A case for as shift in leadership types for Financial Services

by

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Abstract

In this paper we evaluate the changes to the financial services industry likely to come from the emergence of Artificial Intelligence and the impact on the role of leader in this new paradigm. The central question is what leadership styles will be most effective in dealing with the shifting technology infrastructure and the emerging changes in employee behaviors, customer experiences and competitive environments. The new ways of performing the critical role of finance in society will require transformational leadership for the existing providers to remain competitive..

Keywords: Artificial Intelligence, Transformational Leadership, Change Management

The Financial Services Industry

Today's financial services organizations find themselves navigating a period of unprecedented disruption (Dellart & Kernick, 2019). A host of new technologies, regulatory requirements, and market factors are upending long-held business models and how financial institutions work (Dellart & Kernick, 2019). Following on the heels of the 2009 financial crisis, we find an industry in flux.

Introduction to the Industry

According to the United States Bureau of Labor Statistics, the Finance and Insurance sector comprises establishments primarily engaged in financial transactions (transactions involving the creation, liquidation, or change in ownership of financial assets) and/or in facilitating financial transactions, employing over 6.3 million people across nearly 500,000 establishments (U.S. Bureau of Labor Statistics, 2019). Lead by the SEC, for securities related matters, and the Federal Reserve System, for banking matters, a plethora of government agencies oversee the industry from a regulatory perspective on both a national and state basis.

The industry is expected to have generated $4,507 Billion in revenues in 2018, growing 2.5% from 2017 and representing 24% of

the total US Gross Domestic Product (Statista, 2019). The industry has many large contributors, including Blackrock and Charles Schwab in the securities subsector, J.P. Morgan Chase and Bank of America in the banking subsector and Prudential and Berkshire Hathaway in the insurance subsector. Although dominated by some large players, each market participant must deal with the forecasted market disruption.

The Current Leadership Structure and Environment

In its current state, the industry is built around a motivational system that is highly dependent on rewards and punishments, both primarily financial, for motivation. The financial services industry is characterized by notable professional status differences within work groups that influence organizational dynamics and employee behavior (Ho, 2009; Nembhard & Edmondson, 2006). The Leader-Member Exchange (LMX) model is prevalent throughout most financial institutions. The LMX theory is a theory of leadership that focuses on dyadic or “two-way” [sic] working relationships that develop between supervisors and subordinates (Graen & Uhl-Bien, 1995). Current leaders surround themselves with an inner circle, each of whom are kept in line with a series of exchange agreements to manage the balance of power, keeping the leader in charge. The inherent hierarchy has become an imperative to maintain, built on the leader having a combination of expertise and coerced deference.

Leaders who have achieved stellar reputations, like Jamie Dimon of J.P. Morgan Chase, exhibit the traits of transactional leadership with a reputation for being ruthless. A New York Times profile stated that Dimon is a famously bad listener. He interrupts and

finishes people's sentences. At a recent off-site meeting, he was so domineering that one of his partners complained, "Jamie, you're not allowing any give and take." (Lowenstein, 2010) This style of leadership served the industry well after the financial crisis of 2008, but may not equip the industry properly for the future, especially when adaptive change will be required.

Technology Developments Drive a Need for Adaptive Change

Heifetz (1994) notes that technical approaches are most appropriate when there is a clear problem definition and a routine solution available for authorities to implement, but may not call into question deeper-held beliefs about practices and attitudes that may be maintaining lower achievement. Heifetz (1994) relates that adaptive leadership is required when both the problem definition and solution involve learning, not the mere application of a "quick fix." .Much has been and is being made of the impact of Blockchain in many industries. In a recent study done by the IBM Institute for Business Value (2018), over fifty percent of the 1,600 C-suite executives they surveyed expected blockchain to reshape their business model. But few industries will be more disrupted than that of financial services. Smart contracts, distributed ledgers, real-time settlements, tokenization and fractionalization of securities, and the *democratization* of the industry are all terms being used to warn of the impending seismic shift that will require adaptive change. The bigger issue is that of leadership, and specifically the type of leadership, required to steer an industry through what will likely be a transformational era.

Perhaps the largest technology driven adaptive change element is the Blockchain. The first real use of blockchain technology in financial services was that of

cryptocurrency. Although the thought process behind the technology is transformative and the attention to the technology in the media is highlighting its transformative nature, the actual application is rife with problems.

The current financial services infrastructure was developed over time, based on both the needs of the process and the available technology. In the rush to keep pace with technological changes it is important not to lose the important elements of the process itself. As we go forward the challenge will be to identify those element s of the process that are still necessary, and those which are anachronistic**.**

> If cryptocurrencies became the global norm for transactions, long standing systems for trade would need to be completely reformed to deal with this type of competition. For this reason, cryptocurrencies could possibly be the single most disruptive technology to global financial and economic systems. (DeVries, 2016, p. 1)

Additionally, the ability to have a store of wealth outside of the control of regulatory and legal authorities brings with it a many other problems – inability to tax, and control the money supply, being the primary governmental objections and the likely reasons why the cryptocurrencies may never be fully adopted as true currencies on the world stage unless and until these issues can be resolved. Add to that, the anonymity that a cryptocurrency gives, not only as a repository, but as a manner with which to transfer wealth makes these vehicles attractive to exactly the wrong type of individual. Money laundering, financing of unsavory activities such as terrorism and tax evasion are all easy to accomplish in this ecosystem. The radical changes that will occur here are not likely

going to be in the traditional finance space, acceptance of cryptocurrencies into the existing industry, but rather within these currencies, adopting controls that allow them to join the accepted means of commerce (Zetzsche, Buckley, Barberis, & Arner, 2018).

The next application of the Blockchain occurred in the creation of digital securities in the form of coins. They came in two forms, utility tokens and security tokens. As their names imply, utility tokens allow you the ability to do something with it, such as utilize a particular platform you would otherwise have to pay to use(Jackson, 2018). Security tokens represented something akin to a share of stock denominated in one of several cryptocurrencies (Jackson, 2018). Several problems arise from this situation. The first among them is, exactly what are these tokens? Are they securities that need to comply with rules? Are they something new entirely? If they are securities, whose jurisdiction do they fall within? The decentralized, anonymous nature of the tokens does not lend itself to any sort of regulatory compliance and again provided opportunity for fraud and other unsavory activities. Although the Securities Exchange Commission has recently issued some guidance that both types of tokens are considered securities, there will be no easy way for these companies to ever comply (Vigna & Michaels, 2019). Simply knowing who the investor is may be forever beyond their ability due to the nature and method of the token's release. To date, these issuances have been in the form of an ICO, an initial coin offering, that protected the anonymity of the end investor.

It is evident from these two early adoptions of this technology, that these pioneers did not recognize the inherent conflict between the technology and the industry it looks to capture. These technologies are designed to decentralize, distribute and allow any

individual, anywhere to participate. The entire financial services industry has been built around a model that centralizes and controls for efficiency and economies of scale. These opposite ends of the spectrum starting points require thoughtful and deliberate leadership to have success in the deployment of these new tools.

Although there are likely some hugely advantageous situations to be gained from blockchain. The benefits are both tangible and numerous, leading to a desire to find ways to adopt this technology into the industry. These new tools have the ability to transform the industry in many positive ways. Their eventual adoption is inevitable, the path to adoption is, however, not an easy one requiring robust learning within the industry. The benefits will likely be captured only after the technology works with the industry and not against it. The primary bridge to successful adoption will likely require the right type of leaders. The question then becomes, what type of leaders will yield the highest likelihood for success in this era of adaptive change. Critical to the industry, the financial services providers need to ensure the deployment of these new technologies is done correctly, requiring the right type of leader.

> When a single technology touches almost every core part of your business model, you need to pay attention, as it will be a challenging encounter. Banks will be required to apply rigorous thinking to flush out their plans and positions vis-à-vis each one of these major blockchain parameters. They cannot ignore what happens when their core is potentially threatened. (Mougayar & Buterin, 2016)

The basic operational path will likely not likely change – money will be transferred via the financial intermediation process from those participants with a surplus to those participants with a deficit and need. Exactly how this is done will likely undergo a radical transformation. Over the last 50 years, the industry has deployed technologies in a way that simply automated the manual processes that existed before, technical change. Now with the advent of Blockchain, they will need to design new processes that cope with the new technology – while maintaining the key underling needs that have not changed, and that the original process was developed to support.

> Liken it to the replacement of the interstate highway system, where the new roads are all straight lines that can go to multiple places at the same time. Banking procedures are built around the concept of sequential steps. Combined with the elimination of the need for human intervention, parallel processing, simultaneous processing and the elimination of any geographic concerns will dramatically change the world of financial services, creating both the risk of decline for those unprepared and the potential for entrepreneurial success for those who are ready. (Power, 2019)

The Call for a New Style of Leadership

In an era of transformation, where a new paradigm of operations is likely to occur, a new style of leadership will need to emerge to face the challenges primarily through organizational learning.

> The organizational learning is a conscious, purposeful, interactive, dynamic, continuous, and ongoing process which leads to the continuous, fast and effective feedback at the individual, group, and organizational level and acts under the influence of perceptual processes and the applied cultural resources by the individuals and has the aim at making the individual and organization successful (Bass & Stogdill, 1990).

It would logically follow that this new leadership would need to have a transformational style to be successful. They will be faced with the knowledge that they are not the expert, but they must properly guide those experts. They need to ask the right questions and rely on their team to collaboratively answer them. They will need to build consensus in their team to drive innovation. These new leaders will need to be prepared for what will likely be a quantum shift in the core engines of the business. These new leaders will need to be organizational champions and transformational leaders.

These two ideas are inextricably connected. Howell and Higgins (1990) describe organizational champions as entrepreneurs who use informal organizational mechanisms to garner support for innovations. While doing so, they relate the concept of transformational leadership to the literature on organizational champions, suggesting that organizational champions (i.e., entrepreneurs) support and advance innovations at the price of confronting obstacles presented by organizational officials (Shane, 1994). The images that derive from this thinking are that of coach, cheerleader, mentor and colleague, a far cry from the current situation. The industry stands on the cusp of massive change. The players will need to begin finding the people who can effectively lead them

through this impending paradigm shift, or it will find themselves displaced by a new group of entrepreneurs that can answer the call.

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