

CULTURE CRASH

A LEHMAN
BROTHERS
INSIDER REVEALS
WHY THE FIRM'S
BEST TRAITS
TURNED OUT TO
BE ITS WORST.

By Hope Greenfield

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Lehman Brothers veterans, I spent the weekend before the firm declared bankruptcy glued to Bloomberg News, expecting a miracle. Lehman had bounced back from many near-death experiences in the past. Not this time. Having only recently retired but still serving as a consultant, I went in on Monday along with thousands of others after the company declared Chapter 11 to pack my boxes and grieve with my friends. Late in the day, I walked by the office of CEO Dick Fuld, who had led the company for fourteen years. He was sitting at his desk, ashen, the phones quiet. I told him how sorry I was and what an enormously positive impact he had made on people's lives. He thanked me and, just as I was departing, said, "I just wish the ending had been different."

Could it have been different? If the question is whether some immediate bit of financial wizardry, short of a government bailout, could have saved the day, the answer is "probably not." But if the question is whether there is something the company could have done over the longer term to avoid a spectacular demise, the answer is an emphatic "yes."

It all comes down to culture.

For any organization undergoing far-reaching change—and in today's climate, that probably includes your company—the lesson is the same: Clinging to cultural habits that become outmoded as a company grows and as markets change is a recipe for disaster. It can lead to misuse of talent, reward leadership styles that have become dysfunctional, and undermine the company itself.

Lehman became a prime example of this. Certainly, the firm could have

avoided many disastrous business bets. But at a more fundamental level, beyond faulty risk models and stereotypes about greedy Wall Streeters, the Lehman story illustrates the truth of a little-remarked phenomenon of organizational development: The very attributes of a strong corporate culture that underlie a company's success often carry the seeds of its destruction.

Of the many admirable cultural characteristics that had served the business well for generations, four stand out:

- The belief that the firm is a "family"
- Resilience in the face of near disaster
- Pride in being the underdog
- Fierce competitiveness

These traits clearly served the company well for many years, but eventually they went from tonic to toxic without anyone quite realizing what was happening. As Lehman made strategic acquisitions and expanded into new businesses, with net revenues climbing from a little under \$3 billion in 1994 to more than \$19 billion in 2007, the company brought in not only many new people but many new *types* of people. Headcount went from 8,500 to more than 28,000. While the company had changed dramatically, the culture, which was part of its success over the previous twenty or so years, remained fundamentally the same. Lehman proudly tried to fit the new company to the old culture. And ultimately, the old culture helped destroy the firm.

A FAMILY AFFAIR

As befits a company founded by brothers, the sense of family at Lehman was far more than HR boilerplate. In fact, Dick, who had come up through the trading business, used to like to visit the trading floor, where he was well-liked and welcomed. (By 2008, the organization had grown so complex that Dick rarely had time for such visits, and when he did, he no longer knew many of the people who worked on the trading desk. He had become a legend whose face employees recognized via the business press rather than through personal contact.)



In 2001, when I joined the firm, Dick believed that in order for Lehman to grow, managers had to be able to understand its culture and articulate it to successive generations of managers. He felt it would ultimately propel the firm forward if people knew Lehman's past and could become part of its "family." As the chief talent officer, part of my job was to make that happen, often by using oral history in our leadership programs. Joe Gregory, the firm's chief administrative officer, loved being directly involved. He saw part of his job as the "head storyteller," weaving together threads of Lehman's history with his own, bringing the firm to life for newcomers and young managers.

Over the course of the following years, I heard countless stories from employees about finding themselves in some sort of trouble—a sick spouse or child, for example—and the firm rushing to help with everything from encouraging employees to take time off to sending emergency jets to out-of-the-way locations to take people to hospitals. The



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stories came from workers whose loyalty often went beyond the norm and who wanted to infuse their teams with a sense of belonging.

This notion of family also permeated decision-making and heavily influenced the leadership structure. In early 2001, Dick called me into his office one day to talk about the history of that structure, a subject that was clearly painful to him and not fully resolved. The story he told was of Chris Pettit, whom Dick had made president of Lehman in 1994. He explained that Chris had shut him out of too many decisions—in effect, pushing Dick upstairs and too often putting the firm in a precarious position. Two years later, Dick asked Chris to leave the firm.

The story was meant to explain why Dick now spread responsibility around relatively equally without a single person running interference for him. He had established an executive committee and an operating committee. Consisting of only a few people, the executive committee made all the decisions, much in the time-honored manner of a “family” firm. Over time, the operating committee, a group of the most senior corporate staff and division heads, withered away, belying the notion of an extended family of leadership.

While wanting to keep the family intact, Dick understood that he still needed to take action to groom a successor. So in 2002, Dick appointed co-COOs of the firm: Joe Gregory (promoted from chief administrative officer) and Bradley Jack, head of the investment-banking division. Dick, holding tradition as the head of the family, was still leery of giving too much power to one person. (Regardless, after struggling in a role many saw as too senior for him, Brad left the firm in 2005, a year after Joe was named president.)

Dick’s decision to spread responsibility around relatively equally by establishing the executive committee consisting of only a few people was contrary to standard Wall Street practice, as the committee’s members were all paid the same amount

and made all the decisions. They were, essentially, the heads of the family.

However, between those collegial days in the ‘90s and the end of 2008, the family increasingly began showing signs of dysfunction. When the company comprised only eight thousand people, it made sense for the handful of leaders on the executive committee, steeped in the firm’s traditional businesses, to make most decisions of any consequence. But as the organization grew rapidly, Dick eventually expanded the executive committee to give division heads more of a voice and balance out the power of the top few who had historically made the majority of the decisions. While this new structure was clearly necessary, Dick, a classic introvert, was never thrilled about the growing number of people at the table. Furthermore, decisions about who got on the executive committee and who got off (a rare occurrence) were excruciatingly slow. As with most companies, these decisions were based not just on position but on personalities.

Although Dick knew he needed to expand the range of voices at the table, the result was cacophony and competition. Lehman’s traditional culture produced executives unaccustomed to widely distributed power. Although there was talk of giving the next level of senior executives a greater role in important decision-making, that didn’t happen. The heads of the family weren’t secure enough in their own positions to let even more members in on decision-making.

With the executive committee making all major decisions with little say from other entities within the firm, Lehman lost the opportunity to groom the next tier of talent and to shore up decisions with the broadest possible range of input. In the end, new structures were undermined by old cultural habits.

LEHMAN’S NINE LIVES

At another company, this dysfunctional clash of family culture with leadership structure might have raised more red flags. But Lehman had a long history of edging right up to the brink of disaster

and then pulling off a miracle. In 1973, during difficult economic times, the firm brought in Pete Peterson as CEO. A little over a decade later, the company's troubles forced it into the arms of Shearson (an American Express-backed electronic-transaction company), which bought it for only \$360 million. In 1994, Lehman was spun off and was widely expected to be acquired again, but that's when Dick assumed control to keep the company independent, leading it to phenomenal growth. During his tenure, the firm survived the Long-Term Capital Management debacle and the Russian ruble crisis of 1998. And as the only investment bank to lose virtually all of its offices in New York in the attacks of Sept. 11, 2001, the ability to keep its doors open by creating a new trading floor in New Jersey just a few days later was an incredible feat of sheer determination by thousands of employees.

Little wonder, then, that during the fateful weekend in 2008, many of us expected the company to survive—at Lehman, miraculous rescues had become routine.

Needless to say, this belief in the firm's charmed existence lulled many into an insufficient appreciation of risk. Dick's low tolerance for risk had been exactly the right formula for the market conditions in the late 1990s. But by 2001, the firm was growing and had begun to attract a different caliber of senior hires, especially in the investment-banking division. These bankers were savvy businesspeople with an "eat what you kill" mentality, voracious in their quest for big deals. At the same time, the board wanted Dick to take more risk and grasp explosive market opportunities that seemed just over the horizon.

The firm pushed hard to expand. The major move into risky brokerage came when the subprime market took off and Lehman bought Colorado-based Aurora and BNC Mortgage. Lehman also acquired and consolidated several smaller firms into a mortgage-capital division, which by 2005 provided a substantial stream of revenue. Although this division



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didn't tie directly to the rest of the firm's strategy, the opportunity to grow the business was clear.

With the firm's fast internal growth, it was hard to find enough good managers to fill key positions. Many of the top managers came out of the fixed-income business, the biggest and most stable of the divisions. As the organization expanded, the best of those managers were moved on to build or mend other divisions, leaving a solid but decidedly less capable management team behind.

By the time the mortgage meltdown began in 2007, Lehman management knew trouble was brewing across the business. They had choices to make about how quickly to turn off some of the spigots of investment and how quickly to ramp up the firm's liquidity. Unfortunately, the company still flirted with risk. For example, Lehman's early-2008 decision to invest in apartment-developer group Archstone, one of the firm's largest real-estate deals—just before the real-estate market dropped precipitously—made the years of great investments in real estate look almost like dumb luck. In short, the assumption that the company was immortal dovetailed with a trading culture whose immediate transaction-oriented approach diverted attention from a long-term strategy.

PROUD UNDERDOGS

Joe Gregory always liked to joke wryly that he was not exactly Harvard material but was proud of the fact that, like many other senior managers, he was the first in his family to even get a university degree. Indeed, Lehman people generally had far less prestigious pedigrees than executives at the firm's competitors, most notably Goldman and Morgan. Few on the executive committee held degrees from Ivy League schools. In fact, there had long been magic in this underdog mentality. No one cared where you came from, and it was more of a badge of honor to have worked hard to get where you were than to have ridden in on a fancy degree.

Although Lehman eventually started competing hard for the best graduates

from Harvard, Yale, and other top schools, the belief remained that success resulted from hard work and getting the fundamentals right, not from having certain credentials. Adjusting to such an underdog culture was difficult for some Ivy graduates, as well as for many senior managers hired from outside who had demonstrated great success in previous jobs. A clash of culture with a new breed of more aggressive hires versus the old Lehman style of dedicated hard work and loyalty was beginning to have an impact.

Over time, the growing firm's inability to reconcile its hardworking underdog tradition with its enormous talent needs left the company without much bench strength. Too often, roles would remain unfulfilled as managers heroically took on two to three times a normal workload when the need arose, feeding the notion that working harder was what made the firm so successful. Each time the company expanded into a new business or created a new senior position, the same dozen or so names would surface for those jobs. So when the mortgage crisis worsened, there was too little time to find talent within the firm to prevent the organization's fall. However, Lehman had been reinventing itself out of necessity every few years, and senior managers had honed a set of skills for snatching victory from the jaws of defeat. The company had always pulled through in the past, so why should this time be any different?

In the end, the firm's long-held, and in many ways admirable, view of what constituted real talent helped strangle Lehman rather than save it.

AN UNDERDOG-EAT-UNDERDOG WORLD

The pride that Lehman people had always taken in their underdog status had also made them extremely competitive. As the firm grew and aggressively entered new businesses, many believed that Lehman would overtake Goldman and become the premier brand on Wall Street. But with Dick heading for retirement and Joe unlikely to succeed him, the other members of the executive

committee began to jockey for the position. They also sometimes took smug satisfaction in seeing peers falter, and they regarded any newcomer as a potential rival. Not coincidentally, executive-committee members were no longer all paid the same—a “merit system” had eventually been adopted.

Additionally, a lot was expected of senior managers who got promoted to the executive committee, and many of them didn't understand how to step up into a true senior-leadership role. As a result, the company moved people rapidly in and out of critical positions. For example, the fixed-income division, which had been the bedrock of the firm in terms of profit and talent, had three changes of leadership in less than two years. And when the controller who had been promoted to CFO failed to step up fully to the bigger role, he too was replaced. What had once appeared to be a stable group of senior executives started to change so rapidly that instead of focusing on needed work to save the firm, executives were more worried about their own jobs and about who might rise to the seat of power over them.

In addition, Dick and Joe, despite extremely different management styles, had a bond so close that they practically finished each other's sentences. Their goal was to try to set up the firm for long-term success, testing different managers in senior roles to see who could rise to the top. As the race for who might be the next CEO of Lehman heated up, the executive committee and even those lower down in the organization stopped behaving like a close-knit family and started acting like a pack of competitors, hoarding information and resources. So instead of an all-hands-on-deck response to the mortgage crises, which had always been the way Lehman managers responded to threats, this time there was finger-pointing and blame.

Their traditional sense of competitiveness became dysfunctional in the vastly changed circumstances of the

sprawling, unfocused new company that Lehman had become. As the markets began to unravel, the intramural competition and consequent changes of leadership in key roles further crippled the firm at a time when it was essential that everyone pull together.

Lehman management believed that the firm's strength resided within its culture and its people. What else could explain its extraordinary ability to emerge as a top-tier bank from so many near-fatal episodes over the previous twenty-five years? The sale to Shearson had been a detestable interlude for the Lehman faithful that brought the family together and enabled them to spin out the firm ten years later with a core group of people who gave their hearts and souls to make it successful. Their notion of family, their resilience, their underdog pride, and their competitiveness became the bedrock of the culture.

But a culture that is too strong can also end up too rigid and can shut out diversity, especially diversity of perspective. It can cause people not to trust others who may be unlike them or who haven't shared their experiences—confusing the unfamiliar with the incorrect. A strong culture attracts people, both clients and employees. It also repels them, and the more passionate and proud you are of the culture, the more likely in the end you are to blind yourself to other potentially valuable points of view.

For Lehman, the mistake lay in putting too much faith in an outmoded culture and failing to see how its very strength undermined the business. For companies that confidently set out to change their cultures, the Lehman experience offers a lesson about the nature of corporate culture itself: It can be much stronger, more deeply embedded, and far less malleable than glib promoters of “transformation” might suggest. Nonetheless, whether viewed as a strength to cultivate or as a weakness to fix, culture can ultimately exact a steep price. ■