Leadership on Trial: A Manifesto for Leadership Development

Mary Crossan  
*Western University*

Gerard Seijts  
*Western University*

Jeffrey Gandz  
*Western University*

Carol Stephenson  
*Western University*

Richard Ivey School of Business

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1 A demonstrator holds a sign reading “Stop Foreclosures Save Our Homes” during a protest outside the venue of the Wells Fargo & Co. annual shareholders meeting in San Francisco, California, on Tuesday, April 27, 2010. 2 A trader works on the floor of the New York Stock Exchange September 15, 2008 in New York City. In afternoon trading the Dow Jones Industrial Average fell over 500 points as U.S. stocks suffered a steep loss after news that Merrill Lynch & Co. Inc was selling itself to Bank of America Corp., the financial firm Lehman Brothers Holdings Inc. filed for Chapter 11 bankruptcy protection, and insurance giant American International Group Inc. (AIG) was approved to secure capital from itself. 3 Protestors shout anti-government slogans in front of the Greek Parliament in Athens on May 5, 2010. Athens police chiefs mobilized all their forces, including those not on active duty, to restore order on May 5 amid rioting during protests against a government austerity drive.
IS CRISIS INEVITABLE?
1 Customers of Northern Rock queue outside the Kingston branch of the company on Castle Street, in order to take their money out of their accounts on September 15, 2007 in London, England. Northern Rock is seeking emergency help from the government, causing its customers to lose faith in the bank. 2 A general view during construction of new buildings on December 12, 2008 in Dubai, United Arab Emirates. The global financial crisis has taken its toll in Dubai with construction slowing and many projects in the planning stage being cancelled. 3 Federal Reserve Board Chairman Ben Bernanke testifies during a hearing before the House Financial Services Committee July 22, 2010 on Capitol Hill in Washington, DC. Bernanke testified on “Monetary Policy and the State of the Economy.”
CAN WE LEARN FROM HISTORY?
Financial professionals in the Goldman Sachs booth on the floor of the New York Stock Exchange at midday watch President Obama give a speech about Wall Street financial reform April 22, 2010 in New York City. President Obama scolded Wall Street for the financial crisis during his speech, and suggested a path toward regulation to help prevent fiscal crises in the future.

Axel Miller, Chief Executive Officer of the Dexia Group, speaks to members of the media outside the Dexia Bank headquarters in Brussels, Belgium, on Tuesday, September 30, 2008. Belgium and France threw Dexia SA a €6.4 billion ($9.2 billion) lifeline and the chairman and chief executive officer stepped down as the widening financial crisis forced governments to prop up institutions across Europe.

Protestors walk out of the lobby of the Bear Stearns headquarters March 26, 2008 in New York City. Hundreds of housing activists overwhelmed security and stormed the lobby of the Bear Stearns skyscraper in Manhattan, staging a noisy rally and protesting the government-backed sale and bailout of the investment bank.
DO WE HAVE CHOICES?
LEADERSHIP ON TRIAL

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While we are indebted to many, a qualitative study inevitably reflects
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Authors

DR. JEFFREY GANDZ is Managing Director—Program Design, Executive Development and Professor of General Management at the Richard Ivey School of Business at The University of Western Ontario. He designs and delivers executive programs for corporations and public sector organizations, and researches and writes in the area of global leadership.

DR. MARY CROSSAN is Professor of Strategic Management and the Taylor/Mingay Chair in Business Policy at the Richard Ivey School of Business at The University of Western Ontario. Her research on leadership, organizational learning and improvisation is published in top management journals including Academy of Management Review, Strategic Management Journal, and Organization Science.

DR. GERARD SEIJTS is Executive Director, Ian O. Ihnatowycz Leadership Institute, Associate Professor of Organizational Behaviour and the Ivey Alumni Association/Toronto Faculty Fellow in Business Leadership at the Richard Ivey School of Business at The University of Western Ontario. He also heads the Leading Cross-Enterprise Research Centre.

CAROL STEPHENSON, O.C., is Dean of the Richard Ivey School of Business at The University of Western Ontario and holds the Lawrence G. Tapp Chair in Leadership. She is a former CEO with more than 30 years experience in the private sector. Since joining Ivey as dean in 2003, she has led the drive to reshape business education for the 21st century.
GOOD LEADERSHIP MATTERS
RECENT BOOKS AND ARTICLES HAVE ANALYZED THE CAUSES OF THE GLOBAL FINANCIAL AND economic crisis of 2007-09. Yet little attention has been paid to the quality of leadership in organizations that were at the epicentre of the storm, were victims of it, avoided it or even prospered from it.

In the summer of 2009 a multi-disciplinary group of Ivey faculty decided to look at the leadership dimensions of the recent financial and economic crisis. We started by writing a working paper that laid out our preliminary views. We then engaged more than 300 business, public sector and not-for-profit leaders in small and large groups, as individuals and collectives, to get their reaction to this paper and, more generally, to discuss the role that organizational leadership played before, during and after the crisis. We examined leadership not just in the financial sector but also in many other public and private sector organizations that were affected by the crisis.

In a sense, we were putting leadership on trial. Our aim in doing this was not to identify and assign blame. Rather, we examined leadership during this critical period in recent history to learn what we could, and use the learning to improve the practice of leadership today and the development of next-generation leaders.

As we analyzed the role of leadership in this crisis we were faced with one major question: “Would better leadership have made a difference?” Our answer is unequivocal: “Yes!”

We recognize that many people could argue it is unfair to criticize leaders whose decisions were based on their knowledge of the situation at the time and which only eventually, with the aid of 20/20 hindsight, proved bad. We respect this view but we disagree with it. Some business and public sector leaders predicted better than others the bursting of the housing bubble and financial markets turmoil, positioned their organizations to avoid problems, and coped with them skillfully. Their organizations were not badly damaged by the crisis and some even prospered. Some governments and regulatory agencies’ control and monitoring systems were superior to those in the U.S., the U.K., Ireland, Spain, Iceland and other countries that had to bail out their banks and other industries. Our evidence supports the conclusion that these companies, these agencies, these governments and these countries had better leadership. Good leadership mattered then and good leadership will matter in the future.

We are presenting our conclusions about what good leadership involves in the form of a public statement of principles—a manifesto that addresses what good leaders do, who they are, and how they can be developed in organizations.
We believe that these principles apply to leadership in diverse contexts, during booms and busts, in calm and in crisis and across a broad swath of industries.

The ideas about leadership presented in this volume derive from the observations and insights of many scholars, writers, philosophers, playwrights, social commentators and practitioners whom we acknowledge as our inspiration. They have been refined through our own empirical and clinical research and educational experience with leaders in the corporate, public and not-for-profit sectors. We have sought to blend the wisdom of the ages with the current context in which leaders operate and the real-world challenges they will face in the coming years.

Financial crises have occurred at frequent, if not totally regular, intervals throughout history and many of them have resulted in prolonged economic recessions. Since the infamous “South Sea Bubble” in the U.K. in 1720, the “panics” of 1792 and 1797 and throughout the 19th and 20th centuries, there have been economic and banking crises every five to 10 years affecting one or more economic powers. In 1997, we experienced the collapse of Long-Term Capital Management (LTCM) followed by the collapse of the dot.com bubble, and the crash in the high-tech industry in 2001. While none of these was anywhere as devastating as the financial crisis of 1340 that originated in Venice and that, according to at least one account, plunged the world into the “dark ages” that lasted a couple of hundred years, there is a pervasive sense that recently the world came close to a repeat of the Great Depression of the 1930s, averted only by the strong and concerted actions of the governments comprising the G8 and G20 groups of developed and developing nations in late 2008 and 2009.

Examinations of these many financial and economic crises reveal four truths.

First, they all had victims, not just financiers, bankers and brokers, but also ordinary working people—people on pensions, people saving nest-eggs for retirement—and, ultimately, society as a whole.

Second, these were no acts of God or natural phenomena, but resulted from deliberate or unwitting decisions by individuals or groups with devastating consequences for others.

Third, they could have been avoided had people learned from previous crises.

Fourth, while consciousness about crises and their roots is heightened immediately after they occur, it disappears in time, and people resume their previous behaviours.

This history has resulted in many business and government leaders accepting the idea that such crises are inevitable and unpreventable. Indeed, some have even declared these crises as the de facto “governing mechanism” required to cope with the consequences of the animal-like urge to pursue risk.
and this urge is at the heart of the virtuous, entrepreneurial financial system that brings wealth and higher standards of living to developed economies. With repeated failures in the financial system has come acceptance of their inevitability and with this acceptance some dissociation from personal responsibility. This is unfortunate since it detracts from the motivation to work at preventing future recurrences.

The near-collapse of the global financial system in the fall of 2008 also reawakened many people to the fact that the business of Wall Street, and other financial centres around the world, is far too important to be left entirely up to business people to manage. Within democratic capitalist systems, business has always had a conditional licence to operate in the interests of owners and shareholders. Business has generally been free to do so provided it served the expressed and implicit needs of the societies within which it operated. When it ceases to do so—as occasionally in the past—its freedoms have been curbed either by regulatory action or the behaviours of customers in the marketplace.3

The shortcomings of some business leaders that were exposed during the recent financial and economic crisis came very close to undermining the legitimacy of the capitalist system. This is currently being reflected in greater legislative and regulatory control of the financial system simply because too many financial leaders, in the aggregate, convinced policy-makers that they are ill-equipped to lead in the interest of either their shareholders or the public interest, let alone both.

The fact that there were really good leaders, who steered their organizations clear of many of the excesses and poor practices that got others into trouble, has tended to be ignored in the popular media. However, their sound leadership is reflected in the principles of good leadership we present in this work.

The material in this volume is divided into six sections in addition to this executive summary:

A description of the context within which this research was carried out—the economic boom, financial crisis, recession and recovery of 2003-2010.

The research itself, divided into a brief section on methodology, and the findings from our interviews, focus groups and other consultations, and the conclusions we drew from the research study.

Principles of leadership addressing what good leaders do, who they are, how they develop and how organizations can develop more, and better, leaders.

A call to action suggesting what management educators, executives, boards, HR and learning and development professionals can do to improve the current practice of leadership and develop next-generation leaders.

A short conclusion that outlines our commitment to continue to develop curriculum, materials and programs that support the concepts and principles underlying good leadership argued for in this book.
It will take years for the in-depth cause-and-effect analyses of this most recent financial meltdown and economic crisis to be completed and, even then, there will be questions about “who did what and why.” We cannot wait for years—the world moves too quickly. We need to take to heart philosopher George Santayana’s warning, “Those who cannot remember the past are condemned to repeat it.” Lessons have been learned from this recent crisis but it is not a given that these lessons will stick.

We do not accept that the excesses, misjudgments and inactions of the last few years are inevitable and must somehow be repeated. But we recognize they could, and likely will be, unless concerted action is taken to learn and apply the lessons from this crisis. In addition to legislative and regulatory change now well underway, we require improved management education, better leadership development within organizations, and better training and development of regulators and policy-makers. We also need politicians who are able to climb above immediate electoral concerns and take the long view—the leadership view.

Cynics say this will never happen. Skeptics say it’s unlikely. We say there is no alternative that makes sense for our future economic prosperity and social well-being.
Financial and Economic Crisis [2007-09]

WE DO NOT INTEND TO REPLAY THE FULL STORY OF THE RECENT GLOBAL FINANCIAL AND economic crisis. That has been done in many excellent books and will, no doubt, be analyzed by academics and others for decades to come. It is important, however, to describe some of the context within which we examined leadership behaviours since we contend that good leadership is very much about how people utilize simple principles to act in difficult contexts.

Figure 1 (page 25) summarizes what happened in the period leading up to the crisis that unfolded in 2007-09. It could be summarized as a cyclical recession overlaid with a banking crisis resulting in the longest, deepest global recession since the 1930s.

EARLY ORIGINS
The origins of this crisis lay in the continuous and accelerating buildup of household debt in advanced economies that began in the 1960s, which was accompanied and facilitated by credit expansion in the financial system. At the root of this buildup of credit and risk were two U.S. government policy decisions that were mirrored by many other governments around the world, especially in the U.K.

One was the decision to encourage home ownership as a social priority. In the U.S., mortgage loans were made on very liberal terms to middle-class and lower-income borrowers through two federally mandated companies, known as Freddie Mac and Fannie Mae, that securitized the loans and sold them on the bond market.

The other was the decision by Congress, in the waning weeks of the Clinton administration, to deregulate financial services and, specifically, to allow derivatives to be traded without visibility or regulatory oversight. It created, in effect, a “shadow banking system” hidden from regulatory oversight, and not subject to the capital requirements of the normal banking system, which multiplied many-fold the amount of leverage and risk in the global financial system.

INCREASED DEBT AND LEVERAGE
Following the short post-9/11 recession, consumer spending increased dramatically in most advanced economies but especially in the U.S. and U.K. This spending was not fuelled by increases in personal disposable income but by massive consumer borrowing from banks and consumer finance companies in the form of mortgage debt, home equity loans, automobile leases and mounting credit card balances. While increasing their debt loads, many people
felt “rich” because their house values were increasing at double-digit annual rates in many urban and recreational markets, stock markets were booming, and their pension plan assets in stock plans were increasing in value. They also felt reasonably secure because unemployment was low. Speculation in real estate reached record proportions with many middle-income individuals owning multiple properties for purposes of investment. People refinanced their houses, using equity released by this to service ever-increasing debt loads and take on more debt for purchases. Some believed they could continue to do this forever and joined a “revolving debt” subsector of society whose concern was not in paying off debt but only in meeting debt-servicing costs.

This credit expansion was fuelled by very low interest rates and what appeared to be plenty of capital in the financial system. Banks and leasing companies had money to lend because they did not retain ownership of many of the loans. Rather, they sold them off to investment banks that packaged them, together with car leases and other consumer loans, first into collateralized debt obligations (CDOs) and then into derivatives of these CDOs. These were assigned risk ratings by debt rating agencies and sold around the world to yield-hungry institutional and individual investors.

There was so much demand for these securities that specialized mortgage-lending banks and brokers were urged to lower their credit standards further, to the point they were making a variety of sub-prime mortgage loans, many with very low initial interest rates and easy repayment terms. The most liberal of these became known as NINJA loans, where the borrower had “no income, no job and no assets.” These sub-prime loans were securitized, mixed with higher quality loans, rated as investment-grade by bond rating agencies, and sold in special investment vehicles (SIVs) to everyone from individual savers to municipal treasurers to pension plans and other fixed-income asset accumulators. For a time it looked as if financial engineers had done what the alchemists had always dreamed of doing—turning lead into gold or, in this case, sub-prime loans into investment-grade securities.

For reasons that will be debated for years, the U.S. Federal Reserve and its equivalent in the U.K. allowed the property asset bubble to develop and continued to pursue low interest rate policies despite the buildup in debt levels in both the household and financial services sectors of the economy. They did this in the express belief that market forces and the self-interest of financial institutions would control the risk without need for regulatory intervention or restrictive monetary policy.

THE HOUSING ASSET BUBBLE BURSTS
It was a fateful decision. In the fourth quarter of 2006, the U.S. housing market softened and house price increases slowed or, in some areas, actually fell. By mid-2007, U.S. house prices had dropped about 25 per cent from their peak one
FIGURE 1: The Financial/Economic Crisis of 2007-09

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year prior and were down to mid-2004 levels. The causes were clear: there was an oversupply of new houses as builders responded to demand by building more; interest rates increased as central banks finally sought to reduce inflationary pressures and energy-led price increases spread through the economy, thereby increasing costs to borrowers; personal disposable income was not keeping pace with debt-servicing costs for many homeowners; and slowing or falling house prices made them unable to pay increased carrying costs by refinancing their houses. Credit cards were tapped out, people couldn’t borrow and they had to reduce expenditures. Many people could not afford to buy new expensive houses and those that could did not because they were trying to save and reduce debt.

EARLY WARNING SIGNS IN THE BANKING SECTOR
Borrowers with adjustable rate mortgages (ARMs) suddenly had to pay higher rates that kicked in when the introductory teaser rates ended. Some walked away from their properties when amounts owed on mortgages exceeded the market value of properties. Repossessions increased and in states such as Nevada, Arizona and Florida, house prices dropped dramatically as these repos came onto the market or people sold at distressed prices. Some financial institutions that had backstopped lending for individual mortgages and derivatives found themselves without sufficient liquidity and adequate capital to meet obligations once consumers defaulted on mortgages. Starting in February 2007, some major financial institutions, such as HSBC Holdings and Washington Mutual, began revealing the extent of their losses. By April 2007, the second biggest sub-prime mortgage lender, New Century Holdings, had declared bankruptcy. Others, such as Bear Stearns, Morgan Stanley and Merrill Lynch, sold stock to raise needed capital and shore up their liquidity. Banks became increasingly reluctant to lend to each other for fear loans would not be repaid and they would need to conserve their capital to manage their own distressed loan portfolios. The value of the property-based derivatives they held became uncertain as the underlying sub-prime loans proved worthless.

RECESSION GRIPS
In the third quarter of 2007, the U.S., followed by other countries, slipped into recession as the “wealth effect” of rising house values and a buoyant stock market evaporated, energy prices soared to all-time highs, banks tightened lending, individuals reduced spending, and businesses pared costs, laid off employees, and deferred or cancelled planned expenditures. Unemployment rose. Despite various governments’ efforts to stimulate their economies, the recession worsened. In November 2007, the U.S. Federal Reserve and other central banks around the world pumped reserves into the banking system while aggressively cutting interest rates. During the next few weeks, the Fed and other central banks took measures to get more liquidity into the banking system and
prevent credit markets from seizing up completely. The U.S. and other governments enacted several stimulus programs, including tax rebates and breaks to get businesses investing and consumers spending. They didn’t work to stop the economic slowdown and the “real economy” worsened—the world was heading for a severe recession but many believed it would be short.

THE BANKING CRISIS UNFOLDS

Then the banking crisis—simmering for some time but not that visible outside Wall Street, the City of London and other global financial centres—emerged full force.

In March 2008, the U.S. Federal Reserve forced the sale of near-bankrupt Bear Stearns to JPMorgan. In early September, the two dominant mortgage lenders in the U.S., Fannie Mae and Freddie Mac, were placed into conservatorship and the federal government provided capital for them to continue operating.

By September 2008, Lehman Brothers faced bankruptcy, other financial firms declined to come to its rescue, the government decided not to save it and it filed for bankruptcy. Credit markets seized up and even firms such as General Electric and AIG were unable to sell commercial paper to raise money. Lehman Brothers’ failure in September 2008 started a domino effect. One after another, financial institutions around the world failed or nearly failed. Wachovia, Royal Bank of Scotland, Citibank, Merrill Lynch, Washington Mutual, UBS, HBOS, and Hypo Real Estate were all among those that ran into severe liquidity or capital insufficiency problems. Some went out of business. Others were taken over by stronger institutions.

When insurance giant AIG almost failed, mainly because it had backed credit default swaps, the U.S. Federal Reserve and U.S. Treasury rescued it, concluding failure could be contagious and paralyze the whole global financial system. The U.K. government acted similarly with Royal Bank of Scotland and Bradford and Bingley. Iceland followed suit with its three large banks. Governments from Spain, Germany, Switzerland, France, Belgium, Italy, the Netherlands, Japan and others also dramatically recapitalized their banking systems. The exception was Canada, whose banks required no recapitalization although they did benefit from liquidity put into the system through low interest rates.

The 24-hour news and financial markets shows zeroed in on every fact and rumour, magnifying and amplifying them while also expressing horror at the resulting panic. In 2008, global stock markets plunged almost one-third as margin buyers liquidated positions quickly and mutual funds and hedge funds liquidated positions to pay for redemptions. As house and stock prices plunged, the euphoria of paper-wealth was rapidly replaced by real fear. Mainstream media compared events of 2008 to those of 1929 and the subsequent Great Depression, which further fanned fear among consumers and the business sector.
THE "GREAT RECESSION" BEGINS
Consumers reacted in predictable ways. Those with no money for the necessities of life—food, lodging, transportation, medicines, etc.—stopped paying debts, including their mortgages, so they could cover basics. Those with surplus income stopped spending. In the fourth quarter of 2008, car and appliance sales, vacation travel, clothing purchases and other discretionary spending dropped sharply so businesses supplying them had no demand. Consumers simply went on strike!

Businesses with high fixed costs that depended on consumer demand failed. Automobile manufacturing giants General Motors and Chrysler were restructured and sold off after buckling under huge debts and reduced sales.

The recession that had started in the U.S. in 2007 became the "Great Recession." Through 2008 and early 2009, the GDP of advanced economies dropped by anywhere from five to 20 per cent, unemployment climbed, and governments moved into large deficit positions as they tried to counter the recession with stimulus spending and prop up banking systems with loans and liquidity injections into their economies.

RECOVERY STARTS
By mid-2009, the crisis appeared to end and recovery began. By summer 2010, however, the "advanced economies" remain fragile and there are concerns some could slip back into recession or, at best, face years of tepid growth. Public finances are in poor shape in many countries with some, such as Iceland, Spain, Italy, Ireland, Greece, Portugal and Hungary, facing the prospect of radical restructuring, with painful consequences for their populations in the form of higher taxes, reduced pension benefits and increased retirement ages, as well as public services reductions. Strong countries are under pressure to help weak ones and, as in the Euro area that has a common currency, tensions are emerging between countries that share a common currency yet have independent fiscal policies. These may yet boil over into defaults and even divorce.
Research

Process
In the summer of 2009, a multi-disciplinary group of Ivey faculty prepared a working paper identifying what it thought had gone wrong with leadership through the 2002-07 “bubble” period in the global economy, the subsequent financial sector meltdown in 2008, and resulting global recession. This working paper was based on a review of contemporary leadership research and reports that were beginning to appear in popular and serious magazines and journals, and the few accounts of the events leading to the financial crash that were beginning to appear in the first half of 2009. The paper proposed a number of hypotheses as to the causes of the buildup of leverage in the financial system in 2002-07 and the subsequent meltdown with a special focus on leadership actions taken both in financial companies at the epicentre of the meltdown and in the broader economy.

This was followed by 10 focus-group discussions with individuals and groups of CEOs and C-Suite executives in Toronto, Vancouver, Calgary, Ottawa, Montreal, New York, London (U.K.) and Hong Kong, using the working paper as background reading for discussion. Participants were asked to read the working paper in advance of these discussions and then a brief synopsis of the main hypotheses in the paper was presented before moderated discussions got underway. There were also numerous one-on-one discussions during the field research period, September 2009 to May 2010, as well as presentations at practitioner-attended conferences. Ivey’s advisory group of senior business executives and entrepreneurs also played an active role in these discussions, meeting with the research team on several occasions. In total, more than 300 individuals were engaged in small- or large-group settings.

During these months, we also presented and discussed our emerging findings with individual leadership development professionals in major corporations and the public sector and involved business students at various levels in discussing our findings and tentative conclusions.

In the working paper and subsequent meetings we addressed four questions:

- What had gone wrong with leadership that contributed to the 2008-09 economic crisis and the subsequent devastation to people, organizations and national economies?
- Had this leadership problem been confined to the few organizations at the epicentre of the financial meltdown or did this crisis reveal broad-based problems with leadership in both private and public sectors?
What could we learn from those organizations and leaders who had anticipated the crisis and avoided it completely, or who coped well and were benefitting from the recovery?

What more do we need to do, or do differently, to prepare current and future leaders to deal with the kinds of challenges we have seen organizations face in the last couple of years and those—as yet unknown—that they will face in the future?

Given the great sensitivity of a number of the issues discussed in these sessions, we promised participants that the discussions would take place under the “Chatham House Rule,” which promised participants we would not attribute their comments or publicize their attendance at the sessions. Many of those involved were Ivey alumni and were thereby predisposed to help us with this venture. Participants were drawn from a broad range of organizations, large and small, in a variety of industries, including representation from both the public and not-for-profit sectors. Most sessions were taped and transcribed and the anonymous quotations included in this volume are from those transcripts. We readily acknowledge that using the working paper as a set-up for the focus groups may have biased discussions. However, we take some comfort that many participants expressed strong disagreement with our observations and conclusions, although we made no attempt to quantify responses. We also recognize that we were doing this research at the same time as the recovery from the recession was taking place and that views about “what had happened and why” were in flux.

We have also drawn from articles, speeches, talk show appearances, books, documentaries and other publications of expert observers and direct participants in the economic and financial events relating to the crisis. These sources are acknowledged in the endnotes and integrated with the perspectives we derived from our focus groups.

Findings and Discussion

The discussions in the research focus groups were rich, diverse and wide-ranging. In some sessions the primary emphasis was on leadership character; in others the emergent topic of interest was executive compensation and, more generally, rewards in financial sector companies; in others the focus was on issues such as organizational risk culture, the social responsibility of leaders or control mechanisms. We encouraged participants to move in the directions they wanted to discuss, with little guidance on our part. As a result, some of the group discussions focused on the ideas presented in the working paper, whereas several of them went off into other directions, driven by the views and interests of the participants.

What we are presenting in this section is a synthesis of the ideas in the original working paper, our research discussions and the rapidly emerging public literature about the crisis, some of which addresses leadership issues, if only tangentially.
FAILINGS OF CORPORATE LEADERSHIP

There was a dramatic moment at the start of Representative Henry Waxman’s Congressional hearings on the financial crisis in October 2008, when a group of rather stunned-looking bankers raised their right hands and testified they had no idea as to the amount of risk that existed in the financial system, and were totally surprised at what had happened. We have no reason to doubt their testimony and, in the months since this event, it has become increasingly clear that the global financial system that knit together money centre banks, investment banks, merchant banks, insurance companies, proprietary and market traders, hedge funds, sovereign wealth funds and institutional and private investors was a complex system that defied understanding even by those who had created it. We also agree that the actual financial meltdown was a true “Black Swan”—an event that no one could have foreseen because of the complex relationships between parties and counterparties in the financial markets.

The fact that it was a complex system should not mask the fact that those who chose to develop it and sought to make money from it made those choices willingly. Nobody made them do it. Some of them bet all or part of their businesses on the expanding credit bubble, which was underpinned by rising house prices, in the belief that the risks were manageable. What they put at risk was much greater than their own capital. They knowingly violated one of the fundamental principles of safe banking: borrowing short and lending long.

There were leaders of other financial institutions who realized in 2006-07 that much of the prosperity of the previous few years was based on a credit bubble—that it was a house of cards, a fantasy, an illusion that would inevitably collapse or evaporate because of the rot in its foundation resulting from the securitization of sub-prime loans. They realized the danger of asset bubbles bursting as all bubbles do eventually. They understood that the excessive leverage in the financial system was predicated on U.S. house prices continuing to increase at more than the underlying economic growth rate if not in perpetuity then at least for many years to come. And they realized that a recession was surely coming that would pose significant risks to economies fuelled by asset bubbles. This was not high finance. It was basic economics.

Published accounts and legislative committee hearings of what took place in some of the investment, money centre, mortgage lending and community banks confirm that within the broader financial community there were also many people who understood the problem with unregulated hedge fund activity, securitization of questionable mortgages, car loans and credit card receivables, and the critical role that increasing house prices played in supporting the credit bubble and, therefore, the leverage in the financial system.

Our research participants confirmed that this was so obvious to insiders in the financial services industry that many of them steered well clear of these types of investments, or limited their involvement to amounts that were
manageable with their capital reserves. Others had made sure that they would be protected from risk in the event of default by both buying credit default swaps from insurance companies and ensuring that they held collateral from those insurance companies. Certainly some of the staff of the bond and commercial paper rating agencies who were paid to rate the securities based on derivatives of sub-prime mortgages, car leases and other forms of consumer lending knew full well that these securities did not deserve the ratings they were being assigned.  

Those who decided to take a more prudent course curbed the desire of many of their less experienced and aggressive staff to get involved in the more complex financially engineered products. They developed sensible policies and procedures by which they screened products and they kept reasonable controls on those individuals. While the speed and extent of the financial meltdown was shocking, the fact that there was a liquidity crunch in response to a looming recession came as a surprise to very few people in the financial markets. The former chairman of Citigroup stated in a 2007 interview: “When the music stops, in terms of liquidity, things will get complicated. But as long as the music is playing, you’ve got to get up and dance. We’re still dancing.” His was one of the companies that came close to failing in the financial crisis and had to be rescued by the U.S. government’s intervention.

While the failures of Bear Stearns and Lehman Brothers and the near-failure of AIG, Citigroup, Bank of Scotland and many other banks and insurance companies were at the epicentre of the storm, firms in the broader, Main Street economy also demonstrated stress fractures. Giants such as General Motors and Chrysler were just the most visible casualties among thousands of businesses around the world that seemed unable to withstand the recession and liquidity crunch. Other organizations recognized the impending dangers of over-leverage and trimmed investments, shored up their balance sheets, focused on cost-control and were in good shape to withstand an inevitable recession. Some CEOs, CFOs and treasurers of large, medium and small corporations, hospitals and municipalities decided they would invest their surplus cash in asset-backed commercial paper, mortgage-backed securities or other synthetic products appearing to offer “more yield for the same risk” than other more traditional instruments. Others decided that this was too risky, understanding full well that there is no such thing as excess return without excess risk.
LEADERSHIP ACCOUNTABILITY

When we focused the microscope on leadership at the enterprise or business unit level, we encountered some research participants who readily identified individual firms or executives and were more than prepared to discuss why people did what they did. This included some frank admissions about personal mistakes and errors in judgment. They thought it important to identify “who did what and why” so future generations of leaders could learn from their mistakes and prevent recurrences.

Others felt this was inappropriate. They asserted that leaders did what they thought was right based on the information they had at the time, and it was wrong and unfair of us to second-guess them with the advantage of perfect hindsight. Their view was that individuals could not and should not be held accountable for what was a “system” problem. They also felt analysis of events would yield little value for future leaders or leadership development.

There is no doubt that “the system” came close to a meltdown. However, we think deflecting discussion away from personal accountability by focusing on the “system breakdown” would be inappropriate, unwarranted and, ultimately, not useful. This was, and is, about leaders and the decisions they made that both created the system and led to its collapse. If we can’t or won’t learn from their mistakes because we won’t question their decisions, we stand little chance of preparing future leaders to avoid them.

We also heard of many organizations and leaders who had not failed and some that were in great condition to benefit from an expected economic recovery. They had avoided or survived the storm, and their approaches to leadership offer some really useful guides to good leadership practices.

If we are to learn anything from this situation, we must focus on individual, group, organizational and systemic causes, learning both from those organizations that failed and those that avoided failure.

Why did some leaders “get it” while others carried on, seemingly oblivious to the dangers? It was as if many of the captains of industry were steering their boats by looking at their wakes rather than by looking forward. Seemingly mesmerized by their recent achievements, they appeared unable to see the coast ahead, and the dangers that lay in pursuing “last quarter plus more” goals through strategies that were not reconsidered—even in the face of a rapidly deteriorating economic environment.

Leadership Psychology

In the years 1993-2008, with a blip in 2001-02, we were living in a growing economy, albeit one fuelled by increased personal indebtedness. Many in the financial services industry, especially in investment banking and related fields, got so used
to success that they could not envisage failure. Overconfidence and hubris among investment bankers in the period up to 2008 was endemic—they felt invulnerable, superhuman and beyond the reach of even the most fundamental laws of economics. One commentator suggested it might be a necessary trait for investment bankers. Any demonstrated lack of confidence would be fatal for their performance. This same overconfidence that made them certain of things for their clients made it difficult or impossible for them to discern danger signals from their external vantage points.

There is considerable evidence that many of the executive teams of enterprises that got themselves into trouble exhibited high levels of groupthink. This form of collective hubris is well-recognized as a condition that develops in highly successful teams. It is characterized by illusions of invulnerability, unanimity, rationality and morality. Highly cohesive and successful teams tend to believe that they can never lose, that everyone on the team believes the same things, that their actions and decisions are totally rational and that what they are doing is right, proper and ethical. Teams subject to groupthink tend to denigrate or belittle those who tell them they are wrong, stereotype those who oppose them, and construe all information selectively to reinforce their existing perceptions. They become unreceptive to criticism and unaware they are blocking danger signals. They keep people with dissenting views at a distance so that they will not have to deal with any dissonance between their beliefs and others’ viewpoints. Loyal dissenters self-censor to avoid being thought of as somehow not “on the team” or “with the program.”

Conversely, those who agree with the group find ready acceptance of their views. Accordingly, those who saw no risk in the credit buildup found reinforcement in the words and actions of U.S. Federal Reserve Chairman Alan Greenspan, who was continually issuing calming statements in speeches and congressional testimony. He dismissed the “irrational exuberance” of the housing and stock markets as items of little concern, espousing the belief that risk in the financial markets would be managed by the market system and the self-interest of financial institutions. He held this view right up to the end of his term in office and for some considerable period after.

In general, people tend to have “mental maps” about the ways in which things work and they accept information that fits their maps and reject information that doesn’t fit. What this means is that if someone believes that house prices will always go up—because they have never seen them go down—they will discount information that they have gone down. They will tend to view that information as an aberration, faulty, or unreliable and reject it. This often makes people insensitive to information that suggests that their business
models may be faulty. Their “radars” are unreceptive to signals that suggest they should reevaluate their route and consider changing course.

There is also considerable anecdotal evidence that social conformity played a role in suppressing dissent within some organizations. This is the desire to go along with those whom you like and respect, even if you believe that their actions are wrong. This subconscious desire to conform—the distaste for rocking the boat—leads people to ignore wrongdoing or accept inaction in the face of events that call for action. It is hard to swim against the tide of opinion when people you like and respect hold those opinions.

That so many decisions taken at the most senior levels in financial and other organizations seem, in retrospect, ludicrous, is testimony to the power of these distorting phenomena. They have been taught in undergraduate and graduate programs in psychology and business for decades, and are also frequently referred to in popular books dealing with flawed business and public sector decisions. Clearly, however, many players simply did not recognize that they, too, could be victims of these effects. It is a perverse reality that individuals can recognize overconfidence as a problem yet be so overconfident themselves they believe they could not be victims of it! These are normal, not pathological, processes which is what makes them so insidious.

Reliance on Quantitative Models
Many leaders depended on quantitative models to guide their assessment of risk, not recognizing many of the assumptions built into these models. Post-crisis analysis of these models revealed the modellers had not contemplated a prolonged and severe drop in house prices, presumably because this had never happened in their living memories. In other words, the models were deficient. They were sophisticated, arguably more complete and better tested than any that had gone before but—as with all models—they were bounded by assumptions. And the assumptions were wrong. This is exactly what had happened in the buildup and collapse of Long-Term Capital Management a decade previously. Incomplete models, tested with limited data, had given a false sense of security to investors and policy-makers alike.

It doesn’t help, of course, that many of these models depended on a level of mathematics skills simply not possessed by those in senior executive ranks, and that the modellers came with impressive credentials. Many were PhDs from the finest schools and, by the time the crisis erupted, they had impressive resumes listing successes with their models. It took skeptical and courageous people to say: “If I don’t understand it, I’m not going to believe it” and force the modellers to explain their assumptions and the sensitivities in their models. Some leaders did this. Whether or not they truly understood in

RESEARCH

They always asked me what keeps me awake at night. I remember that somewhere I would include in my answer, “...what keeps me awake at night is (quantitative) models.”

HONG KONG

In good times a lot of sins are encouraged and perpetuated. In 2007, a lot of people were saying, “Isn’t it amazing how great things are?” Our CEO said “Yeah, I haven’t felt this good since the summer before the Long-Term Capital crisis. We woke up.”

NEW YORK
technical terms the deficiencies of the models, they recognized the limitations of these quantitative risk-management models in general. These leaders used them as guides, but let common sense and judgment prevail. Here again, there were precedents that pointed out the limitations of such models in assessing risk in financial markets that should have warned people about their inherent dangers.  

**Organization Design**

Poor organizational structure also contributed to poor risk management. Giant financial conglomerates, such as Citigroup, AIG, ING and RBS, were so badly damaged in the financial meltdown because they ignored a simple rule of organizational design. Naval architects build large ships with watertight compartments so a breach in the hull will not sink the ship. This principle should have been followed by all financial institutions—especially those with low-risk and high-risk components, such as universal banks and insurance companies. Some small subsidiaries of financial giants, such as the Financial Products group at AIG and the Dillon Read subsidiary of UBS, were allowed to take on risk that threatened to bring down their parent organizations. Their parent companies made three pertinent errors. They:

- did not consolidate risk at the top corporate levels;
- had inadequate risk reporting and controls; and,
- devolved risk management responsibilities in irresponsible ways.

There is a strong argument for running different types of businesses in largely autonomous divisions, or in subsidiary companies, with their own boards. Such organizational structures increase the degree of differentiation in variables that could be extremely important to customers and shareholders. However, it creates a problem when the independent subsidiaries or divisions have very different risk profiles in their businesses but the total risk is borne by the parent company, unless that risk is identified ahead of time, managed centrally, and monitored in real time. Our research showed many companies did this well and had set up formal structures, systems and processes to ensure this happened. Others had blended risk models that blurred the responsibility and accountability for risk-taking, not just in a legal sense, but also in ways that encouraged risk-taking by small subsidiaries that could not carry the consequences of those risks.

**Organizational Culture**

Some organizations had strong risk-management cultures and others had risk-taking cultures. By “culture” we refer both to shared values among decision-makers and to the organizational systems and processes that ensured those values reflected appropriate policies, processes and practices.
Some organizations had cultures within which individuals or groups that sensed or had reasons to believe excessive or unmanaged risks were being taken by individuals or groups within their organizations, could speak up and be listened to by their colleagues and senior managers. Leaders in these organizations deliberately established and valued cultures of constructive dissent within which freedom of thought and dissent were not just tolerated but welcomed as part of the decision-making process. Emergent decisions may not have pleased everyone but everyone believed they had the opportunity to shape them. In sharp contrast, some organizations discouraged criticism no matter how constructive it was. Some senior executives and CEOs reportedly exercised excessive and intimidating control over those who might question their risk-taking actions or their inaction in managing the risks taken by others. Opposition was seen as not being “on the team.” Those who continued to oppose were faced with sanctions ranging from dismissal to marginalization and social ostracism.

A strong and widely shared risk-management culture was identified as a critical governance mechanism, especially in complex, multi-tiered organizations in which top management could never be expected to be close to activities in subsidiaries. The CEO of one multi-tiered, complex financial holding company stated that the combination of culture and the integrity of people in key roles was the only way in which they could manage risk within that organization. It had served them very well during the financial crisis. There was much discussion in our research focus groups about the role of leaders in creating, nurturing and sustaining corporate cultures of constructive dissent by modelling the required behaviours and personally walking the talk.

**Compensation**

Compensation became the focal point of media criticism during and after the financial meltdown, especially when governments started bailing out banks and insurance companies and members of the general public first became aware of how much money the heads and senior executives of these organizations were making. Not surprisingly, the amount of pay, the way that it was earned and in what form it was paid, proved to be topics of interest in our research focus groups and generated considerable discussion.

When it comes to the amount of executive pay, our research groups tended to take a market perspective, accepting that high pay was a reality in some types of businesses such as investment banking, hedge fund management and private equity. Attempts to place a value on jobs or work are usually fruitless. The price is what the market is prepared to pay. Further, there was great concern that if governments attempted to control price, talented
people would seek jurisdictions in which this would not happen and there would be a flight of talent from those where governments intervened. While this seems logical, there is in fact a dearth of empirical evidence to show that this happens. There is some sense that people within the financial sector are using this argument to forestall income controls and taxes on profits and bonuses by revenue-hungry governments.¹⁹

Our participants expressed greater concern about the relationship between financial incentive plans and risk-taking that was inconsistent with creating shareholder value, and that might lead to a highly unstable financial system. There were some compensation systems that incentivized and rewarded performance by individuals and teams to the detriment of the rest of their organizations. The story of AIG is classic. Here a very small group of people, those in the financial products group, perhaps no more than 100 in all, jeopardized the financial integrity of the entire corporation by building a large, lucrative but incredibly risky business, which committed the firm’s capital base and more.²⁰ When this business blew up, the whole company almost went with it. It was only a massive infusion of capital by the federal government that enabled AIG to satisfy the counterparty risks it had taken on through derivatives contracts, that kept the “good” parts of the company—its excellent insurance operations—alive.

The compensation driving the housing bubble—widely perceived as the precursor to the financial/economic problems—was not just at the executive level but, rather, at the level of sales people who were rewarded for generating mortgages and leases from people who would never have been able to service their debts when growth and interest rates normalized. Financial incentive plans played a huge role in driving the sub-prime lending market, the securitization of those mortgages and the design and distribution of derivatives based on those securities.

A great deal of executive and non-executive compensation was based on short-term operating results and paid in cash, rather than on long-term profit performance, paid in equity [stock, restricted stock or options], which would vest over time. There were few, if any, claw-back provisions in compensation systems that would kick in for poor judgment in risk management. These issues have been addressed in various pieces of legislation in different countries, developed and announced in response to publicity surrounding the many compensation schemes in Wall Street and City firms in 2008. Some of these compensation schemes resulted in government-provided TARP [Troubled Asset Relief Program] funds being used to pay million-dollar-plus bonuses to managers and executives of firms that had lost billions of dollars in capital.

Participants also discussed the ways in which pay acted as an incentive when those receiving the pay were already rich beyond belief. Perhaps money was valued as a symbol of “winning” in an intensely competitive world of ultra-

I see the biggest issue as governance around how people are being incentivized. It’s no surprise that Goldman Sachs did well because they operate as a partnership; that makes a difference. When you have your own objectives aligned with the objectives of the shareholders, you’re fine.

LONDON (U.K.)
competitive people. The public declaration of compensation was a scorecard against which egos could be compared. One tentative hypothesis derived from this research is that some people become addicted to money in the same way an alcoholic needs a drink or a drug-abuser needs a fix. Perhaps it is this addiction that makes people in the investment business so resistant to the public scorn that follows their actions and, therefore, so willing to return to their old compensation practices as soon as possible.

Traditionally, boards of directors have dealt with executive compensation as a “human resources” issue rather than a risk variable. Boards, and their committees, commission studies of compensation in identified “competitor” firms. They assess both the quantum of compensation, and the way it is earned and paid, from the perspective of attracting, retaining and motivating their people, especially their top talent.

This research indicates executive teams and boards of directors need to spend more time and effort understanding the behavioural risk implications of all compensation plans (not just those for executives), for a variety of behaviours, well beyond the narrow dimensions of attraction, retention and motivation to perform. When compensation practices encourage risk-taking rather than risk management, neither shareholders nor society are well served.

Corporate Governance
This financial meltdown and recession ironically came hard on the heels of the biggest reforms in corporate governance in the modern history of business, with the passage of the Sarbanes-Oxley Act in the U.S. and similar reforms in other developed countries. Despite this legislation, clearly the boards of many companies that failed, or nearly failed, did little to restrain their managements. Buoyed by years of stellar financial performance and the allure of more to come, many boards became complacent and careless, creating the perfect conditions for imaginative financial engineers to create even more difficult-to-understand products, and for traders to benefit from the merry-go-round. Then the music stopped.

This was far from a universal problem. In those companies that avoided the worst effects of the economic and financial crisis there was excellent governance. Boards were vigilant and diligent in monitoring risk exposure and pressing for strong risk-management policies, procedures and practices.

Directors are, of course, subject to some of the same pressures to pursue profitable growth as managers and, since they are largely drawn from the ranks of successful executives, we should expect them to think similarly to those they govern. But they should have a wider perspective and longer time
horizon. They also typically do not have similar compensation pressures since they are paid by retainer or share-based plans, rather than options and bonuses.

The challenge for boards was, and still is, two-fold:

First, few directors had the requisite competencies to assess the risk their companies were taking in their exposure to complex financial instruments. Their understanding of risk in complex systems was almost certainly less deep and less contemporary than the managements of the firms they were governing (and we have already suggested the managements were lacking in many of these competencies).

Second, the conventional structure and process of governance creates dependency on the CEO who sits astride the channels of communication to the board, and controls much of the messaging to the board. When this happens, board members must trust their CEO absolutely. From published accounts, it seems this trust became blind faith within several financial companies.

Boards could and should have multiple information sources and they must demand data that is not buffed and polished by the CEO to impress or manipulate the board into doing the CEO’s bidding. They can play a leading role in ensuring CEOs’ goals address more than short-term financial performance and extend to the establishment of a corporate culture and processes that address both risk and returns.

They have the tools to do so through appropriate board committees and the internal audit function that reports directly to the board or one of its committees. They have the opportunity to do so by challenging the assumptions of management and requiring exposure to a variety of executives and specialists within the companies they govern rather than relying exclusively on the CEO. They must, of course, have the will to do this even if it is uncomfortable.

Similarly, several money centre banks found that subsidiaries or departments with relatively few people were betting the capital of the firm on securities whose fundamentals were weak, such as CDOs and SIVs. Senior leaders of these institutions were genuinely shocked when they realized they had allowed this to happen. Even after several years of extraordinary profits from these small business units, they had not realized extraordinary risks were almost certainly being taken to produce the rewards. Cynics believe they wilfully closed their eyes to the source of these profits. That may be the case. Certainly, the leadership of these institutions had become very careless in their supervisory or oversight roles.21

**Learning**

Most disconcerting and critical for our future is the apparent *failure to learn* from previous financial crises, many of which were similar to the recent one. Excessive leverage buildup, uncontrolled asset bubbles, non-transparent risk exposure through derivatives and structured investment vehicles, and
excessive dependence on quantitative models have all been elements of previous financial meltdowns.

In many respects, the collapse of Long-Term Capital Management (LTCM) in 1998 provided a dress rehearsal for the recent market meltdown. LTCM was an unregulated hedge fund founded by acknowledged experts in quantitative analysis, including two Nobel Laureates in Economics. From its start in 1994 to its prime in August 1998, the fund amassed assets of more than $100 billion, most borrowed from American, German, Swiss and other banks. More significant, however, was that the firm had used complex derivatives and very high leverage. By 1998, it had more than $1 trillion of exposure in the marketplace. It rapidly became the darling of Wall Street and main-line banks around the world fell over themselves to lend to and invest in it. Some even launched their own imitative funds.

Then LTCM ran into trouble. It began losing money—lots of it. By September 1998, it had lost more than 45 per cent of its peak capital in less than four months due to yield-curve arbitrage, swaps and equity volatility, trades in developed countries, trades on foreign currency and arbitrage in junk bonds. It owed a great deal of money to other financial institutions, whose own capital bases were being threatened by the insolvency of LTCM. The heads of the Federal Reserve and New York Federal Reserve Bank believed that if LTCM was allowed to fail—which seemed quite certain in September 1998—there would likely be a massive dislocation in the financial markets and credit seize-ups. The U.S. Treasury and Federal Reserve feared this would plunge America and other parts of the world into recession. Although a small company in numbers of employees and clients, because of its huge leverage, LTCM was deemed “too big to fail.” The Federal Reserve arranged for a very reluctant group of investment and money centre banks (including Bankers Trust, Chase Manhattan, Merrill Lynch and Goldman Sachs and other American and European financial institutions) to rescue it, without requiring an injection of government capital. Notably, Bear Stearns refused to participate in this rescue, a fact that may have influenced the decision by other financial institutions not to come to Bear Stearns’ rescue when it was in trouble in 2008.

The government had to take dramatic action to increase liquidity in the market place by slashing interest rates. It was widely recognized, and even admitted, by the then Chairman of the Federal Reserve, that a moral hazard had been created by this action. While partners and employees of LTCM lost personal paper fortunes that were reinvested in the firm, senior people walked away with millions in bonuses and severance payments and resumed careers on Wall Street, founded other funds or went back to teaching and consulting on risk management.

RESEARCH

If people get a chance to make a lot of money, they sometimes do not care who they step over to get there. You are never going to wrestle greed to the ground. It wasn’t a financial crisis. This was a collapse of values. It comes down to character; comes down to ethics. Greed is too soft a word. There is an addiction to money and it is fuelled by the availability of debt.

VANCOUVER
The public policy lessons from LTCM’s rise and fall were clear and well-documented. We believe if they had been learned and applied, much would be different today:

- We would not have had the credit buildup and financial meltdown of 2003-09.
- Derivatives development and trading would have been within the purview of regulators and made transparent.
- There would have been more financial services regulation, not less.
- Government regulators would have focused on preventing financial crises, rather than staging dramatic rescues to fix things after they had happened.
- And there would have been much tighter regulation of the ways in which firms used capital.

None of these lessons appeared to have been learned. In fact, the Federal Reserve took the view through the asset bubble of 2003-07 that firms in the market would regulate themselves despite historical evidence otherwise. Even while commenting on the “irrational exuberance” that gripped the stock market in 2005, Alan Greenspan, still Chairman of the Federal Reserve and one of the key players in organizing the LTCM rescue, continued to pump more liquidity into the marketplace; promote lower interest rates and easier credit; make more money available to Freddie Mac and Fannie Mae; and do nothing about regulating derivatives, hedge funds or private equity firms. Overwhelming faith in efficient markets, rational behaviour, mathematical models and diversification ruled supreme.

Nor did many of the firms that rescued LTCM appear to learn much from that experience. Bear Stearns, Lehman Brothers and UBS were among many financial institutions that experienced major losses through their involvement with LTCM in 1998 and did the same in 2008. Today, the moral hazard from rescuing companies that get into trouble remains a major concern for policy-makers, politicians and regulators around the world. They recognize there are financial institutions indeed “too big to fail” that must be rescued and therefore contribute to the creation of moral hazard. There is, as yet, no consensus about what should be done about this.

Some people, certainly many of our research participants, paid attention to historical events and learned from them. In one session, for example, a senior executive pointed out his firm had decided to de-risk its operations after a partner had said, early in 2007, that “he had never felt so good since the weekend before Long-Term Capital Management had blown-up.” This prompted a discussion; other partners had looked at the LTCM history and concluded a similar sequence of events might well occur in the near-future; and, the firm began to de-risk its operations.
Social Responsibility

In one of our research sessions, a senior international investment banking executive started his comments with the statement: “We should be ashamed of what we have done!” The room went silent as he described a company that had acted with little or no consciousness of the consequences of its actions, let alone a sense of corporate social responsibility. He was genuinely remorseful and many in the room were impressed by his observations and conclusions.

Our research exposed the continuing debate about the social responsibility of business. Most participants in the research discussions had been exposed to recent thinking about corporate social responsibility (CSR) and were aware it was increasingly important in business school curricula. Some were from companies that had taken strong stands with respect to some aspects of CSR, such as environmental stewardship, diversity enhancement, civil and human rights, and support of the arts. Some research participants continue to believe business leaders should not concern themselves with social responsibility issues even in light of consequences resulting from the financial meltdown and “Great Recession.”

Although our research was qualitative rather than quantitative, our sample divided into three clear groups.

One group was emphatic that business leaders weren’t responsible to anyone other than shareholders, provided they did not break laws or regulations. If what they did before, during and after the crisis was within the law and its associated regulations that was just fine by them. If their judgment was wrong, their markets and shareholders would punish them accordingly.

A second group took a diametrically opposite point of view. This group felt business leaders have a duty to shareholders, employees, customers, suppliers and the broader societies within which they operate and have a responsibility to balance these interests to the best of their ability. Some in this group even proposed heads of global banks are responsible to the whole capitalist system and that the failure of people in such positions to act responsibly had undermined this system, perhaps irreparably.

The third group took the view that, in the long run, acting in a socially responsible manner is in the interest of businesses and there was, therefore, nothing to argue about!

These three perspectives permeate most discussions about corporate social responsibility in recent years and we readily recognize the different perspectives around this issue. We were surprised that many people in the financial services industry still seem reluctant to recognize that failure to act in a socially responsible way during the last decade has unleashed a raft of legislation and regulation that will depress profits in this industry for years to come, perhaps forever. Being socially responsible would have been both the right thing and smart thing to do.
Leadership Character

In the view of many participants in our research discussions, character determined the extent to which business leaders pursued high-risk growth strategies in response to the investor community’s relentless pursuit of “more” and the compensation schemes encouraging them. Discussions about character tended to focus on three components: virtues and vices, values, and traits.

In the rush to identify “the” cause of the financial system collapse, many in our study as well as in the mass media were quick to propose that it was the greed of consumers, mortgage brokers, bankers, and others that drove financial leverage to unsustainable heights. Greed (avarice, covetousness, desire for material gain or wealth, without concern for others’ individual or collective needs) was certainly identified as an important factor by participants in our research study, but it did not stand alone. People referred to the other six “deadly sins” as well—pride (excessive belief in one’s own abilities, over-confidence, hubris), sloth (laziness, not doing one’s homework), envy (desire for what others have), lust (extravagance or unrestrained excess), gluttony (swallowing too much, literally or metaphorically) and wrath (anger at being exposed, leading to denial of culpability, thereby impeding learning).

We would add another trait to this traditional list. While competitiveness is a virtue that one looks for in business leaders, like many virtues it can become a vice when carried to excess. There is evidence that hyper-competitiveness was rampant among many in the financial community and that this led to at least some of the most irresponsible risk-taking that ran many firms into deep trouble. It is certainly a better explanation of why people at the top of these organizations pressed for such incredibly high compensation packages even though they were already personally wealthy. It was less about getting more than it was about getting more than the other person was getting!

Many research participants talked about the virtues of good leaders who did not get caught up in the excesses of the last few years, and who had the courage, prudence, wisdom, temperance and sense of proportionality that allowed them to steer clear of investments based on dubious collateral or over-engineered financial instruments with unclear recourse. They also talked about the courage these leaders demonstrated in the extended run-up to the financial crisis when many of them lagged their competitors in financial returns and share price performance and were roundly criticized for this.

Personality traits were also cited as playing a role in why leaders appreciated or failed to appreciate the reality of what was happening around them. Narcissism, hedonism and arrogance distort perception while humility, patience, deliberateness and other traits tend to make leaders listen to and
appreciate others’ perspectives and consider the consequences of their decisions carefully. We suspect also that it was differences in personal or corporate values, personality traits, or a different sense of accountability and responsibility to their shareholders and clients that made the difference between those that went along with the crowd and those that did not.

Invariably, discussions about character, virtues and vices, traits and values led to discussion of the question, “Can character be taught?” There were many strong views expressed about this, with some arguing character is formed in early years by both nature and nurture. By early adulthood, it is what it is. Others took the view that, while the early years are obviously critical, there were many opportunities to help shape character and encourage development of virtuous behaviours throughout one’s life. Clearly many respondents believed the values celebrated or censured in their management education programs and manifested by their early-career mentors, managers and leaders had impacted their own mature value-frameworks.

Leadership Education and Development
This was a sobering research experience for those of us involved in leadership education and development. In polite but forceful ways we were accused of curriculum deficiencies, of not addressing issues of character and leadership commitment when teaching leadership competencies, not equipping graduates and younger leaders with the ability to learn from history, and not inspiring them to become lifelong learners. One editorial in *The Economist* went so far as to suggest that business schools “churn out jargon-spewing economic vandals” and that we need to completely reform our programs and processes.

In the various research group discussions, specific deficiencies were identified in the areas of systems thinking, understanding complex systems, exposure to economic and social history that addresses the causes and consequences of previous economic crises, and over-reliance on quantitative methodologies. Some mentioned we had spent insufficient time and effort to help people get in touch with their values, to legitimize values as an important element of business decision-making and to help people develop skills they need to be effective advocates for an opposing position.

There was also a sense that as business educators we have minimized the importance of strategic analysis, risk assessment, contingency planning and scenario exploration. Within companies, this type of “external” analysis has been restricted to so few people—the strategic planning group, for example—that most next-generation leaders were not getting exposure to this way of thinking. The comments about risk management were quite explicit, suggesting...
that management educators and leadership developers had fragmented the discussion of risk to such an extent that its overall impact on the organization was lost. They called for a more integrated perspective on risk and a higher level of proficiency in risk assessment and management.

Our research participants had varying views on the role and responsibilities of educators and how we could make a difference. There was some skepticism and cynicism. Many pointed out these issues had been identified and discussed before. They had taken courses and programs that focused on leadership, corporate responsibility, ethics and values. They pointed out that people who were actually involved in the companies that failed had also done so. They asserted that people were and will always be motivated by self-interest; the rewards were and always will be huge in industries such as investment banking; and clever people will always find ingenious ways of making themselves rich no matter what the rules and regulations. It was naïve to expect them to do otherwise. Crises like these have happened before, will happen again, and people say they will learn from them but they don’t.

Others were skeptical about the ability to make significant differences through education but felt it was worth trying. They often talked from their own experiences, pointed out situations that had occurred earlier in their lives, whether in school or in early corporate roles that had made a difference to them when properly addressed and when they had been forced or encouraged to reflect on them. Discussion of ethical issues and the social responsibility of business have to be raised somewhere and universities and business schools are the right place to address them. They believed such discussions will not change everyone’s views, but might change some views and at least make those who are resistant to this line of thinking aware that others disagree. This view is consistent with a lot of the research and writing in academic literature.21

Many were optimistic about the chances of making a difference, especially with next-generation leaders. They thought young people today are more idealistic than previous generations. They believed that if business and management schools focused as much on leadership character as they did on building competencies and if curriculum changed to address many of the issues exposed in this recent crisis, it would make a significant difference to enough people to lessen the chances of a recurrence. They felt business and management schools should try to influence those open to being influenced. However, even these optimists tempered their outlook by recognizing that it is the post-graduate experiences in companies that really shape the behaviours of management and executives and, if continual learning and role modelling within the workplace did not reinforce early learning, it was unlikely to influence behaviours.
RESEARCH CONCLUSIONS
We believe people involved in these group discussions were candid, introspective, thoughtful and honest in their observations and revelations about “what went wrong.” They dug deeply into their own experiences, their personal involvement in leadership roles, their inside knowledge and their opinions. They provided insights into leadership at those companies that performed poorly during this crisis and those that thrived. The richness of their contributions could not have been elicited through any other research methodology.

We left sessions convinced there is an opportunity to build on their observations, add our own insights and subject-matter expertise, and improve the practice of leaders today and tomorrow.

This research has shown that failures in leadership played a role in the financial and economic crisis of the past few years. The failures were not universal. They affected some organizations and not others. They were at the very centre of the financial system but also at its periphery. They occurred in companies that were in the Main Street and Wall Street economies.

Our research indicated failures of three types.

There were failures of competence, especially in the areas of environmental analysis, risk management, and the creation of organizational structures, culture, systems and processes to identify, manage and control risk.

There were failures of character demonstrated in the values, absence of virtues and personality traits of some in leadership positions.

Finally, there were failures in the commitment to good leadership—the commitment to do the real, gritty, hard work of leadership that is involved in the governance of large and complex organizations while, at the same time, both accepting and living up to their responsibilities to the communities and societies within which they operated.

By contrast, there were many leadership successes—organizations whose leaders saw what was coming, who led their organizations in ways that avoided the dangers, and in some cases took advantage of the opportunities that were created in the aftermath of the crisis.

In the next section, we link these findings with what we know about good leaders—what they do, who they are, how they become leaders and how organizations can develop good leaders. To this end, we provide a broad set of concepts and principles that we believe will equip current and next-generation leaders with the opportunity to make a real difference through good leadership.
Good Leadership

THE ENORMITY OF THE IMPACT OF THE FINANCIAL MELTDOWN AND ECONOMIC CRISIS CONVINCED us of the need to revisit how we think and talk about leadership and specifically what we should do as educators to develop the next generation of business leaders.

In this section, we step beyond the examination of leadership within the narrow confines of this recent crisis to broadly address leadership principles and practices that appear to be important in an uncertain, turbulent and rapidly changing business world. We think the challenges for future leaders will be greater than they have been in the past. Globalization, increased complexity, unstable geopolitics, the emergence of new economic powers and the very slow growth of advanced economies will put great pressure on performance. Additionally, competition for talent will increase in the face of an aging workforce in all advanced economies.

We present our ideas under five major headings:

WHAT GOOD LEADERS DO: the essential roles and responsibilities of leaders to ensure their organizations perform in the present while building for the future.

WHO GOOD LEADERS ARE: the competencies, character and commitment required of good leaders, now and for the future.

HOW PEOPLE BECOME GOOD AND BETTER LEADERS: the actions that leaders and those who aspire to leadership roles must take if they are to grow and develop as leaders.

HOW GOOD LEADERS ARE DEVELOPED: what business organizations, leaders and educators must do to develop next-generation leaders.

WHAT SOCIETIES EXPECT OF THEIR BUSINESS LEADERS: what they must understand and appreciate about the demands of the societies within which they operate if they are to be accepted and effective as leaders.

Many of these ideas are not revolutionary—they are timeless and tested. However, the analysis of “what went wrong and what was done well” in the financial and economic crisis suggests the gap between good principles and actual practice was wide and costly.
Analyze the environment

Formulate winning strategies

Execute them brilliantly

Build capabilities, capacity and culture

Evaluate them systematically

FIGURE 2: What Good Leaders Do
What Good Leaders Do

Good organizations recognize they need good leadership at all levels, not just in the executive suite. Such leaders:

- Analyze and make sense of the dynamic, rapidly changing and often turbulent global and local economic, political, regulatory, societal and technological environments within which they operate. They are particularly sensitive to complex systems which may not be fully understandable but which must be managed or accommodated if they are to be successful.

- Formulate, develop, articulate and communicate effective integrated strategies that achieve clearly defined goals consistent with the mission, vision and values of their enterprises, business units, departments and teams. Such strategies are based on opportunities, organizational core competencies and fully leveraging the financial, organizational and human capital of the organization. They take into account and integrate the interests of multiple stakeholders in the enterprise.

- Execute strategies brilliantly through effective utilization and alignment of all elements of their organizations. They work with their followers to develop a vision for the future. They align people, systems, processes, structure and culture.

- Evaluate the outcome of these strategies systematically, in real time, ensuring that assumptions are constantly checked for validity and stability. They provide feedback to the strategic formulation process to ensure that strategies remain current and optimized as the organizational environment changes.

- Define and build the capabilities, capacity and culture they need to perform in the uncertain futures into which they are guiding their organizations. By capabilities, we mean the knowledge, understanding, skills and judgment they need to be successful; by capacity, we refer to the numbers of people having these capabilities and available for deployment against challenges; by culture, we refer to the shared values and value-driven behaviours that enlist people in a common vision, engaging them in individual and joint pursuit of agreed-upon goals, encouraging them to strive for excellence, and empowering them to achieve it.

- Strive to perform in the present while building for the future. They do not readily trade off short- and long-term goals but, rather, seek to achieve both. This requires that they lead with their feet on the ground, their eyes on the horizon and their imaginations beyond it.

- Maintain a cross-enterprise perspective and collaborate effectively across organizational boundaries in the interest of the total enterprise even though they may be personally accountable and rewarded for the performance of only part of it.
FIGURE 3:  
Who Good Leaders Are

Character
- Values
- Virtues
- Traits

Competencies*
- People Competencies
- Organizational Competencies
- Business Competencies
- Strategic Competencies

Intellect

Commitment
- Aspiration
- Engagement
- Sacrifice

*Competencies

Knowledge
- Facts, figures, concepts, etc.

Understanding
- Relationships, context, significance, materiality, etc.

Skills
- Analyzing, decision-making, communicating, getting things done, teaming, etc.

Judgment
- Using intuition, timing, methods to use, who to involve, how to do it, etc.
Who Good Leaders Are
The foundation of good leadership rests on three pillars: competencies, character and commitment.

Competencies include the knowledge, understanding, skills and judgment leaders are expected to have, if not early in their careers, at least in their mature phases. These are typically acquired through formal education, training, programs, and coaching and mentoring in the workplace, as well as reflecting on their experiences and the implications for their performance and development. Competencies determine what leaders are able to do. Competencies may be broadly or narrowly based, thereby determining a leader’s situational ability.

Character is fundamental to good leadership. It determines how leaders see and interpret things and how they will react in different circumstances; the criteria they will use for decisions; and how those decisions will be implemented. While competencies can be learned, character is developed both early in childhood and in later stages of life through critical formative experiences and reflection on those experiences. Character influences what leaders will do in different situations.

Commitment is critical. Not just commitment to take on a leadership role, but commitment to do the challenging and rewarding work of leadership. Without such commitment, leaders become figureheads or even obstacles to performance and development. When commitment fades, leaders must be prepared to step aside and hand the leadership reins to others. When leaders sense loss of commitment by others, they must address this fundamental leadership weakness.
**Competencies Count**
Leaders must have intelligence or intellect as well as people, organizational, business and strategic competencies. Such competencies are amalgams of knowledge, understanding, skills and judgment.

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**INTELLIGENCE—INTELLECT**
Good leaders are smart. They can cope with complexity and change. They understand cause-and-effect relationships. They separate the material from the trivial, the important from the unimportant. They think logically and frame and express their thoughts clearly. They find the right stuff to read, the programs to watch, and the experts to whom they should listen.

**PEOPLE COMPETENCIES**
Good leaders understand people—what makes them tick, how to create motivated individuals and teams, factors impacting performance and the levers to pull to increase performance. They recognize potential and actual barriers
to accurate perception and interpretation of the changing world around them. They recruit well or find people to recruit for them. They build and maintain high-performance teams from diverse individuals with different backgrounds, cognitive styles and perspectives. They understand when and how to collaborate effectively to achieve superior outcomes. They understand good leaders sometimes must be good followers, and they are prepared for this. Above all, they have high levels of self-awareness.

ORGANIZATIONAL COMPETENCIES
Good leaders understand how their organizations work. They understand the organization of their competitors, partners, customers and other stakeholders. And they know how to work those organizations. They are politically astute without being corporate politicians. They analyze who exercises influence, persuasion and power in their organizations and how they do it, and then learn to do it themselves. They understand the value of good organizational design and how to align strategy, structure, systems, processes, culture and people.

BUSINESS COMPETENCIES
Good leaders have a deep, intimate knowledge of their businesses or functions, if not at first, then shortly after becoming leaders. They understand how their organizations make money and lose it. They understand the risks they are taking on, how to get paid for taking those risks and how to avoid taking on risks they don’t understand or get paid for. If they don’t know these things at the moment they become leaders, they gather people around them who do and learn from them.

STRATEGIC COMPETENCIES
Good leaders have a strategic competence that enables them to understand how to position their businesses for future opportunities and threats that may arise from changes in economic, political, societal, technological and competitive environments. They understand risks. They move easily between focusing on today’s challenges and what lies on the horizon or beyond. They understand systems thinking and are able to see the impact on others of actions taken to address one issue. They use this strategic competence to chart the way forward for the businesses or functions they run.

TEAM-BASED COMPETENCIES
In large, complicated or complex organizations, leaders may simply not be able to know everything they need to know about their businesses or functions. In this case, their people and organizational competencies should be used to develop a team competence that allows them to supplement their own competencies. These leaders are not ashamed of their ignorance in certain functional areas and ask for help.
DEVELOPING COMPETENCIES
While it is normal for leaders to excel on one or more of these competency dimensions, it is unacceptable for them to be entirely deficient in even one area if they are to function effectively at senior levels. Early identification of developmental needs is critical to building leadership competencies in order to increase strengths and overcome weaknesses that may turn out to be “fatal” flaws at later career stages.

Character Matters
While competencies determine what leaders can do, leadership character determines what they will do in different situations. Character can be expressed as a set of virtues, values and traits.

FIGURE 5: CHARACTER MATTERS

VIRTUES
Virtues are patterns of worthy behaviours including wisdom, courage, humanity, justice, prudence, temperance, compassion, integrity, transcendence, and accountability, each of which can be sub-divided into finer-grained behaviours. The opposite of virtues are vices, or unworthy behaviours such as cowardice, arrogance, recklessness or foolhardiness. In excess, many virtues become vices—excessive courage may lead to foolhardiness, good judgment to boldness, integrity to self-righteousness, and so on.

VALUES
Values are normative beliefs that influence or guide behaviours and many values carry the same labels as the virtues described above. Values cannot be
measured directly but are inferred from behaviours. They are usually associated with words such as “should” or “ought,” as in “Leaders should have integrity, transparency and compassion,” or, “Leaders ought to treat everyone with dignity and respect,” or, “Leaders should be socially responsible.” Values, in this context, refer to individual beliefs rather than “corporate values” though, clearly, compatibility between the two results in better corporate and individual outcomes than incompatibility.

TRAITS
Traits are other personality dimensions including openness, conscientiousness, extroversion, agreeableness, emotional stability, neuroticism, hardiness, resiliency, tolerance for ambiguity and creativity, all of which have been related to leadership success and failure in much previous research. As with values, traits shape virtues: “neurotic” individuals tend to be intemperate and imprudent, conscientious people tend to be cautious, and so on.

CHARACTER AND LEADERSHIP
These virtues, values and traits have been incorporated into various sets by leadership researchers.27 Many of these overlap, some are conceptually close but have different labels, while others share the same label but are conceptually distinct. It is less important that leaders or organizations adhere to one formulation than that they recognize how central character is to leadership.

Those who can lead organizations in good times and bad, through booms and busts, through a variety of ever-changing circumstances, may display characteristics that, at first sight, seem paradoxical. They are confident and humble, aggressive and patient, analytical and intuitive, principled and pragmatic, deliberate and decisive, candid and compassionate. Demonstrating behaviours consistent with seemingly opposed characteristics is a mark of the “leader for all seasons,” unlike the more limited, “situation-specific leader” who is more one-dimensional. Just as leaders may have a narrow or wide competency bandwidth, they can have variable character bandwidth.

Character in its broadest sense impacts most, if not all, decisions made in organizations. Character is formed through living, reflecting, receiving feedback and criticism and refining one’s approach to living28,29 but may also be influenced by experiences in educational and work settings.
Commitment is Critical
Alongside competencies and character is the commitment to do the hard work of leadership and to continue to develop as a leader. Such commitment is forged from individual aspirations, and the preparedness to be fully engaged and make personal sacrifices in return for the opportunities and the rewards. Good leaders will be committed to the good of the organization they serve and the people who follow them rather than solely to their own self-benefit.

FIGURE 6: COMMITMENT IS CRITICAL

ASPIRATION
The aspiration to do the hard work of leadership must be distinguished from the desire to merely occupy the position of leader and enjoy the rewards and privileges of rank. There are many who aspire to the latter but far fewer who are really prepared for the continuous, unrelenting work of leadership, especially in tough times when things are not going well.

ENGAGEMENT
Good leaders are engaged in the mission and vision of the organization, often because they have had a role in formulating them. They are passionate about what the organization does; they have deep, intimate knowledge about how it works. They go the extra mile, take on the tough assignments, and do what’s right for the organization, not necessarily what they would like to do for themselves.

SACRIFICE
Good leaders make sacrifices to attract, develop and retain good followers. They share credit for achievements and shoulder responsibility for failure.
They spend time developing the talents and careers of others when they are short on time themselves. They give up conventional ideas about balanced lifestyles and find creative ways to balance work, family and other commitments.

CONTINUOUS COMMITMENT
There often comes a time when leaders are no longer prepared to commit to the hard work of leadership. This may be temporary or may reflect a more permanent change in aspirations, desired levels of engagement or the degree of sacrifice that effective leadership requires. Those who recognize this state in themselves must act to yield their leadership roles to others who are prepared to take on the challenge. Those who see it in others who may not be conscious of it must intervene to prompt this realization. When leaders no longer want to lead, leadership must change for the sake of both performance and continuity of leadership development.

Learning and Leading
Learning and leading go hand-in-hand and must be pursued at individual, group and organizational levels.

INDIVIDUAL LEARNING
Good leaders learn from every experience they have had and from any leader they’ve seen in action, good or bad. They learn from peers, people who report to them, competitors, partners and suppliers. They learn from their critics and their allies. But, in order to learn, they must be motivated and have the capability to learn.

Not every leader is good at learning or is prepared to constantly learn. Leaders may have personality traits that prevent them from being open to new ideas. They may lack the courage to move outside their comfort zones. They may lack the humility essential for learning or be overconfident, which leads to arrogance. They may be narcissistic and surround themselves with people who will not even suggest they ought to be learning something new for fear of displeasing them. They may simply lack the intellect to learn.

Leaders may get lazy about learning, believing that they have reached the peak of their learning curves and have no more to learn. This may be a psychologically comfortable space but it is one that prevents leaders improving, and will eventually lead to their underperformance and obsolescence. Good leaders never stop learning. At higher levels in the organization they find themselves learning how to lead when the path ahead is unclear. This is a different type of learning than the mastery of a syllabus or body of known concepts, facts and skills. It requires an even greater cognitive bandwidth because much of what they must learn will be incongruent with the mental maps they have formed that previously guided them to success.
Learning
Motivation
& Identity

Policies & Processes

Group Processes
Allegiance & Identity
Engagement

Learning Capability
Learning Motivation
Commitment

Character
Competencies

FIGURE 7: Learning and Leading

GOOD LEADERSHIP
GROUP LEARNING
When leaders show others they are learning themselves, when they recognize learning is taking place, when they sponsor and personally attend learning events, they send signals that, when repeated often enough, become part of the organization’s culture. When they work with other organizations in, say, the context of an industry group, they demonstrate their openness to learning. When leaders openly declare that they have discovered someone, somewhere is doing something better than they are doing it, and are keen to figure out how they can improve, they are shaping a learning culture for their organizations. As well, when they promote learners and pass over or remove those who believe they know it all, they are reinforcing that culture.

ORGANIZATIONAL LEARNING
Senior leaders can establish mechanisms, processes and policies that support learning… or not. A leader can decide whether learning is a strategic imperative or a “nice to have” and how much is spent on learning initiatives. A leader can decide what gets cut when budgets are tight and determine the organizational status of a function such as talent development. Leaders can require that personal development programs involving learning are either integrated into career or succession management or positioned as discretionary. They can be potent promoters of identifying and disseminating best practices within their organizations, or they can take a more passive role and let it happen. They have a determining role in developing the type of learning culture, processes and policies that their organizations will implement.

Becoming Better Leaders
While the concept of “the born leader” may be attractive and suggests that good leadership is just a function of natural selection, for most people leadership is learned. Leaders tend to evolve along maturation pathways that may differ from one leader to another, but also have some common elements:

PERFORMING
To become a leader, it is essential to demonstrate that you can perform at a high level in your chosen field as an individual contributor. This need to demonstrate performance ability is required at all stages of the leadership-development process.

RISKING
Leaders take risks with their personal careers. Not stupid, foolhardy or extreme risks, but pushing for new challenges, volunteering for the tough and sometimes
unpleasant assignments that lead to learning, and making themselves visible by stating their desire for more challenging leadership roles. Some of this learning will come by failing and understanding how to manage that failure. Some will come from success, and learning how to handle that, too.

STRETCHING
Leaders are constantly stretching, reaching for new performance levels and innovative and creative ways of contributing more to their organizations. They don’t rest on their laurels, hunker down in their comfort zones, and become complacent.

LEARNING
One leadership myth is that the learning curve is steepest in the early years, flattens as one learns to be a good leader, and is level toward the end of one’s leadership career. Good leaders report that there is a learning curve—but that it’s shaped the other way! In the early stages they learn what others already know; at more advanced stages they learn about what is currently unknown, which is far more.

SELF-AWARENESS
Through learning, leaders become more self-aware. They understand their strengths and their weaknesses, the impact they have on others and the impact that others have on them. They have a better understanding of their own competencies, character and the commitment they bring to their roles. This self-awareness adds to their strength as leaders, even when it is an appreciation of their own weaknesses. They recognize that they are their own raw material that can be moulded into something better.\(^{10}\)

TRUSTING
Finally, leaders learn to trust. They recognize that to run successful organizations they must be prepared to cede control to others, even as they retain responsibility and accountability for outcomes over which they have little or no control. They learn to trust their teams and themselves, both their knowledge and their intuition. And when that trust is betrayed, as is inevitable, they learn to rebuild trust again, for there is no practical alternative.

Developing Good Leaders
Some organizations develop leaders and seem to have a surplus of them and others have to go to the market every time they need leaders. Most organizations develop some of their next-generation leaders and go to the market to hire only out of necessity or to strengthen or refresh the talent pool. Organizations known for leadership development search out, attract and recruit talented people who have already exhibited leadership in other arenas and have demonstrated potential to do the same for their new employers.
FIGURE 8: Becoming Better Leaders

- Performing
- Trusting
- Risking
- Stretching
- Learning
- Self-Awareness

Becoming a Better Leader
FIGURE 9: Developing Good Leaders
This leadership may have been in academic areas, in social activities, in sports, in the military, in community service, or in a variety of other fields.

These leader-development organizations convert this raw potential pool of talent into mature, high-performing leaders with a defined leadership profile for increasingly responsible leadership roles. The best of them do this in a systematic way that recognizes the importance of policies, pathways, programs and processes in which senior leaders are fully engaged. Designing and executing these requires a true partnership between executive leaders and leadership development/human resource professionals.

**PROFILES**

Leadership profiles are clear statements of what the organization expects leaders to achieve, know, understand and be. The best of these specify the results leaders are expected to achieve (e.g. profitable growth), the competencies they should demonstrate (e.g. lead highly effective teams), and the character elements that describe good leaders in the organization (e.g. integrity). These profiles act as:

- A beacon for aspiring leaders or those that aspire to higher levels of performance;
- A performance check for current leaders;
- A statement of accountability so that customers, suppliers, employees and community members know what to expect of a business organization’s leaders; and,
- A guide for leadership assessment and development.

**POLICIES**

Leadership-development policies address the goals and principles governing leadership talent development and may range from the all-encompassing, sweeping commitment, “to develop leadership talent from within,” to more specific commitments, such as posting leadership opportunities so everyone can apply for them, or promoting the movement of talent between divisions or departments, so potential leaders can get critical experiences needed to develop to their maximum potential consistent with the current and future needs of the organization.

**PATHWAYS**

The best organizations for leadership development have given careful thought to the pathways people can take to get these critical experiences. They have identified jobs, roles, assignments and sometimes even the coaches and mentors who will provide the maximum value-added benefit to leadership development, depending on the individual’s needs.
PROGRAMS
These organizations use both custom-designed and customized programs and widely available open-enrollment public programs to further their development. Custom programs tend to focus on building organizational competencies and common culture, whereas open-enrollment programs develop people, business and strategic competencies.

PROCESSES
Organizations known for leadership development also invest time and money in developing and integrating various leadership-development processes including recruiting, succession management, assessment, coaching, mentoring and personal development planning. Critically, they also ensure they retain leadership talent by continuing to offer challenging development assignments and ensuring compensation and benefits reflect competitive realities.

PARTNERSHIPS
Becoming and being a leadership-development organization requires a partnership between the executive team and leadership-development (LD)/organizational-development (OD)/human-resource (HR) professionals within the organization. The executives must provide the drive, energy and commitment to leadership development themselves by being, “leader-breeders,” and ensuring, “leader-blockers” don’t get in the way of aspiring and capable individuals. They must also break down organizational barriers to mobility so people can get the experiences they need. The LD/OD/HR professionals must design the profiles, programs, pathways, processes and policies that make the whole thing work.

The Social Responsibility of Leaders
As long as corporations and their business leaders can have an impact on the economic, social and environmental health, welfare and well-being of the societies within which they operate, those societies will demand that they act responsibly. The demand for corporate social responsibility (CSR) will be expressed in marketplace response as well as through political and legislative channels and special interest groups.

CSR IS THE RIGHT APPROACH
To be responsible for one’s personal and corporate actions is a moral obligation even if it is not legally required. To the extent that business benefits from what a society has to offer, it is morally obliged to contribute to the health and welfare of that society. Unless faced with a completely unjust law—the apartheid rules in South Africa, for example—there is a moral obligation on business to obey the laws of the land. Beyond that there are moral obligations to clean up one’s own mess, compensate people for harm that has been done, and otherwise take
WHY?

It’s the **RIGHT** thing to do

It’s the **SMART** thing to do

WHAT?

Practice socially responsible leadership—be on the right side of the issues

HOW?

- Identify stakeholders and their interests
- Engage them early, fully and often
- Anticipate their actions and reactions
- Integrate or balance their interests
- Develop a socially responsible organizational culture

HOW MUCH?

- Excellence
- Goodness
- Compliance

**FIGURE 10:**

*The Social Responsibility of Leaders*
GOOD LEADERSHIP

care of those whose lives and livelihoods may have been affected by corporate actions and managerial decisions.

CSR IS THE SMART APPROACH
Business leaders derive their benefits from the societies within which they operate. It follows they must be positive contributors to the continued health and welfare of those societies because it is in their interest to do so.

Businesses have a conditional licence to operate. If they meet societal expectations, they can operate. If they violate them, they will be controlled, regulated or perhaps put out of business.32

Apart from any moral requirement to be socially responsible, business leaders must consider the interests of many stakeholders, including shareholders, integrate those interests where possible, and balance them when they are mutually exclusive (to the extent this is possible). Failure to do this analysis and act appropriately may be reflected in the reactions of customers, regulators, employees, investors and others, with subsequent implications for long-term shareholder value.

THE QUANTUM OF SOCIAL RESPONSIBILITY
At the very minimum, business leaders must comply with relevant laws and regulations. Good business leaders should seek standards of excellence in areas such as environmental performance, safety and health, employment equality and discrimination that reflect positive societal trends when they can see long-term benefits for their shareholders, customers, employees and communities. We are mindful of those that argue it is neither the purpose nor the prerogative of business leaders to lead social revolutions. This is not what we advocate. Rather, it is to respect existing social movements and use the resources of their organizations to enable them for the benefit of their stakeholders.

BEING SOCIALLY RESPONSIBLE
We take the position that it is both right and sensible to act in a socially responsible way. We also acknowledge it is often not easy to define what this is. It requires business leaders to recognize different perspectives, seek creative ways to pursue joint problem-solving and find the appropriate balance between competing interests. We also take the position that it can never be right for business leaders to make decisions without, at least, carefully considering the impact of their actions on the communities, broader societies and economic and political systems within which they operate.
Call to Action

Whether the quality of leadership in organizations improves or not will depend on the efforts of many. In this section we issue a “call to action” to five groups: those like ourselves who are involved in management education in universities and colleges; today’s senior leaders in the business community; professionals in the field of organizational and leadership development; boards of directors of companies; and, finally, to next-generation leaders themselves.

Management Educators

In the wake of the financial markets meltdown, much criticism focused on business schools and their graduates. Some of this targeted the alleged narrowness of the curriculum, some the social irresponsibility of business school graduates, and some their arrogance, overconfidence and sense of entitlement. Whether these criticisms are justified or not, recent economic events suggest everyone involved in management education must do a pulse check and consider in what way the content, delivery and potential consequences of their programs will influence how future business leaders see their roles and responsibilities.

Specifically we believe that:

Curricula should be reviewed to ensure degree-program students get significant exposure to economic and business history taught in ways relevant to today’s issues and tomorrow’s leadership challenges.

Students should be encouraged and assisted to consider values and virtues as part of management decisions in all fields of business, not just those typically addressed by organizational behaviour or human resource courses. Faculty members, unused to doing this and without formal training, should receive help in doing so.

The often single-minded focus of business school professors on maximizing shareholder value and near-exclusive application of financial cost-benefit analysis as the implicit or explicit ethical decision-making framework warrants serious examination. Faculty members from a range of disciplines should be equipped to introduce a wider range of analysis and decision-making models that would broaden students’ appreciation of other stakeholders and their claims in the decision-making process.

Programs must create a greater capability to scan the economic, political, societal and technological environments to identify “predictable crises” before they emerge in full-blown form. They must create greater awareness of complex systems and the options leaders have to manage what they do not understand or cannot control, and give students and program participants the conceptual base and skills associated with systems thinking.
There must be much greater recognition of the social-psychological processes at work that distort reality and interfere with rational decision-making. There must be much tighter linkages between this conceptual understanding and the actions leaders must take to avoid creating organizational cultures in which conformity, overconfidence, hubris and groupthink are commonplace. This will require materials and exercises set in mainstream business contexts in which the consequences are felt in terms that are truly consequential to students.

Students also need to develop the skills of constructive dissent so they can oppose actions they believe are wrong without having to sacrifice their careers. They must be able to analyze that vague sense of “something is not right here” so they can define the issues, check against their values, engage in good conversations with those who can help them think through the issues and their possible response, and then make decisions that are right for them.

While it is difficult to assess the impact of role models students come into contact with in their formal business programs, such as guest speakers, business schools should strive to maximize exposure to really good role models who emphasize the importance of values and virtues as well as competencies and commitment to lead.

Educators’ own behaviours—what they say, do, or don’t say and do—have an impact on many students. If they dismiss some corporate wrongdoing with humour instead of censure, or minimize or avoid dealing with unethical behaviours, they may convey a set of values that will have substantial negative impact. At the same time, they cannot be self-righteous about business practices in the real world if they are to maintain their personal credibility.

Business and management schools and their professors and instructors must take ownership for the organizational cultures they manifest and promote through their own organizations, programs and course designs, as well as the conversations they encourage, and ideas and behaviours they reward. They cannot simply blame systems such as promotion and tenure, the scientific academy, or compensation and reward systems for actions that are inconsistent with a value-based leadership approach to the delivery of their expertise.

Finally, educators must commit to instill in those they have the privilege of educating a deep intellectual and instinctive understanding of the critical relationship between those who lead businesses and the societies within which they operate. The essential nature of that contract is one of cooperative and reciprocal obligations. Whether they accept the philosophical underpinnings of corporate social responsibility or not, they should be under no illusions about the pragmatic consequences of failure to operate within the bounds of societal expectations.

While recognizing our responsibilities in this context, experience tells us we will only make a difference if our actions are reinforced by the experiences our students and program participants have in the organizations they join or come from. We can act to improve education, but we need others to act also.
Current Leaders
Leaders must be the strongest advocates of anticipatory leadership and the prime enemies of complacent thinking. They must be more aware of the dangers of viewing their business environments solely through the lens of their current business models and realize their current business models—what got them here—will not necessarily work in a new environment.

They must integrate short-term shareholder returns with other stakeholder demands and societal expectations if the enterprise is to be sustainable.

They must create and sustain cultures of constructive dissent in which individuals and groups can express their concerns with policies and strategies and can contribute to vigorous debate about alternatives without being devalued or marginalized.

They must strive to create learning organizations by demonstrating they are also continuous learners.

They must insist as much effort be placed on character development of their up-and-coming leaders as on developing their competencies.

They must recognize words, policies, principles and processes mean nothing unless they are reflected in their behaviours and may, indeed, be undermined by any “say-do” gap not closed quickly.

Leadership- and Organization-Development Specialists
There are almost limitless opportunities for leadership and organization development professionals to add more value to their organizations. These opportunities lie in fully exploiting the development of leadership competencies, character and commitment as described earlier in this volume.

One starting point is the development of leadership profiles that capture the key competencies, character and commitment the organization wants to see in its leaders. Such profiles act as beacons. They signal what it takes to be successful as a leader in the organization and what various stakeholders should expect of leaders in the organization. They also serve as visible commitments and leaders must expect to be measured against them.

The development and ratification of a leadership profile opens up a vast scope for learning- and organizational-development (LD/OD) professionals to create programs, developmental pathways, performance and development coaching, succession management and other supporting processes. It serves as the basis for engaging top management in systematic talent reviews and facilitates executive group discussion of career-related moves for high potentials.
Once executives understand the need to focus on leadership competencies, character and commitment, they must be able to turn to the LD/OD/HR leadership to devise or improve the systems for leadership assessment, recruitment, development and succession management. LD/OD professionals will have to be even closer to the business issues and context in which leaders must be developed than they are typically today. Such familiarity will help them establish partnerships with line and functional executives so they can contribute to the development of current and future leaders.

Boards of Directors

One critical lesson gained from the recent financial and economic crisis is that boards should not allow a CEO to be the only conduit of corporate information, nor should the CEO be the sole assessor of risks facing the corporation. Boards must improve their understanding of the strategic, operational, reputational and financial risks in which the organization is engaged. They must be able to verify the extent to which their organizations are exposed to those risks and understand the strategies available for risk mitigation.

Boards, and especially governance committees, must take a more dynamic view of board composition than is traditionally taken. Directors today may require much deeper understanding of risk, technology, or global operations than in the past. Governance committees must ask themselves whether the board has this level of understanding and, if not, what they are going to do about it. This may lead to requirements for more education of boards or individual directors, and it may require boards to refresh their membership more frequently and radically than in the past.

Boards can and should require independent, third-party assessments of critical risks. Where these differ from management’s assessments, directors must be fearless in provoking a discussion.

Boards need to change how they look at executive compensation. It should be viewed as a risk variable and examined by the risk committee of the board or by the board as a whole. The examination should address specifically whether proposed or established compensation schemes encourage or discourage the right risk-taking behaviour.

Finally, boards should be wary of CEOs with narcissistic tendencies, who appear excessively confident, who resist or appear to resent deep and tough questioning, and who appear to be continually “selling” to their boards or “managing” them. When faced with this type of situation, boards should exercise even greater scrutiny and, if resisted, ultimately replace that CEO.
Next-Generation Leaders
Finally, our call to action goes out to those who aspire to leadership. We urge you to:

- Strive to develop the full range of your leadership potential. Know yourself—get in touch with your values, understand your personality traits and recognize how they impact others.
- Take reasonable risks with your career to stretch and learn. Be prepared to make mistakes but be even more prepared to learn from them.
- Stay grounded. Recognize no matter how much success you have, your only guarantee of future success is to retain your basic humility.
Conclusion

WE HAVE USED RECENT EVENTS AS A WAY OF REFLECTING ON LEADERSHIP AND, SPECIFICALLY, leadership of business organizations. Some may think this somewhat unfair but we considered it to be the type of crisis that was simply too good to waste. It forced us to confront the gaps between what we know about good leadership and the state of practice. This research supports the view that good leadership is about the competencies, character and commitment of leaders and how these are reflected in decisions made and implemented in continually changing contexts.

We set out by hypothesizing that good leadership would have made a difference in what happened, both in the buildup to the recent economic and financial crisis, and in the way individuals and enterprises managed the outcomes. We think that the evidence from this qualitative study supports this. We concluded by presenting some basic principles of leadership and leadership development that address what good leaders do, the kinds of people they need to be, how they develop and how organizations can develop them. These principles form the basis for improving leadership practice today and for developing better leaders for tomorrow.

Every author reflects his or her personal values in their writing, and we are no exception. The mission of the Richard Ivey School of Business is: “To develop business leaders who think globally, act strategically and contribute to the societies in which they operate.” We believe in this mission. It has shaped this research, our conclusions and the prescriptions we have presented. We will endeavour to reflect these values in our future work on leadership development.
Endnotes

1. In the last 30 years we saw the 1980s Latin American debt crisis, Black Monday in 1987, the U.S. savings and loan crisis in 1989-91, the Japanese asset bubble collapse of 1990, the Scandinavian banking crisis in the early 1990s, the Black Wednesday speculative attacks on European currencies in 1992 and financial crises in Mexico (1994-95), Asia (1997-98) and Russia (1998).


3. This formulation of the social responsibility of business was provided in a 1982 personal communication from David Grier, a long-time public relations executive with Royal Bank Group.


5. The Financial Services Modernization Act (1999) was passed by both houses of congress on the last day of the Clinton Administration.


This same realization had come to Alan Greenspan, Chairman of The Federal Reserve, toward the latter days of his tenure but he did little or nothing to act on it. In a televised interview he stated that he had realized that the only assumption that could support the growth in leverage in the financial sector was house prices increasing at more than 5 per cent a year in perpetuity.

Examples of statements from former executives at Standard & Poors and Moody’s, as well as email between employees at S&P are cited in a PBS program on December 26, 2008. Further examples are in the records of the Congressional Committee on Financial Oversight and Reform. http://www.pbs.org/now/shows/446/index.html


Technically, overconfidence is usually defined as a state of affairs that is amenable to change once a person can be convinced that they are wrong. Hubris, on the other hand, is usually thought of as a personality trait that is less amenable to change.


For example, see Allison, G. T. (1971). Essence of decision; explaining the Cuban missile crisis. Boston, Little Brown.


See note 17, above.

See note 17, above.


28 See note 26, above.


32 See note 3, above.