Are Financial Advisors Money Doctors or Charlatans? Evidence on Trust, Advice, and Risk Taking in Delegated Asset Management

Qizhang Sun[1], Michael Gibbert[1], Thomas Hills[2], Eric Nowak[1, 3]
[1] Università della Svizzera italiana, [2] University of Warwick, [3] Swiss Finance Institute

Introduction

Much research found that individuals keep seeking low quality advice. Financial study suggests that the trusted advice enables individuals to be more audacious than they would be otherwise, thus enabling them to take more risk, irrespective of the advisor's actual performance.

Findings:

1. **Advisors enable individuals take more risk.**
2. **Individuals favor to follow trusted advisors.**
3. **Individuals favor to follow risky advice.**
4. **Trust allows advisors charge more but still keep the customers.**

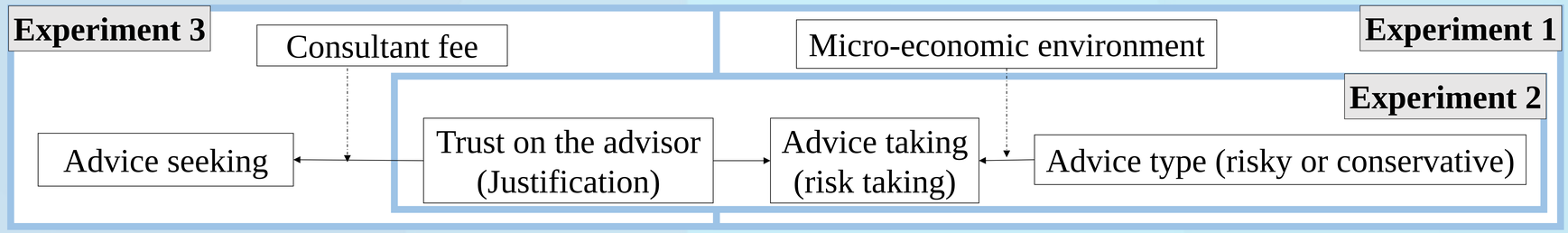
General method

- Decision from experience (repeated choice)
- Advice is free of charge (except from Experiment 3)
- Two alternatives are risky and conservative (Unbeknownst to the participants) investment products

Selected References

Gennaioli, N., Shleifer, A., and Vishny, R. (2015). Money doctors. *The Journal of Finance*, *70*(1), 91-114.
Hertwig, R., & Erev, I. (2009). The description–experience gap in risky choice. *Trends in Cognitive Sciences*, *13*(12), 517-523.
Sun, Q., Hills, T., Noguchi, T. and Gibbert, M., Paying for Useless Advice to Resolve Information Overload, Working Paper.

Insight welcome! Contact: Qizhang.Sun@usi.ch



Experiment 1

- Do trusted advisors enable investors take more risk?
- How the macro-economic environment influences advice following?

Experiment design (between-subject):

3 (environment) x 2 (advice type) x 2 (control)

Environment	Risky alternatives	Conservative alternatives
Bullish	N ~ (0.75, 1)	always 0.5
Neutral	N ~ (0.5, 1)	always 0.5
Bearish	N ~ (0.5, 1)	always 0.75

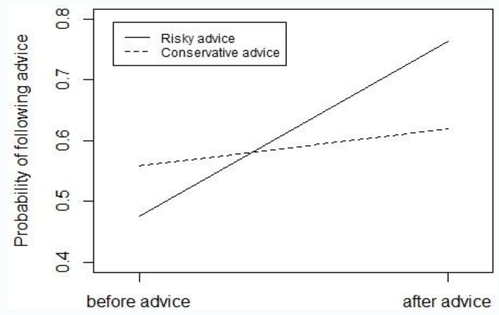
Results:

1.Risky advice enables investors take more risk.

2.Asymmetric effect: Investors are more likely to follow risky advice.

3.Asymmetric effect is robust in all micro-economic environments

- Bullish: 0.63 (SE = 0.23, z = 2.73, p < .01)
- Neutral: 0.77 (SE = 0.23, z = 3.36, p < .001)
- Bearish: 0.53 (SE = 0.20, z = 2.62, p < .01)

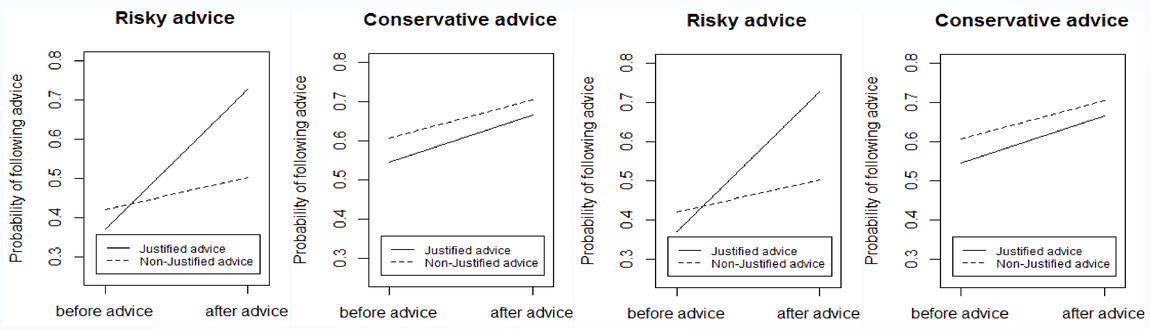


Experiment 2

- Are investors more likely follow the trusted advisor?

Experiment design:

- Between-subject: 2 (justification) x 2 (advice type) x 2 (control)
- Distributions of the two alternatives: risky N ~ (0.75, 1); conservative: 0.5



Experiment 3

- Further test on the question of Experiment 2 (directly manipulating trust).
- Does trust allow advisors charge more but still keep their customers?

Experiment design:

- 2 (high vs. low trust, within) X 2 (same price vs. different price, between)
- Two-phrase setting:
  1. First phrase (30 trials) to build trust: Free advice was showed at the very beginning
  2. Second phrase (70 trials): general test setting

Results:

First research question:

- Yes, χ^2 (1) = 43.75, p < .001
- Selecting: high trust: 91; low trust: 21

Second research question:

- Yes, between different price groups

χ^2 (1) = 43.75, p < .001 (high: 44; low trust: 13)