The Journal of Behavioral Finance
2005, Vol. 6, No. 2, 104–105

BOOK REVIEWS

Review of *What Price the Moral High Ground*

Robert A. Olsen

What Price the Moral High Ground, Robert H. Frank, 2004, Princeton, NJ: Princeton University Press, 203 pp.

In this succinct and incisive book dealing with behavioral aspects of economic decision-making, the author argues that the adaptive rationality of real people, as opposed to the self interested rationality of "homo economicus", can lead to consistency between doing well individually and doing good socially. More specifically, people who love, behave modestly, are generous and loyal, etc. do not always end up on the "short end of the stick" because such behaviors often open up to them opportunities that are foreclosed to those who are purely opportunistic. Adaptive rationality is grounded in biological and evolutionary principles. From a biological perspective, decision makers must adopt preferences and social behaviors that lead to a sustainable flow of resources to ensure survival and reproduction. Because survival and reproduction is often more efficiently obtained through cooperative behavior (non zero sum games), evolutionary principles suggest that group effort and norms to promote cooperation will be important attributes of human society. The degree of cooperative behavior will depend a great deal on the ability of decision makers to detect and punish cheaters. Because cheater detection and punishment is not without cost, society will always contain some mix of cooperators and cheaters. Only when cheater detection is perfect will complete cooperation prevail. Similarly, only when detection is impossible will decision makers be completely self- interested, as in neoclassical economic theory.

In addition to the conceptual argument, the author presents an interesting panoply of empirical evidence suggesting that individuals and firms that cooperate and/or engage in socially beneficial behaviors not only survive, but often do better than their self interested counterparts. In particular, Frank notes that the higher costs associated with socially responsible behavior are often offset by lower commitment costs between the firm and its employees, suppliers, customers, and provides an opportunity to charge higher product prices and acquire labor at lower wage rates.

While this book focuses on economic decision making in general, most of the content and observations have obvious relevance to financial markets. For example, a portfolio manager's need to outperform his/her colleagues, even though the absolute level of return is adequate from the client's perspective, may lead to excessive investment in the portfolio management business and herding among advisors. Also, lack of trust between manager and client increases perceived investment risk, amplifies market volatility and reduces capital flows. Finally, socially responsible firms need not be assumed to offer inferior market return.

Robert A. Olsen is Professor Emeritus from California State University, Chico and a Research Fellow with Decision Research in Eugene, Oregon. He holds graduate degrees in Finance from the University of Oregon and the University of Massachusetts. Professor Olsen has business experience as a Financial Analyst and consulting experience with small business start-ups. Professor Olsen's research interests are focused on Risk Perception and Behavioral Finance.

Requests for reprints should be sent to: Robert Olsen, Decision Research, 1201 Oak Street, Eugene, OR 97401. Email: olsenbfin@msn.com.

Review of *The Wisdom of Crowds*

Robert A. Olsen

The Wisdom of Crowds, James Surowiecki, 2004, New York, NY: Doubleday, 296 pp.

If you believe that the best decisions are to be made by contacting the brightest mind on the subject, you have a lot of company. However, the author of this book will not be among them. In this entertaining and enlightening book the author suggests that the "wisdom of crowds" has gotten a bad rap. More specifically he argues that under the right conditions, the collective wisdom of the crowd may be greater, and its forecasts more accurate, than those of individual experts or small cohesive groups of experts. What are the right conditions? First, subject to some minimal level of expertise, there must be diversity of opinion among the crowd members; diversity based upon different points of view, information sources, methods of analysis. Second, there must be independence among the crowd members. Independence means the ability of the members not to be overly influenced by other crowd members and to be able to maintain a nonconforming opinion based on independent analysis. Without independence, individual opinions may become correlated and valuable marginal insights lost. Third, there must be some mechanism for turning the individual opinions into an overall prediction or choice. That is, there must be some aggregation process that does not inappropriately bias or weight the opinions of individual crowd members but yet summarizes the incremental insights of each participant.

After discussing the appropriate conditions and environments for crowd based decision making, the author proceeds to discuss why and how the crowd decision process can be useful for solving three common types of decision problems. The problem types are problems of cognition or understanding, problems of achieving coordination, and finally, problems of obtaining cooperation.

The second half of the book is devoted to a historical reappraisal of the use and misuse of the crowd decision process in some well recognized real world circumstances. For example the author looks at the influence of crowd decision misbehavior in the case of Long Term Capital Management and the Columbia Shuttle disaster, among others.

In general, the book is well written and edited. While it is not technical and was not written for decision scientists, it contains many excellent references for general readers who wish to follow up with more detail. Also, even though the book is not primarily focused on the financial markets, its relevance and application to financial issues such as asset valuation, forecasting and portfolio management is obvious.

Review of *The Sociology of Financial Markets*

Robert A. Olsen

The Sociology of Financial Markets, Eds. Karin Knorr Cetina and Alex Precha, 2005, Oxford, UK: Oxford University Press, 319 pp.

This collection of new research studies is significant in that it appears to be the first book in many years to focus on the sociology of financial markets. In contrast with psychology, which focuses on individual behavior and mental processes, the readings in this book focus the social relationships and interactions between the people and groups that make up the professional financial landscape. For example there are papers dealing with the behavior of securities traders, the interaction between investors, advisors and brokers, and the relationships between analysts and managers in investment organizations, including the former Long Term Capital Management. There are also multiple papers dealing with differing attributes of global investment networks and even one paper dealing with the politics of the Federal Reserve Board.

The book is divided into three sections, "Inside Financial Markets", "The Age of the Investor", and "Finance and Governance". Each section contains about five papers with each paper having been written by a recognized scholar. Most of the papers are empirical, as opposed to conceptual, with the data having been obtained from surveys, interviews, and other techniques designed to obtain information on working relationships in functioning organizations. Each paper is tightly focused on an individual topic or organizational type and all contain extensive references that allows further in depth investigation of the chapter content.

In general, the book is well written and edited, and it provides a welcome perspective on the influence of social relationships on financial market practices and asset prices.