

Kristofer Lehmkuhl Forelesning 2014

Leadership in a financial world

Av

Björn Wahlroos

Styreleder i Sampo Group

Kristofer Lehmkuhl Forelesning

Norges Handelshøyskole

Bergen, 22. september 2014

NHH



ISSN 1890-5064

Björn Wahlroos:

LEADERSHIP IN A FINANCIAL WORLD

Banking and finance is not an industry renowned for its great leadership. Philanthropic banker-statesmen, cast in the David Rockefeller mould have – fortunately, some investors would say – all but disappeared. They have been replaced either by grey techno- and bureaucrats, or by colourful investment bankers who have now themselves, in the wake of the financial crisis, become an endangered species. When asked to think of leaders in the world of money, our thoughts first tend to go to excesses in compensation and corporate entertainment colourfully described in films like Martin Scorsese's *The Wolf of Wall Street*. Requested to get serious, we may think either of discreet and conservatively dressed men, frequently speaking with a faint German accent, or of screaming men in colourful ties and braces with limited vocabularies dominated by four-letter words, effortlessly firing unsuccessful traders in giant dealing rooms. Neither type matches the standard concept of a great leader. Apparently, the financial industry may breed great investors and personalities like Warren Buffet or Sandy Weil; it just doesn't give birth to Churchills, Thatchers or even Jack Welchs,

Real leaders, we like to believe, are to be found in politics and industry – and in the military of course. Leadership, we say, is not about financial rewards. It is about inspiring men and women, to provide them with a mission; to make them follow you wherever you are headed, not because of promises of huge financial reward, but by the sheer power of your personality and the clarity of your vision. Great leaders are neither bureaucrats, nor financial wizards. They are charismatic individuals who instil in their subordinates the duty to serve – and the ambition to do it well. They set an example and provide a challenge. Like Captain James T. Kirk of the USS Enterprise they guide their people to boldly go where no man has gone before, to develop new products and services, to conquer uncharted territories, and thereby make life better for millions of customers.

Yet finance plays an important, some would say crucial role in all of this; or at least it seemed that way until 15 September 2008 when the Lehman bankruptcy shook the very foundations of our financial economy. But even if Lehman should certainly count as a watershed event, and changed many things, it did not in the end change the way the world works. We still inhabit a predominantly financial world – one better capitalized and more regulated than it was before the crisis perhaps, but a financially driven one nevertheless. To quote the advertising slogan of one of the world's leading newspapers: "We live in Financial Times".

It can even be argued that financial reform and innovation has done much, perhaps as much as industry, to improve the quality of life for billions of people, particularly those near the bottom of the

international distribution of income, in China and India, in Vietnam, Bangladesh and in Latin America. It is finance – sometimes microfinance – that has brought them the means to build their businesses and enter the global market place. Market reform and access to global funding, combined with improvements in the distribution of risk made possible by new financial products, have provided the fertile soil into which so many industrial innovations have recently been planted.

Economics and management

I have the fortune (or misfortune, my wife would say) of regularly being invited to express my views on various topics in economics: financial market conditions; fiscal discipline; macroeconomic outlook; taxation, and so on. These are challenges I gladly accept whenever possible. I tend to recommend lower taxes, labour market reform, and less regulation – a recipe I believe, over and over again, has proven itself capable of re-igniting economic growth and thereby, of improving the standards of living, not just for the few at the top of the income distribution, but for everyone.

Far less often do I have the opportunity to speak on management and leadership. Perhaps this is because my views on the topic are less well known, or thought to be less controversial; perhaps just because I find it a more challenging topic, one to which I have fewer ready answers. Management, it must be said from the start, is to me more art and less science than is economics. Professor Milton Friedman once awarded a colleague the honour of having great economic intuition. Still, most economics is done in a highly formalized setting, where mathematics and the precise use of language minimize the risk of erroneous deduction, leaving little room for intuition. It is no coincidence that there is a Nobel Prize in Economics, but not one in management. Management, like art, offers its own reward: share price developments, and even personal fortunes provide a yardstick against which success in management can, to some extent at least, be measured.

But management is also very different from economics. There are few universal principles of management, even fewer of leadership. Some aspects of management, like executive incentives, may be studied in highly formalized settings, but as a broader topic management rarely lends itself to strict theoretical analysis. Many – and I think I count myself among them – would say that leaders are born, not trained. Still, there is something to be learned from experience, and what experience I have, I will more than gladly try to distil into a handful of concepts and ideas that may (or may not) prove helpful to someone here today.

There are also organizations – most obviously the military – that must rely on well thought-out rules of tactical management and on great leadership to inspire men and women to risk major personal loss in the fight for the greater good. I think there is a lot to be learned from such organizations and

their decision-making and leadership routines. But while the analogy may seem compelling, one disregards the differences between financial and military organization at one's peril. Chief executives who think business is war rarely succeed in the longer run. All-out battles are minus-sum games, far too expensive mechanisms for conflict resolution to belong in an executive toolbox other than as a desperate, last-ditch measure. War may (according to Clausewitz) constitute an extension of diplomacy by other means, but in business war is an unmistakable sign of incompetence, much as it is in most modern diplomacy and politics.

Finally, a word about myself: I have had the great privilege of experiencing many walks of life: in academia, as a banker, an entrepreneur and, for the past fifteen years, at the helm of large financial services companies. Together with my colleagues, we have reshaped a tired, formerly mutual, insurance company and a state-owned Postbank into the largest and most successful financial services holding company in Scandinavia. We have, I believe, been successful, not because we planned for growth, but because we didn't. My only intention when entering the CEO's office in Sampo on January 2, 2001 was to make money for my shareholders, of which I was myself one. We never had an ambition to grow; we never aimed for empire. Yet, almost fifteen years later our record, I think, speaks for itself. We have made more money for our shareholders than most successful hedge funds – certainly a lot more than our competitors in banking and insurance – on generally lower levels of risk. Even so, we now own the largest insurance company and control the largest bank in Scandinavia. It didn't come out the way we planned, but the shareholders don't seem to mind.

First principles of executive management in finance

Let me start with what I like to call the three first principles of management in finance. I can't deduct them from any limited set of premises; nor are they, as far as I can see, universally accepted as general rules of executive conduct in the financial services industry. Still, as a starting point for a discourse on successful strategic management in banking and finance I find them helpful. Here they are:

First and foremost, *respect the market*. Contrary to much present-day writing on market efficiency, financial decisions are generally made in an exceptionally efficient environment, one in which most information is already reflected in prices. It is therefore far from evident that hunches, intuitive moves, and excessive risk-taking – the kind of strategies that are often expected from financially driven executives – will bring success in their wake. Instead of high rolling, you need to focus on risk control, costs, and diversification. Whenever you're convinced that you can beat the market it is advisable to take a time-out and ask yourself: "is this an early sign of hubris, or do I really have a credible argument?" More often than not it will turn out that the former is the case.

Yet every five years or so there may come an opportunity to beat the market, to really make money out of disequilibrium, a mania or a panic. Shorting the market in 2007 was, in retrospect at least, a painfully obvious strategy – one that I missed, largely because market-wide shorting is such an extraordinary investment stance that its exceptionality puts you, as investor, at a disproportionate risk. You really must be an outsider, like John Paulson, or extraordinarily well equipped to bear risk, to go full steam short against the current.

A year and a half later the tide was about to turn. In early 2009, going all in was, to my mind, the obvious move – if you happened to have the capital and the financing. This time we didn't miss the opportunity. Sampo invested nearly 9 billion euros in corporate bonds, mostly Scandinavian investment grade names, usually sold by distressed New York or London-based sellers at yields ranging from 8 to 13 per cent, and at AAA-spreads of close to 200 basis points. We also spent some 2 billion euros on equities, including buying 8 per cent of Nordea at half book value. Once the Fed had stopped the runs and calmed the markets, going against the panic was the obvious thing to do. It also proved very profitable.

The fact that markets may occasionally panic and offer supernormal risk-adjusted returns is no argument against their near-efficiency. Under normal circumstances there isn't much arbitrage in financial markets – if there was, I am certain someone in this room would set up a hedge fund to benefit and thereby eliminate it. It is only when panic and ill-advised regulatory action like bans on short selling has closed down the normal flow of credit that investors strapped for cash are forced to offer the cash-rich exceptional opportunities.

Second, and as counter-intuitive as it may sound, *think more than twice before you announce a strategy*. The world changes, and perseverance is not always as attractive a feature as some would have it be. “Stick to your strategy”, we are advised when faced with problems, or: “don't mind the setbacks, take the long view and stay with your goals”. Let me take a different view: I cannot recall having, in the field of finance, ever heard of a strategy that made sense, and was still in force five years later. The financial world, its regulation, and the markets change much too fast to support an unchanging consistent strategy of the traditional, industrial kind. In financial markets, I think it is good to remember Heavyweight World Champion Mike Tyson's advice: *“Everybody has a strategy 'til they get punched in the mouth”*.

I have done a (very) little bit of sail racing. On board an offshore racer you always have a tactician. He acts as adviser to the captain or helmsman, suggesting course changes, tacks and various other moves as wind conditions change and competitors reveal their respective tactics. There are, however, very few sailing strategists. The reason is simple: offshore racing – indeed any racing – strategy is self-evident, namely to have as few boats as possible between yourself and the goal line.

Although business is not about beating the competition, but of making money – preferably with as little collateral damage to the competition as possible – a similar principle can be applied to banking and finance. The idea is simply to cross the goal line with the leading group, and not to put your crew at too much risk. There is little need for more elaborate strategies.

Bankers deal in products: deposits, credits, payments, savings, investment, and risk control that change little over time. Their production technology may change, distribution will change, but they mostly do so at a leisurely pace that permits competent competitors to stay abreast of developments. The risk of game-changing new technologies is slight; correspondingly the cost associated with joining the technological avant-garde is high. It simply makes a lot of sense to focus on your basic offering and remain competitive. If that counts as a strategy, I must withdraw my scepticism regarding strategies.

It is good to remember that what really sets finance apart from industry is that while an industrialist must keep his eyes firmly locked on to the profit and loss account, a banker should never forget his balance sheet. No bank failure was ever the consequence of an insufficient operating margin. Financial crises, large and small, are without exception caused by bad assets and liability maturities that are significantly shorter than those of the assets. Keeping a keen eye on where your credit officers are lending, and how much commercial paper and other short term liabilities your treasury chief has issued to finance your long-term assets, is therefore what senior bank management is all about. This, of course, is not to suggest that operational excellence and financial acumen would not be important, quite the reverse: it is from them that shareholder value is extracted. But asset quality and risk control are the keys to survival.

From this it is only a short step to my final first principle: *never grow too attached to your assets*, be they a high-yielding bond, tastefully decorated main office, or a particularly profitable division. In finance, we do business in a rapidly changing market economy and asset trades are (an important) part of any successful business concept. Assets are simply the capitalization of your business strategy. In any business, and certainly in finance, ultimate success is often decided in asset, rather than in product markets. The winner is frequently the leader that best identifies trend changes in his product markets and draws the ultimate conclusion from whatever he sees, deciding to acquire or divest. Doing so, he will not only earn the product margin, but the discounted value of many years of expected margins. His reading of the trends, combined with his aptitude in finding an asset seller or a buyer, often proves the ultimate test of leadership.

Just think about it, what are business leaders mostly remembered for. A handful, like Steve Jobs or Pehr Gyllenhammar may be respected for their near-dictatorial control of their respective organizations; a few others are famous for their operational acumen, their ability to manage vast global networks of logistics and sourcing. But most of the spectacular successes and failures in management are made in asset markets; certainly this is the case in banking and finance. Danske

Bank's Irish and (to a much lesser extent) Finnish acquisitions on the eve of the financial crisis, Dresdner Bank's acquisition of Kleinwort Benson and then Allianz' acquisition of Dresdner, or, dare I suggest, Storebrand's purchase of SPP, have all become notorious. In industry, think of Stora Enso's acquisition of Consolidated, Norske Skog's deal with Fletcher Challenge, or Time Warner's merger with AOL. In all of these cases, the sellers drew the longer straw. But failure to execute can sometimes be nearly as fatal. I have myself, in 1992, passed on an opportunity to hold on to some 10 per cent of Nokia at a price of only about a hundred million Euros, just before the stock started to double in value each year until the year 2000, eventually making it worth almost 200 times more. Fortunately for me, Nokia's closest rival, Ericsson, made the same mistake. Neither of us could believe the world could change as much as it did with mobile telephony.

If there is something like a basic recipe for long-run success in banking and finance, I believe it is made up of these three ingredients: A deep-rooted respect for the efficiency of the financial markets; a flexible approach to strategy that permits you to change focus and rebalance your portfolio when the world changes; and active management of your fixed assets with a view to maximize their value by acquisitions and divestments.

Leadership in Finance and Industry

Let me now turn to a more difficult subject, namely leadership. In doing so I need to remind you of the scope of my argument. I deal only with leadership in market-based organizations, the membership of which is voluntary and based on short-term contract. This is to rule out military organization, which is based either on draft or long-term contracts, and is therefore quite different. In the modern non-military world we deal with people who, while bound by certain rules of organization and command, still have an opt-out that can be exercised at short notice. This fact obviously limits the set of tools available to the business leader relative, say, to a frontline military commander. It actually does more than that. The opt-out, in combination with a reasonably efficient job market, has made a fundamental re-evaluation of leadership necessary over the past thirty years or so. Gone are the days of authoritarian command and strict hierarchy; one might almost say that the carrot has replaced the stick as the business leader's tool of choice.

Taking the longer view, leadership has undergone tremendous change. From the hereditary commanders and aristocratic officer's corps of the armies of the early 19th century, to the meritocratic but authoritarian leaders of the great public corporations of just a few decades ago; and on to the modern meritocratic, contractual, and shallow organization, based on direct communication and powerful financial incentives. Even if many family-owned companies still proudly present a family member at the helm, Henry Ford II was probably the last great hereditary authoritarian ruler of a major industrial corporation. With improved access to the best education and

with increased legitimacy requirements, modern leadership must be earned 'in the field'. As a consequence, it has become less and less likely that the best leaders will be born from a hereditary line.

Highly authoritarian styles of leadership suffer from a related legitimacy problem. Authority, irrespectively of whether it is based on wealth, title, seniority, or education, is no longer a given. Even if limited in scope, it must be earned. And because of the many alternatives open to most of us, authority can now only be based on give-and-take. A few exceptional people like Steve Jobs may have provide their colleagues and subordinates with so much in the way of genius and experience that they were willing to accept an apparently authoritarian and occasionally erratic leadership style. For those of us unable to emulate Jobs' visionary personality, the cost of a similar leadership style would, in all likelihood, be prohibitively high.

A successful leader must have the consent of those – or at least most of those – he proposes to lead. Consent, in turn, is based on self-interest. The everyday realities of today's financial marketplace tend to dissolve the charismatic aura of purported men of destiny rather quickly. Instead of grandeur, to be effective, a leader must provide his subordinates with something they desire, be it an immediate financial reward, a good working environment, interesting challenges, an experience-based increase in the value of their human capital, the improved career prospects that go with the reputation of having worked with a master craftsman; or just fulfilment and pride.

Consensual leadership should, however, never be confused with democracy or egalitarianism. In my experience, rule by committee fails without exception. Having signed up for the voyage, the people who work for you have accepted your lead, and it is for you to find the way forward. Correspondingly, they have the option to depart when they suspect you have lost it. To sustain his leadership, a leader must create value for his shareholders, but he also needs to create value, in one form or another, for all those who work with him.

This is the crucial point. A good leader provides a great working environment for his subordinates, not because it is the right thing to do, but because it is in his self-interest. Even if we are frequently told the opposite, loyalty and performance can, of course, be bought. But it is to everyone's advantage that they are not. High pay, incentives, and perks are important to any executive worth hiring. Yet there is a trade-off: the bigger the non-financial reward in terms of human capital pick-up, job satisfaction, or pride, the smaller the financial package needs to be – and the lower the cost to shareholders. Ultimately, non-military leadership is about recruiting and retaining first-class managerial resources at a cost lower than the pure financial compensation package required for their retention.

If the only way you can hold on to the best talent is to pay the full value of its contribution to your organization, you will find it difficult to create much value for your shareholders. This is particularly so in service industries like banking, finance, project engineering, and management consulting. Unless you are able to offer something other than money much, if not all, of your income will just be meted out to members of your organization. For real value creation, real leadership is necessary. And leadership, by definition, is a management style that provides members of your organization with other than direct financial rewards sufficient to ensure their participation and contributions. Only by providing vision, guidance, experience, reputation, pride, and fulfilment can a leader procure an organization of loyal and hardworking members that creates value for him and its investors.

Infantry Command

I seldom read books on management. With very few exceptions I find them tedious and frequently shallow. They rarely offer the practitioner of senior executive management much valuable advice. Somewhat arrogantly one might paraphrase the old saying about teaching: “Those who can, do; those who can’t, write books on management”.

The few practical principles of management I try to apply I picked up at reserve officer’s school. I hold a (by now honorary) reserve commission as a major of infantry, and it is now almost forty years since I received my training as a platoon commander. Still, I have always found the (now defunct) Finnish Army Infantry Battle Manual, and particularly its part III: Platoon and squad operations, most helpful as a guide to the leadership of men and women. Let me give you a handful of examples, and then expand on them by injecting a few comments based on my own experience.

First, *lead by personal example*. Men and women are invariably best led from the front, not from the back. You may be different from your men, your rank may offer you some privileges; still you are one of them, and they need to be able to look up to you. To do that, they must see you from time to time; and they need to see that you are there with them, exposing yourself to the same risks and directing the action; and they need to know your values and skills. Your courage and abilities are important to keep them going and ultimately, for keeping them alive. If your people distrust you, you might as well resign your command.

Obviously, there is a fine line between setting an example and making yourself into something you are not. That is why I believe leaders are mostly born and not made. People tend to spot fakes and once they do, there is very little one can do to limit the damage. This is not to say that one cannot work on one’s leadership style and abilities: to weed out the short fuse, or to become a better

speaker. The whole idea of an infantry battle manual is to offer a few tips on what works and what doesn't – is it not?

Second, to be able to lead from the front and to set an example, it is necessary to *learn the trades of your men*. You needn't be a master trader; you don't have to be able to discount bond cash flows in your head, to program a Bloomberg terminal, or to remember all the businesses some private equity fund is invested into. But you need to know the main things, and some of the technical stuff too. In finance, you need to master the elements of option pricing, you need to be able to work the terminal, you need to follow the markets and have a rough idea of the systematic risk associated with various assets; and you need to know quite a bit of contract and securities law, to name but a few of the most obvious examples.

It is simply not enough just to master trade jargon or repeating whatever was in the Lex column yesterday. The infantry analogy is that you need to know how to use the weapons in your platoon or company – not as well as your best marksmen or gunners perhaps, but still. And you need to be better than they are at important technical skills of platoon leadership like reading a map and placing your machine guns and mortars.

Leadership is ultimately about good judgement, which, in turn is roughly half intuition and half experience. I am reminded of Captain Herbert Sobel, played by David Schwimmer of Friends fame, in *Band of Brothers*, Spielberg's and Hank's World War II epic. He is an excruciatingly demanding young training officer determined to make his men the best company of the 101st Airborne. But once in tactical war games it turns out that he has problems with the map and then, disastrously, with keeping his calm, resulting in his entire company being wiped out by the opposing team. Once in the field, he blames his shortcomings on his subordinates, particularly on Lieutenant Winters, played by Damien Lewis. Sobel is eventually relieved of his command and sent back to train troops. At the end of the war at Zell am See Winters, now a Major and battalion commander, outranks him. There is a trivial, but still important lesson in this. You earn the right to lead by proving to those you work with that you are up to it. In really simple terms: they look to you to protect their lives (or jobs as the case may be) and their trust in you and your leadership is determined by your ability to keep them alive.

Which brings me to my third leadership principle: *never blame a subordinate* (or anyone else for that matter) for your own mistakes. There is probably nothing that destroys respect more effectively than to see a leader blame others. But to develop an *esprit de corps* in a well-working and capable organization, it is not enough to avoid putting blame on others. At times, a leader may need to assume the blame for others' mistakes, particularly when they are more bad luck than incompetence. I find that protecting one's own is a very important aspect of leadership.

This is, however, a principle that can be taken too far. Even if I am no friend of a whistleblowing culture, in a good organization there can be no room for cover-ups of serious mistakes, non-compliance, or breaches of duty. Rules have to apply equally to all. If the mess is due to incompetence, flagrant disregard for rules or procedure, or seriously bad judgement, it simply must have consequences. This is necessary to protect the integrity of your command; inaction would be tantamount to condoning the errors, and would therefore undermine your position as leader. In modern finance, regulators have now lowered the bar to a level where almost any mistake, be it as trivial as an ill-executed buy order, or a brief and unintentional breach of a limit, must have consequences and leave a trail of corrective action. I am not convinced that going that far will, in the end, prove beneficial for either banks or society but, as I said, rules must be obeyed.

Fourth, the Finnish Army Infantry Battle Manual Part III recommends that whenever activity permits, you should bring your subordinate commanders (and if the group is small enough, your men) together, take out your map and *explain to them where you are, where your neighbouring company is supposed to be, where the enemy is expected to be, where you are heading, and what you plan to do*. This is crucial, for several reasons. It gives the men and women in your command a sense of security: they get to know where they are, where danger lurks, and where the others are. But it also provides them with an operational understanding that ensures that, were circumstances to change and independent action is called for, they stand prepared. This will make your unit much more flexible in its response and capable of operating even if temporarily broken up.

The business analogy is obvious. Withholding information to control your organization never works in the longer run. For sure, in the very short run it will make everyone more dependent on you; but once they realize what is going on they will seek other ways of obtaining the information, which means you ultimately lose both control and credibility. To ensure your following, and to retain the option to delegate responsibility for negotiations and other business, you need to keep your team well informed of the bigger picture.

Fifth, in the field *formal rank means little*. With the privileges that go with a commission left behind at barracks, to be effective, communication, while respecting the chain of command, must be direct. Pulling rank is always a sign of weakness. There are many desk (or staff) jobs back home to which those less suited for front line service can be transferred. The same is true for business. When in doubt concerning the ability of a line manager, always transfer or dismiss him and get someone else to take his place. I have never regretted a dismissal, but I have often regretted that I didn't act on my instincts sooner.

Sixth, *never criticize a subordinate commander in front of his men*. Doing so will almost inevitably cause him to lose face and undermine his command. Guidance and criticism are important, since you probably have a lot more experience than the men and women who work for you. But criticism,

other than a joking reference to bad luck or the fact that things might turned out better, should always be kept private.

Finally, *try not to lose battle contact*. By maintaining contact with the enemy you gain valuable information concerning his strength, dispositions, and plans. But at the same time you provide him with information concerning yours; so it is, in practice, a difficult balance to strike. Here the analogy to military tactics may break down, but in business I have always believed in playing with more open cards than required by the rules of the game. "Say what you mean, and mean what you say" is pretty good advice for the novice negotiator. Saying what you mean is certainly preferable to leading your counterpart astray into the wilderness of uncertainty and speculation concerning your intentions. Obviously, there are pieces of information that a good negotiator will choose to hold back: the trick is to strike the right balance; of creating an atmosphere of sincerity, providing your counterpart with sufficient information to prevent him from spending too much time on speculation on your motives and objectives, without giving him any trump cards.

Maintaining battle contact in business occasionally requires a senior leader to disregard protocol and rank. I have always found it to my advantage not to pull rank or insist on protocol. Calling on people even if you outrank them and providing back channels when direct lines of communications are severed or clogged, is always a good idea. I can't recall a single incidence where going the extra mile in terms of distance, rank, or courtesy would not have paid off.

Multinationals

I have so far chosen to disregard the fact that today most large organizations are multinational and frequently multi-ethnic. This fact presents the modern leader with an additional challenge, rarely dealt with in military manuals: how to deal with the almost inevitable factions that form along national, or other ethnic lines? This is not just a cultural problem affecting global multi-nationals; even a Scandinavian organization gets its share of problems emanating from near-inevitable clustering. "Swedes promote Swedes", "the Danes have a more conspiratorial management culture", "the Finns are introvert and stay among themselves", and "Norwegians are just plain impossible" are unacceptable, yet frequently heard characterizations. Even in integrated Europe, nationality counts.

For service industries, financial services included, this problem is frequently bigger than for manufacturing. In services, we don't just run a multinational production apparatus that offers our products to the consumer through various distribution channels. We operate our own distribution network, directly servicing consumers in a multitude of countries requiring us to be local, national and multinational, all at the same time. There is no way Nordea can have Finnish investment advisors

working in its Bergen branch, or Danish credit officers serving Swedish retail customers. We have to be local, we have to speak the language; we have to be seen as a stable presence. Yet, we cannot afford to be four – or seven – different banks, one for each country in which we maintain a weighty presence in retail banking. We must be multinational, yet, at the same time, local.

There are, I am sure, many ways of dealing with this problem. There are those who believe there is value to be made from making the most out of this clustering: by trying, as far as possible, to harness it in the service of the greater good of the organization. “Let’s have the Brits run the trading room, and put the Germans in charge of administration” might be one way of describing this approach. I think most of you will agree with me that such a solution is unlikely to succeed in the longer run. There are also those who choose to ignore the problem, hoping that time will take care of it.

I believe nationality, just like some other skill, should be seen as an asset; one that qualifies you for certain jobs in the organization which may require you to master a certain language or culture. But higher up in the organization that same asset (just like many other elementary skills) becomes more or less worthless, as nationality-specific job descriptions grow scarce. Like some other specific technical competences, such as an exceptional aptitude for bookkeeping or advertising, nationality will become a liability if promoted too loudly.

Major multinational organizations can, I believe, be run efficiently only with total disregard for ethnicity and gender. The trick is to make it perfectly obvious to your organization that there can be no favouritism, and that you require everyone that works for you to weed it out of their respective organizations. This may require a small quantum of “affirmative action” – of actually going out of your way not to favour people of your own ethnicity. It may also require you to loudly, and to some extent politically incorrectly, emphasize the financial objectives of your organization to a point where it becomes obvious to all its members that secondary concerns, such as nationality, are indeed not even tertiary.

I have had the fortune of being born into a minority group – a privileged one, but a minority all the same – in a small country, the majority population of which itself constitutes but a small, and rather unusual minority in Europe. Like most Scandinavians, I have travelled into the world without the benefit of an American passport or the conviction that French is the universal language. While causing minor problem in the short run, this has been a blessing in the longer run. As a swedophone Finn, resident in Sweden and mostly living outside of Scandinavia it is relatively easy to establish one’s credibility as an arbiter of conflicts arising from nationality. Still, it is a credibility that everyone at the head of a multinational company has to develop.

The road to disaster is paved with good intentions

The banker-statesman may now be extinct, and the investment bankers corralled. What the regulators appear to want in their place is a new breed of banker-bureaucrat. Europe's largest bank, HSBC, now spends close to a billion pounds a year on tasks associated with regulation introduced in the wake of the financial crisis. Most of this will I am afraid, eventually be paid by the bank's customers, in the form of higher margins and new service charges.

While that is a lot, new regulation requiring banks to severely limit their activities in securities markets threaten to become even more costly to the banks' clients. If Europe's large universal banks are prevented from using their financial strength to provide liquidity to our capital markets, we risk a return to the investment banking-model of the eighties. Because of insufficient capital, back then banks could rarely bid for their clients' securities issues, choosing instead to execute them on a 'best effort' basis. At a time when banks' corporate lending is curtailed by raised capital requirements, and competition for corporate accounts subsides as smaller banks increasingly pull out of the race, this would severely limit competition and thereby increase the cost of financing for Europe's corporations. Industrial investment is already at a historical low, do we need to shrink it further by making financing more expensive?

In light of the severity of the 2008-2009 crisis new banking regulation was inevitable. Rules had to be revised, but that doesn't mean that every new piece of regulation is desirable. The mere fact that some interventions are popular does not necessarily make them wise. To make matters worse, just as the greatest revision of financial ground rules for eighty years is under way, the banking industry has lost its voice.

What is needed I believe, is for the financial services industry to regain some lost ground through improved management and leadership. The stakes are high: if we permit the banker-bureaucrat to take over at the helm of our great financial institutions, European business and industry will suffer. There is no easier way to make a reasonable risk-adjusted profit in banking than by shying away from all risk, by refusing to extend credit to anything but the most credit-worthy and well-collateralized investment proposal.

Portfolio theory has by now made the risk-reward trade-off part of everyday investment advice. We are also beginning to feel the effects of a similar trade-off in economic policy. To ensure – like Barack Obama in his famous 2009 speech – that the financial crisis “shall never happen again” is in reality quite easy. All you need to do is raise banks' capital requirements from five to twenty or twenty-five per cent of assets. The higher you go the lower becomes the probability of default and crisis. But as

capital ratios go up, balance sheets come down: banks adjust by offering less credit; and less credit means less investment, which translates into less economic growth.

We have to break out of this vicious circle. To do so, lawmakers and regulators must begin to see the risk of severely adverse consequences of their actions. But at the same time banks must also overhaul their systems for risk control, adjust their compensation schemes to support long-term value creation, review their credit policies, and ensure compliance. For this we need determined leadership and skilful management. It is not enough to turn our banks over to a new breed of bureaucrats. Our world is a financial one, and to make it a good one, banking and finance must play its important role with great skill and leadership.