Risk culture in different bank businesses – Marco Di Antonio

1 – INTRODUCTION: literature review; objectives and scope of the research

In this section of the book, we will discuss the relationships between business and risk culture in financial institutions, particularly in banking.

Organisational culture is a complex construct. There are many factors that affect it. Some of them are shared by all the employees and lead to homogenous patterns of behaviours. They are unifying factors, such as the history of the firm, the country in which it operates, the market environment, the ownership model, the regulation. Other factors come from individual and group cultures and operate as differentiating factors. If they are shared by a significant group of persons inside the firm, they create what are called "subcultures": functional cultures, regional cultures (in firms geographicaly diversified), professional cultures, business cultures (in firms strategically diversified).

The nature of the business in which the firm operates is one of the main determinants of the organisational culture. Every business faces specific regulatory, competitive and economic problems and the employees strictly interact and develop successful ways to handle with them. If the firm operates in one single business, the business culture acts as a unifying factor. On the contrary, in the case of diversified, large and complex financial institutions, business culture works as a differentiating factor.

The scientific literature on this topic is poor, peripheral and we didn't find any systematic work on the subject. There are many studies on corporate culture and risk culture, without specific reference to businesses and related differences. In the aftermath of the financial crisis, reseach centres, professional associations, consultancy firms and regulators have studied the risk culture of financial institutions. Often these inquiries make some reference to specific businesses; some of them regard single categories of financial intermediaries (Spicer et alii, 2014, Salz Review, 2013, Protiviti, 2012, Robinson, Ware, 2011). All these studies are descriptive and do not deal with the topic in a systematic way.

Research on organizational subcultures gives an helpful framework to study business culture (in diversified financial institutions, business culture may be defined as a subculture). It is possible to make a distinction between organisational cultures that are cohesive and unitary, or *integrated*, those characterised as collections of subcultures, or *differentiated*, and those that are *fragmented*, ambiguous and open to members' multiple interpretations (Martin, 1992).
Boisner and Chatman (2002) underline how organisational subcultures may be based on different sources: membership in various groups, such as departments, workgroups, and teams; levels of hierarchies, such as management versus support staff; professional and occupational affiliations; physical location in the organisation; socio-demographic categories, such as sex, ethnicity, age, or nationality; informal groups like those formed by friendships; and performance-related variables such as organisational commitment and work performance.

Schein (1988) makes a distinction between pivotal values and peripherals values. The former are central to an organisation's functioning and are shared by all employees. The latter are not essential and can be rejected by some part of the firm. The subcultures share pivotal, but not peripherals values; the countercultures refuse also the former ones. Tushman and O' Reilly (1997) explain how subunits can espouse some values that are fundamental for them but peripherals for the organisation, and at the same time they can accept the core pivotal values.

Another problem in this area of research is the lack of quantitative data. It is very difficult to measure the risk culture, and we did not find any statistical analysis about the relationship between risk culture and businesses.We are forced to rely on anedoctical evidence, on case studies, on qualitative self evaluation by the practitioners (as in the case of surveys conducted by consultancy firms).

When exploring business risk culture, there are two main lines of research. The first one regards the characteristics of business risk culture, the second one is about the coexistence of different business risk cultures in the same organisation. Under the first point of view, the research questions are the following:

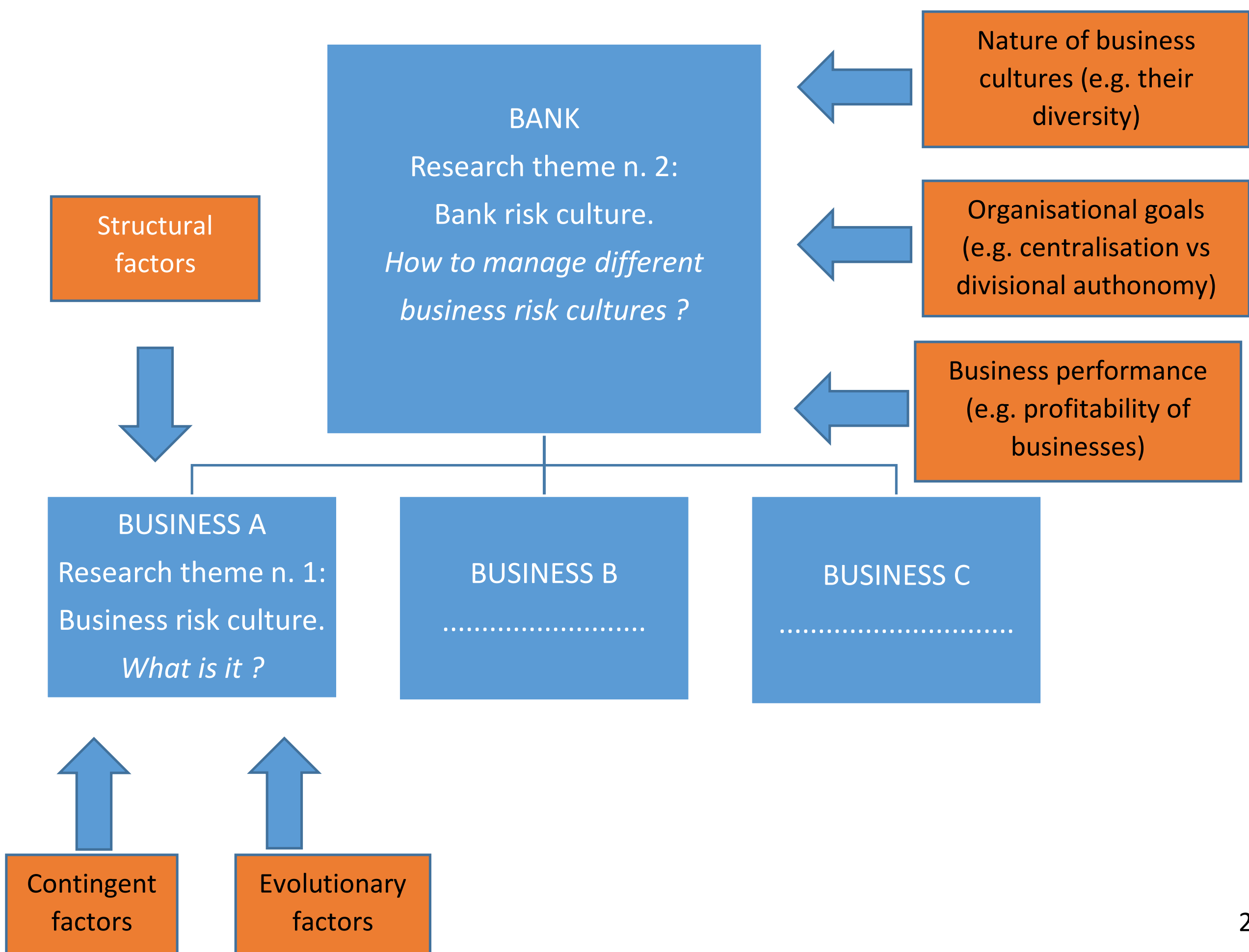
- Does it exist a peculiar risk culture, for every and single business,? Is the nature of the business one of the drivers of organisational risk culture ?
- More specifically, what are the business—related determinants of risk culture ?

The second line of research regards the study of diversified financial institutions. The relationship between the different business cultures can vary, according to alternative models: an integration-model where the bank tries to form a common culture across different businesses; a fragmentation-model where the businesses are kept separate and their different risk cultures coexist; a conflict-model where the different cultures fight to get leadership and become the dominating and integrating culture (in this last case, other business cultures can survive as subcultures). On this topic, the relevant research questions are the following:

- Is the coexistence of different business risk cultures possible inside the same organization ? When ? What are the pros and the cons ?
- On the basis of which factors does a business risk culture become dominant over others ?
- Does a best model to manage different business subcultures exist ? If so, is it integration, fragmentation or domination ? What are the relevant factors to consider in order to make this choice ?

The two lines of research, the categories of relevant variables and their connections are shown in the figure 1 below (for its comment, see § 3.2.).

FIGURE 1: A CONCEPTUAL FRAMEWORK FOR STUDYING BUSINESS CULTURE



In the present contribution, we will follow the first line of research. This choice is motivated both by editorial standards (length limits of every chapter) and by theoretical sequence (firstly we must know what business cultures are, and only after how to manage their relationships).

The aims of the present chapter are:

- to present the available quantitative and qualitative evidences on business risk cultures (descriptive aim);
- to provide a conceptual framework helpful to investigate in a systematic way the business risk cultures and to understand what are the main factors that differentiate them (theoretical aim); the lack of data doesn't allow, at the moment, to test the validity of the linkages between these factors and business culture, or to estimate their relative importance.

2. INTRODUCTORY CONCEPTS: definition and components of risk culture and its relationships with organisational culture

Before starting our analysis, it is helpulf to make clear some basic concepts and definitions about risk culture. We will discuss three issues: the relationships between corporate culture and risk culture, the definition of risk culture, the components of risk culture.

Firstly, we consider risk culture as being a part of the general organisational and business culture. The corporate culture shapes the beliefs, attitudes and behaviours in all the different aspects of organisational life: purpose of the firm, performance, external relationships with customers and suppliers, internal relationships between units and individuals, risk, etc..
Secondly, we define risk culture as: "A bank's norms, attitudes and behaviors related to risk awareness, risk taking and risk management and controls that shape decisions on risks. Risk culture influences the decisions of management and employees during the day-to-day activities and has an impact on the risks they assume» (FSB, 2014; Basel Committee, 2015). Or, alternatively: "Risk culture can be defined as the norms and traditions of behavior of individuals and of groups within an organization that determine the way in which they identify, understand, discuss, and act on the risks the organization confronts and the risks it takes" (IIF, 2009). Together with organisational rules and controls, the risk culture determines the effective capacity of the decision makers to understand, evaluate and manage risk.
Risk culture is a neutral theoretical construct; every organisation has a risk culture, the content of which may be different[1]. The risk can be viewed in a negative or in a positive way, as a problem to avoid or as an opportunity to get. Often, when we talk about risk culture, what we mean in reality is a "healthy risk culture" or "sound risk culture" (FSB, 2014, p. 1) or "risk intelligent culture" (Deloitte, 2012). In this case, the general construct is qualified with some prescriptive attributes, through a process of judgment/evaluation. An healty risk culture can be defined as a culture which: a) it is aware of the risk and gives adequate attention to it and b) orients organisational behaviours towards the optimal management of risk, in line with the objectives of the firm (risk appetite).

In this perspective, it is necessary to distinguish between an healty risk culture and risk avoidance. The former aims to optimize the taking and the management of risk, not necessarily to minimise it[2]. An healty risk culture favours the right setting of risk objectives, their sharing by all the personnel, an effective risk management, a continuous and careful monitoring of the risk[3].

[1] To make an analogy, every company has a customer culture, the content of which may vary: some companies see customer as a contractual counterparty (a competitor, as Porter suggests in his "five forces model"), others as a partner.

[2] This distinction is particularly relevant for financial institutions. They receive from the society the mandate to assume the risk on behalf of economic agents and their productive function essentially consists in the managing of financial risks. They should not avoid the risk, for at least two reasons: they earn money from the taking of risk (in the case of speculative risks) and they are asked to keep the risk in order to free the economic agents from it.

[3] "A *sound* risk culture consistently supports appropriate risk awareness, behaviours and judgements about risk-taking within a strong risk governance framework. A sound risk culture bolsters effective risk management, promotes sound

Risk aversion is not synonimous of healty culture, as demonstrated by too bureaucratic and conservative financial institutions, with a sluggish performance. In fact, they put at the centre of their values not the risk, but the controls and the compliance to procedures. They have, as a dominant culture, a "control culture" or a "compliance culture", not a "risk culture"[4]. Chase Manhattan bank in the 1970s and 1980s is an example of this (Rogers, 1992). The bank had a very risk-averse culture: it was bureaucratic, conservative, paternalistic, "gentlemanly and polite"; it refused conflicts, protected senior managers from bad news, was fearful of mistakes, hampered internal communication. This culture resisted to market changes and worked as an obstacle to the necessary adaptation of bank. Maybe it helped to contain credit and market risks, but it generated a very high competitive risk, and led to the decline of the bank.

At the opposite side, normally the risky businesses (e.g. insurance, securities underwriting and trading) have a strong risk culture. The investment banks were the first to introduce the advanced methods in risk measurement and risk control. Nevertheless, they assumed excessive risks in the years previous to the financial crisis and some of them failed or were bail-out. Was it a problem of an unealthy risk culture ? Were some cultural artifacts advanced (risk management tools) while the risk culture was weakening ? Or, differently, were these banks aware of the risks taken, but their tools went wrong and undervalued risks ? Was it a problem of culture or a problem of organisational instruments ?

Thirdly, for what concerns the components of risk culture, it is helpful to distinguish three main categories of risk (see Figure 2)

FIGURE 2: THE COMPONENTS OF RISK CULTURE – The model of the three risk cultures

TYPE OF RISK	DOMAIN	SUBJECTS AFFECTED	NEGATIVE EFFECTS	EXAMPLES
Productive risk	Operational/ technical/ functional	Shareholders	Economic losses	Credit risk, counterparty risk, market risk, interest rate risk, insurance risk, liquidity risk, foreign exchange risk, operational risk
Customer risk[5]	Ethical/ competitive	Customers	Loss of reputation, loss of customers	Misselling of financial products, lack of transparency, conflict of interest
Compliance risk	Legal	Public interest	Fines and sanctions, loss of reputation	Market manipulation, rigging of market benchmarks, fraud, money laundering, tax evasion

Risk culture must be sound under all three aspects quoted in the table above. For example, the risk culture of some investment banks was healthy on the productive side (supported by advanced risk management systems), but flawed on ethics and on the way they treated customers. Moreover, the "mix" of strengths and weaknesses, along the three different kinds of risks, might be different in different businesses.

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risk-taking, and ensures that emerging risks or risk-taking activities beyond the institution's risk appetite are recognised, assessed, escalated and addressed in a timely manner" (FSB, 2014, p. 1)

[4]. The culture is an internal motivator that drives behaviour "when nobody sees it". It helps individuals to make discretionary decisions and to act inside their sphere of autonomy. An healty risk culture stimulates proactive behaviours (e.g. reporting issues of concerns, whistle blowing, suggesting improvements to risk management), activates social control, dissuades from exploiting controls' loopholes to heighten performance. Instead, rules and controls are external motivators; they are organisational mechanisms, not embedded values.

[5] Some components of customer and compliance risk are grouped in the (mis)conduct risk, a relative new area of concern for the regulator. According to ESRB, "Misconduct risk refers to risks attached to the way in which a firm and its staff conduct themselves. As such, it includes how customers and investors are treated, mis-selling of financial products, violation of rules and manipulation of markets." (ESRB, 2015)

As an example of the usefulness of the three risk cultures model, we quote the empirical work of Cohn et alii, (2015), which showed how bank employees took significant less risks in their investment choices when their professional identity was reminded to them. They invested more than twenty percent less in the risky assets, relative to the control group. Moreover, this risk aversion was higher for employees from core business units, i.e. those who worked as traders, investment bankers, and wealth managers. These findings therefore contradict the conventional thinking that the culture of the banking industry encourages its employees to take higher risks. But the same subjects, when their professional identity was made more salient, were ready to increase their earnings by behaving dishonestly (Cohn et alii, 2014). "As the willingness to cheat and break rules for the sake of personal benefit could also be a potentially important determinant of excessive risk-taking, the combined results of both studies raise the question whether the problem of excessive risk-taking is associated with a problematic "ethical culture" rather than a problematic risk culture" (Cohn et alii, 2015)[6].

Another problem, in studying risk culture in financial institutions, is the difference between espoused values (what we say we do) and practiced values (what we actually do). The former are found in formal documents such as cultural manifestos, mission statements, codes of conduct. The latter reside in the heart and the brain of employees, and guide their behaviours. In the case of British retail banks, the values most quoted in official documents were customer centricity, transparency, integrity, benefit for the community, simplicity. Only one bank (Virgin Money) talked about making "fair but non excessive" profit. Unfortunately, the actual values that led the decision making of managers and employees were quite different: "an aggressive sales culture which rewarded staff for aggressively promoting financial products, irrespective of risk and customer needs" (Spicer et alii, 2014, p. 9).

3. BUSINESS RISK CULTURE: are business risk cultures in the financial sector different? Why? How?

3.1. Does a "business risk culture" exists ?

In recent years, financial system has got through a difficult situation: excessive risk taking and increase in credit, market and operational losses, growth in misselling and regulatory breaches and consequent rise in fines, worsening of reputation. These problems are not uniformly widespred, but depend on geography and businesses.

A Deloitte survey (Deloitte, 2013) shows that in the banking industry the perception of cultural problems is higher for US and British banks than for Asian banks (European banks are in the middle). As far as the business is concerned, the situation is worse for investment banks, followed by universal banks. On the contrary, for retail banks and mutuals banks (building societies and their equivalents), the cultural weaknesses seem to be lower.

Also anedoctical evidence and case study analysis (see below, §4) demonstrate how the risk culture is strongly affected by the business in which the banks operate. A report from The Economist (The Economist, 2013) lists the top ten fines incurred by banks in the USA, from 451 millions dollars for Barclays (Libor manipulation) to 1.9 billions for HSBC (money laundering lapses). In all cases, the institutions involved are large and complex universal banks or investment banks. These kinds of banks show significant ethical weaknesses[7]. Almost three-quarters (71%) of investment bankers interviewed in the survey think that career progression would be tricky without being "flexible" over ethical standards; instead, the average value for the total sample is 56%.

These evidences seem to confirm that in the forging of risk culture the nature of business matters. We expect the business risk cultures to be different under three aspects: a) its importance, i.e. the attention given to risk and its role inside organisational culture; b) the trade-off between return and risk, i.e. the risk appetite and c) the nature of the risks that are peculiar to the business, e.g. credit risk in commercial banking versus market risk in trading vs reputational risk in private banking.

The link between risk culture and business is acknowledged also by the regulator: "Supervisors should consider whether an institution's risk culture is appropriate for the scale, complexity, and nature of its business and

[6] Cohn et alii separate the "ethical culture" from the "risk culture". Our "three risk cultures model" is based on wider definition of risk, that includes not only the more traditional financial risks ("productive risks"), but also the compliance, reputational, conduct and ethical risks ("customer risk" and "compliance risk").

[7] The data quoted in the Report are limited to legal and compliance risk. They exclude productive and customer risks.

based on sound, articulated values which are carefully managed by the leadership of the financial institution". (FSB, 2014, p.2)

3.2. What are the determinants of business risk culture ?

We propose a general framework helpful to analyse in a systematic the more relevant determinants of business risk culture (see Figure 1). We have selected the factors that are more strictly linked, directly or indirectly, with the nature of the business[8]. We group these drivers in three general categories : structural, contingent and evolutionary factors.
Put in a simple way: business risk cultures are different because businesses are different (structural factors) and are exposed in different ways to some external factors that affect risk culture (contingent factors). Moreover, because of the changing of the contingent factors, business risk evolve through the time; they can become more similar or more different (evolutionary factors).

a) *Structural/endogenous factors*

The first determinant of business risk culture is the nature of the business itself. Without pretension to be exhaustive, we list below some of the business-driven factors that affect the risk culture:
- *the activities performed and their embedded risks*. Different activites imply risks that are different under many aspects: a) nature, e.g. commercial banking is linked to credit and liquidity risks, asset management to reputational risk, trading to market risk); b) time horizons, e.g. market risk is very volatile and short term, credit risk is a medium term risk, c) effects on financial results, e.g. productive risks generate economic losses of various intensity, conduct risk causes a loss of customers and compliance costs, liquidity and reputational risks can rapidly lead to the failure of the institution. In the mass market businesses with economies of scale and standardized processes (e.g. retail banking, payments), risks are different comparing to high-tailored and service-intensive businesses (e.g. investment banking, wealth management).
- *the nature and role of customers*: the characteristics of customer relationships vary depending on the business. Customers are very important in corporate banking and wealth management, quite important in retail banking, do not exist, or are simply counterparties, in securities trading and sales[9]. By consequence, the relevance of customer, compliance and reputational risks is different Also the optimal risk/return combinations customers are looking for are variable. In the asset management industry, high net worth individuals who address to hedge funds are more inclined to risk than retail customers who invest in mutual funds or pension funds;
- *the economics of business*: it is not possibile to make profits in proprietary trading without taking substantial risks, nor to earn money in investment banking without innovation (and the related risks); on the other hand retail banking, with lower and more stable earnings, may require a more cautious approach.

Every business has its own hierarchy of priorities between risk and other performance dimensions. It looks for different solutions to the typical managerial trade-offs: e.g. short term profitability vs ethical conduct, shareholder interests vs stakeholder interests, entrepreneurial spirit vs compliance to rules, flexibility vs control.
In one of the most important studies about bank culture, Rogers (1992) describes the three business subcultures in Citicorp:

a) Consumer banking culture: a mass market culture ("MacDonald's culture"), whose values were cost-control, bureaucracy, standardisaton of products, stability and predictability;

[8] We neglect many factors, that affect risk culture, but are not steadily related with specific characteristic of the businesses: e.g. quality of corporate and risk governance, committment of top management (tone from the top), horizontal information sharing, active learning from mistakes, openness of communication, role of risk management and control functions, compensation systems, etc. Some of them are explicitely considered by regulatory authorities

[9] See Tarullo (2014): "This second concern recalls the much-discussed issue of whether a trading mentality has migrated to other parts of large financial firms, so that the position communicated by management to both employees and others is that the firm has no "customers" or "clients", only counterparties. While such an attitude is typical for trading in anonymous markets or with equally sophisticated institutions, it hardly seems designed to engender trust on the part of those who have ongoing relationships with the firm"

b) Investment banking culture, deal-doing, antibureaucratic, short-term oriented, whose core values were innovation, entrepreneurship, speed, flexibility;
c) Institutional bank culture (wholesale business), in an intermediate position: it emphasised the long term relationship with corporate customers, but at the same time shared with consumer banking culture the standardization of products and processes.

The propensity to risk in investment banking was higher than in consumer banking. There were conflicts between the three risk cultures. The investment bankers were seen as greed, lacking sense of loyalty to the bank. As a senior manager said: “They move too fast, without looking at risk. They don’t care that much about the bank” (Rogers, 1992, p. 63)

We can generalize the results of Roger’s analysis and add some further considerations about retail and investment banking. To a certain extent, these two businesses are placed at the opposite side of the spectrum of risk cultures.

Traditionally, the retail business has been quite stable and static. It is a mass-market business, where size, economies of scale and process and product standardisation are critical success factors. Efficiency, stability and predictability are core values. At the same time, it is a “relationship business”, characterised by personal and lasting relationship with customers, who belong to the same local community in which the bank operates (this is especially true for community and mutual banks). The approach to risk is quite conservative. The control of risk comes before innovation and entrepreneurship. The main risk are credit and liquidity risk; the culture of the bank is a “credit culture”. Retail banks are bureaucratic, “command and control” organisations; hierarchy and rules limit individual authonomy and mitigate risks.

Investment banking is a very complex industry, that includes many lines of activities, with different productive processes, customers, economics, risks. Therefore, business cultures are very dissimilar.

Services to corporations (e.g. underwriting, corporate finance, M&A, securitization, IPOs, private equity, advisory) put at the centre the complex needs of the customers. Business models vary: in the American model of investment banking, the relationship with the client lasts as long as the deal lasts; instead the traditional British model is centred on independent advice and long-term relationship (Augar, 2010, p. 224) Customers are very smart, the competencies of the personnel very high, services sophisticated, customised and innovative. The market is very competitive and dynamic; competitive and reputational risks are significant. The organisation is quite decentralised and appreciates flexibility, authonomy and problem solving attitude. The complexity of services requires teamwork. Many values are common to innovative companies: creativity, autonomy, innovation and related propensity to risk (Lyons et alii, 2007).[10]. The control of risk is important, but it should not hamper the entrepreneurial spirit and the efforts to find innovative solutions. Organisational tools (advanced risk management systems) and performance measures and objectives are more important than rules and hierarchy as a risk control mechanism.

In asset management and proprietary trading, the direct counterparty of operations is the capital market; the customer does not exist; it is an impersonal businesses, transaction-based, with short time horizons. Risk-taking is the rule of the game and risk exposures are carefully measured and monitored. The main risk is market risk (and to a minor extent, counterparty risk). Traders are individually responsible for short term results, that if attained trigger large bonuses. The organizational climate is very competitive.

In capital markets divisions of large US investment banks, salespeople work together with traders. But their risk culture is very different. Salesmen are customer oriented and risk averse and this can create a cultural clash. Lewis (1989) and Smith (2012) illustrate well this cultural conflict. In the course of time, the relative power of organisational units shifted: thanks to its brilliant financial results, the trading department captivised the sale department. Placing products and earning commissions overcame the customers’ interests and the fiduciary duties of the bank towards them.

Ware e Robinson (2011) explore the common and the differentiating core values of the three subcultures of investment banking, that they call tribes: investment, operations, distribution[11]. The core of the investment

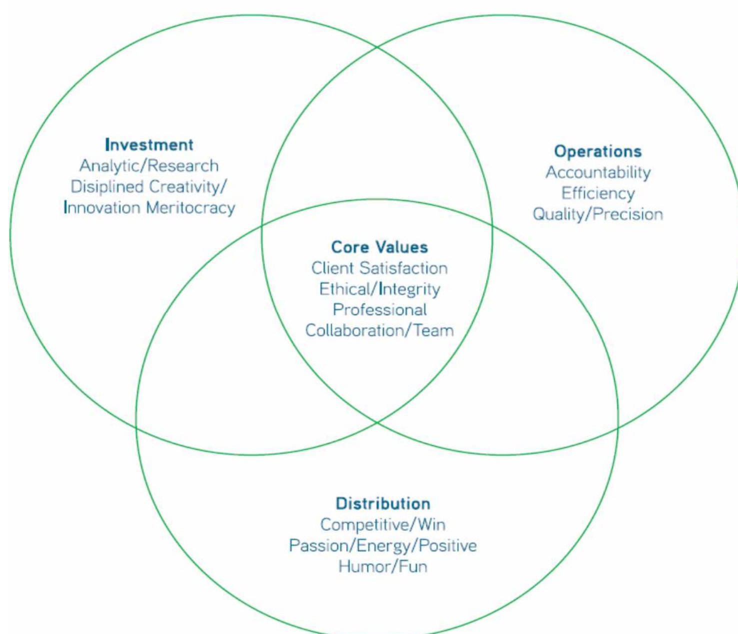
[10] “The notion of significant interaction with one’s clients is considered a best practice in investment banking, and this extends to other professional service businesses. At many investment banks, the concept of anticipating client needs is sacred. For example, one business principle at Goldman Sachs states that “we consistently strive to anticipate the rapidly changing needs of our clients.” Lyons et alii, 2007

[11] . They are described as follows: a) Investment professionals: Portfolio managers, analysts, and other strategists who are making the investment decisions; b) Distribution professionals: marketing, client service, and PR experts who are dealing with all the client-facing and distribution efforts; c) Operations professionals: accounting, finance, compliance and all

banking culture (pivotal values) consists of four values shared by all the three tribes: client satisfaction, ethical integrity, professional standing, collaboration and team approach. But the tribes differentiate themselves on peripheral values (see Figure 3). Investment subculture is defined as “effective decision making in a meritocracy”; it has a strong sense of confidence (often shifting towards arrogance). The distribution subculture is defined as: “compete and win”: it is very competitive, driven by performance (market and financial results), exposed to risk of misselling when the environment is difficult. Operations subculture is defined as: “creating scalable processes and efficiency”; it is centred on attention to details, rationalisation of work, caution, compliance to rules, bureaucracy.

Difference originates conflict. Distribution and Operations staff expresses a sense of disempowerment or disrespect; they feel like the “lower class” confronting with the Investment tribe, considered as the “upper class”. Distribution and Operations collide also between them: competitive/win values contrast with efficiency/precision values. Distribution people are action oriented and driving for results; the Operations teams are required to be fully compliant.

FIGURE 3: THE THREE TRIBES: subcultures in investment banking



Source: Ware and Robinson, 2011

In Barclays, a large and diversified institution with business cultures difficult to integrate with each other[12], “the investment bankers tended to regard the retail bank as slow, indecisive and un-commercial. In contrast, the investment banking characteristics were hard-working, fast, competitive and well rewarded success” (Salz Review, 2013, p. 87). The Barclays’ Corporate Bank, while quite distinctive and emphasizing integrity, was described in the report as being relatively conservative, hierarchical and slow-moving, perhaps reflecting an emphasis on tenure and loyalty over performance. The culture of the Group central functions was described by business units as highly expert, but slow to respond and overly internally focused (Salz Review, 2013, p. 87).

A theoretical framework useful to understand the different cultures in business is the “Competing Values Framework” by Quinn and Cameron (2011). It classifies cultures on two dimensions: i) stability versus

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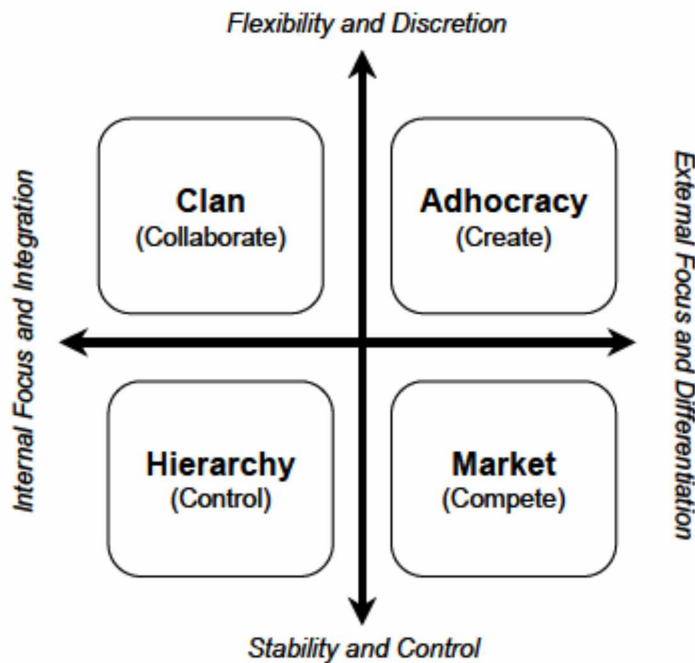
support functions within the firm. When employees are asked, “Are the cultures of operations vs. distribution vs. investments more different or more alike in your firm?” the overwhelming answer (75%) is: “different”.

[12] The cultural integration efforts were made more difficult because of the rapid growth of the bank, the multiple reorganisations and the extensive external hiring.

flexibility and ii) internal versus external focus. We can apply this framework in the analysis of the business risk cultures, obtaining alternative combinations (McConnell, 2013). Hierarchy model emphasises stability and control, formalised structures and rules and internal efficiency; it is a “bureaucratic culture”. In banking, it might be typified by credit card operations or a mortgage-processing unit. Clan model values collaboration, participation and teamwork; it expresses a 'family' culture. It might be typified by a merchant banking group. Market model is based on values such as competition, market share and profitability; it represents a “results oriented” culture. It might be typified by trading units and sales functions. Adhocracy model values innovation, risk taking and creativity. It is an “entrepreneurial” culture. It might be typified by a Mergers and Acquisitions (M&A) group.

FIGURE 4: COMPETING VALUES FRAMEWORK AND ITS APPLICATION TO BUSINESS RISK CULTURES



Source: Quinn and Cameron, 2011

b) *Contingent/exogenous factors*

The contingent factors are not intrinsically related to the business. They affect it indirectly and they can change over time. Moreover, they normally operate differently in various businesses and therefore they become a differentiating driver of the business risk culture. The most important are the following:

- Market competitiveness
- Regulation
- History and evolution of the business
- Size and diversification of the financial institution
- Ownerhip model
- National culture
- Strategic orientation
- Organisational systems and practices
- Employees’ individual culture

The *market competitiveness* creates pressures to increase the level of performance. Making financial results and improving market position (climbing up the bank ranking) become more important than managing the risk accurately[13]. On the opposite side, an excessive exposure to misconduct risk is favoured from a lack of

[13] The positive correlation between the degree of competitiveness and the risk propensity has some exceptions. In the 1990s, the asset management industry in UK was very competitive, with a transparent confrontation between the investment performance of the fund managers. They became scared of underperforming and started to adopt more imitative and risk averse investment behaviours (Augar, 2010, p. 20)

competiton. The limited choice of banks increases the risk of mis-selling and tacit collusion in highly concentrated markets makes easier to manipulate the benchmarks or to charge predatory prices to customers (ESRB, 2015).The degree of competition varies across businesses. Large universal banks and investment banks that compete in global markets face a more competitive market than community banks, or specialised institutions, or boutique investment banks. Also the conjuncture of the market is relevant: when the economy is in a good shape, the attention to credit and liquidity risks decreases; when the capital markets are booming, the attention to market risk is lower than when the markets are bursting.
The *regulation* affects risk culture with contradictory effects. On one hand, more regulation contributes to an healtier risk culture: the risk-based supervision strenghtens the banks' focus on risk and the regulatory guidelines underline the importance of the culture of risk. On the other hand, more regulation might weaken the risk culture, because it shifts the attention from the risk culture to the compliance on rules. Anyway, less regulated sector are generally more risk oriented than more regulated ones. There are many examples: the hedge funds versus mutual funds, shadow banking versus traditional banking, investment banking versus commercial banking. Moreover, protective regulation (e.g. deposit insurance schemes) can generate moral hazard and, again, reduce the risk aversion of the firm.
The *history* of the business is important under at least two points of view. Firstly, past success creates and consolidates culture. As the literature highlights (Schein, 2010), culture is the sum of values and behaviours that are proved to be effective in solving problems and assuring results. Moreover, the success of the bank leads to "organisational optimism", a self-reinforcing cognitive bias that reduces attention to risk (Kahneman and Lovallo, 1993). "A good risk culture can break down when times are good" (McConnell, 2013, p. 40). The prudent risk culture of retail banking has been consolidated through a long period of relative stability of the markets and good financial results. The oustanding profit and growth outcomes of US investment banks at the beginning of 2000s strengthened their aggressive risk culture. In the past, the majority of Italian banks were non profit or state owned and this deeply affected their risk culture. Secondly, in history there are moments of change, gradual or disruptive. The strong forces towards deregulation, competition and free markets, common to all sectors of the financial system, have changed the business culture, shifting it towards the acceptance of higher levels of risk.
Also the *size and the degree of diversification* of financial institutions are important. In the case of large size and rapid growth, organisational cohesion is weakened. The headquarters are far from customers[14]. The infrastructure of risk management and controls is put under pressure. The bank needs more people and the recruiting criteria loosen; the new employees may lack the necessary understanding of risks. Cultural changes are more difficult to implement: the messages about the importance of risk could get lost in their way from the top to the front office. According to Simon the rate of expansion is one of the determinants of the level of risk assumed (Simon, 1999). Highly diversified financial institutions have a more fragmented risk culture and struggle with cultural clashes between business units[15]. The optimal size change depending on the businesses. In some of them, the economies of scale and scope are more relevant, as it appears by comparing universal banking, asset management and payment institutions with community banking and private banking.

The *ownership model* is one of the first driver of organisational culture. A public company is particularly exposed to the pressures coming from financial investors. They are more inclined to assume risks in order to increase the bank's profits and their wealth. This pressure is heightened by the risk shifting behaviours of the shareholders, consistent with the asymmetric incentive system of the limited companies: unlimited profits versus limited losses. Other ownership structures are more risk averse: in a state owned bank stability comes before profitability; in a mutual bank the owners have a long term horizon and are also customers; in a family-owned banks the shareholders have a large portion of their personal wealth invested in the bank.

[14] "*We found small and medium sized institutions had better cultures. Instead of struggling with 'turning around the supertanker', their senior management were mainly focused on reinforcing more customer focused cultures. These smaller banks seemed to have significantly different cultures from the largest institutions. Big banks have made progress, but in terms of culture change the smaller players are still out in front" (*Spicer et alii, 2014, p. 10).
[15] *"We should also note that there is a significant challenge to instilling shared values in a universal bank like Barclays. Cultural compatibility is difficult to achieve across businesses which may attract very different employee profiles, and where the business model and objectives are different. It takes a great deal of finesse to translate the same common values into credible expectations of a trading floor and of a retail branch network. This task is made harder when, as at Barclays, rapid growth (which propelled it from a family bank to a leading universal bank), multiple reorganisations and extensive external hiring (particularly in the investment bank) create a less stable cultural base"* Salz Review, 2013, p. 80.

Laeven and Levine (2008) find that banks with fragmented and diversified ownership and with more powerful owners tend to take greater risks. This is consistent with theories predicting that equity holders have stronger incentives to increase risk than nonshareholding managers and debt holders and that large owners with substantial cash flows have the power and incentives to induce the bank's managers to increase risk taking. The change in ownership structure, from a partnership status to the stock exchange listing, is seen as an important reason for the weakening of the risk culture in US investment banks (The Economist, 2013).

The role of the *national culture* is investigated by Hofstede (2004). At the macro-level, national culture can explain the institutional, legal and economic environment of a country and its influence on corporate risk-taking decisions. At the micro level, culture affects individual risk-taking behaviours. Mihet (2010) finds that the impact of national culture on risk taking is stronger in industrial sectors which are more informationally opaque, e.g. finance: financial institutions in countries with low uncertainty avoidance, high individualism and lower power distance take significantly more risk. The same findings are confirmed by Ashraf et alii (2016). Kanagaretnam et alii (2011) show how in the years previous to the crisis (1993-2006) national culture influenced the quality of banks' earnings: aggressive risk-taking activities were more likely in countries with low uncertainty avoidance and high individualism. Breuer et alii (2014) highlight that individualism is linked to overconfidence and overoptimism and has a significantly positive effect on individual financial risk-taking. Individualistic cultures emphasise self-orientation, autonomy, individual achievements (Hofstede, 2004). Managers are evaluated and rewarded based on their short-term financial performance. In countries with individualistic cultures, the concern for other stakeholders and for public interest is likely to be low; by consequence, customer and compliance risks are higher. National culture is linked to business risk culture because some businesses are more widespred in specific countries. As an example, the business culture of investment banks has its roots in US economic culture: meritocracy, focus on results and performance, efficiency, optimism and self-esteem (sometimes arrogance), risk propension. On the contrary, European retail banks (apart from UK) share "social market economy". In almost all Japanese financial institutions, it is difficult to rely on mechanisms such as speak up and whistle blowing: This is due to the collectivist culture, the respect for the hierarchy, and also a tendency to hide the bad news in order to avoid the shame. When analyzing the culture of asset management industry, Basile (2001) finds differences between Anglosaxons, Europeans and Japanese institutions.

We use the term *strategic orientation* with regards to the main trade-off choices that must be taken at a strategic level. First trade-off: short-term vs long-term perspective of the business; in the first case, the attention to risk decreases. Second trade-off: shareholder vs stakeholder orientation; in the first case, customer and compliance risks are probably higher. Third trade-off: transaction vs relationship approach to business; in the first case, the attention to customer risk is lower. Fourth trade-off: innovation vs stability; in the first case, the propension to risks is higher. Fifth trade-off: profitability vs risk; in the first case, the risk appetite is higher. These choices depend on the business in which the financial institution operates. As an example, a stakeholder approach is more widespred in community or mutual banks; a shareholder approach in global universal banks. A relationship approach is more common in corporate banking, private banking, retail banking; a transaction approach in trading, some sectors of investment banking, product specialists. Investment banking is innovation-oriented; retail banking is stability-oriented.

The *organisational systems and practices* have a two way relationship with business culture. Firstly, they should be an expression (artifact) of the business culture, and as such they should reinforce it. But they also might work in the opposite way: if they are not consistently designed, they forge a practiced culture that is different from espoused culture. In this sense, the importance of performance measurement and compensation systems should be stressed. For instance, if the risk culture statements underline the attention to risk, but the pay for performance systems are based on short term profitability indicators, the organisational risk awareness weakens. The described effects vary according to the business: e.g., the importance of "pay for performance" systems is by far higher in investment banking than in other financial industries. Another relevant organisational choice is between teamworking and internal competition. The latter lowers the peer control and increases the pressure for individual financial performance. Some businesses are more oriented towards teamworking, e.g. investment banking; other to individual competitiveness, e.g. securities trading and sales.

The *employee*s' *individual culture* is one of the cultural layers in the firm, that interacts with the culture of working groups, organisational units, businesses, headquarters[16]. When using culture as a risk governance

[16] Empirical works indicate that risk preferences are partly genetically determined (Cesarini et al. 2009; Barnea et al. 2010), and partly learned through cultural transmission by parents and peers during childhood and adolescence (Dohmen et al. 2011; Booth and Nolen 2012; Eckel et al. 2012). Individuals' risk preferences may also be shaped in adulthood, by

mechanism, we assume that corporate culture can influence individual culture. On the reverse side, the culture of personnel affects corporate culture. An organisation composed by young men is more risk-oriented than one with more aged personnel or more women. Partly, the culture is vehiculated top down, through leadership, "tone from the top", the design of organisational mechanisms such as incentive systems. Partly, it is created from the bottom up, by the people who work inside the organisation[17]. People prefer to work in the business that better reflects their own values. In doing that, they strenghten the existing organisational culture. People who apply for job in a community or retail bank are less aggressive, less competitive and less risk-oriented than individuals who search for a job in investment banking. The latter are more materialist and less inclined to social values (Augar, 2014) [18]. The social sensibility is even more pronounced in ethical banking, ethical funds, mutual banking. The ethnographic study by Ho (2009) shows how in the 1980s the Wall Street investment banks addressed for hiring to "the best and the brightest" recent graduates of elite schools (in particular Harvard and Princeton). These recruits went to Wal Street by bringing with them their social norms and values: individualism, ambition, competitive nature, high risk propensity, often greed and low moral integrity. As newer hires were promoted, and older members departed, a new culture developed within investment banks, replacing the old one.

c) *Evolutionary factors*

In the life of a financial institution, risk culture changes. Some events may weaken it: difficulties in producing satisfactory financial results, together with incresing competitive pressures; cost-cutting programs to improve cost/income; rapid growth; efforts to fulfill organisational integration in M&A operations; high recourse to outsurcing without monitoring the risk culture of the partner; arrival of a new chief executive officer more risk inclined, and so on (Smith-Bingham, 2015).

Also the contingent factors above described change over time. In this case, they operate as evolutionary factors of the business risk culture. Some of these changes may affect all the businesses (convergent evolutionary factors), others might affect only one or a few businesses (divergent evolutionary factors).

In the years previous to the financial crisis, the contingent factors operated as convergent factors, leading a process of cultural transformation towards a weaker risk culture. At the same time, quite paradoxically, the risk management tools became more advanced and the regulation on risk became more stringent: think of Mifid, Basel 2, rules on internal controls, compliance, antilaunderying, corporate governance. In this conflict, as often happens, culture wins: if the risk culture weakens, people can always find some way to circumvent internal and external rules. The evolutionary factors made riskier the risky activities of investment banks and made less prudent the more prudent commercial banks. The most important of these factors are described below.

-The growing *competition of the market* made more difficult for a financial institution to survive and increased the importance of the comparison between banks' performance. As an example of this new environment, one can quote the "famous" interview of The Financial Times (2007) to the former CEO of Citigroup, Chuck Prince. Referring to the loans provided by the bank for financing private equity deals, he said: "When the music stops, in terms of liquidity, things will be complicated. But as long as the music is playing, you've got to get up and dance. We're still dancing".

-The *deregulation* removed many constraints on risks. The principle-based, light touch regulation was based on two assumptions: self-control by cautious financial institutions and self-correction by efficient capital markets: both these assumptions were flawed. We remind only a few examples of this deregulation: the allowance to adopt internal models for the calculation of capital adequacy (Basel 2); and, in US, the removal of the net capital rule for the largest US broker-dealers (2004), the end of separation between investment and commercial banking (1999), the amending of Community Reinvestment Act as to liberalise the subprime loans.

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significant life events, such as natural disasters (Eckel et al. 2009), economic conditions (Guiso et al. 2015), and violent conflicts (Voors et al. 2012, Callen et al. 2014). Cohn et alii show how individuals' risk preferences are also malleable through the work environment. (Cohn et alii, 2015, p. 6).

[17] Lo (2015) describes this effect, which he calls the "compositional effect".

[18] "*However, you have to think what is the product of investment banking? The product is money. And I think there is something different about a business where the product is money. I think that it attracts a different kind of person and I think that it breeds a different kind of behaviour. That presents the industry with a real challenge if it is going to change the culture. It has to recognise that it is dealing with a different kind practitioner, a different kind of professional to, say, the architect or the lawyer. It is not insurmountable but I think it is a really very high barrier"*. Cfr. Augar, 2014, p. 6

-The *bank ownership* changed under at least four aspects: a) from state-ownership to private ownership for european commercial banking sector; b) from concentrated ownership, with an industrial and long term approach, to a fragmented ownership (public company), with institutional investors adopting a short term perspective[19]; c) from partnerships to listed joint stocks companies for US investment banks; d) from cooperative to limited companies for UK building societies. All these changes led to a more risk-oriented culture (Goldstein and Burditt, 2015; The Economist, 2013).
-As a consequence of previous factors, the *objectives* of the financial institutions shifted towards an higher emphasis on financial results and a lower attention to customers, personnel and social dimension. Growth, profitability and efficiency became the main goals of financial institutions. In many retail banks, the more prudent risk culture was replaced by a "profit culture", whit an excessive exposure to productive risk and by a "sales culture", whith excessive exposure to customer risk. In British banks the aggressive sales culture has been acknowledged as a major driver of bank failure (Spicer et alii, 2014). It led banks to promote financial products, irrespective of risk and customer needs, to make riskier loans, to engage in bad practices[20]. Also the poor outcomes of Barclays have been seen as a consequence of a corporate culture too biased towards commercial and competitive features, with little regard for other elements, such as the interests of the customer and of the overall society (Salz Review, 2013, p. 79)[21].
-The *success story* of more aggressive investment banks, with impressive profitability and growth in the years previous to the crisis, became the benchmark to emulate for largest commercial or universal banks[22]. The investment banking divisions were by far the most profitable part of the financial conglomerates. The capital markets too went through a long period of stability (the Great Moderation) and risky securities seemed to be less risky. Though the selling of risky products such as the credit default swaps, AIG could achieve high growth rates in the traditionally low-growth insurance industry[23].
-*Growth and diversification*: as said before, the mainstream business model required a bank to grow, to expand internationally, to diversify, to become more complex and interconnected. As a consequence, the risk management became more difficult and more bureaucratic, the risk culture lost homogeneity, the distance from the customers increased and the relationship with them became more impersonal[24]. Risk controls were put under pressure and they were seen negatively, as a limit to growth and profitability. In the diversified financial conglomerates, the risk culture of retail banking clashed with that of investment banking. In many cases, the latter prevailed, given the better financial performance. At Barclays the old retail and commercial bank culture, with its emphasis on strong relationships with customers, was challenged. The new bank's leadership, put in charge in 2007, tried to mimic the performance of investment bank division, with aggressive growth, less focus on controls and risks, a shift from customer orientation towards size and financial performance (Salz Review, 2013).

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[19] Haldane (2011) shows how, between 1998 and 2008, the average holding period of bank stocks for US and UK banks' investors fell from almost three years to three months.

[20] The incentive systems were a key driver of this cultural change. "*Increasing sales were reinforced through incentive systems which rewarded shop-floor staff for up-selling. Staff performance was typically made public through whiteboards which displayed employees who were leading sellers and who were laggards. Achievements in sales were publicly celebrated. Not achieving sales targets was punished…In one Halifax branch, there was a weekly 'Cash or Cabbages day'. Employees who exceeded their sales were publicly rewarded cash. Those who missed their bonuses were given cabbages*" Spicer et alii, 2014, pp- 20-21.

[21] *"In our view, Barclays did not, until recently, have a clear statement of a common purpose across its businesses. It rather emphasised growth and financial success…Over the period studied by the Review, the push for growth in the investment bank and Wealth, coupled with the need to increase returns in Retail, seems to have replaced the Group's sense of purpose and its customer focus*."(Salz Review, 2013, p. 79).

[22] "*Over the past 35 years it has seemed as if everyone in finance has wanted to be someone else. Hedge funds and private equity wanted to be as cool as dotcom. Goldman Sachs wanted to be as smart as a hedge fund. The other investment banks wanted to be as profitable as Goldman Sachs. America's retail banks wanted to be as cutting-edge as investment banks. And European banks wanted to be as aggressive as American banks. They all ended up wishing they could be back precisely where they started"* The Economist, 2009, p. 18.

[23] *"Paradoxically, the moral hazard of past success may have led AIG to make much riskier investments than a company with a poorer track record of risk management*" (Lo, 2015)

[24] "*The bigger the bank, the greater the distance from the customer… the detachment of bankers from the clients they were serving was extremely important in creating the cultural problems we see in the banking industry* (Deloitte 2014, p. 14)

Another example is UBS: investment banking was allowed to dominate group activity, which led to massive losses on US sub-prime mortgage-backed assets (The Economist, 2009). Spicer et alii (2014) describe the diversification process of UK retail banks. They had traditionally been relatively conservative institutions, with simple business model and an important role played in their community. During the 1980s, they moved from a branch banking model to a universal banking model, by expanding their riskier activities on the wholesale side of the market. As the banks extended beyond the relatively simple business model of the past, retail divisions faced increasing pressure to high rates of profit. To address this challenge, they developed aggressive sales cultures. They refashioned themselves as machines for aggressively marketing new financial products to customers.As a result, 'tellers' within bank branches started to see themselves as 'sellers'".

-The *product complexity* grew; culture is also knowledge, and the increased opaqueness of products undermined the ability to understand and to manage the risks involved; often, the difficulty to grasp the complicated technical features of new products went together with a sort of arrogance and an overestimation of the effectiveness of risk management systems.

-Some *organisational practices* contributed to lessen risk awareness. A key role was played by incentive systems, that over time accounted for a rising share in the employees' compensation, and in all sectors of the financial system[25]. They were based on financial indicators that were flawed: not risk adjusted, backward looking, easy to manipulate. They relied too much on short-term financial results and neglected other factors, such as the quality of service to customers, the sustainability of the business, the compliance to rules and controls. They sponsored a "profit culture" and a "sales culture", instead of a "risk culture".

- Also the *individual culture of the personnel* changed. Gordon Gekko became the idol of the new graduate generation, whose appetite for risk was accurately described by the "greed is good" motto. An "adverse selection" process came out: aggressive and risk lovers people started to flow towards the more successful and dynamic sectors of the financial system.

- In more general terms, it was the *economic culture* that changed. It leaned towards a quite extreme interpretation of free-market model, with emphasis on the efficiency of capital markets, their ability to spread and to reduce risk, the usefulness of financial innovation. The overvaluation of these virtues went hand in hand with the underevaluation of risks.

4. The rise and fall of risk culture in investment banking: the Great Detachments

As described in the previous paragraph, some evolutionary trends in the financial sector have determined a process of weakening of the risk culture in all financial insitutions, independently from the particular business in which they operate. To some extent, the largest US investment banks represent an interesting case study, for many reasons: they were at the root of the financial crisis, they paradoxically had the more sophisticated risk management systems, they were seen as very smart in assuming and controlling risks, they represented to some extent a successful business model to imitate…and they failed spectacularly. And this failure probably has more to do with risk culture than with the effectiveness of organisational tools.

Some literature describes the flaws in the risk culture of these institutions, particularly in the capital markets business, and trading & sales departments. The approach is anedoctical, consisting of narrations drawn from the personal experiences of former employees. It resembles the ethnographic methodology of research, particularly useful to study organisational culture, where the conclusions are drawn from participant observation[26]. In fact, the true culture of the organisation is not described by official documents, rules or data. It is revealed by the choices made by the people in their sphere of authonomy, by their ways to gain social appreciation, by their reactions to unexpected problems or, at the opposite, by their routine behaviours in the ordinary course of business. All these aspects can be better catched by sharing the experience (working at the bank), by direct observation of employees' behaviours, or by interviewing people and reading stories. Based

[25] Many inquiries have proved the role of perverse remuneration schemes as a cause of the financial crisis; e.g. IIF 2008, FCIC 2011, ICB 2011.

[26] Our main sources are Lewis (1989) about his experience at Salomon Brothers (SB), Smith (2011) about Goldman Sachs (GS) and Luyendijk (2015), who interviewed over 200 people working at City's investment banks.

on these literature, we will describe below the factors that are responsible for the "risk culture failure" in US investment banks. This failure can be linked to a rising separation between elements that otherwise should be strictly connected. The great divides:

- *Between finance and real economy: "It's only mathematics !"*. Finance is an economic infrastructure designed to serve financial needs of economic agents. If it loses this touch, it becomes self-referring, "unproductive" and risky[27]. When in 2005, for the first time, she met JPMorgan derivatives traders, Gillian Tett, author of Fool's Gold, could watch them with the lens of her former studies in social anthropology. She could better understand their rituals: "The PowerPoints the bankers presented on topics such as the CDO waterfall, did not merely convey complex technical data; they also reinforced unspoken, shared assumptions about how finance worked, including the idea that it was perfectly valid to discuss money in asbtract, mathematical, ultra-complex terms, without any reference to tangible human beings." (Tett, 2009, p. xii)

Serving-someone's-need culture is replaced by a betting culture, that permeates the trading floor. "Traders would wager on anything: Wimbledon, the Masters, how many White Castle burgers a first-year analyst could eat" (Smith, 2011, p. 50; see also Lewis, 1989, p. 84). Traders love risks. Also managers love risk. The risk is good in itself. Lewis' book starts with the challenge that the CEO, Gutfreund, threw out in the trading room to the best player in Liar's pocker (a sort of pocker game practiced by people at SB): "One hand, one million dollars, no tears" "What Gutfriend said – Lewis comments - "has become a legend at SB and a visceral part of its corporate indentity" (Lewis, 1989, p. 14). Gutfreund wanted to show to everbody, as an example, his courage and his risk propensity: "No fear for the risk".

- *Between material and human/social sides: "Money, money, money !"*. Money is the core value of the business culture. It is the final measure of success. For young trainees, most successful traders are the business heroes. Managers have power and earn impressive amounts of money, they are feared and envied, but they are not the organisational heroes, because they "did not make the money for Salomon. (They) did not take risk." (Lewis,1989, p. 16). Traders are the most respectable people because: "(They) were the people closest to the money. The firm's top executives were traders. There were even occasional rumours, probably started by the traders, that all the salespeople were going to be fired, and the firm would simply trade in a blissful vacuum. Who needed the fucking customers anyway ?"(ididem, p. 85).

The power becomes a tyranny, that is socially accepted: the "tyranny of the trader". "Some of the men who spoke to us (trainees) were truly awful human beings. They sacked others to promote themselves. They harassed women. They humiliated trainees. They didn't have customers. They had victims. ..The point is not that a Big Swinging Dick (a very successful trader or salespeople) was intrinsecally evil. The point is that it didn't matter one bit whether he was good or evil as long as he continued (to make results)" (ibidem, p. 86).

The nicest place to aspire to work at is where money come from (e.g. fixed income securities, in the beginning of eighties at Salomon Brothers). When a trainee makes a silly question, the classmates blow up: "equity at Dallas !" (it means: "you are so stupid that you should sell equities at Dallas", a very traditional and not so profitable business). Not only equity trading, but all the other businesses are despised because they are not so much profitable: "corporate financiers are considered wimps by traders" (ibidem, p. 23); "We all knew never to admit to an investment banker that we were also applying for jobs with commercial banks, though many of us were" (ibidem, p. 32).

Money means profits for the bank, but also it means bonus for bankers. For traders, the yearly bonus negotiation is the most important deal of the year. Chasing for the bonus creates an organizational climate of

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[27] "*Many jobs in a competitive arm's-lenght financial system are problematic for two reasons. First, like the worker on an assembly line, the broker who sells bonds issued by an electric power project rarely sees the electricity that is produced: she has little sense of any material result of her labours. ..Second, the most direct measure of a financial sector worker's contribution is the money – the profits or returns – she makes for the firm…The trader who shorts the stock does not see the workers who lose their jobs or the hardship that unemployment causes their families: all he sees are the profits he will make if he turns to be right in his judgment*". R.G.Rajan, 2010, p. 124

internal competitition, which damages risk culture by stimulating cheating and reducing collaboration and information sharing (Smith, 2011, p. 315). To get bonuses, people steal each other's ideas (e.g. about a new financial product; see Lewis, chapter 9). More directly, a manager can steal a part of the bonus of his salespeople, by crediting on their own account the commissions earned from trades (ibidem, p. 307). In 2005, Goldman Sachs changed its compensation system: it eliminated the subjective component related to how well traders did their job ang how good they were for the organisation.The system became largely mathematical and exclusively related to how much business has been brought in. At the end of the year, a trader or a seller was paid a percentage of the amount of revenue next to his name. And everybody started to do anything that was possible to pump up the numbers next to its name (ibidem, p. 313).

The pivotal role of money, of course, is not explicitly stated. Money's mastery is not an "espoused value", but a basic assumption, implicit and shared (Schein, 2010). When Lewis, in a job interview with Lehman Brothers, answers with honesty that he wants to become an investment banker because he wants to make money, he is kicked off. Only after, he knows from a friend who works at LB the why: "It's taboo. When they ask you why you want to be an investment banker, you are supposed to talk about the challenges, and the thrill of doing deals, and the excitement of working with such high-caliber people, but never, ever mention money". (Lewis, 1989, p. 35). "Learning a lie was easy. Believing it was another matter. From then on, whenever an investment banker asked for my motives, I dutifully handed him the correct answer: the challenge; the people; the thrill of the deal…That the money wasn't the binding force was, of course, complete and utter bullshit" (ibidem, p. 36).

SB' CEO likes to say that money is not so important and criticises the excessive greed of the younger generations, but his hypocrisy is noted and resented by the mortgage traders. "It was easy for Gutfreund to say money didn't matter. He paid himself more than any chief executive on Wall Street" (ibidem, p. 159). It seems to be a good example of how *not* to perform "leading by example" and "tone at the top" !

-*Between the bank and the customer: "Screw'em, they'll eventually forget about it !"*. The only interests to serve are those of the bank. "(The manager's) trademark response to any e-mail that had even a whiff of a client trade was a three-character e-mail back: "GC (Goldman Sachs Commissions) ?" No other words; no question about why the client had done the trade, what the trade was, or anything else about it. Just how much money was made on the trade" (Smith, 2011, p. 308). Once SB launched a CDO divided in two tranches, one backed by the principal of securitised bonds (POs, principal only) and the other by the interests (Ios, interest only). It sold the first one to the customers and kept in the book the second one. The reason was that SB expected the market to crash, a situation in which the POs plummet and the Ios appreciate (Lewis, 1989, p. 182). When a salespeople complains to a trader who lied to him and forced him to sell a bad security to his customer, the trader replies: "Look, who do you work for, this guy or Salomon Brothers ?" (ibidem, p. 207). Once the presidents of SB said: "Customers have short memories", and Lewis comments: "If that was the guiding principle of Salomon Brothers in the department of customer relations, that all was suddenly clear. Screw' em, they'll eventually forget about it ! Right. " (ibidem, p. 208). This is the attitude embedded in the culture of the bank and, these are the socially accepted behaviours; the "strange thing" would be worrying about this. "I had made the mistake of trusting a SB trader. He had drawn on the pooled ignorance of me and my first customer to unload one of his mistakes. He has saved himself, and our firm, sixty thousand dollars...Bellyaching would also make me look like a fool..How could anyone be so stupid as to trust a trader ? The best thing I could do was pretend to others at Salomon that I have meant to screw the customer. People would respect that" (ibidem, p. 208). Not only are the customers screwed; they are also despised. This is why a trader can humiliate a trainee who failed in impressing him by saying: "You are proof that some people are born to be customers". And all the (other) trainees think it is the "funniest thing they had heard all day" (ibidem, p. 213). At the London trading office of GS the informal organisational language calls the less sophisticated customers "muppets". "Being a muppet meant being an idiot, a fool, manipulated by someone else. Within days of arriving in London, I was shocked at how many times I heard people – both very senior and very junior, refer to their clients as muppets. Where, I wondered, had this adversial viewpoint come from – the idea of the client as someone much less smart than you, someone you could try to take advantage of ?" (Smith, 2011, p. 296). Augar (2010) describes the changing model of investment banking in UK, since the Big Bang on: the

City's traditional culture of independent advice and long-term relationship was replaced by the American model, in which the relationship with clients lasts no longer than the deal. "The client-banker dialogue ceased to be about trust and the client's long term interests and became more abut today's profit" (Augar, 2010, p. 224). As said before, this is shown also by the corporate language of investment banks: "They categorized (the customers) by "size of wallet", a crude but telling description of what really mattered to them" (ibidem, p. 224). The time horizon in managing the relationship with the customer becomes shorter and shorter: "Bond traders tend to treat each day of trading as if it were their last. This short term outlook enables them to exploit the weakness of their customers without worrying about the long term effects on customer relations. They get away with whatever they can." (Lewis, 1989, p. 131). After all, serving customers' interests is hampered by conflict of interest, a situation that worsened when the investment banks decided to enlarge the range of their activities and to be involved in proprietary trading alongside brokerage. In trading activites the bank acts for the buyer, for the seller and for its own portfolio. In M&A or private equity deals, it happens that the bank advises at the same time the buyer and the target company. "Under that scenario how can you possibly put the client first ? Which client do you put first ?" (Augar, 2014, p. 2).

- *Between bank and employees: "You want loyalty, hire a cocker spaniel*" Employees' interests are separate, sometimes in conflict, with that of the organisation. Human Resources policies of investment banks can simply described by the motto: "hire-and-fire". "You're a number. That's the deal you make when you go to work in finance: you are a commodity" (Luyendijk, 2015, p. 86). The dismissal procedures are quite famous: you get a call from HR, you are denied the access to your pc, you pack your stuff and you are out of the door in five minutes. Nobody feels safe, never. "Every day you you're getting closer to getting fired", as one boss uses to say (ibidem, p. 88). In the corporate idiom, sudden dismissal are called "executions", or "the cull" (the term used when infected cattle have to be destroyed). All this creates a climate of fear, a "toxic culture" (ibidem, p. 93), where the internal cooperation is hampered (kill or be killed) and politics is very important. "You need to say hello to the right senior people at the right time. Team members co-operate but they are also in competition for a better ranking in the review. As you would expect, friend will give friend good rebviews". (ibidem, p. 89).

If the bank is disloyal to its employees, employees are disloyal to the bank. Loyalty is not a core value; maybe it could be an espoused value, supported by senior management, but not a practiced value, shared by people. When SB tries to dissuade a manager to leave the bank, in the name of the loyalty to the firm, his answer is: "You want loyalty, hire a cocker spaniel" (Lewis, 1989, p. 254). The only link that bounds the employee to the employer is money; if a competitor offers more money, it's time to go. This shortens the time horizons of the decisions made by the personnel. The weakening of the ties between bank and employees is also an effect of the success and the rapid growth of the organization. The urgent recruiting needs loosen personnel selection criteria. Wrong people were selected, with low competencies, different personal values, low loyalty. "But that they let me – and other drifters like me – in the door at all was an early warning signal. Alarm bells should have rung. They were losing touch with their identity.They had once been shrewed traders of horseflesh. Now they were taking in all the wrong kinds of people." (Lewis, 1989, p. 47). In three years, 75% of the the trainees in the class of Lewis (that of 1985) would leave the bank, compared with 15% in the past.

This lack of loyalty, from both parties, shortens the time horizons of the employees' decisions; the weight attached to present results (profits) overcome that of future results (potential losses coming from risk). "If you can be out of the door in five minutes, your horizon becomes five minutes. That was the essence of the stories about zero job security…How realistic is it to expect "internal controls" to do their jobs in such a context ?" (Luyendijk, 2015, p.. 99).

- *Between bank and shareholders: "No more skin in the game !"*. The ownership structure of investment banks changed, from partnership to listed public companies. This separated ownership and control, reduced commitment of partners, who lost "skin in the game" and exposed bank's governance to the short term and profit oriented interests of shareholders.

- *Between productive and control functions*: *"What do they want again ? Tell them I'll call back"*. Controls and control functions are seen as obstacles to the business. Large investment banks have strong control

systems, but weak control culture. In the values' hierarchy, profit, growth and bonuses come before risk control. "To illustrate the point I reiterate the example of when I was a trader in a bank. The call had come through from a member of the compliance team inside the bank, they were after the desk-head of the trading team I was working for. The desk-head, from whom they were seeking a response to a number of questions they had asked, replied. 'What do they want again?' followed by 'Tell them I'll call back'. A few days later the call came again, and again the same response. This charade was repeated several times over the next couple of weeks. Finally, with patience running out, a terse email to the desk-head head was sent stating that they wanted a response by the end of the day or the matter would be escalated. The desk-head responded by sending back a short email with an attachment displaying his and the desk's trading P&L for the year, both were exceptional and far in excess of budget. He added a very short message saying 'Over to you'. The matter was not heard of again. I share this little vignette, not because there was any serious compliance breach, at least not in the context of the early 2000s, but to make a point about the attitude and mindset which was becoming prevalent in banks through the 90s and early noughties" (Goldstein and Burditt, 2015). In JP Morgan Chase, a bank with an outstanding reputation in risk management, "the whale trades exposed a bank culture in which risk limit breaches were routinely disregarded, risk metrics were frequently criticised or downplayed, and risk evaluation models were targeted by bank personnel seeking to produce artificially lower capital requirements." (Permanent Subcommittee on Investigations, 2013, p. 7). "We are tiger" –said another flow trader. "You want traders to be aggressive as they can and make the bank as much money as possible". The risk limits that he had to stay in were his cage" (Luyendijk, 2015, p. 72).

The Great Detachments just decribed became wider and entrenched in the organization because they found confirmation in the outstanding financial performance. The extraordinary results of investment banks in the bullish years before the crisis triggered a deadly imitation game and infected all the businesses. When CEO of Morgan Stanley, Philip Purcell, tried to follow a low risk strategy, he was dismissed by shareholders who wanted a more aggressive approach (Augar, 2010, p. 227). But Purcell was an exception, because no CEO wanted to be considered as a laggard and to be pushed down in the investment banking league tables. Success generated a corporate culture of hubris, overconfidence and underestimation of risk. First and foremost, it was not a failure of some executives, nor the failure of some organisational tools (e.g. risk management systems). It was a failure in the business risk culture.

5. Conclusions

The nature of the business is one of the determinants of the risk culture in financial institutions. The direction and the intensity of this relationship depend on structural and contingent factors. The former are intrinsic and quite stable characteristics of the business, such as the kind of activities performed, the customers served, the economics. The latter are factors that might change over time and that affect risk culture indirectly; if they are different in different businesses, they contribute to shape the business culture. We analysed the most important of them: market competitiveness, regulation, history and evolution of the business, size and diversification of the financial institution, ownerhip model, national culture, strategic orientation, organisational systems and practices, employees' individual culture.

In the years previous to the financial crisis, these factors moved along a common trend, that led to a weakening of risk culture in almost all financial institutions. This process was more pronounced in some sectors, such as investment banking. The analysis of the risk culture of the financial institutions in general, and of the US investment banks in particular, has highlighted its flaws. Undoubtedly, the weakening of risk culture caused at the micro-level the adoption of wrong risk management practices by banks; at the macro-level, the bursting of the financial crisis.

As a consequence, the key role assumed by an healthy risk culture in the governance of financial institutions is strongly confirmed.