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Misleading Customers

Companies taking ethics seriously will ensure that their ethical values are reflected in the relationships they have with their customers. However, according to IBE analysis, in 2012-2013 'mistreatment of stakeholders' was the second most commonly reported business ethics issue in the British media[1].

According to OFCOM, the UK regulator for the telecoms industry, misleading customers undermines consumer confidence and trust in business as well as causing individual harm[2].

This Briefing considers aspects of unethical treatment of customers, their consequences, regulatory responses and the steps some organisations are taking to address this issue.

Misleading Customers

Unethical treatment of customers – be they individual retail consumers, large institutional/B2B customers or corporate clients – is a challenge for companies in many sectors. It takes the form of providing misleading information, whether in the marketing/advertising of products and services or in the sales practices of employees/representatives.

Irresponsible marketing

Misleading customers can take many forms:

- **False claims** in adverts is one example. This doesn't have to be wilful lying but could simply involve an exaggeration of the truth, considered as 'crossing an ethical line'.
- **Stealth marketing** on the other hand, a more subtle form of unethical behaviour, is based on a deliberate intention to deceive whilst remaining within the law[3].
- Another way in which customers can be misled is through the **use of small print** in advertising or overly long terms and conditions, which are designed to be overlooked. This is supported by research in the USA which suggests that only approximately 1 in 1,000 online consumers read licence agreements when purchasing online[4].

Such deliberate abuses of power could lead customers into making sub-optimal choices that unfairly benefit the company. See Box 1 for examples.

Box 1 *False claims and stealth marketing*

The McDonald's fake customers

In 2008, McDonald's launched a new Quarter Pounder product in Japan and, at one of its chains in Osaka, it hired around a thousand people to queue up outside the store to buy one of the burgers. The sight of this huge line of people from before the moment of opening communicated that there was huge demand and excitement for this new product. The apparent 'social proof' for the product launch encouraged many others to join the queue to see what all the excitement was about, and also made the news. It was revealed very quickly to have been artificial popularity.[5]

L'Oreal and false eyelashes

In 2007, the Advertising Standards Authority (ASA) ruled that L'Oreal TV and press adverts which claimed their mascara made eyelashes "up to 60% longer" could be misleading to the public as the model (Penelope Cruz) was wearing false eyelashes. The ASA instructed L'Oreal to include a disclaimer in future adverts featuring models wearing false eyelashes and to ensure any further campaigns for the product made clear that the "up to 60%" claim referred only to the appearance of lashes. They also criticised L'Oreal for its lack of promptness in responding to the complaint.[6]

1. **See IBE Briefing 37:** *Ethical Concerns and Lapses 2012-2013 for further details.*
2. *Protecting consumers from mis-selling of mobile telecommunications services, Ofcom (2009). Accessed 24/02/14.*
3. **See IBE Report: *Marketing Responsibly* (2009)*: addressing the ethical challenges*.** *Available from http://www.ibe.org.uk/list-of-publications/67/47*
4. **Bakos, Y. Marotta-Wurgler, F. & Trossen, D.R. (2009). *Does Anyone Read the Fine Print? Testing Law and Economics Approach to Standard Form Contracts*.** *NYU Center for Law, Economics and Organization, Law & Economics Research Paper Series, Working Paper No. 09-40. Electronic copy available at: http://ssrn.com/abstract=1443256*
5. **See Japan Today (26/12/2008).** *McDonald's admits 1,000 people paid to join queue for Quarter Pounder debut in Osaka, Japan Today, accessed 12/03/14.*
6. **See The Guardian (25/07/2007).** *L'Oreal ad given the brush-off, accessed 12/03/14.*

Sales

Unethical behaviour can arise in the **practices of sales staff** when dealing with customers. Unrealistic sales targets or inappropriate incentive schemes may increase pressure on staff, or contracted sales representatives, agents, and third parties to compromise the ethical standards expected.

For example, towards the end of 2013 **Lloyd's Banking Group** were fined £28 million by the Financial Conduct Authority (FCA) for a 'sell or be demoted' incentive plan which, according to the FCA, created a "*culture of mis-selling*". Under this scheme sales staff across Lloyds, Bank of Scotland and Halifax were put under pressure to hit targets in order to avoid being demoted, rather than focus on what consumers needed. This abuse of the relationship between the company and the customer is especially poignant when selling to 'vulnerable' customers, such as the elderly, the young or those unable to make their own informed decisions. Box 2 gives three recent examples of organisations fined for mis-selling.

Box 2 *Examples of mis-selling to customers*

Homeserve. In February 2014 the FCA fined Homeserve – which insures more than 2 million people in Britain – £30.6m for poor complaints handling and mis-selling. The FCA said the firm had focused on the "quantity not quality" of sales to the detriment of customers.

SSE. In April 2013, SSE – a British electric utility company – was fined £10.5 million for inadequate monitoring, auditing and execution of its sales activities. Whilst the matter was investigated, the company took a number of steps including becoming the first utility company to suspend doorstep sales in the UK.

Swinton. In July 2013 the FCA fined Swinton – one of the UK's largest high street insurance retailers – more than £7.3 million for mis-selling insurance policies. Swinton's aggressive sales strategy meant it failed to treat customers fairly in its telephone sales of monthly add-on insurance policies. The company was also accused of not providing enough information to customers about the key terms of the policies as well as failing to properly monitor sales calls.

Why It Matters

Misleading customers can have serious consequences in terms of reputation for organisations through the erosion of trust, increased regulation, and financially in the forms of fines and compensation to affected customers.

Reputation

Consumer confidence and trust in business to behave ethically is low; the Edelman Trust Barometer 2014 found that only 58% of respondents trust business to do what is right[7]. In 2012 they found that '*listens to customer needs and feedback*' was considered to be the most important factor for building trust, and '*places customers ahead of profits*' ranked fourth. According to IBE research in 2013, in the British public's opinion of the issues that companies need to address '*Advertising and Marketing Practices*' had significantly increased when compared with the results from the previous year[8].

Regulation

Most recently, the UK transposition of the EU Consumer Rights Directive 2011 was introduced to parliament in January 2014[9].

Over recent years, a number of regulatory responses aimed at protecting customers from unethical behaviour have been imposed. In 2009, **Ofcom** replaced their voluntary code with a mandatory General Condition – '*GC23: Protecting Consumers from Mis-selling of Mobile Telecommunication Services*'. This gives Ofcom legal powers to issue fines to non-compliant companies and to require companies to compensate affected customers.

The **Financial Conduct Authority** was specifically set up in 2013 to drive higher standards in the fair treatment of customers across financial services given the previous poor track record in the sector. They have issued eleven binding principles, one of which states that "*a firm must pay due regard to the interests of its customers and treat them fairly*". Another says "*a firm must pay due regard to the information needs of its clients and communicate information to them in a way which is clear, fair and not misleading*"[10]. Breaching any of these principles leaves a firm liable to disciplinary sanctions.

7. *Additionally IBE research in 2013 indicated that 38% of the British public thought that the general behaviour of British businesses was not at all/not very ethical. See IBE Briefing 35: Attitudes of the British Public to Business Ethics – 10 year trends and 2013 findings for more information.*
8. *Research carried out by Ipsos MORI. Base: c. 1,000 GB adults, 16+, asked face-to-face. 16th – 23rd August 2013.*
9. *http://ec.europa.eu/justice/consumer-marketing/rights-contracts/directive/index_en.htm*
10. *Principles 6 and 7 of the FCA Binding Principles.*

Fines

Fines issued by regulatory bodies highlight the **financial** implications of misleading customers.

Historic scandals in the UK which have incurred significant penalties include the £11.8 billion bill for misleading pension sales and the £2.7 billion set aside for mis-selling mortgage endowments by the insurance industry in the late 1980s and early 90s.

To date, Britain's biggest scandal in this area is the way in which Payment Protection Insurance (PPI) was mis-sold throughout the early 2000s. According to some accounts, "*PPI was mis-sold and complaints about it mishandled on an industrial scale for well over a decade*"[11]. Collectively, British banks have now earmarked over £22 billion as compensation for PPI mis-selling[12].

Fines have also been imposed on a number of individual companies in other sectors (see Box 3).

Box 3 *Company fines*

- In October 2013, **Scottish Power** were fined £8.5 million for failing to train their salespeople properly: door-to-door and telesales operators were selling on the basis of misleading information.
- In September 2013 **AXA** were fined £1.8 million by the FCA for making £25.7m from selling investments that 'put a significant number of customers at risk'.
- During 2013 in the US, it was reported that regulators wanted to impose a fine of $80 million on **JP Morgan** for its dealings with US retail customers during the recession.
- In 2012 **EDF Energy** paid a then record fine of £4.5 million after an investigation found that staff could have been misleading vulnerable customers, with salesmen failing to offer full information to customers on the doorstep or over the telephone.
- In 2011, **HSBC** were fined £10.5 million for selling unsuitable products to almost 2,500 elderly customers.

Regarding consumers, research conducted by the Office of Fair Trading (OFT) in 2008 suggested that the British public incurred additional annual costs of £6.6bn as a result of receiving poor products and services. Companies in the financial services were highlighted as the worst offenders[13].

Good Practice

Marketing responsibly implies an approach that is values-led[14]. The International Chamber of Commerce's Consolidated Code on Advertising and Marketing Communication Practice states that marketing should be based on four basic principles: respect, openness, honesty and fairness.

As part of promoting an ethical culture it is common for companies to include commitment and guidance on this issue in their Code of Ethics (or equivalent document). IBE research in 2014 showed that of a sample of 50 FTSE100 company codes, 76% have sections dedicated to the way employees should engage with customers[15]. Box 4 gives three examples.

Box 4 *How some FTSE100 organisations are addressing the treatment of customers in their code of ethics*

Marks & Spencer. M&S values the loyalty and confidence of our customers above all else. We will not compromise the safety of our customers and will always strive to live up to and offer the highest possible standards of Quality, Value, Service, Innovation and Trust. We will always try to make sure our labelling, advertising and other forms of communication are clear, honest and accurate and we will always work to respect cultural and ethical beliefs.

B Sky B. We never forget that people make a choice when they buy our products or watch our programmes. In order to earn their trust and build long-term relationships, we pay as much attention to the way we do business as the quality of the services we offer. That means treating our customers and viewers with respect and ensuring that all our dealings with them are professional, honest and helpful.

Barclays. At Barclays we strive to create and maintain mutually beneficial long-standing relationships with personal, business, institutional and international customers and clients, that meet their needs and exceed their expectations. In doing this we: conduct sales, advertising and marketing of our products and services with integrity and do not make false or exaggerated claims.

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11. Peter Vicary-Smith, Which? *Quoted in: Banking industry gives up on PPI mis-selling battle, BBC (09 May 2011), accessed 21/02/14.*
12. *As of February 2014.*
13. See The FT (15/04/2008) *Business failings cost public £6.6bn, accessed 24/0/14.*
14. *ibid, fn[3]*
15. *In March 2014 electronic copies of 50 codes of FTSE 100 companies were searched for the terms 'customer', 'consumer' or 'client'.*

Requiring that customers are dealt with in a transparent and fair manner, aligned to the core values of the organisation, helps to minimise financial and reputational risk in this area.

Beyond company codes, good practice would include: training staff on how to uphold ethical commitments, ensuring performance incentives are appropriate, having authentic dialogue with customers that enables ethical issues to be identified, and publishing reasons behind employee dismissals. In 2008, for example, **NPower** reported that it had terminated the contracts of four staff in their sales department accused of using dishonest methods to get customers to switch gas and electricity supplier[16].

Another example of good practice is **Alstom** (the French maker of trains and power equipment) stopping using external sales consultants to support their own commercial teams. This was to "further reduce compliance risks to the group and in line with Alstom achieving the highest ethical business standards".

Additionally, in an article in the Guardian in 2014, Ross McEwan, the chief executive of **RBS**, remarked that the fair and ethical treatment of customers was being put back at the heart of the strategy for his organisation:

> "In the rush for growth and profit, we forgot what banking is about – to serve the customer. Now we must go back to basics. ... We need to remember – and then never forget – that the customer is why we are in business. ... To move from stability to renewal, we need to first address and then clean up every aspect of how we treat customers."[17]

About the IBE

The IBE was established in 1986 to encourage high standards of business behaviour based on ethical values.

Our vision is to lead the dissemination of knowledge and good practice in business ethics.

We raise public awareness of the importance of doing business ethically, and collaborate with other UK and international organisations with interests and expertise in business ethics.

We help organisations to strengthen their ethics culture through effective and relevant ethics programmes.

The IBE is a registered charity, supported by subscriptions from businesses and other organisations, as well as individuals.

The IBE will be hosting a lunch discussion on Thursday 12th June 2014 where Clive Adamson, Director of Supervision, FCA will be discussing this topic.

More information about the event and how to book your place is available on the IBE website: http://www.ibe.org.uk/forthcoming-events/56/48

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http://www.ibe.org.uk/list-of-publications/67/47/

16. **See electric.co.uk News (28/04/2008).** *http://www.electric.co.uk/news/employees-sacked-over-mis-selling-1234306.html*, accessed 24/03/14.
17. **See The Guardian (10/02/2014).** *My priority for RBS is to ensure that customers are its heart and soul, accessed 24/03/14.*