Liar’s Poker

The book Liar’s Poker, by Michael Lewis, is a story about the Bond Trading culture on Wall Street during the 1980s. The author was fresh out of business school in 1984, and took a job at one of the most admired companies on Wall Street, Salomon Brothers, which is now a subsidiary of Citi Bank. The book contains interviews with various key players at the company and in the industry, and mainly focuses on the rise and fall of the company as seen through the Fixed Equity Bond Selling and Trading departments. The name of the book is derived from a game called Liar’s Poker, which is a game of poker that is played among Wall Street traders in which the serial numbers on a dollar bill are used as the underlying differentiator between a good and bad “hand” when thought of in poker terms. Traders would play this game for tens of thousands of dollars at a time, and it is representative of the overall culture of greed and recklessness that was running rampant on Wall Street at the time. This novel also sets the tone for some of the more recent greed that has been attached to Wall Street with the advent of the Global Financial Crisis of 2008.

This book clearly portrays the industry in a negative light. Within the first ten pages of the first chapter, the book documents a scenario in which the CEO of Salomon Brothers wants to play the game of Liar’s Poker against the head trader at the firm for an amount of one million dollars. The head trader turns down the offer and suggests that the game be played for “real money” instead, for the prize of $10 million dollars. This is the last time that the game is mentioned in the book, because it only serves the purpose of encapsulating the mindsets of the individuals that led the industry at the time, and the mindset focused on greed and money. It also illustrates an important theme in business that the tone of a company starts with its CEO. While this has been curbed with some recent regulations, Sarbanes Oxley being the most notable, it is still a major theme today, and the tone of the entire company can be positively or negatively impacted by the executives at the top. In this case it is apparent that moral tone set by the CEO of Salomon Brothers did not have a positive effect on the company.
A second example of the poor leadership throughout the industry was the decision for Salomon Brothers to become a public company. The company had been a partnership from 1910 until the mid-1980s when the book was written. For an investment company, it made a lot of economical and ethical sense to be a partnership, with the risk of the firm’s operations being owned by the partners of the firm. It held the operators to a certain degree of accountability. When the CEO sold the company, he put it in a position that inherently transferred the risk from those with personal skin in the game to a position that put the risk on the shoulders of the investors. This single decision, although unknown at the time, was the beginning of the end of the company’s long history of success. Another indication of how this decision was not for the betterment of the firm was that the CEO had an obvious conflict of interest, as he collected around $40 million dollars when the company was sold, with no dependence on its future success or share price.

Another example of how the author portrays the industry, and especially Salomon Brothers, in a negative light, was the ability of traders and salesmen, all in their mid-twenties, and having no credentials to speak of (other than good business schools on their resumes), to carelessly manipulate hundreds of millions of dollars of customers’ wealth only to profit the firm. During Lewis’s first year as a bond salesman with the company’s London branch, he recounts how he had built up relationships with various customers, all investing millions of dollars through him. In one particular transaction, the company had stuck its neck out and made a bad investment in some bonds that were doomed to fail, and would be on the company’s balance sheet as they tanked. The author was able to convince one of his customers to pay almost $100 million dollars for the bonds, which was obviously a move to transfer the risk from Salomon Brothers to the customer. As the salesmen were supposed to be acting as agents in good faith of their customers, this is just one example of how the company was more than willing to see a customer fail in order to profit the firm. This was the single act that had the greatest impact on the author’s career at the firm. He immediately received praise from executive management and head
traders for the work that he had done. This allowed him to get a higher bonus than any of his peers had
gotten for the year.

There are several ethics issues portrayed in this book, but the biggest one is individual greed. The author discusses in depth the greed of individual employees. The only motivation for the
employees is to increase the size of their yearly bonus. This comes at the cost of customer relationships
and internal working relationship in many of the situations. The entire year of employment leads up to
the one day that bonuses are handed out. That is why people work, and that is one of the roots of the
ethical issues. The best example of this was when the author was applauded for passing risk on to an
investor that should have stayed with the firm. One of the managers that reported directly to the CEO
was among those who congratulated the author.

The second ethical issue that is apparent throughout the book is the poor and unethical
leadership of Salomon Brothers. As mentioned previously, there was a tone at the top of the
organization that encouraged greedy and reckless behavior. This type of behavior seemed to be the
standard throughout the financial industry at the time. There was a sense that the employees of the
firm were invincible, almost as if they felt that there would be no repercussions for any of their actions.
All firms on Wall Street were making the same unethical decisions, and there was a mentality that “if
everyone else is doing it, then we should be too”. The CEOs were encouraging their employees to be
innovative with ways to manipulate laws to make money. Where this mentality really starts to become
a problem is in an environment that is desperately in need of stricter regulation, as was the financial
industry during this time period.

The first business ethical dilemma to point out was the author’s decision to either sell bad bonds
to a customer, or to let them sit on the firm’s balance sheet. The issue was resolved when the author
sold them to a customer, and let the customer suffer the consequences. Taken as a snapshot in time,
this was an unethical decision, because the Bond Sellers were supposed to be looking out for their
customers’ best interest. However, this single act garnered the author much praise from executive management. In reality, this is what most individuals would have done in the same situation during the 1980s, because ethics were an afterthought to personal greed. This is a demonstration of what Kohlberg would consider Stage 3 behavior, which means that an individual will do things that are in line with a larger group. The issue should have been resolved at a higher stage of Kohlberg’s framework.

Had the author acted at a Stage Six level, he would have seen that what he was doing was treating a human being with a lack of dignity and respect, and would have let the firm pay for its bad decision.

The second ethical dilemma was a story that the author told about a former trader at Salomon Brothers who had taken the head trader position at Merrill Lynch. This trader had made some bad bets on bonds and had lost almost $250 million dollars during a single trading day. Now this is obviously an extreme example, but it shows how reckless the individuals and the companies were at the time. The root of this issue was that the trend on Wall Street was to take financial companies public, so that the risk of the firm’s operating business was passed on to the shareholders. Prior to this happening, the partners of the firm would have personally lost the $250 million dollars. However, it would have curbed the risk of decisions so that the companies would have never put themselves in this position. The CEO of Salomon Brothers had originally promised the son of the founder of the company that he would keep the company privately owned. However, he obviously lied, and knew that if the price was right that the partners would vote in favor of selling. This is exactly what happened. The CEO, John Gutfruend, made a deal with a buyer and the partners in the firm received an average of $7.4 million dollars each for the buyout. This was the beginning of the end for many Wall Street firms, with the consequences culminating in many of the founding Wall Street firms going bankrupt or purchased in late 2008. I see this behavior as being in line with Kohlberg’s Stage 4, which states that individuals will do unethical acts as long as it is in line with public laws. This is exactly the mentality of Gutfruend at the time. He broke a promise and began the demise of his company, but it was legal and he justified it because he was not
breaking any laws. The CEO should have looked at the long term viability of the firm, and acted with a Stage 5 mindset, which would have been to provide the greatest good to the greatest amount of people. This would have meant that the CEO would not have sold the firm to investors.

The final ethical dilemma was the author’s internal struggle of having to work in an industry that encouraged unethical behavior. Interestingly, when he sold the bad bonds to his customer, he claims that the decision haunted him for years, and marked the point where he decided to slowly remove himself from the industry. This shows that the author learned from his mistakes, and was actually an ethical person in the end. He was acting in Stage 6 of Kohlberg’s framework, showing remorse for his unethical act against a single human being. The author quit the firm after a couple more years, and is now a full time author and has been very successful.