Inviting both Amos Tversky and Solomon Asch: It's not all Casino Capitalism

Author : Robert Rosen

Date : April 20, 2011

Donald C. Langevoort, *Chasing the Greased Pig Down Wall Street: A Gatekeeper's Guide to the Psychology, Culture and Ethics of Financial Risk-taking*, **Cornell L. Rev**. (forthcoming), available at SSRN.

Donald Langevoort demonstrates, again, his ability not only to do behavioral economics but also to reframe it by placing actors in organizational contexts and relations. Behavioral economics, sharing economics' methodological individualism, analyzes biases and cognitive heuristics in regards to individual risk taking. More broadly, social psychology investigates decision effects that result from affects, visceral and cultural factors, as well as pressures toward or against groups and authority. For example, Solomon Asch emphasized that people make decisions in public differently than they would in private, based on their impressions of others, and seeking legitimacy.[1] Langevoort presents research that builds on Asch, for example the finding that in the presence of an audience, facing rivals, with time pressure to make a mark, individual motivation may shift from goal attainment to an obsession with winning at all costs.[2] Such work not only uncovers other sources of bias, but also it reframes the subject as decision-making rather than only risk-taking. In "the 'competitive arousal' model of decision making,"[3] the actor doesn't engage in risk analysis, rather other motivations and models engage the actor. For some it is Tversky or Asch. Langevoort learns and masters work in both traditions, and more.

Langevoort's subjects are the decisions that led to the Global Financial Crisis (GFC) and what gatekeepers need to learn from it. A principal-agent approach to the GFC demands explaining excessive risk-taking by theoretically risk-averse employees (invested in and frightened of losing their jobs). Although he has proffered other explanations, in this article, Langevoort focuses on the firm's shaping of actor's understandings and motivations. A principal-agent approach normally addresses the design of appropriate contracts, incentives, compensation and monitoring systems. In this article, Langevoort focuses on understanding the firm's organizational culture.

Langevoort proposes the functionality to firms of employees being unrealistic and overconfident, able to deflect doubt and sometimes taking unjustified risks. "He who hesitates is lost" is an adaptive mindset for a firm in a competitive environment. In analyzing reports from the GFC, Langevoort draws out a wide range of aspects of firm culture, including routines, myths, scripts, rationalizations, fraternity-like excess, ideologies, and sense-making perceptions and inferences. With such a developed understanding of corporate culture, Langevoort might have added that there are multiple cultures in any organization and the adaptive one on which Langevoort focuses may be joined to others, such as the one that might be carried by gatekeepers, inscribing "Look before you leap."

Langevoort advises gatekeepers that they need to understand organizational culture. Of course, one result is that gatekeepers will understand not to believe everything presented to them. Understanding organizational culture importantly reveals that it is not normally the case that misreporting is the result of deception. The misreporting is scripted in firm culture and makes sense to its participants. Langevoort advises gatekeepers not to challenge the risk-taking culture (no "Fools rush in where angels dare to tread"), emphasizing that awareness of the culture will teach when objectivity must be sought.

Despite Langevoort's analysis, at points he is unwilling to move beyond methodological individualism. He says that the issue is what "might bias the assessment of financial, legal, and reputational risk."(P. 30.) He says he is only "project[ing] individual cognitive biases into the larger organizational culture." (P. 12.) Yet, at other points, he speaks of culture as "making it hard to perceive the need to rethink," (P. 24), or providing "deeply held cultural ideologies" (P. 26.)

There are at least two reasons why it is difficult to move beyond risk-taking as the description of decision-making, neither of which I can do justice to here. The first is that understanding decisions as risk analysis enables experiments and theory development, even as it eclipses the actor. On the other hand, one of the joys of Langevoort's work is that the actor peeks through. In my understanding, to an organizational actor, the choice is not always (or normally) which of a well-defined set of options to choose. The choice is "What shall *I* do." The organizational actor is immersed in actions and in culture. Facing decisions, she solves problems. Of course, she uses evidence and assesses probabilities. But, as she conceives them, intelligence and imagination are her normal tools for decision-making, not risk-analysis. Inscribing the actor within the broader understanding of decision-making may be noisy, but has its charms.

The second reason why it is difficult to move beyond risk-taking is an identification of risk-taking with corporate behavior. One indication of this is that risk management has become the regulatory response to the GFC. This article is relevant to corporate law because gatekeepers (including the board) are increasingly tasked with assessing financial, legal, and reputational risk. This focus on risk management occludes that "risk" has multiple meaning (or that uncertainty differs from risk) and treats all business as if it were the casino capitalism that led to the GFC.

What does the failure to hedge against systemic risk in the CDO market tell us about, say, the decision to chance violating emission discharge laws by a manufacturer? If by legal risk we mean the risk of getting caught and paying a fine greater than a certain sum, then everyone may be in a casino (and ignoring ALI Principles of Corporate Governance §2.01). But, decisions are more complex than that and involve commitments, character and cultures.

Failing to recognize that risk-taking is one part of decision behavior and failing to recognize what appears as a risk may be a predicate to self-defining choices leaves us understanding all of business as casino capitalism.

By inviting both Tversky and Asch, Langevoort invites deeper understandings.

1. S.E. Asch, Effects of group pressure upon the modification and distortion of judgments. In H. Gustzkow (ed.) Groups, Leadership, and Men 177-190. Pittsburgh, PA.: Carnegie Press (1951); Asch, S. E., Forming impressions of personality, 41 J. Abnormal and Social Psychology 258-90 (1946); Asch. S.E., The doctrine of suggestions, prestige and imitation in social psychology, 55 Psychological Review 250-276 (1948). [?]
2. Langevoort, note 42. [?]
3. Langevoort uses this phrase, drawn from G. Ku et. al., Towards a competitive arousal theory of decision making: A study of auction fever in live and internet auctions, 96 Org. Behav. & Human Dec. Processes 89 (2005), cited in Langevoort at n. 42. [?]

Cite as: Robert Rosen, *Inviting both Amos Tversky and Solomon Asch: It's not all Casino Capitalism*, JOTWELL (April 20, 2011) (reviewing Donald C. Langevoort, *Chasing the Greased Pig Down Wall Street: A Gatekeeper's Guide to the Psychology, Culture and Ethics of Financial Risk-taking*, **Cornell L. Rev**. (forthcoming), available at SSRN), http://corp.jotwell.com/inviting-both-amos-tversky-and-solomon-asch-its-not-all-casino-capitalism/.