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Leadership Lessons and
the Economic Crisis
*Where We've Come
From and Where
We're Headed*



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EXECUTIVE SUMMARY

The financial crisis has discredited the leadership and management practices of financial institutions, triggering a wave of thinking and experimentation about what could and should replace them. The crisis will surely produce changes in aspirations and practice in organisational leadership, influencing not just banks and brokerage houses but businesses in every industry. This Perspective puts this process in the context of trends in leadership over the past 30 years, and predicts some of the new and back-to-basics actions we can anticipate. It highlights the rapid changes in board practices and articulates some clear direction for change both in the structure for governance and management, and in the characteristics that leaders will have to display. This crisis will be a powerful catalyst for change in both the theory and practice of leadership and governance.

INTRODUCTION

I have spent 25 years working with leaders in a variety of private companies and government entities. They are very diverse as people, and so are their institutions, but there are always prevailing trends in the practice and theory of leadership—and if anything, these trends are getting more cohesive, not less. When there is approval and applause for any particular model, it creates a gravitational pull on actual practice. Institutions tend to change towards that model, executives promote and behave under the influence of the fashion, and for a time the spread of practice accelerates the trend.

Clearly, since September 2008, the leadership and management practices of financial institutions have been

widely discredited. This is setting the stage for changes in thinking about organisation and leadership within the financial services industry, and it will be an important component in broader transitions in thinking about leadership in business in general. The style of leadership that prevails, and the ways in which management and governance structures change and interact with new leadership styles, will play an enormous role in shaping financial institutions. It isn't yet entirely clear what norms and values the new industry leaders will champion, but the pressures on them are evident, and the history of managerial culture suggests that we will see major transitions in both organisational practice and leadership styles, in ways that few observers currently expect.

A SHORT HISTORY OF RECENT LEADERSHIP STYLES

If a new major trend in leadership style is indeed on its way, it would be the third in the past 30 years. Between the early 1980s and 2001, the “leader as hero” was the most celebrated model. The prevailing philosophy said that clear, strong leadership would shake the corporation free of past bureaucratic mindsets. Tremendous value was created by clear-sighted individuals who took their institutions by the scruff of their necks and propelled them into modernisation and competitiveness. Jack Welch at GE and John Browne of BP shook up old organisations, weighed down by process and committees, and, shining clear light from the top, transformed their performance. The spotlight also caught a number of similarly powerful entrepreneurs, from Richard Branson to Steve Jobs to Bill Gates.

And there was a parallel in politics. These were the years when Margaret Thatcher bestrode the political world. Her style and her definition of leadership were profoundly influential. Even Mikhail Gorbachev reflected, in his persona, that Welch-like, Thatcher-like style of individual leadership that Politburo collectivism had previously suppressed.

Let’s not quibble here about whether the public images of these leaders fully represented the way they really operated. In the public persona, there is always some selection and simplification. But the images in their own right are significant and influential. The leadership ideal of a few key figures, burnished and disseminated, influences the actual practice of thousands in other organisations.

And it certainly affects the recruiting decisions of boards of directors, hoping for organisational renewal. Company drifting? Find your Maggie Thatcher! CEOs intruded onto the covers of popular magazines, business biographies were widely read, and most notably, there was the extraordinary inflation of CEO compensation.

Then, around the turn of this century, this predominant theory of the “leader as hero” was increasingly questioned, first in academic circles and among informed commentators, then more broadly. One thing that pushed the individualistic model of leadership off the pedestal was the fallout from the dot-com bust. That downturn revealed flaws, failure, and even disgraceful conduct of some noteworthy individualistic leaders, in the corporate world especially. This was the time of Enron, WorldCom, Tyco, and Parmalat. Even some genuinely successful corporate heroes turned out flawed. Nothing so ill became Jack Welch’s tenure at GE as his leaving of it, mired in pension benefits, perks, and corporate aircraft privileges. Other successful CEOs were dismissed for backdating stock options. The dot-com bust also led to a period of reform in corporate governance—specifically, the passage of the Sarbanes-Oxley bill in the U.S.—and with some success, perhaps. During the current crisis, we have not yet seen industrial-sector malfeasance scandals to rival those of the dot-com crash.

But as thinking moved away from the “leader as hero,” a new model was needed. The concept of “leadership teams” replaced it. This was certainly

not a new idea, but it became newly popular. Better performance, the theory ran, came from combining a variety of management talents and styles into one cohesive group. The balanced team became the ideal. The most successful leaders were reinterpreted as conductors of the team, as if it were an orchestra.

Perhaps it's no coincidence that the American television miniseries *Band of Brothers* was revered in business circles when it came out in 2001. The teams of the early 2000s were diverse, freewheeling, results-oriented leaders, and pragmatic to a fault. Capable people in regular communication with each other would be able to avoid the errors and exceed the achievements of the individual heroes who preceded them.

Accordingly, there was an emphasis on the people-building skills of the top executive. Teams ran companies. Imperial CEOs got into trouble. People like Bob Nardelli, CEO of Home Depot, were fired for failure to hear and respond to concerns, in his case from shareholders. At Booz & Company we publish a study of trends in CEO succession every year, and that article in 2006 was titled "The Era of the Inclusive Leader." Life at the top became a bit more touchy-feely.

One factor driving the "leadership team" model was demographics. A different generational cohort had moved into top executive ranks. In this period, the transition was especially rapid. The average age of CEOs fell swiftly. The generation that took power was the generation that had come of age around 1968—a genera-

tion that had broken more sharply with the values and ideals of its parents than any other generation, before or since. Their fundamental attitudes had been shaped in the 1960s; they were less hierarchical, less schooled in the military, and more collaborative by inclination than their predecessors.

The shift to this new team-based model was also supported by the quite remarkable strength of the economy during this period. Just as Francis Fukuyama had famously proclaimed the end of history after the collapse of the Soviet Union, so many, from Gordon Brown downward, proclaimed the death of the business cycle between 2001 and 2008. In economic terms, we seemed to live in a new utopia—and it was certainly a flattering environment for managerial performance.

Now we face another transition. Our current disastrous financial and economic crisis once again shakes our confidence in the prevailing leadership style. Organisations until recently hailed as champions, and led by masters of the universe, are seen as hollow monsters. Banks, car companies, regulators, governments—they got it badly wrong, and we are all paying the price. The leadership teams in charge, it is believed, were quietly attending to their bonuses or corporate jets and not paying attention to the risks. The Bands of Brothers may have avoided egocentricity, but in their own Musketeer-like way, they were sealed off from the rest of the world's needs. Until organisational hubris spilled into systemic catastrophe, it wasn't clear how amoral such teams could be,

how thoroughly oriented towards winning, how cavalier with rules and experience, and how confident that they were right—if only because they had each other's support.

So far, most of the debate on leadership that the crisis has produced is about whether the leaders who put us there were knaves or fools. The extent and consequences of the crisis, the impact on the public purse, and the metamorphosis of some prominent leaders from incompetence into personal greed financed by the taxpayer have stoked up revulsion at their behaviour. Were our banking leaders greedy and corrupt? Or just ignorant and stupid? And which is the more frightening of those conclusions?

In the U.K. and U.S., there is focus on the remuneration packages. There was the grotesque spectacle, for example, of the dismissed CEO of the Royal Bank of Scotland, responsible for wasting billions of what ultimately proved to be public money. He was awarded an £8 million (US\$13 million) pension fund increase paid for by public money, set up at the age of 51 to live in luxury for the rest of his life. What were they thinking, the world wondered? And the same was true for the leadership teams of company after bailed-out company: AIG, Bear Stearns, ING, and ABN AMRO.

To paraphrase Winston Churchill, "Never in the field of commercial business has so much been damaged, for so many, by so few." The failure of expectations has been widespread, severe, and rapid. Clearly, the leadership team approach that has been applied will be discredited—but what will replace it?

A RETURN TO CLASSIC PRECEPTS

The impact on leadership in business will probably be felt most quickly at the board of directors level, in how boards play their role. Driven by fear of the risks that have been exposed, boards will start by changing their own behaviours, and go on to revise formal governance structures, team composition, and the personality and skills of the people they appoint. As before, they will respond to prevailing interpretations of recent history, and it will take some years for the implications to roll through. But we can certainly expect them to react to the recent history of collective myopia and to think hard about ways for organisations and individuals to recognise and manage risk more effectively.

A silver lining in the cloud of discredit around the leadership record of financial institutions is that it is driving more reflection about the type of leadership and corporate governance that is needed, both in the financial sector and in business in general. People have been thinking and writing about leadership for 3,000 years. Surely, somewhere deep in the cellars there must be a forgotten vintage of thinking that will be resurrected to lubricate the rebuilding of our economy.

The old truths, and important ones, suggest that to lead, leaders must have foresight, and they must lead by example. They must motivate and inspire on a moral basis, through aspiration as well as rewards and punishments. It is precisely this calm, considered, and ethical leadership, required to lead and inspire large numbers of people when the economics are tough, that seems in such short supply today.

The moral component of leadership is particularly relevant for banks. The crisis occurred in part because the banks collectively walked away from their role as bedrocks of the economy; they turned themselves into profit machines and growth machines, on an international scale. This was not just a financial mistake; it was an abdication of a core responsibility, and the full repercussions of this abdication are still to come.

The new government shareholders and regulatory structures will prevent its recurrence, or at least try to. We will see a recommitment to public responsibility in many of these institutions. Trust and simplicity will become major selling points. Enterprises in banking or industry

that can offer greater trust or closer connection with their customers will see major opportunities. There could be a renaissance of institutions with a mutual or cooperative tradition, of which there are many in Europe (including some, like Rabobank in the Netherlands, that have weathered the storm in financial services reasonably well). As Marjorie Kelly of the Tellus Institute has suggested, a broader scope of alternatives to the shareholder-centric corporate model will be tested, and some will be accepted.

But the change in style will also take place from within, as bankers seek to rebuild their relationships with their customers. Indeed, it's the important core banking functions, such as taking deposits, making loans, and providing money transmission, that warrant the extensive public support that has been provided to banks. The reciprocal obligation of the banks is to commit heavily to these core functions, and to shun the complexity, obscurity, and risk associated with some of the other businesses they have developed.

In the wake of the crisis, there has been a great deal of debate about governance structures, oversight, and the makeup of corporate boards. But when you look more closely,

the concerns that are voiced speak more to characteristics of individuals and groups, and the leadership and governance style of executive teams and boards, than they do to corporate structure and design. You hear that, among the surviving companies, the ability of the board and management to think critically and out of the box, or not, has been essential. However, there is no real evidence that the formal structure of the board or executive team has had much to do with that. There is no data I am aware of that American "outsider" boards (where few directors are part of executive management), or British mixed-membership unitary boards, or Dutch split boards have performed any better than the other. There are failures and successes within all structures. It does not look like the crisis will have any effect on formal board structures.

But it *does* look like there will be changes in board behaviour. Already, board members are finding it untenable to maintain some of the traditional separations between management and board oversight—a separation much beloved by CEOs. Board members worry that lack of intensive oversight will get them into trouble. They want more visibility into corporate practices and risks, and more data to verify more dimensions of

performance directly. They feel they are much more on the line, and they are starting to ask for the staff and capabilities to do more checking up. In the U.K., when search firms recruit chairmen and board members, more and more ask what staff will be provided directly to the board, in order that they may maintain their own sources of information and analysis. We already have separate legal advice for boards in some companies, and now we are starting to see separate management consulting assignments for boards. I completed one last year, around safety assurance for a nuclear power operator. The board members wanted to know how to exercise their governance responsibility for operations and safety. The CEO was allowed little influence over this assignment, because the board wanted direct line of sight on operational performance.

While boards flex their muscle, teams of all sorts are being challenged about their levels of groupthink, and their ability to challenge consensus thinking. Jeffrey Sonnenfeld, professor at the Yale School of Management, draws a stark contrast between leadership at Bear Stearns and at JPMorgan Chase. Bear Stearns' top executive team watched the share price decline for over a year, ignored warnings

that it needed to reinforce its capital structure, overplayed its hand with potential acquirers, and finally went bust. JPMorgan Chase was organised and able to come in with a mopping-up operation. As Sonnenfeld tells it, this difference partly reflects a contrast between individual leaders: James Cayne, the former CEO and chairman of Bear Stearns, was away playing in bridge tournaments at several key moments, while his counterpart at JPMorgan Chase, Jamie Dimon, was on the job and on the ball. But it is also a story of institutions and leadership teams. Bear Stearns' senior executives were part of an approving chorus. JPMorgan Chase was well served by a strong and sober risk committee, which called in advance the underpricing of risk and the overextension of the U.S. mortgage market. Dimon listened—more important, he had to listen. JPMorgan Chase found a way to maintain a rich and multifaceted perspective, while Bear Stearns was locked in a single line of thinking. Leadership styles and corporate structures worked together, either to precipitate or to avoid failure.

Andrew Campbell and others at Ashridge Business School in the U.K. have done some interesting work on what leads good leaders to make bad decisions. They point to a limited number of predictable reasons, and

suggest that most bad decisions are avoidable. Decision makers, they say, tend to base their conclusions on experience and emotion. People synthesise past experience into patterns and use the patterns to process new data. In doing so, they may easily apply a pattern that doesn't actually fit, misperceive the cause of their current problems, and get the wrong answer.

They may also form a view too early. They come to problems prejudiced and look only at the facts that support their preconception. Sometimes they get emotionally connected to particular solutions and ignore the other ones. Or they may be influenced by their self-interest, even if they see themselves as incorruptible.

The Ashridge researchers also observe that the influence of self-interest on decisions is widespread and often unconscious. Individuals are not very good at catching themselves when a decision is biased by self-interest. Someone else needs to do it for them. Therefore, people cannot police themselves. Ashridge's researchers marshal a lot of experimental evidence to support this conclusion. And it is also supported by visible events, such as when CEOs were caught in the stock option scandals. They apparently did not think they were doing anything wrong.

All of these factors were visible in the run-up to the financial crisis. There was a lot of groupthink. Everyone said that subprime mortgages were OK, so everyone thought they would be. The whole RBS board backed the purchase of ABN AMRO; there were no dissenters. Given how disastrously wrong it was, you would think that someone on the board would have taken a different view, that there would have been some debate. But no. At HBOS, the CEO was top of his class at Harvard Business School, and a board and team with outstanding business track records agreed to expand property lending massively at the peak of a property bubble.

When good people make bad decisions, it's often because they are part of a bad collective process. The "leadership team" emphasis on collaboration and fitting in—the trend since the turn of the 21st century—turns out to have a dark side. When a team becomes a chorus, and strengthens commitment to the course by working for consensus for its own sake, it becomes counterproductive. And yes, there was probably some subconscious self-interest guiding decisions at the top of banks, in addition to any conscious self-interest. It is harder to resist attractive conclusions that promise to make you rich, quickly and easily.

THE NEXT LEADERSHIP TRENDS

As we look forward, therefore, our leadership challenge will be to find structures and processes that challenge thinking and retain productive dissent. We will need to populate them with more diverse personalities, who can work together to make the changes that are needed and then to lead institutions in ways that avoid the problems that have been so acute. In corporations, we first need the ability to set some new directions and renew moral leadership, while tapping the potential of team leadership. In the future, to balance the risks of team leadership on a continuing basis, we will need what British politicians call the “loyal opposition.” We have to provoke leaders to think the unthinkable, a lot more often; and character and structure have to interact productively to achieve this.

We also have to learn to recognise the unknowable. Much has been said about the failure of our conceptual systems to comprehend and control the complexity and interdependence of our world. We have learned that complicated conceptual financial models, which seem to represent this complexity accurately, can actually obscure the underlying reality, fooling us that we are getting a better grip on it, when we are actually losing touch with it. There is now some catching up to do. The global financial and economic system is a *Titanic* in strength and speed, but just like that

doomed ship, the technology of foresight and guidance systems has been left behind. Caution on the part of the captains would be welcome.

Leaders in financial services—and elsewhere in business—might be better off realising that we human beings are all limited, that our best course is to accept that we are intrinsically prone to get things wrong, that we need to keep all our wits about us (and those of anyone else we can get hold of), and that we need most of all to keep in touch with reality, through our and others’ messy immediate experience. That means, first of all, people for whom doubt and uncertainty are simply the human condition, not the enemy of action or a sign of weakness. It means also making it an organisational habit to regularly challenge even what seems to be most obviously true, to remain open to different types of data, especially including direct experiential and “feet on the street” observation. I wonder what would have happened if the boards of the banks had visited the neighbourhoods they were financing?

This also means less consensus and more emphasis on diversity, dissent, and a multiplicity of perspectives on a problem. I think this represents a substantial reinterpretation of the previous trends towards team leadership. There’s a danger that, in the

wake of the crisis, companies will revert back to looking for “heroic leaders” who can provide individual salvation. Team-oriented inclusive leadership will be better than that, because it has the potential to integrate divergent experience, talent, and perspective.

But the makeup and management of executive teams may have to change. The evidence is that the most productive teams are those that contain diverse people. Teams composed of “the best and the brightest” and “not so bright” people outperform teams composed entirely of bright people, for example. The dynamics of team interaction often make it hard to preserve diversity, even though it is diversity that makes the team productive. The bright guys want to hire more bright guys. Moreover, in a balanced team, the variety of personality types tends to make the team itself short-lived. People who want to get things done, and there are a lot of them in business, drive out those who want

to stop and debate or who value perspective and understanding as much as action. As those go, so goes the ability to challenge. And those who shrink from conflict or believe that only harmonious teams can be effective will also disapprove of the kind of open dissent that leads to better leadership and decision making.

If people recognise this, we may see a response in terms of better ways of organising and managing executive teams and boards. First, in composing teams, boards should favour a diversity of characteristics, and they should guard against the tendency over time to homogenisation. Second, there will be more active and structural separation of power and control within companies. An increasingly clear distinction may be drawn between governance and management. There may be a separate, internal governance structure in some companies, even separate from the CEO’s control but reaching down into the company, whose role will be to review, check

up on, audit, and hold to account those who have the primary decision-making authority. They will need to look for disconfirming facts and contrary evidence.

We see this already in a few companies. It has helped some institutions avoid or mitigate the effects of the crisis. Barclays is a good example. Their corporate centre is entirely devoted to governance. It has not had management responsibility for the business—that is, within the business units. The centre has a strong risk control function, but also governance roles across many other areas of the business. And despite Barclays’ very extensive involvement in the debt market and other troubled markets, it has avoided many of the problems facing other banks.

The same principle is widely extendable to other functions key to a company’s survival. These might include operational safety in the case of high-risk operations, and perhaps

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customer segmentation and brand integrity in the case of fast-moving consumer goods. Certainly it should include all types of risk exposure for financial institutions.

To make it work, we need further organisational innovations that separate governance and control right down through the organisation and provide visibility and challenge to management at quite detailed levels. The finance function and finance control practice is an excellent and well-established example, but the application of this good idea is not limited to finance and accounting. Put your mind back a few years and you can recall that what got BP into trouble was their problems in safety. There was a single dominant structure of reporting and control, centred on Lord Browne, and heavily financially oriented. They missed the signals on operating performance and safety. That has provided quite an example to other companies with safety-critical operations.

At the same time, there is a risk that such governance structures will simply re-create the old bureaucratic staff structures that hobbled companies in the 1960s and 1970s. What we will need is tightly limited roles and processes, a separate voice and perspective, and not many resources and processes. It is notable that Barclays have been rigorous in restricting the staff and role of the centre even as they have emphasised the importance and distinctiveness of its role. Many of the people who are good in those roles will be less effective as managers; the stance and the skills can differ. In the end, we will see extensive deployment of leadership structures and team selection that maintain outside challenge and questioning across the full range of a company's operating issues and down to much more penetrated levels within the organisation. This will not be easy for many managers to accept.

But it is made even more necessary by the fact that only 25 percent of

new CEOs come from outside the company. The outsider's perspective is not coming from that source. The use of external advisors, either formal or informal, can mitigate the risk somewhat if they can genuinely challenge and test the groupthink logic of internal conversations.

Another component of the solution comes from philosophy. Ludwig Wittgenstein wrote of this problem, "It is not a difficulty for the intellect but one for the will that has to be overcome." In other words, we need to strengthen our moral wills, and not just our intellects, if we wish to see the world more clearly. I am skeptical that today's methods for ridding ourselves of so-called cognitive biases can do the trick. There is no evidence that we can address moral issues by focusing on thinking itself. Nor can we solve this by suddenly getting "moral hero" leaders to fill the shoes of the old "performance hero" leaders of the 1980s and 1990s. We can't depend on a leadership bench of saints.

A better approach may be to recognise the power of the social and collective environment, and to restrengthen some social and public virtues as a counterweight to the inevitable human bias towards self-interest. When I started working in the City of London as a merchant banker in the 1970s, we were schooled together, across institutions, in a collective and collaborative fashion. This tended to make moral issues the province of the business community as a whole, demanding similar ethical dimensions and qualities of performance from all of its leaders and emerging leaders. Harvard's Howard Gardner points out that established professions, such as medicine and law, do the same: The physician's residency is an in-depth apprenticeship designed not just to teach tools and techniques, but to help establish a sense of collective judgment. Rakesh Kurana has argued that a similar sense of professionalism is most needed in business, and that business schools lost sight of this part of their job in the 1950s—with

damaging effects on the practice of management ever since.

Perhaps we have all been guilty—of urging on, with a chorus of consumerism and unrealistic financial and performance expectations, a poor form of leadership in the business organisations of our time. No one planned the current leadership model in practice: leaders placed in the context of unchallenging corporate structures, supported by teams that were too harmonious and operating a business and regulatory culture that was complicit. But all of us, together, bear responsibility for changing it.

To lead us in that change, many corporations will for a time need leaders who are unusually detached in their character and thinking. At this turning point in corporate life, for companies in the centre of the recent maelstrom, leadership requirements will be holistic and integrative. This is not a time for leaders to focus on detail. Rather, they must see the general patterns,

and see them better than others. To call the necessary changes and lead them, yet preserve and strengthen the capability and diversity of the team, the leaders we need must focus on their special mission—to say when the rules the corporate world has lived by need to be discarded.

This is the time for this action for several reasons. First, many institutions, especially but not only in finance, need radical changes of direction. The leaders we need now will have the perspective, the mentality, the confidence, and the authority to call such changes. This cannot be done by teams, yet the strengths of the team are essential; the leaders for this change will preside over the team. They will set up the team and maintain it in place, but not actually join it. I noted earlier the self-destructive tendencies of balanced teams, as well as their virtues. The leader's role is to maintain stability in the composition of a team, where tension in the team's conversations and working

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is inevitable, indeed essential. To maintain the perspective, someone needs to avoid being involved in the detail—someone who may not even need much technical knowledge, but does focus on maintaining the team balance and forcing diverse people to work together. That helps maintain diverse perspectives and challenge, on which, as I say, there will be renewed importance.

The leaders these organisations need will do one more thing distinctively well. They will set the overall purpose and mission of the organisation, not just its strategy. Indeed, they will often concentrate on corporate purpose or mission rather than on strategy, which they will leave to the executive team. The reemphasis on purpose is now of key importance for many financial institutions and others. Leaders with the mentality I describe will distinctively be able to deliver the communication and inspiration needed, and to redefine corporate purpose on the scale required.

CONCLUSION

I noted before the strange parallel between business and political leadership. We see it again today. U.S. President Barack Obama represents a transition not just of a man but of the role of political leadership. He is no experienced international diplomat, not even an experienced legislator. He certainly knows not very much about economics and has no defence background. In short, he is ostensibly far less qualified than many of his predecessors. Yet he does seem to have a gift of clarity: He knows how to simplify the essence of a problem, to strike a new and individual course, and to communicate powerfully and inspirationally. He seems to be complementing these skills with the ability to find and maintain a talented, diverse, and inclusive team. That sort of leadership, with its capacity to catalyse change in direction and mobilise commitment, we will certainly need not just in the U.S. government but, at this time, in our institutions more broadly. To work, a change in the character of leadership will have to complement structural and process change in the rebuilding of our companies, and our economy.

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