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RANCE CRAIN, Editor-in-chief | GLORIA SCOBY, VP, publisher
MARK J. MILLER, Editor | DON NELSON, Managing editor

Leo Melamed: One for the history books

Much of the news coverage of Leo Melamed's surprise retirement as chairman of the Chicago Mercantile Exchange's executive committee focused on continuing allegations of widespread fraud on the trading floor. To us, it's a different—oft-repeated—story: that of the family-run operation grown too large to be managed by the visionary entrepreneur who founded it.

There was a Merc before Leo Melamed, but his entrepreneurial instinct put the exchange on the map. Mr. Melamed sensed a wide-open market opportunity in currency futures and acted to fill it. He recalled that instinct in remarks he made to *CRAIN'S CHICAGO BUSINESS* in 1988, on the occasion of our 10th anniversary, before the federal probe of corruption surfaced:

"Back in the late 1960s, a couple of my trader friends and I were interested in going short the British pound. We thought the price of the pound was being held fictitiously far above the value for the crumbling British Empire, and we were right. But we as individuals couldn't go short because there was no futures market for currencies. Only large corporations could protect themselves by going short on currencies through forward contracts with the banks. One of my trader friends even suggested we lie to a bank to convince them we had a legitimate commercial reason. But I said: "What do you mean: I'm alive! That automatically entitles me to a commercial motivation. Don't I have an estate to protect? Why am I less important than General Motors? If they have a right to protect themselves, why don't I as an average citizen?

Those comments capture the essence of Leo Melamed's brilliance, guts and creativity—qualities that catapulted the Mercantile Exchange from a backwater, second-tier player to the front ranks of financial services. Mr. Melamed seized the opportunity created in the early 1970s by deregulation of exchange rates to transform Chicago into the world capital of trading in currency futures. The result: employment at Chicago's exchanges more than doubled. Exchange spending on wages, rent and taxes nearly quadrupled. And the local financial services industry employs more than 330,000 residents—more than 10% of the local workforce. Those figures don't begin to count the unquantified benefits of Chicago's position as a world leader in risk management.

The entrepreneurial brilliance that made the Merc boom also became a problem as the institution grew.

Unfortunately, the entrepreneurial, family-business culture of the Merc became a serious problem as the exchange grew. Self-regulation proved inadequate to curb trading abuses, in part because the exchange's clubby, in-bred board failed to get tough on its own membership. Mr. Melamed must take the blame for that governance structure, which has helped jeopardize the confidence of the investors Mr. Melamed wanted to invite into his market.

For the Merc's next generation of leadership, the challenge is to install an open, public structure of governance and management capable of shoring up investor confidence. That may well require it to relinquish the entrepreneurial culture that helped the Merc grow in the 1970s and 1980s. Failing that, the Merc will face much tougher, more intrusive government regulation. And it will lose marketshare to growing competitors elsewhere in the world.

The cloud hovering over the futures industry makes it difficult to say just how economic historians will size up Leo Melamed. They aren't likely to excuse the sloppy management that permitted abuses and excesses. But that shouldn't obscure the bigger story: a financial visionary and entrepreneur who made an enormous contribution to the free market system, and to Chicago.