

Bill George October 3, 2008, 1:55PM EST text size: [TT](#)

Wall Street's Latest Crisis of Leadership

Once again, ego-driven operators hungry for glory and power have taken the U.S. to the brink while a few true leaders built sound futures

by [Bill George](#)

The current crisis on Wall Street is being characterized in technical terms that few Americans understand: subprime mortgages, credit default swaps, mortgage-backed securities, and CDOs.

But this is not a crisis caused by the failure of complex financial instruments. This is a crisis caused by the failure of leaders on Wall Street.

The heads of firms like Bear Stearns, Lehman Brothers, AIG, Countrywide Financial, and Washington Mutual all too often sacrificed their firms' futures in order to maximize short-term gains. This meant under-pricing of risk in exchange for immediate fees and taking on inordinate levels of debt to invest in complex, highly uncertain instruments.

Compounding their errors, these leaders were unwilling to face reality when the value of their holdings tanked, as many declined to mark these instruments to market. Instead, they argued that their complex financial models yielded a superior valuation for their holdings. In some cases, this "mark-to-model" approach, or what Berkshire Hathaway ([BRK.A](#)) Chairman Warren Buffet calls "mark to myth," led to their undoing as people inside or outside the firms had difficulty figuring out what their assets were really worth. Had they followed the long-term investing philosophies of Buffet, these firms would be still be around.

A financial failure? No, this is a leadership failure.

The first job of any leader is to preserve the viability of the enterprise. These leaders focused on short-term gains and large bonuses for themselves, instead of ensuring the survivability of their companies and building them for the long-term. In this sense, their behavior mimicked failed leaders from earlier in the decade like Jeff Skilling of Enron and Bernie Ebbers of WorldCom, except there is no indication here of any illegal actions.

In contrast, five leaders of financial firms stand out for their prudent leadership as they prepared for this crisis by anticipating the impact of systemic risks and emphasizing the long-term health of their firms: Dick Kovacevich of Wells Fargo ([WFC](#)), Jamie Dimon of

JP Morgan Chase ([JPM](#)), Ken Lewis of Bank of America ([BAC](#)), Lloyd Blankfein of Goldman Sachs([GS](#)), and John Mack of Morgan Stanley ([MS](#)).

- Wells Fargo's Kovacevich built the nation's leading mortgage banking portfolio by emphasizing sound lending practices and avoiding the unqualified mortgages that led to the demise of mortgage bankers like Countrywide Financial.
- JP Morgan's Dimon and Bank of America's Lewis kept their balance sheets clean and healthy so that they were prepared to purchase distressed firms like Bear Stearns, Washington Mutual, Countrywide, and Merrill Lynch ([MER](#)) at bargain basement prices.
- Goldman's Blankfein and Morgan Stanley's Mack built liquidity and carefully managed risks as their firms shifted to the bank holding company model.

When it comes to authentic leadership in this crisis, no one stands out more than Treasury Secretary Henry Paulson. As a member of the Goldman Sachs board since 2002, I have had the opportunity to observe him at close range. Were it not for Paulson—and his adaptability, tenacity, and ability to get other leaders to face reality—the U.S. financial condition would be in far worse shape than it is.

When he took the Treasury post, Paulson never dreamed of bailing out Wall Street financial firms, because his primary focus was on restoring relationships between the U.S. and finance ministers around the world. As the crisis unfolded, he immediately stepped up to leading the country through it. Using skills honed for decades as an investment banker, Paulson was able to bring the administration and warring political parties to agreement on the \$700 billion bailout package approved by the House on Friday.

Paulson is a fervent believer in the free market system, but he recognized that without U.S. government intervention, this crisis could topple our entire financial system. We can only hope these latest moves, coupled with government takeovers of failed institutions, are sufficiently strong to restore confidence in the market and rid the economy of excessive bad debt.

This is just the latest—and largest—in the once-a-decade crises that Wall Street goes through. We shouldn't forget the savings and loan debacle of the 1980s, the collapse of Long-Term Capital Management in the 1990s, and the bursting of the technology bubble in 2002. Yet creative financial people continue to invent new models and new instruments that create short-term gains, often without understanding the pitfalls they represent.

Many pundits blame these problems on greed, but greed is nothing new. The underlying characteristic of all these fiascos is the same: brilliant managers who thought they could out-smart the market, instead of leaders with the wisdom to build sound firms for the long-term.

The boards of directors of the failed firms bear a heavy responsibility for their failure to select the right leaders and to monitor their actions. All too often they permitted high-profile, ego-driven leaders put their image and drive for power ahead of their responsibilities as leaders.

We will never avoid these problems until boards of directors start selecting authentic leaders to run their firms known for character, substance, and integrity. These attributes are essential if we want to restore the strength and primacy of the U.S. financial system and build our economy for the long-term.

[George](#), professor of management practice at Harvard Business School, is the author of two best-selling books, *True North* and *Authentic Leadership*. The former chairman and chief executive of Medtronic, he serves on the boards of ExxonMobil, Goldman Sachs, and Novartis.