The risk culture in financial institutions needs fixing, but how?

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In the aftermath of the financial crisis and other large scale corporate scandals, a large number of public inquires and documents written by regulators, consulting firms and professional associations drew attention to something that needs fixing: the *risk culture* of financial sector organisations (see, for example, publications by the International institute of Finance, the Financial Stability Board, the Institute of Risk Management, and very recently, the Australian Prudential Regulation Authority).

But what do all these references to risk culture imply in terms of concrete organisational practices? With this question in mind, we started a research project on risk culture in financial sector organisations in 2012. Without a rigid pre-conception of what risk culture is, we wanted to explore how people in financial sector organisations thought about risk culture and how they operationalised it on the ground.

We had extended contacts with a range of corporate actors (managers and members of staff of banks and insurance companies), consultants and regulators over more than four years. We also reviewed a burgeoning body of practitioner articles, regulatory reports and guidance documents. Building on this data, in a recent paper, we argue that organisational actors face two kinds of issues when they seek to do something about risk culture.

First, calls for action about risk culture are characterised by normative statements that urge people in senior leadership positions and also members of staff to 'do the right thing'. But in the post-crisis context what is 'right' or 'wrong' is not easy to determine.

The author of an insightful blog about the post-crisis banking world suggests that he has met with many people working in the financial sector who had learned to keep where they worked to themselves when meeting new people at parties, fearing negative reactions. In other words, the cultural symbols and material practices of financial institutions were dramatically challenged in the aftermath of the crisis. What was normal and 'good' before the crisis rapidly became an object of contestation and, at times, embarrassment. Indeed, even the former Federal Reserve chairman admitted that he has been ‘partially wrong’ in his hands-off approach towards the banking industry.

Second, and central to our analysis, we argue that this complexity about the ends, organising principles and mechanisms of control in financial sector organisations is translated into another source of complexity. It is difficult to understand what are the means through which the ambiguously defined goals of risk culture change can be put to work. In other words, ‘doing the right thing’ is challenging not only because of ambiguity about what ‘right’ means, but also because of different ways in which things can be ‘done’.

Our study sheds light on how organisational actors confront this twofold source of complexity.

We show an initial tendency to stress ‘organic’ management styles of dealing with change in risk culture. These tend to be self-driven, over long time scales, involving the consolidation of existing information sets, and an emphasis on interaction between risk and the business.

But we also show how organic approaches tend to be replaced over time with ‘engineered’ styles of intervening in risk cultures. These are advisor- and regulator-driven, with more of a focus on short-term change – through diagnostic surveys, metrics and performance incentives – by organisations who seek to ‘do something’ visible about risk culture.

Moreover, we suggest that, as engineered approaches to risk culture become prominent, not only do they redefine the means of risk culture intervention, they also reframe the organisational ends, organising principles and mechanisms of control in financial institutions. In contrast with post-crisis criticism and anxiety about ‘reckless’ risk-taking, we observed the use of diagnostic tools, such as surveys, as a way to demonstrate that ‘controlled’ and ‘judicious’ risk-taking is possible and goes hand in hand with performance improvement. In other words, the shift in the means of intervention on risk culture (from organic to engineered) contributes to redefine the criteria used to evaluate what the right thing for financial sector organisations is.

We make no judgement about whether one style of risk culture change is superior to another. Given the highly ambiguous nature of the object itself – risk culture – and the struggles of actors with this ambiguity, there is no standpoint within our study from which to judge whether one operationalisation of it is better or worse than any other. But we note a paradox: while many individuals openly supported the former, it was the latter which was more visible towards the end of our fieldwork.

To explain this paradox, we suggest that organic styles might be good to make sense of local complexity. They help to ‘join the dots’ among the wide range of new policies, organisational structures, training programmes and metrics that are likely to proliferate in the turmoil that follows a crisis. But organic management styles tend to fall short in terms of producing visible and reproducible means of intervention. In contrast, an engineered management style helps to show that something ‘tangible’ is being done.

Our analysis has some practical implications. On the one hand, we suggest that those organisational actors who rely from the start on an engineered approach may face challenges. People may be sceptical of the need of yet another large-scale culture survey; or it may be difficult to identify risk culture-relevant indicators through a top-down initiative. In a way, initially embracing an organic management style may help to make surveys and other diagnostic toolkits a more useful exercise at a later stage.

On the other hand, those organizational actors who rely mainly on idiosyncratic, organic approaches may benefit from increased visibility in the immediate aftermath of a crisis. They would be seen as the people who contribute to make sense of possible alternative or complementary means of intervention in a chaotic post-crisis context. But they are also likely to be challenged over time. Paraphrasing what many of our contacts said, at some stages, they would inevitably face the request: Show me tangible evidence of your risk culture!

To conclude, we suggest that those organisational actors who are able to pragmatically balance an organic and an engineered approach to changing risk culture are likely to maintain or even extend their organisational footprint.

However, somewhat ironically, such balancing act may require a pre-existing cultural predisposition to accept that there is not a universal ‘right’ way to do things about risk culture.

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Notes:

- *This blog post is based on the author’s paper Navigating Institutional Complexity: The production of risk culture in the financial sector. co-authored by Michael Power and Simon Ashby, in Journal of Management Studies, 1–49.*
- *The post gives the views of its authors, not the position of LSE Business Review or the London School of Economics.*
- *Before commenting, please read our Comment Policy.*

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