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## **‘Bank top management teams, disclosure, *learning*, survival and failure - 1990-2017’**

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### **Forthcoming in ‘Qualitative Research in Financial Markets’ in 2019**

#### **Abstract**

##### **Purpose:**

Corporate financial communications concern public and private disclosure (Holland, 2005). This paper explains how: banks developed financial communications; problems emerged in the GFC. It explores policy responses.

##### **Design/methodology/approach:**

Bank cases reveal construction and destruction of social, knowledge and economic world of financial communications over two periods.

##### **Findings:**

In 1990s learning about financial communications by a 'dominant coalition' (Cyert, March, 1963) in bank top management was stimulated by gradual change. Management learnt how to accumulate social and cultural capital and developed 'habitus' for disclosure (Bourdieu, 1986). From 2000 rapid change and secrecy factors accelerated bank internalisation of SWM values; turning 'habitus' in 'Market for information' (Barker, 1978) into a 'psychic prison' (Morgan, 1986); creating riskier bank cultures (Schein, 2004) and constraining learning.

'Masking' and rituals (Andon, Free, 2012) restricted bank disclosure, and weakened governance and market pressures on banks. These factors mediated bank failure and survival in 2008, as 'psychic prisons' 'fell apart'. Bank and MFI agents experienced a 'cosmology episode' (Weick, 1988). Financial communications structures failed but were reconstructed by regulators.

##### **Research limitations/implications:**

The paper introduces sociological concepts to banking research and financial disclosures, to increase understanding; of financial information, bank culture; and how regulation can avoid crises. Limitations reflect the small number of banks, and range of qualitative data.

##### **Practical implications:**

Regulators will have to make visible: change processes; new contexts and knowledge; and connections to bank risk and performance; through improved regulator action and bank public disclosure.

##### **Originality/value:**

The paper shows how citizens require transparency and contested accountability to democratise finance capitalism. Otherwise problems will recur.

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## 1. Introduction

This paper aims to explain how banks developed their financial communications and how problems emerged in the Global Financial Crisis (GFC). The focus is on bank learning about financial communications in the ‘market for information’ (MFI) (Barker, 1998; Holland, 2017). The research question concerns how did banks develop their financial communications function before the GFC and how did it perform during the crisis? The paper explores bank success and failure in learning during 1990-2000, and 2000 to 2008 leading to and during the GFC. The paper makes a contribution to an emerging stream of qualitative literature in finance and accounting concerning disclosure content (Holland, 2009), behaviour (Roberts et al, 2006; Marston, 2008), and function (Rao et al, 1999). The paper is set in the context of the ‘market for information’ (MFI) (Barker, 1998; Holland, 2017) or the world of corporate executives, analysts, fund managers, auditors and other information users. The paper reveals how structure and behaviour in corporate financial communications and in associated disclosure activity can develop through periods of change leading to success and failure.

The core research problem addressed concerns how development of bank financial communications has contributed to problems in: information production; in markets; and banks. Section 2 on research methods outlines sources of data and use of grounded theory methods to understand: bank learning for financial communications; and subsequent problems. The summaries to sections 3 and 4 discussed below provide brief insights or a ‘sneak peek into the investigated scene’ (p121, Locke, 2001). These constitute a short ‘empirical narrative’ for the paper and a concise ‘theoretical narrative’. These provide readers with a ‘map’ to navigate the paper (Golden-Biddle and Locke, (2007) in the next part of the introduction below. They provide an early overview of the richness of the data, overall empirical patterns, and theoretical interpretation of how the case banks learnt and changed their disclosure activities over time. Section 5 notes that connected change processes and resulting social and knowledge risks in financial communications contributed to financial risks in the world of finance and banks. Regulators will have to regulate and make visible the: connected change processes; and newly constructed structures, contexts and knowledge. Both regulators and banks will have to enhance disclosure to reflect conduct, behavior, actions, within changing contexts; all relative to perceived ‘good practice’ and acceptable ethical standards. If not, the same problems will recur. Section 6 outlines the conclusions.

In terms of an *empirical narrative*, section 3 discusses how in the 1990s bank top management learning about financial communications by a ‘dominant coalition’ (Cyert and March, 1963) was stimulated by everyday experiences, environmental change, incentives, gradual shareholder wealth maximising pressures and financialisation processes. Learning concerned how to: organise and conduct bank disclosure (structure, behaviour and content); to stabilize external states within change; and to avoid negative consequences concerning power and reputation of bank top management; and wealth of investors. Learning involved the gradual internalisation of shareholder wealth maximising values in bank culture, hierarchy and teams, and behaviour. Section 4 investigates problems, negative incidents, successes and

failures in the bank learning process over time and shows gradual deterioration in social, culture, power, knowledge and economic structures related to bank financial communications eventually leading to failure. Top management in banks such as RBS and HBoS were unthinking and uncritical in their imitation and conformity when developing: internal financial communications functions; external MFI networks; and disclosure activities (Holland, 2017). They were more concerned about ‘keeping up appearances’ and concealing information when conducting financial communications and a period of increased financialisation (Haslam, 2010) and intensification of shareholder wealth maximising pressures. Other banks such as Lloyds, Barclays and HSBC faced similar pressures to conform but were more critical of the process. These factors were central to bank failure and survival. The empirical insights revealed the: fragility, significance; and function structures in the world of finance, and the need (for regulators and governments) to maintain their stability.

A *theoretical* structure and *narrative* is also developed in sections 3 and 4 to match empirical insights into bank management learning about bank financial communications in stock markets. For example, concepts such as ‘habitus’ (Bourdieu, 1986); ‘psychic prison’ (Morgan, 1986); and Stones’s (2005) ‘strong structuration theory’; are used to explore how: social structures and knowledge mediated the changing impact of shareholder wealth maximising and financialisation pressures; in two distinct periods of gradual and rapid change before the GFC. Differences in bank social and knowledge factors also mediated bank failure and survival outcomes in 2008. Concepts of organisational culture (Schein, 2004) and ‘masking’ and use of rituals (Andon and Free, 2012) are used to analyse bank conduct of communications pre crisis and during crisis. The theories are used to analyse the empirical findings and develop the ‘theoretical narrative’ and frame for interpretation (Golden-Biddle and Locke, (2007). Their use demonstrates the potential to develop a coherent and integrated theoretical frame closely matched to the empirical findings. This embryonic theory or literature frame illustrates the potential to connect: change processes; larger structures (social, economic) that banking and finance agents operate in; their knowledge of, and power in this system; their disclosure actions (or non actions) and behaviour in this world; as well as outcomes. The combination of empirical insights and appropriate theory is intended to enhance understanding, meaning, and the power of critical analysis for those involved in this field. It is intended to enhance trust and confidence for readers concerning the judgements employed in interpreting the cases and in constructing the ‘bank financial communications model’ and its problems. The aim was not to develop or test these theory frameworks or develop meta theory, but to position the paper, its issues and empirical structure, relative to a wide range of relevant literature. The aim was demonstrate their collective power in interpreting the combined phenomena, in suggesting new areas and directions for research, and in contributing to further policy development.

## **2. Research methods**

The paper seeks to explain how banks developed their financial communications and how problems emerged in the GFC, through grounded theory field research and theoretical interpretation. The focus is on bank success and failure in learning during 1990-2000, and 2000 to 2008 leading to and during the GFC. Two sources of data on banks are used in this paper. Firstly, historic field research in banks (and other companies) by the author during 1993 to 2001. Secondly, new public source of data on banks, pre crisis and during the GFC, published in the period 2011 to 2015.

Historic field research in banks revealed many insights into the bank learning about their financial communications to stock market in the period from the 1990s to 2008 and beyond and the many problems they experienced. The author had initially developed bank (and other company) case material for the 1990s period to 2000. This was used to develop an embryonic grounded theory view (Locke, 2001) of bank (and other company) learning about financial communications from cases in 1993-94, 1995-1996, 2000-2001. The grounded theory thus reflected bank (and other company) case experiences over this period. The author's historic case data for large UK banks for the 1990s was drawn from large UK banks such as Lloyds, BOS, RBS, HSBC, Barclays and others. Given the confidential nature of the interviews these banks are not named and have been referred to as Banks A, B, C, D, E in section 3 when discussing change in the 1990s.

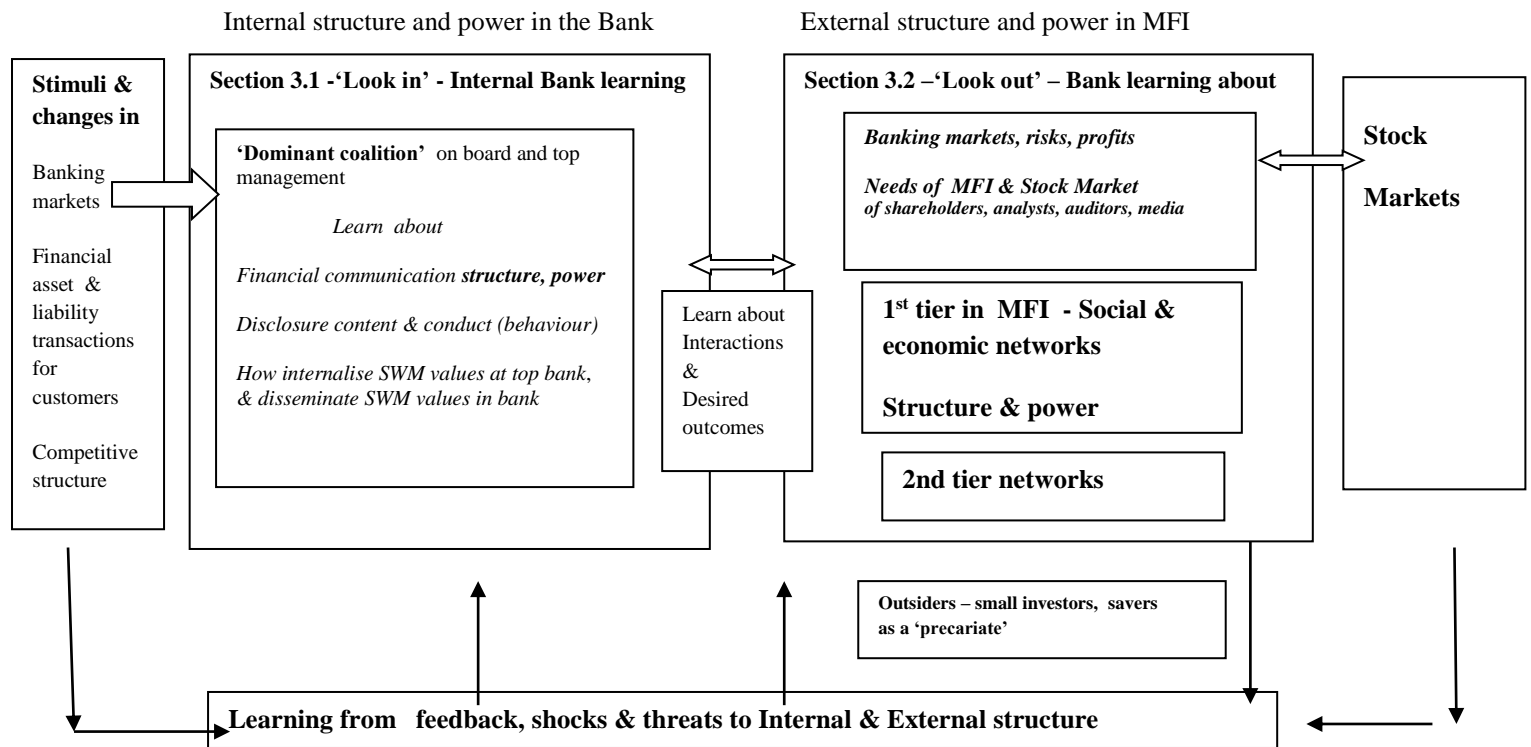
Significant new public sources were developed in 2011-2015 in the form of major books, and regulator reports such as FSA reports, Perman (2012), Turnbull (2013), Fraser (2014), Fallon (2015). These were based on much new insider interview information during 2008-2012 with the main actors in banks such as RBS, HBOS, Lloyds, Barclays and HSBC. These provide new insights into the Northern bank failure and the UK bank problems in the GFC and afterwards. Given these are public sources, RBS and HBOS are used as named banks to illustrate examples of bank failure, and Lloyds, Barclays and HSBC are used to show success. These sources on problems created novel means to further develop ideas on bank learning about financial communication for the 2000 to 2008 period. Thus case and archival data cover the major large UK banks in both periods. The paper combines the author's historic case data for large UK banks for the 1990s with the new UK bank sources in 2011-2015. Together they are used to create many new insights and a grounded theory of 'bank financial communications and learning and associated problems' was developed.

### **3. Learning about bank financial communications in the 1990s**

Section 3 discusses how **in the 1990s** learning: by a ‘dominant coalition’ (Cyert and March, 1963) in bank top management; about financial communications; was stimulated by everyday experiences, environmental change, incentives, and gradual shareholder wealth maximising pressures. Learning concerned how to: organise and conduct bank disclosure (structure, behaviour and content); to stabilize external states within change; and to avoid negative consequences concerning power and reputation of bank top management; in external MFI social networks and stock markets (Holland, 2017). Learning involved the gradual internalisation of shareholder wealth maximising values in bank culture, hierarchy and teams, transactions and behaviour. Figure 1 illustrates the main elements of bank learning about internal and external worlds. The grounded theory in figure 1 provides a summary schematic view of behaviour in the case banks. This is intended to aid reader understanding of complex phenomena captured by the grounded theory of ‘bank learning about financial communications’. The grounded theory is specific to the periods in which data was available. In section 3 this includes the shareholder wealth maximising (SWM) period of stability pre crisis. In section 4 this includes further insights into the fragility of this behaviour and associated grounded theory during the crisis period and its aftermath.

Section 3.1 explores how the UK bank board and the top management teams were leading agents in ‘learning organisations’ (Pedler, et al, 1997; Easterby-Smith et al, 2000). They ‘looked in’ to develop bank organisational forms and processes to achieve their financial communications and disclosure aims concerning the ‘market for information’ (MFI) and stock market environment. Section 3.2 discusses how management also ‘looked out’ and learnt about: Banking markets, financial transactions and competition. They learned about ‘Market for information’ (Barker, 1998) networks; and 1<sup>st</sup> and 2<sup>nd</sup> tiers or sub networks in the MFI ‘tailored’ to the (financial communication and influence) needs of specific banks (Holland, 2017). Section 3.2 also explores how bank top management learnt about: negotiated power in these structures; and how to use power and take disclosure decisions in the structures; to produce desired outcomes in markets. This was how bank and MFI agents constructed understanding of their world as ‘habitus’ (Bourdieu, 1986).

**Fig 1 Bank learning about financial communications - Creating a - dynamic interactive- disclosure system**



### 3.1 Learning about internal bank organisation – ‘looking in’.

Section 3.1 uses the case data to illustrate how UK bank board and the top management teams were ‘learning organisations’ in the 1990s (Pedler, Burgoyne and Boydell, 1997). Learning was led by a ‘dominant coalition’ (Cyert and March, 1963) of actors such as the chairman, chief executive and finance director. They formed: a small elite and closed group; operating as an informal but powerful structure; which spanned the formal board and top management team structures. The ‘dominant coalition’ was concerned about, issues of power and values, as well as creating a financial communications organisation, in the bank. Their learning was stimulated by incentives, and external change pressures to develop financial communication capabilities. They ‘looked in’ and learnt to: internalise shareholder wealth maximising values; develop bank organisational forms; enhance capabilities of individuals and teams; and to maintain or increase their coalition power. Learning actions occurred during everyday disclosure actions (learning ‘by doing’ and ‘by trial and error’); by imitation; and during periods of reflection and discussion (reflexivity) (Pedler et al, 1997). Learning occurred through knowledge transfer mechanisms such as: recruiting experienced managers; observing good practice and benchmarks; and using communication consultants.

A key starting point in the 1990s was that the case banks learnt how to structure and staff the financial communications function by drawing on: the existing 'dominant coalition'; established and formal board and top management functions; and by setting up a specialist Investor Relations function.

Bank D: 'In the past two years we have developed a new bank structure combining the Chief Executive, Finance Director, and Investors Relations staff and we have become much more active in investor relations. We have created new forms of regular contact between these bank executives and the institutions'.

There were many case examples of banks responding to mimetic and coercive pressures operating within an external institutional perspective (Scott and Meyer, 1994; Rao and Sivakumar, 1999). For example, the pressures arose for bank top management to learn to meet market benchmarks.

Bank F: 'There is intense pressure on this thin blue line in our bank to meet institutions and brokers analysts ... and to release more ... information to them and ... market. They benchmark us against ... competition. Market pressure is increasing ... on ... a small management group and is taking up an enormous amount of our time. We question this ... but ... have to fall in line'.

Case banks also learnt about the financial communications function by various knowledge transfer mechanisms such as: recruiting experienced managers; observing good practice and benchmarks; and using consultant advice. Acquisition of experienced staff at board and top management level was one means to learn how to develop this financial communications expertise and to improve internal links. New members of the Board, a new Chief executive and IR staff (or new 'dominant coalition' demanded by the MFI) were often a stimulus to the transfer of new ideas and to learning about the financial communications function. Bank A also learnt about these issues through its mistakes during a bid process.

'we would have been a much more effective in our bid .... If we had bought in a finance director and investor relations staff with experience here ... fund managers would have seen much more of the internal sources of value, ..... poor quality of our communication about a fairly good management team and the good history of performance meant we lost out'

Bank management learnt that their skills and competence at strategy development and execution were vital to the quality of disclosure. They also observed and copied bank disclosure methods in other banks through many mechanisms such as observing major bank problems and 'tricks' of winners. Bank A provides an example of learning from good practice by competitor Bank F during a bid.

' Bank F emphasised contact with fund managers and gave much slicker .. presentations than us. This was down to Chief Executive X and Chairman Y. .... they saw .. the top twenty fund managers two or three times ... were ... more persistent in their contact. ... X in particular, was the star turn with Y backing him up. This behaviour surprised the City because Y was known to despise .. UK fund managers .. during .. presentations ... he backed up X and was ... supportive ... Bank F made up for a weakness in communication skills ... by recognising Y's limits ... put him ... as .. second stringer and put X out front as the main person to implement the strategy and he appeared excellent in terms of his ability to talk about it.'

External consultants, played an important role in guiding this learning and encouraging internal and external exchange of expertise. Consultant activity and their use of in-house rehearsals were central to the rate of learning relative to change, and to imitation and adoption of best disclosure practice.

Bank D shows learning about inter-bank competition and setting benchmarks for other banks

'We .. set the trend ... organising our top team to talk to .. City and .... Investor Relations presentations to the institutions ... increased voluntary disclosure ... in .. report and .. private meetings. But .. we've lost the benefits because .. banks are ... all organised the same way ... doing the same things ... talking the same language ... the institutions cannot distinguish between us ... However, in terms of .. core institutions, we .. have their confidence .... we hope they'll help us when we need their help'



Stones (2005) strong structuration theory can be used to provide a broad theoretical interpretation of the above learning by bank top management. Learning (actions) occurred for top management individuals in external structures as boards, top management teams and 'dominant coalitions'. They exploited internal structure in the form of general and specific knowledge about bank organisation. Learning actions and outcomes occurred: during routine financial communications and disclosure decision actions (learn by doing); and during periods of reflection by the 'dominant coalition' within external and internal structure. Top management faced strong external change pressures and had strong reputation, power and wealth incentives to learn and act in an informed way. Control over disclosure to financial markets was recognised as central to: financial communication effectiveness: power and wealth issues for individuals and teams; and was controlled by the 'dominant coalition'.

### **3.2 Learning about external structure as the 'market for information' (MFI) in the 1990s**

During the 1990s, the bank 'dominant coalition' (Cyert and March, 1963) 'looked out' and learnt (Pedler et al, 1997) about the nature of: the 'market for information' networks and stock market links (Barker, 1998; Holland, 2017). They learnt how top management in large banks were socially and economically connected to large FMs in 'elite social and economic clubs' or '1<sup>st</sup> tiers' or 'status groups' (Preda, 2005) in the MFI. Their operational staff were connected in '2<sup>nd</sup> tier' groups. Bank agents learnt how to develop bank tailored sub-networks in 1<sup>st</sup> and 2<sup>nd</sup> 'tiers' in the MFI. They learnt how to maintain, increase and use power in networks. Learning actions occurred during: everyday disclosure actions (content and behaviour) in the MFI; imitation processes; and periods of reflection and discussion (reflexivity) by these agents (Pedler et al, 1997). Learning occurred by: observing accepted disclosure practice; and using consultant advice. Corporate communication consultants used rehearsals and ongoing interactions in the MFI to 'push bank top management up the learning curve' concerning information exchange structures and disclosure activity within them. Small investors and savers were 'outsiders' to the private world. They had little or no power and can be considered to be a 'precariate' (Savage, 2015) in the world of finance.

Bank top management experience of 'looking out' as a network 'learning organisation' (Pedler et al 1997) was distinguished by a very rich, high pressure, continuously 'live' 24 hour, and competitive 'information environment' about the bank .

Bank E 'Learning by.. financial institution (shareholders) takes time ... you have to reinforce it by regular meetings ...One visit ... is not enough. To..get some benefit ...we require a track record of meetings over several years with...major shareholders.. ...top analysts... They.. listen to our strategic plans in one year and..come back ..next year to compare and..see if..businesses are being managed as ..planned. Shareholders .. insist on seeing top management when asking and discussing these questions'.

Members of the bank 'dominant coalition' (Cyert and March, 1963) and senior executives in the MFI led learning in the MFI. They formed: a small elite and closed '1<sup>st</sup> tier' group; as an informal but powerful structure; which spanned the top of the bank and MFI social structures. The 1<sup>st</sup> tier group included bank actors such as the chairman, chief executive and finance director and MFI actors such as large FM shareholders, and influential analysts (Holland, 2017). The elite 1<sup>st</sup> tier group were concerned about: issues of power (sources, hierarchy of, balance, uses, outcomes); diffusing shareholder wealth maximising values;

and creating network structures for exchange of information and influence between the bank and external MFI agents (Holland, 2005).

Bank top management, often with consultants, learnt how to develop their own specific sub-networks within larger elite networks. The 1<sup>st</sup> tier consisted of links to agents in the largest and most influential fund manager firms (say top 30) each holding more than 1% of the bank's stock. In case bank D these consisted of 5 hedge FMs, 5 very active short term FMs, and 20 active long term FMs. The 1<sup>st</sup> tier links also consisted of close contact with journalists in the highest quality financial media such as in the FT, WSJ, and BBC, as well as links to top rated bank analysts (eg top 5).

Bank D 'We rationalised investor relations .. when our chief executive arrived. Before it was ad hoc...if someone rang ..we saw them. .... We have created.. regular contact between bank executives and..institutions. This includes priority contact between our top management and .. 5 to 10 proactive institutions every 6 months...rest...top 30 active financial institutions every year ..... This is lot of change in a short time, but our consultants are ...bringing us up to speed with our competitors'

A 2<sup>nd</sup> tier network was made up of smaller FMs, less powerful analysts and other MFI agents, who dealt with less senior bank staff such as Investors Relations and Finance Director. The 2<sup>nd</sup> tier group was much less powerful and threatening and hence much less resources (of executive time, reputation and skill) were used when disclosing information to the 2<sup>nd</sup> tier.

Bank D: 'Our investor relation staff maintain contact with ...our top 30 to 50 financial institutions and.. less influential analysts' The above reveals how bank top management developed their understanding of how they were situated in a web or network of situated roles or 'position practices' (Stones, 2005) with other agents in the MFI. The bank 'dominant coalition' learnt how to tailor 1<sup>st</sup> and 2<sup>nd</sup> tiers or sub-networks in the MFI to the (financial communication and influence) needs of their banks. They learnt how to use the 1<sup>st</sup> and 2<sup>nd</sup> tiers in the MFI to achieve desired (bank, personal) market, wealth and power outcomes. The variation and fluidity of the bank financial communications agents in 1<sup>st</sup> and 2<sup>nd</sup> tier MFI networks corresponds to Roberto's (2003) proposed "stable core and dynamic periphery model" of strategic decision making in the 'dominant coalition'. The internal organisation of a bank 'dominant coalition', and its role as a 'boundary spanning' organisation structure (Rao and Sivakumar, 1999) tailored to MFI tiers, provided some form of stability for the bank and for MFI participants in a world of considerable uncertainty.

A key dimension to learning about bank financial communications within MFI structures concerned the development and use of power. Bank and other elite agents were aware that the **function of power** was to create the means for 1<sup>st</sup> tier elite agents (and 2<sup>nd</sup> tier agents) to exercise some control over: what is information in networks; how it is defined; what information is produced, disclosed and exchanged in the MFI; who gets information; and hence who has control over wealth. As a result, the bank 'dominant coalition' sought to understand: external sources of their power and threats to this; and the hierarchy of power in external structures. They discovered how to use bank power to: counter balance external power; take disclosure decisions (content and behaviour) to produce desired outcomes in markets (MFI 'tiers' and stock market); and manage the fragility of these outcomes.

A key stimulus to learning by bank top management involved potentially **threatening** sources of power.

Bank D 'We have learnt to look carefully at ..share register ..who our key financial institutions are. Who is buying, who is selling, who's over and under weight. We have learnt to distinguish the passive, active, pro-active and hedge managers and what their

different investing motives might be.... We're now more realistic why we go to see the institutions and why they buy our shares. .... We have learnt to recognise where power affecting us is concentrated in the market and where it is changing'.

Power conditions in elite or 1st tier group in 'normal' conditions (Holland, 2002) involved a **'balance of power'** rather than dominance by any group. Bank E shows how it learnt about power structures and the balance of power in 1<sup>st</sup> tier with active FMs.

'If.. we make a mistake on strategy or ..change ..strategy ..this can.. radically alter ..view of .. fund managers and ..change their stakeholding .... This ....shows...influence ...fund managers have over us .....but they are not managing us. We are telling them what we intend to do and they ... make a decision ..whether it is acceptable. If it is.... they hold a stake in us but ..expect us to keep those promises .....This is not .. management interference ... They are leaving us with our right to manage'

This learning about the impact of real business actions and information market actions revealed bank management needs to react to the coercive power of market participants in the (structured) MFI institutional setting (Roberts et al, 2006). Learning also concerned outcomes. Bank management sought an enhanced understanding of the impact of their financial communications on tailored 'tiers' and the wider MFI (Holland, 2005). They sought to understand how bank actions via intermediaries: could influence ultimate stock market states such as bank stock prices, liquidity, confidence states; and how these could impact on bank cost of capital. From a bank top management perspective: positive reactions from shareholders and desirable stock price outcomes to disclosure actions (content and behaviour); created positive links between executive pay and bonuses based on stock price performance. Bank F learnt how relatively stable intermediate outcomes could contribute to stock market outcomes.

' If you talk to..core financial institutions and communicate.. well, .. this increases stability.. share price. Institutions are the stable component in ..share price ... we.. keep talking...make sure they learn....are.. well-informed and ..ensure.. stability.

Bank F shows they also learnt about the fragility of expected outcomes in City and global finance networks and the limits of bank power.

'Our aim in investors relations is to... reduce volatility and.. keep.. institutions advised. If there is a thing called loyalty, then we would like to have ... it.... loyalty can vanish if the price is right.. the past two weeks ...our peripheral ...institutions have put the Bank into play for ..takeover.. .... You have to... watch...core .. and peripheral institutions.... ..analysts, the press and the more frothy institutions.. is where most of the volatility lies in our share price and we...seek to minimise the effect. We spend a lot of time trying to get them to learn about us...to keep them well informed and ..try to minimise their volatility.'

#### **4. Bank learning post 2000 - Success, failure.**

Section 4 investigates problems, negative incidents, successes and failures in the bank learning process over time. It shows gradual deterioration in social, knowledge and economic structures related to bank financial communications eventually leading to failure. During 2000 to 2006, control by the bank 'dominant coalition' over bank financial communication functions, and their close connections with MFI agents and structures, combined with many change factors to impair bank financial communications. Factors such as: rapid change and increased financialisation (Haslam, 2010); increasing bank complexity; and increasing role of intangibles in bank models (Chen et al, 2014); increased the power of 'dominant coalitions' to **accelerate** the internalisation of shareholder wealth maximising values in the rest of banks. The same factors played a role in the shared 'habitus' becoming a 'psychic prison' (Morgan, 1986). Both shareholder wealth maximising internalisation and the 'psychic prison' encouraged higher risk taking bank cultures in bank (Schein, 2004). These factors and rapid change led to major failures in learning occurred concerning bank models, risk and communications.

Section 4.1 explores the development of the MFI psychic prison in 2000-06 and how this created problems such as higher risk taking bank cultures. In section 4.2 RBS and Lloyds cases are used to illustrate differing impact of internalised shareholder wealth maximising values and the 'psychic prison' on these banks especially on their culture, with customers, and in disclosure conduct and content. RBS created a high risk culture and adopted highly risky conduct and action with customers and in markets. Lloyds sought to maintain their conservative bank culture and conduct and to counter the external pressures but increasingly faced problems when doing so. Section 4.3 uses the RBS and CEO Goodwin case to illustrate how executive hubris combined with the 'psychic prison' to create a 'toxic' bank culture prepared to take extreme financial risks and at the same time conceal them through deceptive disclosure (content, conduct) in the MFI. Section 4.4 shows how, as the crisis emerged in September 2008 many connected elements failed together. These included: bank business models; 'dominant coalitions'; MFI 'tiers; and agent knowledge of these (as a complacent 'habitus' set in a 'psychic prison'). Regulators and governments immediately stepped in to support bank models, stabilise bank finances; and reconstruct bank and MFI financial communication structures and processes.

##### **4.1 Developing the 'psychic prison' during 2000 to 2006**

Morgan (1986) argued that a 'psychic prison' can arise in inward looking and closed social networks. Blake (1790) referred to this as 'mind-forged manacles' when referring to the poor of London. In this case they refer to 'mind-forged golden handcuffs' of the powerful and rich elite of financial centres such as London.

Various change, complexity and attention factors and the private nature of bank disclosure in the MFI all played a role in creating a 'psychic prison' (Morgan, 1986). They created an illusion of stability in the world of banking and of financial communications between bank 'dominant coalitions' and MFI agents such as large shareholders. They created an illusory world of stable social structure, knowledge

and power conditions which at the same time accepted ideas of rapid bank growth and risk taking. The taken for granted world of: bank and MFI social structure, knowledge and power conditions; began to deteriorate from 2000 onwards; despite appearing stable to the majority of participants.

More specifically, this occurred within (eventually failing) banking firms such as HBoS when the ‘dominant coalition’ in board and top management teams had little prior experience of banking and bank problems. They had general management and financial communications experience but not banking. This formed ‘knowledge faultlines’ (Crawford, LePine, 2013) between the: ‘dominant coalition’; the rest of the board and top management teams; and operational line managers. The ‘dominant coalition’ ignored important changes to their business models (Holland, 2010) and thought that high quality disclosure based on a narrative about growth and value alone (and not bank risk) was adequate for their needs and those of MFI agents. They learnt about: established MFI rituals: conventional information agendas; and disclosure conduct and content; and showed a preference for form in these matters over substance on risk. Their views dominated organisational learning in the board and top management team and set the ‘tone from the top’ for learning by middle managers, and front and back office staff. Similar problems also occurred between other MFI agents such as bank analysts and FMs and in financial media such as the FT and Economist. Before the crisis these connected actors used a common framing or interpretive scheme (Weick 1995) based on established ideas and information agendas about banks and markets (Holland, 2010). These actors were caught up in the ‘spirit of the times’ concerning growth and increasing value. This altered their framing and led to them to ignore or downplay new risks.

The ‘psychic prison’ thus concerned shared private structures, rituals, knowledge, stable power relations, as well as shared narrative, earnings information agenda, behaviour, and values. This comprised shared but increasingly illusory narratives and knowledge how: bank business models worked: and banking markets and stock markets worked. It included bank top team structures closely linked to tailored 1<sup>st</sup> and 2<sup>nd</sup> tier MFI networks, and elite bank and MFI agents operating with expectations of continued growth, exercise of power and success. It contained shared expectations about the primacy of established disclosure behaviour, protocols and rituals in behaviour and interactions. It included shared assumptions about the importance of shareholder wealth maximising aims.

In the period 2000 to 2006 the shared ‘psychic prison’ constrained modes of thinking and trapped bank top management, analysts and investors in webs and myths of their own creation. They focussed their learning and decision actions within established social and power structures (bank organisation, and MFI network); knowledge of these structures and of the stock market; existing disclosure rituals of financial communication; and of conventional information agendas; as outlined in section 3. They were ‘captured’ by the dynamics and intense pressures in everyday bank and MFI interactions and were constrained in their thinking and learning by these factors of established structure, knowledge, ritual and information agendas. In addition, time pressures and incentives (economic, power) meant they did not pay attention to the changing risks in bank business models (Holland, 2010; Chen et al 2014).

During this period the world of stable and functioning social structure, knowledge and power conditions for the bank ‘dominant coalition’ and MFI agents described in section 3 began to deteriorate. As a result bank top management (both ‘dominant coalition’ and others) in banks such as RBS and HBoS were unthinking and uncritical in their imitation and conformity when developing internal financial communications functions and external MFI networks. They were more concerned about ‘keeping up appearances’ in disclosure activity. Other banks such as Lloyds, Barclays and HSBC were facing similar pressures to conform but were more critical of the process.

A spectacular example of the problems this created arose before the banking crisis when bank top management and other MFI agents demonstrated their failure to understand new bank business models (Holland, 2010; Chen et al 2014). In the pre crisis period (2000 to 2006) bank sell side analysts, fund managers and the financial media, found it difficult to explore and learn about bank business models when meeting with bank top management and receiving private information (Chen et al 2014). This was true of all case banks such as RBS, HBoS, Lloyds, Barclays and HSBC as they faced rapid change in banking markets. Despite this lack of understanding both FMs and bank analysts demanded ever higher returns from banks and widespread adoption of the profitable business models. High exposure to financial risk had been accepted by these MFI agents, and by regulators and financial markets within (the assumptions of) a shared intellectual climate based on established knowledge (Turner, 2009; King, 2014). In this orthodox finance theory frame, risk was assumed to be diversified away across markets and residual risk efficiently priced. Major problems of disclosure content emerged. Bank top management (in banks that eventually failed such as RBS and HBoS) were not prepared (or able) to discuss the radical changes in their business models. Banks that succeeded were not able to explain why their business models were not as profitable as other banks. Fund managers and their buy side analysts showed little interest in the risk issues (Holland, 2010, Chen et al 2014) as they exploited rapidly growing earnings and security prices for banks and other financial firms.

Bank top management: and other elite MFI agents (operating in other large financial firms, regulators, and ‘quality’ media); used ‘established knowledge’ (expert knowledge and theory of finance) in a conservative and dogmatic fashion in controlled social structures (MFI networks, bank firms); to create a false impression of ‘correct’ knowledge use (Turner, 2009; King, 2014) and appropriate bank disclosure. This was an effective way for elite insiders: to influence levels of trust, confidence and meaning structures amongst the public, other investors and politicians; to maintain their legitimacy in ‘a battle against others’ (Coad et al, 2015. P155); and muffle the views of ‘outsider’ sceptics predicting problems with banks heavily involved with US mortgages and associated securities..

However, they also created major risk exposures in banks and banking markets that could not be ‘managed’ through principles based on expert knowledge and finance theory. They created a situation: where much of the upside benefits would accrue to them; and where downside losses would be experienced by quasi insiders and outsiders. The quasi insiders included small banks such as Northern

Rock, and the outsiders were the investing and saving public. The latter eventually paid for these problems through their direct losses and their taxes being used to support failing banks.

The combination of low awareness of issues, and high economic incentives noted above was similar to behaviour in non bank firms in the MFI noted in the ‘dot.com’ boom (Palepu et al 2008; Holland, 2002) and the Enron case (Healy and Palepu, 2003). These conditions limited bank top management and other MFI agents search for explanations of emerging problems and hence much reduced the quality of bank disclosure. Northern Rock’s failure in September 2007, Lehman’s failure in September 2008, the problems with RBS and HBOS in 2008, and the subsequent GFC, reflected these problems

#### **4.2 The emergence of major problems in banks and the MFI - before the crisis**

Cases from RBS and Lloyds are used to illustrate the *differing impact* of rapid change, internalised shareholder wealth maximising values and the ‘psychic prison’ on these banks especially on their culture (Schein, 2004) and bank disclosure conduct and content (Andon and Free, 2012). From the mid 1990s, UK banks such as RBS and HBoS created a high risk culture and adopted highly risky conduct and action with customers and in markets. Other banks such as Lloyds, HSBC and Barclays sought to maintain their conservative bank culture and conduct to counter the external pressures. They increasingly faced problems when doing so. The rapid internalisation of shareholder wealth maximising (SWM) values and shift in bank culture was particularly evident in RBS and HBOS, where: the ‘dominant coalition’ of Chairman, Chief Executive and Finance Director, empowered by market support; were in a position to demand active pursuit of aims by the rest of the board, top management, and operational management. They sought to match bank culture to market culture and its demands. Skills in areas such as general management, M&A, and customer selling were seen as ‘SWM friendly’ and prioritized over banking skills and experience. The same bank management teams had strong beliefs in their own capabilities relative to traditional bankers and MFI agents (See Fraser 2014 for RBS; and FSA report on HBOS, 2012). In Schein’s (2002) terms bank culture in RBS and HBOS was changed and controlled by a ‘dominant coalition’ who had learnt how to do the bidding of the MFI and stock market. In G30 terms (G30, 2015, p17) they controlled and changed culture as ‘*the mechanism that delivers the values and behaviors that shape conduct*’

SWM internalisation and shift in bank culture was more gradual in Lloyds (Fallon, 2015), and in HSBC and Barclays. It was moderated by internal factors such as: the dominant coalition being less powerful; and operating within a strong conservative banking culture. The latter was defended by many in the bank and was resistant to wholesale change driven by stock market values. The proponents of this culture maintained: a high concern about risk management; and the perceived importance of banking skills and banking experience at the top of the bank.

RBS and Lloyds provide examples of the differing impacts of the ‘psychic prison’ in the MFI and of bank cultures on bank conduct of communications and disclosure content. The insightful ideas of Andon and Free (2012), Boin et al (2009, and ‘t Hart (1993), are used here for the analysis of differing bank conduct in their pre crisis and crisis disclosure activity. In both RBS and HBOS cases the bank ‘dominant

coalition' learnt how (in differing ways) to adapt their communications strategies of 'masking' (or concealing of information) and the use of rituals (Andon and Free, 2012) during their disclosure activity within 'psychic prison' conditions. Section 3 has shown how banks learnt how the formal and informal disclosure activities took place within well established bank top management and MFI financial communications structures. The disclosure rituals they faced were symbolic behaviour that was socially standardised and repetitive ('t Hart, 1993) in bank teams and with MFI individuals and teams. In both RBS and Lloyds cases disclosure rituals and disclosure content 'masking' were used to persuade MFI 1<sup>st</sup> and 2<sup>nd</sup> tier agents to accept the bank's interpretative frame, and to use this 'core' group (Holland, 2005) to influence the collective sense-making process in the wider MFI. Differences in: strategic decisions; top management skills; beliefs and aims; created different forms of vulnerability in business models, and financial communications structure for RBS compared to Lloyds. They encouraged differences in: management exercise of power (internal and external); disclosure conduct (behaviour); and content. The 'psychic prison' conditions' in the MFI led to: acceptance of RBS and CEO Goodwin's behaviour; and to 'due diligence light' by RBS shareholders and other MFI agents concerning Goodwin. In contrast Daniels as CEO at Lloyds faced intense scrutiny over why he and Lloyds were not imitating RBS's risky growth strategy

The two mini cases for RBS and Lloyds have been constructed from financial media sources, from regulatory reports, and from major new books on banks in the period 2011- 2015. The RBS case shows major problems in: business models (Holland, 2010); bank management and financial communications; in 2005-06 before the GFC. The FSA report (2011) on RBS, Fraser (2014), and the financial media (2007-2015) were the sources for this mini case. The Lloyds case shows conservative banking policies, gradual learning and success in bank management and financial communication matters. Fallon (2015), and the financial media 2007-2015 were the sources for this mini case. Each bank had special factors at work in their failure and success. Both cases reveal emerging problems in the social, knowledge and economic structures in banks and the MFI, especially the intense financialisation and SWM pressures and the development of illusions in the 'psychic prison'. They reveal differences in how bank culture was both changing and acting as a moderating influence on change. Both reflect 'upper echelons theory' (Hambrick, 2007) whereby '*executives' experiences, values, and personalities greatly influence their interpretations of the situations they face and, in turn, affect their choices*'.



### **RBS case:**

Throughout the 1990s RBS had rapidly internalized SWM values. This contributed to a swift change in bank culture to a higher risk and return driven model in their combined commercial and investment banking activities. General management and selling skills were prioritized over banking skills and experience. This change in financial aims, culture and preferred management capabilities was driven by chief executive George Mathewson (an engineer with private equity experience) from 1992 onwards. From 1998 he was supported by deputy CEO Fred Goodwin (an accountant with experience of providing services to banks). This strongly focussed shareholder oriented approach was developed by chief executive Fred Goodwin and Chairman George Mathewson from 2001 (Brinded, 2011; Fraser, 2014). The bank was very successful in this period especially in its takeover of NatWest and had a track record of major increases in profits and stock price from 1992 to 2004. This reinforced top management beliefs in their own capabilities relative to other bankers and MFI agents. Goodwin's success in M&A further stimulated SWM internalisation and intensified the shift in bank culture to higher risk taking at all levels.

However, by 2005, RBS and Fred Goodwin faced major reputational issues in the MFI and stock market (Fraser, 2014 Ch 21). Goodwin as chief executive was accused of arrogance and aloofness towards shareholders, analysts and the wider City. The bank board and top management team were seen as out of touch with the City and dominated by Goodwin. Tom McKillop (a pharmaceutical specialist) took over as chairman of RBS from 2006 until 2008. As chairman he supported many of Goodwin's decisions and continued to promote the new bank culture.

The core information agenda disclosed to the MFI and stock market was about excess M&A deal making activity led by Goodwin. This was perceived to have diluted earnings and reduced bank stock price relative to competition. A 'Goodwin' discount was perceived to be in the share price, as the bank appeared to pursue size over shareholder value. Some countervailing views existed in the MFI which still valued the cost cutting skills of Goodwin with new acquisitions. Goodwin and the bank appeared to learn from this criticism. Attempts were made by RBS in 2006 to improve financial communications with the MFI, to focus the information agenda more on organic growth, and argue in public at least that deal making would stop. There was some scepticism amongst MFI agents that this apparent change in the information 'game' was tactical and Goodwin was still a 'deal junkie'.

The risk and value information agenda between the bank and MFI continued to focus on conventional issues (profits, EPS, growth etc and SWM impact) and ritualised interactions through road shows and 1:1s. Very little emphasis was placed on risk and threats to value from new investment banking activities. The emphasis was on increasing profits, whilst risk management declined as a priority.

Despite these problems RBS learning continued to focus on understanding and changing RBS financial communication structures and disclosure content to match existing City rituals and expectations about forms of information and achieving SWM aims. Learning about financial communications content was about how to persuade markets agents to accept RBS's growth strategy. It was also about how to conceal strategic decisions especially M&A before they were executed, and how to persuade market agents that the subsequent M&A decision was a 'good idea'. Thus like other top management functions in RBS, financial communications was driven by Goodwin's hubris and dominance. This was the focus of learning and change and not the new and risky forms of financial intermediation being developed in RBS (Holland, 2010).

This case reveals how RBS learnt to adapt its communications strategies, both in disclosure conduct and content, in the immediate pre crisis period. The literature can be helpful at this point in exploring this behaviour in the RBS case or field based story (Locke, 2001, p121-122). In terms of Andon and Free's (2012) and Boin et al's (2009) conceptual frame, they make use of 'masking' and rituals. Masking involved: promoting an image of 'business as usual' through sustained business and profits growth; downplaying M&A risks; and obfuscation about future M&A deals and the changing nature of RBS business model and banking markets. The use of rituals (of reassurance, and solidarity) arose internally within formal board and top management team structures and processes. They arose externally in regular 1:1 meeting with

shareholders and other actors in established MFI 1<sup>st</sup> and 2<sup>nd</sup> tier structures. In this frame of analysis, members of the bank 'dominant coalition' learnt how to use rituals and masking to persuade other bank top management, board members and external MFI actors to accept a certain interpretative frame, of crucial importance in a collective sense-making process. In this immediate pre crisis period the select group of RBS top management ('dominant coalition') sought to shape the collective MFI interpretations of the dynamic and fast changing situation they were in. They sought to use disclosure (conduct and content) to shape external MFI sense making: to ensure external agents accepted what the RBS 'dominant coalition' thought were acceptable risks; to demonstrate management control over the risks; and to minimize the perception of threats amongst their insider and private 'public' of 1<sup>st</sup> and 2<sup>nd</sup> tier MFI agents. This disclosure activity was strengthened by many shared (bank and MFI agent) contextual factors such as: SWM values; MFI structures; and by the existing 'psychic prison' conditions in the MFI. Thus in RBS case, it is argued a shared frame was generated in the pre-crisis situation (Boin *et al.*,2009).

### **Lloyds Bank Case**

In contrast **Lloyds bank**, with Eric Daniels as chief executive faced problems in financial communications concerning its conservative banking model, a reputation for risk avoidance, and for stable but relatively lower returns than competitors. In the 1990s, it had gradually internalised SWM values and changed to a slightly more risky banking model in a gradual manner relative to its core retail and commercial banking activities. However, the board and top management team with strong banking experience had sought to maintain a conservative banking culture whereby risk was managed first and this became the means to create profits and shareholder value. From 2005 to early 2007 Lloyds bank top management and board faced constant pressure: during financial communications and interactions with shareholders and other MFI actors; to adopt a much more risky strategy in pursuit of higher returns (Fallon, 2015, Chapter 13). This pressure came from many external sources including: from the network of MFI agents such as bank analysts and bank shareholders (FMs); competitors; deal makers and activists; and from some of their own staff. In particular US investment banks pressured commercial bank lenders such as Lloyds to lower lending standards and produce securities they could sell on at profit.

Daniels had much prior commercial banking experience, prior experience of financial crises in Latin America earlier in his career at Citigroup, and had learnt much in banking markets over thirty years. This led him to question a strategy of bundling of US sub-prime mortgages into very risky asset based securities (ABS) and using rating agencies to provide 'high quality' rating based on very little transaction data. He **privately** questioned the role of commercial banks in originating mortgage loans (sub-prime), holding some ABSs, and using large Wall Street investment banks to sell and distribute the rest of the highly rated ABSs to investors worldwide. Bank profits were soaring based on replacing their 'originate to hold' model with this 'originate to distribute' model. Fallon (2015, p152) noted that in Daniels view key members of the community of top bankers '...didn't properly understand risk and believed that by spreading it around the system in the form of re-packaged collateralised debt they were actually de-risking the system. In his opinion the opposite was true'. He learnt how little the community of top bankers knew of these risks and factors that could cause failure. He identified lack of banking experience amongst his UK competitors as a major factor. For example, he attended a major banking conference in early 2007. He saw (again) how little this community of top bankers (or community of practice, Lave and Wenger, 1991) knew of the prevailing risks and factors in their banking models. Over time he had learnt how much they were 'locked in' to a 'comfort zone' (or shared 'habitus' as an illusionary 'psychic prison') concerning bank strategies. This confirmed his prior experience and learning and the need to stick to a 'contrarian strategic message' about his bank's conservative commercial banking model.

He decided that when a crash came (modest or otherwise) his task was to position Lloyds to take advantage of this. Issues of competitive advantage and waiting for opportunities for Lloyds were factors here. He was backed by the chairman Victor Blank, and the rest of the bank board and top management, and their belief in a conservative but profit making bank culture. Lloyds ignored the intense external

pressures, continued to stay clear of sub-prime derivatives and new financial instruments, and stuck to a conservative commercial banking model. Victor Blank as chairman supported this decision.

Daniels, Blank and Lloyds financial communication specialists did not discuss **in public** the risks they thought their competitors faced. This topic was perceived as a very price sensitive matter for banks and markets and it also formed an important competitive advantage for Lloyds. They did not expect a major crisis but did expect problems for rivals that would create opportunities for the bank.

This case reveals how Lloyds learnt about financial communications. The literature can be helpful at this point in exploring this behaviour in the Lloyds field based story (Locke, 2001, p121-122). Daniels and Blank and their financial communication specialists shared the same 'financial communications habitus' (Bourdieu, 1977) with other bank top management and MFI agents such as large fund managers (often as shareholders in several banks such as RBS). They used the established private rituals (Boin *et al*, 2009) and conventional information agendas in the MFI to persist in communicating this 'contrarian' message about the bank to markets but faced resistance from large shareholders. They continued to actively engage with the external network of bank analysts, FM shareholders in banks, bank rating agencies, and other MFI and 'City' actors, to promote this conservative banking model and its benefits. Daniels and Blank learnt how unpopular they were with these external agents, but persisted in their message. Given the bank's steady performance, the agents learnt that Lloyds was a 'dull, dull, income stock' (Fallon, (2015, p153) and if they wanted higher returns they should invest in the riskier assets chosen by competition such as RBS and HBOS. Ironically, it was this success that meant the UK government encouraged Lloyds to buy HBOS in 2008 and inherit its profound problems, leading Lloyds into part government ownership.

This case reveals Lloyds 'dominant coalition' was also learning (in the immediate pre crisis period) how to adapt their disclosure communications strategies of masking and the use of rituals (Andon and Free, 2012). Masking of disclosure content involved: creating a business as usual image based on a known and conservative business model; downplaying benefits of risks taken by other banks; and obfuscation about Lloyds slow movement towards a riskier business model. Conduct of financial communications was heavily influenced by disclosure rituals. The use of rituals (of reassurance, and solidarity) arose within: formal board and top management team meetings; and in regular 1:1 meetings with shareholders and other actors in established MFI tier structures. The Lloyds 'dominant coalition' operated within a more supportive and less intimidated board and top management structures than RBS. However Lloyds top management faced a more hostile MFI world and 'psychic prison' than RBS. Thus in the Lloyds case, it is argued that contesting frames were generated in the pre-crisis situation (Boin *et al*, 2009). Despite this Lloyds sought: to shape the collective MFI interpretations of the dynamic and fast changing situations they were in; to maintain a conservative banking model; and to wait for strategic opportunities.

### 4.3 The ‘height of hubris’ combining with the MFI ‘psychic prison’.

Extreme versions of disclosure ‘masking’ and misuse of rituals (Andon and Free, 2012) in bank culture and the ‘psychic prison’: were evident in the conduct of RBS’s financial communications (led by Fred Goodwin as a one man ‘dominant coalition’); in the period from March 2007 to the start of the GFC in October 2008; and RBS’s subsequent collapse. At the time executive hubris in Goodwin was not recognised. His conduct was broadly interpreted by MFI agents, such as shareholders more as high executive confidence, competence and control over bank related events. These conditions led to acceptance of: Goodwin’s behaviour; his use of ‘due diligence-light’ for the April 2007 ABN AMRO bid; and to high shareholder support for the bid despite turbulent conditions. The ‘psychic prison’ conditions in the MFI also led to the use of an equivalent form of ‘due diligence light’ by RBS shareholders and other MFI agents. Arguably these joint bank and MFI conditions contributed to bank deceits or omissions and commissions in the rights issue prospectus of April 2008 related to the ‘successful’ bid (Fraser, 2014, 2016).

Fraser (p237, 2014) noted that there were serious problems of financial communications behaviour and disclosure content in RBS during this time. Whilst Goodwin was actively pursuing acquisition (of *ABN AMRO*) he insisted he was unaware of any deals at the time. *‘I can’t think there is anything out there at the moment that seems desirable, doable or affordable’* (RBS results presentation March 1<sup>st</sup> 2007, in Fraser, 2014, p237). Goodwin had to be careful about price sensitive information about a specific target but given RBS’s problems with a ‘Goodwin discount’ in the share price he was required to inform the market that he was now again actively searching for acquisitions. At the same meeting he said *‘we don’t do subprime’* despite being aware of emerging problem in the US arm of RBS (Fraser, 2014, p246).

At an Edinburgh press conference on 25<sup>th</sup> April 2007 Fred Goodwin and Santander and Fortis bank executives announced their joint bid for *ABN AMRO*. Goodwin said that *‘I think that due diligence-light would be what we’d be really wanting to do’* (Fraser, 2014, p243). At RBS’s August 10<sup>th</sup> shareholder meeting 94.5per cent of shareholders backed the deal as the board and top management presented a very positive case. Despite the Northern Rock failure on the 13<sup>th</sup> September, and a freeze in the interbank market, RBS won the battle for *ABN AMRO* by October 5<sup>th</sup> 2007. However, from April to June 2008 RBS raised £12bn in a rights issue to boost its capital reserves to deal with problems emerging from the £49bn purchase of *ABN AMRO* bank. By October 2008, the UK government bailed out RBS and its shares plummeted. This precipitated a hostile FSA report in December 2011 and subsequent investigation into potential criminal acts by RBS board and management.

Fred Goodwin was informed on May 12<sup>th</sup> 2016 by the Crown Office (Scotland, UK) that the ‘insufficient evidence’ meant that it was not going to pursue criminal charges against him or other senior managers in connection with the sale of RBS shares in the months before its collapse. Shareholders who experienced major losses and operated as the ‘Combined claimants group’ continued their legal action on these matters. Fraser (2016) immediately after the Crown office announcement argued that

*'...the 'Combined claimants groups' who are suing RBS for about £4 billion over this rights issue have looked and had access to 9.5 million documents and some of the documents have only just been made available by the bank under duress....there was a whole series of deceptions and deceits which came into being in the aftermath of that disastrous acquisition (ABN AMRO)... If one wants to know a lot of the things that were going on inside the bank, some of which are being revealed I think in these 9.5 million documents, there is ...evidence to suggest that things like .....fraudulent trading ... conspiracy to defraud.... false accounting .... and a number of offences under the Companies Act 2006.. .... were committed by senior RBS executives... in the period from about December 2007 through to ... their ultimate collapse in October 2008...' And 'There were a number of omissions and commissions in the rights issue prospectus of April 2008 which suggest that the board ...was deliberately seeking to pull the wool over investors eyes... and the board of RBS led by Fred Goodwin and Tom McKillop were arguably trying ...to get that money under false pretences...'*

It will not be possible to know the full truth of the above disclosure content and conduct by RBS until the shareholders case against RBS is decided. In December 2016, RBS agreed to pay out £800 million to 77% of the claimants without admitting liability (Herald, Dec 6, 2016). In June 2017, RBS paid out £200 million to settle a group litigation case by small shareholders (Dunkley,2017).

#### **4.4 Crisis and instability in Bank and MFI 'information' structures**

The 2007-08 crisis in banking and finance sectors provides many insights into the instability of structures such as: bank top management teams; bank financial communication functions; MFI 1<sup>st</sup> and 2<sup>nd</sup> tier networks; and associated knowledge and power conditions. In Stones's (2005) terms: external structures as social organisation and power conditions in banks, banking markets, and MFI; and internal structure as bank and MFI agent knowledge and 'habitus'; all collapsed as failing bank top management lost all understanding and 'froze' in the face of the crisis, sparked by Lehman's failure on September 16<sup>th</sup> 2008. Successful bank top management experienced the same phenomenon but their banks models remained resilient.

Management of failing UK banks such as RBS and HBOS experienced a 'cosmology episode' (Weick, 1988, Holland, 2010) where 'things fell apart' in terms of their banks liquidity position, share price and credibility of communications. They fell into the arms of government and regulators and had to relinquish all control over their strategy, asset and financing decisions, and financial communications (disclosure content and conduct) to these new powerful agents. Previously successful banks and their management such as Lloyds were also pushed into the arms of government and regulators and lost a considerable degree of control over their banking decisions, disclosure decisions, and influence over their stock price.

A special group of government and regulator based elite agents entered the vacuum and took control of failing banks, banking markets and MFI functions during the GFC. When banks or banking markets failed, these elite agents became especially important to: provision of funds; and the exercise of power in failing banks and failing banking markets. They became especially important to financial communications. During the GFC the specialist part of MFI dealing with banks: such as 1<sup>st</sup> and 2<sup>nd</sup> tier networks of FMs, bank analysts, bank rating agencies and financial media; faced massive uncertainty, and had little power. They played peripheral roles in creating information about banks: as they awaited decisions by regulators, politicians; and their instructions to bank top management. As a result security

markets experienced major losses and high volatility in banking and associated stocks (in most of the economy). Normal MFI activities were slowed as new temporary means for bank disclosure (content and conduct) to financial markets were established.

Government power and financial resources became central as the power of bank top management waned, and they relied on their 'too big to fail status'. Secrecy about both failing and previously successful banks was enforced by the powerful elite agents as they sought 'behind scenes' solutions to bank and banking market problems. They formally disclosed and informally leaked information about solutions to stock markets, media, and public on selective basis to frame their sense-making, interpretations, avoid panics and to 'jolt' markets and failing banks back into life. Fallon (2015) described this behaviour during Northern Rock failure and GFC. In the Northern Rock case there was division, confusion and ignorance amongst regulators and politicians.

By the time of the GFC in September 2008 they had learnt lessons. They had learnt that banks required: more equity capital; and bank top management with knowledge of new bank models. They had learnt to disclose information about these factors once they were in place. They had learnt to keep tight control over: bank related financial communications; their inner circle of regulators, treasury officials, politicians, and bank top management; and over information flows and economic actions. In the GFC the UK government plan was to *'reassure markets with a decisive, clear and completed intervention in one stroke'* (p298, Fallon, 2015) by providing liquidity and directly or indirectly boosting bank capital to all major UK banks, failing and successful.

'Spin doctors' from politics also entered the bank financial communications process and pursued political as much as economic aims. They 'leaked' to the media, creating momentum to stories and forced bankers to accept government plans. The MFI was not moribund as the Tripartite of Bank of England, FSA, and UK Treasury began to exploits its capabilities. For example, elite parts of the media especially Robert Peston (from BBC) penetrated this 'wall of secrecy'. He did this in the Northern Rock and GFC cases, at times causing the authorities much grief. As one of the government advisers noted during the GFC *'We'd say 'Robert, what are you hearing' and we all shared information. But my goodness, those leaks were damaging'* (p330, Fallon, 2015).

The above reveals bank regulator crisis communications strategies of: masking of disclosure content; and the use of rituals in disclosure conduct or behaviour (Andon and Free, 2012). Masking by the Tripartite (Bank of England, FSA, Treasury) and UK government included: recreating a 'business as usual' and bank soundness image by recapitalising banks, providing liquidity in banking markets, guaranteeing retail deposits, and emphasising the soundness of the bulk of bank loan portfolios. They sought to create a climate of being in control, and sought to boost confidence in banking markets and MFI that a solution had been found. These parties sought to downplay the extent of the crisis and present it as a problem restricted to a few large banks. Obfuscation was tried but failed due to the extensive leaks from a combined political and MFI system. Rituals of reassurance were employed by the Tripartite recreating and using established private MFI channels for communication. Rituals of purification involved removing

all board members and top management in failing banks. Rituals of solidarity included the Tri-partite and government publicly backing management in non failing banks. Regulators sought to define what the crisis was about by reshaping the collective interpretations of the dynamic and fast changing crisis situations, to demonstrate government and regulator control, and to lower the fear and panic amongst insider and private 'public' of 1<sup>st</sup> and 2<sup>nd</sup> tier MFI agents, as well as the wider public of 'outsiders'

The above 'crisis handling devices' (framing, ritualization and masking) reflects 'tHart's (1993) comment that 'attention is drawn to the opportunity spaces that crises entail for policy makers and other crisis actors. To exploit these, it is important for decision elites to influence collective definitions of the (crisis) situation in such a way as to highlight preferred courses of action and to selectively obscure alternative interpretation'

The empirical insights and theoretical analysis revealed the fragility of: bank organisation and MFI structures; of power conditions; and bank knowledge; in the finance based economic system. They highlighted how fragility was based in part on the perceived quality of disclosure content and conduct concerning bank business models and risk management. At the same time the analysis highlighted the continued significance and function of such structures in the world of finance, and the need (for regulators and governments) to recreate stable financial communications structure with high quality disclosure content, accepted disclosure rituals and conduct, and stable financing arrangements, as a way out of the connected problems in banks, banking markets and the MFI. It showed their need to handle the crisis using effective frames, rituals, and masking devices ('tHart's, 1993). The 'information game' in the MFI was as important to them as the 'refinancing, and risk management game' in banking markets.

## 5. How regulators can develop policy.

Sections 3 and 4 have illustrated how connected change processes in the world of information, banking and finance created conditions which contributed to the GFC. At present regulators are focused on regulating individual conduct and behaviour within formal governance structures and market structures. They have shown considerable interest in structural matters such as bank governance (Cheffins, 2015); public disclosure of financial risks; and the public disclosure of private information exchanged in MFI structures (UK PSI rules, US FD2000). They have shown some interest in regulating contextual matters such as bank culture (G30 2016; and FCA in 2015). They have used insights in the pre GFC change process as part of their historical analysis of what went wrong. However, they have shown little interest in regulating or influencing the change process per se. Given the insights developed in this paper, it is clear that this rather limited, and fragmented conventional approach will not work.

The implications of: the GFC; cases such as RBS, Lloyds; and the theory frame adopted in this paper; is that regulators will have to make visible: connected change processes; new contexts; and knowledge. Systematic bank disclosure of information about: context and change has to be established; and matched to improved bank disclosure about economic activities, performance and risk. Regulators will have to ensure visibility and disclosure for: agent conduct; within changing contexts; all relative to perceived 'good practice'. Citizens require much more transparent and contested accountability structures where they have the information and power to control the agenda. This involves new moves to democratize finance capitalism by gaining access to a reformed MFI. If not, the same problems will recur.

### 5.1 Regulating the change process

The paper argues there must be coherent oversight and regulator influence over change processes. Regulators have to influence connected change processes such as: 'financialisation' process (Haslam, 2010); learning; internalising SWM values; creation of the 'psychic prison'; and their impact on: on agent contexts such as (bank and MFI) structure, culture and knowledge. Regulators have to find ways to prevent negative conditions such 'psychic prisons' emerging in the world of bank executives and MFI agents. This paper proposes two ways in which regulators can understand, influence and, in part, manage the change process .

**Firstly**, they can use authors such as Bourdieu (1990) and Stones (2005) to analyse agent learning in the change process and how it is reflected in the mutual reciprocal **interactions** between: structure, culture, knowledge, power, SWM values, actions and outcomes. Regulators could use these theoretical sources to analyse and publicly disclose how the change process and interactions play a central role in creating new contexts of structure, culture and knowledge, and how they in turn stimulate problems of bank culture, pay and behaviour of staff in banking. These complex interactions, associated change pressures, and new contexts, continue to be a primary source of bank misconduct.

**Secondly**, literature on 'organisational learning' could be used by regulators to monitor and influence the change process. This paper has provided many insights into successful and unsuccessful bank learning in the change process. Pedler et al, (1997 discuss empirical findings and theoretical analysis of learning in



many large organisations. These could be the combined basis for: ‘good practice’ guidance by regulators for: bank learning; and bank disclosure on learning. Harris (2002), Antonacopoulou, (2006), Chivers, (2011), Royal et al (2012) provide further guidance for monitoring bank learning.

In addition regulators must address how learning and the construction of bank and MFI structures can be modified by constrained SWM aims such as Porter and Kramer’s (2011) idea of ‘shared value’ or the ‘Group of 300’ (2017) (of worldwide investors) view that social responsibilities have to be included in investment decisions. This would involve regulation to modify SWM aims relative to codes of ethical behaviour and corporate social responsibility. It would require regulation to modify the conduct of bank and MFI agents relative to new aims, and require bank disclosure on adoption of aims.

## **5.2 Regulating contexts**

The paper argues that regulators will have to make explicit the nature of new contexts created by learning. They will have to find ways to make visible new bank and MFI structures, and make explicit new knowledge about this world. For example, regulators must strengthen formal corporate governance mechanisms in banks relative to the informal bank and MFI structures and exercise of power discussed in this paper. Regulators must exercise some control over existing contexts such as the: culture and ethos of financial firms in networks and markets; and their impact on how bank and MFI agents transact and behave. Regulators must ensure that banks disclose more insights into: the bank knowledge base; ethical standards; and prevailing ideology and economic incentives; in these firms, networks and markets.

### *Regulators should focus on **structure and knowledge***

Formal governance mechanisms at board and top management levels in both successful and failing banks satisfied ‘best practice’ during 2000 to 2008. Problems lay elsewhere with rapid change, elite groups, and the creation of dysfunctional informal social structures which undermined formal structures. This paper argues that bank private financial communication structures controlled by: dominant coalitions; MFI 1<sup>st</sup> tiers; must be reformed, disclosed, and governed by formal mechanisms. Regulators will have to: limit and disclose membership of ‘dominant coalitions’; and constrain the power of excessively powerful executives. The power of agents in external networks over banks will have to be formally recognised and the exercise of their power monitored. Regulators must ensure that banks (and other companies) publicly disclose: their list of top shareholders; and analysts; in 1<sup>st</sup> and 2<sup>nd</sup> MFI tiers. They must identify the restricted list of board and top management members who are allowed to talk to MFI agents. Timely information, can keep the rest of the board and top management team informed, and all external shareholders, and hence control a privileged group of bank executives operating as a hidden ‘dominant coalition’. Regulators must play a role in publicly discussing and ensuring bank disclosure about strategies. They must be involved in publicly appraising bank strategies (collective, not specific) to prevent the creation of ‘psychic prisons’ in banks and the MFI.

Bank regulators must also insist that banker insider knowledge of: bank business models; risk management; financial intermediation processes; and role of financial and intangible resources; are robust in a range of circumstances (Holland, 2010). Stress testing of: the financial parameters of models; and

management risk management choices; have been implemented by bank regulators (Bank of England, 2016). However, bank boards and top management must also be regularly assessed and ‘stress tested’ to see if they: understand and believe in their models; have taken actions to ensure their models remain stable and robust; and their risk management skills remain relevant. Such tests of bank management capabilities and attitudes must be publicly disclosed. This could be the basis for a ‘master’s ticket’ or licence to operate as ‘captain of the bank ship’.

*Regulators should focus on bank culture and how it changes*

At present, regulators such as the FCA, BSB, and G30 seek to influence and change existing bank culture, and current behaviour in ongoing transactions. They do so in the interests of: fair dealing with customers and clients; and effective functioning of markets. They seek to change culture with respect to ideas of perceived ‘good practice’, such as embedding desired values and ethics, and adopting effective incentive schemes and ‘whistle blowing’ methods. These are derived from studies of many banking firms (G30 study, 2015). The focus is on bank top (senior) management, middle management and front and back offices, and their incentives, behaviour and actions. The G30, BSB and FCA approaches may prove beneficial but desired changes in banking culture will always be limited if regulators ignore the external context discussed in this paper. As long as current conditions prevail there will always be a tendency for bank culture to become risky and amoral and intensify financial risks.

This paper proposes two ways in which regulators can understand, and influence bank culture. In the first case, the G30 report into bank culture (G30, 2015, p17), defines culture as ‘*the mechanism that delivers the values and behaviors that shape conduct and contribute to creating trust in banks and a positive reputation for banks among key stakeholders, both internal and external*’. This is a somewhat static idea of culture relative to empirical insights developed in section 4. In Schein’s terms organisational culture is ‘*a pattern of shared basic assumptions that was learned by a group as it solved its problems of external adaptation and internal integration, that has worked well enough to be considered valid and, therefore, to be taught to new members as the correct way to perceive, think, and feel in relation to those problems*’. Schein’s (2004, p17) definition of organisational culture is used in this paper because it includes ideas of learning and adaptation. Regulators could demand that banks use the above as a basis to publicly disclose how they understand their culture.

In the second case the empirical evidence in sections 3 and 4 revealed how bank management **chose many** dimensions to culture such as: preserving or ignoring historic bank culture; choosing the balance of SWM versus ethical values; matching risk taking to remuneration; and choosing the rate and degree of culture change.

If bank management can choose these many dimensions to culture, then regulators can also provide general advice and guidance and promote disclosure on these matters. Regulators can demand that bank management choose culture change strategies that do not create conditions of ‘betting the bank’. Banks must publicly disclose how they understand the link between culture and risk. Bank regulators such as the FCA, BSB and G30 could: make public common and desirable themes in bank culture; how this could be disclosed by a bank. The G30 report (2015) is a very useful first attempt in this regard. Regulators such as

the FCA and the BSB could monitor: bank specific factors creating unique variants of bank culture; and how this differs from the common and desirable themes in bank culture. Information intermediaries such as bank rating agencies could monitor public and private information on culture as part of their rating activities. This monitoring could be done to ensure that: an extreme risk taking culture does not emerge; change pressures are being held in check; or used for customer innovation rather than benefit of elites. However, 'rewriting culture' is a challenge to the power of elites in the private and hidden world of finance and banking. They will not give up their power based on their capitals (culture, social, financial as in Bourdieu (1986)) without a vigorous fight back 'behind the scenes' in which they will seek to 'capture' regulators. The removal of the new chairman of the FCA, Martin Wheatley in 2015, and FCA decision in December 2015 to abandon a review of bank culture, does not bode well for the above proposed changes.

### **5.3 Regulating disclosure conduct and content**

New regulation primarily focuses on changing existing conduct by bank agents. For example, UK changes such as the 'Senior Managers Regime' holds bank top management accountable for misconduct. New joint regulation in July 2015 by the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA) regulation on responsibility of bank management was a positive move in this direction.

Regulators have also begun to exploit the technology used in financial communications to change individual conduct and behaviour. The Northern Rock failure, Lehmans failure, the problems at RBS and HBoS problems, and GFC have challenged the 'silent unsaid agreement' amongst elites and empowered the wider public and regulators in new ways. Problems in banks before and during the GFC ('Levin-Coburn' Report, 2011), have encouraged regulators to make public: private MFI agent communications as emails; social media exchanges between say bank analysts; and private discussions amongst bank regulators (Bank of England (2015)). Technology and political pressure have become means to make conduct in social networks more visible. This could be the basis for the regulator to monitor all communications in the MFI between banks and other agents, and to use 'intelligent software' to probe private textual exchanges and phone conversations for emerging problems. Disclosures and prosecutions of problematic cases could act a stimulant to good behaviour

Finally, we can note that regulators have been focussing on the banks and banking markets and have ignored the interactions with the MFI, stock market and the change process. These are the primary source of SWM pressures and bank culture changes. Regulators must also adopt a similar analysis and design conduct codes for key actors here such as large fund managers. As the Banking Standards Board noted (BSB, 2016)

*'if we want to see a change in culture and standards of behaviour right across the sector, individual institutions, owners, investors and the people leading and managing them, all need to step up to the plate'*

Regulation is also required about disclosure content. Conventional bank disclosure, about tangible financial resources such as bank financial assets, liabilities, cash and equity and their risks, is essential.

However, given the role of negative knowledge and social network factors in the GFC, bank disclosure about performance and risk has to include the role of intangible resources as well as financial resources. Risk and return arises from both resources and ignoring the role of intangibles (such as bank top management knowledge) in creating financial risks reveals a fatal flaw in conventional bank disclosure. The focus must be on the bank and bankers ‘juggling’ the financial and intangible resources and their risks, as well as the more conventional focus on the financial resources being ‘juggled’. Top management must disclose information on formal and informal means to control risk. Formal controls include: levels of responsibility and autonomy; incentives and sanctions; control limits; numerical measures of risk; and risk reporting mechanisms, all overseen by top management. Informal controls involve using intangible factors such a culture and philosophy to control risk. Top management must be tested on their knowledge of all risk controls. The IIRC model (2013) for integrated reporting could act as a template for this comprehensive disclosure.

#### **5.4 Citizens, contested structures and democratizing finance capitalism**

This paper argues that citizens as ‘outsiders’ will need much more than a conventional reform agenda. Increasing the quality of public disclosure on matters of change, context and conduct is essential to increasing citizen power. However, given the tendency of this ‘insider system’ to absorb and control such regulatory changes and eventually defeat them en route to another failure, other approaches are required. Citizens must gain access to a reformed MFI where all current disclosure and accountability mechanisms are seized from ‘insider world’ dominance and placed into the public domain and where citizens have substantial power to hold banks and others to account. Accountability mechanisms such as the: Regulator (say FCA in UK); Central bank (say Bank of England); Parliamentary committees; Board meetings; and bank report presentation meetings with fund managers and analysts; will all have to develop into more open and publicly contested structures. Citizens will need ‘outsiders’ as ethical leaders (say in the media, academics, lobby groups, MPs) – to do much of this work to provide them with their ‘outsider line of defence’. They will need formal structures and events to mobilise these ‘critical’ agents on their behalf to criticise the system and its agents in open public debates – in open accountability mechanism where insiders are present – and where they are forced to defend their positions.

Reform of the MFI and disclosure systems could include ‘outsider’ or citizen group attendance at annual report presentations for banks where time was specifically allocated to consider risk and other issues. They could include a new and specialised ‘bank risk’ parliamentary committee where MPs pose questions to bank management in open public meetings, using questions derived from prior soundings with citizens and external ethical leaders. The FCA could also set up annual public meetings to probe related issues. A prior survey of citizens’ views, problems and questions, would be helpful here, thus replicating MFI insider practices. Citizens will need higher transparency, open accountability means and ‘ethical’ leaders to help them overcome the social and knowledge forces that elites use to rule operational agents and to ignore citizens. Citizens need such resources and powers to create and control the social and

economic structures in banking and finance and to drive economic processes in citizens' interests. This implies that finance capitalism should be democratised in some way. Or as **Shelley** put it post Peterloo, in *The Masque of Anarchy, 1832*, Citizens should;

*Rise, like lions after slumber  
In unvanquishable number!  
Shake your chains to earth like dew  
Which in sleep had fallen on you:  
Ye are many—they are few*

The above agenda is quite a task for regulators but an overarching regulatory strategy connecting change processes, new contexts and new forms of conduct is required. The paper has provided an alternative way of thinking critically in an integrated way about policy change concerning the change process, new context formation, disclosure conduct and content. The intention is that this plays a role in creating an open and public conversation about these concerns and this in turn contributes to avoidance of repetition of the same problems.

## **6. Conclusions**

The paper provides novel insight into bank change processes and top management learning about financial communications as disclosure content and conduct in financial markets. It illustrates: many problems of change and of learning; and develops an embryonic conceptual framework to analyse the problems. Empirical and theoretical insights suggest new ways of conducting research, and for increasing public control over banks, bank learning and financial communications. The conceptual framework was the basis for a critical analysis of how banks developed or did not develop their financial communications to respond to changes. The elite character of this change and its power and legitimacy implications were critically appraised.

The paper demonstrates how social and economic theory can be jointly applied in areas of change of banking, corporate disclosure and finance. This offers an effective way of researching and understanding this phenomenon. The insights emphasise the need for academics involved in: empirical research and theory development in the fields of finance, accounting and disclosure; to reflect a combined social, knowledge and economic perspective in their activities. For example, as suggested by Locke, (2001) literature such as Bourdieu (1990) on 'habitus' and Boin et al (2009) on 'masking' and rituals, have been used to interpret the bank case field based narratives about financial communications. The dominance of one disciplinary perspective, cannot address the phenomena in an effective way.

The paper reveals how connected change processes and resulting social and knowledge risks can contribute to financial risks in the world of finance and banks. Regulators will have to regulate and ensure full disclosure of connected change processes; and make visible newly constructed structures, contexts and knowledge. Disclosure will have to be done for conduct, behavior, actions, within changing contexts; all relative to perceived 'good practice'. If not, the same problems will recur.

These solutions also require power over these matters and information to be shared with wider civil society and not just controlled by private, hidden elites. Questions arose in the paper concerning the privileged learning position and control by senior bankers over a privileged financial communications function, information flows and financial transactions. This leads to questions about corporate legitimacy of banks (Cooper (1980, Meyer and Scott, 1983, DiMaggio and Powell, 1991) with a wide range of social, political and economic stakeholders. Reform requires that the proposed regulatory changes be adopted to match the needs of the social context and hence improve legitimacy of the banking firm with a wide range of stakeholders (Cooper et al, 2007; Guthrie and Parker, 1990). This requires much more public and open debate about the nature of the bank financial communications function, how it changes over time, and how this can affect the quality of disclosure content to the MFI and the stock market, and other stakeholders.

Finally, the paper notes that climate change issues are providing a new stimulus to think about these issues. The financial communications function in banks and other financial firms has faced much questioning concerning suitability for producing and disclosing information on climate change issues. The Financial Standards Board (FSB) task force in climate related disclosure (2017) has recommended that firms disclose information on: Governance, Strategy, Risk Management, Metrics and Targets. This provides a new stimulus for the finance sector to look again at the learning, context formation, conduct and disclosure issues raised in this paper. It provides a new stimulus to think about the capabilities of ‘dominant coalitions’ and organisation of financial communications in banks concerning climate change related disclosure. These factors are likely to play a major role in the ‘Governance, Strategy, Risk Management, Metrics and Targets’ disclosure agenda. Regulators can use the ideas developed in this paper to consider how such factors contribute to the desired disclosure outcomes concerning climate change .

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