Could “Small Is Beautiful” Replace “Too Big to Fail?”

Don Shaffer
RSF Social Finance

I encourage you to read “The Quiet Coup,” by Simon Johnson in the May 2009 issue of The Atlantic. Johnson is a former chief economist of the International Monetary Fund. Specifically, focus on the final section of the article, “The Way Out.” I was struck by Johnson’s discussion of the inherent problems of large-scale banks. He employs a simple logic:

Oversize institutions disproportionately influence public policy; the major banks we have today draw much of their power from being too big to fail. Nationalization and re-privatization would not change that; while the replacement of the bank executives who got us into this crisis would be just and sensible, ultimately, the swapping-out of one set of powerful managers for another would change only the names of the oligarchs.

He goes on to argue that banks should be sold in “medium-size pieces, divided regionally or by type of business.” If impractical, they could be sold whole with the mandate that they be broken up shortly. This, he argues, is the best way to limit power in an essential sector of the economy. “Of course,” he adds, “some people will complain about the ‘efficiency costs’ of a more fragmented banking system, and these costs are real. But so are the costs when a bank that is too big to fail explodes. Anything that is too big to fail is too big to exist.”

I also encourage you to read the interview with President Obama in the May 3, 2009, New York Times Sunday Magazine. The President has some encouraging things to say, but I can’t help but feel disappointed in the overall tone and substance of his responses. He says, in essence, “We’ll be fine with a bit more regulation.” He seems convinced that we should just duct-tape our financial/monetary system back together, and reacquaint ourselves with a strong and powerful Wall Street (oligarchy?) as a foregone conclusion. President Obama’s choices for key leadership positions in the administration reflect these views, in particular his choice of Mary Schapiro as chair of the Securities and Exchange Commission (SEC). Schapiro has functioned as a steadfast proponent of Wall Street, and most recently as the head of Financial Industry Regulatory Authority (FINRA), the industry trade association. Obama’s other choices also have many direct ties to the big commercial and investment banks.

I urge you to draw your own conclusions. Certainly no one has a crystal ball, and no one can claim to know the best path to pursue at this point. The biggest issue for me, however,

2 http://www.nytimes.com/2009/05/03/magazine/03Obama-t.html.
is scale, and its relationship to power. Mostly from my study of American history, I’m a fan of small, entrepreneurial, decentralized marketplaces; networks of investors and companies connected through relatively little financial intermediation.

I do not think a $2 trillion bank (such as JPMorgan Chase) is much good at innovation anyway. And let’s face it, services such as online bill pay are weak reasons not to switch to a community bank or credit union if you really think it through. With a giant transnational bank, you have no idea which loans your money is being used for, or where your funds reside at any given time. Plus, how can you trust “collateralized debt obligations” or other “structured” financial vehicles that are designed only to help the bank become a larger and larger pile of money?

In addition to the big banks, let’s consider the mutual fund industry. There is absolutely no reason why the world needs more than 8,000 different funds, most charging fees well in excess of the value they create. Regarding brokers, Merrill Lynch and others have been exposed as hopelessly riddled with conflict-of-interest and incentive-compensation problems.

But Wall Street will live on. Large-scale capital markets will exist, for good reason, for companies and industries that require centralized R&D, manufacturing, and distribution. Think airplane engines, pharmaceuticals, semiconductors. Hopefully investors will reward only the most transparent and honest of the remaining players.

As important, I think we will also see the growth of diversified, capital markets, not dependent at all on Wall Street, and designed to support small- and medium-sized, triple-bottom-line companies in sectors such as food, energy, clothing, building materials, and a whole range of household products. With this approach, people will save more, spend a higher percentage of their overall income on basic needs, keep their investment strategies simple, and their money closer to home.

Getting back to the issue of scale and power, these regional capital markets will ensure a healthy democracy in the United States. Every business student of the post-World War II era has learned about efficient flows of capital. A fragmented market will invariably consolidate, we have been taught.

But I do not think this is true anymore. The twenty-first century will have many fragmented markets because investors and consumers will demand authenticity and real innovation from the companies they support. A growing number of people are connecting the dots as a result of the current financial crisis.

If today’s capital markets can be described as complex, opaque, and anonymous—based on short-term outcomes—then we are beginning to see more financial transactions that are direct, transparent, and personal—based on long-term relationships.

In the years to come, there will be significant growth of:

• Small-scale community banks;

• Holding companies for privately held, triple-bottom-line businesses; and

• New funds that redefine venture capital and the notion of an “exit strategy.”
Who will be the most powerful change agents in this emerging financial system? The following are three individuals that have personally inspired me:

Judy Wicks first coined the term “living return,” as opposed to “maximum return.” Owner and founder of Philadelphia’s 25-year-old White Dog Café and cofounder of the Business Alliance for Local Living Economies (BALLE), Wicks is a role model and national leader in the local, living economies movement. She is also president of White Dog Community Enterprises, a nonprofit 501(c)(3) dedicated to building a local food system and living economy in the greater Philadelphia region.¹

Leslie Christian has reimagined the purpose of a corporation as the chair of Upstream 21, an innovative holding company model designed to build natural, social, and economic capital within communities. In the corporate charter, Christian and her colleagues defined the best interests of Upstream 21 to include consideration of employees, the environment, long-term and short-term interests of shareholders, customers, and suppliers, and the communities in which the company and its subsidiaries operate.²

Penelope Douglas is a pioneer in channeling funds to small businesses in low-income communities. Cofounder and president of Pacific Community Ventures, Douglas launched PCV’s community development investment assistance model. She also founded the first community venture fund on the West Coast and was founding chair of Juma Ventures, a nonprofit organization that develops and operates businesses designed to provide job opportunities to economically disadvantaged teens.³

We can only hope that more women reach the leadership ranks of financial institutions. It may be our best plan for the future. The fact is women have a more advanced intuitive understanding of the challenges we face as a species, including ecological stewardship, food and energy security, the widening gap between rich and poor, education reform, and community health, among others.

Thankfully, more women are demanding that these values be reflected in their investments. They have been served poorly by brokers and bankers over the years, as these statistics show:

- 59 percent of women feel misunderstood by food companies;
- 66 percent of women feel misunderstood by health care companies;
- 74 percent of women feel misunderstood by automotive companies;
- 84 percent of women feel misunderstood by financial services companies;

By 2010, women are estimated to account for one-half of the private wealth in America, approximately $14 trillion. This number is projected to climb to $22 trillion by 2020. Women

¹ http://www.smallisbeautiful.org/publications/wicks_06.html.
control 48 percent of estates worth more than $5 million.  

My friend Sallie recently moved from California to a small town in upstate New York. Soon after arriving, a broker from Merrill Lynch contacted her, wondering if she had considered shifting her investment portfolio given current market conditions “Yes,” she said. “In fact, I was thinking about making a small direct loan to the local family farm that runs our community supported agriculture (CSA), over and above what I pay them annually for the vegetables. I think it’s a good long-term investment in my community. And it will provide an even stronger relationship with a key source of our food. How would I do it? Any ideas?” The broker discouraged it, then gave her a sermon on diversification in public equities and bonds.

Should Sallie pay close attention to the risks associated with this potential investment? Of course. But what would it look like if she and others invested a set percentage of their assets in local, triple-bottom-line businesses, effectively creating a new asset class? Why should this be a crazy idea?

Don Shaffer is president and CEO of RSF Social Finance. Inspired by the work of Rudolf Steiner, RSF has made more than $200 million in loans and more than $90 million in grants since 1984 to organizations in the areas of food and agriculture, education and the arts, and ecological stewardship. Prior to joining RSF, Don served as executive director of the Business Alliance for Local Living Economies (BALL), as well as interim executive director of Investors’ Circle. He remains a trustee of BALL, in addition to being on the boards of Social Venture Network and Comet Skateboards.

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4 Data from 2007 survey, Buying Influence, Inc.