

This article is part of a [multi-part series](#) on human misjudgment by Phil Ordway, managing principal of [Anabatic Investment Partners](#).

Bias from over-influence by social proof — that is, the conclusions of others, particularly under conditions of natural uncertainty and stress - “a lollapalooza”

“Big-shot businessmen get into these waves of social proof...I think time and time again, in reality, psychological notions and economic notions interplay, and the man who doesn’t understand both is a damned fool.” -Charlie Munger

Kitty Genovese’s murder is an example of not just social proof but also “microeconomic ideas and gain/loss ratios.”

The wave of oil companies buying fertilizer companies was driven in part by social proof. One oil company buys a fertilizer company, and all other oil companies follow, with no one having any good reason for doing so.

Efficient Market Theory is “a wonderful economic doctrine that had a long vogue in spite of the experience of Berkshire Hathaway.” The use of the past tense is interesting...

Investing as an activity provides a lot of reinforcement (you do something and market goes up and your paid and applauded) but also social proof, since prices in the market are the ultimate form of social proof in that they reflect what other people think. The combination is very powerful. [So] why would you expect general market levels to always be totally efficient (e.g., the Nifty Fifty and resulting 1973-74 bear market). “If these psychological notions are correct, you would expect some waves of irrationality, which carry general levels, so they’re inconsistent with reason.”

Update

Munger added several thoughts on social proof, emphasizing that it is most easily triggered in the presence of stress and/or puzzlement.

- Social proof is a huge factor for teenagers, and the respect of or interaction with their peers dominates that of the parents. So parents are wise to artfully manipulate the quality of their teenagers’ peer group than any other methods of parenting.
- Outside directors on corporate boards often offer extreme examples of social proof. Joe Rosenfield said, “They asked me if I wanted to become a director of Northwest Bell, and it was the last thing they ever asked me.”
- “Monkey-see, monkey-do”
- “Social-Proof Tendency often interacts in a perverse way with Envy/Jealousy and Deprivation Superreaction Syndrome,” citing relations in the Middle East.
- “Learn how to ignore these examples from others when they are wrong, because few skills are more worth having.”

Social proof is a deeply ingrained - and indeed, an important and useful - human tendency that has been explored to such a depth in recent years that it would have to be an entirely separate topic of its own. Focusing on a just a few narrow areas still leaves many vivid examples.

Joel Greenblatt tells an interesting story involving social proof. A room full of students is asked to look at a large jar of jelly beans and guess how many are inside. The students take a moment, write down their guesses, and hand them in. Then they're asked to go one by one and tell their guess to the crowd; they can keep their prior written guess or change it as they see fit. The jar contains 1,776 jelly beans, and the written guesses averaged 1,771. The oral guesses in the second step? Those averaged 850. A weighing machine (guess #1) versus a voting machine (guess #2), all thanks to social proof. ^[26]

Investors are often subject to social proof on Value Investors Club, SumZero, and other message boards. How many of us feel good about an idea because we get applause or a favorable rating? That creates a marginal anchor to the idea in even the most rational man. In the realm of both social proof and liking/disliking tendency, I am often influenced when a writer I know (or even one I don't but whose writing is especially persuasive) is bullish on something I own. Likewise, how often do I dismiss a good idea because it comes from a prominent idiot? My only answer is to read only those write-ups that disagree with my previously stated thesis, or to limit myself to write-ups that are at least two years old. That practice can be helpful in other ways too, as there is often useful background information in those old write-ups. It is also a good way to learn vicariously from the mistakes of others.

On that note, one way to avoid social proof in investing is by structuring the research process. The right way to do investment research, in my opinion, is to start with what a company is legally required to disclose in a standardized format (SEC filings, regulatory reports, etc.). Then move on to secondary sources (customers, suppliers, competitors) that may have a bias or some axe to grind. Only as a last stop, once my own opinions have a basis in reality and I can argue both sides, do I seek opinions from those with a vested interest (management, sell-siders, etc.). ^[27] And even then - especially then - I'm looking for disconfirming evidence. If I go looking for a CEO to tell me how great his business is, or for a like-minded investor to tell me how cheap a security is, or for a barber to tell me how much I need a haircut, I've never once come up emptyhanded.

Munger's favorite bridge expert Richard Zeckhauser refers to "Monday Morning Quarterback risk" as a form of social proof. ^[28] He's right, and I often wonder how many investments are passed up, despite favorable prospects, due to the chance of a good-decision-bad-outcome event that will be judged harshly by outsiders (especially LPs/allocators, the media, and one's peers). We all feel that pang in our stomachs that comes from the fear of looking stupid in front our friends and our business partners.

The Yale endowment model created by David Swensen was obviously a triumph of rational thought, but as with all good ideas in economics the problem arose when a good idea was taken too far. Many smaller, less able endowments suffered during the GFC and since by trying to copy Yale. And outside of the framework itself there is still social proof at work. One endowment officer once told me that he does look for great new managers, "but to be

honest almost 100% of our managers are sourced from the rolls of other endowments.”
Original thinking will always be at a premium.

Chuck Prince will go down in business lore for an ill-advised comment in July 2007 when he was the CEO of Citigroup. “When the music stops, in terms of liquidity, things will be complicated. **But as long as the music is playing, you’ve got to get up and dance. We’re still dancing.**” He then added, “The depth of the pools of liquidity is so much larger than it used to be that a disruptive event now needs to be much more disruptive than it used to be. At some point, the disruptive event will be so significant that instead of liquidity filling in, the liquidity will go the other way. I don’t think we’re at that point.”^[29] That attitude and mistake may or may not have been driven by social proof; it was made in the broader context of banks keeping or winning business related to corporate takeovers and buyouts, so fear of missing out and incentive-caused bias likely played a large role as well.

Marketing is an obvious field for social proof. In conjunction with Pavlovian association and other tendencies, marketers know how to exploit our innate human desire to be accepted by others. I used to think that the trend of being “cool” and wearing the “right” clothes and brands peaked in 8th grade. But then I watched as many of my friends and peers in their 20s and 30s seemed to revert to the age of 13. Many phenomena associated with otherwise grounded people in their 40s - the “midlife crisis” or the “tiger mom” - seem to draw much of their strength from social proof. In general it seems worthwhile to ask how any activity - especially when it comes to our money and our consumption habits - are driven by a subconscious desire to win the approval of others.

Social media barely needs to be mentioned here, but many software engineers are keenly aware of social proof and they design into their apps and websites. Nothing is more powerful in driving the next Instagram or Snapchat than social proof. Yes, the fans have a point that there are legitimate network effects at play, and that the human desire to share stories, pictures, and gossip is as old as the hills. But that doesn’t diminish the power of social proof to drive human behavior. Entire vacations are planned around how they will appear on social media. I have a friend - as I’m sure we all do - who has literally staged entire photo shoots of various life events (weddings, birthdays, anniversaries, etc.) just to post them in the best possible light on Facebook and Instagram. In fact, I have a theory that there is an inverse relationship between the frequency and the ostensible happiness of social media posts - the seeking of social proof - and that person’s actual happiness.

Politics is likewise an obvious arena of social proof, and the 2016 U.S. election proved that like none other. Social media, Mark Zuckerberg’s absurd protests to the contrary, played an enormous role in creating social proof and reinforcing opinions during the election.

Home court advantage in sports is also an interesting case of social proof. Why does the home team tend to win more games? Travel fatigue? Familiarity with the field or court? Nothing shows up in the data until you get to the number of fouls called, the amount of stoppage time added, and the ratio of balls and strikes. The referees are human beings and they don’t like being booed and hated by the home team fans.

“Life is marketing.” – Carlos Kaiser^[30]

Carlos Kaiser provides a fascinating example – a soccer “star” who could barely play the game and lived entirely on social proof.^[31] His birth name was Carlos Henrique Raposo but he played up some youth-league hype by referring to himself “Carlos Kaiser” to pound in his supposed resemblance to the great Franz Beckenbauer. He looked the part of a 1980s superstar from Brazil – he was the right build, he was in excellent physical condition, and had a perfectly styled mullet. Then he used early social proof that he generated from his friendships with legitimate superstars like Renato Gaucho and Bebeto to get his foot in the door. His superstar friends would recommend him to coaches they knew in various leagues, and the coaches thought that if these great players were recommending a player he must be worth at least a short-term contract.

“His staple trick was to make friends with influential people: he would befriend powerful figures at each club, telling them about his impressive football CV. If he was in the mood, he would approach journalists, players and the club owner, constructing a web of lies so elaborate that nobody could remember who had vouched for him in the first place... ‘Life,’ says Kaiser, ‘is marketing’ – and he told his stories with such infectious conviction that it was easy to be swept along. Bebeto, the World Cup-winning striker of 1994, says: ‘His chat was so good that if you let him open his mouth, that would be it. He’d charm you. You couldn’t avoid it. That would be it.’

“Upon arrival, Kaiser would claim he needed a month or two to get acclimated. Then he would promptly fake a pulled hamstring and ride out the remaining six months or so on the bench while collecting a fat paycheck and acting as an in-house cheerleader. ‘He created a fun, happy and lighthearted mood,’ says Alexandre Torres, the former Brazil international and son of Carlos Alberto. ‘He would tell stories and he would get players dreaming. I think that’s why everybody liked him so much.’”

Some other team not doing its own homework – and all four of Rio’s big clubs took the bait at various points – would hear about this great player with his “promising talent” languishing on the bench of some reputable peer club due to an unlucky injury, and they would decide to take a gamble on him. Rinse and repeat. He also engaged in some forgery and fraud to prolong the ruse, at one point claiming to have been part of a championship team by passing himself off as someone else. He paid spectators to sing his name when the club owner walked by. He also helped his cause by handing out free jerseys and other memorabilia to journalists, convincing them to write fake news stories about him that would propagate his legend. One of the few times he got close was when a team owner demanded that the coach play him, but Kaiser started a fight on the sideline to earn an ejection. He made up a story about being provoked by a fan who was defaming the owner; he was forgiven with a pay raise and a six-month contact extension. This fraud went on for almost 20 years.

^[26] <https://www.youtube.com/watch?v=bZfPJCAVQg0>

^[27] I took this idea from Jim Chanos and Charlie Munger

^[28] <https://www.hks.harvard.edu/fs/rzeckhau/InvestinginUnknownandUnknowable.pdf>

^[29] <https://www.ft.com/content/80e2987a-2e50-11dc-821c-0000779fd2ac>

^[30]

<https://www.theguardian.com/football/blog/2017/apr/26/the-forgotten-story-of-carlos-kaiser-football-greatest-conman>

^[31]

<http://www.atlasobscura.com/articles/soccers-ultimate-con-man-was-a-superstar-who-couldnt-play-the-game> and

<https://www.theguardian.com/football/blog/2017/apr/26/the-forgotten-story-of-carlos-kaiser-football-greatest-conman>