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The effect of dispositional greed on trading behavior

Questionable financial practices by greedy Wall Street bankers are often mentioned as one of the root causes of the 2008 global financial crisis that led to, among other things, increased unemployment and business failures (see, for example, Dalai Lama, 2009; Munasinghe, 2010; Suranovic, 2010). Yet, there is surprisingly little empirical research investigating the trading behavior of greedy individuals in stock markets.

In our first laboratory study ($N = 127$), we tested how individual differences in greed relate to buying, selling, pricing, and ordering behavior in asset markets, and to the occurrence of asset market bubbles. We present results from 15 experimental asset markets with a constant fundamental value, closely mimicking the design of Weitzel et al. (2020). Using multilevel analysis, we found no empirical support for the idea that greedier investors act out their greedy inclinations by showing higher market activity (i.e., they do not order or trade more assets). In our exploratory analysis, we found that greedy people were more likely to sell their assets at higher prices. This result was driven by market orders, rather than limit orders, meaning that greedy individuals are quick in identifying and accepting higher priced buying orders submitted by other traders. This relationship is robust to controlling for risk preference, risk perception, loss aversion, illusion of control, financial literacy, financial experience, and demographics. This result, however, is not robust to the Bonferroni-Holm correction for multiple comparisons. Furthermore, we found no effect of dispositional greed on profitability.

Greedy bankers are likely to be surrounded by a system of other greedy bankers. Seeing others acting out their greedy inclinations might reinforce one's own greedy behavior. In a second study, we used similar experimental asset markets and sorted participants ($N = 162$) into 10 high and 10 low greed markets. We computed RD (relative deviation of prices to the fundamental value) and RAD (relative absolute deviation of prices to the fundamental value) for each market as measures of, respectively, overpricing and mispricing (Stöckl et al. 2010). Furthermore, we computed RDMAX (overpricing at the peak) taken from Razen et al. (2017). Contrary to expectations, results showed that low greed markets are less price efficient than high greed markets.

Overall, our research could not confirm that those scoring high on dispositional greed contributed to the dynamic of the financial crisis.