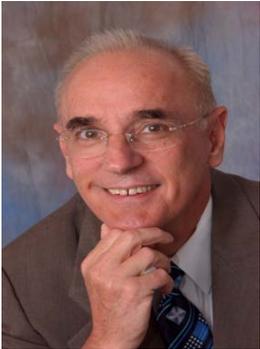


Can Leadership Development Programs Solve Credit Crises?

Does the current credit crisis teach us anything about the development of leaders? We think it does, and in a big and important way. Our thesis? Until leadership development programs incorporate more training in business acumen and financial behavior, credit crises like these will continue—and at the level of the corporation, not “just” the economy.



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Make Mine Minsky

You might have heard recently about the Minsky Moment. Minsky was an economist who preached that business cycles always inevitably end in a panic or mania since irrationality and excesses always develop and this always leads to a bursting of the bubble.

Back in the halcyon days when the pundits were saying that Greenspan had repealed the business cycle this tended to look very passé, but the same pundits are dusting off the theory now, just as happens in every generation when it discovers the inevitability and power of business cycles.

So what is just happening was entirely predictable and in fact normal. It is a reflection of the fact that, despite modern economic orthodoxy, much financial behavior is irrational in nature. The emerging disciplines of behavioral finance and behavioral economics have taken up this approach, but the mainstream still gets surprised by the thought that financial behavior is often essentially irrational.

Down with the Proletariat?

Even more fascinating, it's not just relatively less educated and relatively lower income groups that were irrational in participating in this particular credit to-do.

It was the Wall Street quants and financial product managers who created the securitization of subprime loans with the active support of their leaders, the financial ratings arbiters who blessed the subprime gospel and the leaders of the mortgage companies that happily went along,

The government, not to be outdone, through both its de facto agents Fannie Mae and Freddie Mac, not to mention the Fed with its continued low interest policies also aided, abetted and actively fomented these practices.

It has been the leaders of the financial and economic establishments that have created the environment that led to the financial irrationality of the recent years. The common man just followed their lead. So we have to look to the leaders to explain the problem and to search for its solution.

“...despite modern economic orthodoxy, much financial behavior is irrational in nature.”

Business Cycles so Passé...

Could things be different? Could we repeal the business cycle? Can we avoid or at least ameliorate other sorts of problems we are experiencing now?

“The big area that leadership development programs do not focus on is business acumen and financial behavior.”

Yes, things could be different. And no, we can't repeal the business cycle. But we can educate our leaders to think and act better in financial terms. In order to do this we have to take the bull by the horns and make a deliberate effort to reform our leadership development programs and models to do this.

Otherwise, as they say, to ignore history is to repeat it.

Mathematics and Common Sense

Leadership development programs in large corporations focus on many good things. Interpersonal skills, diversity, ethics, teamwork, emotional intelligence, strategic alignment, execution and vision.

But here's the rub. The big area that leadership development programs do not focus on is business acumen and financial behavior.

The one thing our leaders are not trained to do in a formal way is to look critically at the implications of their own financial behaviors – rational, irrational and otherwise. The assumption seems to be that either our leaders know this stuff – which is patently untrue, or that their financial education both in MBA school and the corporation will inure them against irrational and destructive financial behaviors – again patently false.

Once More Unto the Edge, Dear Friends

Smart or not, experienced or newbie, high or low – the vast majority of leaders and managers default to following the herd in matters financial. Even the government and the regulators go along until it's too late.

And even the Fed, which should know better, when it comes to a choice between moral hazard and a system meltdown goes for a short-term – albeit pain-diminishing – fix which merely perpetuates bad leadership development and irrational and destructive financial practices by either removing or downplaying moral hazard.

Leadership development programs can be part of the solution, as long as the will exists. HR and leadership development managers have as much a role to play in solving this and future crises as do the banks which inject liquidity into the financial system – in any case only a short-term palliative. The long-term solution lies in changing behavior, not in quick infusions of liquidity.

These programs need to focus on business acumen as well as the more conventional subjects. They need to show executives and managers that there is an alternative to following the herd. These leaders need to be able to explore the financial consequences of their financial behaviors, and to bring critical thinking to them as a preparation for the financial crises that will inevitably impact them in their careers, both inside the corporation and outside. Only by achieving this awareness do they and we as a nation have any hope of avoiding the episodic manias that rock our system at least once, and usually several more times, each generation.

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MBA for Dummies

And we are not talking about what sometimes goes under the name business acumen training in some companies. These courses are typically primers on how to read financial statements. This is not to say that they are not doing some good.

But the participants of these courses are typically relatively junior managers who will generally not be influential in the sorts of financial phenomena we are talking about here. The leaders we are talking about

are well beyond such simple courses.

What we are talking about is much more sophisticated in nature that explores the impact of financial behaviors on companies and the economy. That involves the current and future leaders who will be in a position at some stage to help influence the outcome. They can be high potential, or already senior, but either way we need to be focusing more on this issue.

The New Behavioral Physics

And, we say, if you have them, you should also include leaders and managers of quant units, the group of high-intelligence mathematicians that developed the securitization models that led to the subprime crisis.

Not because they are responsible, because we all are, but because it will give them a searing new perspective on how they themselves and the world generally works that will lead to new insights that will improve their professional effectiveness and the value of their models.

What is needed now in leadership development is more financial self-awareness, more criticality, more understanding of the role of human and behavioral factors. We need to give upcoming and current leaders insights, not just models and numbers.

The companies that do this will truly be making a major contribution to the long-term stability of our society and to the well-being of its less-fortunate citizens.

Hints and Recommendations

- Introduce business and financial acumen components into leadership development programs.
 - Avoid the temptation to rely solely on the business literacy route.
- Be sure to emphasize the link in these programs between business acumen and ethical and social objectives to make it clear that these programs have much broader societal objectives.
- If you have quants, provide them with business acumen training and development too, as a way to provide them with more real-world behavioral insights.

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