The Coming Demographic Transformation:
When is the World Series not the World Series?

"The Flop," "Fourth Street," and "The River."

"K," "Clean-up," and "Can of Corn."

Both sets of terms have to do with the World Series, but depending on your age, you will likely be far more familiar with one set than the other. Baseball was and probably still is the national pastime, but only those who watch regularly are versed in all of the nicknames for different aspects of the game. In fact, the World Series is probably the only exposure a majority of Americans have to baseball. Poker, and specifically the "World Series of Poker," has become a phenomenon. The terms used by aficionados of Texas Hold-em, the game played in the World Series, are just as unfamiliar to the casual observer as are baseball terms.

Why start an article about community banking with a digression on the World Series(es)? The reason is simple: the demographics of the United States are changing in ways that will make the market a lot different for banking services over the next ten years. For the last 50 years, marketing in the US has been pretty straightforward. Figure out the needs of the Baby Boom generation (or their parents) and prepare to satisfy them. First, we needed to build and finance houses in the suburbs along with cars to drive to and from work. This led to shopping malls and drive-through banking. Then we had the rise of fast food, followed by student loans, mutual funds, and now second homes and 401(k) plans. But as this "largest generation" follows the "greatest generation" into retirement, new business opportunities will migrate to younger generations. This article will explore the changing landscape and some of the issues implied by changes.

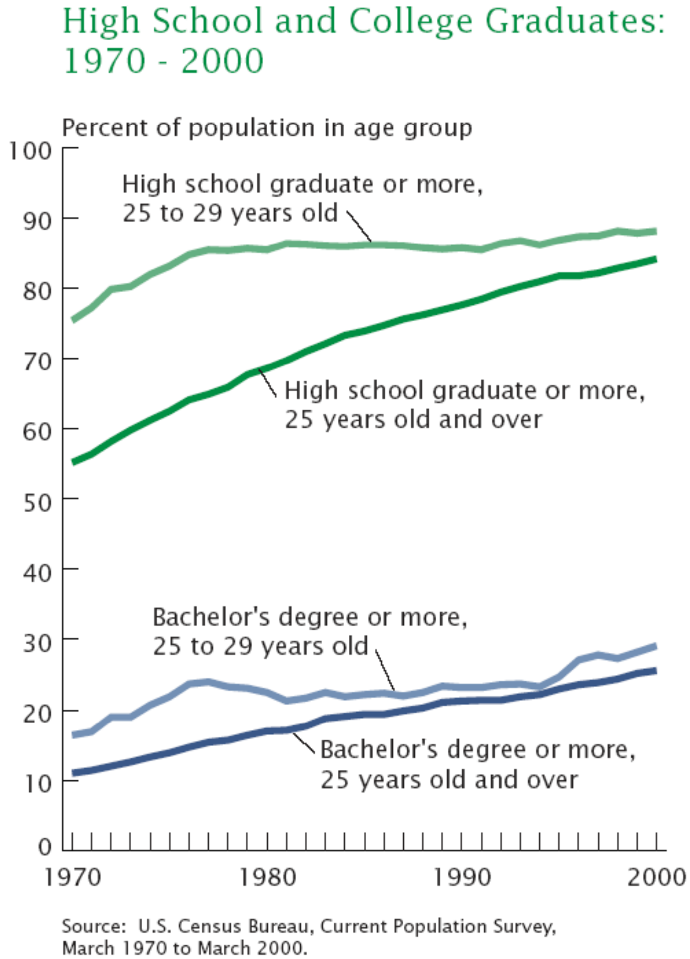
Demography is Destiny

The Baby Boom generation is generally defined as those born between 1946 and 1964. Live births increased from about 3 million per year at the beginning of the boom to over 4 million per year as it ended. The decade or so after the boom saw births fall back to below 3.5 million before they gradually rebounded to the 4 million level again in the early 1990s.

This profile means that although the fastest-growing group over the rest of the decade will be those 55 and over, there will be a dearth of individuals in the 35 to 45 age group (the so-called "Baby Bust." These offset the youngest of baby-boomers, causing the total 35 to 54-year olds to simply hold their own. This is a dramatic turnaround from the last ten years when the 35 to 54-year olds were the fastest growing group.

One other important demographic trend is the educational attainment of the population. The US is dependent on education to keep ahead of other economies and generate higher productivity. Note the following chart from the Census Bureau:

The Coming Demographic Transformation: When is the World Series not the World Series?



Customer Implications: Products and Delivery Channels

What sense can we make of these trends? First of all, those folks entering their retirement years will be looking for different financial services than they did when they were buying a car and a home. More sophisticated investment options along with a decreased appetite for debt is likely. Furthermore, second or retirement homes will become more important in the mix.

Just as importantly, regular residential real estate lending would be expected to slow as the population of 35 to 54-year olds levels off. This is the group that has had home equity to tap and the need to do so to pay for college expenses, etc. Given that almost all of the lending growth in banks over the past few years has been driven by this factor, it is an important change.

Some of the products for aging baby-boomers are obvious and have been zeroed in on by a wide range of financial service providers. In order to be credible in offering more sophisticated financial services, banks will have to offer more than just CDs. They will also need to present themselves as credible financial advisors rather than new account clerks. Whether this can be accomplished within the current branch and personnel footprint or whether a separate line of business is necessary is a key decision facing those who want to compete for this customer.

Let's not forget those now entering the labor force, however. Instead of a lack of twenty and thirty-somethings, the rest of the decade is destined to see growth in this group of new workers. In fact, the percentage of the labor force made up of workers younger than 35 is likely to bottom out in the high 30% range in the next few years. It will then start to grow. The last time this happened was in the early 1960s when the oldest of the baby-boomers entered the labor force. That led to a twenty-year period of younger workers before the percentage peaked in the early 1980s. Note that this was a time of both social upheaval and rising inflation. It also represented a period of dramatic financial innovation as mortgages, installment loans, and credit cards became ubiquitous. The last twenty years have marked a retreat from high inflation and a dramatic rise in productivity as the younger workers aged and pushed the percentage of those over 35 beyond 60% of the labor force.

What products will these younger workers want from their bank? First-time homebuyers have been less important in the last few years as trade-ups, refinances, home equity lines, and second homes dominated the growth of the residential real estate market. As retirees decide to vacate the northeast and move south and west, homes will become available for these younger workers. The trick will be to be able to provide financing. Retirement products are a long way off for these folks, but access to credit, even without hard collateral, will be primary. Can banks figure out ways to safely lend on the criteria of future earnings from higher educational attainment?

Delivery systems will need to evolve to address the needs of both the older baby-boomers and Gen X/Y workers. Neither group will be likely to rearrange their day to visit your branch, the former because they are on the beach 2000 miles away, and the latter because they grew up with 24/7 access to everything. Convenience will move away from close physical proximity to branch locations and toward easy access through multiple channels.

Check 21 is likely to hasten the move from physical payments (checks and cash) toward plastic and electronic options. Debit cards are already one of the fastest growing payments channels and stored value cards are quickly becoming the option of choice for merchant rebates. Students who use stored-value cards to buy food in their college cafeteria are going to view checks as more alien than plastic. How will banks capture the payments business of these customers?

<u>Where will my workers come from?</u>

There is currently a lot of hand-wringing over the lack of job growth in the American economy. However, the longer-term trends suggest that we may be facing a worker shortage. This is most apparent in the Social Security projections which suggest that the ratio of retirees to workers is destined to increase to unsustainable levels in the next thirty years. That timeframe is too long for us to discuss here, but over the next five years it is likely that the labor force growth from demographic changes will be practically nil. Of course, it is possible that 65-year olds will not retire on schedule, but failing that, the number of new entrants will only just match those leaving the labor force. That means it will be a seller's market for labor.

We can see this trend in the level of the unemployment rate. Recall that the unemployment rate topped out at a little less than 11% in the early 1980s just as the share of younger workers hit its peak. The early 1990s recession saw the unemployment rate at a bit les than 8% , and our most recent experience registered a high point of 6.5%. I don't think it is any coincidence that this is correlated with the least trained workers becoming a smaller percentage of the total. Now that total labor force growth will slow, it is reasonable to assume unemployment rates will stay in a lower range. This puts a premium on getting the right employees and keeping them motivated.

Another angle on this is to take the Wal-Mart route. They tend to use older part-time workers as greeters. This may be a possibility for banks, but the better upside would be to figure out how to use retirees for part-time positions of responsibility. They might also have excellent credibility with older customers looking for retirement products.

Wrap-up

The demographics of the US have been dominated by baby-boomers over the last 50 years. This is still likely to be true for the next few years, but the impact is going to wane as retirement takes hold. To add new customers and new employees, the focus needs to change to younger Americans, and not just five or ten years younger. The big change in the population profile is that the prime age group for banking products will not be the growth group but rather the slow growth group. The wave of the youngest Americans is the place where real growth in banking needs will happen.

One of the great things about this kind of analysis is that you can easily see it coming. The number of Americans entering different ages is known pretty closely many years into the future. The flip-side is that there is no excuse for not incorporating the data into your planning process.

Michael Jamesson heads Jamesson Associates, a consulting firm located in Scottsville, N. Y. that specializes in balance sheet management, merger and acquisition analysis, and strategic planning for community banks.