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Financial Advice Giving and Taking—Where are the Market's Self-healing Powers and a Functioning Legal Framework When We Need Them?

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Abstract German banks tend to emphasize how satisfied their clients are with the financial advice they offer. Empirical evidence, however, suggests that this satisfaction may have little to do with the quality of the information exchange between clients and advisors but rather with substitute factors like the friendliness and appearance of the advisor. Applying the theoretical perspectives of New Institutionalism and Behavioural Finance we explain in this article why the coexistence of information and interest asymmetry between retail clients and advisors must lead to poor advice quality and why the market's self-healing powers and the actual regulatory framework fail in preventing that. We support our theoretical analysis with some empirical evidence from a recent study we conducted to test the factual quality of the advice German banks give in the retail banking area. The results obtained are very consistent with previous findings of a poor level of quality of the information exchange between client and advisor and predominantly confirm our theoretical conclusions. We finally offer some suggestions that might pave the way out of this dilemma.

Keywords Financial advice · Behavioural economics · Service quality · Asymmetric information · Regulatory framework

Introduction

Although German banks tend to emphasize how satisfied their clients are with the financial advice they offer, empirical research suggests that financial advisors, particularly those employed at banks, are either hardly able or do not really want to keep the marketing

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promises of their employers. While they perform well in quality areas that have nothing to do with the quality of the actual advice (e.g., tangible environment, advisor's appearance, and friendliness), they perform particularly poor in exactly those areas which refer to the information exchange with their clients and therefore constitute the core quality of financial advice. Advisors do not only put insufficient efforts into collecting information about their clients, their situation, and needs, but they also fail in providing them with the relevant facts for their investment decision and in evaluating these facts considering their individual situation. Under these circumstances the lacking individuality of the recommendations based on these information collection and provision processes is no surprise (Hanke et al. 2006; Jungermann and Belting 2004; Kallhardt 1997; Kohlert 2009, pp. 295–361; Oehler and Kohlert 2008; Klöckner 2007; Mangels and Galle 1999; Rehkugler et al. 1993; Stiftung Warentest 2000; Stiftung Warentest 2005).

These findings are particularly alarming as the demand by German citizens for competent as well as comprehensive financial advice has grown strongly due to several fundamental changes in circumstances. Wealth and disposable income of German private households have advanced to new record heights[1] while an incisive make-up of the German social model has lead to severe changes of the social protection mechanisms and requires citizens to more and more autonomously cope with earnings, employment, and general life risks by themselves (Bundesregierung 2005, p. 254; Dollinger 2006, p. 7; Oehler and Kohlert 2008; Oehler and Wilhelm-Oehler 2008).[2] Moreover, financial services and products offered are permanently becoming more numerous and complex, just like the challenges for those who have to choose among them (Kohlert 2009, p. 1; Oehler and Kohlert 2008; Tilmes 2002, p. 2). The financial literacy of the German population, however, is in general very limited (Kohlert 2009, pp. 263–266; Leinert and Wagner 2004; Oehler and Kohlert 2008; Oehler 2006; Micklitz and Oehler 2007).

The discrepancy between the low-quality advice offered and high-quality advice demanded by German citizens underscores the importance of a thorough analysis of the advice giving and taking context. For much too long, however, neoclassical economic theories[3] have made not only scientific research but also regulators blind for the real problems inherent in the relationship between clients and advisors. Since the empirical findings suggest that not only the (obviously not) perfect market fails but also the legal framework (there actually are particular legal duties developed with the objective to prevent poor quality advice), an analytical foundation is needed that opens the black box of individual decision processes and explicitly considers the interests of individuals and institutions involved. If the assumptions about the market's powers as well as the legal requirements are out of touch with reality, they cannot achieve what they are supposed to.

New institutional economics—and within this framework especially information economics and principal-agent theory—and behavioural economics represent an ideal foundation for a holistic and thorough analysis of the advice giving and taking context.

[1] Financial assets available to private households have more than doubled from about EUR two trillion in 1990 to more than EUR 4.5 trillion. Including tangible assets, particularly real estate, total wealth in place surpasses EUR nine trillion. Due to a high savings ratio of about 10%, German citizens have of more than EUR 150 billion disposable income per year to invest (Deutsche Bundesbank 2007, pp. 24–25).

[2] This is due, for example, to cuts in social security contributions and benefit cuts in social insurance (e.g., the lowering of net pension levels).

[3] Under a neoclassical perspective individuals are perceived as rational decision makers who dispose of and process all relevant information. According to the expected utility theory, they distribute their resources including their human capital over their entire life span and react sensitively to external changes. Furthermore, since the market is assumed to be perfect, financial intermediaries and financial advice are irrelevant.

While information economics allows for concretely specifying the information asymmetries between clients and advisors and therefore for determining the degree of information asymmetry between the parties, principal-agent theory is very useful in more closely identifying eventual interest asymmetries between the parties and to demonstrate the negative consequences they might have for the clients.[4] Namely, not until the specific problems in the relationship between clients and advisors have been identified, can be evaluated if and why the market and the legal framework eventually fail under these conditions. Finally, behavioural economics allows for leaving the meta-level and gaining in-depth insight into the black box of financial advice giving and taking as perceived by the individual clients. It is based on the more realistic bounded rationality concept which emphasizes that individual decision-making is subject to restrictions firstly concerning the internal limitations of the mind and secondly concerning the structure of the external physical and social environment. Bounded rationality implies that the individual makes (sufficiently) good decisions with the externally available information structure (Oehler 2005, p. 36; Oehler and Werner 2008).

This article will be structured as follows: "Financial Advice as a Service Offered by Banks from the Perspective of Information Economics and Principal-Agent Theory" analyses the client–advisor relationship from a theoretical perspective of Information Economics and Principal-Agent Theory. "Why the Market and the Regulatory Framework Must Fail" explains why the market and the regulatory environment must fail under the given circumstances. "An In-depth View on the Process of Financial Advice Giving and Taking" provides an in-depth view of the advice giving process. "Empirical Evidence" presents empirical results that verify the theoretical findings. "Conclusion" concludes and offers concrete solutions.

Financial Advice as a Service Offered by Banks from the Perspective of Information Economics and Principal-Agent Theory

Information Asymmetry

From the perspective of information economics, financial advice (as a service offered by banks) has all the typical characteristics of credence goods. First, it is based solely on the advisor's promise to perform his service. How he performs his service, however, is therefore highly ambiguous for the client at the time he enters the corresponding contract.[5] Second, financial advice giving and taking is cognitively very demanding to the involved parties due to the multitude of factors an investment decision must be based on, and their strong interdependence. Finally, due to its decisive role for the development of a client's future situation and the necessity to closely cooperate with the client in developing recommendations, financial advice can also be considered of high value and highly specific (Kohlert 2009, p. 132).

[4] While information economics considers market uncertainties as unequal distribution of information among the market participants and focuses on the information flow during all contract phases (before and after a contract has been concluded), principal-agent theory more specifically characterised the researched transactional relationships as relationships between a client and an agent who works for him and focuses particularly on the time after the contract has been concluded.

[5] This refers to the conclusion of an advising contract from a legal perspective, where an implicit oral agreement is sufficient. See e.g., Micklitz and Träger (2004), p. 127.

Most of the quality properties of financial advice—as the above suggests—can be considered credence characteristics whose quality—due to time or cost restrictions—can neither be inferred before nor after a decision has been made (Caswell and Modjuzska, 1996; Darby and Karni 1973; Reisch 2005). This particularly applies to the core quality properties of financial advice services, namely, whether the advisor is gathering all information necessary to allow for custom-tailored recommendations (information collection), whether he is providing all information the clients need for their investment decision (information), and whether he is effectively giving custom-tailored recommendations (recommendation; Kohlert 2009, p. 133). Studies concerned with financial literacy in Germany clearly support this thesis (NFO Infratest 2005; Leinert and Wagner 2004; Micklitz and Oehler 2007).[6] Therefore, only few clients who have a high financial knowledge are able to evaluate the quality of these properties. For example, since knowledgeable clients know better which information the advisor needs to collect about them to make customized recommendations, a superficial and fragmentary information collection will serve as a quality indicator. Naturally, the higher the level of a client's knowledge the more easily will he be able to notice false and incomplete information as well as implausible and futile arguments given by the advisor. Finally, highly knowledgeable clients can easily compare the recommended products with alternative offers since they know the relevant criteria and can more easily access alternative sources of information. The vast majority of clients, however, does not have the know-how to do this and therefore has to rely on other quality properties it can evaluate before, during or after a session. Those properties, however, such as the tangible environment (e.g., features and cleanliness of office premises) or personality traits of the advisor and the bank's service-personnel (e.g., friendliness, cooperativeness), are not necessarily associated with the quality of the information exchange between advisor and client (Kohlert 2009, pp. 133–134). With regard to this core quality, clients have to trust their advisor to not only have the necessary skills for an expert advice but also to make use of them (Eschenbach 1997, p. 595; Kohlert 2009, p. 134; Maier 1999, p.75; Oehler 2004; Schäfer, 1993, p. 533; Stapfer 2005, p. 49; Wöhle 1999, p. 118).[7]

Interest Asymmetry

The sole existence of information asymmetry between both parties, however, does not necessarily result in detrimental consequences for the clients. Only when the advisor has an incentive to exploit the situation, in other words, if there is an asymmetry of information and interests, they face a high risk of receiving bad advice even without recognizing it. Unfortunately, exactly this situation is characteristic of the German retail banking system (Kohlert 2009, p. 131–150). Here, mega trends like globalisation, technologisation, and a changing competitive environment have lead to an enormous cost pressure (e.g., Oehler and

[6] For example, according to Spiegel Verlag's 6th representative debit and credit study 65% of Germans in 2004 had not heard about stocks. See Spiegel (2004), p. 86.

[7] Three kinds of goods—search, experience, and credence goods—can be distinguished based on the degree of information asymmetry between seller and buyer. A search good is a product or service with features and characteristics which can be easily evaluated before purchase. An experience good, in contrast, is a product or service where product characteristics such as quality or price are difficult to observe and/or evaluate in advance, but these characteristics can be ascertained upon consumption. A credence good, finally, is a good whose utility impact is difficult or impossible for the consumer to evaluate, even after use and consumption, respectively. Only the seller of the good knows the utility impact of the good, creating a situation of asymmetric information (Darby and Karni, 1973; Nelson 1970; Oehler and Kohlert 2008; Weiber and Adler 1995).

Kohlert 2008; Rouette 2005; Walter 2005; Wimmer 2005). Therefore, banks have shifted their focus to the cost–benefit ratio of the financial advice services they offer (Blattberg and Deighton 1996; Walter 2005, p. 285; Zezelj 2000, p. 10). In regard to the retail banking customer these particularly meaningful since studies suggest that the majority of clients pertaining to this customer group (some suggest over 90%) does not contribute to profits or is even characterized by a negative profit contribution (e.g., Blache and Hahn 2002). It is therefore no surprise that a financial advisor in the retail segment has to take care of 850–2,000 clients (Eichhorn 2004, p. 259; Haferbier 2004, p. 71; Hook and Ulrich 2003). Furthermore, according to a study of the consultancy McKinsey and Company, only 13% of a financial advisor's working time is dedicated to advising and selling tasks, while the remaining 87% is spent on administrative duties (Stiller 2003). Another study interestingly shows that advisors allocate two-thirds of the time available for advising or selling to selling (Lucius et al. 2004, p. 95). Finally, since under the prevalent pricing model the actual service of advice giving is offered free of charge and then cross-subsidized by provisions and fees resulting from the sale of the products subsequent to the advice giving process (service model; e.g., Kaas and Severidt 2002), advisors are under enormous pressure to sell their products as efficiently as possible.

Consequences of Information and Interest Asymmetry

Due to these circumstances there can be little doubt that in the retail banking area there are information and interest asymmetries which will inevitably mislead advisors to capitalize on the clients' information disadvantage (Kohlert 2009, pp. 134–150). Even before the actual advising process has started, the advisor can capitalize on hidden quality (Akerlof 1970; Oehler 2005; Oehler and Kohlert 2008)[8] by making unrealizable promises and overstating his skills. The opportunities to exploit the clients which arise during the advising process (ex interim) can be distinguished into the well-known categories hold-up and moral hazard.[9]

Hold-up will occur only rarely in this context since the majority of the clients (those with low financial knowledge) will not even notice the advisor's inappropriate behaviour and those who do will either convince the advisor to change his behaviour or leave in consequence of the breach of confidence. Consequentially, the main problem in advice giving and taking is moral hazard since it happens unnoticed by the client. This type of opportunistic behaviour is typical for situations in which the clients cannot even ex post properly assess whether a success (failure) must be attributed to the advisor's skill or to chance. The reason for this is not only the clients' lacking know how but also the influence of exogenous risks on the investment performance that can neither be predicted nor controlled for by the advisor (e.g., 9/11). Therefore, poor results usually can be excused with exogenous shocks (Klaffke 2002, p. 123).

[8] The term hidden quality characterises the problem that the principal (client) cannot evaluate the agent's (advisor's) potential (e.g., skills, knowledge, and experience) as well as determination for performance in advance. He therefore has considerable leeway to behave in an opportunistic way.

[9] Hold-up occurs when the agent's true intentions are ex ante hidden from the principal (hidden intention) and the latter is able to observe and evaluate the formers actions but cannot act on them since he has already made a sunk, relationship-specific investment (e.g., advising feel; Williamson 1975; Spremann 1996, p. 698). In the case of moral hazard, the agent usually has more information about his or her actions than the principal does and thus can use this information advantage to act inappropriately (from the view of the principal). The latter can either observe but not evaluate the actions of the agent (hidden information) or neither observe nor evaluate them (hidden action; Holmstrom 1979; Oehler 2006).

Both hidden information and hidden intention are crucial types of asymmetric information in the context of financial advice giving and taking. First, although the overwhelming majority of clients can of course hear what the advisor says, they usually cannot completely understand this information. Advisors therefore can provide false, flawed or incomplete information without facing a high risk of being exposed (hidden information). A typical example for this behaviour is the tendency of advisors to recommend those products with the highest commissions and/or issued by the own bank or associated institutions, even though there are products in the market with a much better fit to the client's needs (Kaas and Severidt 2002; Rouette 2005, p. 237).

Second, the clients can also neither observe nor evaluate how much time and effort the advisor has spent in devising his recommendation (after the first meeting and if there is a second one).

Finally, since banks and advisors do not participate on the results and particularly failures of the dispositions made by the clients acting upon the advice given (see below), there is little incentive to make them act in the latter's interest. This enormously increases the risk for the clients that advisors capitalize on hidden information and hidden action.

Why the Market and the Regulatory Framework Must Fail

The Market's Self-healing Power

We have clearly shown that bank and advisor, respectively, have not only an incentive but also plenty of opportunities for opportunistic behaviour. The clients therefore face the risk that, without even recognizing it, their advisors will capitalize on these opportunities. This, however, applies only as long and as far as the market's self-healing power and the regulatory framework cannot prevent advisors from exploiting their clients. Several studies finding poor quality of financial advice have empirically shown that this is exactly what is happening. We will now explain the theoretical reasons for this failure.

The market's self-healing power usually summarizes the following:

- Screening (Stiglitz 1975, pp. 283–300, Oehler 2004, Fleischer 2001, p. 143): the party with less information actively tries to learn as much as she can about her potential contractual partner and to therefore rectify the information asymmetry she faces. In order for this to work, the relevant information must not only be available but also cognitively assessable.
- Self-selection (Stiglitz 1982; Oehler 2004; Shapira and Venezia 1999): self-selection is a special form of screening. Here, the party with less information provides the party with more information with several contract types in order to cause it to unveil the relevant information by selecting one of these contract types. In order for this to work, the motivation of the party with more information to deliberately choose wrongly must be eliminated by high penalties.
- Signalling (Spence 1973; Spence 2002; Oehler 2004): signalling implies that the more knowledgeable party moves first by conveying some meaningful information about herself to the party with less information. The aim is to facilitate the quality assessment for the latter. Since the validity of the signal (the provided information) is difficult to identify, its credibility must be ascertained. The most important characteristic of the signal therefore is the negative correlation of the costs of signal creation with the level of quality the signal communicates.

- Guarantees (Fleischer 2001, p. 126): voluntary product guarantees have a similar effect as signalling strategies. They do, however, directly affect a contract since suppliers of high quality products can offer them at a lower surcharge than suppliers of low quality products.
- Alignment of interest (Datta et al. 2005; Gottschalg and Zollo 2007; Kaas 1992): this refers to using certain incentive and control systems to thwart opportunistic behaviour of the potential contractual partner (e.g., performance-related compensation, contract penalties). Even those systems can be considered signals.
- Reputation-transfer (Kaas 1995, pp. 30–31; Weiber and Adler 1995, p. 31): reputation-transfer means that clients reason the quality level of credence qualities from the quality level of the search and experience qualities they experience (non necessarily by themselves).
- reputation-constraint (Kaas 1995, pp. 30–31; Weiber and Adler 1995, p. 70): there is the postulate that suppliers with a high reputation will always act in the clients' best interest since they do not know which qualities the latter perceive as search, experience or credence qualities. To keep up their reputation premium they therefore always need to act on the worst-case assumption of being confronted with an expert-buyer who is factually able to assess the qualities most clients perceive as credence qualities.

Challenges to the Market's Self-healing Power

Although the protection mechanisms introduced above indeed seem powerful, the question must be asked how exactly they can protect clients against the problems which the twofold interest and information asymmetry between client and advisor brings about. It is necessary that a potential solution accounts for the entire trials of quality characteristics, particularly, however, for the dominating role of the credence qualities (Kohlert 2009, pp. 144–147).

While problems related with search qualities can be easily solved by directly studying the relevant object, in the case of experience and credence qualities the client must resort to adequate substitutes (signals; Weiber and Adler 1995, pp. 64–65; Schade and Schott 1993). In fact, when confronted with search qualities, screening is the most suitable uncertainty-reduction strategy; not only because of its relatively low cost but also the marginal additional uncertainty-reduction value of other strategies in this case (Göbel 2002, p. 326; Weiber and Adler 1995, p. 68). When dealing with experience qualities, however, screening is often not sufficient since the relevant quality characteristics cannot be examined in advance. Therefore, a basic credibility problem exists in such cases (Kaas 1995, pp. 23–24; Weiber and Adler 1995, p. 64). This problem can again be solved by self-selection, signalling (e.g., amount of marketing expenses as a signal) as well as alignment of interest strategies. Since the effectiveness of these strategies depends on the possibility for the client to punish the advisor in case of poor performance, it is mandatory that the client can assess the contractual partner's performance (Kaas 1995, p. 30; Weiber and Adler 1995, p. 69). When confronted with credence goods like financial advice, however, this condition is not given (Kohlert 2009, pp. 132–134; Oehler 2004; Oehler 2005, p. 41; Oehler 2006). The client who wants to enter into a contractual relationship therefore has to trust his advisor in terms of deliberately accepting the existing information asymmetry (Voit 2002, p. 211).

Some authors argue that it is the opportunity of reputation-transfer which allows the market to still heal itself even when those other strategies fail. This argument, however, can easily be rejected. As search and experience qualities, namely, like the features of the advisor's office or his friendliness, are not necessarily positively correlated with credence

qualities like the adequacy of the information the advisor provides, the reputation of bank and advisor, respectively, is at best partially based on the factual quality of the advice given before (Kohlert 2009, p. 146). Feedback is always associated with a high level of ambiguity (Oehler 2006). Consequently, it is highly questionable whether a lasting reputation premium can be kept up at all and thus allows for separating good from bad advisors. Since a financial advisor is easily able to at least roughly assess the client's prior financial knowledge during the advising session, he can just as well accordingly adapt the information he provides. Therefore, even the reputation-constraint thesis must fail in the context of financial advice giving (Kohlert 2009, p. 145–146).

In conclusion, if the clients cannot assess the core quality of the advice and thus to adequately reward good advice and punish poor advice (e.g., by switching advisors), no competitive advantages can be achieved by improving the quality of the information exchange. Therefore, quality competition among financial service providers cannot be expected (Kohlert 2009, p. 146).

Challenges to the Regulatory Framework

Since the market's self-healing power fails at least partially it would be irresponsible to solely rely on it, not only with regard to the social consequences for the individually affected clients but also to the society as a whole (Keßler and Micklitz 2004, p. 8). It is therefore not surprising that in this context a functioning legal system that offsets those problems is highlighted (Apolte 1999, p. 11; Fritsch et al. 2001, p. 304; Keßler and Micklitz 2004, p. 8). The hope is that an adequate normative framework can enable the market to fulfil the expectations placed on it, which is to level the prevailing asymmetries between client and advisor out (Keßler and Micklitz 2004, p. 8).

There are particular legal duties developed with the objective to prevent poor quality advice (Kohlert 2009, pp. 150–209; Micklitz and Träger 2004, pp. 127–129). In short, the advisor has to collect all relevant information about the client he needs to provide the client, considering the latter's knowledge and experience, with all facts relevant for the potential investment decision. He then has to evaluate these facts and align his product recommendation with the individual situation of the client. The duties are based on the principle of necessity which means that the less the clients know and the less experienced they are, the more exhaustive the information collection and information processes have to be. That even these duties are at most partially successful in establishing a level playing field between clients and advisors, however, is not only the implication of the multitude of empirical studies which show poor results with regard to the core quality of financial advice but can also be theoretically deducted (Kohlert 2009, pp. 209–239).

There are three reasons for this failure of the legal framework. First, the duty to collect information about the individual customer is neither comprehensive nor specific enough to assure an adequate basis for the individualized recommendation that should be based on it. For example, the advisor is obliged by law to evaluate the client's financial knowledge and risk tolerance. These two essential constructs, however, are neither defined, nor are there any regulations about how and what information advisors have to collect. To a large extent advisors therefore have a free hand in how to do this, which often leads to superficial and heavily biassed results as well as a misguided information provision and improper recommendations. Second, the duty to provide information is based on unrealistic assumptions about the clients' rationality, which is—as we will show below—necessarily bounded. Even if the advisor would dispose of the necessary skills, due to the clients' mostly low financial prior knowledge it would regularly be impossible to provide them with

all information relevant for their investment decisions, let alone provide this information in a way that enables them to correctly perceive, process and store it. Aggravatingly there is the fact that the clients often do not even want to be informed about the financial details, precisely because of the excessive cognitive demand that comes along with it (Jungermann 1999; Jungermann and Belting 2004; Oehler and Kohlert 2008). Now the question arises why there are financial advice services offered at all since when it is impossible to fulfil the legal duty to adequately inform the clients there would be so many claims for damages that offering those services could not be profitable. The reason for this is the so called "as-if" behaviour of clients and advisors which we will explain below, and also the fact that the onus of proof that primarily lies with the clients makes it very hard for them to assert their claims and does not sufficiently keep advisors from behaving opportunistically (Micklitz and Träger 2004, p. 137).[10]

An In-depth View on the Process of Financial Advice Giving and Taking

Overview

So far we have analysed the service of financial advice on a meta-level. This allows for identifying and explaining the specific problems in the relationship between client and advisor but not for analysing the clients' bounded rationality and their real behaviour resulting from it. In order to develop meaningful solutions for the identified problems it is necessary to specify the concrete asymmetries between the parties and thereby gain in-depth insight into the process of financial advice giving and taking. The latter can be analytically distinguished in three main phases, the information collection, the information, and the recommendation phase, which in reality frequently overlap (Kohlert 2009, pp. 209–211).[11]

Information Collection Phase

Background

The legal duty to collect information has the aim to level the information asymmetry the advisor faces with regard to the individual client's situation out and to thereby force the former to give client-customized advice. Consequently, the less the client is able to evaluate the suitability of the multitude of existing investment products for his own situation the greater the effort the advisor has to make in assisting the client with this task. The greater the effort made by the advisor is, however, the higher are his transaction and opportunity cost. This represents an incentive for opportunistic behaviour which can—as opposed to the aim of the duty—lead to a deliberate reduction of the efforts in collecting information about the client. Also, the advisor may prompt clients to make certain decisions or give them incomplete, altered or reinterpreted information.

The duty to collect information about the client specifically refers to the latter's knowledge and experience, his financial situation, risk tolerance, and concrete investment

[10] For a detailed review and assessment of the legal framework see Kohlert (2009), pp. 150–239.

[11] In this paper we focus on the advice giving and taking process. For the clients, however, not only this core phase but also the pre-advice and post-advice phases are of enormous importance for the clients. For a detailed analysis of the pre-advice, advice, and post-advice phases in their entirety see Kohlert (2009), pp. 209–239.

objectives. With few exceptions, these essential constructs are hardly defined, nor are there any regulations about how and what information advisors have to collect.

Knowledge

In the case of the client's knowledge, for example, it is obvious that the term knowledge primarily refers to concrete facts which are so plentiful that it would be impossible to ask for all of them. Consequently, advisors tend to ask general questions about the client's financial knowledge which lead to subjective self-assessments with regard to certain types of investments (e.g., "are you familiar with stocks?"). The answers to such unspecific and qualitative questions are susceptible to framing, which means that presenting the same choice problem in different ways can affect the decision one makes (Elliot and Hayward 1998; Kühberger 1998; Tversky and Kahneman 1981). For example, depending on how the advisor formulates his question (e.g., "well, you certainly are well familiar with stocks, aren't you?") and how explicitly he describes the possible types of investments, particularly their chances and risks, the client's answers can vary. Also, such subjective assessments are greatly affected by past experiences. Investors who have never had a bad investing experience, for example, are more likely to overestimate their actual knowledge than clients who have made bad experiences. This irrationality is due to phenomena like illusion of control and loss of control. While the former means that clients who have had some successes in the past, albeit random ones, start to spuriously believe they can somehow influence stock prices and therefore take ever greater risks (Gervais and Odean 2001; Langer 1975), the state of loss of control sets in when clients realize that they cannot anymore attribute negative results to exogenous factors. In consequence, they tend to retreat from their engagements and at worst become completely inactive (von Nitzsch and Friedrich 2002, p. 10).

Investment Objectives

Even collecting information about the clients' concrete investment objectives is not as easy a task as it might seem at first view. A considerable problem often criticized by advisors and also discussed in other areas like health care namely is that many clients often have not even thought about investment objectives when they seek advice (e.g., Dorn-Seifert 2004). Therefore, they often do not have fixed preferences and opinions about what lies in their interest but instead develop their preferences during the actual advising session (Hibbard et al. 1997; Slovic 1995). When this is the case, however, clients first have to operationalize their motives (e.g., consumption, saving) (Oehler 1995, p. 91) and to hierarchically arrange them. This, however, often requires handling complex motivational conflicts. These conflicts again do not only regularly occur between different motives and therefore necessitate a decision which motive to follow (appetence–appetence conflicts like between saving or consumption) but can also occur within a single motive (ambivalence conflicts like with regard to positive and negative attributes of an investment product; Schmidt 2004, pp. 99–100). Once the client has handled these motivational conflicts he must assign specific objectives to his preferred motives (e.g., buying a car, real estate, saving for retirement) considering the consequences (monetary and other) this might have for his individual situation and construct an individual objective function based on the relative importance of these objectives. After that, he must try to anticipate and evaluate potential future expenses (e.g., heating repair, car maintenance) and integrate them into the objective function. It seems impossible that the client is able to faultlessly collect and retrieve (from

the memory), respectively, and process the necessary amount of information during an information collection phase which is limited in time (mostly takes less than 10 min). It also must be assumed that time pressure and the complexity of the information leads to a highly biassed information selection as well as the ignoring of relevant information and the focusing on specific (though sometimes not relevant) alternatives. The task of collecting information about the client's investment objectives therefore often cannot produce more than an imprecise snap-shot, which makes it difficult to give long-term recommendations. Simply by selectively mentioning certain objectives (e.g., old-age provision) while neglecting others the advisor can easily influence the client and manipulate the data collection process in his own interest.

Risk Tolerance

As in the case of the term knowledge the equally missing definition of the term risk tolerance will lead to a superficial data collection. The vague regulation represents little incentive for the advisor to explicitly perform his duty. This is particularly problematic since the concept of risk tolerance is unknown to many clients and bounded rationality can have particularly detrimental consequences in this context. Therefore, many clients are dependent on how the advisor asks for this construct and the particular method he uses, respectively. Due to the lacking concretion of the term risk tolerance the advisor is completely free in this respect, with the consequence that in addition to in principle scientifically accepted methods often completely inadequate rules of thumb or "naive" methods are used.[12] It must be assumed that when such methods are used which either suggest the user's lacking competence and/or his intention to simplify the process of data collection and to minimize the corresponding efforts as much as possible, an adequate description and explanation of the concept of risk tolerance cannot be expected.

The result of the determination of the client's risk tolerance can also be easily manipulated by exploiting the latter's bounded rationality no matter what method of determination is used. For example, if the advisor asks the client to directly choose among certain options which differ in their risk, the latter's decision is greatly influenced by the information the advisor gives him about the attributes of the option and by the presentation of this information. The advisor can highlight, neglect, or distort specific risks, chances or other attributes or simply give false information. Even the order in which information is given—information given at the beginning (primacy effect) and at the end (recency effect) of an advising session tend to have a greater influence on the final decision than the information provided in between (Gierl and Höser 2002, p. 13; Igou 2001; Kühberger 1998; Moore 1999)—framing (e.g., presenting the same alternative in terms of gains or in terms of losses) or the format of presentation (e.g., choice of the time intervals when presenting stock returns) can be used to control the client's decision. However, even without opportunistic behaviour on the part of the advisor the results of the determination of a client's risk tolerance is often biassed by past experiences or wrong opinions due to ignorance. For example, clients tend to raise their risk tolerance after investment successes and lower it after having experienced losses (Barberis et al. 2001; Thaler and Johnson 1990). This results from phenomena like illusion of control and loss of control. Clients also overemphasize certain negative (positive) experiences which seem more representative for the population of negative (positive) events to him than they really are (representativity heuristic, Kahneman and Tversky 1973) and/or come particularly easy to mind like the

[12] For example, selecting the level of risk tolerance on a scale from 1 to 10, and proportion of stocks=100−age.

bankruptcy of one's favourite company (availability heuristic, Kleindorfer et al. 1993, pp. 94–95; Tversky and Kahneman 1973).

Information Phase

Background

Like in the case of the information collection the information the advisor provides the client with has to be specifically customized to the latter's individual situation. The less the client knows and the less experienced he is the more information the advisor has to provide him with. This information has to be specifically customized to the client's individual level of understanding. Therefore, independent of his individual knowledge and experience level every client is theoretically sufficiently protected, at least if he is able to correctly perceive, process, and memorize all information he is provided with. However, since a more individual and exhaustive information provision is naturally associated with higher transaction and opportunity cost, there is again an incentive for the advisor to behave in an opportunistic way. This, for example, can materialize in the deliberate provision of false information, the belittlement of certain facts (foremost of risks) or the accentuation of others (foremost of chances).

Information Overload

Here, particularly the client's bounded rationality can again lead to considerable problems since it is highly doubtful that the client is able at all to make proper use of the information he should be given. Namely, when the complexity of the information provided exceeds the client's information processing capacity, the quality of the latter's decision will be affected negatively in a considerable manner. What follows is the state of information overload (Eppler and Mengis 2004; Chewning and Harell 1990; Tushman and Nadler 1975). In order to answer the question of how probable this is, we will initially take the complexity of the information to be provided into account as a major determinant of the information burden the client faces. Decision-relevant components of complexity are the number of available options, the number of available corresponding attributes, the similarity, and interdependence of the options and the time pressure in the decision situation (Detje 1996, p. 75; Jungermann et al. 2005, pp. 281–282).

Clients in principle have to be informed about general risks and mechanisms of the capital market, transaction-related as well as investment type-specific and product-specific facts. The sheer amount of information the customer has to perceive and to process means a high grade of complexity on its own. The number of options and corresponding attributes inherent in this quantity of information clarifies that. If the individual investment types and products, respectively, are considered decision options, the client is confronted with about five options alone at the investment type level (e.g., liquidity, bonds, stocks, insurance, funds) with different subgroups each (e.g., money market funds, bond funds, equity funds, real estate funds) of which each again has a much higher number of corresponding attributes. The multiplicity of attributes can be clarified by considering different attribute levels (e.g., level 1: cost, level 2: purchase cost, level 3: indirect cost, level 4: kick-back payments). Furthermore, the information the client receives during an advising session are highly interrelated. The client consequentially does not only have to understand single facts (e.g., cost, tax regulation) but also be familiar with the interdependencies within the specific areas (e.g., no front load but higher administrative fee) and between the areas (e.g., market

cycle and product return). Moreover, the time of an advising session is usually very limited and it is possible that advisors urge clients to make a decision.

Based on these facts there is no doubt that financial advice is a highly complex issue for most clients who regularly do only have little or no knowledge and experience in the investment area. This conclusion is further supported by the empirically proven fact that lacking knowledge and experience, respectively, in a certain problem area are per se good indicators for a high information burden (San Miguel 1976; Schroeder and Benbasat 1975). The latter particularly applies to problem areas in which ambivalent information is common (Eppler and Mengis 2004), just as it is the case in the investment area. Here, the same information often can be interpreted as well positively as negatively (e.g., a high return potential always comes with a high risk).

If we consider that humans cannot simultaneously process more than nine information units, even less in the case of complex problems (Kintsch 1977; Miller 1956; Payne 1997, pp. 355–356), it is unavoidable that the majority of the clients who have little or no knowledge and experience in the investment area will suffer from information overload. The idea to provide the client in a usually short advising session with all information relevant for an informed decision is out of touch with reality. The assumption that trying to make the client familiar with even one asset class will regularly cognitively overstress him seems much more realistic. Even if the advisor limits the information provision to nine information units at a time, which is hardly practicable, the client could not memorize the information provided. The ability to memorize, namely, greatly depends on the intensity of rehearsal (Atkinson et al. 2001, pp. 262–299) and/or the depth of processing, that is, how deep the level of analysis is and how many attentional resources are dedicated to a problem (Anderson 2001, pp. 174–201; Sternberg 2004, pp. 176–215).

The client who seeks financial advice will neither have the opportunity to intensely rehearse nor to deeply process the received information since as to that the advising session is much too short. Even if he is able to perceive and process the first nine information units he receives, some of them he will most likely already have forgotten and overwritten when he is confronted with the second nine information units. This effect naturally increases as time goes by. Furthermore, since the information content of information units depends on how familiar one is with the corresponding problem area (Anderson 2001, pp. 174–201; Atkinson et al. 2001, pp. 295–299; Sternberg 2004, pp. 176–215), the ignorant client will suffer twofold. Since decision makers also tend to be more satisfied with their decision when a high amount of information is given, even if only few of it is actually used (Wärneryd 2001, p. 68), they are often not aware of the information overload they face and the reduced decision quality that comes along with it.

Consequences of Information Overload

It is obvious that in the context of financial advice taking it is less an exception and more the rule that the clients suffer from information overload. Therefore, the question must be asked what consequences beyond a mere loss of information this might have for the processes of information perception, processing, and memorizing. The first important consequence of information overload is selective perception which means that the client not only neglects part of the information but also distortedly perceives the other part due to former experiences and future expectations (Aronson et al. 2004, pp. 587–588; Flade 1994, pp. 834–835; Oehler 1995, p. 26). This phenomenon is particularly important when clients already have specific investment ideas when they seek advice. In this case they namely tend to only superficially evaluate, neglect, suppress, or even reinterpret new information while

at the same time to look for information that corresponds with their ideas. These effects are supported by the fundamental cognitive drive to avoid cognitive dissonance, i.e. interpreting available information in favour of the preferred alternative (Gilovich 1991, p. 62; Russo et al. 1996, p. 107).

Information overload furthermore keeps clients from distinguishing relevant information from noise and from memorizing received information. It makes them become credulous, leads to superficial information processing, often even to complete refusal from it, and the intensified use of heuristics (Einhorn and Hogarth, 1981; Jacoby 1975; Klein 1983; Malhotra 1984; Schneider 1987; Schick et al. 1990, Schmidt 2004, p. 87). Under these circumstances clients are also extremely vulnerable to manipulation by the way the information is presented (order, framing, format). The mentioned effects are greatly intensified by the emotional manipulability of the client. Advisors are being trained to raise the client's emotional susceptibility for their persuasion attempts. Since it is well known among marketers and empirically proven that people in a good mood collect less information and process them less analytically and critically—which is why differences in the quality of arguments become less important—(Bless and Ruder 2000, p. 306; Johnson and Tversky 1984; Jungermann et al. 2005, p. 225; Nerdinger 2001, p. 37), advisors will try to create a pleasant atmosphere and to put their clients into good humour.

In addition to that, the client will not have a strong subjective competence, i.e. a strong belief in his own competence (Schaub 1993, p. 69; Staeudel 1987, p. 54), in a serious state of information overload. If people do not feel up to a certain task, however, as it is then the case, they tend to show a behaviour of retreat from this task since the perceive things they do not know, do not understand and expectedly will not understand despite great efforts as unpleasant (Doerner 1994, pp. 144–145; Doerner 1998, p. 312; Statman 2004). They reduce or even totally halt their efforts to collect information because new information could jeopardize their self-assuredness (Doerner 1998, pp. 328–331, Staeudel 1987, p. 55). Empirically the preference for this self-protecting behaviour over the attempt to thwart weaknesses in one's own thinking has been well confirmed (Heath and Tversky 1991; Keppe and Weber 1995).

The AG&T-Model

Against this background the plausibility of JUNGERMANN's advice giving and taking model (AG&T) becomes clearly visible. The model is based on the insight that the assumptions of traditional models of informed decision-making that people want to make their own choice and that they know better than others what is good for themselves are not given in the context of dyadic situations like financial advice giving and taking. Instead, the advisors are the experts who know more about the conditions and values of the clients than the clients themselves knew before the matter. The client is regularly confronted with an investment decision for the first time and neither has the procedural nor the factual knowledge necessary to approach the problem and understand the information given to him, is only a the confused layperson trying to keep up with the discussion. He realizes this asymmetry in his relation with the advisor and therefore does not expect to be offered a variety of options and to be enabled by the advisor to make an informed decision. Instead, he expects to be recommended a specific option which he can accept or reject (Jungermann 1999). The consequence of all this is that the client acts as if he understood the advisor's information and recommendation and at the same time the advisor acts as if he had appropriately informed the client and believed that the latter understood everything. Only if the proprieties are observed a contract can be concluded since only if the client openly

declares to have understood the information provided by the advisor, the latter has the justification to continue with the conversation and to give a recommendation (Jungermann 1999; Jungermann and Belting 2004; Jungermann et al. 2005).

The goal to provide the client with all relevant information, let alone provide this information in a way that enables him to correctly perceive, process, and store it, cannot be achieved the way it is intended. Only in the case of clients with high financial knowledge might this be possible.

Recommendation Phase

Even in this phase opportunistic behaviour in terms of moral hazard is particularly problematic since the recommendation given by the advisor is greatly influenced by transaction and opportunity cost considerations on the part of the bank. Here, the risks the clients face mainly consist in receiving product recommendations which are more in the interest of the bank and the advisor, respectively, than in their own interest. For example, advisors may primarily recommend products which are not in line with the clients' needs but from which they hope to gain high commissions. The clients' ability to evaluate the suitability of the recommendation and its justification, on the other hand, again depends on their financial knowledge.

It is therefore interesting whether the client follows a possibly opportunistic advice. According to the AG&T model the predominant strategy of financial advice giving is to categorize the client based on the information collected during the information collection phase and to then select the product options which the bank considers the best for clients belonging to this category. If the advisor finds several options, he will pick the one(s) which have proven most successful in the past. Consequentially, clients do not choose one out of several alternatives in view of their consequences for their individual situation but are instead recommended one specific option they have to accept or reject. The decision whether to accept or reject the advice is a function of the evaluation on two sets of attributes, option-related and person-related attributes. Option-related attributes are the perceived quality of the recommended options as judged, based on pro and con arguments, by the advisor, and, as judged by the client him or herself based on plausibility, perceived soundness, benefits, and risks. Person-related attributes are the perceived quality of the judgments provided by the advisor (his or her credibility), and provided by the client him or herself (his or her confidence). For example, a client might follow the advice of an advisor he or she considers trustworthy although he personally evaluates the recommended option negatively. Alternatively, the client might not follow the advice he personally evaluates positively if he does not trust the advisor (Jungermann 1999; Jungermann and Belting 2004; Jungermann et al. 2005).

The weighting of the attributes depends on the grade of information asymmetry between client and advisor. If the information asymmetry is high, the decision mainly depends on the credibility of the advisor. In case of a low or not existing information asymmetry, on the other hand, the decision is mainly based on option-related attributes, particularly the arguments of the advisor and his justification of the recommended options (Jungermann 1999; Jungermann et al. 2005).

The relevance of the presented attributes for the acceptance of a recommendation has been empirically confirmed. Not only has the perceived quality of the advice as judged by the client himself a great influence on the decision to accept or reject the recommended options (Harvey et al. 2000) but also are clients more likely to accept a recommendation if the advisor shows much confidence in the chosen option(s). The reason for this is that

clients consider confidence a substitute for skill, experience, and knowledge regardless of whether it reflects factual quality (Sniezek and Buckley 1995; Sniezek and van Swol 2001; Sniezek and van Swol 2005). It also seems self-evident that the decision to accept or reject a recommendation depends on whether the client trusts the advisor or not. Important, however, is that the level of trust depends on the level of the client's financial knowledge. The lower the latter is, the more the client tends to trust his advisor (Sniezek and van Swol 2001). Finally, lacking confidence in one's own judgment leads to a higher probability of following the advisor's recommendation (Harvey and Fisher 1997).

This reasoning shows that clients who do have sufficient financial knowledge are very likely to accept advisor recommendations regardless of their objective quality. When complex decisions have to be made and/or the level of knowledge or experience is low, the clients' level of confidence in their own judgment tends to be low (Harvey and Fisher 1997; Schrah et al. 2006; Yaniv 2004; Yaniv and Kleinberger 2000). Furthermore, recommendations are usually given towards the end of an advising session, when the state of information overload already has materialized and an eventually high involvement at the beginning of the session has switched completely. In this situation it is very likely that the subjective competence of the client is as low as his confidence in his own judgment. At the same time, is it very likely that the client perceives the advisor to be highly credible since banks will do anything to improve the quality of the search and experience qualities which the client can assess during his visit. Therefore, they will go to great lengths to make the tangible environment appear as professional and of high quality as possible. Moreover, advisors are extensively trained in making a good impression on clients. This training particularly encompasses behavioural, arguing, presentation, and selling techniques which are supposed to make the advisor appear credible, competent, self-confident, etc. Finally, since clients often do not have stable preferences when they seek advice and therefore do not even know what they want, the probability of being manipulated by the advisor is very high. Also, it could be hypothesized that a recommendation is not comprised of neutral facts that the client would have to evaluate on his own situation and draw the respective consequences to which due to the complexity of the information he is mostly not able. Instead, it is comprised of a manageable amount of information which explicitly establishes a connection between the problem (need for advice in terms of evaluation of information) and a concrete solution, facilitates the client's mental work and is therefore much easier to process and to memorize. The client will then rather follow these relatively simple lines of reasoning than try to disprove them on the basis of information he is not able to cognitively process.

Empirical Evidence

Background

In February and March 2007, we conducted an empirical study to test the quality of the financial advice German banks offer their retail clients, and whether the clients' prior financial knowledge and/or socio-demographic as well as socio-economic status have an influence on the quality of the advice given. As a byproduct we hoped to obtain information about the effectivity of the market's self-healing power and the regulatory framework in assuring high quality advice and in assuring a level playing field between more and less vulnerable client group. Our thesis was that due to the weakness of market and law, advisors can to a large extent freely decide which clients to advise better and which to advise worse. Therefore, the quality of financial advice a client receives will strongly

depend on his individual characteristics and on how these characteristics correspond to the advisor's cost–benefit considerations. Consequentially, clients with high financial knowledge[13] and/or status would be offered qualitatively better advice, which fundamentally contradicts the legal duties the advisor should actually observe.

Methodology

To test our hypotheses, 90 covert participant observations[14] were conducted in the Nuremberg Metropolitan Region by intensely trained test clients.[15] As it is the case with any kind of empirical research, the quality of the data obtained by covert participant observation depends on how reliable, valid, and representative they are. Following the recommendations in the literature (e.g., Deckers 2003; Finn and Kayande 1999; Grove and Fisk 1993, p. 222; Matzler and Kittinger-Rosanelli 2000; Schlich 2006), we tried to maximize the reliability and the validity of the results by developing as realistic test scenarios and character profiles as possible. For this, we used statistical data about the socio-demographic and socio-economic status[16] of German citizens as well as behavioural science findings.[17] The aim was to present a realistic as well as typical client to the advisor and to ensure that the presence of the former did not affect the behaviour of the latter. We developed comprehensive general specifications[18] which were complemented by three specific character profiles. In order to allow for the testing of our hypotheses, the crucial differences between the developed client types were related to their financial knowledge and status. While one type was characterized by high levels of financial knowledge and status (A), his counterpart had a low financial knowledge as well as a low status (C). In order to avoid confounding, we finally created a third client type with a low level of financial knowledge but a high level of socio-demographic and socio-economic status (B).

[13] The higher the client's financial knowledge is, the greater the efforts advisors will make to thoroughly advice him, since a client who has a high expertise can much easier discover and evaluate poor performance delivered by the advisor and particularly he can pass the information about what he experienced on to others. This enables him to effectively destroy welfare positions of the advisor. In consequence, the advisor´s motivation to act in an opportunistic way declines while simultaneously his motivation to make a good impression rises.

[14] Participant observation refers to research that involves social interaction between the researcher and the study subjects in the environment of the latter, during which data are systematically and unobtrusively conducted. Covert participant observation is performed without the knowledge of possibly interested third parties and specifically without the knowledge of those being observed. Due to these characteristics it is much better suited for the financial advice context than more traditional methods of research such as questionnaires and interviews. The method is often called "Mystery Shopping" in a practical context.

[15] For a detailed description of the study, its background, methods, and further results see Kohlert (2009), pp. 257–361, Oehler and Kohlert (2008).

[16] We used data from the actual German Income and Expenditure Survey, the Public Sector Collective Agreement as well as publicly available job databases to determine the test clients´ yearly gross income, calculated the corresponding net income and monthly data, and finally defined the clients´ monthly discretionary income based on Bundesbank (German Central Bank) data about savings quotes for different income levels.

[17] We built behavioural multi-factor models using a combination of behavioural science concepts such as subjective competence, risk perception, involvement and locus of control, amongst others, and, based on those models, developed behavioural specifications for each test client type.

[18] For example, the only information our test clients should provide were their name and their wish for advice; all other information basically had to be asked for by the advisors. Also, the clients had inherited money, and, after paying inheritance tax, spent some of it on consumption and they now seek advice on investing the remaining amount of EUR 50.000. For a detailed description see Kohlert (2009), pp. 263–268; Oehler and Kohlert (2008).

While the A-type was behaving more actively, trying to make an informed decision and had a relatively high risk tolerance, the latter types were very risk averse and showed the typical much more passive "as-if" behaviour.[19]

Furthermore, to measure the quality of financial advice we developed concrete criteria which were separated into the core quality areas information collection, information, and recommendation, and the secondary quality areas documentation, characteristics of the advisor, and characteristics of the advice environment.[20] While the criteria for measuring the core qualities came from a thorough analysis of the literature on financial advice quality and the regulatory framework that a bank has to follow when giving financial advice (e.g., Einsele 2008; Kohlert 2009, pp. 150–209; Veil 2008; Weichert and Wenninger 2007), with regard to the secondary qualities, which are not regulated by law, we used criteria from the services quality and customer satisfaction literature (e.g., Donabedian 1980; Garvin 1988; Kohlert 2009, pp. 113–120; Meffert and Bruhn 2006; Parasuraman et al. 1988). In preparation for the realisation of the actual study and after intensively rehearsing scenarios and methods of data collection, we performed two pretests with a total of 23 bank visits which had the purpose to test the plausibility of the scenarios and the test clients' familiarity with them as well as the technical quality and practical usability of the data collection form. In regard to the remaining criterion of the quality of empirical research, it was obvious beforehand that due to lacking information about the distributions of the advisor and client characteristics as well as the characteristics of the interactions of both parties, representative results would not be obtainable.[21] There is no empirical research design, however, that fully meets all requirements. Therefore, the preference for detailed and close to reality results delivered by covert participant observation to their generalizability is justified (Schlich 2006),[22] particularly since various measures were applied in order to moderate even that problem.[23] The 90 visits of the actual study were segmented by number of inhabitants (45 visits in each case) in city (more than 12,500 inhabitants) and country (less than 12,500 inhabitants) and by client type (30 visits in each case). As proxy for the bank specific distribution of the advising sessions we used each bank type's approximate share of private deposits in the German market (savings banks 50%, cooperative banks 30%, and commercial banks 20%).

[19] For a detailed description of the client types see Kohlert (2009), pp. 263-268; Oehler and Kohlert (2008).
[20] The secondary quality areas contain criteria which do not directly relate to the quality of the information exchange between advisor and client but are still important components of the advice quality, even if only with regard to the clients´ satisfaction (e.g. friendliness of the advisor, orderly appearance of the service personnel).
[21] Representative results require that all relevant characteristics of the advice giving situation are identically distributed in the sample as they are in reality, and not only by themselves, but also in conjunction with each other (Haas 2002). It is impossible, however, to develop the corresponding test plan, not only because of the enormous number of test visits that would be needed, but also because the elements of the underlying population do not even exist at the time when the sample is being constructed. As it is always the case with observational research, the underlying population cannot be empirically defined and the sampling units cannot be clearly determined. They mostly are not even known (Kromrey 2006, p. 363). Even using a representative sample of potential event spaces and times as substitutes (Finn and Kayande 1999; Kromrey 2006, pp. 363–364) fails, since the corresponding distributions are also unknown. Therefore, the extent to which the sample resembles the underlying population cannot be determined (Haas 2002).
[22] For a realistic view on the representativity of related studies see Oehler (2004), p. 182.
[23] First, it was taken care for a sufficiently high number of observed advising sessions. In the literature, recommendations ranging from three to 40 tests per researched group can be found. Moreover, biases in the sample were avoided by carefully designing the test plan. The real client flow was approximated by avoiding the scheduling of the sessions at "convenient" times like the afternoon and instead distributing the test contingent over several days of the week and different times of the day. Finally, as also suggested in the literature, tests under special conditions were avoided (e.g. just before close of the bank).

Results

The results that we obtained are very consistent with previous findings of a poor level of quality of the information exchange between client and advisor. Neither in the information collection (44% A, 29% B, 30% C) nor in the information area (46% A, 30% B, 37% C), were the advisors on average able to reach half of the possible points, independently from the specific client group. On a slightly higher level the same basically applies to the recommendation area, with the exception that the advisors of the KT group scored fairly well (53% A, 58% B, 79% C).[24] These results confirm our theoretical analysis. There clearly is a failure of the market and the regulatory framework. With regard to the information collection phase we concluded that the duty to collect information about the individual customer is neither comprehensive nor detailed enough to assure an adequate basis for the individual information provision that should be based on it. Concordantly, only four out of 90 advisors did at all ask for the clients' knowledge about base risks which can basically apply to all kinds of investments (liquidity risk, market risk, inflation risk, cyclical risk, country specific risk, and currency risk). One-third of the advisors did not ask their clients about their knowledge about different investment types. Those who did, like those who did ask for the clients' experience in certain investment types often left it at asking whether the client had "already done something with stocks or investment funds". Furthermore, collecting information about the clients' risk tolerance often was a matter of less than 2 min and correspondingly superficial. In 11% of the cases the advisor did not ask but derive the clients' risk tolerance from the investments the latter had done in the past. In 19% of the cases the clients had to directly choose a certain risk category (e.g., safety-oriented, chance-oriented, and speculative) whereby there was no explanation of what that meant. In further 26% of the visits clients had to make the same choice and the advisor tried to explain those concepts, however, in most cases inadequately (e.g., "do you want to know exactly what your result will be or does your focus lye on the return of your investment?"). Other 4% of the advisors tried to measure the clients' risk tolerance by having them mark a certain point on a risk-return-diagram. In two cases this diagram was a straight line on which the client should mark a spot somewhere between 0 and 1 and 0 and 100, respectively. In the third case it was a "magical triangle" which consisted of the poles risk, return and, well, gain. The most popular method of determining the clients' risk tolerance was to let them directly choose between different asset allocations (31%) which again often were only explained rudimentarily. In one case the advisor even forced the client to choose a certain asset allocation by stating that he could not give a sensible recommendation if the client would not choose a category characterized by at least a medium risk.

Even with regard to the criteria more clearly defined by law, however, advisors regularly failed. For example, only 10% of the advisors did ask for the income freely available for spending on a monthly basis, only 51% for the income situation at all.

The results in the information and recommendation areas are hardly surprising considering our theoretical analysis of the advice giving process. In all but a few cases it will be simply impossible to adequately inform clients about all theoretically relevant facts they would need to hear and understand to make an informed decision in a normal advising session in the retail area. The reasons for this—cost pressure on the bank and advisor side, information overload and even unwillingness to learn—we have already explained in our theoretical analysis.

[24] The reason for this, however, is the high financial knowledge and experience of the KT type because of which there were no point deductions in the fit category if the advisor provided wrong, distorted, or incomplete information.

What is worse than these generally poor results, however, is that seen from a relative perspective advisors put much more effort in collecting information, in providing information, and in their recommendation when their clients' financial knowledge is high. In all three areas the results were highly significantly[25] better for the client group with a high financial knowledge than in the groups with a low financial knowledge. What is more, not only did the average advising session take significantly longer for the group with high financial knowledge (68 min A, 51 min C, and 49 min B) but this group was also presented and recommended a significantly higher number of products. Furthermore, the frequency of recommendations including products issues by other institutions was significantly higher (21 of 30 A, 13 B, and nine C). Finally, even the subject of old-age provision was thematized more often in the knowledgeable group.

Contrary to expectations, we did not find any significant differences between the B and C groups. That the socioeconomic and demographic status of the client does not seem to influence advice quality is surprising on the one hand, on the other it is alarming. Namely, if there are no significant differences despite considerable disparities between the constructed client types with regard to income (approximately 20,000 EUR), wealth (more than 20,000 EUR), education, profession,[26] and therefore also to a potential relationships future potential, then this shows how little advisors differentiate among clients in the retail banking segment. The at the same time significant influence of the client's prior financial knowledge indicates, against this background, how unimportant the single retail customer is to be for the bank, since better and more differentiated advice could be given. One reason for the poor results therefore is the lack of the advisors' motivation and/or the guidelines of the banks they work for. This is also confirmed by the fact that the information collection, information, and recommendation areas were strongly correlated.

Conclusion

Neither the market's self-healing power nor the regulatory framework can do what they are supposed to do. There is no functioning quality competition with regard to the core qualities of financial advice that could lead to a strong position of the customer, and there is no regulation which can assure this. Instead of being forced to offer a high quality of financial advice and to create a level playing field for all clients irrespective of their individual characteristics, advisors have a large freedom of action. This, in turn, leads to a discrimination of those clients which are vulnerable due to their low financial knowledge and need an equitable and exhaustive advice. The consequences not only for the individual client but also the society as a whole are painful. The wealth destroyed by spurious advice is estimated at about EUR 20 billion which is more than 10% of the freely disposable amount of money that can be invested by German individuals per year.[27] Again, the weaker

[25] The *U* test we used to compare the results of the three groups is a non-parametric test employed with ordinal data in a hypothesis-testing situation involving a design with independent samples. If the result of the *U* test is significant, it indicates there is a significant difference between medians of the samples and a high likelihood the samples represent populations with different median values. The null hypothesis accordingly is that the tested samples are drawn from a single population, and therefore that their probability distributions are equal.

[26] While the A and C types were grammar school teachers with an gross income of EUR 37,300 and total wealth of about EUR 80,000, the B type was a physiotherapist (secondary school) with a gross income of EUR 19,200 and total wealth of about 60,000 EUR (always including the inheritance of EUR 50,000).

[27] Habschick and Evers (2008), p. 12.

the clients are, the more likely it is that it is them who suffer the most. There are two potential solutions for the problems described here, the first aiming at improving market transparency, the second at improving, respectively changing the legal system.

A first step in promoting a competitive environment in the area of financial advice giving is to substitute the credence characteristics of the information exchange by credible, unbiased, and neutral signals which enable clients to reward good and punish poor quality without actually being able to assess it themselves. This could be achieved by considering the ability to adapt to the individual clients and to advise them equally individually and primarily in their own interest a necessary basic qualification which is certified by an institution which is not only demonstrably qualified for this purpose but also neutral. In addition to the ability to advise thoroughly, its practical application should regularly and neutrally be reviewed and the results should be publicized and thus made accessible to as many potential clients as possible. While these requirements can be enforced by law, a voluntary commitment would also be a credible signal to the customer. Suitable institutions for the testing of the ability to advice and its application can be NGOs like consumer associations, neutral consumer publications, investor protection institutions, or academic institutions. It is a precondition for this that there are clear and consistent rules and standards that guarantee valid and reliable results. Such transparency alone, however, is not sufficient, since it would not solve the problem of the low or negative profitability of the majority of the retail clients as long as the service model of advice remains effective. It instead represents a necessary prerequisite to abolish the latter, for example by separately disclosing fees for advice and products. Since clients are enabled to assess the quality of the advice they should now more likely to be willing to pay for advice and to pay more for good advice and less for poor advice.

The second alternative offered here is based on the thought that there is no point in burdening the legal system as well as the involved parties with highly complex regulations if the latter do not sufficiently take the reality of the advice giving context into account. Since only those clients get better advice who need it the least, the preventive potential of the law fails when it is needed the most. Advice regulations do not protect weak clients against inadequate investment decisions. The logical consequence of the failure of preventive protection by means of information collection, information, and recommendation duties is to establish a solid liability framework, in other words, to tighten ex post regulation to complement or even replace ex ante regulation.

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