

Buy Low, Sell High or What Would You Pay for a Pearl of Wisdom?

By Jeffrey M. Saltzman, M.A.

Buy low, sell high is sage advice. However, what is low and what is high? Certainly if you look at the cost of buying shares of a company, they are lower now than they were a few months ago, but are they as low as they are going to go? What is the real value of a share of stock, an automobile, a house or a pearl? The short answer is that the share of stock, the car, the house or the pearl is worth whatever someone is willing to pay for it. This is often based on the demand for those goods or services and the buyers' perception that what they are purchasing has value. The perception of value is partly derived by demand because if everyone is buying the item, it must be desirable and, therefore, of value. It is also based on the context in which the product or service is placed in your mind.

I smiled the other day when I received an ad inviting me to attend a "watches of importance" sale. Nice positioning. I have to admit a certain weakness for watches, as I own three. I don't think I can tell time any better by owning three. I don't think having more watches makes me any more punctual, or efficient, but in certain moments of weakness, starting about 20 years ago, I went out and bought several nice watches—a Breitling, a Movado and a Muhle Glashutte.

I have never met an important watch before. I wonder if an important watch gets a glass case all to itself or if it needs to bunk with other watches, heaven forbid, resting next to a Timex? Clearly, the phrase "watches of importance" is just positioning to let prospective buyers that "we are going to charge a lot for these watches, and we are trying to shape your thoughts, making you feel that these watches are valuable and rare." They are only as valuable to you as you allow them to be. It is a tribute to the watch manufacturers' marketing savvy that there is still a very large demand for expensive mechanical watches, even though quartz watches are more accurate and cost just a few dollars. Apparently

as odd as it sounds, the accuracy of the watch is not the feature of overriding importance in determining its value. Why did man invent watches? Oh yeah, to accurately tell time.

In the creation of the black pearl market lies an interesting story. In the mid 1970s, there was no market for black pearls. People did not particularly attach any significance to them and there was no demand, hence, they were not considered valuable. James Assael owned a source of black pearls and was interested in making some money from them. He went to his friend, Harry Winston and convinced him to display them in his famous jewelry store window on 5th Avenue in New York City with an extremely high price. You can almost hear their logic, "do not think of them as valueless, something that no one wants, think of them as rare and affordable only by a few fortunate ones." Assael took out ads in fancy magazines showing the strands of black pearls next to diamonds, emeralds, rubies, comparative references and gems that people attributed value to, creating a worth for the black pearls by association. Relatively soon, black pearls festooned the necks of the rich and famous in New York and a niche market for these gems was born. Once the "market leaders" adopted the black pearls, they became more widely desirable and a robust trade in black pearls ensued. Are black pearls inherently worth any more than they were when no one wanted to buy one? Were they all of a sudden found to cure horrible diseases? No, of course not, they were worth more only because people were willing to pay more for them, people who were skillfully manipulated into creating a market for black pearls.

The human mind is drawn to basing the value of an object or a service by making comparisons to benchmark items of known worth (or at least generally recognized worth). If you put your house up for sale, the realtor, assigning value to your house, will

begin by showing you comparisons to other houses in the neighborhood. You might see hidden value in your house that makes it one-of-a-kind, but potential buyers will be comparing your house to others. This process is not simply due to the secret guide realtors use on how to price a house, but also because the human mind looks for comparators and context in order to place a value on something.

I just read about a house being built in Greenwich, Connecticut that is about 85-90% complete. The asking price for the house is close to seven million dollars, which by Greenwich standards makes it a nice, but certainly not an over-the-top kind of house. Given the current housing market, the builder indicated that he couldn't find an interested buyer. He stated that there is no point in finishing the house if it is just going to stand empty. Therefore, it stands with its door ajar and leaves blowing into the entry foyer. As it stands, there is no one who sees the house as being worth seven million dollars and once the market turns, the builder stated that he believes the house will likely be torn down, only to be replaced by a new one according to the tastes-of-the-day. For instance, the builder speculated that new houses that are viewed as "valued" in that price range, after we get out of this economic downturn, will be those with a zero carbon footprint, and can operate off the grid. Therefore, this perfectly good, almost complete house will be torn down to build a new one with a zero carbon footprint that will make it attractive to a potential buyer. I could not help but think how much carbon is being squandered by tearing down a perfectly good house.

When employee surveys are conducted, the management team has an intense interest in how they compared to normative data, the aggregated average of how employees respond across other organizations to similar items. Management is simply being human, looking for comparators and context to help them interpret their own survey results. They often have a difficult time looking at survey results in an absolute fashion, without any comparators and judging their results. One survey item often asked is about pay satisfaction. Using a large number of organizations, the average score regarding pay satisfaction is about 48% favorable, meaning that 48% of the population feels on average that they are paid fairly. The other respondents are either neutral or unfavorable. Given that context then, it is normal for a management team to think, "well, we scored about 50% favorable on pay satisfaction, which is similar to other organizations, so I guess that is pretty good."

In an absolute sense, 50% favorable means that 50% were either neutral or unfavorable, but the result is more easily dismissed because of the natural human tendency to compare to others who responded to a similar item. (It is a myth that no one ever rates his or her pay favorably. Those who feel that they are paid well—surprise—do rate their pay favorably). If I were to change the item,

however, and ask about quality and receive a similar response, 50% favorable, all sorts of alarms would go off and efforts would be made to improve the quality of the products and services being produced.

Whether or not people view themselves as being paid well depends completely on whom they are comparing their pay to and whether their level of pay meets their minimum needs. Over the years, in an effort to control the spiraling salaries of CEOs, there have been efforts to disclose their salaries publically. The thinking was if these were publically disclosed, CEOs would be embarrassed by their pay levels and would be willing to take lower amounts. Yet exactly the opposite happened. Once CEOs were able to compare their salaries to other CEOs, which they felt were the appropriate comparison group, CEO pay shot up enormously. This happened because they could see what other CEOs were making, sparking a salary competition, allowed by compliant boards, to have comparable pay levels for "their" CEO. Management intuitively knows what is going on. Ask a senior HR person, or a CEO, if the idea of publically disclosing all pay and bonus levels for each person in the company is a good idea and you will see the blood drain away from their faces.

If we go outside of our materialism and try to place values on things without true comparators, the resulting challenge can be great. What is the value of an education, an open mind, being able to spend time with and provide for your family, making someone else feel good about themselves, having time to pursue a hobby, helping those in need, doing what you can to preserve our planet, or just feeling good about your priorities? These things are much harder to place a value upon because their worth may be very specific to each individual and hence, non-comparable. Some may value these things beyond all, while others may view them as incidental; most of course will fall somewhere in the middle of the continuum.

What does this comparative valuing mean to our current economic situation? I got into a discussion regarding how quickly we could pull out of the economic downturn. I was among the more optimistic in the group saying that within the year, while we may not have completely recovered, we would be well on our way to recovery. On what basis do I make that statement? A lot of what is going on is structural—housing loans being made to those who could not pay them, intricate financial dealings being thought of as having no comparable basis for valuation and organizations that leveraged themselves with debt that could only be serviced with unrealistic growth. Indeed, a good chunk of how people view the health of our economy is perceptual. I don't think we could have just continued to go on the way we were, but I also don't think that things need to be as bad as they currently are. What needs to happen?

There needs to be a shift in the perception of how bad things are and that the right things are being done to address the issues. Why did the Treasury Secretary, Henry Paulson, change gears and not invest in the banks as he thought he original should? It was clear that the investment would not have significantly changed the situation from a psychological perspective among the investing public and the investment would not have the needed impact to shift the perceptions of the economic climate.

Without getting into politics, from an apolitical standpoint, we are very fortunate at this moment in time to have a new President who is clearly a break with the past, for in that lies opportunity, the opportunity to change the psychology by which people are viewing this economic climate. If President Obama can create a new psychology, then we will be able to turn the corner and pull out of this mess faster than we would have. Confidence has to be, if not restored, then pushed significantly in the positive direction. A balance between installing people who have proven track records that instill confidence needs to be struck with those that represent a break with the past and so far, this is exactly what is being done. Therefore, I am cautiously optimistic.

What does all of this mean in terms of future bubbles that we will experience and the likelihood that our economy will churn through additional up and down cycles? Simply put, because of our human nature, these cycles will continue—some cycles worse than others—for the basis of how we view value, how we determine the worth of various things, which is relatively arbitrary, will continue. ■

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