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Disclosing advisor's interests neither hurts nor helps☆

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ABSTRACT

We set up an experiment to study whether disclosure of the advisor's interests can foster truthfulness and trust. We measure how advisors expect decisionmakers to react to their advice in order to distinguish between strategic and moral reactions to disclosure by advisors. Results indicate that advisors do not expect decision makers to react drastically to disclosure. Also, advisors do not find deceiving morally more acceptable with disclosure than with no disclosure. Overall, disclosure neither hurts nor helps; deceptive advice and mistrust are equally frequent with as without disclosure.

1. Introduction

Conflicting interests may provide advisors with incentives to give biased advice. Insurance agents, for example, may be led by the commissions they receive on different products and not just by the interests of their customers. Besides the interests of their patients, physicians may be affected by their relationship with pharmaceutical companies.[1] One of the solutions suggested to mitigate such problems is that advice recipients be informed about matters that present a potential conflict of interest. Mandatory disclosure rules exist in many domains, including accounting, retail finance, medicine, and academia.[2]

In this paper, we test how disclosure affects advisors and advice recipients in a simple sender–receiver game based on Gneezy's (2005) deception experiment. The receiver has to choose between two options without knowing the associated

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[1] Numerous experiments also show that a substantial portion of subjects deceive an uninformed party when doing so gives a higher payoff (see, for example, Gneezy, 2005; Sutter, 2009; Angelova and Regner, 2013; Danilov et al., 2013; Sheremeta and Shields, 2013).

[2] For example, the Insurance Conduct of Business sourcebook in the UK requires "a firm to provide its customers with details about the amount of any fees other than premium monies for an insurance mediation activity" (FSA, 2012, Section 4.3.1), and the EU Market in Financial Instruments Directive (MiFID) (European Union, 2004) has similar provisions.

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Table 1
Low and High Incentive payoff structures.

Payoff structure	Option[a]	Payoff to	
		Sender	Receiver
Low Incentive	*A*	8	3
	B	6	6
High Incentive	*A*	15	5
	B	5	15

[a] In this table Option *A* gives higher payoff to the sender. In the experiment the option with higher payoff for the sender could be either *A* or *B*.

payoffs. The sender knows the payoffs of each option, and sends a message stating which option is better for the receiver. In our baseline treatment, the receiver has no information on the sender's payoffs (as in Gneezy, 2005). In our disclosure treatment, the receiver is informed about the sender's payoffs for each of the two options. Comparing the two treatments allows us to see how disclosure affects the sender's advice and how the receiver uses the advice.

Interestingly, previous experimental studies have suggested that disclosing conflict of interests may actually hurt advice recipients (Cain et al., 2005, 2011; Inderst et al., 2010; Koch and Schmidt, 2009; Rode, 2010). With disclosure, advisors bias their advice more than they do without disclosure, and advice recipients fail to account for this sufficiently. As a result, disclosure makes advice recipients worse off compared to no disclosure. Cain et al. (2005, 2011) provide two possible explanations for the increased exaggeration by advisors. One is moral licensing, according to which advisors find it less unethical to send deceptive messages once their own interests are revealed. An alternative explanation is that the increased bias is strategically motivated to compensate for the anticipated reaction to disclosure by the advisees. An important feature of our experiment is that we measure the beliefs of the sender about the receiver's reaction to her messages. This allows us to distinguish between the two reasons for why senders might change their advice in response to disclosure, since the sender's beliefs provide us with a direct measure of the strategic motive.[3]

We also run a treatment in which disclosure is not automatic but must be requested by the receiver. This treatment is inspired by circumstances in which clients have to explicitly ask for disclosure.[4] In line with the 'hidden costs of control' (Falk and Kosfeld, 2006), we hypothesize that solicited disclosure is particularly prone to increase the moral license to deceive felt by the sender.

2. Experimental design and procedure

Our design is based on the two player sender–receiver game from Gneezy (2005). The sender observes payoffs to both players associated with two options, Option *A* and Option *B*, and sends one of the two possible messages to the receiver:

Message 1: "Option *A* will earn you more money than option *B*."
Message 2: "Option *B* will earn you more money than option *A*."

After receiving the message from the sender, the receiver chooses one of the two options and both players are paid according to the chosen option. In our *No disclosure* treatment, as in Gneezy (2005), the only information available to the receiver is the message sent by the sender. The receiver observes neither the payoffs to the sender nor the payoffs to himself. In the *Disclosure* treatment in addition to the message sent by the sender the receiver observes the payoffs to the sender for each option but not the payments to himself. Thus, the only difference between the two treatments is that the receiver observes the sender's interests in the *Disclosure* treatment but not in the *No disclosure* treatment.

We also implement a treatment where the receiver decides whether the interests of the sender should be disclosed. The sender is informed about this decision before she sends a message. With this treatment we want to test if leaving the decision to disclose the potential conflicts of interest to the receiver leads to different outcomes. We call this the *Endogenous* treatment. Depending on the receiver's decision whether or not to have the sender's interests disclosed we will have two conditions: *Endogenous No Disclosure* and *Endogenous Disclosure*. For convenience, we call the latter two 'treatments' instead of 'conditions' in what follows. Thus, overall we have four treatments: *No disclosure*, *Disclosure*, *Endogenous No Disclosure*, and *Endogenous Disclosure*.

To test the robustness of our results we implement two different payoff structures: Low Incentive and High Incentive. Table 1 provides details of both payoff structures. Note that under both payoff structures there is a conflict of the interests. We are interested in how the receivers will react to the disclosure depending on the magnitude of potential conflict of interests.

[3] Another feature of our design is that with disclosure the receiver knows the sender's interests but not that there is a conflict of interest. Our experiment shares this feature with de Meza et al. (2011). An alternative approach, used in most other experimental studies, is that disclosure uncovers the conflict of interest between the sender and the receiver. See Li and Madarasz (2008) for a theoretical analysis.

[4] For example, the Insurance Conduct of Business Sourcebook in the UK requires that "an insurance intermediary must, on a commercial customer's request, promptly disclose the commission that it and any associate receives in connection with a policy" (FSA, 2012, Section 4.4.1).