A Tale Of Leverage and Hubris

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A tale of leverage and hubris

As the financial crisis of 2008 fades into history, most people have remained confused about the causes of this economic tsunami. Since the nature of the train wreck goes a long way towards explaining the present stagnation of the U.S. economy, this is unfortunate.

A large part of the confusion lies in the partisan wrangling about the roots of the crisis. Bethany McClean and Joe Nocera have written the most balanced and comprehensive account of the evolution of this cataclysm. The starting point is the idea of financial leverage, simple to understand but complex in implementation.

In finance you use leverage by purchasing an asset with borrowed funds. The advantage is more of the asset can be borrowed funds. The try not to lend too much to any one borrower (diversification) and they don’t commit every possible dollar to lending. Capital reserves represent. However, the reserves do not earn anything, so there is a continuing pressure to use capital reserves.

One of the lessons of the Great Depression was that lenders tempted by profits do not keep adequate capital. So, since the 1930s lenders have been required by law to maintain certain minimum levels of reserves. This results in continual gaming of the legal capital requirements.

Beyond this, practices were embraced in the name of diversification that had no relation to actually reducing the risks of lending. In particular, the process of creating new securities by bundling poor credit risks from several distinct sources resulted in increased risks since these securities were even more likely to default.

In effect, all of the traditional protections against bad lending were forfeited in the rush to exploit the phony diversification of securitization. McClean and Nocera lay this all out in painstaking detail. They also do so without the partisan axe grinding that characterizes so much that has been written on this subject.

It’s highly recommended reading. Dr. John H. Brown is an associate professor in the School of Economic Development at Georgia Southern University. Dr. Brown can be reached at jbrown@georgiasouthern.edu.


Parker honored as ‘innovator’

Parker’s convenience stores’ tech-savvy approach to its business has led a food service industry trade publication to name the company’s president and CEO, Greg Parker, as convenience store “Innovator of the Year” for the southeast region.

The Griffin Report of Food Marketing picked the Savannah businessman because of his “unique take on operating practices such as product selection, inventory and management,” according to spokesman Mike Berger.

A feature on Parker will appear in a future issue of the publication. Another trade publication, Convenience Store Petroleum, or CSP for short, profiled Parker recently, dubbing him the “Profit Prophet.” The piece examines how his 21-area convenience stores consistently rank among the nation’s most profitable according to National Association of Convenience Stores data.

“We’re doing a lot of new stuff, and I’m honored by the recognition,” Parker said. “We really are innovative. We’re doing things that nobody else is doing.”

Adam Van Brimmer