Sears Incentives: A Wall Street Parallel

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Sears Incentives: A Wall Street Parallel

By JAYNE W. BARNARD

This summer, Sears, Roebuck & Company started compensating its auto repair and service departments on a direct percentage basis - a move that high-margin services may violate the consumer-protection laws, at least in some states. Chairman Edward A. Forasen quickly justified Sears's compensation scheme, saying it was meant to fix but concealing it had led to "mishaps of customers being green-painted hereafter." New York Times, 10 August 1992.

As it happens, Sears's new compensation program looks a lot like the system by which many brokerage firms, including Sears's own, routinely compensate their stockbrokers. The result is likely to be the same: a situation in which brokers have a financial stake in selling specific services, car owners are overcharged for unrelated work, where stockbrokers have a financial stake in selling specific products, investors may find themselves steered toward a product by an agent, and investors may find themselves steered toward a product by an agent.

What kind of objective recommendation can a brokerage customer expect when a broker, who misleads her into a firm-managed mutual fund may receive 10 times the commission she would receive if the customer had put the same amount of money directly into an equal-sized but much more high-risk mutual fund? If the customer were to ask her broker about the relative risks and benefits of the two mutual funds, the broker may not even be able to answer the question.

In California, for example, brokers, allegedly set sales targets for specific services, like wheel alignment or new adjustments. Many brokerage firms have set sales targets for new and existing accounts, as well as for new accounts for new and existing clients. The California Securities Commission has received complaints that brokers may have been pressured to meet these targets, even if it means recommending products that are not in the best interest of the customer.

In California, Sears created sales targets that paid neighboring stores against each other in a race to sell cars and cars. The winning stores received cash prizes as tickets to California's largest car show. The contest was called the "Sears Auto Show," and it was designed to make cars and cars more attractive to customers who might otherwise have been put off by the high prices.

MANY brokerage firms are exploring alternatives to traditional compensation schemes. One Florida firm now offers customers the option of paying commissions on an open-end basis, with the commission deducted from the investor's account as they are earned. Other firms have experimented with systems that automatically match the investments to the investor's risk tolerance.

Whatever the eventual outcome of these efforts, investors should consider the value of the products that they are purchasing. The first step, of course, is to ask your broker just what these practices are.