

# ACTIVATE BEHAVIORAL WEALTH!

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LEVERAGE NEW  
DISCIPLINE OF  
BEHAVIORAL FINANCE



**White Paper**  
**Activate Behavioral Wealth!**

**September 2019**

[www.perthleadership.org](http://www.perthleadership.org)

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## EXECUTIVE SUMMARY

**Part 1: Behavioral Wealth Activation** - Modern finance teaches that it is difficult to beat the market and the best you can do in normal circumstances is to merely keep up with it.



Wealth **management** usually means wealth preservation. Most efforts at 'wealth creation' actually result in getting only a *marginal rate of return*.

**Part 2: The *emergence of behavioral finance*** opens up a new approach to wealth creation. This teaches that people have unconscious cognitive financial biases. If they can address these it opens up the *potential for behavioral change that will lead to real wealth creation*.



**Part 3: The Perth Model Provides the Missing Link**  
This new and sophisticated approach uses a proprietary model that allows prediction of actual financial outcomes at the level of the specific individual, team or company.



**Part 4: The Wealth Activation Process:** Based on Perth's *innovative, proprietary psychometric assessments* that show the impact of key cognitive biases on financial and valuation outcomes.



This *paves the way for behavioral change* that activates the behavioral mechanisms to provide a material increase in real wealth creation.

## *Part 1: What is Behavioral Wealth Activation?*

### Family Wealth Creation

The process by which families creates wealth usually starts with a founder. The founder is often charismatic, gifted or exceptional in some way. By dint of personality the founder creates and grows a company that serves its customers well and becomes an institution in its own right.

But at some stage the founder either dies or undergoes a deterioration of health that prevents her from running the company. At that stage the question is who will be the successor to the founder. Usually but not always the choice will be to select someone inside the family. But often that person does not have many of the characteristics that made the founder so exceptional. That person can do a good job, but maybe not the same job as the founder.

If we could we would train the successor to develop the same characteristics and behaviors as the founder. Obviously, that does not happen often. But it would provide the right answer if it could be done. But this has never been done before because it has not been in the current state of the art. That is, the knowledge, disciplines and techniques had not yet been developed.

In this White Paper we are going to show that the start of the Art has now changed sufficiently to make it possible to provide some, if not all of the founders characteristic behaviors, to successors so that they can assume the mantle of leadership and continue the process of wealth creation.

### Wealth Preservation versus Wealth Creation

Families that have a business or many businesses have two main aims. The first is to create more wealth. The second is to preserve the wealth they already have.

In practice, wealth creation is difficult. What enabled the founder to do it were exceptional and relatively rare behaviors, a great idea well executed, and some luck. As these are difficult to emulate, the wealth creation side of the equation is often not achieved. Most of the effort by companies that individuals that help family companies are focused on wealth preservation, with the hope that with some luck, they can manage a little wealth creation into the bargain.

But the wealth preservation part of the equation is not without its own risks. There are tens of thousands of companies all trying to do the same thing. This arbitrages most of the potential gains out of the results since if anyone finds a “sure” thing, everyone else jumps in and does the same thing.

We now understand that most investments don’t make money on their own merits. Most investments hover around an average return, which is the average return for the whole market, So the realistic aim for most wealth managers is to achieve the same return as the market. That is why ETFs are so popular. But the result is that most wealth management is about achieving wealth preservation, not real wealth creation.

### The New Behavioral Techniques

Each of us has a propensity to create wealth. That propensity is governed by out innate and learned behaviors. Most people have never learned to connect with these behaviors because there wasn’t any recognized way to do it. Yet it is these behaviors that are possessed by the people who create products, companies and wealth and who become rich in the process.

Until recently there was no way to scientifically identify, measure and manage these behaviors. But in 2002 a Nobel prize was awarded to Daniel Kahneman for his development of the new discipline of behavioral economics. This discipline drops the assumption that economic and financial decisions are always made on rational grounds and instead substitutes the idea that many of our decisions are driven by irrational considerations. These considerations are almost always unconscious. Yet we usually believe that we are making rational decisions. These decisions are driven by unconscious cognitive biases.

The emergence of these new disciplines has, for the first time, given us a scientific framework and tools to be able to model the behaviors that create wealth. The tools also provide us with new ways to model those behaviors, show how they are linked with certain aspects of wealth creations, and reveals how we can use this information to help them change their behaviors such as to create wealth.

We have developed unique psychometric approaches based on behavioral economics and finance which link individual and team behaviors directly to financial and valuation outcomes. We have published several books and several hundred articles that reveal this framework and techniques. We will provide more detailed information and references later in the White paper. However, for the moment it is just sufficient to understand that we can identify and measure these behaviors scientifically and have done so in practice with thousands of people.

Perth's assessments include:

- The Financial Outcome Assessment (FOA)
- The Executive Outcome Assessment (EXOA)
- The Corporate Financial Outcome Assessment (CFOA).

Later we will show how these assessments manage to get the relative information on personal and team behaviors that allow us to predict what impact they will have on wealth creation. In particular they allow us to predict the financial and business outcomes of these behaviors, if necessary, in quantitative form, and in such a way as to predict the actual market value and even the market valuation that result from these behaviors.

## Wealth Activation

Wealth activation is the process of applying these behavioral techniques to individuals and teams in a company in order to achieve real wealth creation. By “real” we mean an increase in capital value that materially exceeds the average market return that is typical of wealth preservation investing.

The wealth activation process includes:

1. Identifying executives and family members whose who have strong profit-making behaviors.
2. Showing them how to improve their financial impact using behavioral techniques.
3. Building a pipeline of people with strong profit potential for succession planning purposes.

We need to understand the following about the wealth activation process:

1. It is not training in finance, economics or accounting.
2. It is not about how to engineer numbers to provide an “enhanced” perspective of the value of the company.

3. It is a map of the behaviors that create wealth
4. It shows innate behaviors and compare them with learned behaviors
5. It reveals how to change learned behaviors to make them more aligned with the financial mission of the company
6. It shows what direction and magnitude these behavioral changes need to be to achieve the desired financial mission
7. It shows that is possible and likely to achieve and what might not be possible and likely
8. The aim is to create s cultural process of change which is sustained over the longer-term
9. We call this process “Continuous Valuation Management” or CVM.
10. The ultimate aim of wealth activation is not just behavioral change on the part of individuals and team members; it is also a change to the culture of the company such that wealth activation becomes a n Intrinsic part of the culture which by its very nature will push the company int the direction of maximizing its value beyond its current limits.

## *Part 2: New Wealth Creation Approach Based on Behavioral Finance*

### Shareholders Want to Know Where's the Beef

Leadership in modern organizations is required to increase profitability and valuation. This applies to both public and private companies alike. Scarce capital is used by these organizations and the ability to make it more effective is a key requirement of modern leadership. Leaders who do not do this are routinely removed in order to find leaders who can. So, leaders must drive better financial and valuation outcomes in order to be better leaders.



Yet the classical leadership corpus signally fails to do this. Leadership assessments focus on interpersonal skills and certain behavioral competencies. While these are relevant to leadership, they do not define its success in modern organizations. Success in modern organizations is ultimately financial and valuation outcome. To be precise, if an organization gets a better valuation outcome than its competitors, then its leadership has performed better. Nothing else counts as long as the organization operates ethically and is reasonably managed.

The major criteria in the classical leadership corpus for leadership success are interpersonal, team and organizational functioning. This derives from their intellectual bases which are psychoanalytic, sociological and anthropological. Basically, they look to harmony rather than outcome. They tend to be employee- rather than shareholder-focused. So, they lack the intellectual underpinnings which focus on the building of financial valuation and maximization of capital creation.

The overwhelming problem with modern leadership approaches is the failure to link directly with leadership outcomes, defined in financial and valuation terms. The classical leadership corpus cannot help this since it has intellectual foundations that are largely unrelated.

In order to build the necessary linkages, we need to turn to the disciplines of economics and finance. These are disciplines which experts in conventional leadership and human resources are generally uncomfortable with. This probably explains at least partially why these disciplines have not been enlisted. So, we shall turn our attention to them now to see to what extent they can meet the requirement of linking leadership and financial and valuation outcomes.

### But Traditional Economics and Finance Assume Perfect Rationality

Classical economics has a history dating back to the 19<sup>th</sup> century. The classical economists ranging from Adam Smith to Keynes built formal models based on a very particular psychological platform. That platform assumed that individuals and corporations are rational economic actors. This allows a sophisticated structure of models to be built.

At the microeconomic level it allows for the development of utility theory. This in turn allows for the development of choice theory for both consumers and corporations involving indifference curves and the like. The assumption of rational economic actors underlies the full range of microcosmic topics ranging from pricing, demand theory, consumer choice and more latterly decision and game theory. Latterly these theories have been extended to modern work in the areas of options and options prices, derivatives and synthetics.

At the macroeconomic level, the assumption of rationality allows for the development of theories regarding a wide variety of topics including interest rates, money supply, and consumer demand. These in turn have been built up into models of growth which incorporate linkages between investment and consumer behaviors, savings and investment, interest rates and money supply. It is from this base that the idea of the efficient market hypothesis arises. All of these models depend on the assumption of rationality to work.

Economists have always known and accepted that these theories are an approximation to the real world. The models work fairly well when conditions do not change much. However, it has become increasingly clear that the classical economic models do not work at all in the following cases:

- When conditions change significantly
- In predicting major changes in corporate valuation
- In predicting macroeconomic inflection points and crises

It is increasingly being seen that classical economics tends to work best when conditions do not change much, and when rational behaviors dominate the market. When these conditions are infringed, then classical economics and finance break down and cannot predict the outcome. In this sense, classical economics and finance are reminiscent of classical leadership models. In both rationality is the basis for the model to work. When irrationality enters, the models break down. In both cases the models cannot predict what happens if most behavior is not rational. So, the classical theories have major restrictions that limit them to only being valid in particular, relative narrow situations.

That is one reason why leadership approaches have not been able to incorporate classical economics and finance in order to link financial and business outcomes. These classical disciplines assume a level of rationality that is just unrealistic in leadership and thus prevents them being used for real-life leadership situations. For economics and finance to play a part in linking leadership with business outcomes, they must be able to address irrationality in decision-making.

### Irrationality is Now Being Addressed Through New Behavioral Disciplines



We have always known that leaders and decision- makers have biases. The trouble is that they are difficult to model in particular situations. We may know that a leader tends to under-spend or over-spend but predicting that in advance for a particular leader or company is difficult and requires models that have only recently commenced development.

We know that there are numerous other types of biases that affect decision-making. However, these had never been cataloged or their effects formally described. So, although theorists knew that rationality was not really realistic, a formal platform had never been developed to model those biases. The issue has been how to link irrationality – or to be more accurate, mixed rationality - in decision-making with economic and financial outcomes.

The first steps in this process have been made with the emergence of the new disciplines of behavioral economics and finance. These disciplines formally relax or drop the assumption of rationality in building models of economics and financial phenomena. For the first time we now have a language and models that link financial outcomes to real- decision-making in the real world.

This allows us for the first time to formally link decision-making that is not necessarily rational to financial and business outcomes. Since this is what leaders do, we now have for the first time a set of models that can use be used to describe and predict leadership behaviors and outcomes, in business and financial terms.

## Behavioral Economics & Finance Open Up New Leadership Approach

**Their Novelty Explains Why Leadership Approaches Haven't Caught on Yet:** The field of behavioral economics and finance can be said to have received formal

recognition of their intellectual coming-of-age with the award of the 2002 Nobel Prize for economics to Daniela Kahneman of Princeton University for his work into behavioral economics.

Research into this field commenced in the 1960s with work by Nobelist Herbert Simon and expanded in the 1970s with the development of what is called prospect theory. Prospect theory is a theory of decision-making where decisions have uncertain outcomes and people have different ways of evaluating gains and losses. These decisions are not necessarily financial in nature although much of the work that surrounds them is concerned with economics and finance

**“.....good analysis in the hands of managers won't naturally yield good decisions...” McKinsey**

The research has been motivated by the increasing divergence between prediction and reality in the fields of economics and. It had become increasingly clear that economies and finance were not approximating reality and that a new approach was needed.

For the first time, what we term “irrationality” has been formally opened to research and investigation in the fields of economics and finance. These new fields provide comprehensive explanations and models as to what constitutes irrationality in decision- making and show how it leads to totally different types of economic and financial outcomes to those predicted by classical theories.

## Behavioral Disciplines Explain Much That Was Hitherto Inexplicable

The new behavioral disciplines have far-reaching ramifications for most business and economic areas. They impact decision-making, human resources, strategy, marketing, consumer choice, advertising, talent development and human resources, investor behavior, and stock market behaviors to mention just a few. So far, the impact is at an early stage since the fields are still very new and practitioners of these disciplines are only slowly coming to grips with their many implications.

McKinsey Quarterly has carried an article on this subject<sup>1</sup>. They cite some of the problems that are caused by the lack of understanding of behavioral strategy. These include failed mergers and acquisitions, large projects usually being over-budget and strategies usually ignoring competitive responses or getting them badly wrong.

McKinsey has conducted some fascinating research on this issue. This research concludes that, contrary to what one might expect “good analysis in the hands of managers does not naturally yield good decisions...” This of course flies in the face of conventional approaches that assume if we are smart, reasonably educated and have the right data, we will have a very good chance of making a good decision that will have a beneficial outcome. It explains why, to the contrary, so many decisions at all levels of management, informed by the best analysis possible, so often yield poor outcomes.

As one might expect from a consultancy that focuses on strategy, the McKinsey research has a lot to say about the implications of behavioral disciplines for strategy development. Their work suggests that cognitive biases affect the smartest executives in the most important strategic decisions in the best companies.

For leadership this has critical implications too. It suggests that most leaders are unaware of their biases and therefore are not in a position to compensate for them. In hiring, developing and promoting leaders, those who participate in these processes cannot identify these biases and predict their impact on the quality of leadership of the managers they are promoting.

In sum, if anyone ever wanted a good explanation why so many leaders fail, and why so many boards and leadership experts tend to make so many bad hires, one has only to look at the previous formally unrecognized issue of cognitive biases.

**“... cognitive biases affect the smartest executives in the most important strategic decisions in the best companies...” McKinsey**

The behavioral disciplines are not just about finance and economics; they are ultimately about leadership and how flawed the outcomes of leadership are likely to be. That these outcomes can also be measured in financial and economic terms is a bonus, but the behavioral disciplines provide a new perspective on any type of decision, be it economic and financial or otherwise.

### In Categorizing Types of Cognitive Bias

In their new theory, termed prospect theory, Kahneman and Tversky in the late 1970s identified and set out a number of cognitive biases that routinely impact decisions, both financial and otherwise. What they pointed out was that these biases had never been taken into account in classical economics and finance.

The existence of these biases meant that the rational decisions assumed by classical theorists were very unlikely in the case of many if not most decisions.

It is not the intention of this White Paper to provide a primer on behavioral economics and behavioral finance. However, it will help to provide some examples of these cognitive biases. In their book, some of the principal biases mentioned were as follows:

- **Framing effects:** The way a problem or decision is presented to the decision maker will affect their action, even if it is a hopeless case
- **Status quo bias:** people prefer that things remain the same, or that things change as little as possible, if they absolutely must be altered.
- **Endowment effect:** people value a good or service more once their property right to it has been established.
- **Loss aversion:** people's tendency to strongly prefer avoiding losses to acquiring gains. Some studies suggest that losses are twice as powerful, psychologically, as gains
- **Anchoring effect:** the tendency to rely too heavily, or "anchor," on a past reference or on one trait or piece of information when making decisions
- **Overconfidence effect:** excessive confidence in one's own answers to questions. For example, for certain types of question, answers that people rate as "99% certain" turn out to be wrong 40% of the time.
- **Survivorship bias:** concentrating on the people or things that "survived" some process and ignoring

those that didn't or arguing that a strategy is effective given the winners, while ignoring the large number of losers.



There are numerous other cognitive biases that have been identified. These biases are not just ones that have been observed. All of them have been tested through actual experiment so that the situation can be controlled scientifically. So, the existence of these

biases have been scientifically confirmed, measured and manipulated to see their effects in many different situations.

It will be clear that these cognitive biases operate within the decision-making environment of any company. So, these cognitive biases must be a key driver of problems in these companies. They are

therefore an important microeconomic factor. Of course, this also means that they are a crucial factor in leadership, talent management and talent development for any company.

**“....so, these cognitive drivers.... is a crucial factor in leadership, talent management and talent development for any company...”?**

Since these biases operate in all companies and in all organizations, including in nonprofits and governmental organizations, they also operate at the macroeconomic level. This means that they impact demand and supply at the macroeconomic level, and in the areas of growth, trade and investment. Again, this impacts leadership at the national levels as well as the international levels.

It does not take a great leap of imagination to see that these cognitive biases are crucial in assessing and studying leaders and the outcome of the decisions. Yet none of this way of thinking has yet impacted leadership approaches.

### But the New Behavioral Models are Far from Perfect

**Some Key Issues Not Yet Addressed:** So, the new behavioral models open up vast new swathes of territory not only in the economic and financial arena, but also in the arenas of decision-making, leadership, talent management and development. They also provide a new perspective on strategy development and implementation. They suggest that too much information can be as dangerous as too little. They provide new ways to improve decisions and to optimize their outcomes in business terms.

But as with any new discipline, they still leave vast swathes of problems unaddressed. This is not a criticism; it is just to state that now these new disciplines have opened up new territory for investigation, they have also allowed new questions to be asked which so far have not been answered and in some cases cannot be answered without more advances in theory and more data from experience. This is the case with the behavioral disciplines.

Some of the problems that are not addressed by behavioral economics and finance are the following:

**The Problem of Individual Prediction:** The behavioral disciplines have identified a rich catalog of cognitive biases and described their effects. Although these effects work at the level of the individual, we can only use them predictively at the level of the group. The new behavioral disciplines provide no model that allows us to predict how these cognitive biases will act in the case of a specific individual, a specific team or a specific company.

We term this problem, the “atomism” problem. We can predict at the level of the organization, say the country, or a large group of consumers. But we cannot make predictions at the level of the individual social atom, the individual, the consumer, the manager, the specific team in a specific company. For the behavioral disciplines to be seen to be more than an academic exercise, they need to address and provide solutions to this problem.

**Predicting Precise Business Outcomes:** Even more importantly these do not show the actual financial outcome of these cognitive



biases for any individual, team or company on business outcomes such as profitability or valuation. Yet it is precisely these issues that are of most interest and utility to shareholders, investors and economists who wish to predict these matters so that the work can have **real-world relevance**. We term this problem the “outcome” problem. We need to be able to do more than just say that a particular cognitive bias will distort the outcome of a decision. We need to be able to say how this will happen in practice. In particular we need to be able to couch the outcome in measurable and quantitative terms that are part of the financial and valuation metrics of a company so that we can link behaviors and cognitive biases directly to profitability and capital creation or consumption.

**The Problem of Non-Financial Decisions:** Not all or even most decisions have an explicit financial element; yet the behavioral disciplines couch their terminology in financial and economic terms, as they must give their intellectual background.

Yet it is clear that cognitive biases impact non-financial and economic outcomes just as much as they do financial and economic outcomes. The behavioral disciplines have done much less to analyze the impact on the non-financial arenas. This is because they incorporate a game-theoretic approach, garnered from the game theories of the 1960s which again have a decidedly financial approach.

In this instance the boot is on the other foot. The behavioral disciplines have a gap in the areas of social, sociological and anthropological functioning that is as much as a gap as leadership approaches lack a focus on business outcomes.

**The Problem of Non-Financial Actors:** The behavioral disciplines started their work by focusing on consumers and investors. It was only later that they broadened their focus to corporate managers but even then, the focus was on corporate financial managers rather than all managers.

But the work has not yet broadened its reach to actors who are explicitly focused on non- financial issues such as corporate managers of sales for example. Yet it is clear that these players also have an impact on business outcomes through the impact of their cognitive biases. Just because they are not primary initiators of investment or P&L managers does not mean they do not have an impact on the overall P&L of the organization, or on its valuation.

But the behavioral disciplines are not so comfortable in the non-financial arenas and so have tended to avoid these issues. So, these new disciplines so far are more oriented to actors that are explicitly economic and financial actors which limits the applicability of the research to some of the most intriguing and important issues in corporate decision- making and finance.

**Atomism and Outcome Problems Most Important:** Of the above, the atomism and outcome problems are the two most important. This is because they prevent the theory being operationalized so that it can be used in practice to improve the outcome of decisions. If the aim of a scientific theory is control, then the behavioral decisions are still some way away from this goal. Later in this White Paper we will show some later developments that specifically address these problems and provide some solutions.

### Neuroscience and Neuro-Economics Provide Atomistic View

As behavioral economics and finance have emerged and expanded, so has the demand for other types of investigations that would provide increased knowledge on behavior, decision-making and in particular

economic and financial decision-making. This new research addresses the issue of the individual level head-on and provides an atomistic perspective that advances the understanding of behaviors at the individual level.



This research relies on MRI, magnetic resonance imaging. This allows scientist to look a brain in real-time to see precisely which areas are impacted when the brain is carrying out certain activities which the subject has been told to think about in advance. These include making decisions on certain matters or thinking about certain things.

This research aims to elucidate the physical and physiological mechanisms that are involved when decisions are being made or when certain types of thoughts are being played out. The aim is not only to look at physical brain locations involved, but also to look at the types, intensity and frequency of brain waves and other impactors such as changes in brain chemicals and neurotransmitters.

The more general science has been termed neuroscience. This broader approach investigates thoughts, decisions and emotions. The narrower research is called neuroeconomics. The aim of this science is to elucidate physiological mechanisms involved when the brain is making economic and financial decisions and making choices.

Like neuroscience, neuroeconomics can be experimental in nature so that the fully range of scientific tools can be made and hypotheses investigated. Experimental economics can be combined with neuroeconomics to gain a much deeper appreciation of the biological mechanism involved in economics and financial decisions.

This research also extends to neurochemistry and in particular to the neurochemical oxytocin, the so-called love chemical. This research also looks the impact of certain neurochemicals on behaviors, particularly trusting behaviors and their impact in human interactions. While oxytocin has been the hot topic, it is likely that this is just one of a class of neurochemicals that mediate behaviors including financial and economic behaviors and also the mechanisms of choice.

These new channels of research are also opening up new perspectives on economics, finance and decision-making, this time from a biological and physiological perspective. However, we need to note that these are not cognitive but “wetware” models that give us physical rather than cognitive explanations of decision-making and choice.

**The wetware models do address the atomism issue.** They add to the knowledge concerning how to make predictions at the level of the individual, something that we cannot do with current behavioral economics and finance. But these approaches still do not allow us to make predictions about business outcomes, a key requirement for relevance and use in the corporate world.

#### ***Recent Empirical Studies Address Behavior and Business Outcome***

However, there is increasing work which investigates the decision-making characteristics of CEOs and managers and links these to their impact on company financial and valuation performance. One pioneering piece of research by Marianne Bertrand and Antoinette Schoar<sup>2</sup> specifically looks at the managerial characteristics of CEOs to investigate their impact on a wide range of corporate financial variable.

This work finds a high correlation between the two. The authors find that these managerial

**“... The literature now shows that the issue of managerial financial style is real and can be correlated statistically with characteristic financial and valuation outcomes....”**

behaviors can be characterized as distinctive financial styles that have a characteristic and unique impact on company financial metrics and performance. The authors specially note that they are departing from the usual economic approach which is to look at financial outcomes at a firm, industry or market level.

In other words, this study specifically addresses the issues of atomism and outcome in leadership behaviors. This work finds high correlations between the two. The literature now shows that the issue of managerial financial style is real and can be correlated statistically with characteristic financial and valuation outcomes.

More recent research shows the consistency of financial styles between personal and corporate financial choices on the issue of personal and corporate leverage, again linking financial behaviors with financial outcomes.<sup>3</sup> It shows that CEOs' personal financial behavior is at least partially predictive of their companies' financial performance.

In sum, this recent empirical work addresses the issue of business outcome more comprehensively than has been done with the classical works of behavioral economics and finance. The problem is that there are no theoretical constructs or models underlying the behavioral side of the problem.

So, while wetware and CEO studies address respectively atomism and business outcome, neither address both nor link the atomistic level directly with business outcomes in a formal model. This is what is required to link behavioral economics and finance directly to wealth creation.

### Part 3: The Perth Model Provides the Missing Link

#### Financial Signatures Address Atomism

The Perth Leadership Outcome Model is so-called since it is concerned only with the outcome of behavior, not the behavior itself<sup>4</sup>. It defines outcomes in financial and valuation terms.<sup>5</sup> This model addresses both the issue of atomism and the issue of business outcome in a formal model that categorizes the types of financial behaviors and the financial and valuation outcomes that flow from the,

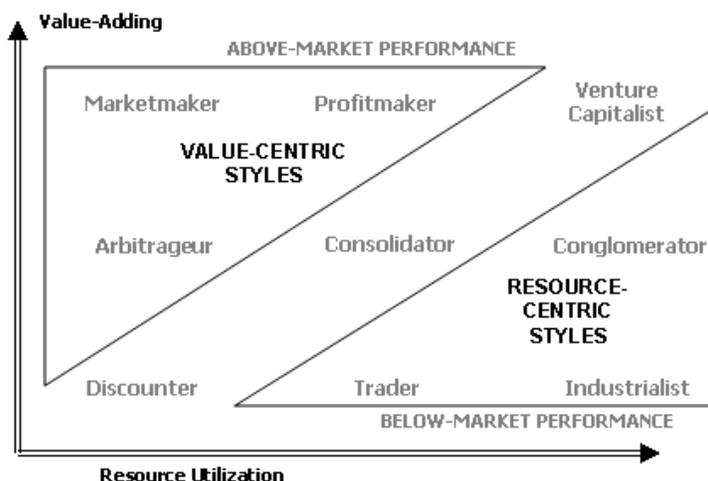
The research is based on fieldwork with some several hundred CEOs and then with numerous other senior executives. It is based on the observation that we all have individual financial traits. These financial traits lie deep within us, so we shall call them innate. These financial traits constitute an internal calculus which drives how each of us approaches decisions involving risk and reward and cost and benefit. They imprint themselves on all of our decisions, in the vast majority of cases without us knowing this.

The research shows that there are distinct behavioral patterns which reflect different ways that individuals are driven by these internal factors to create financial value. These behavior patterns are called financial signatures. The research has identified nine financial signatures which we show below.

*Figure 1 The Three Financial Styles*



Figure 2 Market Impact of Financial Signatures



These financial behavior patterns, or financial signatures, are composed of two dimensions of financial traits. These are the propensity to utilize resources to a greater or lesser degree in achieving business goals, and the propensity to add commercial value to products or services, again in achieving business goals.

Each financial signature is in effect a personalized and at least a partly irrational response to a financial situation which imposes a systematic and predictable bias on all of our financial decisions. Thus, individual behavior and individual cognitive effects have led the decision to be at least partly irrational in the particular manner which is dictated by the particular position that the manager occupies on the above diagram. Thus, the model is one that incorporates the cognitive biases of the individual concerning the factors of value-adding and resource utilization.

### And Provide a Formal Model of Business Outcome

The resulting financial signature shows us the behavioral propensity of an individual to generate capital to a greater or lesser extent. In the diagram, financial signatures to the upper left generate more capital since their propensity to add relatively high amounts of

value more than outweighs the resources they are behaviorally inclined to consume in achieving this value.

**“.... Each financial signature is in effect a personalized and at least a partly irrational response to a financial situation which imposes a systematic and predictable bias on all of our financial decisions**

On the other hand, on the right-hand lower side of the diagram, individuals will be using a level of resources which generally will not be outweighed by the value-added contribution, which will lead to the generation of less or even the consumption of capital.

Financial signatures represent the most basic level of financial behavior. These can be grouped into styles which aggregate the signatures into a higher level representing the financial impact of these styles.

We can divide the nine financial signatures into three financial styles based on this diagram. These are the Value-Centric, Balanced and Resource-Centric styles. The first will tend to outperform the market and the last to under-perform while the balanced styles will perform at the market level.

Thus, financial signature and style can tell us not only about the level of individual performance we can expect, but what will happen if a company is composed mainly of a particular financial signature or style relative to its close competitors and to the market it participates in as a whole.

### The Model is Measurable in Business Terms

Perth has developed instruments to identify and measure financial signature<sup>6</sup>, most notably its Financial Outcome Assessment instrument. This has been given to almost 1,000 participants. Results show that most people cluster to the lower right of the financial signature chart.<sup>7</sup>

Most managers have financial signatures that lead them to under-perform the market and either to generate less capital than their close competitors or to consume it. This pattern prevails even at high executive levels and so far, the research has not been able to find a statistical difference in financial signature between executives and other levels.

This parallels work done in other leadership studies which shows that on both personality and competency tests, there are no significant differences between managers at widely different levels.<sup>8</sup> It also provides a more scientific underpinning for studies that show that few leaders consistently make money and that the vast majority fail as leaders, on both straight leadership and financial results grounds.<sup>9</sup>

**“... the Value-Centric financial styles lead to relatively high growth and high capital generation over the longer-term...”**

The value-added dimension of financial style is reflected in the gross margin of a unit or enterprise relative to other similar units or close competitors. That is, this

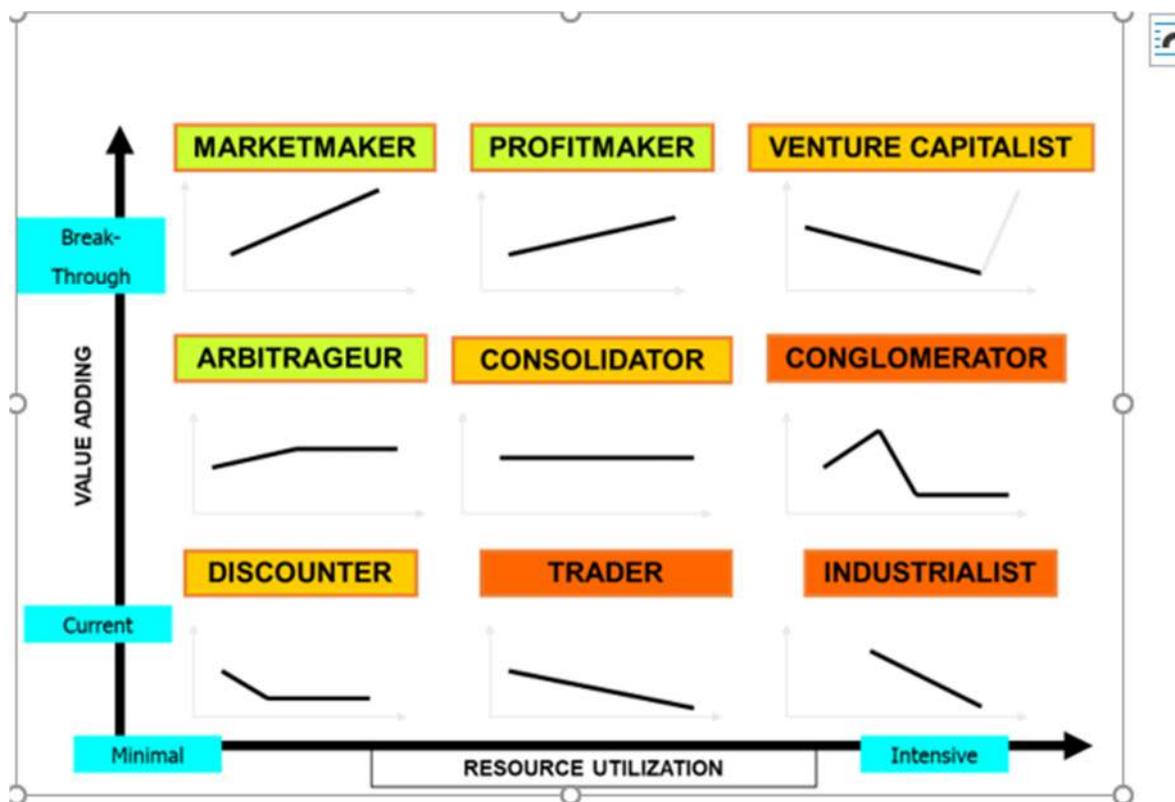
accounting measure is a true measure of value-added, both at a corporate and at a behavioral level. We use this measure and not profitability since the latter does not measure value-added. It was not designed to do so, and in any case is too prone to manipulation to be useful.

Similarly, the resource utilization dimension of financial style is reflected in the level of indirect expenses relative to other units doing similar work or to close competitors. Once again, we need to convert this to a percentage of revenue to allow comparison with other units in the organization and with close competitors.

By adopting this approach, we can calculate the financial mission of the unit or enterprise and compare it to its competitors. This will show the relative positions of the enterprises in a market from the viewpoint of their financial mission.

If financial signature leads to a systematic bias to financial decisions either by individuals or teams, we would expect this to be reflected in the valuation of a company. Our original research found such an impact. Basically, the Value-Centric financial styles lead to outcomes that create capital.

Figure 3 The Nine Valuation Trajectories



The Perth model addresses corporate and microeconomic issues and decision-making via the concept of the financial signature and the associated valuation outcome. It addresses macro-economic and regional and national decision-making via the aggregation of these signatures at the appropriate social levels. The cognitive biases it addresses can be measured both psychometrically through assessments and financially as reflected in the financial statements of a company.

The Perth approach does take behavioral finance a major step forward by enabling prediction to be carried out at the level of a specific individual, team or company and to predict the precise financial and valuation outcomes that will flow from these decisions. The approach is measurable and able to be operationalized so that it provides results that can be falsified, the major criterion of a scientific method.

### Providing an Atomistic-Outcome Behavioral Synthesis

The Perth model is strictly concerned with business outcomes. They must be measured in terms of their value and valuation impact. Leadership only has an impact if it impacts business outcomes. Anything else may be a valuable outcome but unless it impacts organizational value and valuation measured in financial terms, it is not a criterion for deciding if leadership has been successful or not

The Perth model leads to a new type of synthesis between behavior, business outcomes and leadership. This results in the following principles:

**Leadership is valuation;** we can only measure leadership through its results; leadership can only be said to be successful if the valuation of the unit, team or enterprise increases relative to its competitors.

**Valuation is outcome:** In any organization, its valuation relative to its competitors drives its outcome. This valuation may be measured in financial or non-financial terms both quantitative and qualitative, such as in nonprofits or a governmental organization.

**Valuation is behavior:** Valuation is not profitability, assets, sales or intellectual property; these are merely symptoms of behavior. The financial metrics which measure these quantities are merely measuring the results of behavior and they should not be confused with behavior or valuation itself.

**All employees have a virtual P&L:** every employee contributes to the valuation of an enterprise, even if they are not aware of that fact. Each of them has a virtual P&L, whether or not it is recorded. The job of all employees is to increase their own virtual P&L so that they increase the valuation of their unit, team or enterprise.

**All decisions have a value impact:** Even if the decision is not explicitly financial in nature, it will have a value impact since it comprises two drivers, value-adding and resource utilization. These may be measured in financial or objective or in qualitative or non-financial terms.

## *Part 4: What is in the Wealth Activation Program?*

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### THE WEALTH ACTIVATION PROCESS

There are four steps in this process. These are:

- A behavioral audit of the key players using the Perth assessments.
- Sessions with top and emerging leaders to show how to use this information for strategy, operations, and financial analysis and planning purposes.
- A debrief session with assessees to use this information to improve their own financial and profit performance.
- Show how to use this to achieve improved valuation.

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### A BEHAVIORAL AUDIT OF THE KEY PLAYERS

Perth has three core assessments. These are the Financial Outcome Assessment, the Corporate Financial Outcome Assessment, and the Leadership Cockpit assessment. These measure the following wealth activation attributes:

- Financial signature – innate wealth creation behavior of key individuals and teams
- Financial mission – the current, learned wealth activation approach being used by individuals and teams
- Corporate financial mission – the wealth creation approach being used currently by the organization and the level of alignment with the wealth creation approach currently being used by individual leaders and team.

These assessments provide comprehensive reports on all the aspects of wealth creation by leaders and key subsidiary leaders in the organization. They provide information on the key cognitive biases for all these people so as to predict their results in terms of financial outcome, impact on valuation and business outcomes as distinct from financial outcomes.

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### COACHING AND FEEDBACK SESSIONS

One or more sessions are conducted with all key leaders who have been assessed. This provides them with information customized just for them on what behaviors are creating wealth and which behaviors are detracting from this end.

Particular issues addressed include:

- How they can improve their own financial mission
- What financial mission they should be pursuing
- Their level of alignment with the financial mission of the organization that will achieve the optimum valuation outcome

- How they need to change their leadership style to meet the optimum business impact and financial valuation of the company

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#### TRAINING AND DEBRIEF SESSION WITH ASSESSEES

AS full training session with assessees is held so that they can understand the linkage between their behaviors and the financial and valuation impacts. This is important because they will not already know. In addition, it is very unlikely they will be aware of their own cognitive biases and how this affecting their financial and valuation impact.

In general, this session will last between one half-day and two days depending on the level of depth the organization wants, and the individuals require. In these sessions there will be interactive groups to show participants how these behavioral processes work in practice and to provide an interactive learning environment for concepts that will be unfamiliar to almost everyone in the session.

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#### STRATEGY SESSION

There will need to be a high-level strategy session following the preceding steps. The aims of the strategy session are:

1. To identify the company's optimum financial mission
2. The actuary valuation that his implies for the company
3. Which people need development effort to achieve changes in financial mission to be better aligned
4. Positions in which different behaviors are required or where behaviors need to be changed appropriately
5. The extent to which behaviors can be changed or not
6. The level of change needed to achieve the optimum valuation and whether or not the people involved can achieve this.

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#### WHO WILL BENEFIT FROM THIS UNIQUE APPROACH?

- Founders and CEOs of family-owned companies
- Family and non-family executives and emerging leaders
- Wealth and portfolio advisers
- Registered investment advisers
- Investors and family offices
- Board directors

## ENDNOTES

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