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How to Risk-Adjust the Culture of Global Finance

By Allan D. Grody
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The concept of "culture" is traditionally connected to the idea of national or ethnic culture. But culture is also referred to in a large range of financial areas. Changing that culture is critical to risk-adjusting the financial system.

In business terms, we hear about corporate culture; in risk terms, we speak of the risk culture of the organization. In traded capital and contract markets, we speak of the culture of participants in behavioral finance terms. In those same markets, we also speak of the market makers and client-facing representatives as having a sales culture. In general, we see the culture of finance on all sides as a culture of fear in one case and greed in the other.

The bifurcation of culture into these two opposing forces – fear and greed – is what gives us a buyer for every seller and a winner for every loser. It also creates the liquidity necessary in market pricing. The rapid transformation of one view of fear and the other of greed is transitory, moving at a different pace in each human player. It also gives us arbitrage opportunities across asset classes, across geographies and between markets, helping to keep economic equilibrium.

When either fear or greed is universally shared, it gives us gridlock - no buyer for any seller, no price discovery, no values for our intangible financial assets and no liquidity. Worse, it leaves us in financial crisis, with a universal fear that the global economy is badly broken. That is our current state.

Culture is a product of shared beliefs that get played out every day in one's life, whether privately or professionally. The optimal state of a culture is to be common to both of those lives. That this culture cannot be created overnight is obvious. It's the result of a consistent, multiyear, open exchange of views, healthy skepticism and questioning of widely held beliefs. It gets played out in a parent shaping a child's national or ethnic culture, in a coach or dance instructor teaching discipline, in a pastor or rabbi instilling moral and ethical values and in a mentor shaping an apprentice's corporate culture.

What skews culture in the financial industry is a widely held belief that winning is all that matters. That greed has no counterpoint in fear. That if I get to the finish line by any means I can take the money off the table and never look back. In Nick Dunbar's great book "The Devil's

Derivatives," he talks about this as the transformation of a bank culture from "hate to lose" to "love to win."

The personification of the greed culture was described in a *New York Times* op-ed piece by Greg Smith, a young investment banking recruit of 14 years' vintage. He announced publicly that he believed the decline in Goldman Sachs moral fiber, attributed to the leaders of the company, represented the single most serious threat to its long-run survival.

I too lived in a century-old private partnership as it grew and became global. My partners and I increasingly became globe-trotting rainmakers. We became increasingly detached, ever so slowly, from the personal mentoring that was so critical to communicating a culture across decades let alone generations.

We kept pace with our clients' globalization aspirations spending less time in preserving the culture we had inherited. We recognized this change and hired professionals to teach ethics and imbue our culture, but it wasn't the same. We weren't alone. Our clients, great financial institutions steeped in centuries-long "vision and values" cultures, hired the same outside mentors and tried similar programs.

In 1999, Goldman Sachs, one of the last holdouts from an era of public offerings of investment banks, went public. The growing globalization of the firm and the public offering of shares in Goldman came together to detach the family/partners' money, substituting it with other people's money.

That was the tipping point in a culture change at Goldman that the young recruit I referenced earlier observed, but incorrectly diagnosed. The fact that the Goldman partnership debated the decision to go public for decades and was one of the last of the great investment partnerships to do so says more about its high moral standards than a single employee's disgruntled observations on his way out the door.

There was a feeling of closeness in professional firms back then - a sense of intimacy felt both culturally and physically. The personal mentoring was easier in this environment. Culture was transmitted almost effortlessly. In seeing a transgression, it could easily be remedied.

Globalization removed the intimacy in which culture is best transmitted. Partners taking their own capital out of the business through a public sale of its shares removed the tie to their best risk control, putting their own money on the line.

The final nail in the coffin was the anonymity permitted by the evolving technological complexity, black box culture and pseudoscience of risk management that grew up in the now "too big to fail" giant financial institutions.

Restoring the lost culture of the congenial partnership business model will not be easy. But blaming Goldman's changes on one or two men and the inference of pervasive moral hazard in the firm is wrong. The easy sightings and explanations of a young man with a single decade of context should be considered against the observations I have conveyed about the more complex forces of competition and change that evolved over decades and generations that changed the culture of finance.

Risk-adjusting the culture of global finance will not be easy. It starts by governing your business around the principles of doing the right thing for your customers, shareholders, community and employees.

Finally, take care of your management team last – not the other way around. Vet new ideas through risk management and audit committees, not the marketing and sales department. Don't let the marketing materials, slideshows or brochures out the door until the technology, risk management and operations departments sign off. Manage incentive compensation around risk-adjusted performance metrics.

If you can't explain an idea, product or technique that your firm uses, lose it. The success of the three pillars of your business—your capital, your people and your data—all rest on the back of a fourth: information technology. Give it its due.

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