

A Consultant's View

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Bubbles and Human Nature

Over the last few months, I've received many a spam message claiming that we were on the brink of a financial catastrophe. Financial bubbles have been a part of Western Civilization since the 1500's (and perhaps even before). Is there anything that can be done to prevent such bubbles? Can we prevent bubbles from bursting?

When we look at the Great Recession, it is very obvious that all the trouble with the banking sector stopped at the US northern border.

Canada did not have the financial bubble that we had. Their banking system is far more regulated and far more conservative. Banks didn't write mortgages for sale.

They kept most on their books. Banks did not have so many derivatives on their books. It is possible to keep banks from participating in a bubble.

However, such regulation does not prevent bubbles. While Canada's banks did not go under after 1929, the Toronto stock market had a similar crash to Wall Street's crash and crashed in 2008 along with Wall Street. Other Canadian asset classes have had bubbles and crashes.

Bubbles are part of human nature. Wikipedia reports that a number of experiments with sample markets have shown bubbles even when the value of the traded asset can be easily computed. These bubbles happen because of human psychology and when people have extra money to spend. When the price of something is going up, people

jump in to prevent being left behind. When the bubble is bursting, people jump out to avoid the train wreck.

Is there any way to regulate the system to prevent a bubble? The problem with trying to regulate such activity is that people will believe what they want to believe. Facts do not get in the way. We see this in many fields where people hold ideas that are not backed up with verifiable facts. The regulators have the same problem as everyone else. Thus, people at the Federal Reserve failed to see the real estate bubble happening and failed to foresee how bad the results would be of the mortgage collapse. There is no way to regulate people so as to prevent a bubble.

Can Not Prevent Bubbles

Can we prevent the damage of a bubble burst? Over the past years, the Federal Reserve has tried very hard to alleviate the damage caused by the bubble burst. However, the housing burst has lasted about as long as the housing bubble did. No matter what the Fed did, the burst has lasted a long time.

The trouble with trying to prevent bubbles and bursts is that our efforts often make things worse. It is far better to have many smaller bubbles and bursts than to try to have a long period of economic expansion and then a large burst. (See Catastrophe Theory for the mathematical proof.)

Financial bursts will always be greater than the regulatory system is prepared to handle. This is a consequence of human nature, capabilities, and politics.

Coupon Changes

Coupons have been a way of life for retailers and consumer products. However, more and more people are "gaming" the coupon system. In 2012, a Phoenix Az woman was arrested with \$25 million in fake coupons. This is causing retailers and manufacturers to change how they deal with coupons.

For many years, manufacturers focused on finding the dishonest retailers who would submit many more coupons than their customers actually presented. However, when the fraud moves from the retailer to the consumer, it is harder to track. The coupon clearing houses are tracking coupon submissions and look for signs of coupon fraud such as copying, duplicates, or sequence numbers in succession. The industry is also switching to the GS1 barcode format for coupons which can include a specific identifier for each coupon.

With the Internet, people are passing around fraudulent coupons like crazy. These appear in a number of formats including many spam emails offering free products or meals. There are web sites offering to sell you stacks of coupons or even offer them for free. A good percentage of those are fraudulent being either copies or screen prints of legitimate coupons.

To combat the internet coupon fraud, sites are printing the person's identification on the coupon, preventing multiple copies from being printed, printing in color to prevent copying, and more.

Accepting coupons requires good training as clerks need training both in how to spot coupons that won't go through and how to deal with a customer who presented those coupons. Technology can also help as it is now possible to have unique coupon codes for each person.

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