

Oil discovered in hell

Linda Pelzmann: The Triumph of Mass Manufactured Will. Malik on Management Letter, November 2002, pp. 185-205.

An oil prospector, moving to his heavenly reward, was met by St. Peter with bad news. "You're qualified for residence", said St. Peter, "but, as you can see, the compound reserved for oil men is packed. There's no way to squeeze you in." After thinking for a moment, the prospector asked if he might say just four words to the present occupants. That seemed harmless to St. Peter, so the prospector cupped his hands and yelled, "Oil discovered in hell." Immediately the gate to the compound opened and all of the oil men marched out to head for the nether regions. Impressed, St. Peter invited the prospector to move in and make himself comfortable. The prospector paused. "No," he said, "I think I'll go along with the rest of the boys. There might be some truth in the rumor after all."

The story was told by the legendary investor **Warren Buffett** in September 1999 to Harvard Business School students in order to illustrate the dynamics of crowd psychology. When this dynamic is in action, analysts and economists refer to this type of behavior as being **irrational** and **unpredictable**, but this is not the case. This crowd behavior has a **rationality** of its own and is **predictable**. I will demonstrate the circumstances in which it operates and the rules of conduct which govern it.

[...]

The freedom of the individual to want, to decide and to act is regarded as a fundamental feature of our economy. Economic theory rests on the idea of a free and definite will that is the prime mover of action. *The Efficient Markets Hypothesis* stands or falls by the independent and genuine decision-making of the individual.

However, when economists maintain that this highly developed order in market relationships applies at all times and in all places, they are mistaken. For there are other circumstances in which people do what other people are doing, without thinking or deciding for themselves. People only need to **panic** or, even better, to be filled with **enthusiasm**, and they will prove that this is true. In "*no-data situations*", where there is no information available and people cannot fall back on experience, they also become other-directed.

The fact that markets are generally efficient, because market participants use the available information to make independent decisions, does not prevent manic phases occurring in which people, on occasion as victims of irrational exuberance, greed, over-optimism and over-trading, revert to primitive behavior . A characteristic feature of this type of relapse is that **people become other-directed**. The pull, or attraction, which is exerted by other people on an individual grows with the size of the manipulable crowd. The extent to which panic and euphoria will spread is a quantitative question. The contagion often develops in geometrical progression.

People tend to adapt their behavior to the structure of the information available in the environment where they form expectations. They act ecologically rationally to the degree they are using the structure of the information provided by this environment. One factor of this type in people's environments is other people. "*The others*" are a significant source of information and means of orientating oneself. In conditions such as uncertainty, insecurity, anxiety but also euphoria, it is "*the others*" who provide the individual with his coordinates.

The confrontation with an unknown environment, in which people do not know their way around, leads circumstances to evolve in

which people create new rules of conduct. People respond with a new pattern of actions which give their group an advantage in the competitive situation. The new rules of conduct do not develop as consciously acknowledged conditions for a conscious purpose. They occur because the groups which put them into practice have more success than other groups and as a result, these rules displace other sets of rules.