The charmed generation becomes generation broke

By DICK STROUD

The way pensions have historically been funded is a central factor in creating a prosperous financial future for today's 60plus generation. But future pension funding together with significant social and economic changes is creating a generation who will be relatively poor in retirement by comparison. Dick Stroud spells out the bad news for marketers

PENSIONS ARE A bit like root canal fillings: not something you want to think about unless absolutely necessary. That time has come. Who pays for pensions and who receives them affects the level and profile of consumer expenditure. And that's something which marketers cannot ignore.

The issues impacting pensions are simple and obvious. We are living longer, having fewer children and not saving enough. It doesn't take a genius to deduce that fewer people working will have to support increasing numbers of older people. The term 'support' doesn't just mean paying pensions; it also includes providing health and residential care. This situation is not good, but it is only the start of the bad news.

Today's pension position is pretty grim, with 50% of older people having such low incomes that they are entitled to additional hand-outs from the state. If we look forward to 10 years' time then today's pensioners will appear wealthy. The picture in 30–40 years' time is too horrible to consider.

There are no easy choices. It either means working longer, saving more money, starting to save money at an earlier age, paying more tax or, most likely, a combination of all four remedies. The *Financial Times*, not known for hyperbole, said: 'The traditional British penchant for muddling through has bequeathed a system that is incomprehensible, inequitable and inadequate.'

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The Charmed Generation

In the UK, part of the group of people who are retired and who will retire in the next five to ten years have a level of wealth and income that is unlikely to be repeated in future generations. They are the Charmed Generation and represent a business opportunity that, once gone, is unlikely to be repeated.

The reason for their good fortune is explained by the 4Ps: pensions, property, parents and prudence. Not to be confused with marketing's 4Ps!

Pensions

Many people of this generation receive, or will receive, a defined benefit pension. This scheme pays the highest level of guaranteed income, relative to the person's salary of any type of pension. It is unaffected by changes to the stock, bond, currency or any other market. Its recipients receive a guaranteed level of income for the rest of their lives.

In the UK's commercial sector, the number of active members of these schemes has fallen by 60% since 1995, by 50% since 2000, and could fall by a further 10–20% in the future. This generous form of pension provision is fast disappearing.

So, unless there is a drastic change in pension law, the era of receiving a guaranteed level of pension from an employer is over.

Government employees are the only group of employees who are guaranteed a defined benefit pension. The cost of meeting pension commitments for civil servants, teachers, NHS employees and the emergency services has risen so quickly that it now dwarfs the level of public-sector debt. The unfunded public-sector pension liabilities reached £690 billion in March 2005. The size of this figure is staggering, as is the problem it presents to the government.

If you don't work for the state then you could be required to spend a sizeable amount of money – maybe as much as 25% – on funding not only your pension but those of older people and public-sector employees.

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Money that is funding a pension is not being used for consumer spending.

Property

In the UK, the proportion of people under 45 years old owning their own property has declined since 2001. If you are 30 or younger you are less likely to own a property now than people of the same age group 20 years ago.

The barrier to becoming a home owner is the relatively high cost of property. If you were buying a house between 1960 and 1970 it would cost you three times your annual earnings. Today it is exactly six times.

In 1994, three in every five first-time buyers came from the 18–30 age group. In the last 10 years property prices have trebled and now only two in every five first-time buyers are of this age.

These facts mean that much of the UK's property assets are owned by people over 45 and that the financial barriers for future generations to join the ranks of property owners will keep rising. Saving for a deposit and paying the mortgage consumes a large chunk of household's income.

Like paying for pensions, every pound spent on housing debt is not spent on consumption.

Parents

Another repercussion of the rapid rise in property prices is inherited wealth that the over-50s are receiving on the death of their parents. Few older people have used the equity in their property to fund their retirement, which means that most of the property value is passed on to their children as an inheritance.

Today's 50 year olds need to fund, on average, 20 to 30 years of post-retirement life. Releasing equity (wealth) from the value of the home, will become an important way this is achieved.

Already a fifth of people, moving between owned properties on which there is no mortgage, say they want a

cheaper house. This is a euphemism for saying they want to release some of their property value into cash.

Nearly 40% of people in the UK, aged between 51 and 60, who have a pension, believe the equity in their home will be part of their retirement assets.

The outcome of the over-50s' dependence on property wealth has a worrying implication for their sons and daughters. Property wealth spent on funding mum and dad's retirement, will not be inherited. We have witnessed the birth of the SKI phenomenon – spending the kids' inheritance.

In truth, nobody knows how much of retired people's housing equity will find its way back to their children or be consumed in funding retirement; what effect the reduction in the number of young people will have on housing prices, or what will happen when interest rates rise.

Where there is little doubt, however, is that converting the equity held in property into income will be a central issue in the pensions funding process.

Prudence

The UK's level of debts on credit cards, mortgages and loans has reached the gigantic figure of £1,004,290 million.

Very little of this vast mountain of debt resides with today's retired generation; they come from the pre-credit card era, when debt was something to avoid at all costs.

Things are different for younger people and those close to retirement. As the Director General of Age Concern said: 'Older people have historically been reluctant to get into debt but some of the next generation of pensioners appear to have quite different attitudes.' It appears that many 50 year olds are spending rather than saving. This change in behaviour is likely to affect intergenerational transfers of wealth as older people have to use their property value to repay debt.

The Charmed Generation benefited from good pensions, rocketing property assets and low debt. Furthermore they grew up during a period when the state paid for higher education, and when all but the very wealthy went to state-funded schools and used the free health service. Now the burden of paying for education and health is increasingly transferring from the state to the individual.

It is not surprising when you look at the wealth profile of the UK that so much of it is concentrated with those 50-plus. The children and grandchildren of this group are very unlikely to accumulate the same level of wealth.

The 50-plus cohort in a decade's time will almost certainly have a very different wealth profile. It will still contain its very rich and very poor but the group of people who benefited from the unique combinations of the 4Ps will be missing.

Charmed Generation		Generation Broke	
✔	Pension income	✘	Paying to fund pension
✔	Property equity	✘	Low growth in wages
✔	Low debt (beginning to change)	✘	Debt from funding education
✔	Accumulated savings/investments	✘	High housing debt repayments
✔	No need to fund long period of retirement	✘	Lower inter-generational wealth transfer
✔	Inter-generational transfer	✘	Likely tax increases to fund ageing population

Table 1: the factors affecting the spending power of the Charmed Generation and Generation Broke.

Generation Broke

The Charmed Generation has a mirror image. It is called 'Generation Broke'.

The name for this generation was coined by Demos, the New York public-policy group, which sees a future where: 'Younger Americans (18–34) face a "perfect storm" of debt, massive student loans, slow wage growth, underemployment and rising costs. People in this demographic, coveted by advertisers and marketers, are slipping into a downward debt spiral that is unmatched in modern history'.

Generation Broke is not just a US phenomenon. It is estimated that the average student in England and Wales now leaves higher education owing around £12,000, and this keeps increasing.

According to the Demos report, young adults, aged 25 to 34, are experiencing record levels of debt burden. The statistics are frightening. These young adults' average credit card debt increased by 55% between 1992 and 2001. Households in this age group, with credit card debt, spend nearly 24% of their income on debt repayments.

The 18–34-year-old age group has suffered from a combination of factors that results in its precarious financial position. Many of the costs associated with young adulthood have increased dramatically during the past 10 years. Housing costs have

risen by a significant amount when compared to salaries. Education costs that were once free are now an expensive entry into adulthood. Salary levels have been suppressed and many permanent jobs have been replaced with short-term contract employment.

To make matters worse, this generation has experienced the full might of credit card and retail store companies' marketing machines. There has never been an era when buying on credit has been so simple.

With all of these financial commitments it is not surprising that the one thing this age group is not doing is contributing enough to securing its pensions. In the UK, between 2002 and 2003, the number of under-35 year olds saving for pensions declined. This wasn't a tiny little drop but a huge fall: 13% of men and 12% of women in this age group dropped out of saving for a pension in a single year! During the same period the percentage of 45 to 64 year olds paying into a pension increased by around 7%.

Since 1997 an additional 1.7 million people have entered the UK workforce. But, during the same period, the number of people both working and contributing to a pension has not increased by one person.

It is plain that this situation cannot continue. Either through higher tax or enforced saving the 18–35s are going to have to pay a large chunk of their income into a pension.

This is bad news for marketing's favourite age segment. Every penny paid into a pension scheme or tax is a penny not spent on consumption.

Financial life is going to get bleaker for the 18–35-year-old cohort. They are going to have to fund their own retirement plus that of their mums, dads and grandparents. Marketers had better get used to the idea that this age group is going to get relatively poorer as it is forced to stop spending and start saving.

The marked difference in financial outlook of the two generations is shown in Table 1.

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A simple but profound message for marketers

There are five key insights for marketers to consider.

1. The concurrence of the 4Ps that created the Charmed Generation is not likely to be repeated for the foreseeable future. Future generations will contain such people but never so many as there are today. This group represent a 'one-time' opportunity for marketers.

2. The conclusion from analysing the 18–35-year-old age group is that their future is littered with financial commitments that will constrain their ability to consume.

3. These woes will not affect all members of this generation and there will remain an attractive subgroup worthy of marketing attention. But, at an aggregate level. you have to conclude that this age group's relative marketing attractiveness is declining.

4. The importance of translating property wealth into income is central to how many people will fund their retirement. During the next decade their will be a bonanza in the financial and support services associated with property equity release.

5. Finally, the way companies collect customer information must reflect the difference between the pre-retirement affluent, those with wealth derived from work income and the post-retirement affluent, those with income from pensions and property. In many cases the two groups will be the same, but this will not always be the case. Some customers' income will plunge when income stops and inadequate pensions start.

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