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Doing business the Puritan way

“Astrology developed into a strange discipline – a mixture of careful observations, mathematics and record keeping – with fuzzy thinking and pious fraud.”

- Carl Sagan, from the TV series ‘Cosmos’.

The late Carl Sagan was talking about astrology, but with those references to observation, mathematics, record-keeping, fuzzy thinking and outright fraud, he might just as well have been referring to economic theory. Or banking, for that matter. Magical thinking masquerading as knowledge – with hypotheses stolen from the physical sciences – is just one of the factors behind a financial crisis that, contrary to popular opinion, lives with us still, slowly continuing to drip poison into the real economy.

Another factor, which we suggest has been less closely examined, is the role of ownership and management. In an outstanding book (“The Puritan Gift – reclaiming the American dream amidst global financial chaos” by Kenneth and William Hopper; I.B. Tauris & Co, 2009) the authors make a convincing case that it was bad management and deviation from the long-established principles of innovation and discipline that were / are really at the heart of the banking crisis. The Hoppers define the Puritan Gift as “a rare ability to create organizations that serve a useful purpose, and to manage them well.” As opposed to organizations that serve no useful purpose, and managing them into the ground. Lehman Brothers, anybody ?

The Hoppers trace what many of us already knew as the Puritan work ethic back to the early settlers who founded the Commonwealth of Massachusetts. From there they trace its spread to Japan under a largely altruistic US Occupation (1945-1952), which established first a managerial revolution and then an economic miracle, and thereafter from Japan to the later Asian Tigers and on to mainland China. The agonizing tragedy of the Hoppers’ message is that successful economies have very short memories. Their advice to the American businessperson of today is to re-discover the “secrets” of their predecessors’ success as organizers:

“There is a surprising ignorance today about how business was done only half a century ago, totally misleading statements being routinely offered to an unsuspecting public by academics and consultants who should know better.”

Their second lesson, which gives a flavour of the book’s tone, is that,

“if the whoring after false managerial gods is abandoned in favour of the pursuit of true ones, the uneven redistribution of relative wealth that occurred in the United States in recent years can be halted and perhaps even reversed. Much commercial activity in the US since 1970 is best described as ‘financial engineering’ rather than true wealth creation – and the chief beneficiaries, needless to say, are the ‘financial engineers’.”

Sadly, what started on Wall Street did not stay on Wall Street, but went on to infect the rest of the business world. We are now living with the consequences. The Hoppers’ third lesson, however, is more upbeat:

“..no nation or society is condemned to poverty by its past. Until World War II, it was assumed that rapid economic growth was a characteristic only of Western societies. When General Douglas MacArthur became the ruler of Japan at the mid-twentieth century, he demonstrated that America’s inherited managerial culture could be successfully introduced to a less enlightened land.”

And there is no reason why his success cannot be replicated today, internationally. There is certainly growing evidence that the economic baton has already been passed over to Asia, leaving the Western economies mired in ex-growth financial torpor.

By comparison to poor management, bonuses are a sideline. But greedy bankers make a convenient scapegoat for politicians whose excuses now require ever more extravagant logical contortionism. Take soon-to-be former UK prime minister Gordon Brown:

“..what let the world down last Autumn [reinforcing the “it’s now all over” meme] was not just bankrupt institutions but a bankrupt ideology. What failed was (a) Conservative idea..”

This from a party that has been in office (though not necessarily in control) for 12 years, and which itself established the regulatory regime that has failed so spectacularly. In the land of the sighted, the one-eyed man is evidently just a dangerous, unpopular, self-delusional fantasist. As Charles Pridgeon wrote in a letter to the Financial Times last Friday, the political left failed in regulation, failed in reducing public debt during the (illusory) boom, failed to set aside funds for contingencies, and presided over breathtaking profligacy;

“Europe’s left would do well to reflect over the coming years over how it plans in future to put “socialism” and “sound economic management” back in the same sentence.”

There are 25 principles, by way of conclusion, that are cited underlying good practice in “The Puritan Gift”. They apply to all businesses, but some have a particular relevance to banking and financial companies. For example, Principle Three states that the most important sub-system in any organization is its managerial hierarchy. Hierarchy permits systematic delegation. But delegation is not necessarily simple. When the US engineer Homer Sarasohn examined the weaknesses of Japanese manufacturing in the late 1940s, he found that when managers delegated a task to a subordinate, they thought that they had also delegated the responsibility for that task. He taught his staff that the delegater retains responsibility, as if he were performing that task himself. In the words of William B. Given, “Always remember, your man’s failure is your failure.”

Or take Principle Five: Leadership should as far as possible be collective or ‘collegiate’. Like others of the Puritan Principles, this one was laid down by Peter F. Drucker in ‘The Practice of Management’. It now seems abundantly clear that many financial companies failed due to strategic weaknesses stemming from the concentration of decision-making within the chief executive’s office; see Lehman Brothers, for example, again. On a related note, there is Principle Nine:

'Integrated decision making' leads to the right conclusions. The implications of any important policy should be worked out in great detail **before** the decision whether to proceed is taken. The same group of people should be involved in each phase of the managerial process: planning; decision making; execution, and follow-up. Each phase therefore becomes part of a continuum. Not least, careful provision should be made against the contingency that some of the original assumptions might be incorrect. It is not altogether fanciful to speculate that if such an approach had been taken at Lloyds TSB, its former chairman Sir Victor Blank might not have been allowed to push through the emergency takeover of HBOS with such alacrity. (Coercion from soon-to-be former prime minister Gordon Brown doubtless also played its part.)

Some of the Principles will offend the deservedly offended – for example, Principle Fourteen: You should use consultants sparingly, and 'strategic' consultants never. But few would take issue with Principle Seventeen: Avoid debt like the plague – or, if that is impossible, use it sparingly.

There are then, of course, two immediate applications of Hoppers' book. One is to assess its relevance to one's own business and to see if, in their own words, "If it ain't broke, you should try to make it work better" (Principle Sixteen). The second is to apply its message against (the corporate management connected with) equity investments either already held, or being contemplated. Judging by the most recent behaviour of the stock markets, there is no particular urgency about making those investments. According to data from investment researchers TrimTabs, only \$2.5 billion has gone into equity-related mutual funds since the lows in March. By comparison, \$254 billion has gone into the bond market. This would seem to answer the question: who has been doing all the buying? Answer: not that many individual investors, for starters. And if the marginal buyers have been hedge funds (or doltish quasi-index-trackers), that calls into question just how sustainable the post-March "rally" will prove.

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