective outcomes (pay and/or promotions) stand as a measure of career success.

Second, job and career satisfaction provide reactive stimuli to individuals' chosen career paths. Third, people, in general, exhibit the same level of concern about success achieved by objective criteria; yet, do not exhibit the same level of concern regarding the subjective criteria. Fourth, a presumption exists that people evaluate their respective success relative to self-referent criteria and career aspirations.

Compensation and Perceptions of Success within Financial Planning

Early financial planning success studies focused more on objective elements, while research that is more recent includes subjective elements. In a study of 275 practicing CFP-designated professionals, Van Auken, Hira, and Norris (1989) find that CFPs working in larger population centers, offering a larger selection of products and services, and using a commission-based fee structure exhibit higher income levels. Gresham and Cooper (2001) suggest a grading system for assessing success with the main components of additional assets, referral business, and new business. The planner evaluates his or her success in the components versus client goals and expectations.

Levin (2001) includes subjective elements, measuring the success of financial planning against a client's long-term life plan. If wealth of client is a measure of success, Levin integrates all aspects of a client's resources with a focus on the financial, emotional, physical, and spiritual.

The Financial Planning Association 2001 compensation and staffing study finds that personnel management in financial advisory firms in the United States dramatically affects the success of the financial planning firm. The study reveals the importance of human resource factors in compensation, especially competitive pay (Tibergien & Palaveev, 2001). Peatey (2007) reiterates the importance of quality service and thus, quality of staff for success in financial planning.

Veres (2002, 2003) discusses the importance of time and time management as two of the most important components of financial planner success. Scholp (2004) examines career success planning by merging the objective criteria of monetary gain and recognition with subjective criteria such as work/life balance. Vance (2004) finds that trust building with the client and giving back to the community are important components to success. Evensky (2005) evaluates changes to the financial planning industry over the prior two decades. Instead of success measured by the planner's ability to outperform benchmarks, Evensky states that clients will judge future success by how well the planner meets the client's long-term planning goals.

Vessenes (2005) provides practice analysis with a quiz that planners can self-administer to see where they measure relative to peers defined as superstars or to planners commanding a gross annual income of one million dollars or more and serving an average of 350 clients. Success is with not just more clients, but closing more deals.

The College for Financial Planning's *Survey of Trends* (2007) found higher rates of CFP certification and job satisfaction among financial planners. Financial planners credited their communication and people skills, referrals, and the CFP designation as major factors affecting their individual success (O'Brien, 2007). Mahli (2005) relates success for independent planners to the basic marketing concepts of referrals, targeted emails and mailing campaigns, public relations initiatives, community functions, benchmarking data, and best practice profiles.

Hayden (2006) promotes creating customer loyalty and thus, renewal income, as a measure of success. A planner can create loyalty through repetition of quality service combined with high ethical standards. Drozdeck (2005) notes

the importance of increased proficiency in financial and psychological profiling and practice management while improving professional knowledge as fundamental to a successful practice. Gagne (2005) opines that understanding clients, obtaining a field of specialization, and maintaining currency in the field are essential to success. Gunz and Heslin (2005) present a search of practitioner literature in general terms yields literally thousands of manuscripts about career success.

While subjective elements are more prevalent in the research, basic success measurement is still objective, whether it is total pay, yearly additional pay, or total asset base. The subjective elements, broadly combined into client satisfaction, influence planner success through increased business and referrals but also internal elements of job satisfaction. A fundamental aspect of internal job satisfaction is relative value added to clients and not just absolute remuneration.

DATA AND METHODOLOGY

The data utilized within this study were gathered via a survey instrument developed and administered in an online format in 2008. Contact procedures for this Web survey followed a modified Dillman e-mail methodology consisting of pre-notice, survey invitation, thank you message, and reminder e-mails (Dillman, 2000). Participation in the survey was voluntary and participants had the option to withdraw at any time without penalty. Respondents choosing to participate in the survey were directed to a secure third-party instrument. The Web survey link ensures all respondent data were collected via two-way secure socket layer (SSL3) security protocols. At no time did the researchers have access to any identifying or highly sensitive respondent information in conjunction with the survey instrument. A total of 403 respondents (4% response rate) who are members of the FPA (Financial Planning Association) and agree to receive email from the organization answered the survey. This result is statistically representative of the FPA membership with a 5% margin of error at a 95% confidence interval. The final sample used, after significant non-response cases were eliminated, was 349 respondents (3.5%). All representative data were to reflect the information given by respondents practicing financial services consistent with the six-step financial planning process. Of those 403 respondents, 23 cases were deleted as respondents reported job or FPA membership tasks not related to the financial planning process. Further, of the remaining 380 respondent cases, 31 additional significant non-response cases were eliminated, providing 349 respondent cases for the final dataset.

The instrument utilized within this study comprised of 47 questions, ranging from demographic and compensation information to more qualitative data based on the preference for numerical information as in work from Viswanathan (1993) to need for emotion data based on the work of Raman, Chattopadhyay, and Hoyer (1995). The instrument was piloted tested by a group of 14 individualstwo weeks prior to survey launch. The purpose of this pilot test was to ensure the instrument functioned properly via the Internet.

The explicit empirical model employed to investigate the determinants of annual compensation for financial planners is specified as follows in equation 1:

$$(1) \text{COMP}_i = B_0 + B_1 \text{PSUCCESS}_i + B_2 \text{PCOMP}_i + B_3 \text{EDUC}_i + B_4 \text{CFPI}_i + B_5 \text{OWNER}_i + B_6 \text{SMALL}_i + B_7 \text{FEMALE}_i + B_8 \text{MINORITY}_i + u_i$$

Table 1 presents summary statistics for model variables. The dependent

variable COMP measures the annual compensation of financial planners participating in the survey. The average compensation level of the survey cohort is \$155,000 per year, which includes a minimum of \$42,000 and a maximum of \$635,000. The perceived level of success variable (PSUCCESS) measures the degree to which a person believes they have achieved success subject to a Likert scale ranging from a low of 1 to a high of 5. People that perceive themselves as successful are expected to earn higher annual compensation. The second dependent variable in the model (PCOMP) measures the cohort perception of the total annual compensation a successful financial planner should earn. The PCOMP variable for the survey cohort averages \$207,000 per year. The expectation is for perceived compensation associated with being a successful financial planner to have a positive correlation with actual annual compensation. The EDUC variable measures the numbers of years of education post high school achieved by financial planners in the survey cohort. The EDUC variable defines an associate degree as two years, bachelor degree as four years, master degree as six years, and doctorate degree as nine years of education. The average education in the sample is 4.92, which indicates that most survey respondents achieve at least a baccalaureate degree and a significant number pursue professional degrees.

The last five dependent variables in the model are categorical variables. The CFP variable captures the number of financial planners earning the Certified Financial Planner designation. Eighty-one percent of the survey cohort hold the CFP designation. The expectation is that earning the CFP designation will have a positive impact on annual compensation of financial planners. The OWNER variable measures the percent of financial planners that are owners or partners in a financial planning firm. The expectation is that financial planners that are owners will receive higher annual compensation. Fifty-eight percent of the survey cohort own or are partners in a financial planning firm. The model defines small firms (SMALL) as a company employing less than five financial planners. Twenty-eight percent of the financial planners in the survey work for a small firm. Finally, thirty percent of the financial planners in the study are female (FEMALE) and six percent are ethnic minorities (MINORITY). The expectation for the variables SMALL, FEMALE, and MINORITY are for all to have a negative impact on annual compensation given the hypothesis that small firms tend to manage fewer portfolios and females and minorities face some degree of customer discrimination within the profession.

RESULTS

Table 2 presents the estimated empirical relationship between the explanatory variables and annual compensation of financial planners. The ordinary least squares (OLS) model explains over 68 percent of the variance in annual compensation of financial planners. A model with logarithmic transformations of the dependent variable was considered but was not substantially different from the parsimonious OLS model. The alternate specification raised the R-square to over 70 percent but did not fundamentally change the significance or relative magnitude of any of the independent variables. All of the independent variables have a correlation less than .70, implying excessive multicollinearity is not a concern for the model specification. Five of the eight variables in the model are statistically significant.

The first two variables in the model are PCOMP and PSUCCESS, which measure the impact of perception as a factor that influences annual compensation level of financial planners, holding other variables constant. Both variables are have

a positive coefficient and are highly significant. Total annual compensation one thinks a successful financial planner should earn (PCOMP) is positive and is the most statistically significant variable within the regression model ($t = 8.794, p < .01$). The mean value of reported total annual compensation is approximately \$155,000, while the mean value of what the respondent thinks a successful financial planner should earn annually is approximately \$207,000. The gap between actual compensation and the amount identified as successful implies the typical financial planner does not view him or herself as a success. Nevertheless, the model includes a variable measuring perceived level of personal success (PSUCCESS), which has a positive and statistically significant impact on compensation ($t = 8.54, p < .01$). It is interesting to note financial planners appear to correlate perceived level of success to annual compensation, despite the observation that most financial planners believe success requires a compensation level that is significantly greater than their current level. It appears individuals who perceive themselves as moderately successful have not reached what they consider their full earnings potential. One possible interpretation is that the field of financial planning attracts goal-oriented individuals that seek continued financial improvement for their client, which normally yields higher earnings for the financial planner since most obtain part of their compensation from percentage-based asset management. This desire for continued improvement might lead to a gap between current compensation and the compensation level required to achieve self-perceived personal success. Heider (1958) observes individuals “strive for prediction and understanding of daily events in order to give their lives stability and predictability.” For financial planners, it is possible striving for the next level of compensation provides stability and predictability within their own lives. Consistent with success literature, the financial planner strives to attain maximum growth potential regarding decisions made on a client-by-client portfolio basis (Leyes, 2006).

The empirical model also includes the human capital variables measuring amount of college education obtained (EDUC) and earning a CFP designation. Surprisingly, the education variable has a negative coefficient. The result implies that higher levels of formal education have a negative impact on compensation. The empirical results imply every year of education lowers financial planner annual compensation by \$4,850. The anomaly of a negative coefficient on the EDUC variable is somewhat mitigated by the fact that the variable is not statistically significant and the CFP human capital variable has a positive coefficient and is highly significant. For the individual who completes the CFP designation, the return with respect to compensation is approximately \$29,850. The combined results indicate the return to financial planners from formal training toward earning the CFP designation is much greater than seeking advanced college training.

Survey results indicate that owning or being a partner of a financial planning firm has a positive and statistically significant impact on compensation. The OWNER coefficient implies being an owner or partner adds approximately \$29,000 in additional compensation for financial planners, holding all other factors in the model constant. In contrast, a financial planner working for a small firm of five or fewer planners will tend to earn less annual compensation relative to working for a large firm, although the result is not statistically significant. Holding other factors constant, compensation from working for a small firm is approximately \$11,000 a year less than working for a larger firm. One explanation for the result is that smaller firms are more likely to have problems achieving economies of scale with respect to marketing, information, and other support services.

The last two variables in the model are the demographic variables FEMALE and MINORITY. Empirical results from the model indicate the FEMALE variable has a negative and statistically coefficient. Specifically, female financial planners earn approximately \$17,000 less than their male counterparts. Although changing, men dominate the financial planning industry by a rate exceeding two to one. The male domination of the profession appears to impact compensation by gender. One possible explanation is that customer discrimination is the sources of the male compensation premium, assuming a large percentage of wealthy clients prefer to have a male serve as their financial planner. Another possible explanation is that a woman moving into the financial planning industry is a relatively new phenomenon, and the average experience of the male professionals is significantly greater. A limitation of the model is that it does not control for professional experience. MINORITY is the final variable in the model, which has a positive coefficient in magnitude of approximately \$8,000 per year associated with the attribute. The survey cohort characterized as an ethnic minority is only six percent. Despite the modest number of minorities in the sample, minority financial planners earn a small premium, although the result is not statistically significant.

CONCLUSION

This study investigates the determinants of annual compensation for financial planners. The research sample consists of 349 financial planners responding to an online survey sent to the membership of the Financial Planning Association in 2007. Perception of personal success, perception of the total annual compensation a successful financial planner should earn, holding the designation of being a Certified Financial Planner (CFP), and being an owner or partner of a financial firm are positive and statistically significant determinants of annual compensation of financial planners. The positive and significant variables lead to an overall conclusion that a positive perception of success, high expectations relating to financial success, professional certification, and a willingness to be a leader via owner or partnership are keys to financial success in the financial planning industry. The CFP designation and ownership traits are of particular importance, which are both associated with close to \$30,000 a year in additional compensation.

The only variable with a negative and statistically significant result relates to the trait of being female. Holding other factors such as education and CFP designation constant, the trait of being a woman is associated with a compensation penalty of approximately \$17,000 per year. The male compensation premium might provide evidence for the existence of customer discrimination in the financial planning industry. Alternatively, the model does not control for years of professional experience, which might also explain the male compensation premium. Working for a small financial planning firm, amount of college education, and minority classification are not statistically significant determinants of financial planner compensation for the survey cohort.

Avenues for future related research include investigating the preference for numerical information and need for emotion within financial planning, financial planner behavior impact on success in financial planning, customer selection of a financial planner, and customer perceptions of a successful financial planner.

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Table 1
Summary Statistics for Annual Compensation of Financial Planners

Variables	Minimum	Maximum	Mean	Standard Deviation
COMP	42,000	635,000	155,101	87,112
PSUCCESS	1	5	3.91	0.915
PCOMP	50,000	500,000	207,042	71,033
EDUC	0	9	4.92	1.84
CFP	0	1	.810	0.394
OWNER	0	1	.580	0.497
SMALL	0	1	.281	0.450
FEMALE	0	1	.302	0.460
MINORITY	0	1	.061	0.240

Table 2
Determinants of Annual Compensation of Financial Planners

Variables	Coefficient	t-statistics
Intercept	4,800.096	0.824
PSUCCESS	3,940.788	8.546*
PCOMP	0.471	8.794*
EDUC	-4,850.097	-1.507
CFP	29,850.593	2.818*
OWNER	29,003.592	2.471*
SMALL	-11,080.299	-1.126
FEMALE	-17,010.342	-1.99*
MINORITY	8,108.023	1.05

*Notes: R-square = .6808, n = 349, F = 29.38, and *p<.05.*