December 2008

: Finance Faculty Reflect on the Financial Crisis

INTRODUCTION

Tales of the ever-widening financial crisis have dominated the business and mainstream news in recent months. From lost homes to lost jobs to the sale and even collapse of iconic companies, the scale of the damage has been tremendous. Public and private sector institutions alike have struggled to take appropriate and productive actions that might help to minimize harm to stakeholders and begin to right the wider economy, in the midst of a public discourse that is fraught with finger-pointing and confusion.

As of the writing of this paper, the full effects of the financial crisis are not yet known and its causes are not yet fully understood. Some believe that the problem originated with well-intentioned government home ownership policies that went awry in their interface with the market. Others point to poor regulation of bank and non-bank financial institutions, misaligned incentives that rewarded the sale of loans that were likely to default, and a lack of transparency around complex financial products. Still others blame a failure of character—whether among home owners who took on mortgages they could not afford, or the leaders of financial companies who signed off on unsound investments—citing individual greed and irresponsible behavior. It is clear that the problem at hand is complicated and that its myriad and overlapping causes and effects will not be fully understood for years to come.

Nonetheless, as individual businesses both played a central role in causing the crisis and have been extensively damaged by its effects, the financial crisis has profound implications for business education.[1] Indeed, given that the particular sales, risk management, and investment practices of individual companies have had real-world (and in many cases devastating) effects for a vast swath of the world's population, the crisis presents a particular challenge to faculty who are attuned to the role of business in society to interpret the crisis and distill its lessons in teaching and research.

This *Closer Look*—which highlights several MBA finance professors' teaching on the financial crisis and sets forth some of their thoughts on how finance as a discipline might best adjust its pedagogy and core assumptions going forward—is the first in a series of short papers that will examine business education's response to the crisis. The series aims to cover a range of disciplines and, where possible, to highlight current teaching. [2]

While it is too early to know which approaches to teaching on the financial crisis will ultimately prove most effective, the series is intended to spark brainstorming and dialogue in examining the following questions:

- How can faculty help their students to understand the financial crisis when its long-term lessons are not yet known?
- How can they use this complicated and historic calamity as a "teachable moment" through which to equip students with mindfulness about the real-world effects of their actions?
- How can faculty use the intellectual frameworks particular to their own disciplines to help their students grapple with the most important economic events of the day?

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[1] See also Alison Damast, "B-Schools and the Financial Bust," *BusinessWeek*, November 4, 2008.

[2] To offer your thoughts, please contact Rachel Shattuck at rachel.shattuck@aspeninst.org.

- Most importantly, what attitudes and skills can faculty can convey to their students—the business leaders of the future—that might help to avert potential future crises?

FACULTY AND STUDENT RESPONSES

Given the unprecedented scope and rapid unfolding of the current financial crisis, the in-class responses of those interviewed have been largely improvisational. Despite the difficulties of teaching about events whose lessons are not yet known, and news on which rapidly becomes outdated, there is a consensus that as much as possible finance faculty must help their students grapple with the causes and lessons of the crisis. Responses from some of the faculty interviewed include the following.

- **John Becker-Blease,** Assistant Professor of Finance at Washington State University-Vancouver, is attempting to help his students understand the extent to which the various causes of the crisis are intertwined, looking at, among other things, housing policy, the role of speculators, and the extent to which correlated failures at individual banks led to widespread failures of solvency and liquidity. While he reports that his students largely enter into the discussion eager to place blame, they begin to understand that "among all the homebuyers and bankers and regulators and politicians, it's hard to tell who was behaving really foolishly and who just got unlucky."

- **Thomas J. Nist**, Donahue Chair in Investment Management at the Palumbo-Donahue School of Business at Duquesne University, has worked with his students and the media in western Pennsylvania to try to help the public better understand the issues at stake, particularly the debate around the government "bailout." He encourages his students to consider the kinds of ethical questions involved in financial sales and marketing that have come to the fore in the current crisis, as well as the need for business people to take responsible actions and not to follow leaders unquestioningly. According to Professor Nist, "My class has not yet drawn a conclusion on the question of blame, and I am not sure that I have either."

- **Don Smith**, Associate Professor of Finance and Economics at the Boston University School of Management, wound up deviating significantly from some of the lessons he had planned in his class on government securities in order to bring in content on the financial crisis. He says "At the beginning of the semester I was all ready to talk about the auction rate securities problem, which has lots of ethical implications, but now that's completely on the back burner. It seems small and inconsequential in contrast to the collapse of the entire financial system." Professor Smith reports that his students are highly engaged with class discussion of the crisis, and that they view it as critically important to their career prospects.

- **David Weil**, Professor of Finance and Economics and Everett W. Lord Distinguished Faculty Scholar at the Boston University School of Management, is preparing to include content on the financial crisis in the course he will teach next semester on the role of public institutions in private markets. Professor Weil plans to spend several sessions on the topic, and will look at the role that regulation played in the crisis, and the ways in which improved regulation might produce better outcomes in the future. He will ask students to think in particular about the potential for tension between different positive public policy goals, the role of incentives, and the role of disclosure, and to consider how better disclosure systems might have mitigated the crisis.

THE FUTURE OF THE FINANCE CURRICULUM

The six finance faculty interviewed believe that the causes of the financial crisis were so many and complex that simply training MBAs differently could not necessarily have prevented it. However, they nonetheless agree that the crisis offers an opportunity for finance faculty to reflect on the ways in which they might better prepare MBAs going forward. They also believe that once the crisis is fully understood it will yield rich lessons and teaching cases for use in the classroom.

Faculty thoughts on how finance as a discipline can respond the financial crisis fall into three major areas.

Risk Management

Most of those interviewed believe that since the crisis was caused in large part by a breakdown in risk management practice among individual banks, general MBA programs should better incorporate teaching on risk management, and convey its importance to their students. Based on his experience as a practitioner, **Thomas Nist** points to an atmosphere that is common among firms in which "the sales force is measured against what people produce in terms of asset growth—someone else is responsible for risk management." Nist asserts that "There needs to be more transparency about risk. Coming out of business school, future leaders should know how to evaluate the risk profile of a decision regardless of the role they play in their organization."

Sylvia Maxfield, Associate Professor of Management at the Simmons College School of Management, adds that an inadequate understanding of risk can be doubly disastrous for students who plan to enter the financial services industry. "Every MBA should understand that any kind of risk can dramatically undermine the value of your stock when the value of your company is largely intangible. A major part of the value of a financial services company is the fact that outsiders believe the people in the company really understand their own business."

Dwight Crane, George Fisher Baker, Jr. Professor of Business Administration, Emeritus at Harvard Business School, underscores one of the potential pitfalls of teaching risk management. "Sometimes you can end up teaching risk management models that have underlying assumptions that turn out to be untrue. We need to help our students both to understand risk models *and* understand that they can sometimes go wrong, which is not easy to do, especially if the person teaching has been designing and studying those models!"

Ethical Questions

Professor Nist also points out that that the question of how to train students as effective risk managers bleeds easily into questions of leadership and ethics. "There's a mindset that's evolved," he says. "Maybe it's being like lemmings, or maybe it's just wanting to make hay while the sun shines, but the risks were so blatantly obvious, and people were somehow not held accountable for managing the risk of what they were executing."

Most of those interviewed also believe that finance professors must find a way to work ethical considerations into the finance curriculum but concede that the questions this raises can be complex. **John Becker-Blease** says, "I don't think that there were very many people sitting around thinking sinister thoughts about how to exploit the situation." Rather a complex mix of individual personality, group culture and incentives led to managers' poor choices: "Imagine you're a major investor in a bank that is at the bottom quartile of earnings, while competitors are making lots of money by investing in mortgage-backed securities—would you be happy with your bank's managers?"

Professor Crane believes students need to be prepared to be able to withstand these kinds of countervailing forces: "Part of real leadership and accountability has to do with how an individual behaves as a leader when other people don't agree with what he or she thinks."

Those interviewed also agree that students must gain an understanding of the real-world implications of their own professional actions—something that can seem highly abstract, especially in classes that deal with the more quantitative aspects of finance. **Don Smith** suggests the inclusion of "big-picture" topics in his teaching as a lead-in to discussing the ethical implications of finance. He says, "I try to talk about the financial blow-ups, the things that went wrong, and the mistakes that people have made."[3]

The Big Picture

Sylvia Maxfield proposes that a course on market failures and imperfections be required of all MBA students.[4] To instill a sense of the "big picture," she also asserts that MBA finance courses should expose students to a wider array of economic theories than those most students currently encounter: "In the last twenty to thirty years there's been a hegemony of the idea that markets are most efficient in conjunction with minimal state intervention. There's a widespread acceptance of this one particular model, which leads to the sense that we shouldn't have to worry about regulation." Alluding to the prominent role that Goldman Sachs alumni have played in the crisis, she says, "If we did a better job of helping people to envision alternative models and see upsides and downsides we might have a set of Goldman Sachs people going into government with a more eclectic view of the world."[5]

Dwight Crane concurs that exposing students to the bigger picture of the markets and the economy is desirable for the ways it can expand students' thinking on the topics at stake. He says, "As finance professors we need to educate people to trade well and design useful products but also to take an integrative view of how market systems work and should work." Professor Crane suggests that one of the most valuable things an MBA education can impart to its students is a sense of skepticism of accepted ideas and the ability to think critically about norms of practice.

ONGOING QUESTIONS

The ideas set forth by the faculty interviewed above open significant philosophical questions for the finance discipline and offer productive avenues of inquiry for other disciplines as well. Business faculty are likely to be grappling with these questions for years to come, and the ongoing discussion will no doubt prove to be fascinating and potentially transformative. Questions to consider include

- How can faculty best balance the need to convey necessary skills and competencies with the responsibility to help students understand the current financial crisis?
- How can faculty help students explore the ethical issues inherent in the financial profession and develop an understanding of how their own actions can have implications outside of the individual firm?
- How can students develop the confidence in the workplace to speak up in the face of possible hostility when their companies undertake actions that are unwise or unethical?
- How can faculty help students develop a healthy skepticism of accepted wisdom and the skills to think rigorously and critically about the actions and culture of their companies and industries?

NEXT STEPS

This *Closer Look* is part of an ongoing series of papers that will look at business faculty's responses to the financial crisis, both highlighting current teaching and offering their ideas about how the management curriculum might productively change going forward. We aim to feature perspectives from an array of disciplines. To share your thoughts, please contact Rachel Shattuck at rachel.shattuck@aspeninst.org.

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[3] For one approach to tackling discussions about ethics and individual agency in the workplace in classes across an array of disciplines, see The Aspen Institute's *Giving Voice to Values* curriculum at http://www.aspencbe.org/teaching/gvv/index.html.
[4] See The Aspen Institute's teaching module on market failures at http://www.caseplace.org/d.asp?d=2793.
[5] For a finance syllabus that focuses on a stakeholder model of the firm, see John Becker-Blease's "Problems in Financial Management" at http://www.caseplace.org/d.asp?d=2853.

For more resources from The Aspen Institute, please visit the websites below.

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A Closer Look is a regular series of briefing papers on topical issues in MBA education, based on the research and programs of the Aspen Institute. The Aspen Institute's Center for Business Education encourages future business leaders to innovate at the intersection of corporate profits and social impacts.

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