Wall Street to Chapel Drive

How the economic crisis may affect current college student's financial future
by Luke Medhus

The prognosis for the world economy seems to be looking gloomier by the day. Despite the votes of confidence of Warren Buffet and other such big name investors, the forward-looking stock market is pessimistic as ever – the Dow Jones Industrial Average is approaching the 8,000 mark just months after hitting 14,000, in spite of the efforts of the United States government to staunch the flow. Looking forward, the economic prognosis is none too positive for students our age, even those looking toward areas of work other than Wall Street.

According to Arthur B. Laffer, author of the coming book “The End of Prosperity” and the economist who popularized the so-called Laffer curve, financial crises rarely have a large impact on the real economy – output, employment, production, etc. In general, asset values will fall sharply, rightly wiping out those who extended themselves too far, borrowing or lending more than they should have. Due to the government's intervention, however, this free market process will be distorted going forward. The government does not create, but simply redistributes, and does so without great efficiency – for every $100 billion of the $700 billion Troubled Asset Relief Program, writes Laffer, $130 billion in taxes are required for funding. The $30 billion extra is, of course, the cost of the government's intervention.

While in 2001 the net national debt was 35% of GDP, the current figure stands at 50% – one which does not even include any consideration of the $5.2 trillion guarantee of Fannie Mae and Freddie Mac, the $700 billion allocated to the Troubled Assets Relief Program, nor asset swaps undertaken by the Fed in bailing out Bear Stearns, AIG, and others, according to Mr. Laffer.

Furthermore, Congress plans another $300 billion “stimulus” during the next session of Congress. All this amounts to is a redistribution of wealth from the taxpayers, those who work, to those who recently failed – a process that, as the Laffer Curve proposed, will not encourage economic growth (and hence a boost in tax revenue) in the long term. It does seem, then that the panicked, hurried actions on the part of Congress may lead a bear market for many years to come.

Aside from the obvious concerns surrounding such an economic environment, students at colleges across the country have serious concerns about the ability of their schools' financial aid departments to make good on promises of meeting all demonstrated need. Phil Day, president of the National Association of Student Financial Aid Administrators, claims that “it’s putting more demands on the system when the system can least afford the new demands economically. It’s going to be tight.” Across the country, the average student now graduates with $21,000 in debt, and estimates predict that 400,000 students last year decided to forgo higher education simply due to the cost; that figure in the current market will certainly become more substantial in the coming years. In addition, according to Bob Brandon of the Campaign for College Affordability, 47 percent of students have more debt than they would be able to repay if they wanted to go into social work, teaching, or another form of public service – an issue which weighs heavily on the mind of Duke students, many of whom choose careers in investment banking and related fields largely to quickly recoup their substantial financial investment in a Duke education.

Lucky for Duke students, though, the financial aid office has recently reaffirmed its ability to meet such promises. In a recent letter to the Duke community, President Richard Brodhead wrote, “Duke’s longstanding commitment to need-blind admissions, and to meeting the full demonstrated financial need of all students admitted and enrolled, remains unchanged. Indeed, it is in times of financial stress that this promise is most important. The imminent completion of the $300 million Financial Aid Initiative is tangible proof of our dedication to this promise.” While Duke students are thus in a more fortunate position than many others in the wake of the crisis, those currently on financial aid with student loans will certainly feel a greater
The Intersection of Business and Philanthropy
by Dong-Jae Chung

Charitable giving in the United States has always been popular as 70% of households made contributions to charities in 2007. Furthermore, the sheer size of charitable giving commands attention, which in 2007, made up 2.2% of the Gross Domestic Product, at $306 billion. Furthermore, philanthropic foundations that provide grants to organizations have almost tripled in number from 23,770 to 64,843 between 1982 and 2002, and the non-profit sector employs 10.2 million people, accounting for about 7% of the total workforce. With the growth in the sheer size of charitable giving, a new perspective on how to administer philanthropy has developed, especially in the operations of philanthropic organizations. Alan Marty, Managing Partner of Legacy Venture, a philanthropic fund of funds notes that business principles such as the emphasis on results, strategic planning, people management and financial management are just as prevalent in the operations of foundations and not-for-profits as for-profit businesses. Especially with the amount of money involved, philanthropies have felt more and more pressure to achieve their goals and prove to be efficient.

Many foundations and not-for-profits have been criticized for being inefficient, meaning they have not maximized impact with the funds they have raised. With this complaint in mind, the Bill and Melinda Gates Foundation, which has pledged to give away $100 billion in their lifetime, has focused on delivering measurable results. Much like a business, the Gates Foundation emphasizes the use of strategy to achieve concrete goals such as ending extreme poverty by 2015, a Millennium Development Goal set by the United Nations that the Gates Foundation supports through many different global health, agricultural and education initiatives. The Gates Foundation delineates four different steps in their grant making process: Develop Strategy, Make Grants, Measure Progress, Adjust Strategy. In essence, the foundation develops a business plan, executes its projects, procures feedback and responds accordingly. The Gates Foundation’s emphasis on effectiveness and approaching its grant giving systematically is shared within the philanthropic community as “The Economist [has] added an annual special section on global philanthropy, including ‘Benchmarking the Billionaires,’ a ranking of the most effective givers based on rigorous tests of money spent and what was achieved.” Charitable organizations are not only concerned about promoting social good, but also about efficiency in doing so as evidenced by using principles from the business world to drive their operations.

Ways in which business principles have intertwined with philanthropy are shown by the development of social entrepreneurship and venture philanthropy. Michael Edwards defines social entrepreneurs as those who use innovative methods that reach across different sectors and disciplines to accrue profit for personal gain, but for a social cause. For instance, Paul Newman’s Newman’s Own brand gives away its profits from its line of food products to educational and charitable causes. In venture philanthropy, venture capital fundamentals are applied to charitable organizations. Emphasis on donor involvement such as board memberships are encouraged. Taking the organization to scale is stressed by placing importance on measured results that meet specific goals. In addition, dynamic efforts are made to generate enough revenue so that philanthropic organizations are financially sustainable. As a result, venture philanthropists like the Omidyar Network, started by the founder of eBay, invest in a wide range of vehicles that include for-profits, new technology and even their own subsidiaries to achieve sustained financial viability to fund social projects. Further evidence of business principles applied to the philanthropic world is in the prominence of major strategy consulting firms that engage in pro bono work for non-profits. Consulting firms such as McKinsey, Boston Consulting Group, Bain and L.E.K. all have programs that reach out to solve challenges foundations and non-profits face by applying solutions from the business sector. Bain even has branched out to create the Bridgespan Group, which is completely devoted to servicing foundations and non-profits. Not only has business trickled into philanthropy, but the converse is true as well. For major Fortune 500 companies, it is rare to see any enterprise that does not promote and broadcast their work in the community and commitment to social responsibility.

The application of business principles to philanthropy has not been without criticism. Bruce Sievers, in his article, If Pigs Had Wings: The Appeals and Limits of Venture Philanthropy, argues that the concept of bottom line results cannot be applied in the non-profit world. How can one measure the results of an organization that strives to promote cultural understanding? Even further, how can one compare the effectiveness of that organization with another that seeks to provide shelter for the homeless? Another criticism is that if donors take on the perspective of investors, the potential for undue influence of major business people who run non-profits.

Know Your Hand
Wisdom for Today’s Students from Lewis’s Liar’s Poker
by Luke Medhus

On September 29th, Connel Fullenkamp reflected in The Chronicle that students discouraged by the current financial crisis and ongoing economic downturn must “figure out whether [they] really like working to create and deliver financial services, or [they] were just in love with the idea of working for an I-bank.” This same message is the overarching motif of Michael Lewis’s Liar’s Poker—which truly is “devastatingly funny,” but, for the undergraduate at a top university, is undoubtedly described even more fittingly as “wonderfully insightful.” In describing the rise of Salomon Brothers during the newly deregulated bond market of the 1980s—one which he describes as “the center of a modern gold rush”—Lewis reflects upon the gravitation toward investment banking and the accompanying prevailing herd mentality on elite college campuses, an issue which is as relevant today as ever before.

In the 1980s, when Lewis was entering the job market, students like him who partook in the investment banking recruiting process—some of the best and brightest of our top universities—often lacked adequate self-awareness, almost blindly following the crowd to Wall Street. “There was, I think, a sense of safety in the numbers,” he writes. “The larger the number of people involved, the easier it...Continued on page 3
With a tight job market likely to be a defining characteristic of the coming years, students with loans outstanding may find it difficult to pay off their debt in a timely fashion.

In the short-term, issues such as tighter consumer credit will directly affect our ability to obtain car loans and other credit lines after graduation. Credit card spending is predicted to fall this year, as credit card issuers roll back credit lines to tighten their belts. But this contraction should be welcomed as a necessary part of a free market economy in the wake of financial institutions’ speculation and overextension that led to the current crisis. What should really worry us as current college students are the imprudent fiscal policies of recent times. As the national deficit passes 50% of our nation’s GDP, it has become increasingly apparent that our government’s policies will weigh heavily on our wallets for the foreseeable future. Duke students should perhaps count themselves among the fortunate few, though; not only will their financial aid needs continue to be met, but they are positioned with a first-rate education, a prestigious degree, and an alumni network that should give them a leg up in the hairiest of bear markets.

The Intersection of Business and Philanthropy

Donors over the organization may lead to a conflict between its original mission and the passions of significant donors.7

While the extent to which business principles should be applied to charitable organizations may be questioned, it is clear that its application has helped spur innovation, expansion and great ambition within the philanthropic world. However, perhaps this is due to a more fundamental trait that delivers success to any organization. As Alan Marty notes, “Most great organizational leadership principles are applicable to both business and philanthropy. I call these leadership principles, not business principles.”

2. Charitynavigator.org
4. National Center for Charitable Statistics
5. Fulton & Blau, 50

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Know Your Hand

was for them to delude themselves that what they were doing must be smart. The first thing you learn on the trading floor is that when large numbers of people are after the same commodity, be it a stock, a bond, or a job, the commodity quickly becomes overvalued.13 The same concept, he argued, applied to studying economics: it was not that his classmates actually enjoyed spending their time “drawing funny little graphs” while studying a subject “which was becoming an ever more abstruse science, producing mathematical tautologies which no obvious use,”14, but that it served as a pre-banking sifting device – an accepted, even glorified default option for the practical but not passionate, for those inclined to look for safety in numbers. In the game of liar’s poker, one must be not only acutely aware of one’s opponents but keenly in tune with one’s own position: “Each player seeks weakness, predictability, and pattern in the others and seeks to avoid it in himself”15. Yet, Lewis argues, when it came to choosing a career path, the best and brightest often neglected to do so, having moved overwhelmingly toward that “weakness” and “predictability” – in a sense, failing to know their own positions before placing their bets on their careers.

This description seems more fitting today than ever, in an age in which nearly half of work-force bound Harvard seniors headed for financial sector companies one year ago.16 In an industry in which the entry-level employees, “investment banking analysts,” work approximately ninety hours per week essentially as “slaves to a team of corporate financiers” (for what amounted to about six dollars an hour, according to Lewis, in 1986 – and has not increased by much, inflation adjusted, since then), it would seem imperative to analyze its merits. But it seems that a significant chunk of college students have failed to heed such advice – to introspect adequately enough to decide what is in their best interest. In many ways it is a seemingly counterintuitive result, considering that many of these students have studied a field founded on individual welfare maximization, but it is just what New York Times columnist discovered when he recently taught a journalism class at Princeton, Lewis’s alma mater. “I was captivated by the bright, curious minds in my class,” He notes, “But when I asked students what they wanted to do, the overwhelming answer was: ‘Oh, I guess I’ll end up in I-banking.’ It was not that they loved investment banking, or thought their purring brains would be best deployed on Wall Street poring over a balance sheet, it was the money and the fact everyone else was doing it.”17 Lewis would undoubtedly cringe upon reading that remark; indeed, it does not seem that much has changed in that regard since his time at Princeton three decades ago.

Nonetheless, Lewis does not intend to suggest that investment banking in itself is an ill-advised career path, discussing the field in a manner that is more cheeky than snide. What he seemingly intends to suggest is that wide-eyed, impressionable college students often have an idealized view of the field, overlooking or misunderstanding the drawbacks of the industry – as well as the fact that one must be passionate about the work to succeed, just as in any other field. “The strength of the firm,” he remarks, “lies in the raw instincts of people like John Meriwether, the Liar’s Poker champion of the world.” While Lewis quit due to a lack of passion and adventure, “People with those instincts, including Meriwether and his boys, are still trading bonds for Salomon.”18 What he suggests is imperative, then, is for prospective bankers to determine whether they possess this instinct and passion – such ability and desire as is necessary to survive in the game.

But, perhaps more importantly, as his mentor “Alexander” argued, some of the best decisions one can make are the ones that are “completely unexpected, the ones that cut against convention” – those in which one dares to be contrarian, to break off from the herd. After all, Salomon Brothers rose to power on Wall Street by taking a product that no one wanted to touch – mortgages and setting up a trading desk that no other bank had at that time;
furthermore, Salomon's demise was largely a product of its attempt to imitate Drexel Burnham, which played the same innovative role in promoting the junk bond market years later. "Michael Milken at Drexel created that market," Lewis explains, "by persuading investors that junk bonds were a smart bet, in much the same fashion that Lewie Ranieri persuaded investors that mortgage bonds were a safe bet." Most notable here is perhaps Lewis's phrasing: "Michael Milken at Drexel" and "Lewie Ranieri", not simply "Drexel" and "Salomon," created those markets. They were the passionate, motivated people behind the brand, those willing to "cut against convention." Those are the kinds of people who achieve success on Wall Street, just as on Main Street or anywhere else.

Lewis's work, then, contains a good deal of wisdom for college juniors like us, bright students in an eerily similar position to Lewis's nearly thirty years ago. He conveys that the best and the brightest, despite their uncommon intellects, are no less susceptible to the herding mentality than others. But like Michael Milken and his discovery of undervalued "fallen angels," we must avoid being "constrained by appearances" and taking just the default, accepted route. As Duke senior Nick Alexander remarked last year in The Chronicle, tongue-in-cheek, "I've learned that the path to success is a very narrow, well-beaten one. Just follow what others before you have done, regardless of any personal strengths or interests, and, when in doubt, choose the route that you think will make you the most miserable. There will always be tomorrow to enjoy the fruits of your labors." A little bit of such wisdom, suggests Lewis, can go a long way.

1. Connell Fullenkamp, "Ibanka up, I'm Not," The Chronicle 29 Sep 2008
3. Lewis, 24.
4. Ibid.
5. Lewis, 17.
10. Lewis, 248.
11. Lewis, 213.
12. Ibid.

ESU's Member Profiles

David Kelly, President of ESU is a senior double majoring in Economics and Public Policy. This past summer David interned at Habitat for Humanity of Durham as well as Wachovia in Charlotte. At Wachovia, David worked in the Capital Management Group as a Portfolio Strategist. He worked in their Retirement Services Division, researching mutual funds for 401k line ups, which included researching investment philosophies and performing quantitative screens looking at total return, risk, and expense ratios.

Lisa Lam is a senior and currently serves as the VP of Finance. Over the summer she worked as a summer analyst in the Financial Institutions Group at Wachovia Securities Investment Banking division. She spent a lot of time researching the industry, creating marketing presentations, and developing financial models for valuation. Lisa believes it was a rewarding experience to be able to learn so much about the industry in a relatively short amount of time.

Dong-Jae Chung is a senior Economics major and is the Vice President of Publications. This past summer he worked at Legacy Venture, a philanthropic fund of funds in downtown Palo Alto, California. At Legacy, DJ created an original, searchable database of all limited partners, which included background information, financial track record, philanthropic interests and specific relationships to Legacy. DJ also pitched recommendations to the managing partner for key note speakers for the consumer mobile venture panel for the Annual Meeting held in September.

Daniel Szoke, VP of Student Affairs, is a junior majoring in Economics and Mathematics. This past summer he chose to do Duke Engage in Guatemala, where he worked with a local NGO on various social entrepreneurship ventures. He joined indigenous women selling essential healthcare products in remote communities and aided them by performing feasibility studies and improving their marketing campaigns. He also contributed to the development of a web-based community of Guatemalan NGO's in an attempt to create synergies between the organizations and to provide improved access to funding opportunities.

Luke Medhus, VP of Technology, is a junior from northern New Jersey, working toward a B.S in Economics, a B.A. in Psychology, and a certificate in Markets & Management Studies. This past summer, he attended Capital One's Summit for Future Leaders where he worked with Capital One associates and other students from top schools to develop an original credit strategy, which they then pitched to Capital One executives. Afterwards, he returned to Duke, where he worked at the Center for Cognitive Neuroscience in the lab of Dr. Roberto Cabeza, conducting memory research and exploring his interest in decision-making and behavioral economics.

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