THE INFLUENCE OF COMPENSATION AND PRODUCER CHARACTERISTICS ON PRODUCT RECOMMENDATION

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ABSTRACT

The importance of maintaining consumer trust has led the financial services industry to become increasingly sensitized to issues regarding the ethical conduct of business. To better align the interests of financial institutions, producers, and consumers, and to promote ethical practices, it is necessary to identify structures that contribute to untoward behavior and to explore mechanisms designed to ensure accountability. We propose to test the view that commission compensation undermines the integrity of the agent-client relationship, and leads agents, brokers, and financial planners to abrogate their (self-proclaimed and/or legal) fiduciary responsibility to consumers. In addition, we propose to investigate the extent to which a compensation-sales link is moderated by sales experience, agent type (captive or independent), product menu offered (multi-line or nonmulti-line), and professional certification. In order to address these issues, we propose to survey a systematic random sample of 1500 insurance agents drawn from a list of producers to be requested from the Illinois Department of Insurance. Agents will receive descriptions of hypothetical products with associated compensation values. A between-groups design will be employed to assess how manipulated differences in compensation associate with the likelihood of selling a particular product. The null hypothesis is that product compensation is not significantly related to the percentage of agents recommending a particular product. If the evidence does not reject the null hypothesis, then criticisms of the compensation system may be misguided. On the other hand, if compensation and product recommendations are highly correlated, then the efficacy of various solutions to ensuring financial service professionals' accountability need to be explored.

PROJECT DESCRIPTION

Research Problem

The proposed study incorporates two of the Katie Illustrative Topics For Funding: #1) Banks in Insurance, and #3) Insurer Distribution Systems. The convergence of banks, securities firms, and insurers leads to important questions regarding effective distribution of products by financial services providers. The proposed study is one in a planned series of investigations designed to assess the extent to which existing compensation systems in the financial services industry are incentive-compatible in the sense of aligning the interests of insurers, producers, and clients. The present study proposes to test the widely held view that commission compensation undermines integrity of the agent-client relationship, and leads financial services professionals to abrogate their fiduciary responsibility to consumers.

Lawsuits and scandals in the insurance industry have received widespread publicity in recent years. In a survey of sales professionals, Cooper and Frank (1991a, 1991b) found that "false or misleading representation of products or services in marketing, advertising, or sales efforts" was identified as the number one major problem facing the insurance industry. Such practices adversely affect consumers to the tune of six billion dollars annually, according to the Consumer Federation of America (1997).

The importance of maintaining consumer trust has led the insurance industry to become increasingly sensitized to issues regarding the ethical conduct of business. Duska (1999) contends that “Leaders in the industry are adapting to the pressure to have companies and cultures that are ethically attuned to the needs of their clients, agents and other stakeholders. Some have done so simply in response to market, regulatory and court pressures, others from a more enlightened sense of social values” (p. 247). To promote ethical practices and to better align the interests of financial institutions, producers, and consumers, however, it is necessary to identify structures that contribute to untoward behavior and to explore mechanisms designed to ensure accountability.

One place where accountability has been seriously questioned resides in the insurance agent-client relationship. By definition, an agency relationship occurs “between two (or more) parties when one, designated as the agent, acts for, on behalf of, or as a representative for the other, designated the principal in a particular domain of decision problems” (Ross, 1973, p. 134). In essence, the agent does the bidding of the principal. Since the customer/client relies on a sales agent’s expertise and access to products, the agent and the client share an agency relationship. The client’s trust of the agent rests on his/her expectations regarding the fiduciary obligation of the agent towards the client (Barber, 1983). In other words, the relationship between agent and client assumes that the agent will act specifically in the best interests of the client.

The agency relationship between agent and client is complicated by the fact that the agent simultaneously serves another principal. As Kurland (1996) indicates, the salesperson’s employing company constitutes a principal “because it compensates the salesperson for labor rendered” (p. 291). Thus, in addition to serving the client, the agent serves the institution as well. The institution’s confidence in the agent derives largely from its expectations regarding the agent’s sales performance (Barber, 1983). The fact that sales agents service two principals creates the opportunity for competing loyalties.

A number of authors have argued that the system of agent compensation affects the likelihood of a conflict between an agent’s and a client’s self-interests. Specifically, these authors contend that the straight-commission compensation system (SCCS) creates a conflict of interest whereby the fiduciary obligation of the agent to the client is compromised (e.g., Basu, Lal, Srinivasan, & Staelin, 1985; Kurland, 1991; Oakes, 1990). Because such a system aligns the agent’s interests more closely with those of the employing institution rather than the client, the agent’s behavior favors the interests of one principal (the institution) over the other (the client). In essence, the agent presumably attempts to sell products that yield the maximal profit to the institution and/or agent compensation, rather than the products that are in the client’s best interest.

Although the arguments regarding the potentially inimical effects of the straight commission compensation system for the consumer are cogent, there remains a lack of empirical data to evidence the influence of compensation on agent selling practices. We are aware of only one investigation that attempted to directly assess the influence of compensation on agent practices. Kurland (1995) presented a hypothetical product scenario to agents. She assessed the extent to which agents would disclose all available and ethically relevant information to a client before recommending the product. The survey also asked agents to indicate what percentage of their income for the previous year was earned in commission. Results showed that there was no relationship between compensation and ethical intentions. Unfortunately, limitations of Kurland's sample and design may have undermined the validity of her study. For example, all the agents were affiliated with a single marketing organization that explicitly recruits agents who purportedly are not commission-driven. In addition, measurement of agent disclosure confounded information on product quality with information on product commission. Thus, the study proposed here is intended to provide more valid data regarding the possible connection between compensation and selling practices. We specifically pose the following research question:

RQ1: To what extent does product compensation influence agent intentions to sell particular products.

To the extent that compensation does influence propensity to sell one product over another, this association is likely to be moderated by various factors. For instance, Robertson and Anderson (1983) demonstrated that older, more experienced agents tended to render more ethical judgments, presumably because they had a better understanding of long-term consequences of unethical behavior (such as diminished reputation). We might also speculate that captive agents have fewer products to sell a client than do independent (broker) agents. Consequently, captive agents may be influenced more by compensation than their independent counterparts. Moreover, multi-line agents may feel less pressure to sell high-commission products than agents who specialize in one type of product. It is also possible that professional certifications (e.g., ChFC, CLU, CFP) may help to familiarize agents with professional codes of ethics. Although prior research on ethics training has not shown a link to ethical agent behavior (e.g., Hoffman, Howe, & Hardigree, 1991), further research is needed to discern whether knowledge obtained in the process of professional certification might acculturate agents to adhere to their fiduciary obligation to clients. We therefore propose the following research question:

RQ2: If compensation influences agent selling of particular products, to what extent is this effect moderated by sales experience, agent type (captive or independent), product menu offered (multi-line or nonmulti-line), and professional certification?

The proposed investigation yields important information. If compensation is not significantly associated with agent selling practices, then strident calls to change commission compensation systems may be misguided. On the other hand, if compensation does take precedence over promoting product suitability/quality for the client, then the efficacy of various solutions to ensuring agent accountability need to be explored in subsequent research.

Methodology

Sample. A systematic random sample of approximately 1500 insurance agents, brokers, and financial planners will be drawn from a list of producers to be requested from the Illinois Department of Insurance.

Design and Procedures. Data will be collected via a mailed survey. Agents will receive a questionnaire, along with a postage-paid return envelope. Standard procedures for enhancing response rate will be employed, including a follow-up mailing. Agents will be told that the purpose of the survey is to assess agent preferences in the sale of various products (such as cash value policies, term insurance policies, etc.). Hypothetical sets of products will be described, with compensation values included. Respondents will be given a forced-choice protocol where they will indicate within each set of products, which of the products they would be most likely to advise a prospective client to purchase.

A between-groups design will be employed to assess how manipulated differences in compensation associate with likelihood of selling a product. In other words, product descriptions will be held constant across all agents. However, the compensation values attached to each product will be manipulated to vary for different groups of randomly assigned agents. We will examine the concept that a relationship may exist between product compensation and the likelihood of an agent, broker, or financial planner recommending that product.

Efforts will be made to ensure that scenarios containing product descriptions and compensation values possess mundane realism (see Weber, 1992). In addition, attention will be paid to mitigating a social desirability response bias by including dummy content in the survey, and by obtaining a brief measure of social desirability. Scenarios will be developed and refined through pilot testing with local agents.

Descriptive information will also be collected regarding respondents' age, sex, years of experience, professional certifications, agency type (captive versus independent), professional clasisification (agent, broker, financial planner, other) and proportion of income that is commission-based.

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