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Daring more entrepreneurial spirit in the financial sector

The banking industry is shrinking – for the first time in 60 years. In Germany as well as in the rest of the world. According to the European Central Bank’s statistics, the balance sheet totals of major local banks have already decreased by 11% from October 2008 until June 2009. Further decline is anticipated. The market leader Deutsche Bank’s quarterly report even included a decrease of a grand total of 23%. These figures might harbingers of terrible things for many institutions: massive cost reductions, the closure of departments and cuts in staff. Within the financial system however, the ongoing process of deleveraging is indispensable, overdue and quite healthy. Too strong was the credit leverage, too weak the connections with the real economy.



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Indeed Germany is regarded – as opposed to Great Britain for instance – as always having had a comparatively strong bond between the real and financial side of its economy. Yet even in our country the financial sector has been growing at a faster and more furious pace than the industrial and the service sector.

Marx and Engels

Let us examine the thoughts of Marx and Engels without inhibition; as pertaining to the industrialisation they spoke of the estrangement between the worker and his product and therein identified the cause of the wrongs of the early industrial working environment. Comparably, the estrangement between the real and the financial economy might have been the root cause for the financial crisis.

Financial products in themselves do not create value. Finance’s central function is rather to connect the demand for and the supply of capital. Therefore the financial industry is the catalyst for all economic activity. No more and no less.

Without a perpetuum mobile

However, particularly over the course of the past ten years the belief that financial products, as a perpetuum mobile, would produce returns in and out of itself has been growing. That is a fallacy. Regrettably, the bursting of the subprime bubble has re-illustrated that behind even the most complicated structured financial product there is a real-world asset – and that only its development, be it positive or negative, finally determines the return. So to speak, at some point gravity catches up with even the most complex products. And explicitly this connection to the underlying has been estranged from many bankers. One of the predominant goals of the planned reforms for the financial systems should be to correct the sector's self-perception and to emphasise business ethics.

Strong ties

What is necessary to once again strengthen the bond between the financial and the real economy? A renaissance of owner-managed institutions, which are firmly rooted in their region's economy or a specific sector, would help. Over the past years' the creed has been that only large, listed, and globally active corporations have the necessary understanding for the business and its inherent risks. But viewing the current scenery amongst financial institutions, the owner-managed banks, or the respective banks with entrepreneurial majority stakeholders, have endured the crisis with significantly less damage and do not depend on governmental aid.

A solution for the bonus situation

It would be desirable – and in the taxpayers interest – if the government signaled its appreciation for owner-managed institutions more frequently. Beyond that, owner-led institutions inherently provide a partial solution to the bonus problem. To an entrepreneur, the notion of receiving high payments – or granting them to others –, without their recipient bearing the appropriate risk, generating a measurable performance and lasting profits, would be unbearable. Put differently: The best and most sustainable decisions are taken, when there is an existing union between risk and return. Completely without complicated regulations, simply due to human nature.

Participation in losses

In this manner, entrepreneurship could be simulated for hired managers. High bonuses are not the problem, but only the flip side of the coin. It is simply a matter of facilitating a lock-step between the pursuit of returns, and the limitation of risks.

That implies on the one hand participation in the returns, but equally on the other hand the participation in losses. Not – as currently demanded at the upcoming G20 summit in Pittsburgh – an absolute restriction on bonuses. For entrepreneurially thinking managers bonuses and penalties should not present a problem – and anybody else is just not a manager.
