CULTURE IN BANKING

THE ‘SOFT STUFF’ DRIVES THE HARD RESULTS

Twenty years on from the publication of **Excellence in Banking**, author **Steven Davis** has returned to the subject in a new book, **Excellence in Banking Revisited.** Amongst the issues he explored is the topical question of banking culture. **Accountancy Ireland** asked him to share his reflections.

What do bank lending disasters like Parmalat and Enron as well as the rogue traders in Barings and AIB have in common? And, for that matter, why do so many banks have a deserved reputation for failing to satisfy customer service expectations?

We suggest that banking culture is a common theme underpinning bank performance – both good and bad. Not the only one, but certainly one of the least understood by outside observers. In this article we explore the nature of culture in banking, why it is even more important today than in the past, and how it might evolve in the future. Our research is based on recent interviews with excellent banks for our book *Excellence in Banking Revisited*.

Quite simply, culture is viewed by most people as ‘the way we do things around here’ in our organisation. Academics like Barney (1986) are more specific: ‘a complex set of values, beliefs, assumptions and symbols that define the way a firm conducts its business’.[1]

Is banking culture any different from that in other fields? We found no significant academic or management writings on the subject, but it was clear from our research that there is a significant difference between the culture to which many banks aspire and what exists today. Large commercial banks are widely viewed – both internally and externally – as hierarchical, bureaucratic and slow-moving organisations dominated by a ‘silo’ mentality in which individual units look to their own political interests rather than that of the bank as a whole. What the customer wants may or may not be their focus, but integrating their efforts on behalf of the customer is often extraordinarily difficult.

The nirvana for the variety of cultural change programs undertaken over the years by banks is thus a ‘one bank’

mentality in which the customer is the focus and where individual line and staff units collaborate to maximise the bank's profitability through providing an integrated service package to the client. A by-product of this collaboration is open communication which provides top management with an insight into risk and other issues. To return to the disasters listed in the lead sentence above, one can argue that rogue traders and unwise lending and underwriting practices are more likely to be uncovered and discouraged in such an open environment.

Our research in earlier books on the management of excellent banks (see biographical note) demonstrates how difficult it is to convert a large bank's embedded culture into a customer-oriented, one-bank mentality. Even among highly regarded institutions, in our interviews in the 1980s we found the chief executives of excellent banks, like the former Bankers Trust and Credit Suisse, espousing such values but unable to prevent massive financial and reputational losses in the 1990s.

Why is culture so critical?

Why is a bank's culture such a critical management issue today? We suggest three reasons:

- banks desperately need to sell more to existing customers to achieve the double-digit annual revenue growth demanded by investors. Such 'cross-selling' gains usually require convincing a client to move existing business from competitors, which in turn implies a level of superior service quality. In our view, few banks in reality can demonstrate this superiority. Sustained organic market share gains are rare indeed across the banking world.

- the same pressure to boost revenues increases the likelihood of unethical or unwise credit or market risk judgements. The ideal culture of open communication and consideration of the best interest of the bank and its client is one of the few effective barriers to such reputational and financial losses. One would like to think that open discussion at the top management level of the merits of off-balance sheet lending to an Enron or Parmalat might have mitigated the subsequent disaster to a number of banks. And such a culture should have exposed the rogue traders at Barings and other banks.

- managing size and complexity has become a key management issue as institutions like Citigroup and HSBC, with hundreds of thousands of employees and hundreds of operating units across the globe, have become a new model of universal banking. Once again, a common culture of mutual trust and communication is one of the few means of overcoming the inevitable bureaucratic, political and silo barriers which hamper flexibility and impair customer service.

A management priority

Our research in 2004 for *Excellence in Banking Revisited* highlights these challenges. Of the nine excellent banks selected for their management quality by our independent panel of international banking experts, four believe they have achieved the nirvana of a true client-oriented culture. And most of the others have targeted this culture as their top management priority.

Culture can be positive or negative

The four success stories are Goldman Sachs in investment banking, Handelsbanken of Sweden in corporate/ retail banking, and two predominantly retail banks: Banco Popular Espanol of Spain and Fifth Third in the US. Perhaps the most signal characteristic of this group is the time it has taken to build a one-bank, customer-oriented culture. At Goldman, a defining moment was the agreement on fourteen core management values, including customer focus and a one-bank orientation, in the 1970s. Sustaining these values in a fiercely competitive world is not a simple task; one of Goldman's managing directors refers to a 'muscular Christianity'. But Goldman's name features more rarely in recent reputational disasters than many of its peers.

In the other three success stories, a change in management going back two or three decades underpins the introduction of today's one bank, customer-oriented culture. Jan Wallander in Handelsbanken and Luis Valls at Banco Popular introduced in the 1970s the culture which continues to distinguish these role models, while today George Schaefer of Fifth Third carries on the cultural message of several of his predecessors.

Among our other excellent banks which aspire to a single, customer-facing culture, the diversity introduced by a series of mergers is the major challenge which must be overcome. In UBS, CEO Peter Wuffli is driving a customer focus to bring together executives from the host of UBS's predecessor institutions.

In the case of HSBC, whose conservative culture was based on trust and communication within a core of British expatriate international bankers, CEO Stephen Green notes that

'*nurturing culture is a significant task which is never finished … every culture in the world is represented in our work force*'.

At Citigroup, which for many represents the 'new model' global bank, the former Travelers team has driven since the merger in 1998 a new culture throughout the world's largest financial institution. Hans Morris, the CFO of the corporate and investment bank, describes the 'secret sauce' of the culture as 'intellectual honesty of the numbers, clear accountability and entrepreneurial zeal'.

But a strong culture can be a negative as well as positive force. JP Morgan figured as one of the most admired role models in our two books written in the 1980s on excellent banks – in large part because of its client focus. Yet in 1999 the bank felt obliged to merge with the larger Chase Manhattan to sustain its investment banking momentum. Many observers both within and outside the bank attribute this outcome to management's unwillingness at an earlier date to consider a merger which might have diluted this unique culture. As one of our interviewees opines,

'It was a Shakespearean tragedy. What creates a great institution bears the seeds of its downfall'.

Looking to the future

What does the future hold for banking culture? How many success stories of cultural change are likely in an environment of sectoral consolidation, pressure on revenue growth and the emergence of giant global banks?

Pressure to perform

First, it must be pointed out that many banking cultures have already changed dramatically since the 1980s. The 'family' culture of caring for executives

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and employees over their careers – almost regardless of their contribution – has disappeared in many banks in the face of pressure to maximise earnings. Academics speak of the breaking of a lifetime contract between employer and employee in recent years. Whether or not this 'contract' ever existed, the pressures on individual bankers today to perform or depart are enormous. Not only do investment bankers at Goldman Sachs need to survive '360 degree' annual evaluations, but also commercial bankers at Fifth Third and Handelsbanken are fully conscious of the need to meet their targets or be 'processed out'.

Mergers

Second, the likelihood of further M & A activity in banking globally will increase the pressure on banks striving to create the one-bank cultures so highly prized among our excellent banks. We note that only three (out of a total of 25) banks have figured in our excellence lists in each of our books on excellence written since 1984. Citigroup, HSBC and UBS are now massive institutions built more on acquisitions than organic growth. Mid-sized banks on our excellence list in 2004 like UniCredito and Handelsbanken face the unpalatable choice between failing to meet investor growth expectations and risking the dilution of their unique management culture through major acquisitions.

Leadership

Third, the leadership needed to achieve and sustain major cultural change is a very scarce resource. Academics like Edgar Schein of the Sloan School at MIT and John Kotter of the Harvard Business School are convinced that only such strong leadership, sustained over an extended period of time, can do the job. Yet recent surveys have shown that the typical CEO's tenure is less than four years, arguably too short to achieve durable change in a mature, complex business such as banking. The CEOs – past and present -we met in writing this book, such as Sandy Weill of Citigroup, Dick Kovacevich of Wells Fargo, Stephen Green of HSBC, Marcel Ospel of UBS and Alessandro Profumo of UniCredito, are truly an exceptional breed. For the sake of the various constituencies involved, we hope there are many more on the way!

Conclusion

Our conclusion? Sadly, we believe that the pressures from competitors, investors, and internal resistance to change will limit to a small handful the number of banks which can truly lay claim to the status of one bank built around a culture of customer service. Even iconic Goldman Sachs is under massive pressure to retain its unique culture as former partners depart and the old partnership culture is diluted.

One final word in conclusion from Colin Price, the London head of McKinsey's organisational practice:

'Banking isn't different from other businesses…(but) culture and leadership have low priorities for most banks … a fanatically dedicated leader can change the culture in a bank in two or three years; it's all about good leadership'. ■

[1] Barney, J.B. 'Organisational Culture: Can it be a Source of Competitive Advantage?' Academy of Management Review, 11(3). 1986.

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The Chairman of the Revenue Commissioners, Frank Daly, will be addressing Chartered Accountants in Banking at a lunch on Thursday, 28th October. Details from ICAI's Business Members Dept. Email: businessmembers@icai.ie

Wednesday 13 October, Reporting Financial Instruments – Applying IAS 32 & IAS 39 at the Guinness Storehouse. Details from cpd@icai.ie

Tuesday 16 November – Mutual Funds in Jurys Hotel, Ballsbridge. Email: cpd@icai.ie

Wednesday 17 November – Portfolio Risk Management also in Jurys Hotel. Email: cpd@icai.ie