

Fooled by your 'friends'

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Do not get too friendly with your investment adviser. It lowers your guard and increases your risk of being deceived, warn BI researchers Harald Biong and Kenneth H. Wathne.

There are regular reports in the media about private individuals and organisations who feel they have been duped by deceitful salespersons when purchasing various types of financial products.

In many cases, the salespersons have represented reputable financial institutions. The customers often had a close and trusting [relationship](#) with a salesperson who called himself investment adviser or financial adviser.

Associate Professor Harald Biong and Professor Kenneth H. Wathne at BI Norwegian School of Management have studied this phenomenon in more detail, and looked into what happens when we feel we have been duped by our adviser "friends". The result of their study has been published in the Norwegian popular science magazine Magma.

Complicated products

A common feature of the cases that have come to the attention of the media is that they involve products so complicated the customers found them difficult to understand. This applies both to risks and the return potential.

"The seller knows more about the qualities of the product than the

buyer. In technical terms this is referred to as asymmetrical information between the seller and the buyer,” Biong and Wathne point out, both of BI Norwegian School of Management’s Marketing Department.

Not only are the products highly complex. They also have experience and/or credibility qualities which make it difficult for the buyer to assess the product qualities prior to purchase.

In some cases this can be a motivator for the seller to sell products he or she will make a profit from, but which are not necessarily the best option for the customer. In such a case, the seller acts opportunistically, i.e. he (or she) acts deceitfully vis-à-vis the customer in order to serve their own interests.

Performance-related pay results in more raw sales

Many financial institutions make use of provisions and other performance-related award schemes both at institution and individual levels. A bank will charge a certain percentage for handling a loan. Stockbrokers receive a commission in the form of a percentage of shares traded. Salespeople receive a share of the sales they generate. The more a salesperson sells, the more he will earn and the larger the employer’s turnover will be.

For services which also involve advice, such as financial products, the seller also has another employer, i.e. the customer.

The customer expects that the seller will provide advice on products that are in his or her best interest. The customer, however, is often not qualified to check whether the seller does in fact provide the right advice.

”If this is the case, performance-related pay will increase the risk of the

seller proposing solutions that are in the best interest of the seller, rather than the customer. Thus, the award system of the financial institution may promote deceitful behaviour, according to the market researchers.

In their BI Master of Science thesis (Kjenslie and Kringlebotten 2008), Celin Kjenslie and Inger Kringlebotten have examined companies' and municipalities' purchases of financial products.

They proved that performance-related pay for sellers of financial products increases the risk of them selling products whose promises cannot possibly be delivered and that result in more profit for the seller than the customer.

Keep your adviser at bay

In order for financial institutions to be able to sell complicated financial products, they need to establish good and trustful relationships with their customers. This is true for both personal and corporate customers.

This is also the reason why many financial institutions invite their customers to various social and relationship-building events. Biong and Wathne urge buyers to be on their guard.

More information: Biong, Harald og Wathne, Kenneth H.: Nlr "venne" lurer deg. Magma Issue No. 5-2009 (in Norwegian), published by Fagbokforlaget.

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