6 Making Markets: Opportunism and Restraint on Wall Street

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Homo Economicus Unbound: Bond Traders on Wall Street

> *Bond trader* (looking out across the trading floor): Traders are dying to make money. That's all they care about. Most traders don't care about the diplomacy that you see in the corporate environment. They don't care about titles. They are here to make money. They live in a four-by-four foot space and put up with all the bullshit that goes on around them. They put up with a lot, but the money is worth it.
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> *Mitch*: What else is different from the corporate environment?
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> *Bond trader*: Wall Street salaries are so much higher that you are comparing apples and oranges. The typical guy that walks in the door on Wall Street is probably making what a senior V.P. is making in corporate America. And this guy is younger and cockier. A lot of guys under thirty making big bucks. You don't find that too much in corporate America . . . On Wall Street there is no "working your way up." You have a good year, make a million dollars. You're a hot shot.
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> *Mitch*: What happens to the guy who has a bad year?
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> *Bond trader*: There's always someone waiting to take your chair. Lose a few hundred thousand in a week or over six months and you're out. You see winners and you see losers. It's best not to get too excited for the winners and it's best not to get too close to the losers.

I began my fieldwork on bond markets in early October of 1987. I did not know then that I was observing the peak of a speculative mania in financial markets. Bond markets had experienced explosive growth since October 1979, when the Federal Reserve Board decided to let interest rates float. The mania came to an end on October 19, 1987 when the Dow Jones Industrial Average crashed 508 points. Just four days before the crash a managing director in bond trading at a major investment bank explained the firm's strategy for growth: "The strategy is simple. You fill up one trading room, and you open a new one. You go out and hire the talent. A guy's making a million dollars a year . . . you can give him two million. He's making two you give him . . . [w]hatever the numbers are. Simple." After the crash, the heady optimism and bravado of the pre-crash era never totally evaporated, but the trading community was chastened. My fieldwork in the bond market continued for another year and a half after the crash. Market growth receded during this time, but salaries remained high and trading continued to be a profitable business for the firms.

Original publication: Chapter 1 of Abolafia, Mitchel Y., *Making Markets: Opportunism and Restraint on Wall Street* (Harvard University Press, Cambridge, MA, 1996).

My first day on a bond trading floor left a strong impression. My field notes recorded the youth, intensity, and pace: "There is almost no gray hair to be seen. Most traders are white men between twenty-five and thirty-five years old. They wear short hair and dark business suits with the suit jacket slung over the back of a chair. There are a few women, most of them clerks or analysts,[1] and a few older men . . . The people on the trading floor are highly focused. They stare intently at computer screens, hold several phones at once or shout information to nearby colleagues in staccato bursts. Their concentration on the immediate transaction is all-consuming. We are on the fortieth floor with windows all around offering spectacular views of New York harbor. No one is distracted . . . All of this activity is performed at a dizzying pace. Deals are begun and finished in less than a minute. Market fluctuations generate flurries of activity. Money, though invisible here, is in constant motion. The energy of the market infects everyone, myself included."

As the weeks went by the market slowed down and it became more difficult for traders to find profitable trades. Some of the energy began to dissipate. This gave the traders more time to talk with me. Behavior that had at first seemed like explosions of chaotic aggression began, instead, to look like a highly organized, even ritualized, game. Firms offered huge incentives to aggressive young people willing and able to play a game of deep concentration and discipline. The game required that they gather endless amounts of information to be applied in periodic bursts of risk-taking.

Based on their youth and incomes, bond traders looked like a fairly exotic group to study. But there was something familiar about them. This resemblance was not to any person or group but to an academic idea. Bond traders bore a striking resemblance to *Homo economicus*: the highly rational and self-interested decision maker portrayed in economists' models. Bond traders' behavior appeared to come closer than I expected to the economists' assumptions of perfect rationality and unambiguous self-interest.

The Study

The subjects in this study are fifty-four bond traders employed at four of the ten largest investment banks on Wall Street. They perform the dual roles of broker and dealer. As brokers, they match buyers with sellers, thereby earning commissions for the firm. As dealers, they trade bonds for the firm's account, either buying or selling, to create profits for the firm. Traders are paid a salary plus a bonus that often exceeds their salaries. The work consists of a continuous stream of transactions each worth millions of dollars. The pace, which is often frantic, is dictated by the activity and volatility in the market.

The traders in this study work on large trading floors surrounded by one hundred to two hundred other traders, salespeople, and support staff. They work at desks that are typically four feet across and are piled with three or four quote screens, a personal computer, and two or three telephones. These desks are attached to other traders' desks on three sides. Traders can be seen standing by their desks, holding several phones at once on long extension cords, and simultaneously carrying on a conversation with a nearby salesperson or clerk. The air vibrates with the low roar of voices punctuated by an occasional effort to be heard above the tumult.

The data consist of formal interviews and extensive field notes based on observation. Interviews and observation were completed between October 1987 and March

1989. Formal interviews were conducted on the trading floor or in adjacent offices. All interviews were taped, transcribed, and coded. Less formal conversations took place through follow-up phone calls and meetings with informants.

Economic Man: A Grounded Model

Although the Wall Street bond traders interviewed differed in age, education, and personal style, certain common concerns predominated. The limits and variations of these concerns were explored in successive interviews. Taken together these concerns constitute a skeletal script for membership on the trading floor. The inductive model of economic man constructed from these interviews is based on the primary goals of traders, their strategies for attaining those goals, and the institutional rules that define both the actors and the action.

Economic behavior is pursued for more than one reason. The primary purpose of economic behavior in market societies is the accumulation of wealth. Extraordinary personal wealth is the dominant goal among bond traders. The trading floor of investment banks provides an organized and legitimate institutional context for turning undirected desires into viable strategies of action. It is a context in which a certain amount of specialized and focused self-interest is considered a very good thing. Self-interest is the raw material from which the local version of economic man is constructed and legitimated.

Even the drive for extraordinary personal wealth has a subsidiary meaning, a meaning given by the related but subordinate goals of the bond trader. Trading is construed as a source of both excitement and mastery among bond traders. Bond trading is a form of what anthropologist Clifford Geertz, writing of Balinese cockfighters, calls "deep play." In such games, successful play confers high prestige. As Geertz writes, "In deep (play), where the amounts of money are great, much more is at stake than material gain: namely, esteem, honor, dignity, respect – in a word . . . status."[2] Among bond traders, trading is often described as an ordeal that, if successfully mastered, confers status. A typical story told repeatedly on the trading floor involves the first time a trader goes home for the night having purchased a large block of bonds for the firm, especially when the market is particularly volatile. "Until you've taken your first position home and tried to go to sleep at night and woken up with a loss staring you in the face, you'll never know if you can make it." Like other games, the process of playing and winning is the reward. "It's not just the money. It's the excitement, the chance to test yourself every day," one trader commented.

The dominant metaphor on the trading floor is the game. Bond traders compare themselves to gunfighters, fighter pilots, and professional athletes. The comparison is not to team-based games but rather to one-on-one challenges. Traders also compare trading to such betting games as poker and shooting dice. Each transaction is a one time gamble in which there is no room for complacency or compromise. The trading floor is not understood as a place to footdrag or merely survive, as are other organizational settings. It is a place to win. As one trader expressed it, "The sheer raw enjoyment of winning . . . you'll never find anything like it in any other business."

The money, the heightened materialism, is not the only goal in this game. For a significant share of veteran traders the ultimate goal is the excitement and status incumbent in winning. As one senior trader explained, "There is a tremendous feeling every day when you roll down here and you come onto the Manhattan Bridge and see the Wall Street skyline. This could be the day I win it all." "Testing" and the "raw joy of winning" are powerful seductions to professional athletes, fighter pilots, and professional crooks, as well as bond traders. Success in these forms of deep play results in immediate, visible status. Bond trading is the practical method available to these MBA graduates by their social position.

If the trading floor is a context that attracts those with a pressing desire for extreme wealth, it is because it is constructed to do just that. Unlike most of corporate America, there is no career ladder for traders. There are only traders who make more and traders who make less in a continuous contest for wealth. Traders refer to themselves as entrepreneurs in the sense of being self-reliant. Ironically, it is a self-reliance framed by the organizational structure in which they operate. "You trade for your own account," one trader explained. "You have the ability to hang yourself here. They're giving you a framework in what you should do and that framework is pretty loose. Each individual is making his own market . . . Profit and loss is what the trader is all about."

The means for achieving entrepreneurial success are provided by the investment banks that employ the traders. These means must then combine with the individual characteristics ascribed to economic man: self-interest and rationality. They become visible as strategies that traders enact on Wall Street: opportunism and hyper-rationality. Bond traders construct their own version of entrepreneurial behavior, becoming local and somewhat stylized versions of economic man.

Strategies

The economist Oliver Williamson defines opportunism as "self-interest seeking with guile." We will use the term to refer to those actions in which a trader uses his advantage to deceive his trading partner. Among opportunism's most significant forms is the selective or distorted disclosure of information in a transaction. Not surprisingly, none of the subjects in this study voluntarily described their own behavior as opportunistic. As J. Van Maanen notes, few informants in an ethnographic study are likely to reveal their hidden techniques, but informants freely offered that deceptive practices were part of their business, that they had seen instances of deception, and that one had to be wary. In this sense, opportunism is part of the script in terms of what *other* people are likely to do to *you*. The trading floor is understood as a dog-eat-dog world, one in which individualism is a survival strategy. Thus, while traders would reject the label of "opportunist," they were quite comfortable describing incidents in which their own behavior had been particularly "aggressive" or "entrepreneurial." Such aggression often turned out to involve locally approved forms of opportunism.

Bond traders are at the center of the market-making process, yet they never deal directly with their transaction partner. They have two options. They may trade "in the Street" or with the investment bank's customers through its institutional salesforce. "In the Street" trading is based on bids or offers that are publicly available through computer screens or "broker's brokers" who cover specific sectors of the market. Trading through the salesforce involves dealing with a salesperson, usually on the same trading floor, who manages an average of four or five institutional customers that want to buy from the firm or sell to it. Trading through the salesforce is preferred in that it services the firm's customers and carries a higher return for the firm. It also affords most of the possibilities for opportunism.

Opportunism among bond traders takes the form of culturally scripted strategies. The first and simplest form of opportunism is "laying off" bonds. It involves offering incomplete information and taking advantage of a transaction partner's ignorance. Traders may communicate incomplete or misleading information to the salesperson when selling bonds out of the firm's inventory. As one trader admitted, "The trader will know the true story on a bond and sell it anyway, where they know they shouldn't sell it for as much." Although the trader knows that the bond is not worth that much, he also knows that such behavior is acceptable in this context. As Michael Lewis, a former salesman at Salomon Brothers explained, "The trader can pressure one of his salesmen to persuade insurance company Y that IBM bonds are worth more than pension fund X paid for them initially. Whether it is true is irrelevant. The trader buys the bonds from X and sells them to Y and takes out another eighth" (i.e. he charges Y a commission of an eighth of a point).[3] The belief that this happens frequently leads institutional customers, such as mutual funds and insurance companies, to resent and mistrust bond traders. This mistrust is reflected in the fact that institutional customers often seek information from four or five different firms before transacting. "There are a lot of accounts that feel that Wall Street is a conniving, calculating institution that would rip the eyes out of anyone they can," one trader commented.

A second, more deceptive form of opportunism is the use of false information. Traders not only conceal information, they may actively distort it by "showing a bid." This refers to posting a false, but highly visible bid on a computer network in order to support the price of bonds you already own. As a trader explained, "Frequently, if you own bonds you show a bid on the Street to support your position. If I own bonds and I think they are worth 65 I'm going to show a bid on the Street so that when an account comes in and wants to know what the market is, another trader in another shop will say, 'Well there's a bid on the Street for them . . .'" Traders may post a deceptively high bid on the Street and then strategically withdraw it. In the following instance my informant was lured into buying bonds cheap that he intended to sell to a high "bid in the Street." The high bidder withdrew his bid, leaving my informant stuck with the bonds he bought. He expects that he will still sell the bonds to that bidder, but at a considerably lower price, just as his adversary intended.

> I bought some bonds the other day based on a bid that was in the Street. The bid was very rich. When I turned around to sell those bonds to that bid in the Street the bid was no longer there. The guy who was bidding needed the bonds. He was probably short, but he wanted to smoke me out and make me panic. I think he needs the bonds but is just not showing his hand. So his bid is ridiculous now. Ten points below his bid before. It's just a waiting game. At first I thought I'd gotten raped and was going to get buried. Fortunately, it wasn't a large block.

The two strategies discussed above represent relatively mild forms of opportunism. They are considered a routine part of playing the game. As one trader put it, "You can be too honest and you'll go nowhere." The selective use of information is a taken-for-granted part of the local repertoire of strategies. At more extreme levels of deception are the third and fourth forms of opportunism: agent opportunism and insider opportunism. They involve the theft of proprietary information and are considered significant violations of the securities laws. The most common script for agent opportunism is front-running. In front-running a trader becomes aware that a customer is going to place an order. The trader then buys the bonds, marks them up, and sells them to the customer through one of the firm's salespeople. This form of opportunism is very hard to catch, although bond traders agree that it is fairly common. Insider trading is the use of information about the economic condition or intentions of a bond issuer that is not available to the public. It is sometimes referred to as "trading a leak" and is still considered a rare occurrence. Both of these are very clear violations, although traders believe that the former is more common and less egregious than the latter.

Much opportunism occurs in what traders themselves refer to as the gray areas: instances in which a particular formal market regulation is widely ignored. At such points traders bend the rules. "If an account [a pension fund, mutual fund, etc.] had given bonds to another broker/dealer for the bid and that broker/dealer goes to a broker's broker and you just happen to find out what account it is that has the bonds out for bid, now you're getting into one of the gray areas. You're not supposed to go direct (to the account), but more times than not you'll go direct and save the broker's commission."

Young traders acquire a working knowledge of these "gray areas," learning which forms of opportunism are part of the local script. Older informants suggest that the script in the bond markets became more opportunistic in the 1980s. "A lot of things that are OK now, we thought of and dismissed. Nice people wouldn't do such trashy things." In the eighties, following the floating of interest rates by the Federal Reserve Board, the bond markets grew in volume and volatility. There was much more trading and many new traders. The firms expanded their trading floor operations so rapidly that it became increasingly difficult to socialize trainees to the unwritten scripts and the institutional rules defining the limits of opportunism. In addition, the Reagan administration sent clear signals that regulatory oversight was being reduced. Noting the changes, one informant in his mid-forties explained, "It began to occur to me that I was playing some old game that is no longer. The rules have changed. To play ball, you really have to get in there and root around." Another said, "It used to be 'My word is my bond.' That was all you needed to know."

Opportunism, particularly in the first two forms discussed, was a common strategy among the subjects in this study. The strategies existed prior to the action – part of the tool kit available to every trader. Opportunism is one of the forms of rationality accessible to traders. In the next section I discuss the dominant mode of rationality on the trading floor: hyper-rationality.

Just as self-interest is constructed as opportunism on the trading floor, rationality appears as hyper-rationality. The question is not whether alternative forms of rationality exist, but rather the conditions under which they make their appearance and the resulting forms that they take. In recent years, economists have shown an increasing recognition that rationality is not a simple fact of nature. In the ideal type of economic man, the actor has fully ordered preferences, perfect information, and immaculate computing power. All of these assumptions have been called into question recently by economists[4] as well as non-economists.[5] The ideal type of rationality has been replaced by cognitive biases and heuristics,[6] rational foolishness,[7] and anomalies.[8] All are alternative forms of bounded rationality.

Bond traders exhibit a form of bounded rationality that might be called hyper-rationality. Hyper-rational decision makers are those who make the greatest use of analytic techniques, but still include elements of intuitive judgment in their decision process. Among bond traders, hyper-rationality is manifested in habits or ritualized customs that are tacitly but continuously invoked throughout the trading day. The most important elements in hyper-rationality involve context-dependent versions of vigilance and intuitive judgment.

Vigilance involves the ability to search and assimilate a broad range of information that one expects may be useful in decision making. Trading floors are continuously deluged by economic indicators and interpretations of those indicators. During their internships, novice traders learn which indicators and modes of analysis are most culturally valued on the Street and in the firm. Hyper-rationality involves dealing with continuous information overload using prescribed modes of vigilance. "Everybody is inundated with information," a trader noted. "Every machine in the world is spewing out technical information, fundamental information, news releases, everything. You have to be very agile, very focused."

Bond traders engage in a continuous and aggressive search using a variety of electronic, print, and interpersonal information sources. There is a sense that indicators must be assessed because they are available. Each represents a potential resource for reducing the uncertainty of highly consequential buy and sell decisions. Such indicators come in a wide variety of forms, from government statistics to experts' predictions and local rumors. Specific strategies of vigilance vary from market to market. Vigilance in corporate bond trading is slightly different than it is in government bond trading: the most valued specific indicators are different for each.

Vigilance consists of several related elements: sorting, checking, and establishing value. The first step in vigilance is sorting. The volume of information available is so overwhelming that a subsidiary industry has grown up to supply information and analysis of market trends to traders. Most traders depend primarily on statistics and the highly regarded interpreters of such statistics who publish newsletters and have columns in the trade papers. These interpretations are important because all traders are presumably looking at the same numbers. The interpretation of such numbers is somewhat equivocal. Every trading floor has an adjacent research department offering interpretations of the behavior of the Federal Reserve Board, as well as the latest government reports and statistics. Every trader must sort through both the numbers and their multiple interpretations. Most develop a routinized sorting procedure to cover their favored sources. This procedure is enacted daily prior to the start of trading and continues throughout the day.

New information often interrupts the routinized sorting. The trading community grabs at new pieces of information. Stories on the newswire occasionally require immediate consideration. At the moment when a key indicator is about to be released by a government agency, traders all over Wall Street stand poised at their phones. When enough people with significant trading power share the same belief about the meaning of this information, the collective effect may be a self-fulfilling prophecy. This is particularly evident when the government releases indicators like the Producer Price Index or retail sales figures. If the news is surprising, it will often move the market. If it fails to move the market, traders will say that it has already been discounted.

Once information has been gathered and sorted, traders employ a checking strategy to see how others are perceiving the same or different information. They are in contact with an assortment of brokers, salespeople, economists, and informants in government agencies. Traders are generally aware that it is not the correctness of the interpretation that counts, but rather the degree to which others will read the same information the same way. As one trader explained it: "A lot of smart people don't do very well at trading because they know what information means. When you trade you need to know what people *think* the information means. You don't have to be smart, you just have to be perceptive. You have to have a sense of what motivates people – to be a good listener to what people think."

The same point is made by John Maynard Keynes. "[Professional investors] are concerned, not with what an investment is really worth . . . but with what the market will value it at . . ."[9] In keeping with this, most traders do little analysis themselves. Rather, they work hard, through sorting and checking, to stay apprised of what others are hearing and thinking. This is shown by their constant recharting of the yield curve, an indicator that reflects what others have most recently been willing to pay for bonds at a range of interest rates and maturities. Market rivals make buy and sell decisions by watching each other.[10]

Establishing value is the final step in the script for vigilance. It is the local term for making an estimate of where a bond "ought to be" in terms of price. It is at this point that traders focus on a particular bond. The most important rituals in establishing value are called "taking the runs," in which a trader finds out what's available in the Street from an intermediary known as a broker's broker and through the "inquiry" from the salesforce. These are ritualized morning activities that provide the trader with price information on past transactions and ongoing bids and offers. Both of these rituals allow the traders to begin to array their alternatives. In this kind of highly liquid market, recent transactions are among the most important sources of information for establishing value.[11] There are also norms about appropriate price movement over time and the influence of movement in one instrument on another that influence the process of establishing value. One trader explains his ritual: "Each morning I call my broker's broker to take what is called a run. This is a list of bonds I trade. These [pointing to long pages of handwritten price quotes] are the very active issues. On Friday I used five brokers. They gave me a whole run of issues and the size of those offerings or bids. Then the inquiry from the salesforce begins."

The post-modern trading floor is a setting that elicits vigilance. Every major investment bank reproduces this context for vigilance. All over the Street investment firms provide a nearly identical set of resources. They create the setting for vigilance activities in the form of daily strategy meetings, internal economic reports, and informal interaction that defines the meaning of various types of information. But in the end, a firm cannot make the individual, split second decisions required in bond trading. "The key thing is judgment," a trader explained. "It's the toughest thing about being here, not the mechanics (of trading). Those things are simple; very easy to follow and not a big deal. But that split second judgment that you have to make. (It) probably comes from some subliminal input you don't even recognize. That's what makes the difference. You can't be trained to do that. You just have to be exposed."

Traders often say that they did a trade because it felt right or felt good. Asked to explain this, one trader said, "It's a visceral thing. The brain to mouth reflex. Traders cannot put into words what they've done, even though they may be great money-makers. They have a knack. They can't describe it." Intuitive judgment involves the use of tacit knowledge in an unconscious process to arrive at a decision. Jerome Bruner suggests, "Intuition implies the act of grasping the meaning or significance or structure of a problem without explicit reliance upon the analytic apparatus of one's craft. It is the intuitive mode that yields hypotheses quickly . . ."[12] Intuitive processes are built up through trial and error experience, independent of any conscious effort to learn. Intuitive judgment is most often contrasted with "analytic thinking" and is considered a critical decision tool by bond traders.

Although vigilance is a cultural capacity that may be developed through training and access to information resources, intuitive judgment about bond prices is a craft that is learned through practice. The bond trader develops an abstract sense of how the raw material, in this case the market, reacts under various conditions. These abstractions or images are developed through watching others trade, "paper" trading, and ultimately, the direct experience of trading for one's own account. The novice engages in a lengthy internship during which he is first exposed to the market and ultimately thrown in for a "baptism by fire."

Traders often say that successful trading is an art. "If you have to know how to trade you will never be any good. That's sort of a certainty here. It's not a science, it's an art. People who have to know never make money. You can't learn it. We don't teach it. We just sort of expose people." As Michael Polanyi explained, "An art which cannot be specified in detail cannot be transmitted by prescription, since no prescription for it exists. It can be passed on only by example from master to apprentice."[13] Recruits compete to apprentice themselves to the best traders. These traders do not reveal their "trading secrets," rather the recruits watch and listen as the trader connects disparate facts to arrive at successful choices.

The last steps in the trader's vigilance routine, "taking the runs" and "inquiry," are the precipitants to arriving at particular buy and sell decisions. Traders are faced with a series of immediate opportunities by their brokers and salespeople. They must assess this information in light of other information derived from sorting and checking. This assessment of disparate facts occurs instantaneously as the broker or salesperson waits for a response. It is the flow of bids and offers in the market that stops the vigilant search and precipitates choice. This "flow" forces decisions about whether to act or not.

At this point, the trader takes a leap, hoping that his interpretation is correct and that a particular bond will respond to the forces as expected. This is the point where most traders acknowledge such non-analytic tools as experience and "feel for the market." The technology of trading changes dramatically at this point. It is less like the continuous processing of information and more like custom craftsmanship. One trader explained, "Experience is the next step. You find over time that each issue trades a bit differently. You can only get it (experience) by being on the desk and trading. Just sitting on the desk and watching trades occur in your own positions. Seeing where they trade."

The uncertainty and ambiguity of the decisions described come from the nature of the information being gathered, the time constraints set by the rapid flow of bids and orders in the market, and the cognitive limits of humans as information processors. The flow of information about the market cannot be fully assimilated. As one trader explained, "The market is a nebulous type of animal that you can't get your arms around. It is always right. It is never wrong. It is something you spend countless hours trying to second guess, trying to interpret." Recruits learn that they must develop "the knack" or fail. Although judgment itself may not be easily taught, the belief in its efficacy has become an important cultural script in the decision process.

Institutional Rules

Recruits to the trading floor seeking extraordinary wealth do not arrive on Wall Street and create the world anew. They arrive to find an established institutional order. This order, most evident in its rules, is the result of traders' habituation to existing strategies, e.g. opportunism and hyper-rationality. These rules have come to have external force in the lives of traders. They are experienced as objective standards of behavior, even though they are derived from habituation to the most salient strategies. The recruit encounters an ordered social world that must be learned before he will be allowed to sit at a trading desk. "The institutions must and do claim authority over the individual, independently of the subjective meanings he may attach to any particular situation."[14] I begin this section with a discussion of the institutional rules on the bond trading floor and then turn to the socialization process through which these rules are learned.

The trading floor, as a social setting, is constituted by both general and specific institutional rules that define the identities of the traders and the patterns of appropriate action. There are historical rules legitimating the form of exchange (over-the-counter), the form of securities being traded (bonds), and the modes of rational calculation employed (yield curves, inflation rates). They reflect not only the local setting but more widely accepted strategies of finance capitalism. These rules are really accounts of how this part of the economic world works.

At deeper and more specific levels, institutional rules define both the identity of individuals and the patterns of appropriate action. They operate as vocabularies of motive, explaining to the trader and others the reasons for action. The institutional rules of the trading floor are, not surprisingly, caricatures of the "spirit of capitalism" identified by Weber.[15] Among the most significant are those relating to self-reliance, risk, and money – key elements in this version of the spirit of capitalism.

Self-reliance

Traders are very clear that they are expected to be self-reliant. "It's a very entrepreneurial business. No one is going to help you make money. They're too busy helping themselves." Traders sitting in a room full of other traders feel atomized and alone. In the words of another trader, "I don't really feel like I can rely on anybody here. *That's the way this business is*. You've got to rely on yourself." Such statements define both actors and action, revealing the rules of the game. They describe an impersonal environment in which trust and cooperation are nearly absent. One of the oldest informants stated, “There is an adversarial relationship in that the trader is not a fraternity type of brother. It is you against him. You would love to make money at his expense and that’s all over the Street.” In this context, trust is minimal, one’s only obligation is to oneself, and opportunism is understood as an appropriate form of action.

Risk

Another institutional rule is that traders should excel at *calculated* risks. Money supplies the incentive, and rationality is the means linking money and risk. “Trading is taking calculated risks using the capital of the firm. We just went to an [Treasury] auction. I spent $200 million on seven year notes. They’re ours. I have to do something with them. If I keep them and the market goes down, I’ve lost money.” Traders are aware that the stakes are very high. “There is a high roller mentality ingrained in the job description. There are big dollars on the line.” Although such commitments of capital are risky, “with risk comes reward.” As another trader puts it, “You are rewarded for the risks you are incurring.” Implicit is the understanding that the pursuit of extraordinary wealth requires some worthwhile risk.

At the same time that traders see themselves as risk-seeking, they also see the risk as highly calculated and rational. “You’ve got to keep your position balanced. You’ve got to be in a situation so that no one trade can take you out.” A trader does not trade randomly; he tries to predict market direction. “You are trying to lower the odds against you. I mean, obviously it’s a crap shoot. If we had all the answers we’d all trade our own accounts. You try to get a good feeling for the market.” It is a game of chance with an extraordinary incentive to win attached. As one trader explained, “You have to make a rational game out of it.” Many of the traders from high status MBA programs grudgingly admire the small but visible group of locally bred risk-takers who seem to balance calculation with risk-taking intuitively: “You have to have a lot of street smarts to do trading, so some of the boys from Brooklyn have done very well for themselves.”

Money is everything

It is nearly a cliche to say that the pursuit of money is at the heart of Wall Street culture. As one trader put it, “It’s a money business. People are very focused on it and that’s across the board.” Like self-reliance and calculated risk, heightened materialism is one of the key elements in the contemporary spirit of capitalism. But on the bond trading floor that spirit is magnified and sanctified.

Money is more than just the medium of exchange; it is a measure of one’s “winnings.” It provides an identity that prevails over charisma, physical attractiveness, or sociability as the arbiter of success and power on the bond trading floor. The top-earning trader is king of the mountain. Consumption is often immediate and conspicuous. A young and aspiring trader explained, “It’s about how much you made this year or what you bought with it. How many cars, where you go on vacation, where your apartment is or how big your house is. A lot of money goes into things that are just smoke: clothes, dinners. Nobody knows where it goes. There are a lot of status symbols in this business." This penchant for squandering reinforces the idea that it is not the accumulation of money that is important, but its symbolic ability to convey status. Money defines who you are and what you ought to be doing. Another trader put the rule more succinctly, "Money is everything in this business. Whatever money you make is what you're worth."

Self-reliance, risk-taking, and materialism are part of the culture of entrepreneurship that defines the contemporary spirit of capitalism. But the interpretation on the trading floor seems narrower and more extreme than that which is in general use. Self-reliance is enacted as aggressive opportunism, and calculated risk becomes hyper-rational gaming. These local interpretations or scripts are constructed in the process of interaction by traders and learned during the extended training programs with which every trader begins his career.

The initial socialization experiences of subjects in this study ran from six months to two years. These training programs included a short period of classroom work to learn the technicalities of bond trading, and a much longer period of internship on the floor. During this extended internship the recently graduated MBAs were rotated from desk to desk, mostly doing clerical tasks and trying to fit in. "You were supposed to go around from desk to desk in different departments. If they liked you they would offer you a job. If they didn't they'd send you on your merry way." During this time they are in an extended limbo, having low status, and are not yet guaranteed a space on the trading floor. Trainees are expected to ingratiate themselves with the traders. This "stripping down" of the self, common to a variety of socialization experiences such as boot camp, builds commitment to the role of trader and signals this commitment to others. The trainees are often left to fend for themselves on the trading floor, learning self-reliance. The training program ends when the recruit is awarded a trading desk and the opportunity to succeed or fail. As one recent graduate of such a program explained, the status degradation often continues until the trainee has made his first big win or behaved opportunistically with abandon.[16]

It is during this long internship that trainees become aware of the repertoire of strategies available. They observe senior traders, overhear conversations, and receive explicit communication about what it takes to survive. "You watch the guys around you . . . I got my post-doctorate degree in the bars, mostly after work, hanging around with the older guys, letting them beat me up and tell stories. Then you begin to see how things work." It is during this time that they acquire role-specific vocabularies and tacit knowledge about the rules of self-reliance and risk by which all traders live. Self-reliance and calculated risk are institutional rules that define the relationship of the trader to his actions. Traders can both draw their identity from these rules and define appropriate modes of action.

The significance of socialization in determining trader behavior was confirmed by the few traders in their late thirties and forties I was able to interview. The feeling among these senior traders was that the moral climate had changed. As one trader put it, "The kids coming in now are smarter . . . more educated really, but something's missing." The rapid growth in bond trading created pressure to bring in new recruits. Along with the increased competition among traders, this meant that each recruit received less attention from a senior colleague and the attention he did receive was focused on rapid return on the firm's growing investment.

Structure and Culture

Traders' construction of their culture does not occur in a vacuum. There are important structural conditions that shape traders' strategies and are, in turn, shaped by the continued use of those strategies. These structural conditions are significant characteristics of traders' environments. They are the variables most likely to cause changes in the strategies and rules on the trading floor. In the absence of these conditions, or the presence of others, we should expect to find different strategies and, ultimately, different forms of competitive capitalism.

The structural conditions of opportunism

The key structural conditions underlying the probability of opportunistic action are extraordinary incentives, opportunity, and low levels of informal and formal restraint.

Extraordinary short-term incentives

The compensation system for bond traders is structured by the firm to inspire maximum individual performance. Informants believed that average traders, who were predominantly between 25 and 35 years old, made between $250,000 and $750,000 a year. The best traders were paid into the millions of dollars. More important than the size of these rewards is the fact that bonuses are known to fluctuate widely based on individual contribution to the bottom line. Several older traders pointed out that the association between contributions and rewards was not linear. Some of it was based on what you were paid last year and what it might take to keep you from jumping ship, as well as on profits in the department and the firm. Regardless of the actual explanation for compensation calculations, traders believed that the organization gave them strong incentive to maximize their individual performance through "aggressive" behavior.

Investment banking firms have given their traders unquestionable incentive to maximize personal income and firm profits as quickly as possible. This is heightened by the fact that there is no career ladder for a trader. There are few incentives for loyalty. Informants volunteered that they had no desire to move into management. Managers frequently earn less than their best traders. Traders move easily and frequently to other firms in search of higher rewards. In fact, there is considerable disincentive to delay proving one's financial worth to the firm given the competition for the best trading desk assignments. Failure to compete effectively leads to transfer off the floor or dismissal.

Opportunities for information impactedness

Opportunism requires a situation in which the opportunist has some potential advantage. Most opportunistic actions are based on the opportunity traders have to know more than their exchange partner or to offer incomplete or misleading information to a salesperson or customer. Traders' knowledge of the firm's inventory and of the placement of particular bonds gives them information not generally available in the Street. Like the used car dealer or antiques dealer who can hide the current market value of a commodity from the customer, traders are able to take advantage of their position in the marketplace.

Traders may also use knowledge of a customer's intentions to trade ahead of that customer without the customer knowing. The limited ability of customers to monitor traders' behavior enhances the impactedness of information, even when customers suspect that someone has traded ahead or taken advantage of them. Customers must choose their trading firms based on the firm's reputation and the alternatives available in the market. They are caught between the desire for aggressive agents who offer profit opportunities and the fear that this aggression will shade into opportunism against them. The resolution of this dilemma requires close monitoring of the trading process, which even the institutional investor is not in a position to design or enforce.

Limited informal restraint

Bond trading in this setting requires relatively little cooperative behavior or even interaction between the buyers and the sellers. Traders are anonymous to other professional traders, trading through brokers' brokers. They are buffered from customers by salespeople. There is little sense of obligation in this most fleeting of relationships. Traders talk about trading "for their own account" although it is the firm's money with which they trade. Under these conditions, there is very limited opportunity for restraint based on continuing relationships or trust. In contrast, market makers at the stock exchange and futures markets transact primarily with known participants in daily face-to-face interactive cliques, thereby developing bonds of trust and a reputational network. On the floors of these exchanges the participants constitute a trading community.[17]

Limited formal restraint

The de-regulation movement during the Reagan administration sent clear signals to the financial community about the level of formal restraint from government. Many of the older traders in this study remarked on the changed regulatory environment. Among Reagan's earliest actions was the appointment of John Shad, an executive from the brokerage firm E. F. Hutton rather than a securities lawyer, to head the Securities and Exchange Commission (SEC). Aggressive enforcement at the SEC was reined in.[18] This, in turn, took pressure off the National Association of Securities Dealers (NASD), the self-regulatory association in the bond market studied here. The self-regulatory system is most active in regulating the interface between retail brokers and the general public.[19] It is here that complaints from vulnerable retail clients, or what traders refer to as "widows and orphans," are most likely to attract intervention from Congress and the Securities and Exchange Commission.

The self-regulatory system is more passive and susceptible to politics when regulating the trading floor, an arena where traders trade only with other trading professionals.[20] The system seems to wink at the strategies of opportunism common to the trading floor. The rules of the NASD and the government oversight agencies seemed distant to my informants in the bond market between 1987 and 1989. When

I mentioned them informants were mostly either ignorant or indifferent.[21] The manipulation of the Treasury bond market by traders at Salomon Brothers, discussed in the Introduction, is perhaps the most egregious example of the casual attitude toward self-regulation common on bond trading floors.

This, when combined with the bond trader data presented in this study, suggests a pattern of passive self-regulation and a culture of tolerance that is inadequate to inhibit opportunism on the trading floor. Self-regulation functions as a system of cooperation among firms to maintain a market that offers optimum benefits to the market makers. It has little impact on the day-to-day actions of traders whose opportunism is aimed at other traders and at large financial institutions such as insurance companies and mutual funds. The trading floor is thereby maintained as a stage on which economic man may play his part in a relatively unimpeded fashion and self-interest may be turned to aggressive opportunism.

The structural conditions of hyper-rationality

A rich and continuous flow of information

Trading floors are designed to provide a steady flow of information to the trader in addition to the information he more actively searches out. There are also commercially available predictive models and interpretations by a network of associates. Another source of information for the trader is the continuous and immediate feedback on performance. Traders are provided with a daily profit and loss statement by which they assess their contribution. This feedback is an additional goad to hyper-rationality. The trader is reminded of his progress in the competition for high bonuses. He may also be reminded of specific bonds that are losing value. With computerization of the daily trading record of every trader, short-term profits and losses are closely tracked, visible, and salient.

High outcome uncertainty

The strategy of hyper-rationality is most likely to be employed under conditions of high market volatility. In highly volatile markets price is changing rapidly and in unpredictable directions, a common feature of the bond markets of the late 1980s. Volatility has several consequences. First, traders are uncertain of the appropriate market price for a bond thereby eliciting increased search. Second, bids and offers may disappear at any moment, forcing rapid action. Third, volatility enhances the potential for asymmetric information. Traders with better information, born of exhaustive search or better access, can take advantage of those with less information. The trader must increase his vigilance. Ultimately, the flow of information cannot be assimilated and the direction of the market remains uncertain. Predictive models and expert opinions are not definitive, and traders must make intuitive leaps.

High stakes outcomes

Hyper-rational decision making is most likely when the outcome is highly consequential. Like the fighter pilots and the surgeons to whom my informants compared themselves, bond traders perceive themselves as taking relatively large risks. Despite the fact that they are employees of large investment banks, the hazard is experienced as personal. "I commit my own capital, it's completely my own risk," remarked one trader. The result is exhaustive search behavior that is only interrupted by the unpredictable flow of transactional opportunities that force a rapid choice.

These structural conditions cannot stand alone as explanations of economic action. Actors must create a meaning system of personal strategies and rules. The strategies are themselves embedded in cultural idioms like "entrepreneurship" and "risk-taking" that interact with structural conditions to enable and constrain economic action. The structural conditions and cultural forms identified here are themselves social constructions. They are shaped and reshaped by the creative action of economic actors over time.

Discussion

The analysis of self-interest in this chapter and the scandals in financial markets in recent years suggest that there is a culture of opportunism in the bond market. It seems reasonable to wonder why customers tolerate such opportunism. Why doesn't a market for fair-dealing firms develop? In fact, reputation does operate in the bond market, but to a more limited degree than in the stock and futures markets discussed later in this book. First, in stock and futures markets trading is centralized on a single trading floor, like the New York Stock Exchange or the New York Mercantile Exchange, where market makers transact face to face, day in and day out. The bond market is "over-the-counter," meaning that trading, even among market makers, is over the phone and often buffered through intermediaries. The personal relations so important in reputation are mediated by distance, technology, and the rapid growth in the number of institutional investors.

Second, traders' relations with their firm's customers are mediated through the salesforce. Traders feel little obligation to the customer or the salesperson. Institutional customers are faced with a dilemma in that it is the most "aggressive" firms, like Salomon Brothers and Drexel Burnham, that also provide the deepest markets and the greatest profit opportunities. In most bond markets, the number of primary dealers is limited and dominated by a few. While reputation is important, reputation for providing profit opportunities may take precedence over reputation for opportunism, especially if the uncertain cost of opportunism is less than the presumed or real profit opportunities afforded by a relationship with a top firm. Finally, traders and salespeople reported that institutional customers expect traders to use opportunistic strategies, but could not predict which of the many transactions conducted would involve opportunistic strategies. Even after Salomon Brothers admitted manipulating the Treasury securities market, most of their customers continued to trade government securities with them.

Bond traders in Wall Street investment banks in the 1980s produced their own version of *Homo economicus*. He was hyper-rational, highly self-interested and relatively free of social control as he traded in the debt of corporations and governments. More specifically, he engaged in both opportunistic and hyper-rational strategies and was guided by rules of self-reliance, calculated risk, and extreme materialism. These characteristics are products of a unique environment in which new entrants to the labor force soon find themselves trading in millions of dollars of government or corporate debt. Tom Wolfe captured the ego inflation and cockiness inherent in this situation in his novel, *Bonfire of the Vanities*, referring to bond traders at investment banks as "masters of the universe."

But this version of *Homo economicus* is not universal. While most economic actors exist in dense webs of trust, obligation, and reputation, investment banks in the 1980s constructed an environment with minimal interdependence, extraordinary incentives for self-interest and limited constraints on behavior: a poor prescription for a legitimate or stable economic system. Other financial markets that had high historic levels of opportunism responded by constructing systems of restraint.

Notes

1 Because I was accustomed to teaching women MBAs, it was surprising to see that there are still occupations, even in major banks, where women are so under-represented. Male pronouns are used to maintain realism.
2 C. Geertz, *The Interpretation of Cultures* (New York: Basic Books, 1973), p. 433.
3 M. Lewis, *Liar's Poker: Rising through the Wreckage on Wall Street* (New York: Norton, 1989), p. 34.
4 See Oliver Williamson, *Markets and Hierarchies* (New York: Free Press, 1975); Williamson, *The Economic Institutions of Capitalism* (New York: Free Press, 1985); A. Sen, "Rational Fools," *Philosophy and Public Affairs* 6 (1977), pp. 317–34; T. Scitovsky, *The Joyless Economy* (New York: Oxford, 1976); H. Leibenstein, "Allocative Efficiency vs. 'X-Efficiency,'" *American Economic Review* 56 (1966), pp. 392–415.
5 See H. Simon, *Administrative Behavior*, 3rd ed. (New York: Free Press, 1976); J. March and H. Simon, *Organizations* (New York: Wiley, 1958); J. March and J. Olsen, *Ambiguity and Choice in Organizations* (Bergen, Norway: Universitetsforlaget, 1976); and A. Etzioni, *The Moral Dimension: Toward a New Economics* (New York: Free Press, 1988).
6 A. Tversky and D. Kahneman, "Judgment under Uncertainty," *Science* 185 (27 September 1974), pp. 1124–31.
7 Sen, "Rational Fools."
8 R. Thaler, *The Winner's Curse* (New York: Free Press, 1992).
9 J. M. Keynes, *The General Theory of Employment, Interest, and Money* (New York: Harcourt, Brace, 1964), p. 154.
10 For a model of how this works, see H. White, "Where Do Markets Come From?," *American Journal of Sociology* 87 (March 1981), pp. 517–47.
11 For a discussion of establishing value in other markets, see C. W. Smith, *Auctions: The Social Construction of Value* (Berkeley, CA: University of California Press), 1989.
12 Jerome Bruner, *On Knowing* (Cambridge, MA: Harvard University Press, 1962).
13 M. Polanyi, *Personal Knowledge* (Chicago, IL: University of Chicago Press, 1958).
14 P. L. Berger and T. Luckmann, *The Social Construction of Reality: A Treatise in the Sociology of Knowledge* (New York: Anchor Books, 1966), p. 62.
15 Max Weber, *The Protestant Ethic and the Spirit of Capitalism*, trans. Talcott Parsons (New York: Charles Scribner's, 1958). The spirit of capitalism may be thought of as a typification of the strategies of the early Calvinists. These Calvinists would likely be shocked by the behavior of the bond traders, particularly their materialism.
16 Lewis, *Liar's Poker*.
17 W. Baker, "The Social Structure of a National Securities Market," *American Journal of Sociology* 89 (January 1984), pp. 775–811; and M. Y. Abolafia, "Self-Regulation as

Market Maintenance," in R. Noll (ed.), *Regulatory Policy and the Social Sciences*, (Berkeley: University of California Press, 1985).

18 D. A. Vise and S. Coll, *Eagle on the Street* (New York: Charles Scribner's, 1991).

19 D. P. McCaffrey and S. Faerman, "Shared Regulation in the United States Securities Industry," *Administration and Society* 26 (August 1994), pp. 204–35.

20 Abolafia, "Self-Regulation."

21 In contrast, a study of specialists on the floor of the New York Stock Exchange found that the specialists were conscious of regulation, easily citing three regulations that constrained their trading on a daily basis.