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The Business of Fleecing Others

Q: Goldman Sachs promises to put customers' interests first. At the same time, Goldman was able to avoid serious financial trouble by hedging positions in ways that placed bets against clients. **Do Goldman's leaders need a new business strategy, or do they need to just do a better job at explaining their business to regulators and the public?**

Sadly for Goldman, the latter is not an attractive option. The better job Goldman Sachs does in explaining exactly what its business is, the more outraged regulators and the public will be. The only reason that Goldman has avoided negative publicity for so long is that the public has had no idea how far its business model has changed from one that the public could reasonably understand. Even the regulators are largely flummoxed.

Goldman Sachs, not that long ago, was a firm that raised capital for companies who wished to grow and advised companies that wanted to buy another company or sell themselves to another company. These are now minor sidelines for Goldman. The overwhelmingly large portion of its revenues and profits come from trading. And to be clear, this is not brokerage whereby a firm executes trades on behalf of someone else. This is trading on its own account for its own benefit.

Goldman should no longer be thought of as a professional service firm, providing professional services to a clientele. It is now (principally) a trader that lives to find people who are dumber than it is and take advantage of its intelligence advantage to enrich itself and impoverish its trading partners. So it is hard to argue that it serves a particularly useful purpose for society. It exists to serve its own interests which can only be served by causing a disservice to its trading partners. If the public really understood that business model, Goldman would have a much bigger problem than it has now.

That is because the public would start to ask: "If markets are supposedly perfect, and everyone has access to the same information, how can one firm consistently, without fail, win huge in its trading operations?" (And remember, its trading business is hugely profitable even after paying out stunningly high bonuses to the traders.) "Is anybody that smart that they can, day after day, week after week, month after month, year after year, find more suckers with whom it can trade and, in the process, fleece? How is that possible?" Then the public would quickly go to the current Goldman-Paulson scandal and say: "Oh, I get it. *That* is how. You rig the trade before making it. Yup, that works."

Goldman would be foolish to increase the transparency of what it does. What then should it do? That is a toughie. The business of fleecing naive trading partners is so incredibly profitable that it would be difficult to change the business model to one that is at least marginally good for society. My guess is that Goldman will point to how it makes the world a better place by exporting its leaders to the political realm, giving more to charity, firing all of its 'rogue traders' and keeping on doing what it is doing, but more discreetly.