Essay 1 Economics of Leadership

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Eco/Fin Policy and Leadership ADS 770

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July 21, 2018

Economics and finance are interwoven with leadership, whereas economics and finance affect leadership and leadership affects economics and finance illustrating a correlation or connection. Economics, finance and leadership

Economics is a social science concerned with the production, distribution and consumption of goods and services (Investopedia, n.d.). Economics is the study of how individuals, businesses, governments and countries decide to allocate their resources to meet their wants and needs, through coordination and organization, maximizing their outputs and wealth. There are numerous economic principles when examining economics in of itself; however, all of the principles can lead back to how leadership affects those principles.

In Mankiw’s “Principles of Economics” he defines economics as the study of how society manages its scarce resources. He goes on to say that most societies, resources are allocated not by a single central planner but through the combined actions of millions of households and firms. Therefore, economists study how people and organizations make decisions by how much they work, what they buy, how much they save and how they invest their savings. Lastly, economists study how people and organizations interact with one another with respect to finances (Mankiw, 2012).

Finance is a term describing the study and system of money, investments, and other financial instruments (Investopedia, n.d.). In general finance can be divided into four finance categories: public, corporate, personal and social. All four finance categories have several common aspects, which require good leadership. For example, all finance categories have to regularly asses their current financial standing: liquid cash, assets, revenue, budget, debt, savings, ethics and viability.

Sources of public finance include charges from ports, airport services, fines from breaking the law, revenues from licenses, license plates, and sales of government bonds and securities (Investopedia, n.d.). The federal government is responsible for regulating and controlling the public finance and stabilizing the economy. The majority of the funding towards government controlled public finance programs are done through taxation and by selling government bonds.

There is a myriad of options for a business or a corporation to obtain financing: credit, equity investments, investors, and stock purchase programs. Leaders within the corporation are responsible for increasing the value of the company passing on dividends and wealth to shareholders. In addition, leaders constantly evaluate the company’s financial position and needs, while securing investments and raising capital for those needs.

Personal finance or financial planning involves analyzing an individual’s or a family’s current financial position, predicting short-term and long-term needs (Investopedia, n.d.). A family or individual would consider the appropriateness of their needs via checking and savings accounts, credit cards, consumer loans, 401k programs, and mutual funds.

Social finance are investments made in social enterprises including charitable and not for profit organizations. Moreover, social finance is the managing of money that provides a social dividend and economic return. For example, the mission statement of Social Finance, the company, is “nonprofit organization dedicated to mobilizing capital to drive social progress. We believe that everyone deserves the opportunity to thrive, and that social impact financing can play a catalytic role in creating these opportunities. We design and manage public-private partnerships that tackle complex social challenges, such as achievement gaps, health disparities, and prisoner recidivism. (Social Finance, n.d.)”

A leader is someone with followers. Following is inherently a voluntary activity. Hence, a central question in understanding leadership is how a leader induces others to follow them. Leadership is used synonymously with leader; however, there is a distinct difference. A good leader inspires an individual or a group of people to genuinely and willing work towards a common goal. Leaders provide support and direction, whereas leadership is the art of creating the map towards a common goal or good.

 In Hermalin’s article“Towards an Economic Theory of Leadership: Leading by Example” leading by example can be one way to motivate employees and organizations to do something you want done, because they want to do it. Furthermore, Hermalin shows a direct financial correlation due to good leadership. Hermalin created mathematical equations showing the greater a leader leads by example the greater the output of his or her employees, which yields larger profits. Lastly, Hermalin analyzes different scenarios that incentivize employees to yield more profit. His equations and formulas look at different economic models providing the best return on investment for the organization. Hermalin provides an equation for nearly all conditions within an organization, which provides a mathematical financial solution for all interactions within the organization (Hermalin, 1988).

Akerlof and Dickens discuss the concept of cognitive dissonance, which can be related to leadership, finance and economics. Whereas, cognitive dissonance can provide a type of synergy where people feel positive about a leader who is economically sound. (Akerlof & Kranton, 2000)” This type of synergy is only as good as the leader is proven by their leadership.

Followers follow because it is in their interest to do so. What could make it in their interest to follow? One answer is that they believe the leader has better information about what they should do than they have. Leadership is thus, in part, about transmitting information to followers. But this cannot be all there is to leadership: A leader must also convince followers that he or she is transmitting the correct information; that is, he or she must convince them that they are not mis-leading them (Hermalin, 1988).

In conclusion, there are several types of leadership styles, which can be used with versatility. The different types of leadership styles are: autocratic, democratic, strategic, transformational, team, cross-cultural, facilitative and laisses-faire. All leadership styles can be influenced by outside contributors and factors such as economics and finance. A successful household, organization, society, and government requires a strong leader, one who leads by example, makes good decisions, incentivizes employees with accolades.

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