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Opinion

Corporate Culture and Individual Responsibility in Banking

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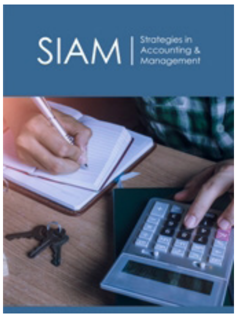

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Submission: January 23, 2019

Published: March 27, 2019

Volume 1 - Issue 2

How to cite this article: David T L. Corporate Culture and Individual Responsibility in Banking. Strategies Account Manag. 1(1).SIAM.000502.2019.

Opinion

It is ten years since the most serious banking crisis in generations and one that imposed enormous economic and social costs on a wide range of stakeholders. Along with other forms of misconduct trust and confidence in banking has been eroded: there is market research evidence that the reputation and esteem of banks has been badly affected. In the words of the authoritative Group of Thirty: “the reputation of banking and the broader financial sector has deteriorated since the financial crisis and is now at an historical low in terms of trust on the part of clients and customers”. The impact on trust is also seen in the Edelman Trust Barometer 2017.

There is also criticism that those responsible for the crisis and other bank misconduct seem not to have been adequately punished if sanctioned at all. While this is not altogether true, we can understand why the perception has arisen. Four types of misconduct can be identified: cavalier risk management, mis-selling of financial products to potentially vulnerable consumers, violations of national and international rules on, for instance, money laundering, and manipulation of financial markets. In other words, the crisis of 2008 (whose effects are still working through) is not the only factor. Other much-publicised examples of misconduct include mis-selling of PPI, pensions mis-selling, instances of rogue trading, the manipulation of LIBOR, and examples of money laundering. As a result, massive fines have been imposed on banks-but who exactly pays the fine is a central issue.

This is important because trust and confidence is crucial in banking for several reasons: we do not purchase some financial products frequently which means there is limited opportunity to learn from experience; there is a principal-agent relationship between financial firms and their customers; the value of many financial contracts are not known at the point of purchase and so it is not always clear precisely what we are buying; given the long-term nature of many financial contracts, the behaviour of the financial firm after the transaction has been made impacts on the ultimate value of the contract; and there is often a lac k of transparency in complex financial contracts. Furthermore, many financial transactions (e.g. investments and pensions) are long term in nature and we know that trust is always important in long term contracts. The erosion of trusty is, therefore, a serious issue.

We can look at a multitude of specific factors that have led to bad behaviour by financial firms and many specific factors have been analysed to explain why the crisis occurred. In the School of Business and Economics we have a post graduate module devoted entirely to this! But is this the right approach? Ultimately, and abstracting from these specific causes, it is a matter of the central culture of the bank and the degree to which individuals within the bank are held accountable.

Culture is central in all firms when considering corporate responsibility. Different authors have offered a wide variety of definitions of “culture”. For our purposes we refer to that given by Allison Cotterall (Chief Executive of the Banking Standards Board): “Collective assumptions, values, beliefs and expectations that shape how people behave in a group”. The group focus is important because we learn from a study of Identity Economics (and our own experience) that people behave differently in different environments. We all of us have multiple identities: in the family, amongst friends, in a group, etc. Behaviour is often different in each case: in a given situation, behaviour is shifted towards those norms that are associated with the more salient identity at the time. We can assume that those bankers who attempted to illegally rig interest rates would not take money from the collection box at their church service on Sunday. Would a sales officer in a bank knowingly sell an inappropriate product to their dearly beloved grandmother? People behave differently in a group than they do acting alone. Group culture is therefore a central issue to consider.

The culture of any firm or any organisation is important to understanding of individual and collective behaviour: it creates business standards and influences employees' attitudes and behaviour and generally establishes norms of behaviour. This is turn provides a link with consumer trust and confidence. This is particularly important in banking and finance because of the pivotal role that financial firms in general and banks play in the economy. This is also recognised by the banks themselves many of which have culture change programmes.

The biggest banking crisis for generations has spawned the biggest change ever in the regulatory regime. But is this the right approach? My experience having been involved with the regulation of banks is that regulation is a necessary but not enough condition for good behaviour. There needs to be a greater focus on the underlying culture of banks because if this is hazardous no amount of regulation will prevent misconduct. At the heart of many instances of misconduct (including the failure of risk management in the run up to the banking crisis) are a combination of hazardous culture, perverse incentive structures within financial firms, weak internal governance arrangements, and a lack of individual responsivity and accountability. No amount of regulation can compensate for bad ethical behaviour. Indeed, the Financial Conduct Authority has argued that culture has been at the root of conduct failures.

When considering the banking crisis and other examples of hazardous behaviour, two issues immediately come to mind: who was responsible and why? When focussing on the "who" dimension it is a question of whether the focus is to be on the institution or the individuals working within it and actually making decisions. Anthropomorphisation is a word that no-one ever uses but all of us assume it! The tendency to assign human characteristics to inanimate objects or institutions can lead to a wrong approach to, for instance, understanding bank behaviour and where sanctions should be applied. Banks do not make decisions: but individuals within banks do. Who should be held responsible for bad behaviour: the financial firm or individuals who made decisions?

This is where the link between culture and individual behaviour comes to the fore and provides the link between corporate culture and individual responsibility. The two interact in a complex way: behaviour can influence culture and established culture influences individual behaviour. It is also a question of effectiveness: what is likely to influence future behaviour more-a £10 million fine on the bank (ultimately the shareholders and customers themselves) or a £50,000 fine on individual employees? Perhaps the focus has been wrong and should be more on individuals than firms (in practice perhaps it should be both) and a regime that makes individuals responsible and accountable for their actions.

Focussing on the role of culture, we can establish that there are five main influences that can create "bad" behaviour:

1. The culture of the firm

2. The culture of the industry

3. Peer group pressure on individuals-especially those new to a firm

4. Specific incentive structures (e.g. sales targets within an organisation where a person's salary or bonus is determined by the number of sales made irrespective of whether they were appropriate to the innocent buyer), and

5. Internal governance arrangements within the firm and the extent of individual accountability.

Reform is needed though this is difficult given the complex interaction between corporate culture, individual responsibility, and official regulation and supervision. Within this nexus culture needs to become a supervisory issue (in that supervisors should examine the underlying culture of financial firms), and a greater focus needs to be given to individuals including when sanctions are imposed. Individuals need to be made more accountable for their actions and decisions when this has a negative impact on consumers' welfare.

A welcome move comes with the Financial Conduct Authority's Senior Managers Regime which has recently come in force. Regulators now require that all relevant employees within financial firms are covered by a set of conduct rules and act with integrity, due skill, care and diligence….and pay due regard to the interests of customers and to treat them fairly." In addition, "senior management is subject to additional conduct rules requiring them to take reasonable steps to ensure that the business of the firm is controlled effectively." This means that individuals are to be held responsible for their actions with the possibility that they may be individually sanctioned.

Culture has changed within banks as anyone who watches Dad's Army on television will know. The local bank manager may have been a pompous fool. But everyone had trust and confidence in him and he always acted with utmost integrity at all times. While he managed a much simpler bank than exists today, perhaps there is a case for "Come back Captain Mainwaring-all is forgiven."