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Understanding change in retirement income planning

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As the retirement income industry continues on its evolutionary path from customers accepting probabilistic accumulation strategies to expecting reliable income streams, a new set of questions emerge from many points of view.

Some of the current questions whirling across the industry include:

- What is the scope and magnitude of retirees' need to dip into their savings in order to supplement or maintain their retirement incomes?
- Will intermediary-based (advisor) distribution meet the demand adequately, given expectations of declining advisor ranks and an increasing customer base?
- What can advisors do to improve communications and prepare for the transition?
- What third-party enabling developments must gain acceptance before the new retirement income solutions can emerge?
- Will structured products be the new winners and become to mutual funds what mutual fund became to pre-401(k) insurance products?
- What are the implications for the financial industry if key aspects of the retirement income business are governed by the economics of information technologies and subject to annual price-performance doubling laws?

While there are no clear cut answers to these questions, it is important that the industry players have a common view of the broader context. That view starts with a shared understanding of how change happens in business with the goal of using an explicit model to help find the answers to these burning questions.

After all, evolutionary change as a model has great explanatory value for business and industry development. Products and companies are born within any dynamic business environment. Many fall by the wayside early on and a few thrive. Eventually those early winners also fail and are replaced by others that ultimately succeed above all. The fall of GM and the rise of Toyota come to mind when looking at the car industry, for example.

THE CHANGE MODEL

The retirement income industry is being propelled by the grassroots change caused by the demographics and demands of the Baby Boomers. For our purposes let's focus on the following three-step evolutionary change process:

Differentiation
Selection
Amplification

Differentiation is the first step where many solutions appear in close time proximity to respond to exploitable changes in demand. Who the winners will ultimately be is far from obvious during this period. For instance, it was not easy to find the early winners when we moved from horse and buggy riding to car driving. This was true at many levels of observation. Early automotive power technology included steam, electric, diesel, and gasoline. There were scores of car companies, and Henry Ford failed before he succeeded. As a result, placing the right bet on the winning technology, let alone the winning competitor, is not obvious in the differentiation phase.

Following the initial differentiation bloom, the market begins to select the winners. We no longer use horses for daily transportation. We no longer see steam-powered cars. Electric-powered cars may or may not become the next generation of transportation, but certainly they were not the winners at the outset.

Once the market selects a winner or winners, these companies "take all" in that their success is amplified in both growth and profitability. The amplification continues until success reaches a limit. This is a lesson that we saw in real-time during the Internet boom. We still see it today, for example, when you consider a company like Google with its amazing growth and image in the marketplace.

OBSERVATIONS FOR THE RETIREMENT INCOME INDUSTRY

Where is the retirement income industry in this model for change? I would suggest that it is in the early stages of rapid differentiation. While it is dangerous to confuse metaphor with actual observation, it is time to ask: where are our horses, steam, electrical, diesel and gasoline powered offerings? Where are our Henry Fords? Today's financial companies are struggling to develop new products and innovative processes that will meet the varying demands of the retirement income market place.

Interestingly, we will most likely not anticipate it correctly until after the market selection has become clear for all to see. Haven't we seen our share of innovations that did not work because our view of reality was not the choice of the market? Who bought Betamax because it was the better technology over VHS?

While this change process unfolds over time, many who need to give investment and retirement income advice to consumers feel that they are sitting "between chairs". The old accumulation products no longer look adequate, and the retirement income products designed for today's and tomorrow's retirees have not yet appeared. The answers are not known, but we can take comfort in the following observations:

This cycle of change was started by the demographics of investing Baby Boomers. These changes are a grassroots, bottom-up movement that the industry cannot stop, but must embrace as the major opportunity it represents.

It is too early to pick winners as the market has not spoken. It may be that a large number of differentiated innovations have yet to come to market. These are frustrating times for advisors and financial companies alike. What are the right questions to ask to avoid leading ourselves and our investors towards complicated dead-ends?

It may take several years for the differentiation and market selection phases to play out. Surprises should be expected once things get rolling because change is non-linear. Nothing seems to happen for a long time. Then, all the sudden, a new, promising manufacturing and distribution business model emerges.

WHAT CAN WE DO NOW?

A good answer to difficult questions always seems to be: "It depends."

Indeed what we can do depends in large measure on the characteristics of the specific market segments being served. If the target market is the top-end of the high net-worth segment, much of the retirement income discussion is irrelevant. The clients' assets are many times higher than their annual expenditures. Accumulation focused and efficient asset diversification advice continues to makes a lot of sense for many, if not most, of them. Legacy issues are their next significant concern.

The true challenge and opportunity lie with customers in the affluent and the mass markets. The retirement income discussion becomes increasingly relevant. This is where the industry must meetneeds of client cohorts that cannot wait until the retirement income winners become clear.

To hasten the rate of change and ultimately the development of winning products, companies and processes, our industry can focus on a number of things.

The first is to conduct the research, across silos, to better understand the consumer and gain the knowledge necessary to create the blue prints for new products and processes designed specifically for retirement income.

The second is to drastically improve communications with consumers about retirement income strategies and the workings of financial products.

The third is to develop the training and education that will help advisors, those who are on the retirement income frontline with investors, better work with retirees to create their own financial security.

Lastly, our industry needs to keep the dialogue among manufacturers, distributors, researchers, and academia, open and constructive as we continue to travel through the current phase of differentiation.▲