

PRINT

**THE DAILY
BEAST**

BLOGS & STORIES

Goldman's Shell Game

 by *Roger Martin*

April 18, 2010 | 10:40pm

READ THIS SKIP THAT

A report now says senior execs, including CEO Lloyd Blankfein, played a "pivotal role" in the mortgage unit accused of defrauding investors. The Daily Beast's Roger Martin reveals how the charges against the financial giant stemmed from a zero-sum culture that produces precisely nothing besides profits—and how to change the rules.

When the SEC charged Goldman Sachs with fraud for allegedly letting a hedge-fund manager handpick subprime collateralized debt obligations to short, and then selling that same batch of CDOs to its unsuspecting customers, I immediately thought of the scene in the Hollywood classic *Casablanca* in which Captain Renault (Claude Rains) opines disingenuously that he was shocked to find out that gambling was going on in Rick's American Café.

As with Humphrey Bogart's cafe, where anybody with any knowledge about Rick's understood that gambling was not only going on at Rick's but a prime reason for its existence, anybody with any knowledge of Wall Street knew what Goldman's traders were doing. Specifically, the only thing they know how to do: Make money from other people's losses. Know this: The only function of the trading operations of Goldman Sachs and its competitors, now and forever, is to make money from other people's losses. This is trading, not building. When you build something, a company, for example, there is the possibility of creating benefits for multiple parties. Steve Jobs created the iPod, sold it to all of us and both made our lives better and made a ton of money for Apple. That is a positive sum game.

This payoff structure: Hit a home run and you are mega-rich; strike out and you are merely very rich.

In Wall Street trading, if a trader makes one dollar, it is only because some other poor bloke loses exactly and precisely one dollar. It is a zero-sum game.

Who then is the optimal trading partner in this zero-sum game? He (I use 'he' because they mainly are 'he's') has three characteristics. First, he should be particularly clueless. Conveniently for traders, cluelessness is contextual: A partner can be smart about traditional products but clueless about a crazy new one that you create. Second, he should be deep-pocketed—that is, able to lose lots and lots of money because the amount of money that you cause him to lose defines the amount of money that you can make. Third, he shouldn't take losses too seriously.

- [Charlie Gasparino: Goldman's Dirty Pool](#)

How could the latter be? Doesn't everybody take losing money seriously? No, not really. People generally take seriously the thought of losing their own money, but not so much losing other peoples' money. So optimally the partner should be managing someone else's



Lloyd Blankfein (Pablo Martinez Monsivais / AP Photo)

- [Alan M. Dershowitz: The Fallacy of Fraud](#)

- [Big Fat Story: Can Goldman's Chief Survive?](#)

clients' money rather than actually take care of it—i.e. hit a home run and you are mega-rich; strike out and you are merely very rich.

So it was pretty simple, the Goldman traders needed clueless, deep-pocketed fiduciary institutions managed by folks swinging for the fences on the other side of their trades in order for Goldman to make maximal money.

Goldman created a product, ABACUS, which was attractive to clueless, deep-pocketed fiduciary institutions that were managed by folks swinging for the fences and then merrily traded with those partners and made gobs of money. This is not rocket science. It is tantalizingly simple.

Let me be clear: I think it is utterly disgusting and appalling if the allegations are proven. But it is not even minimally surprising.

This kind of behavior will continue to march forward until the rules of the game are changed. Under the current ones, the folks who make the most money in America create zero value. These traders—like John Paulson—just shuffle existing value from one entity to another; they don't build net value. Yet our society rewards them most; more than we reward builders of value.

And these traders will continue to have their way with pension fund managers as long as we force millions of Americans to place their pension dollars with monopolist managers who like being fêted and stroked by hedge-fund managers more than they like being prudent for their pensioners. Remember for John Paulson's firm to make a reported \$15 billion in trading profits, it needed clueless fiduciary agents to waste \$15 billion of their clients' savings—and waste it they did. If we don't like monopolies in America, why do we allow so many pension funds to have the monopoly right to serve large employee groups, such as the public employees of entire states?

Roger Martin is dean at the Rotman School of Management at the University of Toronto. He writes extensively on corporate strategy, executive compensation and governance, business design and integrative thinking. His most recent book is [The Design of Business: Why Design Thinking is the Next Competitive Advantage](#) (Harvard Business Press, 2009). Read more on his website at www.rogerlmartin.com.

For more of The Daily Beast, [become a fan](#) on Facebook and [follow](#) us on Twitter.

For inquiries, please contact The Daily Beast at editorial@thedailybeast.com.

URL: <http://www.thedailybeast.com/blogs-and-stories/2010-04-18/goldmans-shell-game/p/>

PRINT