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Perceived Decision-Making Pressures on Community Bank Chief Executives

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Perceived Decision-Making Pressures on Community Bank Chief Executives

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The community-banking environment has experienced high levels of stress from increasing regulation, poor loan performance, investment devaluation, lower bank revenues, and public scrutiny during the period since 2008. The CEO decision-making process as a result, receives influence from several stakeholder groups with interests in differing outcomes. The objectives of this research were to identify and rank by importance the most pressing issues that develop decision-making stress among community banking executives. The examination of priorities and concerns facing a selected group of community bank CEOs utilizing an online Delphi method to determine the types of contextual cues (situational variables) that created the greatest levels of perceived pressure among the executives polled. .

INTRODUCTION

Compared to larger banks, community banks face disproportionately large cost increases as a result of increasing regulatory demands created by recently passed Dodd-Frank legislation and ongoing requirements from the Office of the Comptroller of Currency (OCC) and the Federal Deposit Insurance Corporation (FDIC) that resulted from increased oversight as a result of the Global Financial Crisis Additional demands from shareholders, board members and local communities add to the pressures with which community banking chief executives must deal. With a slowed economy causing greater stresses on bank finances, community bankers say it has gotten harder for them to survive. Growing numbers of community banks are looking more closely at mergers in order to survive or are considering selling out to larger banks – or worse, succumbing to pressure to employ "creative" banking practices in order to survive. These methods may have induced some questionable practices to increase income, to alter appearances of bank financial strength, to divulge information in a less than forthright manner, etc.

These behaviors, when discovered and made public through media reporting, add to the public impression that banks are by and large only interested in their profits and are often willing to employ morally questionable tactics to accomplish their goals. According to the World Economic Forum 2011-2012 annual report on banking and capital markets (World Economic Forum, 2012), the public perception of the banking industry has dramatically worsened.

> This deterioration is mostly fuelled by increasing scepticism (sic) on the quantity and quality of actions taken as a reaction to the financial crisis. The uncertain economic recovery, ongoing fiscal crises and continuous credit challenges have greatly influenced the public to believe that some of the most critical issues highlighted by the crisis have not been addressed, specifically the level of systemic risk, banks' governance, bankers' compensation and how to deal with problem assets. All of this has contributed to a significant erosion of public trust in the overall financial services industry, including industry players and regulators, and has ultimately created a broad lack of confidence and uncertainty. ¶ 1

Results from a Gallup poll released in August 2012 (Sauter & Froelich, 2012), show that of the 25 largest industries in America, banking has seen the biggest increase in negative image since the survey was first conducted, with 53% of respondents reporting negative feelings, up from 23% in 2001. Frank

Newport, editor-in-chief of Gallup noted that the reason for the banking industry's poor image is fairly straightforward, as the sector has "been involved in major issues since (the demise of) Lehman Brothers in 2008, and it still looks like a problem." High fees for banking services likely have contributed to the negative image according to Newport.

While large banks' reputations have been sullied by numerous unethical business practices that led to and followed the global financial crisis, some community bankers contend that their reputations have not been so adversely affected (Pratt, 2011). Nonetheless, the public perception of the banking industry puts additional pressure on banking executives to generate return for their shareholders and other stakeholders while at the same time avoiding the potential costs that negative public reactions can present.

Current Banking Industry Issues

The community banking industry has been subject to many of the same pressures of the "too-big-to-fail" financial institutions. The regulatory changes of the Dodd-Frank Act require increased capital in banks along with lower fees, higher FDIC assessments, asset valuations and increasing levels of costly regulatory reform. The smaller banks have experienced lower margins, challenges in raising capital and general societal scrutiny concerning their operations (McTaggert & Callahan, 2011). The large financial institutions were well publicized for their receipt of TARP (Troubled Asset Relief Program) funds from the federal government. Many small banks also took part in the expensive program to prevent failure (Morris, 2011). Over 700 banks received the funding that was necessary to assist those institutions that discovered an extreme and unexpected devaluing of their assets (Black & Hazelwood, 2012). The sudden decline in the value of commercial properties, home mortgages, and investments in mortgage-related funds forced community banks to close, borrow from the TARP program or downsize (Morris, 2011).

The financial crisis was accompanied with increasing regulatory requirements and a less profitable economy that created a situation where CEOs and Boards of Directors had to make decisions never before experienced. Ongoing scrutiny of banking operations along with increasing competitive pressures from non-banking organizations (credit unions, investment firms, and other financing and investment alternatives) have further reduced profitability. While there is a 14% decrease in commercial lending in banks since 2008, credit unions continue to increase their lending activity. Credit unions also have lower capital requirements which results in higher institutional leverage (Hussein, 2012). All stakeholder groups (shareholders, employees, management, board members, community, borrowers, and depositors) were impacted by the changes occurring in the dynamic financial services environment. Several academics met in 2008 to discuss the financial industry and the results produced the "Squam Lake Report: Fixing the Financial System" (French et. al). These academics wrote a long and comprehensive list of recommendations including; regulatory improvements, higher capital requirements, changes in the central banking system and actions pertaining to lowering large bank failures.

The closing of 406 banks since 2008 ("FDIC Failed Bank List," 2013) has made community banks keenly aware of the risks associated with the current banking competitive market. According to a major accounting firm, Crowe Horwath (2012), mergers and acquisitions which would be common when banks and markets become available have not occurred. There are also signs that large banks are selling their branch operations and consolidating efforts in larger markets, paying down Federal Reserve borrowings and growing through online banking ("Bank of America Sells," 2013).

In spite of these challenges, community banks are attempting to take advantage of the relationship with their customers. The local nature of the smaller banks serves markets often ignored by larger banks (Yurcan, 2012). Often the loans made in smaller communities are not as acceptable to the regulatory process due to the unique requests and strong personal relationships (Cocheo, 2010). Increasing reliability on technology is expensive and ever-changing (DeYoung & Duffy, 2004). Opportunities exist

with lower cost of funds and the stabilization of the economy. The preparation of employees for the "new" era of banking has also challenged bankers with many more changes than is customary in the traditional bureaucratic structure (Cocheo, 2008). Hiring people and attracting board members who can engage with technology, and understanding the new regulatory reforms is resulting in a better educated and younger workforce to the industry.

The literature is full of primarily practitioners and government publications providing case evidence of significant environmental change and stress. The actions recommended tend to respond with procedural change to identified issues. Little has been written about management stress and resulting behavioral challenges of determining how actions and decisions are evaluated from a moral or ethical perspective. The present study addresses the issues that cause the greatest stress that challenges management behavior.

Management Moral Behavior

Behavioral economics research has shown that decision making based on traditional utility theory does not always occur, particularly in pressure situations (Ariely, 2008; Bazerman & Tenbrunsel, 2011; Gazzaniga, 2011, Kahneman, 2011; Kahneman & Tversky, 1984). Instead, contextual cues become prominent in decision making, and these contextual cues are manifest through heuristics and biases that can adversely affect rational decision making. A recently identified heuristic, *moral decoupling* was found to be possibly at play in the decision processes of the respondents involved in the present study. While more research is needed to confirm the researchers' suppositions, the finding at this point in the research is potentially profound and a brief discussion of moral decoupling is therefore reasonable at this point before the study's methodology and findings are presented.

Behavioral psychologists have long known about the cognitive construct of moral rationalization, whereby people reinterpret improper behavior in order to lessen the obvious severity of the transgression in order to maintain affective support for a transgressor. In contrast, recent research (Bhattacharjee, Berman, & Reed, 2012) has identified another similar but distinct decision-making heuristic, *moral decoupling*, wherein judgments of performance are separated from judgments of morality. According to Bhattacharjee et al., by separating these judgments, moral decoupling allows customers to support a transgressor's performance while simultaneously condemning his or her transgressions. Additionally, moral decoupling may also allow business decision makers to separate moral judgments from performance judgments such that they can decouple ethical contexts from situations that contain ethical issues and focus their decisions only on performance metrics. As will become evident throughout the discussion of the findings in the present study, moral decoupling may have been manifest in the sample groups' responses.

RESEARCH OBJECTIVES

The objectives of this research were to identify and rank by importance the most pressing issues that develop decision-making stress among community banking executives. The research also identified the types of contextual cues (situational variables) that created the greatest levels of perceived pressure among the executives polled. Members of the several CEO Forums of the Community Bankers Association of Illinois (CBAI) comprise the sample groups from which panelists were selected for two online surveys.

METHODOLOGY AND DATA SOURCES

General questions underpinning the theoretical concepts for the research were developed by the researchers and then discussed in a face-to-face meeting with four community banking CEOs from the

eastern Illinois area. Based on feedback from the face-to-face discussion, survey questions were developed for a pilot study. Qualtrics online survey software was used to deliver the survey. Before the first round was sent to the respondents, the survey was pilot tested with eight area community banking CEOs from Indiana and Illinois to ensure clarity of the questions. Feedback was obtained from the pilot test subjects and adjustments were made to the first-round survey before it was sent out to the panel of respondents.

While the initial research methodology specified use of a three-round online Delphi survey to capture expert opinions about the research objectives, the drop off in responses after the first round of the Delphi survey reduced the sample size to a number that lacked sufficient statistical strength. Repeated attempts to increase response rates were ineffective and therefore only the first two rounds of the Delphi were completed. In an attempt to develop more robust opinion data, a second Delphi survey was launched with a different sample group of CEOs from the CBAI, and response data were collected as well; however, as in the first Delphi, the response rate was less than robust after the first round and only one round was completed. In total, two separate panels of community bank executives were used to generate the finding for this research. The research had received approval from the lead researcher's institutional review board (IRB) prior to being launched.

The online survey platform used to gather response data was the Qualtrics Survey Software. Both Delphi panels were provided a brief introductory comment at the start of the online survey instrument followed by a copy of the informed consent form approved by the IRB. The survey then provided a statement to frame the context of the subsequent questions in the survey:

> What keeps you awake at night?
>
> Today the public is challenging the ethical behavior of all businesses, but particularly banks, claiming that bankers do not care about the customer or the communities, only about their profits.
>
> This creates a dilemma for bank executive officers. The challenge of a banker is to make their enterprise profitable and at the same time maintain the perception that the bank is not functioning in unfair, illegal or immoral ways.
>
> Where in that balancing process of decision making do you feel the greatest pressure psychologically?

The two sample groups that served as the panels for this research received the same basic first question but worded differently in such a way that the first panel (Delphi I) was primed to address the pressures that they perceived causing them the greatest stress. The second panel (Delphi II) received the same basic first question but with wording that primed them to address specifically is perceptions of ethicality in the pressures they identified. Delphi I received the following first question: "What types of decision dilemmas cause you the greatest stress?" Delphi II received the following first question: "What specific issues pressure you the most as far as working toward profitability and also ensuring a perspective among stakeholders that your organization is performing ethically?" Both panels were also asked follow-up questions as will be discussed below.

FINDINGS

The findings below are organized according to each panel that was polled and the number of iterations (polling *rounds*) conducted in the survey process.

Delphi I, Round One

Members of Group 1 of the CBAI CEO Forum and three Indiana bank CEOs who expressed an interest in the research comprised the sample (n = 22). All were contacted on two occasions prior to the launch of the survey to solicit their participation; once by the chairman of the group, and once by the researchers.

Question one asked: "What types of decision dilemmas cause you the greatest stress?" Several possible topics were provided as examples. Respondents could enter as many topics as they wished. Responses were received from 12 CEOs, a 54.5% response rate. Table 1 shows the topics identified in order of importance based on frequency of mention.

TABLE 1
RESPONSES TO QUESTION ONE

Decision Topic Causing Stress	Responders (*n = 12)*
Regulations and reporting	10
Personnel management	3
Profit/earnings	3
Capital requirements/liquidity	3
Community demands	1
Non-engaged board of directors	1

Question two asked: "Please describe how various stakeholder groups (name the group) cause you the greatest stress in your decision making." Table 2 shows the responses and frequencies.

TABLE 2
RESPONSES TO QUESTION TWO

Stakeholder Groups Causing Stress (and examples)	Responders (n = 11)
Bank regulators/examiners – state and federal motivated to find fault have double standard mandate "complicated models"	4
Shareholder difficulties unengaged, only concerned about their dividends difficult to communicate management problems to tl difficult to get strong ones (capital)	4
Board members lack of understanding and empathy about managem	4
Accountants /FASBI	1

In addition to the topics of concern expressed by the panelists, the phrase analysis conducted by the researchers yielded three primary interpretations:

There is a predominant perception of **diminishing managerial control** due to several factors including regulation and regulators, higher costs, and a poor loan environment.

There is a perceived **challenge concerning the management of change**. This was primarily associated with examples of personnel, board of director makeup and regulatory preparation.

There was a palpable **lack of optimism that improvement would occur in the "near future."** The lack of optimism was closely associated with continuing regulatory development.

An interesting observation about the responses is the fact that, while the survey questions were framed in the context of public perceptions about bankers as being non-caring and only interested in their own profits, none of the responses addressed this public perception, which was what the researchers were hoping to stimulate. Responses only focused on managerial problems caused by banking regulations, personnel and shareholders, i.e. performance metrics.

Delphi I, Round Two

In the second round of the Delphi the researchers provided the feedback above to the panelists about their responses from the first round and sought additional responses to questions that more explicitly addressed ethical perceptions of community bankers by stakeholder groups. Respondents were fist asked to rate their level of agreement or disagreement with the researchers' interpretations on a five-point Likert-type scale ranging from *strongly agree* to *strongly disagree*: a) sense of diminishing management control, b) perceived challenge concerning the management of change, and c) lack of optimism that improvement will occur in the "near future." The ratings displayed in Table 3 show that the majority of the six CEOs that responded to the second round survey agreed with the interpretations.

TABLE 3
RATINGS OF ROUND-ONE INTERPRETATIONS

Round One Interpretations	Strongly Agree	Agree	Neith Agree nor Disagree	Disagree	Strongly Disagree
sense of diminsihing managerial control	1	4	1	0	0
perceived challenge concerning the managmeent of change	1	3	1	1	0
lack of optimism that improvement will occur in the "near future"	1	5	0	0	0

Three questions followed the rating task. Question one asked: "If you do not agree with the above interpretations, what would you offer in their place?" The one respondent that disagreed with the interpretation that there is a perceived challenge concerning the management of change stated that "Change is every day and in our organization maybe it is not always embraced but it is understood. … Without change an organization eventually dies."

Question two asked: "Concerning the areas of diminishing control, management of change and a low level of optimism, how will you alter your management and decision style to deal with the stresses?" Five responses were generated to this question. One CEO stated that he or she would always be a proponent of change, another claimed they would retain more capital, a third stated that they would "stand their ground" in balancing regulatory compliance tasks and serving customers, the fourth stated that they lead by setting a positive example, and the fifth stated that they would delegate more responsibility to

their management team and "tread water" for five more years and get out of banking. The researchers found no common theme in this range of responses except that they all focused on performance criteria. Again, there were no responses that addressed the public's perception about the banking industry.

Question three asked respondents more explicitly about the ethical character of dealing with stressful issues: "Do you feel Community Bank presidents/CEOs are struggling with ethical conflicts due to the stresses created by regulation, change, and the uncertain future? If you do, what actions will most likely be involved?"

Of the five responses submitted, one CEO stated that they were not struggling with any ethical conflicts, one acknowledged that a few ethical cases had been encountered but did not clarify them, one could not characterize their conflicts as ethical conflicts ("sounds too dramatic"), one stated that sometimes cutting corners to save costs or make loans should not be done, and the last respondent stated that it was the regulators' efforts were not "directed correctly," but stated no specifics to support the contention. The researchers did not identify any common theme in the responses. Further, there were no responses that clearly addressed the ethical perception issue.

In summary, the CEOs' responses to the two rounds of the Delphi I focused on managerial issues that caused stress in decision making. The primary managerial issues of concern were by far the banking regulations that resulted from the financial legislation following the Global Financial Crisis, and personnel and shareholder issues. Responses only focused on managerial problems. For this reason, the researchers decided to launch a separate online survey that asked the same questions but worded more explicitly with regard to public perceptions of banking ethics.

Delphi II

Using the identical format as was employed in the first online Delphi, the researchers launched a second online survey directed to a different group of 26 CEOs of the CBAI. The survey provided the same introductory comment (see above) to frame the respondents' answers in terms of public perceptions of banks as unfairly profit motivated. Question one was worded more explicit to focus attention on perceptions of ethical performance: "What specific issues pressure you the most as far as working toward profitability and also ensuring a perspective among stakeholders that your organization is performing ethically?" Table 4 shows the results of the eight responses to this question.

TABLE 4
RESPONSES TO QUESTION ONE

Decision Topic Causing Stress	Responders (n = 8)
regulators and examiners	5
costs of compliance	4
income fees	4
personnel issues	1
loan demand	1
community demands for support	1
collections on delinquent loans	1

As in the responses by the Delphi I panel, the Delphi II panelists' responses focused on regulation as the most frequently cited cause for pressure, followed by the costs to comply with the regulations. Matters to do with income fees ranked high in levels of perceived stress followed by singular mentions of personnel issues, low loan demand, high community demands, and collection efforts on delinquent loans. Surprising to the researchers, the narratives that were provided by Delphi II panelists in response to question one did not mention the issue of public perceptions of potential unethical tactics by banking institutions even though those perceptions were clearly stated in the question. The response narratives focused exclusively on managerial interpretations with no mention of ethics or morals.

Question two asked the respondents to: "Please describe how various stakeholder groups (name the group) cause you the greatest stress in your decision making." Four responses identified regulators as the stakeholder group causing the greatest stress, two responses cited board members, and two cited none.

Question three explicitly addressed how CEOs dealt with potentially being perceived as unethical in the instances cited in the preceding questions: "How do you deal with potentially being perceived as unethical in the preceding issues that you identified?" Table 5 displays the responses to question three.

TABLE 5
TACTICS FOR DEALING WITH PERCEPTIONS OF UNETHICAL BEHAVIOR

Tactics for Dealing with Being Perceived as Unethical	Responders (n = 8)
not a problem / ethical interpretations do not apply	3
charge fairly for services / listen to cutomers	3
comply with regulations	1
personal character of the CEO	1

ANALYSIS AND RECOMMENDATION

It was no surprise to the researchers that regulation and compliance issues were the most stressful to the bankers in both surveys, followed in importance by issues dealing with employees and shareholder interests. However, the most striking observation about the responses in the second Delphi is that, despite explicit wording about potential public perceptions of bankers as unfair and unethical, the concept of perceived unethical issues in decision making were not just not acknowledged, but the concept of ethicality itself was discounted as irrelevant to decision making. In effect, the respondents perceived the context of their banking decisions as purely managerial and not ethical – even when primed with questions grounded in ethical context.

The researchers feel that this last observation, i.e. that the CEOs in both of the online surveys did not recognize any ethical contexts inherent in the stressful situations that they identified may be a manifestation of moral decoupling. This decision-making heuristic warrants further investigation. To this end, the researchers believe that the best way to investigate the nuance of the CEOs' interpretations about managerial versus ethical matters is to meet with them in person to discuss these results openly. The researchers hope that a face-to-face conversation with a group of CEOs from the CBAI will better help them finalize their interpretations.

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