Exploring risk perception and management in U.K banks

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Thesis submitted to the University of Essex for the degree of

Doctor of Philosophy (PhD)

April 2015

Declaration:

I declare that this thesis is my own work and has not been submitted in any substantial parts to any other institution or organization for the award of a higher degree.

Dedication:

I dedicate this thesis to my father, Joel Roberts who passed away just before I began this journey.

I would also like to dedicate it to my best friend Aron Mak and my son, Tramel Roberts.

ACKNOWLEDGEMENTS

Many people have helped me along this process and I would like to say special thanks to all of them. Some, however, deserve special mention.

First of all I would like to thank God, for His unfailing love, guidance and mercies throughout this challenging process. His presence and encouraging scriptures lifted me, carried me through when I felt dispirited or disheartened. I would also like to thank my supervisors, Ann-Christine Fransden, Michael Sherer, for your certitude and belief in my competence and for your invaluable direction, supervision and patience. Special thanks to my mother, Matilda, whose undying love and encouragement helped propel me to this point. Heart-felt thanks too, to my wife, Roxann and my son Tramel, for your understanding and endurance throughout this process.

Additionally, I would like to thank Iqbal Khadaroo, for his kindness and care from the beginning of my research and his role in helping me secure funding for the interviews. Special thanks go to the Institute of Scotland and Wales, for the research funding granted to me. My list would not be complete if I did not thank my siblings, especially Cheryl Roberts; the faculty and staff at Essex University and particularly Essex Business School for the scholarship and guidance throughout.

Finally, I save the best for last. Most sincere thanks to my best friend, Aron Mak for being my strength and support, morally and financially when I needed it most. I appreciate your care and unfaltering commitment to my success. You are the best friend that anyone can ask for.

List of Acronyms

ABA	American Bankers Association
ACT	Association of Corporate Treasurers
ARROW	Advanced, Risk-Responsive, Operating Framework
BIS	Bank for International Settlements
BCBS	Basel Committee on Banking Supervision
BOFIs	Banks and Other Financial Institutions
BSRC	Banking Standards Review Council
CBA	Canadian Banking Association
CBI	Confederation of British Industries
COSO	Committee of Sponsoring Organizations
CRO	Chief Risk Officer
DP	Discussion Paper
EBF	European Banking Federation
ESFS	European System of Financial Supervisors
ESRB	European Systemic Risk Board
EU	European Union
FSA	Financial Services Authority
IOD	Institute of Directors
IBF	International Banking Federation
JSDA	Japanese Securities Dealers Association
LTV	Loan to Value
NEDS	Non-Executive Directors
PER	Pan European Reform
SEB	Southern European Banks

SEP	Supervisory Enhancement Programme
SIFI	Systemically Important Financial Institutions
TCF	Treating Customers Fairly
UK	United Kingdom

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Abstract

The concept of risk has been interpreted, defined and researched overtime in many different ways. This research uses semi-structured interviews to explore the perception of risk through the views of UK bank managers. Although different risks are identified and discussed in this thesis, the main risk that these interviews are concerned with is credit risk. It builds on previous work from Mikes (2009, 2011) and Wahlstrom (2009) and uses structuration theory to understand how human beings interact with social systems to produce organizational outcomes.

Twenty five (25) interviews were conducted among banking managers and executives over a period of close to two years. There were five (5) banks that participated in this research but the largest two banks (Glass bank and Penny bank)[1] were analysed and presented separately because of the significant differences in their approaches to risk management despite their similarities in size and international operations. The other three (3) banks were much smaller in operations with no global operations and not much overall differences in their approach to risk management.

The research finds three distinct approaches to risk management, based on perception. The first approach is based on a perception of risk as a measureable and quantitative construct. Managers and risk executives from Glass bank are strong believers of this risk philosophy and hence, the social subject (agent) is consciously separated from the object (the system) and the rule and procedures are viewed as being separate and distinct from the agents that implement and reproduce them. This approach mirrors what Layder (1987) refers to as "structural dualism"

[1]These are pseudo names used to conceal the identity of the participating banks.

where the subject and the object are independent of each other but work together to produce organizational outcome. The emphasis in this approach is on the structure.

The second approach to risk is situated in the belief that risk should be explored as a social variable, where the emphasis is not exclusive to measurement and calculation but rather on understanding risk by examining customer needs and building relationships through communication in an effort to better serve risk needs. This approach was mostly evident in Penny bank where risk is operationalized, as opposed to being centralized as in Glass bank and the focus is on customer satisfaction and a moderate risk-return philosophy. The emphasis on this approach is on the agent.

The third approach to risk, views risk as a mixture of both system or structure and agent. This approach was most common among the other three (3) smaller banks. Fairly equal weight was ascribed to understanding risk as a social force and measuring it as a wealth creator.

In each case, the role of the agent was recognised but the importance of the agent in reproducing organizational outcome is different. This study also finds that the changes made to the risk management system after the financial crisis reflects an intensification of the old procedures in all of the banks. This, is a mostly because bank managers do not believe that the system is inherently flawed (as argued by McGoun 1995) but rather needs to be improved and perfected.

Chapter 1: Introduction, objectives and motivation for the study

1.1 Introduction

For centuries, risk management has played a menial role in the world of business, simply reduced to trust and basic instinct (Bernstein, 1996). However, this once lucid concept proved crucial with the onset of the Asian crisis that struck in the late 1990's and the Russian crisis that followed soon after (Wahlstrom, 2009). Yet, appreciation for and understanding of risk outcomes was seemingly quickly overshadowed by a wave of finger pointing and blame tagging (Buckley, 2011). Eminently, then, the recent financial crisis served as an awakening to financial experts, market advisers, insurance houses and bankers alike commanding attention of the almost forgotten unpredictable concept of risk.

As professionals struggled for answers, several literatures emerged (for example Mikes 2009, 2012, Power 2009, Buckley 2011) each seeking to provide much needed explanation into the workings of Enterprise Risk Management: its definition, core meaning, attributes and role in the fervent fight for ever increasing returns particularly in the financial sector. The argument that managers are often faced with tough decisions that can help shape or stall the risk culture of an organisation is almost widely accepted (Mikes 2009, Power 2007, 2009). Nevertheless, several questions still remain unanswered as they relate to risk's true identity and managers' duty in shaping, stalling or promoting an acceptable risk environment. Power (2009) likened this to risk appetite while Slovic, (1987) argued that perception of risk plays a key role in mitigating or fostering a satisfactory risk environment.

Throughout its trajectory, risk has remained a construct of measurement and calculations based on probabilities of past events. However, McGoun (1995) argues that this approach to managing risk is inherently flawed and should be addressed.

To this end, this research examines some of the key issues that surround and help define risk. It explores risk as a concept of perception through the lens of UK bank managers. Types of risk that are important in the banking industry are also explored.

1.2 Research questions

Research question 1

This research examines managers' perception of risk in UK banks. My main research question is:

How do bank managers in the UK perceive and manage risk?

Risk perception, has a major role in managers' risk decisions (Adams, 2003). These decisions are shaped by, along with other components, the managers' immediate visions of risk which in turn influences the attention it commands in the decision making process. Mikes (2009) argues that risk is an ever changing concept that has varying meanings even for managers of the same organization. In this main research question, the aim is to understand the meaning of risk through perception from a bank manager's outlook and examine the consideration given to the risk concept in decision making based on the manager's understanding. It would explore bank managers' views of risk and how these views in turn translate or influence the risk process that characterises risk management.

Research question 2

What changes (if any) did the financial crisis bring to the risk management process?

Changes usually follow events, especially when such events are as significant as a financial failure. The Sarbanes Oxley Act of 2002 was drafted primarily as a result of the Enron and WorldCom fiascos. Similarly, the Basel committee, the Bank of England, The Bank of Canada, United States Treasury, the Financial Services Authority and other regulatory bodies have issued changes to bank policies in the U.K, Canada and the U.S.A after the financial crash. The effect of these changes is intended to mitigate the chances of a future financial catastrophe. This research question examines some of the main areas of change in risk procedures in U.K banks as a result of the financial debacle.

These changes are a reflection of the old risk policies since managers perceive the risk management system as authentic. Hence, the changes made to the system were that of an intensification of the existing rules and procedures before the advent of the crisis.

1.3 Research Objectives

The main objective of this research is to understand how risk managers perceive and manage risk. Other objectives include:

(i) To determine the main types of risk that is of concern to bank managers in the U.K.

(ii) To examine the changing perception (if any) of the concept of risk in banking institutions in the UK.

(iii) To evaluate the changes (if any) ushered to risk reporting as a consequence of the global financial crisis and managers' perceptions of these changes.

(iv) To assist in creating a practical approach to risk philosophy through literature that may be applicable to practicing executives in the banking industry while enriching the body of research on risk ideology. Additionally, this research intends to further provide a skeleton for much needed studies on Enterprise Risk Management (ERM).

1.4 Motivation and Justification

The subject of risk can never be really exhausted and although numerous researches have been carried out (see for example Linsley et al. 2006, Arnold 2009, Aven and Renn 2009, Billet 2010), the very nature of risk makes it challenging to fully comprehend this concept and so research findings can lead to more questions than answers (Bhimani, 2009) Additionally, risk management is an ever evolving notion and much direction is still needed (Power, 2007; Wahlstrom, 2009; Mikes, 2009). Hence more research may be necessary to help understand risk and its changing dynamics.

Past and present researchers have helped create pathways for future work. Mikes', (2009) examination of the risk cultures of banks is crucial in guiding this investigation. Nevertheless, the risk tendencies discussed focuses on almost all aspects of banking including retail and corporate (Mikes 2009), leaving an opportunity for core research with a sole focus on investment banking. Added to that, the role of managers' perceptions in the banking industry is not addressed, and neither is the impact of the global financial crisis on risk atmosphere. Moreover, perception of risk on the decisions made is omitted from Mikes' work as this is not the focus of her research. Similarly, Wahlstrom (2009) did extensive work on risk perception, oscillation and bank managers' reactions. His work provides a skeleton for this research.

However, his research includes several Swedish banks and scrutinizes managers' perceptions of risk in the context of Basel II only. Hence, his research does not address risk management in its entirety, for it narrowly focuses on the risk regulations imposed by Basel II in Swedish banks.

Linsley and Shrives (2005) examines current banking risk disclosure procedures against the Basel II requirements[2]. They argued that risk taking is inherent in any banking institution as part of its normal operations. Hence, the challenge for banking institutions is integrating their risk culture as part of their good corporate governance practices. Their research analyses the guidance of the Basel II risk framework and its relevance in addressing the perceived shortfalls of risk disclosure by the banking sector. Subsequently, Woods et al (2008) examined risk management practices in the U.K financial service sector. The debate on risk has intensified in the wake of the financial crisis and this research draws from previous work of other scholars and risk frameworks (particularly, Adam's 2003) to contribute to the debate.

This research intends to fill the gaps of previous research by exploring the risk perceptions of bank managers in the U.K by drawing from Adams (2003) risk framework, especially in the wake of the financial crisis. To date, no research has covered this ground. Baltazar et al (2010), in a survey of 199 Canadian bank managers, studied perceptions and managerial configurations in the Canadian banking industry. Although the study does not focus on risk, it provides a basis for discernment of attitudes and viewpoints of Canadian bank managers, which may have implications for bank managers outside of Canada especially in the context of globalization. These attitudes and prospective may impact their managerial decisions even on risk. However,

[2] This research was more specific to a section of the Basel II, the Pillar 3.

like other research, and as Mikes (2009) indicates, risk atmosphere and hence culture and attitudes can vary from bank to bank and even among managers in the same institution.

Risk perception is critical in the decision making process of managers and executives (Renn, 1998). However, there is a lack of research in this area that needs to be filled in order to help better understand risk mechanisms and temperaments (Slovic, 1997; Renn, 1998). Further, the recent financial crisis is evidence that experts are still deficient in deducing and explaining the full workings of Enterprise Risk Management (Power, 2009). Apprehending risk appears to have been the focus of risk professionals immediately after the crisis. Nevertheless, this course seems to have changed to understanding and interpreting risk behaviour in different contexts (Mikes, 2009). Providing meaningful guidance on this tract would involve employing various views of risk managers, which are essential to the decisions that affect global financial health. This adverse, yet fundamental phenomenon is the main motivation for this study. Additionally, the findings of this research may help guide not only managers but regulators and other risk executives who too, need direction in the face of significant pressures from the public for better protection from financial disasters (Turner Review, 2009). Simultaneously this investigation can have positive implications for banks seeking to better manage risk by adopting small sections, segments or procedures from one region that may be cogent, relevant and applicable to their own situation. This can lead to further changes in the engineering of risk and promote, however small, a contribution to a global risk environment.

1.5 Theoretical framework

This research uses aspects of Giddens Structuration theory to help place managers (as agents) understanding of risk and their interaction with the rules and procedures (system) that helps produce their decision (organisational outcome).

The making and evolution of society has always been a topic of contentious debate among theorist. From the Marxist viewpoint, social order is a construct of the powers in society and a constant fight to maintain authority by the owners of capital (Marx 1961, Foucault 2003)**.**This "determinism" as it is commonly called by supporters of the Marxist philosophy (like Weber, for example) is the driving force of social change.

Giddens (1983, 1984, and 1990) offers an alternative view of societal formation and human relations in society. One, not based on power or the owners of capital; nor on a shift in modes of production or movement in social order from capitalism to communism, but rather one that envisions society and social environment as an integral part of human actions and the systems or structures they operate within, help create and change and the interaction between the two that cannot be easily separated (Macintosh and Scapens 1990).This theory explains the reciprocal action of human beings in the context of their surroundings and environment, the social system and the production and reproduction of that system (Giddens 1984). Structuration theory is an ontologically based theory which endorses a view of the organization as being integral with its constituents and explains the resulting reciprocal action through interaction of humans and structures. It seeks to interpret and explain the reliance of humans as agents on systems as

structures and encompasses a wide network of other factors like anxiety and the unconsciousness in human behaviour (Layder 1987).

Additionally, the correlative communal approach that the theory employs attests to the research question by acknowledging the relationship between the banking institution and bank managers and the dependence each assumes. Hence, this research uses structuration theory to explain organizational phenomena and the role of humans as actors or agents in interacting and integrating with systems to shape organizational decisions (Dillard et al 2004). Bank managers, operate as agents and decision makers within the scope of the banking system, rules and regulations. However, these managers themselves help shape the system by the decisions that they make and the procedures that they implement. Structuration theory offers a route to examine bank managers' risk reality as agents and individuals in the context of their banking environment and their influences on and ability to effect changes to the banking system while operating within it.

1.6 Research approach and methods

The measurement of human relationships and the accompanying underlying notions about knowledge and reality has led to varying philosophical viewpoints that influence research methodology (Johnson 2000). This research falls within the scope of interpretivism.This approach of understanding the nature of reality and human behaviour is crucial in supporting, relating and strengthening the concepts of Giddens (1984) Structuration theory.

The interpretive approach along with its foundational inductive reasoning would be used to help understand risk managers' perception in U.K banking institutions. Several studies including

Mikes (2009) and Wahlstrom (2009) capitalized on similar measures to examine managers' attitudes and behaviour in various social settings. Mikes' study of culture in financial institution supports the use of this philosophical design. Moreover, an ontological doctrine also purports an examination of the interactions and relations that interplay in financial institutions, governing bodies and managers.

Ethnography is one way of conducting interpretive research (Myers 2009). Becoming an integral part of the organization's work and social structure can be central to interpreting, analyzing and observing human interaction and understanding perceptions and behaviour (Mikes 2009). However, such a method requires an extensive commitment of time, usually to study organizations in their full context which is outside the scope of this research. Instead, discussions, (formal and informal) interviews, direct questioning and company literature would all be used as means of gathering and accumulating relevant and important information for this study.

Therefore, the main method of obtaining information would be through in depth semi structured interviews with bank managers and analysis and evaluation of company documents (primarily annual reports). In depth semi-structured interviews would allow for flexibility, expression and reason in the communication process (Silverman 2008).

This study recognises the role and significance of validity and reliability of data in empirical research and the need for understanding and applying the data collected in the context of the study (Johnson 2000). To this end, this research does not propose to seek a single truth about risk

management or to give solutions to risk challenges, rather, it proposes an exploration and give suggestions on how risk can be better understood based on the views of managers in U.K banks. Other studies on risk, using a different philosophy (like positivism for instance) may offer different results or suggestions based on objectivity, using data from the same banks.

The use of in depth interviews does not always guarantee information that is verifiable since it entails subjectivity and opinions can change overtime (Silverman 2008). Hence, this research is highly qualitative and thus is expected to be meshed in subjectivity, since perceptions, feelings, intellect, attitudes and knowledge may not always be otherwise adequately explained.

Critical theory would not be directly engaged in this study; nevertheless all claims would be analysed in their own context and challenged on the grounds of purpose and scope. This slightly critical position would help enlighten some of the drawbacks in explaining managers' behaviour as supported by Giddens's Structuration theory**.** The notion that there is not always a single best way (Macintosh and Scapens 1990) is an underlying theme of this research.

1.7 Structure of the thesis

The rest of the thesis would flow from previous reviewed literature to summary and conclusions. It would include the research design and methods, theoretical framework, exploration of risk concepts, risk regulation, findings and analysis and conclusions.

Chapter two would examine past and present literature pertinent to this study and include the history of risk, its trajectory and early perceptions of risk management. This chapter will outline

the historical development and the gaps in the literature that this study addresses and. will also include a brief discussion on the perceived role of risk management or mis-management in the financial crisis and if any changes were made to the risk process as a result. The reliance on models and measurement for understanding risk is also discussed in this chapter.

Chapter three would continue to examine literature, pertinent to risk management and regulation. The chapter begins with an introduction to the role of regulation specific to risk in U.K banking institutions. Different regulatory frameworks would be examined along with the shortfalls, challenges and deficiencies of each. Other risk frameworks (like Adams, 1996) would also be discussed.

Chapter four would follow next with the theoretical framework that this study uses to help understand risk perception in banking institutions. Giddens' (1984) Structuration theory is used to help explain how managers as agents, operate within the constraints of the banking system that they themselves help create and change constantly. The rationale for using this theory would be discussed along with the shortfalls of structuration theory. Additionally, this chapter would also include a short discussion on other alternative theories like the actor-network theory, institutional theory and agency theory and why these theories were not chosen for this research.

Chapter five introduces the research design including the methods that are used in this research. This research uses the interpretive approach. The research process, including challenges and ethical considerations would be addressed here. Data collection and analysis of the data would be discussed in this chapter.

Chapter six represents the first of two findings chapters and discusses the analysis of secondary data. These findings are a reflection of data contained in the annual reports and other documents obtained during the interview process from the participating banks. The chapter analyses risk in regard to reporting and interpreting it from documents, particularly with respect to the banks under review (Glass bank, Penny bank and other banks). Regulatory reporting requirements and changes to such as a result of the financial crisis are also discussed.

Chapter seven would support the preceding chapter in understanding managers' perception of risk in the banks examined. This chapter would account for the results from the in depth semi-structured interview along with a discussion on the application of structuration. It will outline the background of the banks and present the perceptions of the bank managers with regard to risk. Risk would be discussed in terms of meaning, process and changes. Regulatory requirements would also be part of the discourse but in the context of acknowledging both voluntary and mandatory requirements in the risk process, especially when making risk decisions.

Chapter eight would conclude the thesis and includes a discourse on understanding risk behaviour and attitudes. The chapter summarises and discusses risk as a moral compass and its importance to everyday life. It also reviews the research contributions and presents opportunities for future research.

1.8 Summary and conclusions

This research presents empirical evidence and an analysis of secondary data of the views of bank managers' perceptions of risk in U.K banks. These perceptions are based on the managers'

understanding of risk reporting, regulations, and the risk process and risk decisions. The data is collected from five different U.K operating banks and the research finds that most managers perceive risks almost in the same way after the financial crisis as they did before. However, there is a small difference, which has to do with the inclusion of a social side to risk (judgement, values, ethics) that may have been widely ignored before. Hence, this research proposes an integrated approach to risk (an integration of social aspects and mathematics) developed using bank managers' perception as a base.

Understanding, monitoring and engaging in risk decisions may be challenging for bank managers who are under frequent scrutiny to produce returns. Guidance is needed in risk apprehension, but such direction can prove difficult for a notion like risk that can have different meanings to managers of the same organisation (Renn 1998, Mikes 2009). By extension, ERM[3] may be perceived adversely for bank managers of different institutions.

The recent financial crisis saw the fall of several UK banks that had to be rescued by the government. Canadian banks, however, which employ similar governance structures to the UK held on and rode the crisis wave. For example, one bank operating in both regions signed to be rescued in the UK but stood strong in Canada. The extent to which managers' perceptions in risk decisions and regulations are responsible is an ongoing controversy.

This research examines both sides of the coin by investigating bank managers' perceptions of risk and the extent to which these influence their decisions, in the wake of the financial collapse.

[3] ERM refers to Enterprise Risk Management which acts as an umbrella term for most risk situations relating to business and accounting.

The research uses Structuration theory to place managers in the context of being individual agents, with their own perceptions shaped by their culture, social interactions and experiences. However, these managers operate within a particular banking structure that they draw from and contribute to on an ongoing basis, changing, producing and re-producing the system.

In depth interviews are used as a means of collecting data and structuration theory is to understand and interpret the views of U.K bank managers. These views are analysed using the assumption that bank managers are social beings who experience and interpret risks in their own way but who are also operating within a system that can both constrain and encourage their behaviour.

Chapter 2: Exploring the concept of risk through its history

2.1 Introduction

The last chapter presented an introduction to this thesis and outlined the research questions, research objectives, the research contribution and the theoretical framework for understanding the context in which this research can be understood. This chapter aims to discuss and offer some critical insights on the literature on risk. Both earlier literature and current literature are examined. The chapter begins with a review of some of the earlier literature on risk and risk perception, when management of risk was based on the perception of the concept as an unknown variable, translated into a known attribute through calculation and measurement (Knights 1921, Fisher 1929). The next section examines the acceleration of this perception (that risk can be measured almost accurately) and the development of tools and mechanisms to advance the measurement of risk. McGoun's (1995) analysis of the history of risk is useful in helping to understand how risk was elevated by translating the uncertain into what was believed to be certain and measuring it by using flawed probabilities measures. This trend of risk management led to risk being used as a performance measure for financial fruition and results. Hence, risk innovation emerged as a means to advance or to excel the management of risk by sharpening the means to measure risk through computer programming, financial modelling and other statistical and estimation tools. This is discussed in the next section.

It is important to recognize that along its course, its history and development, up to the 1990's a lot of the literature on risk focused heavily on institutional structure as the pivotal precept in determining organizational outcome (Willet 1901, Fisher 1906, Knights 1921 and McGoun 1995) Little or no emphasis was placed on the human aspect or the role of the agent in

determining risk outcomes. The rapid progress of risk measurement as the way to manage risk led to the evolution of complicated financial instruments and coupled with unscrupulous risk taking behaviour brought about an eventual meltdown of the global financial system in late 2000's.[4] The section that follows examines what lies ahead for risk management, especially in the light of the financial crisis; how customers, investors and consumers may react to risk management policies implemented on their behalf. Beck (2008) suggests that investors will become more engaged and force a new approach to risk.

The next section continues this discussion and examines what emerges from the financial crisis especially as it relates to risk perception and how it impacts the management of risk; was there any real change in perception? Mikes (2009) argues that there has been a culture of calculating risk as evidenced by earlier literature that appears to be changing and that new boundaries are being explored. However, this risk perception change that Mikes (2012) is referring to, has not been translated into a change in risk management approach or procedures, or is not significant enough to impact the risk management philosophy away from the central doctrine of measurement and calculation, being currently employed. Thus this section takes a closer look at Mikes' (2009, 2012) research and outlines how my research draws from Mikes' work, with similarities, differences, gaps and thus the theoretical contribution. The chapter concludes by reviewing the concept of risk as predominantly consistent today with earlier perceptions, but with recognition that change in perception is needed.

[4]Risk management was not the only factor responsible for the financial crisis. Hall (2010) argues that other factors, like governance (which risk is also a part of) contributed to the financial crisis.

2.2 Earlier literature on risk, risk perception and management

Early literature indicates that the concept of risk may have begun at the start of the 1900's with the work of Willett (1901), Fisher (1906) and Knights (1921) (McGoun 1995). It can be argued that these theorists in effect, had created a foundation for the development of the concept of risk. Their works, however, like the many others that followed characterized risk as a quantitative measure (Covello and Mumpower 1985). Risk has since been changing its appearance and the attention that is now given to this area in organizations has markedly increased (Power 2007). Before the turn of the 21st century, risk management was closely tied to economic theory; hence measuring risk was preferential to understanding or exploring the concept (Mikes 2011). This measurement attitude was traced back to the 17th century when the probability theory was developed (Covello and Mumpower 1985). Hence, the perception of risk was understood to be a variable that can be readily measured and thus the management of risk took the form of calculations, estimations and mathematical and statistical computations. This mind set toward risk management, seeks to make certain the uncertain future, by quantifying unknown variables via estimates, trying to make them known (Rosa 2010, McGoun 1995, Fisher 1906, 1929,). Differentiating between known unknown and unknown unknown was the focus of the debate, since risk was perceived as a uniquely measureable arbitrary. This distinction was central in separating risk (which was perceived as measurable) from uncertainty (which was perceived as unpredictable) (Fisher 1929, McGoun 1995).

Covello and Mumpower (1985) has traced the history and culture of risk management as a measurable, quantifiable construct to a much earlier time of 3200 B.C to a group called the Asipu. According to Covello and Mumpower (1985) in order to understand why risk has

emerged as an unknown variable that can be measured to become known, we should examine the history of risk rooted in probabilities beginning in the 17th century when John Arbuthnot argued that the probability of an event occurring could be calculated. This was based on an earlier notion of "probability theory" developed by Pascal in 1657, where matrices were used to determine the probability of the existence of God. This theory was adopted in almost every sector of governments and public life for managing and deducing natural disasters, epidemic diseases and pollution. Soon enough, in the early 1900's it entered the world of trade and business and although it has metamorphosed since, it never left.

Along its trajectory, risk did not lose its key feature as a quantifiable, calculable variable, by turning the unknown into the known and measuring it (Miller et al 2008). This has helped shape its definition, perception and approaches to risk research and risk management. This mathematical imaging, presented risk and risk management as a variable that can be easily controlled. Eventually, and because of the value placed on mathematical engineering and reasonable assurance of correctness, risk became an engine for performance measurement and used as a channel for earmarking rewards (Adams 2003)

Although for many years (dating back to the 17th century) risk provided an almost true representation of expected results from a particular scenario, it does not mean that it was without faults. The Asipu group mentioned earlier examined several alternatives from a single situation before making a decision or selecting the one that was deemed to be the best choice. Nevertheless, there were almost no alternatives to probability reasoning or estimating as it relates to risk. This is because for the situations in which it was applied, the probability theory worked,

for the most part and any encountered problems were discounted, ignored and treated as insignificant (McGoun, 1995). Hence, probability evolved as the best chosen option without any competing or contending ways to dealing with risk. Today, there are other ways to managing risk especially in banking institutions[5] but perhaps if these were examined or explored in earlier years as possible options, then the effects of the financial crash could have been less[6]. McGoun (1995) by following the history of risk, warned that the probability measures used were flawed and problematic and that these problems were known by mathematicians and other economic experts but were rejected and overlooked for fear of raising questions about the reliability of the measurement. Perhaps if faults of the measurement techniques were not scorned, then possibly a better theory of measuring or appreciating risk could have emerged:

> *"One can only guess whether the rejection of a probabilistic measure of risk would lead to a loss in status of the profession, a severe depreciation of painfully acquired human capital, a horror at the absence of any apparent alternative, or some or all of the above. It might certainly lead to better theory". (McGoun 1995, p 530)*

In recent times, although risk management has experienced a metamorphosis in approaches, the main focus, still is an expression of formulae and computational measures rooted in probability and estimates that are faulty. This is because along the way, risk perception did not change materially from what it was in earlier times. While measuring and estimating are important in

[5]Two of the participating banks in this research (Glass bank and Penny bank) have almost complete approaches to risk management.

[6]There is no evidence to suggest that a different risk approach by banking institutions could have mitigated the effects of the financial crisis, this is only a theoretical possibility.

risk management, the measures used can undermine the results. Improving this measure should be or should have been the focus of earlier economists and mathematicians but it appears that expanding it and intensifying it with its faults became the attraction. The next section examines how risk moved from measurement and calculation to improving the process of measuring and calculating by developing and employing tools to measure risk more accurately instead of correcting or attempting to alleviate the faults in the measures used.

2.3 Historical developments in and current state of risk and risk management

As stated in the previous section, risk management is historically based on a perception of calculation and measurement (McGoun 1995, Mikes 2009). Measuring risk is important because it helps us to determine values for assets, liabilities and equity. These measurements also help us to attach numeric outcomes as returns and profits so that investors can relate to their investments and economic wealth can be assessed in terms of growth. However, when the measure used is inherently defective, then the results can be misleading or can even lead to catastrophic decisions. For years, the mode of valuation used in assessing and calculating risk has been a probability measure that gave early indications of flaws, defects and errors, but these were neglected and treated as insignificant. Admitting the problems of the probability measurement may have been too high a price for economist and mathematicians and may have meant disputing or denouncing the probability theory when there were no readily available alternatives. McGoun (1995) argues that this may have been the beginning of a chain of misguided actions in economics and accounting that continues even today. He sums this up as follows:

"In economics, finance and accounting, risk is measured probabilistically. Relative frequency probabilities, however, are subject to a number of severe problems that make their use as measures of risk very questionable. From the current literature in economics, finance and accounting, one would never know that these problems existed but the historical record is quite different, by 1930, early enthusiasm for the potential applications of probability to economic issue was extinguished as economists acknowledged the insurmountable problems, but by 1930, mathematicians who had crossed over into economics began sidestepping these problems and by 1950, they had been largely forgotten. To admit the problems would now mean abandoning modern portfolio theory and the asset valuation models which form the core of much of finance and capital markets in accounting despite their dismal empirical record" (McGoun 1995, p 511)

Whether, mathematics or economics is to blame for the extended use of the problematic measures, the attention given on correcting or rectifying the probability measure was minimal at most. Perhaps, the current measure of probability is the best one for current market valuations and estimations but with no attempt to improve or correct its flaws, we may never know if there exists another method or a modified version that can be better applied to risk situations. One of the fundamental problems with the current probability measure, as argued by McGoun, (1995) is that it is applied universally, similarly to how probability works in mathematics. However, the underlying defect here is that accounting, economics and finance (especially accounting) are interpreted through meaning and cannot simply be manipulated by numbers or else the meaning may change. According to Power (2004, 2007, 2009) this universal application of the numbers to risk has led to the risk management of anything, everything and nothing.

Another problem with the relative frequency probability currently being used in accounting and finance is that it is based on historical data that may or may not represent current market conditions (McGoun, 1995). This is crucial especially in light of the financial crisis, since historical data emerged as the prime culprit in deceiving investors and customers. Market conditions are rapidly changing and in some instances even small changes can lead to big differences in investment results. These changes however are not reflected in the probability models because the data used is historic. While historic data can be used to reasonably estimate some future scenarios, it can't possibly determine every future outcome based on similar past situations

Based on McGoun's argument, it seems logical or rational that current practices be amended or at least be improved in an attempt to help reduce misleading results based on a measurement system that is inherently faulty, especially in the light of the financial crisis. However, banks and other financial institutions have stepped up their intensification and use of these measures, seeking to perfect them, not by changing the fundamental probability tenets that are faulty, but by using technology to help perfect future predictions. It is unclear, whether or not any changes would mean a more efficient way to manage risk but at least it might mean an improvement from the current practices that brought down the entire global financial system.

2.4 Lack of evidence on risk perception and risk "innovations" in the light of the financial crisis.

Arguably, the recent financial crisis that began in the late 2000's is a reflection of the failed practices and policies of economics, finance and accounting. As indicated before, a large part of

the blame was assigned to how risk was perceived and hence managed. It seems logical then, that after thorough investigations and findings, improvements to the system of managing risk would be eminent[7]. Hall (2009) proposed several changes to governance and risk management based on UK's investigative bodies, like the Turner Commission and the Walker Commission. Although both the Walker and the Turner Reviews were more governance based, they both addressed crucial areas of risk management that needed to be overhauled, like better oversight, more sub-committees, better internal controls and the like. Nevertheless, neither the Walker nor the Turner review suggested any changes in the way risk was being measured. Hall (2009) argues that admittedly, governance is crucial in every aspect of business but the reviews lack specific guidance on risk as a major contributor to the financial meltdown and thus, banks resumed to *"business as usual"* as soon as the hysteria over the financial crisis died.

If risk management is a continuation of measures that brought us the financial crisis, then this may imply one of two things. Either there was little or no change in risk perception or that the changes in risk perception did not translate into new or improved risk management principles. Adams (2003) predicted through his risk model[8] that punishment for risk failures (like the financial crisis) is essential if any change in risk perception is to occur. He also argues that although rewards are important, they should not overshadow the *"morality of risk",* since risk decisions are moral decisions. Sikka (2009, 2011) claims that there were no real lessons learnt from the financial crisis since banks resumed their usual routine of careless risk taking, and motivated an unmonitored rewards program. Sikka (2011) argues that banks are even more

[7]Examples of investigations into the causes of the financial crisis include the Walker review and the Turner Review. These are discussed in more details in chapter 3.

[8]More on Adams risk framework in chapter 3.

ruthless now in their approach than they were before the financial crisis, with little regard for investors and shareholders and that regulators are pretending to be busy trying to stop them but are actually *"rearranging the chairs on the Titanic while it is sinking".*

Based on these arguments, it appears that the apparent continuation of risk measurement based on impaired probability models seem to be motivated by a lack of proper governance structures (Hall, 2009), a compulsion to greed (Sikka 2009,2011) and an absence of punishment for the ones responsible (Adams 2003). Hence, risk innovation has been stifled by an unwillingness to explore other options and ways of managing risk and although the financial crisis should serve as a catalyst to incite new measures to handle risk or at least to investigate and improve the old ones, no such response seems to be forthcoming. In the absence of this, Beck (2004) warns that the customer or investor will force a new approach to risk by becoming more engaged and more involved in the operations of the business. This according to Beck would lead to a *"reflective society".* The next section introduces Beck's theory of reflection and discusses what lies ahead for risk perception and management.

2.5 Towards new risk ideas and risk management links

The inaction of regulation and the push by banking officials to retain and even extend their current risk philosophy is not unique to the United Kingdom. In the United States, the new democratic government that took over power of legislation in 2008, tried to enact a new approach to risk by imposing more regulation and risk oversight on Wall Street. This new avenue of assessing risk was not meant to change how risk was measured but how much risk is reasonable, how to mitigate risk, who should be held accountable for future failures and how to

protect investors against careless financial institutions (especially banks) that act on their behalf. The bill, known as the Dodd Frank Act, failed to gain traction in the United States congress as political figures became entrapped in a fervent debate about weighing economic prosperity against consumer protection[9]. This demonstrates that risk is just as political as it is financial and the legislative influence or non-influence may play a larger role on the future of risk management.

Buckley (2011) also cites political barrage as a major hindrance to the development and advancement of risk management. According to Buckley (2011), the dissolution of the UK tripartite into the Bank of England as the sole legislative authority over financial institutions was a political move that can be detrimental in the future. It is difficult to conceptualize what lies ahead for risk perception and management but it is unlikely that risk will undergo any revolutionary changes in the coming year. The history of risk as explored by McGoun (1995) describes the unwillingness to abandon the measurement ideology of risk since it evolved and was sold as a trusted system of appreciating risk. However, if the financial crisis could not trigger new ways of dealing with risk then it appears that the challenge of convincing experts and professionals that the current system is flawed and needs improvement is one not being met.

Beck's (2004) theory suggests that a revolution is brewing and that it is inevitable. However, the main tenet of this revolution is based on the idea that investors would become more involved. The problem with this theory is that investors often are not as engaged because they lack the

[9]The argument that banks create economic prosperity is frequently made by lobbyist for the financial sector. However, the Basel III has cautioned that the creation of wealth by financial institutions does not obscure consumer protection. A discussion on creating this balance is given in later chapters.

competence in this field and trust the manager to act in their best interest. Even if the information on risk is made available, there is no guarantee that the investor can adequately interpret it or has the resources to have it translated into language that he can understand. How then will risk innovate? Perhaps Power (2007, 2009) gives us some insights. According to Power, risk management has to change, but the form of the change is still unknown. It must begin, according to Power, with the recognition by experts that change is needed and would take a pool of resources from all concerned parties.

Mikes (2009, 2011) argues that this change is already in progress but the focus on calculating risk will remain. Small changes, Mikes argue, is what is being implemented and whether or not this is just symbolic or practical remains to be seen. The next section will discuss Mikes' work and how it differs from what I am currently researching.

2.6 Perception and meaning of risk: The gap in the Literature

This research is an attempt to present field based evidence on the perceptions and management of risk based on a history and culture of measurement and calculations. Do these bank managers view risk as a series of computational exercises? How important do managers think the calculations are in understanding and mitigating risk? Are bank managers interested in understanding risk at all and if so do they think that the current risk models are helping? This research fills this gap by examining bank managers' perception of risk by building on research previously conducted by Mikes (2009, 2011).

Mikes (2009) investigated risk management in banking institutions and found that risk is understood as a calculative culture of numbers that are interpreted by managers and experts to a universal meaning of profits and returns. The focus of her study here was to explore how risk achieves organizational significance through perception (by interpreting calculations). In 2012, Mikes extended her research by investigating how managers can set new boundaries by making risk count instead of counting risk. Here, the focus was on how to use risk better as a means of achieving organizational goals. Her research was based on Power (2007) notion that risk management calculating practices have not ceased or lessened but rather intensified. Mikes argues that if we are to employ this risk philosophy then banking institutions should not just measure risk but ensure that it has meaning that can translate into organizational importance. Her research was on investigating this meaning. She found the meaning is almost universal across banking institutions because of the culture of calculations being interpreted similarly and management control systems being similar.

This research seeks to add to the knowledge of risk understanding by building on previous research conducted by Mikes (2009, 2011) by examining perception and management of risk by the numbers. Specifically, this research seeks to investigate what risk means to bank managers and what their perception of risk is and how risk is managed based on the manager's perception. This is examined in the context of risk being historically calculative and contributed to the financial crisis. The research would also examine whether or not there were any real changes to risk management policies as a result of the financial crisis and the role of regulation in determining what risks should be of most importance.

Mikes (2009, 2011) was not the only academic to examine risk perception and management. Whalstrom (2009) also examined risk perception and meaning but in the context of Swedish banks and the interpretation of the Basel II. His research focused on how the Basel is interpreted and applied in Banking institutions and whether or not it had any real organizational impact. He found that the Basel II was well established and well received as a way of handling risk.

I would use structuration theory to help understand the role of the manager and the risk system at hand that he must integrate with. Hence, the calculative culture that was observed by Mikes, although crucial in understanding and appreciating the history and direction of risk, left room for researching risk perception and management through the lens of structuration theory, where the bank manager's action is fused with and reliant and dependent on the rules and resources that he himself create and use in managing risk. Hence, there is a disconnect in the perception of risk and the management of risk based on what Mikes reported. What managers think risk perception is and how they actually perform risk management are not congruent to each other:

As a result, this research aims to address the gap left by Mikes by examining risk perception and management by presenting field-based evidence and using aspects of structuration theory to understand how managers and the internal risk procedures that they implement are reliant and dependent upon each other in shaping risk decisions. This theory asserts that the object (structure) and the subject (agent) are intertwined and help to configure each other. The agent is dependent on the structure that he creates and the structure cannot exist without the agent since it is a fragment of his mind set[10].

[10]More on structuration theory in chapter 4.

2.7 Summary and Conclusion

Risk management can be traced back to the early 17th century when John Arbuthnot asserted that the probability of an event occurring can be calculated. This was based on the probability theory developed earlier by Pascal in 1657 and this theory contends that possible results of an unknown situation can be translated into a known one through calculation and measurement. Although the probability theory has its roots in trying to determine the existence of God, it soon entered all aspects of life and was introduced to the world of business in the early 1900's.

Today risk management at financial institutions is a major part of the organizations' operations, and although it has been altered and modified along its course, the measurement and calculation domain has remained. Banks (not only in the UK but around the world) have been growing tremendously, using risk to make major investment decisions by depicting possible outcomes of future events and managing risk based on the established perception that it can be controlled, monitored and assessed almost accurately, through measurement.

Making risk predictions was possible in the past with simpler sensitivity analyses and mathematical programs designed to make estimations based on past events. However, risk has evolved into much more complex endeavour requiring not just information about past economic performance but current market conditions which includes the likelihood of unexpected changes. Thus, risk management, especially at banking institutions, have developed into an exercise that requires the adoption and use of sophisticated tools and methods to enhance the accuracy of future outcomes and produce information on market behaviour. McGoun (1995) argues that this challenge was met by the business community by developing these sophisticated measures of

probability despite indications of problems with the measurement. The rapid expansion and intensification of these measurement tools led to the development of more complex financial instruments, which were not properly understood and spun out of control, creating a spin-off effect that led to a meltdown of the entire financial system in the late 2000's (Buckley 2011).

Bank managers are now faced with a challenge of creating new and better ways to manager risk that can yield excellent returns without abusing investors trust. But Beck (1985, 2004) argues that this may be a mountainous task for managers and institutions as a whole, since the modern day investor is now more reflective and won't simply accept the rationales handed to them by institutional agents. According to Beck, trust has become a major issue for the investor and so managers must now devise new ways to rebuild investor trust and confidence.

Mikes' (2009, 2011) work is instrumental is appreciating the current perception of risk and the possible direction of future risk resolve. Mikes (2009) argues that risk management is based on a perception of calculation that is part of a mix which includes strategy, technology and shareholder tensions. Mikes examined the management of risk by numbers as a system that has been culturally accepted and developed by managers (agents) and implemented as established practices in banks over time. Although she did not use structuration theory, the focus of her research was on the manager (agent) and the structure (the social practices, rules and resources) as two separate functions (dualism) that each plays a part in effecting the perception and management of risk. This research builds on this notion but through the lens of structuration theory, where the social practices and the agents are dependent upon each other and none can effect change without the other (duality).

This chapter has presented some of the literature that traces the development of risk as a calculable and measurable concept based on flawed probability that can lead to misleading estimates. Bank managers in their quest to fulfil growth and expansion requirements, relied on the perception that these estimates were solid, to the extent that they became performance measure overtime. The chapter also presented the gap in the literature that this research addresses and apparent future direction and challenges in risk perception and management. Each major risk category was presented separately and discussed in the context of banking and risk management as a whole.

The next chapter will engage in further discourse that examines the definition of risk, the major categories of risks and the regulatory frameworks that supports the management of risk. These would be examined in the context of risk perception as a tenet of the management of risk.

Chapter 3A: Risk management and regulatory authorities

3.1 Introduction

'Government, banking and regulatory elites have attempted to pass responsibility for the crisis onto others and blur the reality of the debacle. This is because the driving forces of the collapse reside, primarily, with these establishment groups themselves' (Buckley 2011, p 11)

The last chapter examines the literature on risk from early periods to current risk research. This includes the different definitions of the term and the changing perceptions along its trajectory. This chapter continues along this path, and discusses risk management from a regulatory point of view. The chapter begins with a discussion on the need for regulation and why regulation appears to be more reactive than proactive in providing guidance, especially in a crisis situation. The different regulatory bodies that provide substance on risk reporting (including the FSA and Basel III) are included along with some of the risk frameworks that were developed to help provide guidance on risk temperament. The chapter closes with the gaps in the literature that this research addresses and some concluding thoughts.

Risk definitions and interpretations

Attempts to define risk can be traced back to the early 1900's with a comparison to and a distinction from uncertainty (Knight 1921). The underlying substance of what became known as *'the knightian'* definition was to separate what was unknown but can become known in the future from what was unknown and may never be known. The latter Knight (1921) believed is uncertainty because it cannot be measured and should be separated from risks. For Knight, this distinction was crucial in order to properly identify and manage situations that we have control

over from those that we do not have power to influence. This division of risk from uncertainty proved crucial in the advent of the recent financial crisis which if characterized by a knightian definition would better resemble uncertainty events rather than risk mismanagement (Buckley 2011). However, this differentiation is not so important to some present day risk champions who still prefer to classify risk synonymously with uncertainty:

> *"Indeed the starting point for all common risk management frameworks is the classification of uncertainties into categories such as market risks, credit risks, and operational risks. The next step in counting risk is second order measurement the aggregation of numbers into units of control and the derivation of ratios and indices that can serve as the backbone of performance measurement"* (Mikes 2011 p 3)

It seems that for Mikes, who muddled risk with uncertainty, the emphasis should not be on demarcating the two, but rather on moving away from a characterization of risk as a calculable domain. This deviates markedly from a knightian prospective that advises against trying to measure uncertainty since it cannot be quantified and should be distinctly disjoined from risk. Agreeing with Knight, is Bhimani (2009) who contends that the separation of risks from uncertainty is crucial for the:

> *"Operational strategy for the management and regulation of risk in organizations"* (Bhimani 2009 p 2)

Although Bhimani (2009) himself did not endeavour to define risk, he concurred that risk and uncertainty should not be comingled (agreeing with Knight) but opposed to the traditional measurement of *"economic theorizing"* which he claims is too shallow to fathom the meaning of risk management and therefore no longer applicable by itself, in today's dynamic risk environment (Bhimani 2009).

A universal definition of risk and risk management is yet to be developed (Aven and Renn 2009) and the problems experienced as a result of the measurement techniques used to characterize risk by both investors and regulators proved *"highly problematic"* for some banking organizations and are not properly understood by auditors (Sikka 2009). Yet, most definitions of the term include some measurable or calculable circumstance. For example, Lowrance (1976) describes risk as a probability measure while Kaplan and Garrick (1981) added consequences to that definition. Rosa (1998, 2003) included human actions, value and outcomes in his characterization of the term. Hence it appears that risk can be several things, everything and nothing at the same time (Power 1999, 2003). This is captured in Garland's (2003) definition of risk which seems to be an attempt to arrest all previous definitions.

> *"Risk is a calculation. Risk is a commodity. Risk is a capital. Risk is a technique of government. Risk is objective and scientifically knowable. Risk is subjective and socially constructed. Risk is a problem, a treat, a source of insecurity. Risk is a pleasure, a thrill a source of profit and freedom. Risk is the means whereby we colonize and control the future".* (Garland 2003 p 49)

By this definition, Garland (2003) has proposed the way forward for risk management by suggesting that risk contains both subjective and objective aspects. This can be translated as risk having both a quantitative and a qualitative side. By including contrasting terms in his definition like treat, thrill, problem and pleasure Garland (2003) implies that risk can be all things at the same time, a similar position taken by Power (2003, 2007). Nevertheless, the very diversity of this definition of risk can open a gateway to criticisms for being too broad and not taking a specific stance (Aven and Renn 2009).

Beck (1992) defined risk as *'indiscriminate'*. By use of a model he called 'risk society' Beck (1992) argued that risk is random, chaotic, blind and aimless and that society should be careful, watchful and diligent (Beck 1992). This explanation by Beck has been popularly endorsed by risk experts and professionals and has crafted the way we view risk today (Hanlon 2009). It supports the idea that risk cannot be completely controlled nor fully understood and attempts to limit its effect may themselves not be effective. Hanlon (2009) disagrees with Beck and argues that risk can be understood from an *'ontological view of knowledge'* which would better be seen as an engagement with this abstract idea rather than a fear of it (Hanlon 2009). This according to Hanlon (2009) would promote a better understanding of risk regardless of its form or consequences.

Perhaps one of the most prominent definitions of risk was proposed by the Committee of Sponsoring Organizations of the Treadway Commission (COSO, 2004). This committee not only defined risk but also positioned its role in organizations by providing a framework that will later come under heavy scrutiny:

"Enterprise risk management is a process, effected by an entity's board of directors, management and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within its appetite, to provide reasonable assurance regarding the achievement of entity objectives" (COSO 2004 p 35)

By its definition (COSO 2004) is advocating that risk is a process that affects all aspects of an organization. This is evident from the committee's framework on risk management that attempts to integrate all aspects of functionality with risk across the organization (See figure 3.2)

3.2 Risk and regulation

It has become customary for regulation to follow a crisis (Ridpath and Reid 2009). The purpose of such regulation is usually to investigate the causes of the problem, propose solutions and curb activities or transactions in an effort to mitigate the possibility of a future reoccurrence. However, sometimes regulation itself, if not closely monitored or properly administered can be an accessory to future catastrophe (Association of Corporate Treasurers, 2009). For instance, excessive regulation on risk can stifle financial innovation, lead to timid risk behaviours, unwarranted costs and '*stagnation of wealth creation'* (Institute of Directors, 2009 P 8). This could have implications for the perception and management of risk and possible distortion or refinement of current risk processes (Turner Review 2009, Walker Review 2009).

In the recent financial debacle, the U.S Treasury issued the Timothy Geithner Proposal, Europe had the prominent de Larosiere Report and the U.K presented the Turner Review. As was

expected, regulatory bodies emerged into the spotlight and sprang into action as the financial crisis intensified worldwide. Four (4) such regulatory figures in the U.K are the Basel Committee, Bank of England, the Financial Services Authority[11] and the Her Majesty's Treasury.

3.2.1 The Basel Committee international framework

The Basel Committee on Banking Supervision (BCBS) came into effect in 1998 mostly as a response to the Asian crisis and the failure of the BankhausHerstatt bank in West Germany (Monroe, 2010). With its main focus on capital structure of banking institutions, part of the Basel's pivotal aim was to prevent major financial catastrophes like the one that began in 2007 (BCBS 2009). Since its inception, the Basel has been well respected and reasonably adopted as a global regulatory force in the operations of banks, especially very large banks that cross international borders (Wellink 2011). Seemingly, the ease of adoption is what propelled banks to confirm to Basel, but by the time Basel II was introduced in 2004, questions were raised by cynics as to the effectiveness of the regulatory body whose minimum capital requirement standards were so weak that almost no adjustment was needed by banks to confirm to the standards (Wahlstrom 2009).

The BCBS has since undergone several changes and the new Basel III focuses strongly on a rigid capital requirement, markedly increased from Basel II (See table 3). This focus of the New Basel highlights the committee's commitment to a macroeconomic focus to banking regulation

[11] At the time of this research, the Financial Services Authority (FSA) was part of the UK tripartite governing bodies and was regarded as the main regulator of the financial industry. However, the FSA has since been dissolved and replaced by the Prudential Regulatory Authority (PRA) and the Financial Policy Committee (FPC).

(Wellink 2011). Previously, as in Basel II the focus was on having a capital structure that confirms to risk appetite (micro policy) whereas in the Basel III the strength of such a capital base in ensuring a stable financial system is the focus (macro policy). Some regions have welcomed the Basel III with optimism, but implementation remains a big challenge.

The United States for example, would have difficulty implementing some aspects of the Basel III since a few of its recommendations are at odds with its national laws. For instance, in the U.S, the Dodd-Frank Act mandates the removal of credit rating companies as a risk assessment base; however the Basel III continues to recommend the use of credit rating companies as a reliable risk assessment medium (Ennis and Price 2011). Another area of contention for the Basel and the U.S banking system is that of the new leverage ratio. Currently, U.S banking institutions are permitted by national regulation to omit off balance sheet items from the calculation of their leverage ratio. The new Basel III proposes full inclusion of all off balance sheet items as a means of mitigating against the risks associated with these assets, although the American Banking Association (ABA 2010) argues that the inclusion of these assets in the leverage ratio does not transfer into an understanding or apprehension or their risks. The United Kingdom's, national accounting bodies, however, do not encourage off balance sheet reporting but conforming to Basel III is not without controversy. The U.K's regulatory bodies appear to be adamant about regulatory power and can be reluctant to relinquish authority over its financial system to Basel (Hall 2009).

Critics, (for example Southern European Bank 2010, Winston and Strawn 2010) are sceptical as to whether or not the Basel III represents any real change to the financial structure, as the risk

and capital frameworks basically remain the same and most banks had already met the new capital standards even before it was announced in 2010. Following the crisis, banks (Like Penny bank and Glass bank in this study) had taken steps to increase their capital structure and most Significantly Important Financial Institutions (SIFI's) had already surpassed the Basel's minimum requirement for capital (Wahlstrom 2009). Although not convincingly different from the Basel II, the Basel III does add supporting capital and counter-cyclical buffers to help absorb losses and cushion the effects of rapid credit expansion in the *'boom'* period (BCBS 2009). What the BCBS brought that other regulators (national and international) appears to have overlooked was the perceived impact of the new proposal on the slowly striving economies; This the committee argues is part of promoting and enhancing its macroeconomic focus. To this end, the Committee has postponed implementation until the year 2013 with a six year period to full adoption, so that the economic recovery would not be adversely affected by the new rules (See Table 3). The drawback to this is that by the year 2019, the rules may become outdated and may no longer effectively reflect current market operations.

Stress testing, though not new, is an important part of the new Basel proposals. The capital and countercyclical buffers are key to the stress tests that are basically an experiment to assess the amount of financial strain especially in the areas of risk, capital and liquidity that a banking institution can undergo before it begins to collapse. However, the stress test itself may need to be tested and possibly revised (IOD 2009). The Committee's method and measures for stress testing were called into question when nine (9) out of ten (10) building societies in the U.K were downgraded by credit rating giant, Moody's, just a few months after passing the Basel's stress test (Financial Times 2009). Similarly Europe and The U.S tested the stress test program

proposed by Basel III in 2010. Ninety one (91) European banks applied the test and eighty four (84) passed. The situation was not same for U.S banks, where ten (10) out of nineteen (19) banks failed the test and were asked to raised their capital structure by a combined USD75 Billion (Buckley 2011).

The full impact of Basel III is a long way off and its effects on the global banking system remains to be seen; however, markets reacted positively with rise in stock prices shortly after the new rules were announced. This may be a sign that the diluted Basel III is too lenient and large banks may take advantage by lowering their capital ratios to confirm to the Basel's minimum requirements (Canadian Bankers' Association 2010). Regulation is always contentious, especially across international borders. The difficulty lies in the question of how to reduce unwanted risk while encouraging free market, competition and financial innovation (Ennis and Price 2011).

Table 3: Capital changes from Basel II to Basel III (2004 to 2019)

	Basel II	Basel III		
	2004	2013	2016	2019
Common Equity Capital Ratio	2%	3.5%	5.125%	7%
Minimum Tier 1 Capital	4%	4.5%	6%	6%
Capital Conservation Buffer	0%	0%	0.625%	2.5%
Counter Cyclical Buffer	0%	0%	0.625%	2.5%
Minimum total Capital requirement	8%	8%	8%	8%
Minimum Total Capital plus conservation buffer	8%	8%	8.625%	10.5%
Removal of DTA From Capital[12]	Fully included in Capital	90% Included in Capital	60% Included in Capital	0% Included in Capital
Liquidity coverage ration	No LC Ratio	Observation	Minimum standards operational	
Net Stable Funding Ratio	No NSFR	Observation		Minimum standards operational
Leverage Ratio	No Leverage Ratio requirement	Supervision and monitoring of leverage	Parallel run	Migration to Pillar 1
Capital for SIFI	0%	Stated as 'significantly higher' than the general requirements above.		
Capital instruments that no longer qualify as Tier 1 or Tier 2 Capital	All instruments were classified	Phased out over a 10 year period beginning January 1st 2013		

Source: The Basel Committee on Banking Supervision (2009 P.69)

3.2.2 The Turner Review

Perhaps the most respected of the regulatory bodies that governs the operations in the financial sector in the U.K is the Financial Services Authority (FSA)[13]. With the advent of the financial distress the FSA's Turner Review was published with the view of explaining the causes of the

[12] Deferred Tax Assets (DTA) was included in capital by mostly all Basel Members under Basel II. However, from the beginning of 2013 only 90% of deferred tax assets would be recognised as capital with a drawdown to zero percent in the subsequent 5 years. This is expected to have an adverse effect in some regions like Italian banks for instance, whose regulation allows 18 years of DTA to be included in capital.

[13] The FSA was dissolved in early 2010 and replaced by the Prudential Regulatory Authority (PRA) and the Financial Policy Committee (FPC), both arms of the Bank of England (See figure 3). The discussion here is placed in context at the time the FSA ruled.

crisis and providing guidance on the way forward (Georgosouli 2010). According to Chambers (2009) the Review identified "*Macroeconomic imbalance, financial innovation of little social value and important deficiencies in key capital banking regulation"* (Chambers 2009 p 159) as the main causes of the crisis. This may be translated as meaning that present risk procedures were inadequate to cope with changing business policies, technological advancement, and worldwide market developments, coupled with a diminutive regard for morals and values along with a lack of proper regulatory control in the banking system.

The real task however for the authority is not so much recognizing the cause of the problem but creating feasible solutions (Money Marketing 2009). The challenge for the FSA, then, as it relates to financial advancement is how to build a banking system that is free enough to promote economic activity and create wealth but restricted from endeavouring into unscrupulous risk behaviours (Ridpath and Reid 2009). This it seems would be a mountainous task as the FSA is charged with balancing economic prosperity against investor and customer protection in a highly politically influenced environment.

Johnson (2009) contends that banks should be restricted as they are the major facets of an economy's financial structure and to allow total 'freedom' of activities is to threaten the entire system's existence that can have a detrimental effect on customers and investors (Johnson 2009). Chambers (2009) on the other hand disagrees and notes that society may miss out on positive financial prosperity if the *'Boom and burst'* cycle, that characterizes capitalism and economic advancement is curbed (Chambers 2009). What the FSA is attempting to do, then, is to prevent extremes of the cycle so that adverse effects and distress would not reoccur. Accompanying, this

is the suggestion that the FSA should focus more on educating investors on how to read the signs of highs and lows of the natural economic cycle so they can be more proactive in their decisions on investments (Georgosouli 2010).

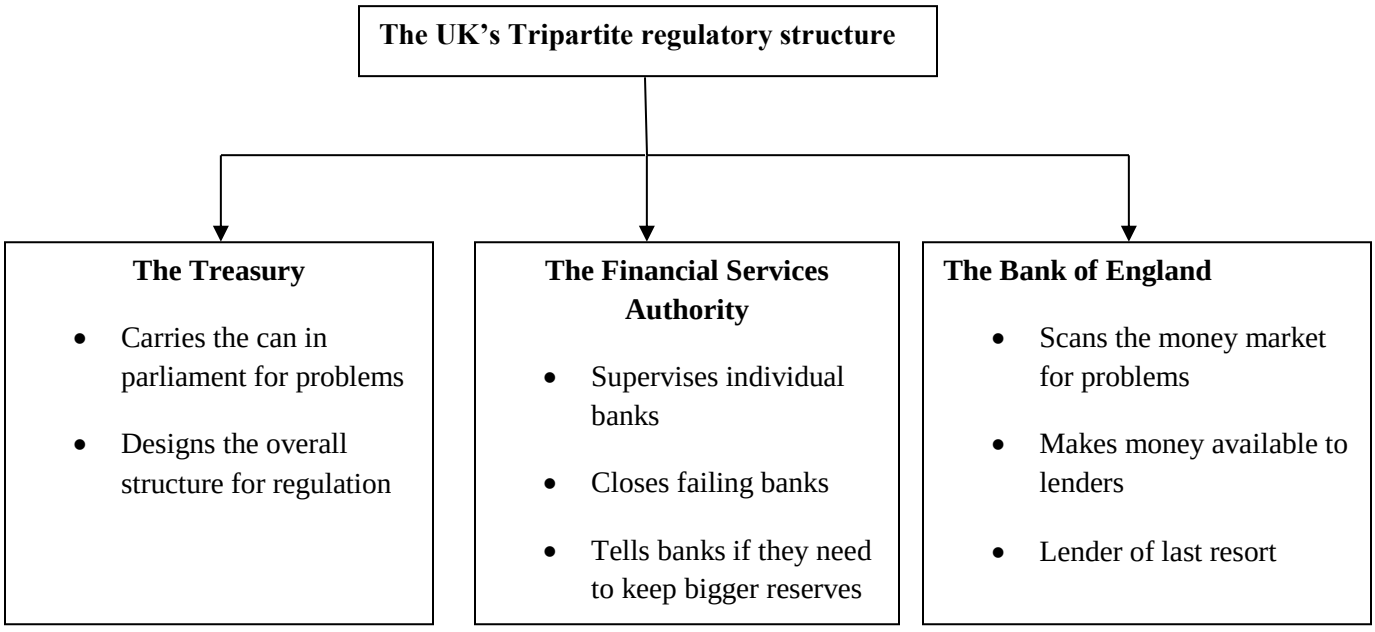
The reform proposed by Lord Turner in his review was not radical and so its effect on the financial system was being questioned. Such a cautious approach may be too relaxed for banking institutions that may need a draconian attitude to effect any change. Lord Turner himself admitted that he was too lenient as he watched banking institutions revert to *'business as usual'* after the proposed reforms (Hall 2010).Perhaps a possible reason for this is the changes in the FSA's culture of participative consultation. Banks and Other Financial Institutions (BOFIs) were omitted from the customary dialectics with the FSA on matters of the financial crash and the way forward (The Turner Review 2009). Whether positive or negative, the measure of success of the Turner Review is the ultimate impact it would have on the financial services sector, especially banks, their systems, processes and philosophy to risk management in future engagements with customers and investors.

The political nature of the financial regulatory authorities in the U.K continues to be a matter of concern to customers (The Financial Times 2009). Such a concern seems valid as the new government (Liberal Democrats) dissolved the FSA and the role of the Treasury, effectively disintegrating the UK's long standing tripartite system and cementing the power of the Bank of England in regulatory control. Critics, like Sikka (2011), however argue that the new structure does not attend to the problem at hand but merely adds water to an existing mud puddle. As Sikka (2011) puts it:

"The Government's plan to replace the Financial Services Authority with the Prudential Regulation Authority is akin to rearranging the deckchairs on the titanic" (Sikka 2011 p 2).

Figure 3 outlines the UK's regulatory body structure from 1997 to 2009.[14]Figure 3.1 shows the new regulatory structure of the United Kingdom beginning 2010.

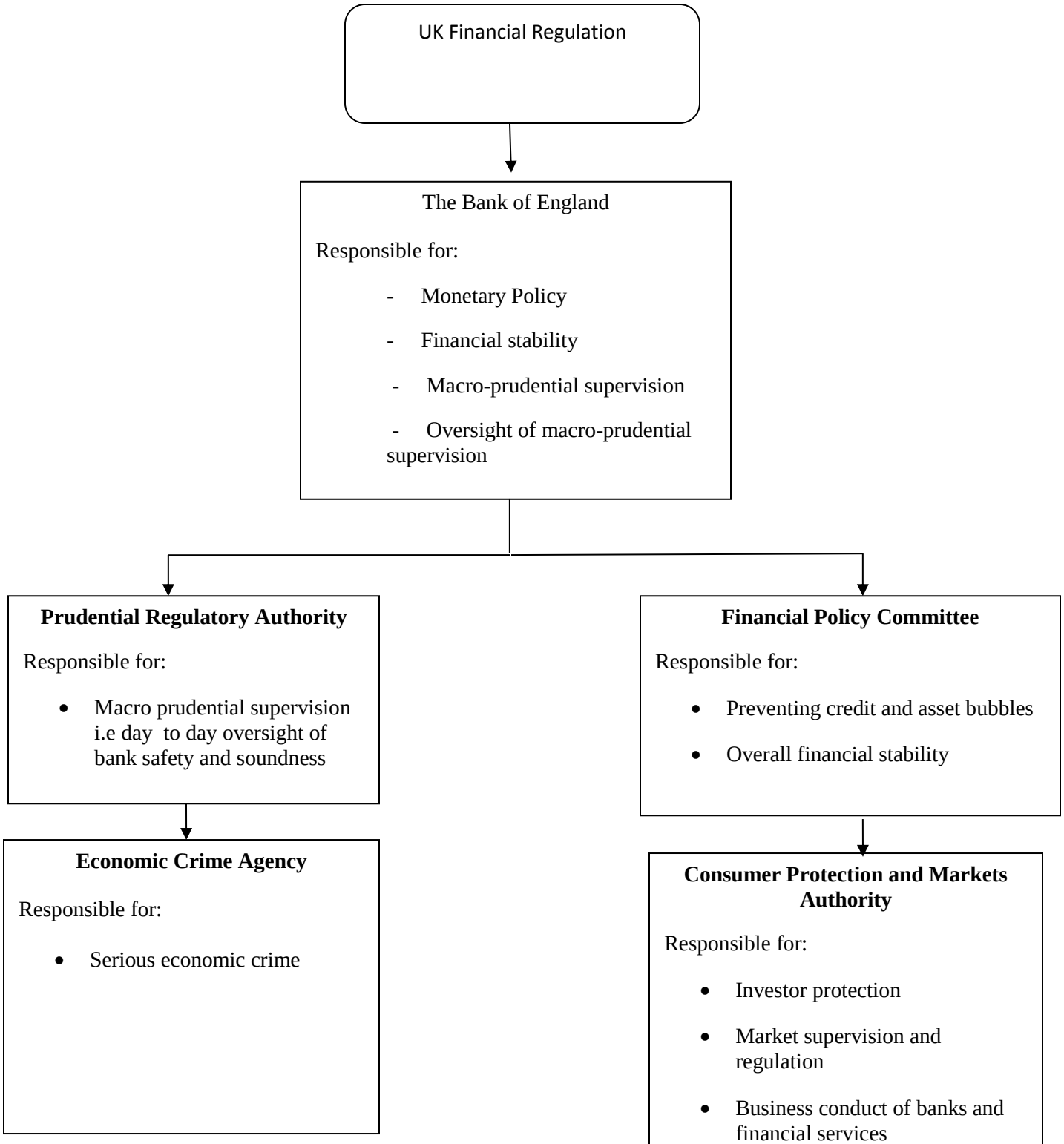
Figure 3. UK's Financial Regulatory structure (1997 – 2009)



Source: Buckley (2011 p 108)

[14] Although the Tripartite structure included three governing bodies, most of the authority over financial regulation rests with the FSA. This, it is argued, was a political game by the out-going government to limit the role of the Bank of England.

Figure 3.1The new financial regulatory structure of the United Kingdom (2010 to present)



Source: Buckley (2011 p 112)

3.2.3 The Walker Review

The Walker Review, with its 39 recommendations has been labelled *'the toughest governance regime in the world'* (LeBlanc 2009, p. 316). Sir David Walker, on behalf of Her Majesty's Treasury, issued the report that fused risk as an integral part of the governance structure of organizations. Close to 45% of the proposal (17 recommendations) addressed the problem of risk and remuneration along with their perceived associations. With such a large contingent of the proposition fixed on risk and rewards, the Walker Review appears to be making an assumption about the behaviour of human beings in organizations, especially BOFI's as it relates to risk taking and its alleged ties to compensation. Such a view was expressed earlier by Adams (2003) in his risk thermostat model that recognized the impact of returns on risk decisions (see figure 3.3).

Although the Review was viewed by many as being stringent, it received unprecedented support from industry experts, other regulatory bodies, commentators, investors and customers much unlike the Turner Review (Risk Management Report 2009). A probable reason for this is because the Walker Review paints a picture of shareholders as the 'victims' of sinister behaviour of BOFI's boards and their governance predilections. The Institute of Directors (IOD) and the Confederation of British Industries (CBI) disagree with such an image and refute some of the blame placed on board members and governance systems for the financial crisis. Shareholders, the IOD (2009) argues, continue to avoid engaging with directors and executives especially before the financial crash, a behavioural pattern synonymous with 'absentee landlords' (IOD 2009).

It is argued that the Walker Review is proposing an overhaul of the governance structure of BOFI's that can lead to marked changes in the risk processes and procedures of financial firms and by extension the entire system (Leblanc 2009). Some of these changes include the addition of a Chief Risk Officer (CRO) with special responsibilities for risk oversight, a separate risk report as part of the financial reports, the introduction of a risk committee and increased roles for non-executive directors. These changes may help force a different approach to risk management that can alter or shape a new risk culture in BOFI's (Mikes 2009). A change in the role and governance of risk is inherent in the Walker Review. It appears that the review wants the board of BOFI's to play a more active role in risk management rather than the conventional duties of risk oversight (People Management 2009). Such a shift can encourage the transformation of risk practices but at the expense of a burdensome task to the already strained board of directors (IOD 2009).

The proposal by Sir Walker to add a CRO and a risk committee to help strengthen risk administration was heavily criticised by some analysts (Leblanc 2009, CBI 2009, IOD 2009). Some experts claim that these alterations come with added costs and do not necessarily transfer into better risk management practices. Moreover, it is believed that these changes would most likely shift risk responsibility to particular individuals and relieve the board of its commitment to an improved risk strategy. Overall, critics warn that regulations, while welcomed, should be administered with caution and not wildly as to disadvantage UK firms on the international market, especially as it relates to competition (CBI 2009).

3.3 Risk management frameworks

There are various risk frameworks that financial institutions can use as a guide to help practice better risk management principles. However, there is still confusion on what constitutes "*better"* as it relates to the management of risk (CBI 2009, Lebanc 2009). Some academics (Adams 2003, Mikes 2009) argue that the best risk management practices are the ones that encourage an integrative approach to risk, capturing both numerical aspects (like strong capital structure) and social positions (like the welfare of the investor). While the Base III agrees with this perspective, the Basel II in its recommendations shows strong support for one particular approach to risk (The COSO risk approach).

Three (3) different approaches to risk management that are popular in the accounting literature are the COSO framework, Adam's risk thermostat and Beck's risk society. Each one suggests a different approach to risk and although they are popular in the accounting literature, none are used by any of the participating banks in this research. Each of the banks', use their own developed framework but were unwilling to disclose exactly what the framework is due to confidentiality reasons.

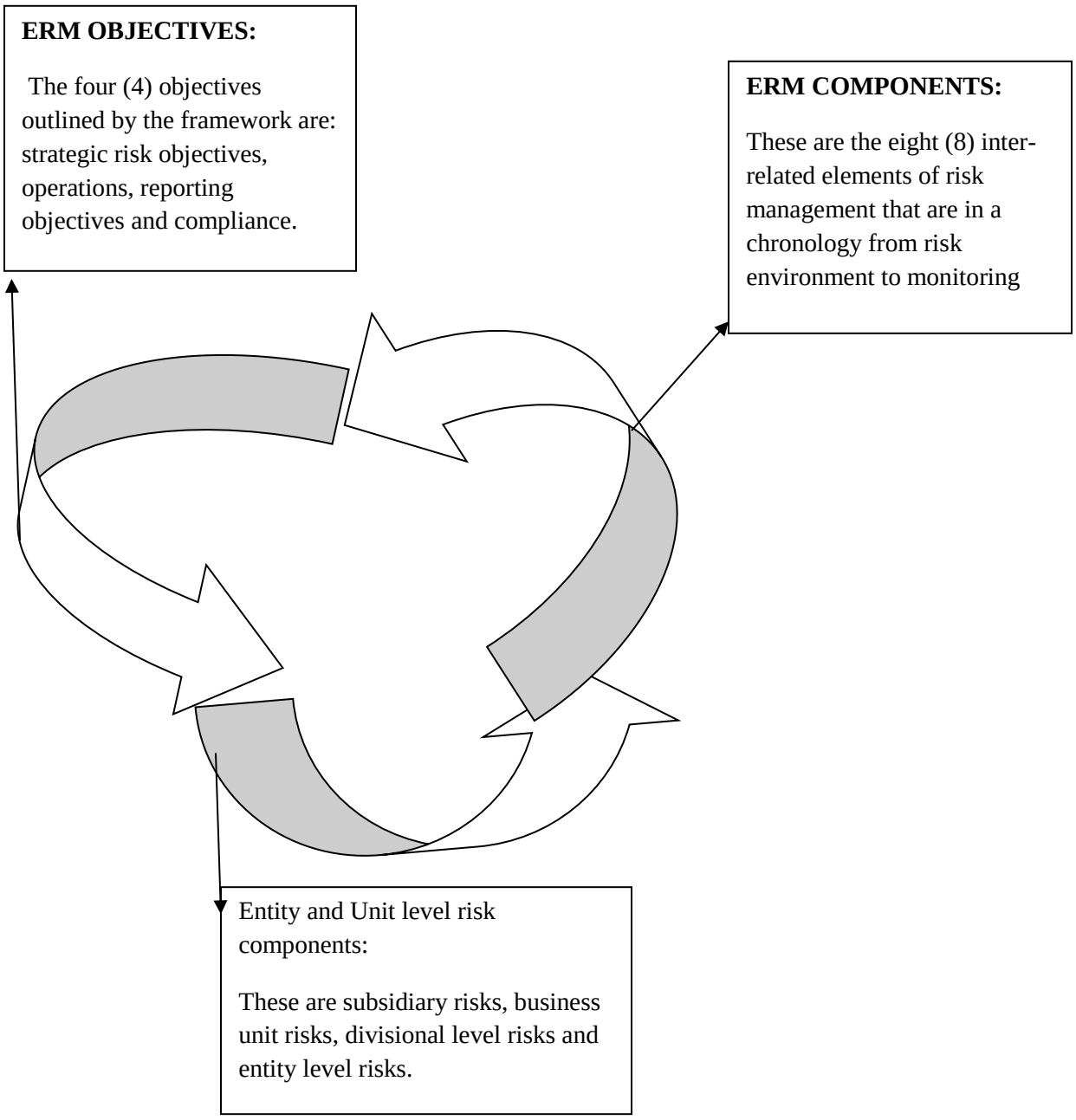
The COSO has been heavily criticised for being too complex to be practical and Beck's risk society model has been criticised for being too theoretical in that it does not engage the active role of risk experts in the decision process but rather foresees society and the public as the main players. Adam's risk thermostat is deficient in that it has no place for regulation in the risk atmosphere and does not clarify whether risk management should include both mathematical and social factors.

There is probably no single best approach to risk. The framework adopted is mostly based on the organization's position and manager's perception of what risk is and how it should be managed. Nevertheless, the three (3) popular suggestive approaches in the accounting literature along with their shortfalls and limitations are discussed next.

3.3.1 The COSO Framework

One of the major advantages of the COSO risk framework is that it encourages an integrated approach to risk (Bowling and Reigner 2005). Such a holistic view of risk management helps to better understand the processes, flow and mechanisms that characterize the risk environment especially in banking institutions of different cultures, as opposed to a risk silo pursuit where segmentation of risk activities may result in loss of benefits only realised through integration (Mikes 2009, 2011). The framework proposed by COSO includes an interconnectedness of the organization's people, risk philosophy, objectives, strategy, risk appetite and the risk environment (See figure 3.2). Added to that, the clear sequencing of activities proposed by the framework can help better define risk channels and procedures and bolster a robust risk atmosphere (Bowling and Reigner 2005). For example, according to the COSO framework the organization needs to first understand its risk appetite before setting objectives or attempting to assess risk (COSO 2004). The framework, which also places heavy emphasis on daily management of risk, proposes a top-down approach with a focus on processes, especially in banking institutions.

Figure 3.2 THE COSO ENTERPRISE RISK MANAGEMENT FRAMEWORK (AN ILLUSTRATION)[15]



Source: COSO Executive Report (2005 p 5)

[15] The original graphical display of the COSO ERM framework is in the form of a three dimensional cube. This circular demonstration is used to better portray the dependency and interconnectedness of the three main segments of the framework.

The ERM framework suggested by COSO takes a comprehensive view of risk management by considering risk at all levels in a company (see figure 2). This may have some positive implications for banking institutions that have become so complex in their structures that risk ventures at some levels in the organization may be given less attention or even go unnoticed due to the perception of irrelevance placed on them under the risk silo approach (Palfi and Papoca 2009). A reduction of compliance cost and strengthening of corporate governance principles are also other merits outlined by COSO through its framework. This association of governance as part of risk management and vice versa was strongly expressed by the U.K's treasury (Walker Review 2009). In sum, this framework is expected to promote a more balanced approach to understanding risk management, improve risk processes and curb unwanted risks by harmonizing risk activities across organizations (especially in banking institutions), orchestrating risk as part of the company's strategy and considering both the internal and external risk environments as compared to arresting, eliminating and controlling risks under the risk silo approach (Berry et al 2009). It has been very influential in promoting a structure for regulatory control in other regions like the establishment of the Criteria of Control Board (Coco) in Canada and the Turnbull Report in the U.K (Power 2007).

Nevertheless, the framework, like others, is far from perfect and was heavily criticised in almost all regards for trying to oversimplify such a complex notion as risk into an easy eight step approach and its reluctance to acknowledge the social implications of risk (Dermont 2007).

3.3.1.1 Shortfalls of COSO

As an integrated approach to risk management, the COSO risk framework with its focus on an organizational path to identifying and managing risk, is a commendable effort at risk process engineering (The Financial Executive 2006). Nevertheless, it is remote from being accomplished. COSO, developed the framework from its definition of risk, which is *'Complex and Broad'* (Reiger and Bowling 2005). Hence, the structure outlined is not easy to comprehend by some businesses. Some SIFI's, it appears, were able to implement the COSO at a faster rate than others that struggled to define their business process and move from a risk silo approach. Smaller businesses, especially banks, attempted to implement COSO but were unsuccessful. To this end, the committee acknowledged the shortcomings of the framework as an abstract ideal and issued guidance to businesses on how to implement and integrate risk into their procedures, strategy and objectives. Nevertheless this guidance did not come until approximately four (4) years afterwards, much too late for some financial businesses (Compliance Week 2009).

Possibly the most prominent shortfall of the COSO framework is its reliance on risk as a measurable, objective construct. Dermont (2007) contends that the framework ignores the social implications of risk, a crucial embodiment in the perception of risk and risk management. What this may mean for businesses that adopt, for example, is a dependence on a '*calculative culture of risk'* (Mikes 2009, 2011). Such a mathematical label can divert attention away from values and morals in the risk process, and promote a bias toward 'fortune seeking' attitudes similar to the ones that led to the financial crash (The Walker Review 2009). According to Dermont (2007) overcoming this numeric stamp on risk, is imperative, if a true integrative approach like the one advertised by COSO is to be realized.

Another flaw of the COSO framework lies in its confidence in auditor judgement (Ritchie and Khorwatt 2007, Power 2009, Sikka 2009). The COSO risk design was built from an internal audit control structure. Added to that, the entire skeleton was designed and developed by an audit firm. By using audit as its base, COSO is making a critical assumption about the knowledge, trustworthiness and integrity of auditors as it relates to risk. Ritchie and Khorwatt (2007) argue that the framework assumes that auditors can easily differentiate between different types of risks and understand their behaviour. This may not always be true as auditors themselves can be blamed for not being better '*watchdogs'* and for giving assurance that '*are frequently punctured by unexpected corporate collapses, frauds and failures'* (Sikka 2009, PP 868). Perhaps the COSO committee, through a consultative process could have involved other risk experts in developing the model, but for now, the question of auditor superiority that is embedded in the framework, looms over some critics who are sceptical as to whether the types of risks outlined by COSO are the same ones that are generic to most businesses, especially financial institutions (Moeller 2009).

Another criticism of the COSO framework is that it narrowly conceptualizes risk appetite as a capital based construct, ignoring the human elements that are important in characterising risk. Power (2009) expresses this argument as follows:

> "*A thin conception of risk appetite predominantly focused on capital rather than human behaviour is an important source of intellectual failure with the ERM model which should be addressed by regulators, senior management and boards" (Power, 2009 p 854).*

Nevertheless and despite its imperfections, the COSO risk management framework, continues to be one of the most widely used and well respected structures worldwide in ERM as it represents a comprehensive, integrated approach to risk management.

3.3.2 Beck's Risk Society

A prominent framework was developed by Beck (1992, 1996, and 1999) that places risk in an entirely new dimension from what was known to be customary. This schema became rather salient and quite influential throughout the U.K and North America (Bloor 2002, Alexander 1996). According to Beck, we live in a new era; one characterised by individualization rather than collectiveness or family structures. This current trend is distinctive because people, citizens are more involved, more educated and more conscious of their environment and the decisions that they make as individuals (Beck, 1996). No longer are humans willing to accept blindly the advice of experts, but rather they question and seek information; this he calls a *'reflective modernity'* and which is accompanied by new types of risks for example catastrophe risk like technology and environmental risks. In his theory Beck (1996) claims that experts are key and are separate from lay persons and that knowledge is highly politicized, leading to a mistrust of the professionals that possess this knowledge.

Beck (1996) contends that there is a cultural dependency on calculus measures of risk that society no longer accepts because of its inaccuracies. In other words, Beck (1996) rejects a sole technicist approach to risk and suggests that risk is more of a social construct, evolving through everyday experiences and interaction of people, their community and systems (Hanlon 2010).

As a result, the traditional views of an *'actuarial calculation'* of risk is no longer authentic by itself, but must be accompanied by allowances for perception, political influence, social beliefs and connections that help shape approaches, attitudes, feelings and knowledge of risk (Froud 2003). To this end, Beck assumes a separation between scientific and social reality and between expert and lay knowledge (Hanlon 2010). According to Beck's (1996) theory regulation will play a new role of constantly trying to appease the public to regain trust and establish superiority in a highly political battle.

Can Beck's (1996) risk society be justified by today's risk dilemmas? Beck hypothesizes risk in this new era as *'disastrous'* that can lead to '*catastrophic'* events; Is there evidence of this in the recent financial crisis? It can be argued that the technological risks that Beck (1996) postulated, which is rooted in a numeric base and driven by compensation gave rise to the financial crisis. Beck's (1996) theory of risk is suggestive of a marked change in risk ideals; A new revolution not foreseen by experts, regulators nor citizens. However, this is contrary to what some critics propose (Harney 2010, Williams and Noyes 2007). According to Harney (2010) these changes in risk behaviour by professionals have not been and are not expected to be radical but rather additive with slight adjustments to risk mechanisms, actions and decorum to risk and risk management. Hitherto, what then, does this mean for companies risk processes, risk perception and attitudes to dealing with risk especially by regulatory bodies? It may mean a more balanced approach to risk, where both social and numeric factors are considered in a risk decision (Bernstein 1996). Business risk procedures, therefore, especially in financial institutions would need to be adjusted, updated or modified to accommodate this new consortium but a complete overhaul of the structure or system may not be required as Beck (1996) is suggesting.

By his reflective modernity, Beck (1996) explains that individuals are now reluctant to heed to the advice of professionals without scepticism and their own judgement. This can probably be translated into meaning that customers, investors and clients may not trust banking experts on issues of risk and investment as was done previously. Rather a reflective mode of *'knowledge and self-consciousness'* steps in and questions are raised by the now new individual that Beck states will challenge experts and their knowledge of risk (Hanlon et al 2006). Risk decisions are then characterised by a participative process of scrutiny, built on and propelled by the new vigilant individual, seeking to safeguard his/her own self and with less regard for the system, structure or others (Linsley and Shrives 2009). However, Beck too, became the target of heavy criticisms for his ontologically lacking theory that seems to fall short of explaining how knowledge is created in this new society and whether or not the new individual will remain at this present stage or continuously evolve to suit his/her changing risk environment (Hanlon 2010).

3.3.2.1 Beck's Risk Society Uncovered

According to Hanlon (2010) caution should be exercised before deciding to implement, adopt or believe Beck's (1996) framework because it is seriously flawed, rooted in an abstract theorization of a model that is not grounded in empiricism or supported by any evidence whatsoever (Hanlon 2010). Furthermore, Hanlon (2010) argues that Beck downplays the role of sociality in knowledge construction and thereby underestimates its impact on risk decisions especially among experts struggling to maintain political distinction. The minimizing of ontology in Beck's theory was also examined by Carter and Toms (2010), Lash (1993) and Elliot (2002) who all took similar positions to Hanlon (2010) and questioned Beck's '*reflective modernity*'

especially his notion of individualization and the supposed breakdown of social class, family values and collectiveness. Accordingly, regulation does not play a *'new role'* as Beck (1996) suggests, rather the regulation of risk would experience a metamorphosis fuelled by a watchful society, portraying togetherness in forcing regulatory bodies to amend laws to divert harmful risks away from citizens as a whole and not just single individuals (Crow et al 2002, Harney 2005)

Although Beck (1996) recognized the problematic role of the numeric identity placed on risk, he does not sharply criticise it, thereby, conveying that there might be opportunities for the mathematical stamp to continue to dominate and trigger risk direction (Alexander 1996). Mikes (2009) suggests a mixture of social and numeric constructs to be the new pathway in risk dimension but Bloor (2002) and Scott (2000) caution that to understand knowledge of risk we must first contextualize how this knowledge is obtained; thus social values are more crucial in risk decisions than Beck admits. Social interaction, community interplay, values, morals and self-involvement are key ingredients to awareness, consciousness and knowledge (Giddens 1984). Although recognised as part of knowledge philosophy, critics (like Hanlon 2010, Scott 2000) argue, that the social side to risk was *'softened'* by Beck and as a result *'does not adequately analyse how meaning is assigned'* (Hanlon 2010, P 216). Such meaning can possibly be explained in the constant interaction of lay persons and experts that Beck (1996) claims are separate and different.

Perhaps the most acute criticisms of Beck's (1996) theory are the ones relating to public faith, trust and lay persons (Harney 2002). Beck (1996) assumes that the new era is branded by little

faith of the public in systems and structures (Giddens 1984) and that the public seeks justification and punishment from regulators for those who abuse and misuse their power and authority putting lay persons at risk for their own accord (Douglas and Wildavsky 1982, Adams 2003). Adams (2003) made a similar argument in his framework, postulating punishment as an integral part of risk mishaps (See figure 3.3). However, critics (like Scott 2000, Crow et al 2002) argue that the system is so politically championed that such punishment is side-lined and has to be forced. Perhaps there is evidence of this viewpoint in the recent financial crisis where experts, professionals and risk advisors escaped penalty for the debacle that displaced customers, investors and shareholders. However, if unwanted risk behaviour is not chastised, then such actions may cause a disruption to a balanced risk atmosphere (Adams 2003, see figure 3.3) and can also be misunderstood as endorsed attitudes (The Turner Review 2009) much to the discomfort of the ordinary lay person.

Although heavily criticised, Beck's (1996) theory continues to be widely accepted as it appears to closely mirror the actions and attitudes of risk philosophy in today's society.

3.3.3 Adam's Risk Thermostat

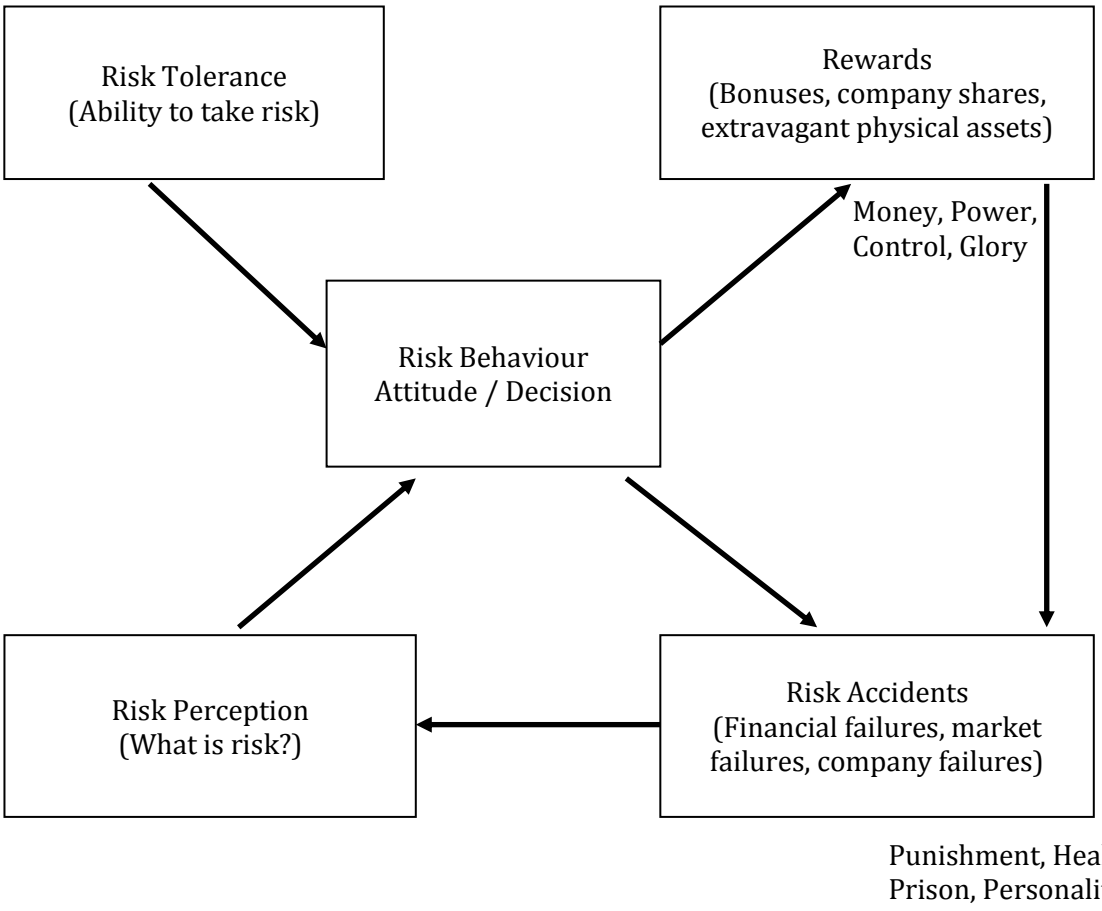
Before the financial crisis, risk research focused heavily on control, evaluation and measurement (McGoun 1995). However, with the advent of the financial crash, the attention shifted away from risk containment to exploring, understanding, and interpreting risk (Power 2004, 2007, Bhimani 2009, Mikes 2009, 2011). This shift in contemporary approaches to risk management was long awaited (Beck 1986, 1992, 1996, 2000). The COSO (2004) risk assessment framework is a valuable guide for comprehending the new trends in risk research, but although it recognises risk

as an integrated compound it falls short of appreciating risk as a perceived notion (Slovic 1997, Simon et al 2000, Williams and Noyes 2007). Accordingly, risk perception is a crucial part of a harmonized structured developed by Adams (2003) (See figure 3.3) that envisions risk as a set of connecting variables that forms a balance in our conscience especially when making a risk decision. This according to Adams (2003) is because:

> *"Risk decisions are moral decisions, made in the face of uncertainty (but)..there is no moral consensus about the right way to manage risk, but rather a set of connecting moralities"* (Adams 2003, p 87)

By his model, Adams postulates three types of risks. Risk perceived through science he argues, is explained and accounted for by scientific means; for example, to guard against the risk of cholera you may need a microscope to see it, scientific training to understand it and medicine to treat or prevent it (Adams 2003). All these are scientific absolutes that characterizes Adams first risk category.

Figure 3.3: Adam's risk thermostat



Source: Adams (2003 p 93)

Risk that are '*directly perceived'* are the ones that we do not need scientist to explain or experts advice on, but rather we make our own assessment and decisions based on our knowledge and learned experiences. For example, we cross the road only after appraising traffic and determining that it is safe to do so. We do not need to call the traffic department or the road safety division to help us decide whether or not it is safe to cross the road. It is Adams' third category of risk, *'virtual risk'* that is most paramount here. These risks according to Adams (2003) are not perceived directly, neither are they explained scientifically, for example, the risk of global

warming, stock market crash or by extension the financial crisis. Consequently, Adams devised a framework he termed a *'Risk thermostat'* to examine how we regulate the factors that affect our decision making concerning virtual risks. Rewards, risk tolerance, perception and accidents are the fundamental footholds of this framework and they should form a balance in any risk decision. When such a balance is disturbed, then we have a *'crisis'* which will in turn influence our perception and future decision making as it relates to risk (Adams 2003).

Presumably, there may be validity in Adams (2003) thermostat especially in rationalizing the recent financial crash. It can be argued that rewards, one of elements of Adam's thermostat, was too influential in the risk decisions made by financial institutions, especially SIFI's and hence caused an upset in the harmonized balance of the risk atmosphere which led to a major financial crisis (a virtual risk catastrophe). When this happens, Adams (2003) suggests punishment to the element responsible for the commotion in order to help restore the equilibrium balance (See figure 3). He argues that this punishment is necessary because of the morality attached to risk decisions (Adams 2003).

If no punishment is administered then our perception of risk may not be altered as expected, but may remain unchanged leading to a risk management philosophy that can encourage unscrupulous risk taking behaviour because of attractive rewards not matched by punitive measures (The Turner review 2009).

3.3.3.1 Deficiencies in Adams Thermostat

Beck (1992) described risk as *'manufactured and incalculable'* while COSO (2004) saw risk as a mixture of qualitative and quantitative constructs. Adams (2003) on the other hand, does not clarify his vision of risk. In other words, is Adams' (2003) risk thermostat a representation of risk as a social ideal nourished by personal and institutional experiences? Or is it an abstract compound explained by a representation of mathematical and calculable variables? Adams (2003) vision of risk is muddled in his thermostat and there was no attempt made to clarify whether his framework would be best suited for a qualitative perspective of risk or a more measurable risk predicate. This distinction is significant because according to Covello and Mumpower (1985) risk attitudes and decisions are predominantly influenced by whether or not we can measure it. Slovic (1987) agrees and adds that risk measurement is crucial in monitoring and evaluating risk against performance. Such measurement is even encouraged by the COSO's (2004) framework in fostering an integrated and unified risk culture. However, Garland (2003) warns that to exclude the influence of the cordial side of risk in any risk atmosphere would be to our own disadvantage.

The lack of clarity from Adams (2003) framework as it relates to what approach we take in evaluating risk seems to suggest that it is immaterial. What Adams (2003) does stress, however, is the inclusion of perception in risk decisions rather than what constitutes that perception.

Regulatory role has no place in Adams (2003) thermostat. Beck (1992) advises that regulators are politically corrupt and the new individual has become a skeptic to their advice. Perhaps there is evidence of the political atmosphere of regulation in the U.K with the recent change of

regulatory power over financial institutions from the Financial Services Authority (FSA) to the Bank of England (see figure 3.1 and figure 3.2). However, the Basel Committee on Banking Supervision, Her Majesty's Treasury, The American Bankers' Association and the Canadian Bankers' Association are all adamant about the valuable role of financial regulators in protecting and building investor and consumer confidence (BCBS 2009, ABA 2010, CBA 2010).

Nevertheless, Adams appears to be silent on the functions of a regulatory society in his framework. The emphasis placed on punishment for disrupters of the balance in his structure seems to suggest the involvement of regulatory power, but the extent of guidance, direction and supervision is not explicit. This can lead to questions as to whether or not the elements of the structure work together in unison as Adams is suggesting, creating a network of *self-regulatory* control over each other. For example, after a risk accident (like the financial crisis), our perception of risk (whether it be social or calculable), rewards and risk tolerance are affected and altered in a way that prevent further accidents, without the intervention of legislative regulatory control. This argument was also supported by the IOD (2009), ACT (2009) and Chambers (2009) who caution that regulatory power may seek to limit prospective growth otherwise experienced by market factors, thereby limiting avenues of prosperity.

Probably the most salient criticism of Adams framework comes from its resemblance to what is sometimes referred to as a *'prison notion'* stemming from its apparent enclosed structure (see figure 3.3). Adams (2003) is suggesting by use of his framework that risk is a concept that can be *'captured'* if his structure is applied. Power (2007), however, argues that frameworks (like COSO 2004 and Adams 2003) are deceptive in their portrayal of risk as a *'canned'* idea that can

be easily apprehended once the structure is followed. Such models, according to Power presents a:

> "*Decorative and perfectionist formulation of risk management which is unlikely to be a basis for resilience in organizations and may even create paralysis when flexibility is needed"* (Power 2007,p 155).

Risk management should be studied in a more exploratory realm, allowing for adjustability especially in today's dynamic business environment (Weick 1993).

Despite its imperfections, Adams (2003) framework perhaps represents a more practical approach to risk management by linking rewards, perception and risk appetite in an equilibrium balance, regulated by risk accidents for cogent risk decisions.

Chapter 3B:Types of risk

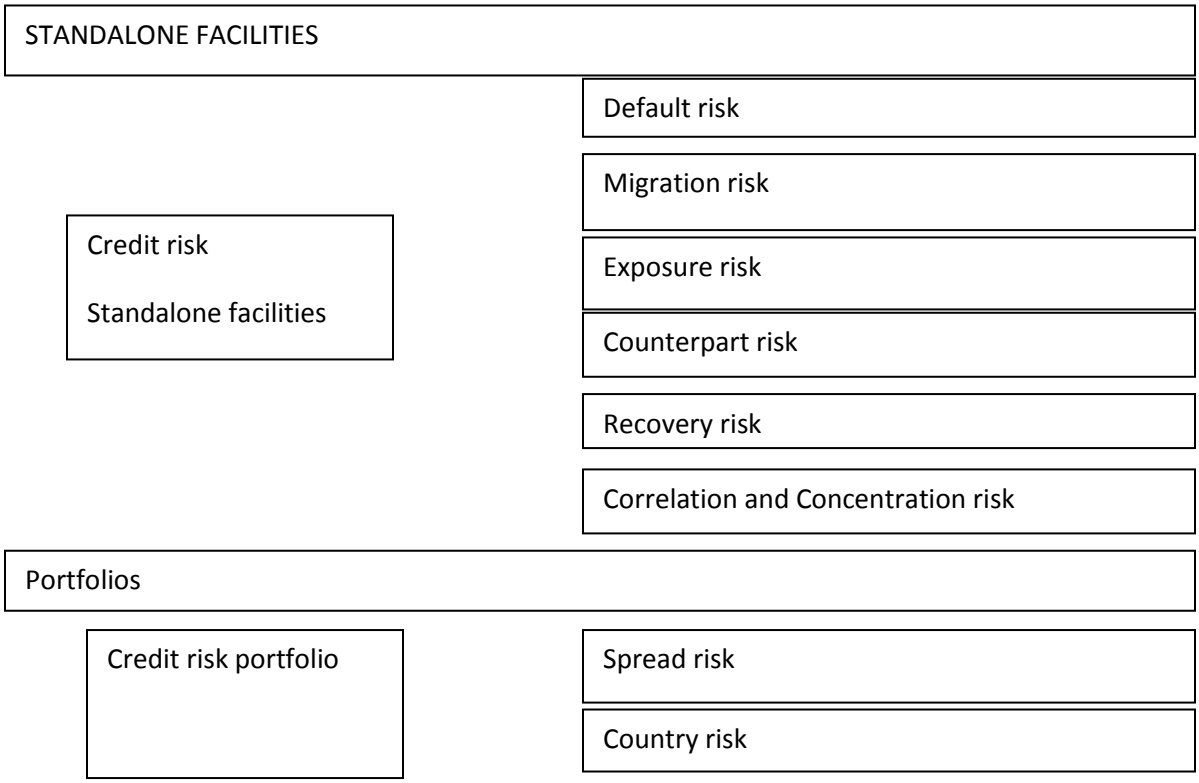
Over the last twenty (20) years, the banking industry has undergone extensive changes, not only in the U.K but in the United States as well. Much of these changes had to do with deregulation of the financial industry that gave rise to a new banking structure (Casuet. Al 2006). The removal of imposed restrictions on the financial sector over the last two decades was designed to promote free market competition, free trade and generate economic wealth (Choudhry 2011). However, this commercial freedom was accompanied by a change in risk taking and risk management approaches (Bessis 2010). Banks ceased the opportunity to pursue a more aggressive growth strategy, by balancing their risk environment to their desired profit outcome (Buckley 2011). With the onset of the financial crisis, regulators sought to restore economic order by imposing requirements on the financial sector with the intention of not only rebuilding a more robust banking system but also to redeem and strengthen investor confidence in the banking system (Bonfim 2009). Restoring fortitude in the banking system remains a challenge for the British banking system that is plagued by a toxic culture of rewarding unscrupulous risk taking (The Independent 2013).

The major risks that have been manipulated by banks in search of economic prosperity include credit risk, capital risk, liquidity risk and operational risks. The different groups of stakeholders that are affected by these risks include borrowers, depositors and investors. Investors (in this thesis) are mostly taken to be the common layperson who trusts institutions and agents to make investments on their behalf.

3.4 Credit risk

The main risk that this thesis is concerned with is credit risk. Credit risk refers to the likeliness that a customer or borrower will be unable to repay or make payments to a lender (Bessis 2010). Investors, depositors and borrowers are all concerned with and are affected by credit risk As it relates to banking, credit risk includes the risk of customers being unable to make payments to their loans, mortgages, credit cards or line of credits (principal and or interest). It is considered to be the most important risk in banks because it represents loss of income to the institution and can pose a going concern problem by undermining the liquidity of the bank (Casuet. Al 2006). As a result banking institutions are particularly adamant about who they lend too. This was not always the case in the United States and to a lesser extent in the UK just before the financial crash. Several toxic assets were repackaged and resold as a result of substandard lending (Saunders et al 2010). This led to an increase in the trading of assets that were essentially worth a lot less than they were sold for because of the sub-standard credit that was accepted by banks from borrowers. Credit risk can be divided or classified into several risk components as shown in figure 3.4 below:

Figure 3.4 Components of credit risk



Adapted from (Bessis 2010 p 28)

During the financial crisis, it was the default risk component of credit risk that proved catastrophic. Although default is a standalone risk[16] it is closely tied and related to exposure risk. Put differently, customers default on payment because the bank is exposed and did not ensure that these payments would be feasible by customers on an ongoing basis.

The significance of credit risk to banking institutions is also evident from its association with financial stability and macroeconomic development. During periods of strong economic growth

[16] A standalone risk is a risk associated with a single division, company or asset. If this division closes, the risk will cease to exist (theoretically). If the company sells the asset the risk is associated with then the risk will be absconded. Systemic risk, however, relates to the possibility of the entire financial market or the financial system failing (like the financial crisis).

(boom cycle), there is more likely to be excessive credit-risk taking which can result in higher default rates causing a puncture (burst) in the economic cycle (Bonfim 2009). This is one explanation offered for the financial crash that began in 2007 (Buckley 2011). Additionally, counterpart risk (a component or credit risk) has evolved over the years to include very complicated and complex financial instruments that banking institutions did not properly understand but attempted to measure, sell and re-sell each time with increased values (Millo and Mackenzie 2009). This resulted in a zealous over-estimation of the values of these financial instruments.

Both internal and external conditions affect a bank's credit performance (Mileris 2012). Inherent factors that relate to the strategy and the financial condition of the bank such as regulations, other banking and financial services providers, institutional environment and microeconomic conditions all affect and help determine the credit environment (Karaa and Krichene 2012). Figlewskiet.al (2012) argues that the credit worthiness of banking institutions is also affected by the macroeconomic atmosphere like the unemployment rate, inflation, Gross Domestic Product (GDP), consumer behaviour, the financial market condition and interest rates. These factors are particularly crucial in credit risk management on loan portfolios (See figure 3.4).

Assessing credit risk is pivotal to the financial security and credibility of a banking institution. Such assessments usually come in the form of credit rating agencies like Moody's and Standard and Poor's 500 that lend credibility to banking institutions based on a merit credit system (Carey and Hrycay 2001). Nevertheless, banks do have their own internal rating systems to evaluate customers that include a mixture of both qualitative and quantitative factors:

"*The credit risk management in banks requires assessing the credit risk level of every credit applicant. So banks must have the instruments that are able to classify the loan applicants into two main classes: those who are likely to keep up with their payments and those who are likely to default on their loans. The credit risk level indicators of clients are the credit ratings determined by the internal ratings models used in banks. The credit rating of a company condenses a range of qualitative and quantitative assessments of the creditworthiness of a company and reflects the credit quality of a debtor" (Mileris 2012 p 496)*

Although both numerics and qualitative attributes are fundamental to evaluating credit risk, mathematical models are the rudders in determining the credit worthiness of customers (see for example, Mausser et al 2012, Mitra et al 2006, Carey and Hrycay 2001). This culture of calculating risk represents a silencing of the qualitative side of risk and is grounded in its trajectory of association with numbers and is unlikely to experience any profound change in the near future (Naceur and Omran 2011, Broadbent et. al 2006). However, after the financial crisis of 2007, banking institutions were encouraged to abstain from omitting qualitative factors in their credit process (BCBS 2011).

3.5 Capital Risk

Capital risk (in a banking context) refers to the probability that a bank would lose part or all of the value on its capital. A bank's capital includes buildings, factories, equipment and liquid securities. In other words, the bank's capital is its net worth, usually embedded in shareholders' equity (Casu et. al 2006). Thus, capital risk represents the risk that the bank would have more liabilities than assets which can lead to bank failure. For this reason, capital risk is also known as

insolvency risk or risk of failure and is closely tied to financial leverage, especially since banks are highly leveraged institutions (Sawabe 2001). Capital risk is pivotal to the strength of the bank's financial assets and should not be treated separately because it underscores liquidity risk, operational risk, interest risk and credit risk. For instance, excessive credit risk can result in the bank not having enough capital to cover its losses and can lead to failure (Choudhry 2011). The Barings bank collapse was a case of insufficient capital to cover losses.

For these reasons, banking institutions, other lenders and particularly regulators became uncompromising on capital risk after the financial crisis. The Basel III sets out new minimum standards for capital requirements as a result of the financial crisis (see table 3)

The level of capital that banks are required to hold has a positive relation to the amount of risk that the bank takes. Although capital risk is a function of the quality of the asset and the risk profile of the bank, normally banks taking greater risks are required to hold more capital (Gilles et. al. 2013).

The importance of capital assets in assessing risk is emphasised by the BSBC (2011). In addition to stringent increases in capital structures, the Basel III recommends additional capital buffers (capital conservation buffer and capital cyclical buffer see table 3) for added boost to ensure the robustness of banks' capital structures. According to Basel III recommendations, the additional capital buffers are to establish common-sense practices in securing financial security and stability in the sector and to safeguard against abuse of the minimum capital requirements by huge banks that would have no difficulty in meeting the minimum standards. While this is

critical in obtaining capital protection, it is important to recognise that such additional requirements may be unnecessary since the economic cycle dictates capital needs and the imposing of supplementary capital specification may restrict the bank's ability and capacity to adequately manage its capital to generate shareholder returns and economic prosperity (ABA 2010, CBA 2011, Arvest 2010).

The resilience of a banking system lies in its capital structure (BCBS 2012). Such resilience was tested and resulted in failure during the financial meltdown that began in 2007. In response, regulatory authorities reciprocated by introducing stricter capital adequacy requirements in an attempt to protect consumers and investors from future financial catastrophe and to restrict excessive and unscrupulous risk taking behaviour, especially by banking institutions (LeBlanc 2010). However, such swift reaction to curbing capital use may have implications on economic advancement that is usually grounded and propelled by a strong banking system with the ability to generate sustainable commercial wealth (Hall 2009).

Risk taking (whether capital, credit or liquidity) is an ingredient of economic activity (Rochet 1992). In the context of banking, risks are particularly important since they represent an attempt to make certain, an uncertain future by securing financial viability not only for local markets but also in the international arena. However, to do so, banking institutions often incur risk to reduce risk[17] of failures and even so, a more economic viable system is not guaranteed. To curtail unwanted risks, banks must not only adhere to regulatory recommendations but also adopt risk

[17] In order to reduce risks banks often incur other risks. For example, derivatives were developed to reduce risks by hedging techniques. These escalated into uncontrollable, complicates financial instruments that are attributable to the financial crisis.

practice that encourages appropriate asset and liabilities management along with adequate hedging strategies (Casu 2006). In the case of institutional investors, this may include both financial and geographical portfolio diversification (See figure 3.4 above).

The challenge for banking institutions and regulatory bodies is forging a plausible balance between generating economic wealth without creating an environment that can lead to financial catastrophe (Korinek 2011). Capital risk plays an important role in ensuring the preservation of a resilient and resolute financial system that encourages strong liquidity and a credit risk appetite that bolsters lending but secures payments on both interest and capital, to reduce the probability of default (Schantz 2010).

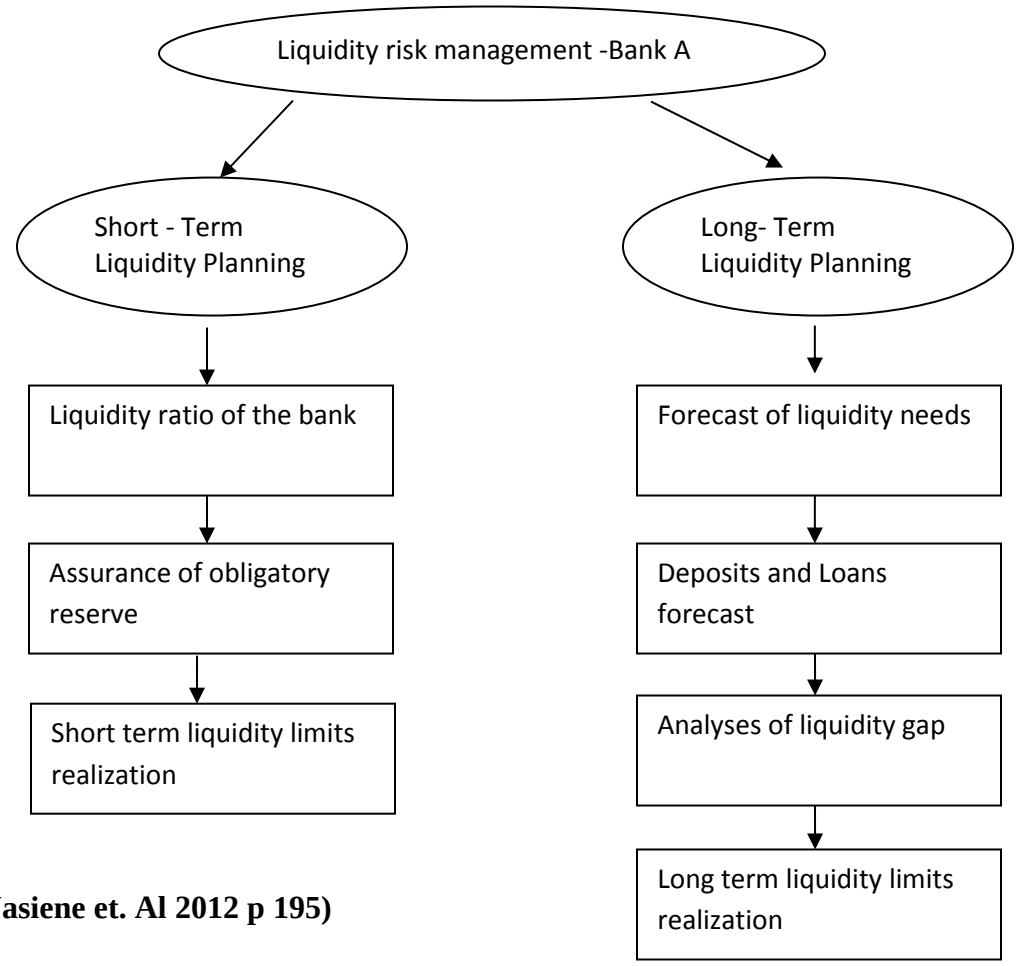
3.6 Liquidity Risk

A liquid asset is an asset that can be converted into cash swiftly without having to bear the loss of capital or penalties on interest (Merrouche and Schanz 2010). Hence, liquidity risk is the risk that a bank is not carrying enough liquid assets on its statement of financial position and thus may not be able to make the required payments to meet operating or other expenses without penalties or impairment to capital (Brandon and Wang 2013). Liquid assets include cash, marketable securities and government bonds. Generally, liquidity risk represents a mismatch between the maturity of these assets and the current liabilities that they cover (Casu et al 2006).

In addition to surges in operating costs, banks need a robust liquid position in order to assure loans to customers. Banks must therefore engage in rigorous liquidity management to ensure that both foreseeable and unforeseeable liquidity demands are satisfied. This may include processes

and structures for both long term and short term liquidity management and should acknowledge the need to mitigate against excessive credit risk, since default on credit services can weaken the bank's liquid position (Jasiene et al 2012). Figure 3.5 below shows a liquidity management model for a commercial bank.

Figure3.5Liquidity management model



Source: (Jasiene et. Al 2012 p 195)

Perceptions of strong liquidity in financial institutions (like banks) are rudimentary to investor confidence and in avoiding a liquidity crisis that can be triggered by a bank run. For example, if depositors perceive a particular bank to be in a weak liquid state, they would urgently withdraw their funds in an effort to protect their investment. The illiquid bank may be unable to cover

depositors' demands and seek to borrow from other financial institutions in the market. The financial market may be unwilling to lend for fear of credit default, and the illiquid bank may move from a liquidity crisis to a solvency crisis that may lead to eventual failure.

The importance of financial institutions to possess a solid liquid position has been underscored by international regulatory bodies that emphasise the connectedness of financial markets on a global stage (Gibson and Mougeot 2004). In recent years, the BCBS has made a cogent call to standardize liquidity requirements for all large banks[18] by setting standards for liquidity coverage and stable funding ratios (BCBS 2010). The standards proposed are based on systematic stress presumptions and represents a combination of idiosyncratic and market-wide scenarios, to build investor confidence and protect the integrity of the financial system worldwide (BCBS 2010).

Liquidity affects all aspects of a company's operations but can also threaten the existence and firms, regulatory authorities, governments, countries and markets (Financial Times 2013). Greece's inability to pay its debts in 2011, led to a European bailout of the member country and a complete overhaul of its financial regime. Recently, the United States announced that the country had insufficient funds to meet its debt requirement unless congress granted permission for additional borrowing (Financial Times, 2013). It is unlikely that the United States, the largest financial giant, would be commissioned for bankruptcy, however, this highlights the significance of the need for an entrenched and robust liquid position, not only for companies but also for system, countries and markets.

[18] Large banks are often known as the big four and are often different from country to country. In the USA the big four are JP Morgan, Bank of America, Citigroup and Wells Fargo. In the UK they are Barclays, HSBC, Lloyds and Royal Bank of Scotland

3.7 Operational risk

The risk associated with the bank's probability of control failure, or the failure of the bank's internal system is known as operational risk. This includes the risk of failed technology[19] and human error. The BCBS (2001) defines operational risk as follows:

"The risk of direct and indirect loss resulting from inadequate or failed internal processes, people and systems or from external events" (BCBS 2001 p 2).

The broad definition of operation risk by the BCBS (2001) is justified by the diversity of risk categories that it encompasses since it represents a measure of the institution's internal efficiency (Schrand and Elliott 1998, Willman et al, 2002). Before the Basel's new accord[20], operational risk was comingled with credit and capital risk (Wahlstrom 2006, BCBS 2001). The rise of operational risk to its own category, signals the importance of maintaining and protecting the integrity of operations in the banking system (Wahlstrom 2006). Approaches to addressing operational risk involve classification of the different risks that affect operations into categories. This would include both internal and external risks and would comprise people processes and systems as outlined in Table 3.1 Below:

[19] It should be noted here that technology risk is different from operational risk. The technology aspect of operational risk occurs when there is a malfunction in technology or a break down in the technological system. Technology risk, on the other hand occurs when investments in technology fail to produce the expected savings or economies of scale (Saunders and Cornett 2003).

[20] The new accord referred to here was issued by the Basel Committee on Banking Supervision in 2001. The first accord was issued in 1998 in response to the South East Asian crisis of 1997 and is now known as the old accord.

Table 3.1: Operational risk classification

Internal risks		
People	**Processes**	**Systems**
Employee fraud employee error Employer misdeed/responsibility Employment law Health and security Industrial action lack of knowledge/skills Loss or lack of important personnel	Accounting error, capacity risk Contract risk selling unsuitability Product complexity Project risk Error reports Settlement/payment error Transaction error	Data quality programme error Security breach Strategic risk System capacity system compatibility System delivery system failure System unsuitability
External risks		
External: Legal Money laundering External sources Political Regulatory Supplier risk Tax **Physical:** Fire Natural disasters Physical security Terrorism Thieves Theft		

Source: (Jednak and Jednak 2013 p 66)

It is apparent from the table, that operational risk would contain both qualitative and quantitative aspects. For instance, the need for adequate knowledge or skills or competent personnel (people risk) would suggest some qualitative connotations while data and programming quality convey a quantitative side (Jednak and Jednak 2013). However the BCBS (2007) advises that operational risk be measured by a quantitative approach through statistical models, similar to the ones used for market risk and Value at Risk (VaR)[21]. The reliance on mathematical tools and measurement

[21] Market risk and VaR would be discussed simultaneously in the next section.

in accounting has its roots in the perception that there is consolation in numbers (Chua 1996, Hoskin and Macve 1996, Frandsen and McGoun 2010) and that measurement is a technology for overseeing events and lending credibility to practice (Porter 1995). Hence, operational risk is legitimized in a system of calculative programmes tailored to predict the banks' ability to withstand losses occurring from human, process and system errors (Garliste 2013).

Operation risk has become a prerequisite for the effective management of all risks in the banking industry because it represents the contemporary circumstances of what is needed to adequately arrest the challenges that the industry faces (Garliste 2013). These challenges reveal themselves through both humans (agents) and processes and systems (structures) (Tinker 1982). Consequently, borrowers are however, the proposed resolution for addressing these problems is through estimations and predictions, grounded in a numeric footstool (Cornalba and Giudici 2004, Marshall and Siegel 2007). In so doing, regulators (like the BCBS for example) appear to be sending a strong signal to financial institutions about the meaning of operational risk and how it should be managed.

3.8 Market risk and Value at Risk

Market risk is also known as systematic risk or trading risk and it heralds special attention since it is one of the very few risks that can be hedged against but cannot be reduced or eliminated through diversification (Casu et al 2006). Market risk is closely associated with movement in market prices and particularly relates to trading of derivative products, assets, liabilities, other short term products and fluctuations in interest rates. Consequently, market risk can lead to uncontrollable and catastrophic outcomes if managers are not sensitive to the implacable and

unpredicted reaction of the market due to economic or other market related events. The challenge for bank managers is finding ways to curb market risk, given that diversification offers no solution and that regulations have intensified the importance of this systematic risk, by mandating an additional stringent capital cover (see table 3), thereby signalling the urgency in recognizing market risk as a crucial player to sustained financial health (Bessis 2010).

The management of risk is no easy task (Power 2007,2009) and market risk magnifies this already arduous situation by reacting to movement in prices caused by both macro-economic factors (like changes in banking policies by regulatory bodies) and micro economic factors (like specific banking reforms). Mitigating market risk would involve almost accurate predictions about present market conditions and future market events (Gray et al 2002). The uncertain state of future events, especially as it relates to risk, makes alleviating and managing market risks a mountainous task requiring excellent visionary skills amassed from years of experience and towering competence in dealing with financial markets, derivatives and interest rates (BCBS 2011). Such capability must be complemented by adequate and practical tools or methods designed to capture probable movements in interest rates, exchange rates and securities. One such method used for measuring market risk employed by large banks to help arrest the likelihood of unwarranted market exposure, is Value at Risk (VaR).

VaR is a risk measure that replaces sensitivity analysis with volatility to estimate potential losses on portfolios (Bessis 2010). Large banks often use VaR involving volatility while smaller banks apply sensitivity analysis to derive VaR approximations. While not unique to market risk, this method is employed extensively by banking institutions around the world and has been heralded

by the BCBS as a practical and empathic way to measure and assess market risk. The merit of this form of assessment lies in its reliance on volatilities and historical trends to predict the likelihood of conventional losses on banks portfolios (Hawkins and Turner 1999). Hence, there is a certain measure of statistical confidence that probable losses will occur based on historical trends and banks can use this data to prepare, make adjustments and take management action to reduce the impact of these losses or even curtail the extent of the loss. VaR represents an improvement or at least has been presented as advancement in the continual evolution of risk management. Linsley and Shrives (2000) argue that risk management has become more sophisticated over the year. The new highly developed methods of measuring and assessing risk (like VaR for example), brings with it a better understanding of risk management which translates into improved risk reporting and greater shareholder involvement:

"More sophisticated ways of measuring risks have been developed, bringing about a greater understanding of risk and an increased ability to manage risk" (Linsley and Shrives 2000 p 115)

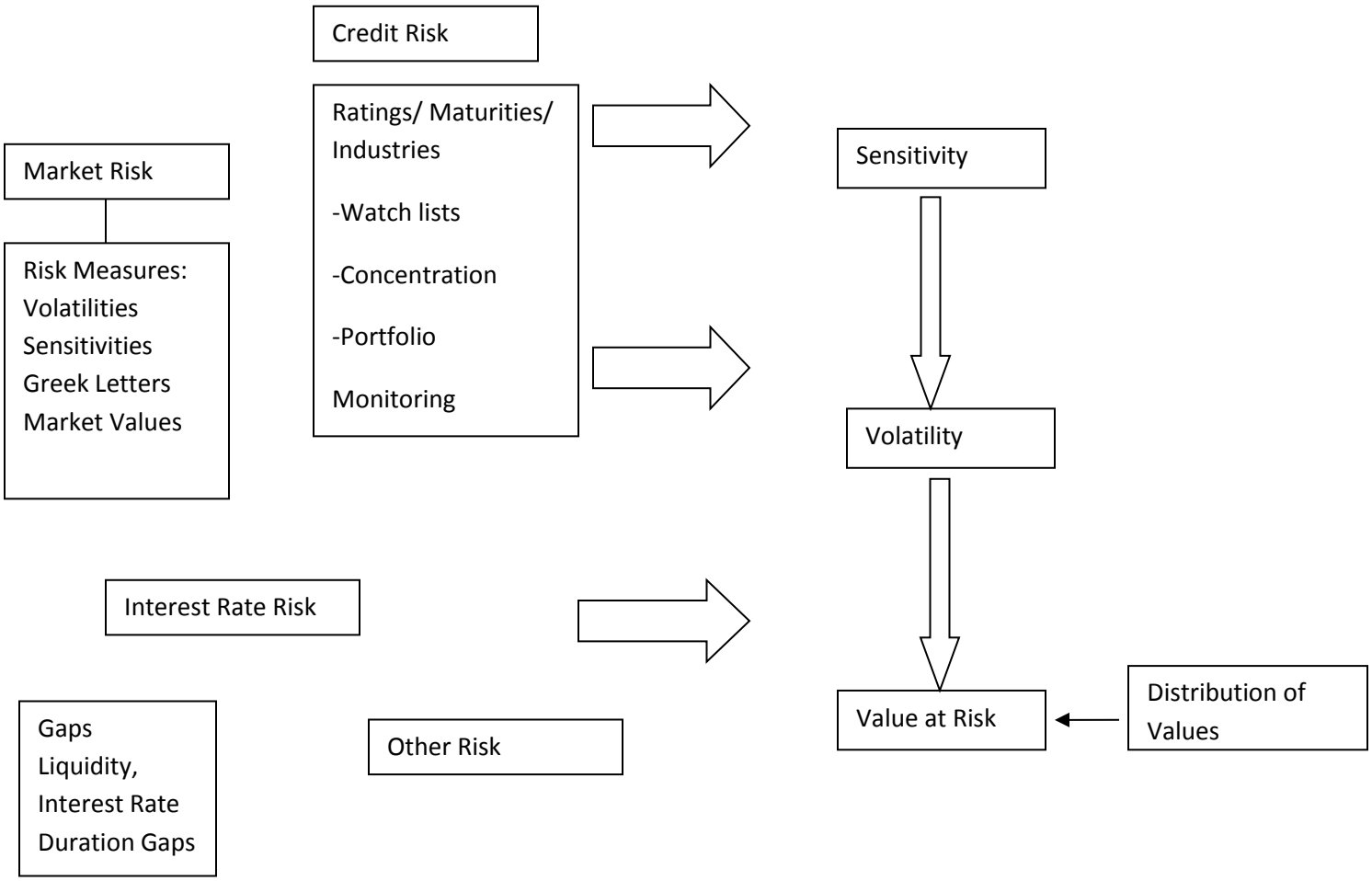
The use of statistical volatility to appraise market risk has been strongly supported by some pundits (Logan 2004, Brown 2008, and BCBS 2011) for its almost accurate result oriented approach to abating risk and improving the overall risk management process. However, some critics (for example Einhorn, 2008) have been harshly critical of this approach citing its inability to accurately predict market events and its strong ties to revenues and compensation that leads to unnecessary abuses of the financial system, causing catastrophic failures and financial demise like the recent financial crisis. Einhorn puts it this way:

> *"How do investment banks justify such thin capitalization ratios? And, the answer is, in part, by relying on flawed models, most notably value-at-risk (VaR). VaR is an interesting concept. A risk manager's job is to worry about whether the bank is putting itself at risk in the unusual times – or, in statistical terms in the tails of distribution. Yet VaR ignores what happens in the tail. It specifically cuts them off. A 99% VaR calculation does not evaluate what happens in the last 1%. This, in my view, makes VaR relatively useless as a risk management tool and potentially catastrophic when its use creates a false sense of security among senior managers and watchdogs. This is like an airbag that works all the time except when you have a car accident"* (Einhorn 2008, pp 11-12)

Einhorn argues that VaR encourages bank managers to take excessive but remote risk by ignoring the possibility that the 1% probability might surface and magnify itself quickly since there was no structures put in place to arrest it, should it appear. This according to Einhorn, is akin to what caused the recent financial crisis.

VaR has also been criticised for its strong ties to management compensation. When the 99% possibility surfaces often, the bank makes extraordinary returns on an ongoing basis and this translates into bigger compensation and bonuses for management employees. Hence, risk managers are incentivised to keep betting on the 99%, not only to secure investor returns but also for the exorbitant compensation packages that it brings. Nevertheless, VaR remains the prominent way to assess measure and manage risks, a significant deviation for traditional approaches to risk measurement. Figure 3.6 below shows the development of risk measurement from traditional approaches to VaR.

Figure 3.6 – From traditional measurement to VaR



Source (Bessis 2010 pp 203 and 212)

3.9 Summary and Conclusions:

This chapter presented some of the risk philosophies and perceptions that are embedded in regulatory bodies and institutions. The COSO framework is a risk approach that seeks to manage risk by using an integrated network of strategies and risk objectives. Beck risk society and Adams framework take different approaches. The types of risks that are of importance to banking institutions are also presented.

Banking institutions are pivotal to the functioning and sustenance of a country's financial system. However, the system is often challenged and affected by various risks inherent to the organization. Banks act as institutional investors, lenders and holders of deposits. Hence, the risk of default, the risk of failure, investment risk and interest rate risk can threaten and undermine a solid financial system. Guarding against these risks and protecting the common investor and depositor should be paramount to the bank. However, Buckley (2011) argues that this is a task too mountainous for banking institutions and regulators should become more involved.
The next chapter presents the theoretical framework for this research.

Chapter 4: A theoretical approach to understanding risk

4.1 Introduction

The last chapter presented some of the key debates surrounding the management and perception of risk. These debates help shape, promote and build an understanding of risk philosophy, which includes the history of risk, changes in approach to risk management and the risk management atmosphere as a whole. Traditionally, a calculable approach to risk has been the backbone of risk decisions (Beck, 1996, Adams, 2003). However, a move away from this established approach to a more holistic resolution is making inroads in contemporary risk perception and attitudes (Power, 2007, Mikes 2008, 2011).

This chapter diagrams a theoretical framework in which the perception and management of risk can be understood. Understanding the behaviour of human beings in organizations, helps in appreciating how risk is perceived in the context of organizational structure, culture and systems. The chapter begins with an outline of the theory that this study employs (Structuration theory) and the major concepts that the theory is grounded in. The reasons for using structuration follow along with a discussion on its limitation. Nonetheless, there are other theories that this research could have engaged or used to conceive risk management in banking institutions. Some of these include actor network theory, institutional theory and contingency theory. These would be examined and their main merits and demerits assessed in the context of risk perception in U.K banking institutions.

4.2 Structuration Theory

Giddens (1984) structuration theory examines the relationship that exists in organizations between agents and structures. This theory acknowledges humans as actors or agents in an organization, shaped by and influenced by the organizational structures that surround them (Giddens, 1984). The theory assumes that humans are free agents that interact with the organizational structures to form social reality. Hence, institutions are a product of a *"duality of structure"* where the social structures are both constituted by agents and are themselves the medium of this construct. In the context of banking institutions, structuration theory would propose risk managers as knowledgeable actors that help shape risk systems and processes but can operate independently outside of their beliefs, values and norms that may have helped shape these systems (Scapens and McIntosh, 1996). Hence, a risk decision is the result of the process and policies (structure) that guides the institution, independent of the manager's (agent) belief of what the decision should be. However, Giddens (1984) does acknowledge the influence of agents through their interactions and social cooperation with other institutional members both intentionally and unintentionally.

Hence, structuration theory explores the interplay between agents and structures and understanding the inter-link between the activities of informed, conscious human beings and the construction and formation of social systems (Giddens 1976, 1984). This theory was developed as a result of Giddens discontent with emergent social theories that purport social reality to be a product of either organizational structures or human agents. The common perception of social reality as human agency or organisational structures produced the concept of *"dualism"*. Giddens rejected this status quo approach and argued that social reality constitutes a reciprocal

interchange between both human agents and structures. This he terms "*duality of structure"* and it brings together two opposing theoretical viewpoints; one of the structuralist that perceive social reality as an objective construct of organizational social structures, separate and distinct from human interaction. The other discerns social reality as dynamically subjective and involves the role of human agents in shaping social reality, a viewpoint shared by hermeneutics and interactionists. Hence, Giddens (1984) sees no division between the object (society) and the subject (the individual) in his duality of structure.

Structuration theory ignores the micro/macro level differential when studying organizational phenomena. Although this has been cited as a limitation of the theory, it can also be presented as an attraction for researchers wishing to study organizational experiences across the two levels.

Although structuration theory is widely used in accounting literature, it is profoundly criticised for ignoring humans as social agents, capable and willing to operate by our own accord (layder, 1997). Thus, agents or humans are seen as objects of reaction to structures and not as operating from motivation or understanding. In this context, a risk manager would make a decision based primarily on the process and system in place and not on his/her ability to understand risk. This theory has also been criticised for being too broad and too far reaching because it includes issues of the unconscious and anxiety in human behaviour (Layder, 1997).

4.2.1 Dominant concepts of structuration

To understand his argument, Giddens uses a number of core concepts. Signification, domination, legitimization, duality of structure, structural principles and dialectic of control are some of the

concepts that Giddens employs to help explain his theory of structuration. Understanding the interplay between agents and structures and the connected socially constructed meanings, social practice and resulting subjectivity involve the role of humans as reflective agents, free to make choices or exercise any particular course and follow on this course of action. This is the concept of Agency. Giddens (1984) defines agency as follows:

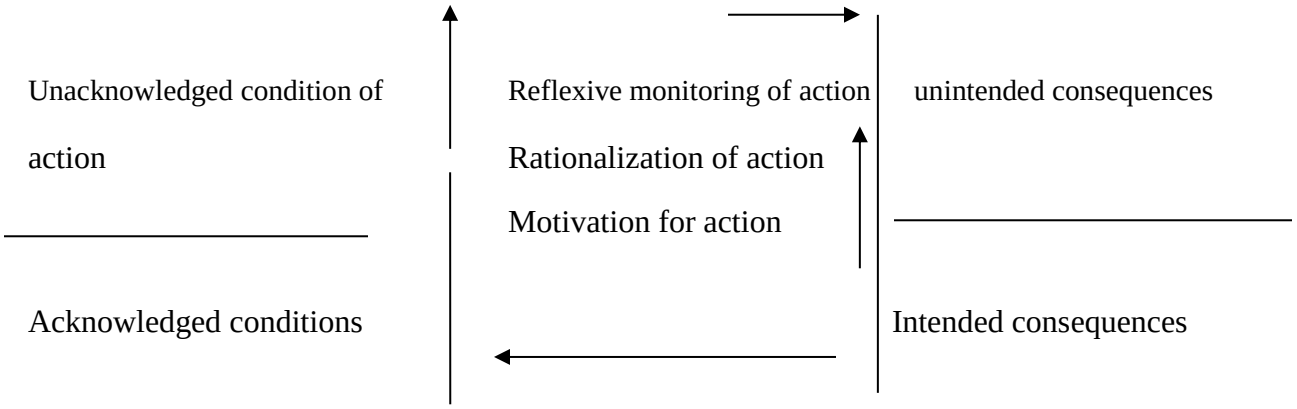
> *"Agency refers not to the intentions people have in doing things but to their capability of doing those things in the first place (which is why agency implies power). Agency concerns events of which an individual is the perpetrator, in the sense that the individual could at any phase in a given sequence of conduct have acted differently. Whatever happened could not have happened if the individual had not intervened*".(Giddens 1986, p. 9).

Giddens is suggesting that humans as agents, influence or conduct human activities through action. Hence, action is crucial in the production and reproduction of social systems and the practices that inform those systems. According to Giddens:

> *"Action is a continuous process, a flow, in which the reflexive monitoring which the individual maintains is fundamental to the control of the body that actors ordinarily sustain through their day to day lives".* (Giddens 1986 p 9)

By this assertion, Giddens is suggesting that human consciousness is key in human action legitimized in daily processes that are an integral part of social structures. Hence action is the

transformation of agency's intentions into activities (Giddens 1986). To elevate his argument on the role of agents in his theory, Giddens developed *"the stratification model"* that emulates how agents (through reflexive monitoring) maintain a consciousness of their activities, which can affect the systems that they are part of. This is depicted in figure 4 below.



Giddens stratification model of the agent (adapted from Giddens 1986 p 5)

Giddens emphasises the self-consciousness of agents to act on their own accord and follow a particular course, reflect on their actions and expect results. However, not all resulting circumstance is welcomed and so the notion of unintended consequences emerges. To place this in context, a risk manager is immersed in the decision that he[22] makes to yield a particular outcome. So a decision to accept a credit customer's request for a loan assumes an expressed level of self-awareness that a desired outcome is perused. In this instance, interest income for the banking institution and financial rewards for the manager may be the desired result[23] or

[22] He is used here as a general term to refer to all managers and not specific to gender. Both male and female managers are implied by the use of the term.

[23] A bank manager makes this decision because he has the power to do so, not just in the capacity of his office but as a conscious human being. The concept of power in Structuration would be discussed later on the section "dialectic of control".

"intended consequence". A reflexive monitoring process occurs through review of the customer's profile and the manager's own assessment of the client's ability and willingness to repay. If the customer is unable to repay, the resulting outcome is an *"unintended consequence"* that Giddens argues accompany every rational course of action that agents engage with. In this particular case, a contribution to the failing profits of the bank and an eventual collapse of the financial system are unintended consequences that result from a manager's conscious decision to accept a credit customer.

Regulatory bodies may respond to deflect further financial harm and take preventative measures by imposing stricter rules and enactments on financial course of actions by bank managers. This can also be labelled an unintended consequence and can immeasurably affect the process of agent's consciousness, reflective monitoring and motivation for future action. Hence, the agent is interacting with and affected by the operating system both within and outside of the banking structure.

4.2.2 Duality of structure

For Giddens, a structure is not restricted to events or processes that characterise organizations and set organizational boundaries, but rather a structure includes rules and resources that are not confined by space or time and is distinctively characterised by the absence of a subject. Adversely, social systems (in which structures are implicated), are the conscious activities and actions of human agents produced and reproduced across time and space. Giddens rejects the notion of structure as simply a "*patterning of social relations or social phenomena" (*Giddens 1986 p 16). This conception of structure, Giddens purports, imposes a restriction on the human

agency in taking conscious action and gives a false perception that agents are not integral but are instead external to the structure. Giddens offer this definition of structure:

*"Structure thus refers in social analysis to the structuring properties allowing the binding of time-space in social systems, the properties which make it possible for discernibly similar social practices to exist across varying spans of time and space and which lend them systemic form. To say that structure is a virtual order of transformative relations means that social systems, as reproduced social practices do not have structures, but rather exhibit structural properties and that structure exist as time space presence only in its instantiations in such practices and as memory traces orienting the conduct of knowledgeable human agents." (*Giddens 1986, p 17)

Giddens is asserting that structures do not really exist (virtual) and that it is a fragment of our thought and imagination (memory trace). What are real, according to Giddens are the practices that humans enact that are independent of our social experiences. Hence, bank managers may draw on their cultural and social experiences in decision making but can distinctly, separate their thought and accumulated social dispositions from the actions that they take. These are only legitimised in structures that do not really exist or cannot exist without agents. To place this in context, take a bank manager who decides to accept a credit customer because the customer meets the requirements of a credit test. By his theory Giddens is claiming that the process of testing the customer's credit worthiness is really non-existent. What exists is the manager's own actions and he (the manager) believes that he is following a set of rules and regulations but these only exist in his head (virtual) since they cannot be enacted without him.

This is why Giddens developed the concept of duality of structure. Separating the subject (agent) from the object (society) is what Giddens proclaim is wrong with contemporary social theories. This action he terms structural dualism and it asserts that humans as agents can distinctively separate themselves from their actions. However, since humans produce actions, Giddens argues that this separation is virtually impossible and hence what results is a duality of structure, where agents and social structures are intertwined and irremovable from each other. Hence, bank managers rely on their social experiences in all the decisions that they make and cannot make risk decisions without the influence of their past experiences in dealing with risk. Put differently, a bank manager is unable to decide whether or not to accept or reject a credit customer (regardless of whether or not the customer fails or pass the credit test) without his thoughts, knowledge and past experiences on accepting or rejecting customers. Hence, organisational outcome is shaped by an interlocking of social dispositions and virtual structures (Giddens 1984, 1986).

Hence, by this duality Giddens is suggesting that social structures are constituted by human agents, by their actions and yet are the means of this constitution. Thus a production and reproduction of the system in constantly ongoing and this enables the social practices to be situated but constrains these practices by the same medium. Table 4 below depicts the role of structure and social systems in producing structuration.

Table 4 – The Duality of Structure.

Structure(s)	System(s)	Structuration
Rules and resources, or sets of transformation of relations, organised as social properties of systems	Reproduced relations between actors and collectives, organised as regular social practices.	Conditions governing the continuity or transmutation of structures, and therefore the reproduction of social systems

Adapted from (Giddens 1986 p 25)

One of the challenges of Giddens duality of structure is his notion that structures are virtual (Stone 2005). The inability of structures to exist outside of the actions of agents calls into question the *"reality of duality".*[24]

4.2.3 Modalities of structuration - Social structure

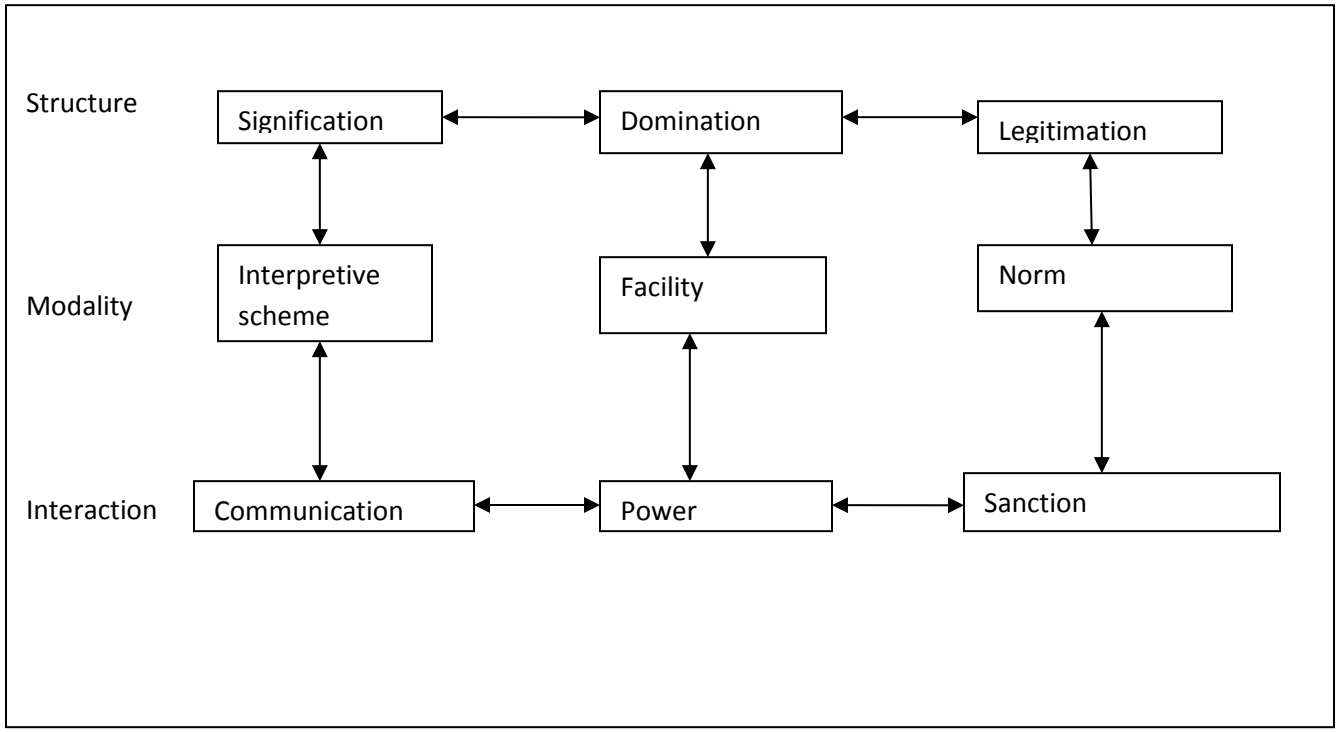
Giddens (1984) asserts that a structure does not only include rules and processes but also organizational resources that are not set in any contextual time-space setting. This structure is social and it is also implicit. Social structures are thus *"methodological"* and can be *"bracketed"* into two different levels for analysis. One level of analysis focuses on the agent and his interaction with the structure and resources to reproduce the social system. The other level of analysis centres on the institution which justifies institutions as a set of skills, rules and resources that are legitimized in the social actor and his consciousness of actions and decisions that are

[24] If structures are non-existent on their own, then the duality that Giddens refer to as an interaction of structures and agents is only possible on the agent's accord. In other words, this interaction cannot be separated. It is a fused action of the agent.

reproduced on an ongoing basis. The dual approach to structuration Giddens terms *"methodological bracketing"*, however, in the context of organizational analysis, these cant be separated. They exist in theory as two separate approaches to understanding organisations, but must be studied as a single accession to perceiving the roles of agents in institutions (Giddens 1986).

Only from this point of view can a researcher discern the meaning, morality and power of the agent in decision making in the organisation. These are the three *"modalities of structuration"* and Giddens refer to them as *signification, legitimation and domination.* Below is a diagram that outlines the modalities of structure and the interplay of the agent in each.

Figure 4.1 – Giddens model of Structuration



Adapted from (Giddens 1986 p 29)

Giddens argues that we, as social agents possess power and interact through communication and meaning alongside rules and norms that exist in a virtual structure that we produce and reproduce constantly through our own actions. Macintosh and Scapens (1990) contend that Giddens modalities are inextricably linked and consist of rules, procedures and resources that act as mediators between the virtual structure and the situated interactions of the agent. Thus, the meaning that bank managers prescribe to risk is situated in the signification panel that is connected to the interpretation of the agent and the power that he has to exercise his actions and decisions, not in the context of authority, but as a human being and social agent (Giddens 1986). The rules (banking regulations for example) that risk managers follow and the resources (technologies, for instance) that they adopt in the exercise of risk decisions act as intermediaries that transcribe understanding of the risk action between the manager and the virtual structure. In other words, the rules and resources are both constraining and allowing the agent to act (Giddens 1986).

For the purpose of this thesis, Giddens theory would be used mostly as a sensitizing device (Conrad 2014, Conrad and GuvenUslu 2011, Cohen 1989), to place social constructivism as a social phenomenon, a manufacture of the bank manager as an agent. Hence, for the analysis that follows (in chapters 7 and 8) emphasis would be placed and referenced drawn upon the interpretive scheme and the interactive role of communication and signification in organizational outcome.

From an organizational perspective, the signification panel personify the interpretive scheme that agents use to construe their actions (past and present). Thus the interpretive scheme are

reproductive modes, containing agents conscious actions produced and reproduced, legitimised through reflexive communication that contains justifications for their actions (see figure 4.1 above). The cooperation and interaction of signification with domination (from the agent's perspective) recognises the ability of the agent to draw upon available resources in order to exercise power[25] over their actions. Giddens argues that this power possess two distinctive characteristics. First, agents can exert power over material things like objects and goods. Second agents can exert authoritative power over other agents and social actors because of stronger capabilities and abilities to organize, coordinate and mobilize (Macintosh and Scapens, 1990). In this context, power symbolizes a resource that bank managers can utilize at their discretion in the formation and execution of risk objectives legitimized through quantitative, calculative measures and (or) social actions.

4.2.4 Dialectic of control

Although an in depth analysis of Giddens organizational power dynamics would not be examined in this thesis, it is crucial to acknowledge power as a key concept of his theory in the forming of social relations and agents influential role in the duality of structure. Giddens asserts that humans as agents, have a grounded unconscious need for *"ontological security"* and hence they create routines, accumulate, develop and employ an aggregation of knowledge to guide, justify and rationalise their actions in the fulfilment of this philosophical need. Hence, the use of power by agents as social actors now consider, not only the organizational outcomes that the

[25] A thorough discussion of the power dynamics in structuration theory is not included in this thesis. As indicated before, this theory is applied to sensitize the current research (as was advised by Giddens, for the use of his theory) and hence the extend of power relations is debated in the context of understanding bank managers actions as agents and the banking system they operate in.

agent aspires to achieve but also the unconscious[26] attainment of his or her own satisfaction, comfort and gratification in fulfilling these needs. It is important to understand that Giddens does not view the use of power for achievement of personal needs and organisational outcome as separate and external to each other but rather as a set of intertwined social relations embedded in the agent's conscience and sub-conscience.

The mobilization of social action and the ability of agents to engage and shape the outcomes of their activities through the use of resources is codified in Giddens *domination* sphere and identified as the concept of *"dialectic of control".* It includes the notion that by our very actions (both intended and unintended), we as humans, social agents, exercise power. Hence power symbolises *"the transformative capacity of human actions".* This can be interpreted as meaning that the achievement of organizational outcome, includes an implicit involvement of the use of power that the agent exerts through his or her actions grounded in a circle of knowledge (gained through reflexive communication) drawn from virtual structures. Otherwise stated, power becomes the means of resource mobilization by the agent.

The perception of power as an emblematic resource utilized by the social agent has been criticised by some pundits (for example, Latour 1986, Callon 1986, and Law 1992). Callon argues that power mean:

> *"describing the way in which actors are defined, associated and simultaneously obliged to remain faithful to their alliance"* (Callon 1986 p 224).

[26] Giddens theory was heavily criticised by Layder (1987) as being too far reaching into areas as the unconscious. Further criticisms of Giddens theory would be discussed in section 4.4.

For Callon, power is not an intricate resource, encapsulated and exercised by social agents but rather a mechanism of relationships and associations that keep networks[27] together. It is a way of explaining how things are kept together. Power is the phenomenon that holds networks (like technologies) together through associations and connections. Once these associations are lost, power is lost and so a reconstruction (reassembling) begins. According to Latour, power is not an internal resource that can be drawn on by humans but rather, an approach to explaining the many connections and associations that form the social.

The "*dialectic of control"* that Giddens assigns to his theory exemplifies the agent's role to execute power at will (to act or not to act). This is crucial in explaining bank managers' ability to use power as a tool of manipulation and political discretion to achieve organizational outcomes especially as it relates to risk, not just for investors and other stakeholders but for themselves. According to Giddens, this typifies the relationship that exists between action (like whether or not to accept a credit customer) and power (like deciding not to accept the customer). Giddens relates this as follows:

> *"To be able to 'act otherwise' means being able to intervene in the world, or to refrain from such intervention, with the effect of influencing a specific process or state of affairs. This presumes that to be an agent is to be able to deploy (chronologically in the flow of daily life) a range of casual powers, including that of influencing those deployed by*

[27] A network is a concept used by Latour (1986, 2005) in his explanation of his Actor-Network theory. The term can be somewhat problematic because it does not relate to relationships or connections *per se* but rather a term used to describe something (like for example a piece of legislation, a rock or music). Latour also introduces technical networks that relates to the description of specific things or groups like technologies that can enact on their own. In other words, they are actors that emerge into networks (See Latour 1986, Callon 1986 and Law 1992 for more on actors and networks).

others. Action depends upon the capability of the individual to make a difference to a pre-existing state of affairs or course of events. An agent ceases to be such if he or she loses the capability to make a difference that is to exercise some sort of power"[28] (Giddens 1984 p 14).

Giddens renounces the structuralist's (like Durkheim) views of power as a "property of social formations". These social formations, according to Giddens, depend largely on dialectic of control in structuring social systems that are grounded in congruity of autonomy and dependence. Otherwise stated, power is inextricably interrelated and any party involved in the exercise of power is neither entirely autonomous nor dependent. Hence, managers are motivated by the activities of the societal and economic level (macro level) but are also reliant on subordinates, and organizational rules and procedures (micro level). This two-level interaction is pivotal in understanding the dynamics of manager's actions and the use of power that leads to a conventional occurrence that Giddens terms "routinization" (doing the same thing over and over again across space and time). However, when a disaster emerges (like the financial crisis) managers abandon their routines in search of solutions. This is examined in the next section.

4.2.5 Structuration and the financial crisis

Although Power is regarded as one of the building blocks of Giddens theory, there are other critical concepts that Giddens uses to explain how agents and structures interact, produce and are reproduced. Routinization is a vital aspect of this process and it asserts what agents do on a

[28]Structuration theory places significant emphasis on humans as social agents. The discourse on power in this thesis is important since Giddens maintain that the agent does not exist without his or her ability to exercise power. Power is also an essential tenet of Giddens theory.

habitual basis across time and space. According to Giddens (1984, 1986) in routine situations human beings as social agents do not make a conscious attempt to engage in activities; rather agents function without cognizant or attentive care. Agents do not consciously engage (speak or think about their actions). This is because social structures contain *"primacy*;" a routine command or authoritative power that does not require consciousness in routine action.

Hence, bank managers, examine documents and conduct conversations with prospective credit clients on an ongoing basis by relying on the social structure, their experiences, accumulated knowledge and power of authority to do so. This according to Giddens does not require a conscious effort to engage with the client since this process has been routinized and has created a system of stabilization that the manager trusts and depends on. This trust, however, is not a function of truthfulness from the client but a belief in the social structure that the manager accepts and has confidence in as an established and durable source of expertise.
Some pundits (for example Layder 1987) disagree with Giddens acceptance of routine activities as being stable and his assumption that agents are not assertive in this process. While repeated activities may lead to routinization across space and time, Layder (1987) argues that agents are always reflexive and emphatic even in routine situations (Layder 1987).

When a crisis occurs agents abandon their routines and actively seek solutions that can lead to a new form of stabilization over time (Giddens 1984). Here, the structure is reproduced frequently, in search of a new solid routine that would lend assurance and a sense of security to the agent's ontological needs. In the context of the financial crisis, risk managers would repudiate the reliance on the old established structure (that they once relied on as secure) and fervently seek to

find a new structure to rely on. The new structure would be created or produced by the agent through a process of conscious engagement and involvement. In this instance, managers may implement new rules or procedures for managing risk or regulatory bodies may step in to impose restrictions to curb the catastrophe and restore faith in the financial system. This is evident from Glass bank's[29] reaction to the financial debacle. Risk procedures became more stringent and international guidance was quickly implemented by the bank.

The reflexive discourse and assertive communication that forms part of the new routine become the building blocks of the new social structure (Giddens 1984, 1986). This would become routinized overtime and lead to a new level of stability that the agent would resort to trusting again until another crisis occurs. It can be argued that this is already evident in the UK banking system, where the new rules and regulations regarding risk management are already being manipulated and managers and other risk officials have resorted to engaging in the same unscrupulous risk behaviours that led to the financial melt-down in the first place (Sikka 2009). The formation of new structures through crisis management is crucial in conceptualizing how bank managers perceive and manage risk in changing situations, especially when disaster has poisoned the risk atmosphere.

Although structuration assumes stability by routinization, it is cardinal to understand that routines form the basis for stabilised social structures. This is important because Giddens (1984) declares that when routines are abdicated in crisis situations, then this leaves an opportunity for radical change during the crisis period. According to Giddens (1984, 1986), extreme change

[29] Glass bank is a pseudo name for one of the participating banks in this study. A more detailed discourse on the findings is found in chapters 7 and 8. The example here is contextual.

measures would be adopted by agents to show their consciousness of the current undesired situation and enhance opportunities to retract and reproduce a new stable, reliable structure. This is helpful in analysing the role of risk managers' perception and actions after some risk decisions may have yield to ill-favoured or unacceptable results. However, the extent to which this affects the banking system and current risk practices is not satisfactorily captured by Giddens model, since he asserts that the structures are social and virtual.

4.3 Justification for choosing structuration theory

A number of academics have employed structuration theory to the study of accounting as a social science (Willmott, 1987; Capps et. Al, 1989; Roberts and Scapens, 1985; Conrad, 1999; Macintosh, 1994, 1995; Whittington 1992, Chan 1990, Scapens 1989, Whittington 1992, Macintosh and Scapens, 1990; Dirsmith et al, 1997; Conrad and Guven-Uslu, 2011, 2012; Ashraf and Uddin, 2012; Stergiou et al, 2013). In some instances aspects of structuration theory was applied in the context of management accounting and control systems. In other cases, Giddens theory was used as a device to examine, track and report on organizational change in the context of structures and role of agents. Chan (1990) applied structuration in a different way. He used Giddens theory to examine international accounting standards and its effects on different cultures.

Structuration theory has been applied to a variety of areas in the literature. From management accounting change (Macintosh and Scapens 1990, Ashraf and Uddin, 2012, Stergiou et al 2013) to performance measurement in NHS trusts (Conrad and Guven-Uslu 2011) to crisis and conflict management in the public sector (Conrad and Guven-Uslu 2012) to international accounting

standards and culture (Chan 1990). Nevertheless in all of these circumstances the role of agents and their impact on social structures in an organizational context was employed.

Macintosh and Scapens (1990) argue that a further look into management accounting systems may reveal the three aspects or major dimensions of social structures. These are signification, legitimation and domination. Hence management accounting takes the role of an interpretive scheme, communicating between the signification structure and social domination and interaction of agents with the structures (Macintosh and Scapens 1990). Therefore, the transcribing and interpreting of meanings that acts as a regulatory device for agents' behaviour in organizations is defined. In the context of banking for example, this may take the form of agents using the structures to achieve banking outcome; like for instance specific returns on risk taken or setting profit targets on customer loans. In so doing management accounting legitimises the actions of agents and routinizes them in time. It sets parameters for actions and holds individuals responsible for their decisions. As it relates to bank managers, this responsibility takes the form of targeted results, customer satisfaction and banking performance.

It can be argued that structuration theory provides a road map for responsibility accounting by outlining what agents should and should not do. This embedded implication is rooted in the production and reproduction of values, morals and norms that are characterised in Giddens (1986) legitimation panel and it serves as a source from which social interaction can be drawn within organizations (Willmott 1987). Hence, an understanding of agents and social structures is crucial for appreciating management accounting change in organizations and structuration theory provides such a framework.

Conrad and GuvenUslu (2011) imported aspects from structuration theory and bound it with institutional theory to provide a theoretical basis for understanding how Payments by Results (PbR) affects performance management and measurement in UK National Health Service trusts (See table 4.1). According to Conrad and GuvenUslu (2011):

> *"Structuation theory can offer valuable insights into the role of management systems in organizations…(because) it is concerned with the relationship between agents' actions and social structures in the production, reproduction and regulation of social order. As a sensitizing device, it alerts us to the relevant dimensions of social structure, particularly the way in which structures of signification are inextricably to structures of legitimation and domination. It emphasis the crucial role of agency in the reproduction or change of existing structures"* (Conrad and GuvenUslu 2011, p 48).

Giddens has advocated that his theory should not be applied as a solution to understanding all existing social phenomena but instead as a sensitizing device to appreciating the role of agents and structures in social research (Giddens 1984, 1986). Conrad and GuvenUslu (2011) employed Giddens theory as a sensitizing device and hence this research uses structuration in a similar way. In the current research, bank managers' perception is taken in context of Giddens signification panel, as a resource used by organisational agents to draw upon, to interact, to legitimize and to make risk decisions. The outcome of these decisions is a precept of the experiences and interactions that are understood in a certain context. Structuration theory provides this context by lending a theoretical framework to sensitize the research, leaving room for interpretation and explanations; Giddens suggests a similar use for his theory as follows:

"the concepts of structuaion theory, as with any compelling theoretical perspective, should for many research purposes be regarded as sensitizing devices…they may be useful for thinking about research problems and the interpretation of research results" (Giddens 1984, pp 326-327, cited from Conrad and GuvenUslu 2011, p 48)

Table 4.1

Structures of signification, domination and legitimation in the NHS

	Pre- NPM: Fiscal prudence	NPM; Performance Measurement	NPM: Performance Management post 2002
Signification	Non-accounting style Clinical needs language	Cost conscious:NRCI League tables	Income Conscious Pbr BSC
Domination	Clinical autonomy Ministerial authority	Managerialism	Market mechanism Accountants
Legitimation	Founding principles	Efficiency/economy	Effectiveness – Choice

Adapted from Conrad and GuvenUslu (2011 p 49)

Structuration theory has also been applied to case studies, solidifying the extent of use of the theory in social research. Using a case study approach, Conrad and GuvenUslu (2012) examined conflict and crisis management on performance in the UK health sector. In their analysis the

researchers noted that the use of structuration was partly because it provides a basis for understanding and conceptualizing the rules and resources that characterize and define human behaviour in social settings. Performance management systems are actions and processes by which agents influence, dictate or change other agents (like managers using employees) to achieve organizational goals. This places heavy emphasis on the agent aspect of structuration and allows for interpretation of the changes in the management structure, thereby highlighting Giddens duality concept (Conrad and GuvenUslu 2012). By virtue of communication and interpretation (signification), structuration also supports both micro and macro level analysis[30]. The theory helps by offering a more valuable micro analysis by understanding the behaviour of human beings (actors[31] or agents) in organizational settings.

In table 4.2 above Conrad and Guven-Uslu (2011) outlines how accounting interacts among and within Giddens (3) panels of signification, domination and legitimation to produce different outcomes in the UK NHS trust. Stergiou et al (2013) applied structuration theory differently, focusing mostly on the signification panel of Giddens theory to draw meaning and interpret actions from agents that lead to management accounting change. The authors employed structuration theory to understand the actions of agents and to interpret and apply meaning to their actions. Giddens theory provides a solid basis for constructed meaning that can be applied to institutional perspectives of organizational outcomes (Stergiou et al 2013). Nevertheless, the

[30]Structuration also supports a non-distinction between micro and macro level analysis by interaction among and across signification, domination and legitimation. However, within each of these micro level factors can be identified and analysed.

[31]Actors here take the form of human actors. Some theorists (like Latour) use the term actors to include non-human things that "act" or participate in action to enhance or produce organizational outcome. For the rest of this thesis, the term actor(s) would take the implied meaning of human actor(s) unless otherwise stated.

researchers did recognise the limited and meagre portion of power that is ascribed to agents in their actions (Dimaggio 988). Giddens (1984) asserts that actions become routinized over time and so agents do not need to make a conscious effort to perform them. This diminishes the agents role as an *"active participant"* in routine situations but establishes the inter-related role of the agent with the structure:

> "*In order to address the apparent tension between agency and structure some accounting studies inspired by Giddens structuration theory have adopted the duality approach. For Giddens social structures do not exist independently of human agency; they are constituted by human agency, but at the same time, they are the very medium of this constitution. This strand of research has been used extensively in accounting literature to explain management accounting control change"* (Stergiou et al, 2013, p 64).

Structuration theory is by no means an exclusive approach to understanding social phenomenon in organizations (Ashraf and Uddin 2011). However, it offers insights on how human beings communicate and transcribe information among themselves within an organization structure, drawing from a social structure (duality of structure) that is non-existent by itself (Giddens 1984). This virtual structure is produced and reproduced by agents in the presence of meaning, understanding and interpretation (signification), norms and sanctions (legitimation) and power (domination).

4.4 Criticisms and Limitations of structuration theory

One of the precepts of structuration is that it helps to highlight some of the problems with social research (Giddens 1984). As a result, Giddens theory of structuration can only be applied in context with limitations to broader application (Stone 2005). The theory is situated in a socialised atmosphere and that makes it suited for and widely used in social research. Nevertheless, by this same merit, the theory is less useful outside of parameters of *"the social".* Giddens theory asserts a particular definition of the social that includes human actors, their actions, interactions and experiences with society (Boland 1993). Hence, the social has already been "assembled" as a phenomenon that already exists, and Giddens uses this *"social"* to help understand human behaviour in organizations. However, there are other definitions of the social that includes other actors and actions, not by human agents but by artefacts' and other non-related possessions and conditions (Latour 1987, 1999; Callon 1981). Structuration theory ignores or does not recognize the existence of these artefacts that can form the social, emerging from facts and conditions rather than being already in existence.

In this context, the perceptions of risk managers in the UK (and by extension any human being) are already formed and the discussions and discourse that the managers are engaged with are based on these already existing social forms. This leaves little opportunity to explore other forms of social existence, not already created by the agent. For example, the application of structuration theory asserts that a bank manager is relying on his knowledge and experiences of risk management to engage in conversation (like during an interview)and that these are already assembled and complete in his mind. However, Latour (1987) argues that the social does not always exist as an already built state but rather, an opportunity to be built and created. This

means that for a bank manager, building the social during the interview process may represent a missed opportunity to establish and develop his or her perception during the conversation and for the researcher to apply it in a different context.

Another limitation of structuration theory is Giddens "duality of structure". This concept is one of the foundational blocks of the theory and it asserts that agents produce and reproduce a virtual social structure that they draw from but re-create or reproduce constantly (Giddens 1984). This virtual structure Giddens argues is part of the agent and the two cannot be separated. While this may provide a reasonable explanation for agents organizational outcome, this concept was heavily chastised by Layder (1987). Layder (1987) argues that what actually exists is a situation of "structural dualism", where agents and structures meet and interact to create organizational goals. According to Layder (1987) this structure is not virtual, but real and consists of rules, processes and resources distinct and separate from human agents. If structures are virtual, as Giddens claims, then they exist only in the minds of the agents and rules and regulations of organizations and organisational order is purely agential (Ashraf and Uddin 2011). In the context of banking, Giddens' virtual structure would consist of banking regulations and procedures only to the extent that they are performed or observed by the bank manager. Hence, the risk processes that a bank manager employs in a risk decision do not exist if the manager does not use them. Layder (1987) argues that these rules and regulations that help maintain organizational order do exist whether agents observe them or not.

Thus, if a manager does not adhere to banking principles and regulations then the duality of structure that Giddens asserts is non-existent. During my interviews with these managers I have

found that in some cases the rules and procedures are followed and in other cases they are not. What does this mean for structuration theory? It may mean that the social structure is only recognised in those instances where managers recognise the rules. This may exemplify a weakness in structuration where the duality of structure may not exist if the social structure does not.

Perhaps one of the more noticeable shortfalls of Giddens' theory is its "all inclusive" approach. Structuration theory is very far reaching and includes even the unconscious and psychological aspects in the theory (Layder 1987, Archer 1982). Giddens appear to be trying to capture every possible aspect of social life and in so doing ventures outside the scope of the known (Burns and Scapens 2000, Thrift 1985, Craib 1992). Thus structuration theory is extensive and can be applied to a variety of different organizational situations. While this may appear to be advantageous, it can also be perceived as not being focused enough in application (Layder 1987). Gregson (1989) refer to the broad reaching scope of Giddens theory as: *"conceptualizing the general constituents of human society" (Gregson 1989 p 245).* According to Gregson (1989), structuration is not concerned with theorizing or explaining the specifics of organizational phenomenon but rather is a sweeping methodology for all organizational ills. Giddens did recognize his theory as being a methodological approach to organizational phenomenon and admitted to the broad views that his theory covers, arguing that the ideas he presents should not be based on how wide-reaching they are but the fundamentals of the idea itself, even if it may be different and needs improvement:

> *"If ideas are important and illuminating, what matters much more than their origin is to be able to sharpen them so as to demonstrate their usefulness, even if within a framework which might be quite different from that which helped to engender them*" (Giddens 1984 p XXII)

Despite the many criticisms of structuration theory, it is still very widely used in understanding organizational outcome and perceiving human behaviour in their environment. This research would employ some concepts of structuration (especially from signification) to help understand bank managers perception of risk in UK banks. This would include the manager's interaction with their peers, the structure, the banking system and their own cultures, beliefs and norms. It would also include the transfer of meaning and how risk is interpreted through meaning.

4.5 Other theories examined

Structuration theory provides a theoretical resolve in which this research can be conceptualised and applied. However, other theories could have been applied as well to promote and foster understanding of risk in banking institutions, not just in the U.K but in the wider context of financial institution and organizations worldwide. A review of some of these theories, their strengths and weaknesses is provided below.

4.5.1 The Actor Network Theory

The Actor Network Theory (henceforth called ANT), views organizations and institutions as a composure of heterogeneous factors working together with human actors to effect organizational

outcome (Latour, 1987, 1999). It focuses on the role of different technologies and the change in technological structure as the main antecedent in forming networks with other technologies and actors (called actants) within the organization (Cooper and Hopper, 2007). According to Latour, what *"sociologists of the social"* refer to as *"the social"* is really a collection of associations that can be traced but can also evolve into other things. Sociologists of the social believe that the social provides an explanation but sociologists of associations believe that the social itself is to be explained, and it can be by making associations and tracing connections:

> *"I can now state the aim of this sociology of associations more precisely: there is no society, no social realm and no social ties, but there exists translations between mediators that may generate traceable associations".* (Latour 2005 p 108).

The tracing and making of associations involve the employment of several concepts like translation, black boxes, objects and actors[32] (both human and non-human) to assemble or-reassemble the social (Latour 1999). Actor-network theory also uses artefacts, facts and connections that builds and shape the social.

For Latour, the social constitutes actions of non-humans, machines and objects that work together in a particular way to make the present what it is. When these are deployed, they create many controversies that are to be examined in the context of what they lead to, what they create and where they came from. This is done by the process of "*translation"* that is a form of

[32] Actors are technologies, agents, individuals or collectives that can disassociate, disassemble, associate or be assembled by other agents. Table 4.1 identifies some of the actors involved in the process of hiring a lecturer at a university for a unionised position.

stability[33] during the change process. For change is constant and translation serves as a crossover point: a point of displacement and at the same time a point of mobilization (Callon and Latour 1981).

For example, ANT can examine the concept of risk in light of the different risk associations that surrounds it. A risk manager would not be viewed in relation to his already assembled expertise on risk but rather as part of the many objects that constitute the concept of risk. These may include the computer on which he works, the telephone that he uses to get advice on risk, the cup that he drinks from when discussing risk and all other objects that are present or are part of the environment that relate directly or indirectly to the formation of the risk concept. These are all actors and they form networks among themselves and can expand to or advance to other networks even outside the banking institution.

If a risk manager uses or employs the advice of regulatory authority in this process, then risk has translated (or at least part of it) in regulation. It can be traced to regulation and followed from regulation into what it becomes after that.

Hence, risk would have a different meaning that would include all of these objects that cannot be discounted as useless in the social world. Callon and Latour explain this further:

> *"There is no thinkable social life without the participation – in all the meanings of the word-of non-humans, especially machines and artefacts….our point is that the activity of*

[33] See figure 4.1 for more on stabilization in ANT and how this evolves to new issues from problems.

> *dismissing them is as difficult, as contentious, and as revealing as the attribution of meaning, will and intentionality to humans"* (Callon and Latour 1992 p 360).

The taken-for-granted meaning of the social by traditional sociologists assumes that the social is already assembled. It already exists in this form that is known. That should be accepted and used as "the social". Latour challenges this notion and argues that the social does not exist, but it emerges constantly taking differently forms and involving different activities that sociologist ignores.

Actor Network theory has been used extensively to study accounting change and technology (Lowe 2001, Andon et al 2006, Briers and Chua 2001). It offers a variant view on how reality is experienced by perceiving the social as a journey and not an established state (Czarniawska and Hernes 2005). ANT is not a discourse, but a way to new discourses; It is an approach to research that lets the actors tell the researcher what their social world is, their realities and how it comes into being. This method of research encourages the actors to tell their story.

Despite its strong epistemological stance, ANT has been criticised for classifying humans as objects in its use. Human beings are not perceived as superior to machines in their role with ANT. Additionally, Actor Network Theory is flat and does not recognise the different levels that may exist in organizations. In this context, micro level banking activities and procedures like accepting a credit customer would not be perceived differently than macro level procedures like increasing profits or maintaining economic wealth. Put differently, all levels of organizational

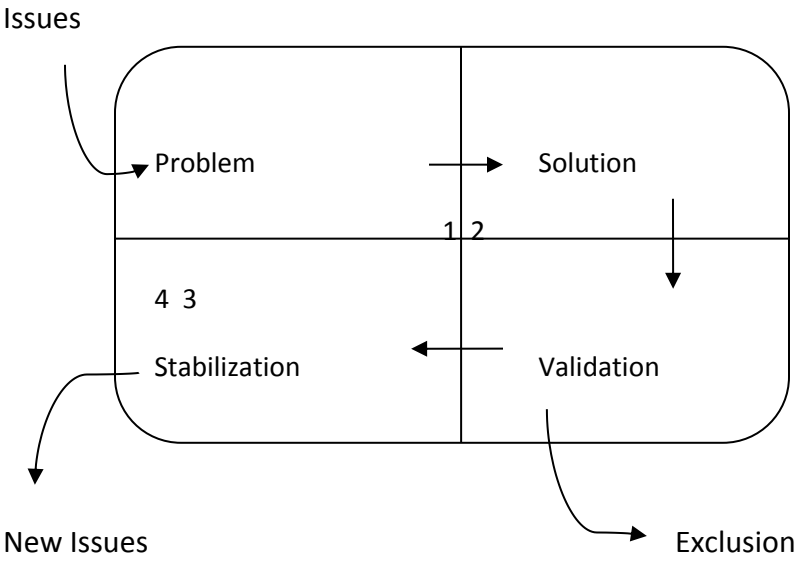
existence would be viewed in the essence of how they are connected or associated with formulating the social; how they can be traced and what they evolve into.

Table 4.2 – Different actors in a hiring process

Institutional Macro Actors	Organizational Actors	Individual Actors
The principle of academic committees	The nomination committee	The chairman of the nomination committee
The University	The University (represented by its board) The institute (represented by its board) The faculty (represented by its board)	The head of the institute
The social science field	The nomination committee	The chairman of the nomination committee
Law	The trade union	The trade union lawyer

Source (Czarniawska and Hernes 2005 p 121)

Figure 4.4 - The negotiation loop of problems, solutions and new issues.



Source (Czarniawska and Hernes 2005 p 185)

4.5.2 Labour Process Theory (LPT)

The Labour Process Theory conceptualizes how labour, responsibility and skills operate in the workplace to influence organizational outcome (Cooper and Hopper, 2007). This theory perceives labour as a force of internal struggles, conflicts and disagreements; rarely unanimous and often fuelled by a fight for power within the organization (Armstrong, 2000). Hence, generating *"surplus"* from the labour supply is a constant and ongoing process of assessing, acknowledging and allocating resources to the agents that can effect meaningful change to the power struggles that exists among agents (Cooper and Hopper, 2007). The theory disproves the notion of a "smooth organization" with workers all vying to aim and reach to achieve organizational goal in an effective and efficient manner. Consensus, is rarely achieved and the dominant actors will coerce the more modest or unaggressive ones in the struggle for resources (Tinker and Neimark, 1986).

As it relates to risk perception in banking institutions, this theory will advocate junior risk managers, supervisors and risk agents as being in a constant battle to effect change in the risk process, not for the benefit of the banking institution, but for their own recognition and motivation for power and acceptance by senior managers. Therefore, risk decisions are not perceived as an outcome of banking processes or practices but rather a consequence of conflict and power battles for personal recognition and acceptance. This may lead to contaminated risk decisions with unjustified outcomes that could have been different if the process was not bruised by conflict.

Although the theory of labour process explains the workings of actors within the organization, it has been denounced for its inability to explain the conflicts that exists between labour and capital (Cooper and Hopper, 2007). The theory also fails to explain the smooth operations that exist within organizations, where actors cooperate with each other in the interest of improved organizational outcome (Tinker and Neimark, 1986).

4.5.3 Institutional Theory (Old and New)

Old institutional theory views economic outcome as a complicated set of inter-connected variables (like the individual, the organization, the state and social norm) and the power relations among them as a way of explaining organizational or institutional phenomena. Hence, the organization is not understood as a single unit on its own, but in the wider context of its social and technological environment (DiMaggio and Powell, 1983). Old institutional theory proposes the understanding of organizational and institutional outcomes as a result of macro-economic integration of the state, the firm and society (Greenwood et al, 2002). Hence, human behaviour,

reasoning and motivation are seen as complex social actions that cannot be easily understood nor be explained in the context of the institution alone. In the context of risk and banking, old institution theory would explain risk decisions as occurrence dictated by macro variables like regulation, competition and technology. The risk process becomes a mere avenue in which the risk decision is legitimized based on complex individual actions and motivations.

This theory is heavily criticised for ignoring the role of human as the basis for economic decisions and the institutions influence in shaping decisions. For example, a risk manager's action to invest, accept or reject a loan application is not taken in the context of the rules, processes or policies of the individual nor the institution, but rather viewed as an outcome of what external regulation, competition or interest rates might be at the time.

New institutional theory (neo-institutional sociology) conceives decisions, processes and practices as outcomes of one of three (3) possible situations that can explain how institutions develop (Greenwood et al, 2002). Unlike old institutional theory, neo-institutional sociology does not use macro-economic factors to explain institutions or organisational outcome. This theory looks at institutions from a sociological prospective, placing emphasis on interaction and involvement of the organization with society and societal factors (DiMaggio and Powell, 1983). According to this theory, institutions imitate each other and develop similar systems and modes of operations. Emerging in this way would mean that institutions are not *"unique"* in their processes or policies but are rather the consequence of an *"isomorphic"* process. Hence, risk decisions at a particular are made based on the systems and procedures borrowed from other banking and financial institutions in the industry. Thus a diffusion process exists that allows

organizations to disperse information to each other through social interactions of people, organizations and the government (DiMaggio and Powell, 1983; Djelic, 1998).

Another way that neo-institutional sociology explains the emergence of institutions is when some old processes and policies are adjusted or redressed over time to suit the organizational needs, but these are no longer seen as old practices but as a new process with organizational value (Sahlin-Anderson, 1996). In the context of risk and banking, the inclusion of *"total family income"* in the process of deciding whether or not to grant a loan would be perceived as a "new process" rather than an adjustment to the existing one. This is significant in determining changes to the risk procedure as opposed to the implementation of new processes especially in an industry as highly volatile as financing.

Finally, neo-institutional sociology suggests that a third way an organization can develop is by introducing new procedures, policies, systems or order, learnt by interaction with other organisations (Lawrence et al, 2002). This learning process does not occur by imitation but by association and dealing with each other. For example, the decision to accept or reject a loan application by a risk manager is explained by the interactions that he/she had with other risk managers through networks and shared experiences.

New institutional theory recognises the role of agents in shaping organizational outcome and the social environment of the organization (Cruz et al, 2009). Hence a unique mix of structures (practices, policies and procedures) and agents (human interactions, process) are comingled to explain risk decisions at banking institutions.

4.5.4 Contingency Theory

Contingency theory recognises that there may be numerous factors that can act independently or as a network to stimulate the process or dictate how things are done within an organization (Otley, 1980). Hence, organizational decisions are the result of several factors acting as one at the time that the decision was made (Chenhall, 2003). Both external (like regulation, customer needs) and internal (like technology) factors bond together to influence organizational outcome and the balance between the two is dependent upon what best "fits" the organization. In the context of risk, a decision to invest or not to invest in a particular portfolio or to accept or reject a customer loan would be based on the bank's internal criteria for granting or rejecting customer loan; government regulation on capital structure and the current market conditions. Nevertheless, contingency theory ignores the role of human interaction in organizational decisions (Giddens's, 2002). Hence, in the context of risk, the social facet of a risk decision does not exist. Human judgement or interpretation of current market conditions is irrelevant and other social ideals like moral values and trust are not part the risk discourse. Thus, there is no room for reflexive action in any risk decision or no role for micro processes characterised by human judgement (Kunz and Pfaff, 2002)

4.5.5 Agency Theory

The agency theory views organizations as being represented by two main parties; principals and agents. Agents are managers that act on behalf of principals, the owners (Watts and Zimmerman, 1983). This theory assumes that managers do not always act in the best interest of and peruse the goals that are desired by the owners of the organization. In the context of risk and banking, the agency theory would postulate risk managers as making risk decisions that do not best serve the

interest of their customers. Hence, managers transact, invest and make risk decisions on behalf of themselves rather than their 'clients using the information available to them. However, shareholders and customers rely on managers to exercise integrity and prudence on their behalf (Chua, 1986).

Consequently agency theory considers the agents' ill-intentions to transact on their own behalf at the expense of the principals. Thus, managers may be motivated to seek their own gratifications through the decisions that they take (Kunz and Pfaff, 2002). For instance, a risk manager may decide to invest on behalf of his client, not because of the returns that the investment may bring for the client, but because of the higher remuneration that may result for the manager (Adams, 2004). Additionally, the agency theory assumes that the information generated by the organizational system is reliable but not endorsed by both principal and agent as trustworthy (Dillard, 2004). However, managers may manipulate information or rely on information that is not always accurate. This is particularly significant in the context of risk where a calculable culture of measurement is heavily relied on by most U.K banking institutions.

4.6 Summary and Conclusions

This chapter presented some of the fundamental concepts of structuration theory that would be employed in the analysis of the data and findings of this research[34]. Structuration theory has been employed extensively in the accounting literature, especially in management accounting change. The change concept of the theory originates from Giddens ideology that human agent's produce

[34]Not all of the core concepts would be used in the analysis of the findings chapters. Only the concepts that apply to and can be used to understand the context in which the findings is to be placed. Some of the concepts used in the analysis include duality of structure, agency, structural principles and dialectic of control. Some to a lesser extent than others.

and reproduces the social structure constantly. Change happens during this reproduction process. The theory is built on a platform that supports the temperament of a "duality of structure", a notion that agents and structures are inescapably linked and inseparable; Agents build this structure, relies on it and changes it to meet their organizational goals.

The pervasive use of Giddens theory in the literature is credible evidence that the theory is useful in perceiving human behaviour in organizations. Hence, this research employs aspects of structuration to help understand the context in which the findings are to be appreciated. Not all of Giddens theoretical concepts are employed and in some instance a distinction would be made between micro and macro level analysis (within and among the modalities of structuration) of the data.

The theory has been denounced by a number of other social theorists (Archer 1982, Layder 1987, Craib 1992, Gregory 1989, Thrift 1985, Gregson 1989) and used as a building block for other theories (Stone 2005). The strong emphasis placed on human agency in structuration theory gives it a bias accommodation for studying human behaviour in organizations (Roberts and Scapens 1985). In this research, portions of structuration are used to engage the findings and to place it in context of the banking atmosphere.

The next chapter presents the first of two data analysis chapters. In the next chapter, analysis of data from financial statements and other banking documents would be used to engage in a discussion on risk reporting in UK banks.

Chapter 5: Research Methodology and Methods

5.1 Introduction

In the last chapter, I presented Structuration theory as an engine to help sensitise how risk is understood and translated in organizations. This theory is used against the backdrop of an interpretive approach as actors or agents create and transfer meaning to systems while at the same time they interpret and enact meaning from the systems which they are a part of and help to produce and re-produce it (Giddens 1984).

In this chapter, I will outline and explain the research methods that I employed to gather data, how the data was collected and analysed, the challenges and limitations of the methods I used and the ethical issues involved. Since I am using Interpretivism, I used semi-structured interviews to gather my data. Silverman (2008) argues that in-depth interviews are a commendable method of gathering data in social research since it allows and encourages expression, reason and exploration. Mikes (2009) and Whalstrom (2009) also conducted semi-structured interviews to examine risk perception.

The chapter begins with an explanation of the overall research design. Here I would explain the nature of my work and the approach I am taking to help answer the research questions. This research is exploratory in nature and it seeks to answer questions of "how" and "why", hence the method selected (semi-structured interviews) was chosen because it allows for probing and obtaining depth in order to better answer these questions. After that, the chapter explains my research process in terms of how I conducted my work, the time it took and the experience of the

journey. My sampling procedure is discussed after that and here I outline who the participants were including a brief summary of their profile and why they were chosen.

Access to data is paramount to any research as it is the blueprint for reporting any results from empirical research. The next section will discuss how I got access to the participating banks, the interview process including the approximate length of the interviews, the recording process and the documents that I was allowed to examine at the interviewees' premises and those that I was allowed to leave the premises with along with the confidentiality issues or concerns of the participants and how these were addressed. The section that follows data access, deals with data collection and in this section I outline how the interviews were conducted, how I recorded the data I obtained and the process of transcribing and translating the data. Here I would also include a discussion on the kind of documents I received from the participants and the information they contained. The data analysis section follows and here I would outline how the information I collected was scrutinized, coded and interpreted. This section also includes a discussion on the financial statements examined, why I examined them and how the findings would be related in the chapters that follow.

Ethical issues are important in social research and in the next section, issues of ethics, including trust, honesty and confidentiality are considered. Here I would relate my obligation as it relates to the integrity of the information reported, the storage of the data collected and the ethical permission granted to conduct this research. Banking institutions possess highly sensitive information and so issues of confidentiality are crucial. The assurance of privacy given to the participants would be discussed in this section. Similarly, there were several challenges

encountered while conducting this research exercise and although social research on risk is valuable, it has to be taken in context and can be limited beyond a certain scope. In the section that follows, I discuss the challenges I came across and the limitations of this research. Finally this chapter ends with a brief summary and conclusion.

5.2 Overall Research Design and research process

This social research explores risk management and perception in UK operating banks. Social research usually answers two essential types of questions; what is happening? And why is it happening? Whitley (1984) argues that exploratory research falls into the context of how and why a particular phenomenon exists. This research also addresses the question of how is it happening? The overall design of this study takes into account the research questions that are examined and the methods used to obtain the data, the data analysis process, the banks that were selected and how access was obtained. Each step taken builds on a process leading to the findings that are presented and discussed. Ethical issues are also considered since ethics is the cornerstone for trust, confidentiality, honesty and truthfulness that is crucial in research in order for the findings to be reliable and meaningful.

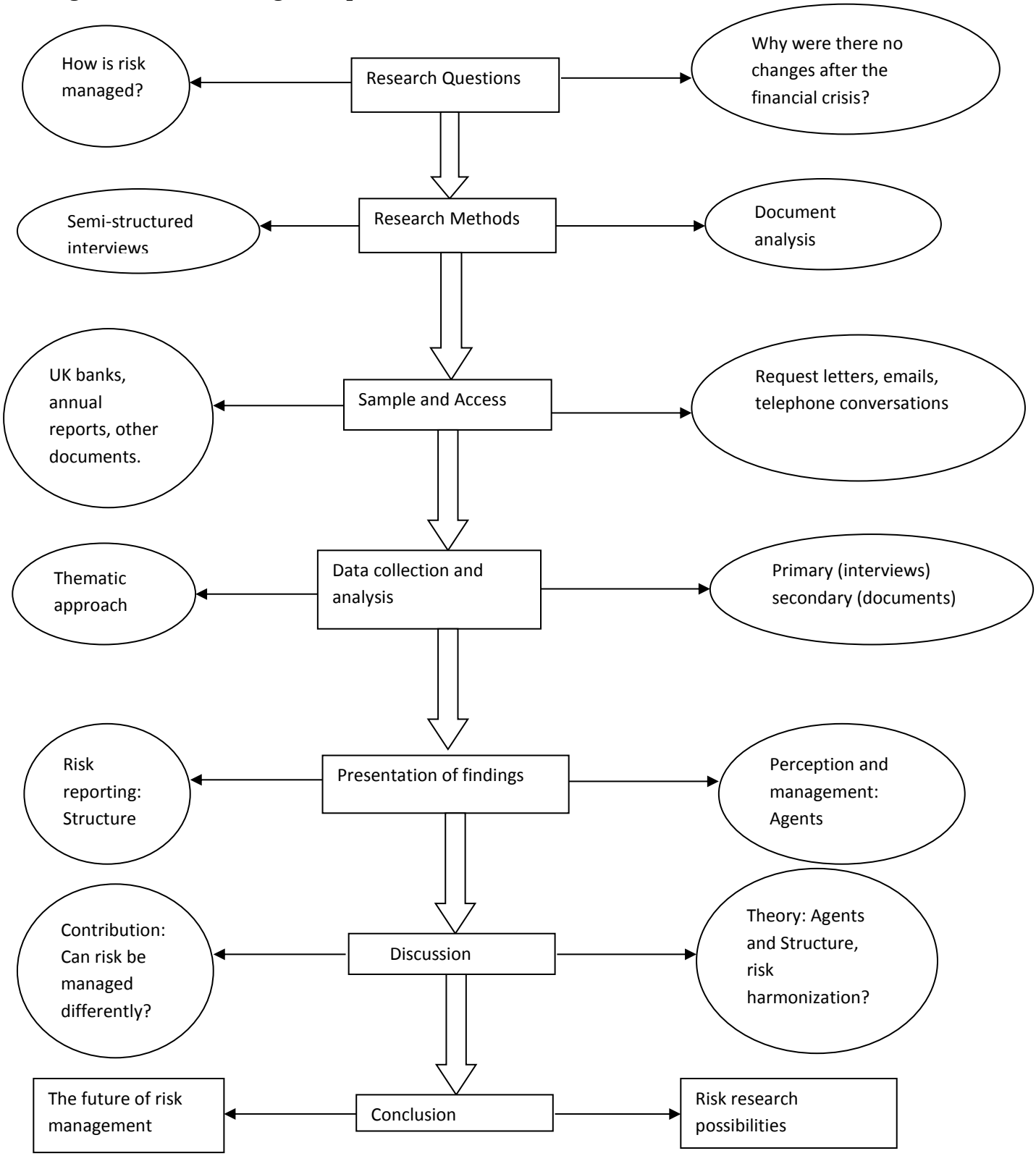
This research resembles a case study approach but not in its entirety. There are a total of five (5) banks that participated in this study and two of them are examined, discussed and presented separately. This bears similarity to a case study since the data collected from each of these two banks are discussed independently but contrasted for similarities and differences in approach, especially as it relates to how the agent and the structure interact or rely on each other in particular situations (examples of this is given in chapters 6 and 7). However, the other three

banks are discussed together for the most part. The rationale used for this approach is the varying sizes and amount of banks that are a part of this study, and the similarities in approach to risk among the smaller banks. It should be noted, however, that although Banks A, B and C are presented in the analysis together, each has their own unique story and not all aspects of risk management are similar in these three banks.

Since this research seeks to explore risk in a particular context (banking institutions) the approach taken and the findings that result are not to be interpreted as a prescription for any deficiencies in risk or risk management, but rather as a way to appreciating the possibilities of other approaches to risk that may exist. The opinions expressed by the participants are their own ideas and suggestions based on their personal experiences and positions and are not meant to be representative of all risk professionals or experts. The interview questions were designed to encourage the flow of a particular set of information about risk that addresses the research questions of this study. Hence, not all aspects of risk or risk management are engaged or discussed in this project.

A full list of the interviews conducted is included at the end of this chapter. A flow chart of the research process follows.

Figure 5 Research design and process:



5.4 Sampling procedure

A total of twenty five interviews were conducted across five different banking institutions that operate in the UK. Each of these banks was of different sizes, but two of these were much larger than the other three. Glass bank and Penny bank were the larger banks. The other three smaller banks referred to as Banks A, B and C are much smaller in operations and capital structure. Glass bank began operations in the 1600's and grew rapidly through amalgamations, mergers and acquisitions. To date, the bank has approximately 140,000 employees worldwide, an asset base of 1.3 trillion pounds and annual revenues of close to 30 Billion. Its main operations consists of investment banking, commercial and retail banking and wealth management. Penny bank is smaller but considered a large bank with over 16,000 employees and annual revenues of over 10 Billion. The bank also grew over the past decades by merging and forming strategic alliances with partners throughout Europe and the UK. Banks A, B and C have similar stories to each other; each has one branch in the U.K with their head offices outside of the UK.

The five (5) banks were not exclusively chosen. Invitations for interviews were sent out to several banks and the ones chosen were the banks that had risk officials who were willing and interested in discussing my research with me. There were two other banks that were also willing to give me interviews initially, but subsequently cancelled. The process of securing and attending interviews was a long and tedious one, but the interviews themselves were interesting as different perspectives on risk and risk related issues were fleshed out and deliberated. In most cases, only senior risk officials participated in the interviews and on two occasions, junior risk trainees/officials were allowed to observe and listen but not given permission to answer any of the interview questions or to actively participate in the process. This may have been because of

the perception that the knowledge of the trainees was not concrete enough to engage in an in depth debate on risk. Both small and large banks were chosen to explore possible variety in perception based on size.

The interviewees consisted of senior risk officials, branch managers, a personnel manager, deputy manager, and in the case of the smaller banks, a general manager. Each had some level of competence with the issue of risk either from their current position or from their past posts. For example, the personnel manager from Penny Bank was a credit supervisor before who has extensive experience in credit risk management, lending and supervising employees. Two of the branch managers at Penny bank were former risk supervisors at Glass bank. Each participant agreed and was ready to engage in a conversation with me on risk after receiving a copy of the possible interview questions. The years of experience played a major role in the participants' knowledge and position in the company. Although qualifications were of merit, interviewees frequently referred to their personal experience during the interview as their base for their opinion and reason.

Secondary data also forms part of this study. The secondary data was drawn from the documents of the banking institutions that are a part of this research. The documents analysed include bank annual reports, sustainability reports, Basel exposure drafts, letters from CEO and other banking officials, bank of England public releases and the (then) FSA risk reports. These documents were selected because they contain the views and opinions of banking officials that are a part of their perception. In addition, the financial statements that are contained in the annual reports are a socially constructed register of accounting meaning maintained in a knowledge structure that

legitimizes accounting procedures and processes (Rutherford 2003, Haigh 2006). Thus, the analysis of such reports is pivotal in understanding the concept of risk that is enacted as an important part of informing stakeholders of the banks' risk approach.

As previously stated, several documents were analysed. However, the majority of the substance in the discussion that follows is from the annual reports. In all of the participating banks, the risk report is an integral part of the annual report. This, according to one branch manager, is to present the concept as an interspersed acumen, central to other functions and operations of the bank:

> "*Here at (Penny Bank) we do not have a separate risk report. It makes no sense. Risk is an integral part of our function as a banking institution, it is central to what we do. Our financial performance depends on the risks we take so it would undermine our goals not to combine risk as part of our annual report. Risk is not a separate thing that happens in this bank. It is part of all our functions"* (Branch manager, Penny bank).

Hence, the annual report of Penny bank (and of the other banks) is central in obtaining the socially constructed risk ideals of the bank managers.

The annual reports analysed span a period of four (4) years (2006 to 2009). This period was chosen to gain insights into the reporting of risk before the financial crisis and to evaluate financial crisis changes (if any) to the report. All of the annual reports analysed were published, public documents.

5.5 Access

This research explores bank managers' perception and management of risk in UK banks. I use an interpretive approach to examine and probe deeper into the issues surrounding risk perception and management. In order to get the information required, I conducted twenty-five (25) semi-structured interviews. Access to banking institutions for the purpose of conducting research can be very difficult to obtain. The entire process from initial contact to the completion of the interviews took approximately eighteen (18) months. I began my access plan by researching banking institutions in the UK, searching their websites, noting the risk personnel and designing a letter outlining my research plan and requesting an interview. Before my request letter went out to the various banking institutions, I also liaised with persons who were either working at or had a working relationship with banking personnel in an attempt to secure interviews.

Initial contacts were made and some interviews were conducted by using personal contacts and friends and associates that knew some of the banking professionals. These interviews were not sufficient and they did not produce more interviews as I had imagined. Eventually, I sent out the request letters (a sample is included in the appendix) and the replies were slow but favourable for the most part. Overall, I was able to secure twenty-five (25) interviews, with twenty of those recorded with a voice recorder and the other five not recorded.

The banks selected all had operations in the UK and this was the main criteria for selection. Requests for interviews were sent to the six (6) largest UK operating banks and ten (10) small banks. The banks that gave me access included two (2) large banks and three (3) small banks.

Most of the interviews conducted were with risk personnel, but on some occasions non-risk specialists like human resources manager and operations manager also spoke with me and shed light on their areas of operations and their perception of risk.

Each interview lasted for approximately one hour, about twenty minutes longer than expected. In some cases interviews were as long as ninety minutes and in other cases as short do thirty five minutes. Most of the internal documents that were given or shown to me had to be examined on site in the presence of the interviewer, except in one instance where I was allowed to take the document with me because the information contained did not pose a confidentiality issue to the bank. After each interview, I would ask about the possibility of a follow-up interview and if there were any recommendations as to whom else I can talk to in that bank regarding the issue of risk.

There were no restrictions on the kind of questions that I was allowed to ask as long as they were professional and within reason of my research. However, on some occasions, (on 3 occasions) the interviewee informed me that he could not disclose such information because of confidentiality reasons. For example, questions on the institution's risk framework or model followed for decisions seem particularly uncomfortable for some participants.

None of the participating banks requested to see my transcript nor did I promise to reproduce it to them: however, in return for the interview all participants were promised a short report of my findings. Participants were informed of the intention to publish my findings and were assured that anonymity and confidentiality would be maintained

5.6 Data collection

A total of 25 interviews were conducted. 30 Interviews were scheduled but some were cancelled by the interviewees. Time constraint was the main reason why some interviews were cancelled. Two interviews were cancelled because the participants changed their decisions and decided not to discuss risk management or perception due to confidentiality concerns. All interviews were conducted at the participants' place of work. Interviewees were not given any other places as options for conducting interviews and agreed to be part of the interview process at their places of work. The location of interviews included branch offices and head offices. Participants were given a copy of prospective questions although these were not exclusive. As the interviews were being conducted, other questions arose that seek to probe and explore in more detail the issues that surround risk. Gill and Johnson (1991) argue that semi-structured interviews allows for deeper investigation as new but related questions can arise from the pre-set ones based on the discussion at hand. This research was no exemption. For example, one pre-structured question asked about how important is understanding risk before making a risk decision; other spin-off questions were, why (the factors mentioned) are so important, and whether or not the participant believes that it has a real impact on the risk decision[35].

Each interview varied in length. The longest interview was close to 2 hours and the shortest was approximately 30 minutes. The average time of the interviews was one hour. This is twenty minutes longer than was expected. Participants were informed that each interview would be

[35] The follow-up questions to the main pre-set questions were formulated and asked at the time of the interview in an effort to get more detailed information. They were not previously known to me or the participant. A list of the pre-set questions is included at the end of this chapter.

about 40 minutes long in the invitation letter (Sample in the appendix). The questions discussed in the interviews were designed to obtain information that addresses the research questions. Hence, questions of how and why were mostly at the forefront. These questions help to explain the phenomenon (risk) and the reasons why risk is perceived and managed this way. Other questions did address the issue of what; for example, in exploring the types of risks that are of importance to bank managers, the question of what was used.

All interviews explored the same questions with and generated similar discussions with all participants. Risk perception was the main topic of discourse. Credit risk is the risk of primary concern. Credit risk is crucial because it encompasses influences and affects default risk, liquidity risk, operational risk and reputational risk. Credit risk, to most banking institutions can determine the organization's success or failure. It has been used as an indicator for bank performance and in some cases, future outlook for market performance (Buckley 2011)

All interviews were recorded except for 5. The five interviews not recorded were as a result of confidentiality issues with the participants. Interviewees did not want to be kept on record taking a particular point of view and were not convinced that the material collected would be adequately safeguarded and that privacy was not at risk. Although all interviews were recorded, notes were still taken. The notes were taken as a back-up to the recorded conversations and in instance where there were no recordings, the field notes were used as the primary source of data. Even in instances where the conversations were recorded, the field notes were scanned for main points/ideas that addressed the research questions.

Some of the participants gave me access to company documents. These included public financial statements, quarterly reports, sustainability reports and special risk bulletins. Only two participants gave me access to their company's official risk frameworks, and in all instances, I was not allowed to leave with it nor take a copy. I could only memorize it since participants requested that I did not take any notes or draw any images to keep on file that might resemble a part or their full risk framework. A copy of the risk framework was requested from all participating banks, but due to confidentiality issues the other three participating banks did not grant me access to their risk framework[36]. The framework is important in understanding how the bank manages risk; what aspects of the risk decisions are based on the structure and how much freedom the agent (manager) exercises in executing a risk decision; the risk framework is also important in exploring different approaches to risk. Other documents were examined at some of the banks where available and with the participants permission. These included risk memos, diagrams and other literature on risk. I was only allowed to leave with documents that were available to the public or those that were included in the company's annual reports. Not all of these documents were pertinent to my research questions, but in some way they helped to formulate and construct ideas on how risk was being managed at the banks, the role of the structure in place and the interaction of the agents (managers) with the structure.

[36]The risk framework reoffered to here is in reference to the company's official risk framework. Parts of the framework were available in some instances from the company's annual reports. Penny bank gave me access to part of its framework but I later discovered that it was also available online and in the company's annual reports.

5.7 Data analysis

The data collected was analysed using a thematic approach. Under such a method, information containing similar themes are grouped together, as 'codes' then streamlined for the main findings. Richards (2009) argues that this approach to data analysis is significant in social research that can sometimes be highly subjective. The codes or themes used form a basis for the main ideas for discussion. After the data was collected, it was transcribed and reviewed several times. First each participant's answers were reviewed separately, in order to get the substance of the main ideas expressed by the participant. At this stage the themes identified were words or phrases that defined the main ideas or the gist of the participant's replies (Auerbach 2003). These were then reviewed again for particular themes that reflect the research questions (Edwards and Lampert 1993) For example, as it relates to research question one, that explores the participants perception, codes or themes like "views", "opinions", "judgements" and "impressions" were identified. Other themes like attitude, belief and conduct were identified in addressing relevant data that supports this research question.

After the data was coded into themes, the major themes were encircled and placed on a 'mind map'. This map enabled me to see all the major themes that emerged from the data and further streamline them if needed. It also allowed me to group themes of similar tones together. Arranging the data in this way was done individually for each participant at first. The next step was scanning my field notes for words, phrases or sentences that reflect the themes identified by each participant. For example, words like *objective, subjective, truth or unbiased* support the theme that expresses the perception of risk (views, opinions) while calculation, constructed,

mathematical programs; non-sociable and detached from society all reflect attitudes toward risk management. Other themes identified related to the banking structure and changes before, during or after the financial crisis. Coding the data into themes is important in gauging concepts and opinions from interviewees in social research that is highly subjective (Friese 2012). The drawback to this method is that it is a time consuming process and it can be difficult identifying the key themes that relates to your research (Fionn 2005).

With the mind map now coded into themes and the data organised into these themes, I was then able to bring the maps together and search for common expressions. These were identified and separated particularly for developing my findings. Although common themes were drawn from the responses, the findings are presented with the recognition that each executive is unique in his expression, a concept supported by social constructivism (Rutherford 2003).

5.8 Ethical considerations

Ethics plays a key role in the research world and the treatment and behaviour of human beings in social research (Kvale 1996). For this study, an ethics form was filled, and signed by myself and approved by my institution, granting me permission to undertake this study. This form is a binding, legal document that requires me to confirm and attest to the rights and treatment of participants involved in this study, including the treatment of information and collection and storage of data. In addition, all participants were given the assurance of confidentiality and anonymity of this study. The study was conducted in adherence to high levels of ethical standards and all the information presented are a true reflection of the views expressed by the individual participants.

This research is not intended for any publication outside the scope of the information gathered. Participants were also informed that no person nor company name would be revealed in any form, nor would any information that can cause the identification of the company be revealed. Given the highly sensitive nature of the information that the banking industry possess, participants were also assured that any information revealed to me whether directly pertinent to this study or not, would be completely confidential. Each participant agreed to an interview with the assurance that there is mutual trust between us and it is not my intention to violate this trust.

All interview notes, scripts and transcription notes are kept by me in a safe location, to which I alone have access. The participants' names are not written or found anywhere on these notes. The names of the participants and their companies are not kept on record and will remain anonymous. In some instances (on 5 occasions), the participants did not agree to a recorded interview for fear of being kept on record for expressing a particular view that might become controversial. Assurance of confidentiality and integrity were not enough in there instances to convince the interviewees that a recorded conversation would be more beneficial to the research results.

Overall, there were no issues of concern as it relates to ethics that compromised the research process, the integrity of the information, the confidentiality of the participants or the overall credibility of the research. An informed consent form which bears my signature was presented to each research participant, as a precept of my commitment to the confidentiality and treatment of the information collected. The forms were signed and retained by the participants to give a more

comforting assurance of anonymity. Not all participants accepted or signed the form. A copy of this form is included at the end of this chapter.

5.9 Challenges and limitations

This study is not intended to make generalizations about the views expressed. The opinions and views obtained are unique and applicable to the managers and executives studied in their companies and do not express the opinions of all executives in all banking institutions in the UK. These viewpoints may or may not differ in different banking organizations across the UK.

The beliefs expressed in this investigation are not meant to be taken as a rolling forecast for the future. With time, the opinions and views of the participants may change. Hence, this research should not be used as a guide to understanding the perceptions of banking executives ten years subsequent to when this research was first conducted. Nevertheless, although the information gathered is relevant and applicable at the time that the research is being conducted, it may provide some groundwork to build on in the future.

Interpretivism explains this research as a means to understanding human behaviour in organizations. If studied using a different approach (like positivism, for example) the results presented may be entirely different.

This research recognises the influence of my own opinions and views in the construction of the data and the presentation of the findings. My personal feelings, judgement, attitude and thoughts are embedded in the research process and the presentation of the results. Although, I did not

explicitly express these, Bryman and Bell (2003, 2007) argue that they are included in my choice of words, sentence construction and tone. Hence, this research is much a reflection of what I think (indirectly) as it is what the participants think (directly).

All of the interview questions were given to the participants prior to the interview. As a result, participants had enough time to prepare, formulate or compose answers and recite them on the day of the interview. Hence, their expressions and opinions on risk perception may have been a learnt import rather than what they thought risk perception is at the time of the interview. The effects of this, however, was mitigated (in some ways) by follow up questions that arose at the time of the interview and to which the interviewees were not previously exposed. Additionally, all of the interviews were conducted at the participants' place of work. This may have had an effect on the opinions expressed. If interviews were conducted away from their place of employment, then perhaps the participants would have felt more comfortable or relaxed to express their view more freely.

Travelling to and from different offices or branches of the same bank located extremely far from each other was tiring and exhausting. Another challenge for me was taking notes while the participant was relating his or her opinion, especially in the few cases where no recording was allowed. Often times it was difficult and asking the participant to speak slower or to repeat for recording purposes was most times futile. Although all of the interviews were conducted in English, it was sometimes difficult to understand the accent or the articulation of the participant and this posed a challenge during transcription; I had to listen to the same sentence repeatedly, which was time consuming.

The biggest challenge that I encountered during this research was securing interviews. This was a very long process that lasted close to two years. Although only twenty-five (25) interviews were conducted almost twenty-eight (28) were scheduled: the rest were cancelled. Some of the risk officers were willing to meet with me but their supervisors were not in agreement. In other cases, time restraint led to cancellations and in other instances, the participant had a change of mind-set and did not want to do the interview anymore. It was difficult to secure even 25 interviews over two years. Nearly 60 requests were sent out to almost every bank operating in the UK.

Despite the challenges and limitations, this research has been a rewarding experience and I have learnt a lot about conducting social research and reporting results.

5.10 Summary and conclusion

This chapter has presented the research design for understanding and exploring the concept of risk perception and management in UK banking institutions. This research adopts an interpretive approach and uses semi-structured in depth interviews to obtain information from bank managers and executives about risk. This method (semi-structured interviews) presents an opportunity for detailed discussions, probing and exploration of the concept of risk, which can lead to a better understanding of how managers perceive risk and why their perception remains unchanged.

Five (5) banks participated in this research exercise. Two of these were very large (in terms of capital structure, worldwide operations and net assets) and the other three banks were much smaller in operations and resembled localized operations. The interviews conducted lasted over

an hour on average, and the participants were selected because they were willing to have a conversation with me about the topic and were all risk related professionals. It was a challenging, tiring and long process securing interviews but once this was done, participants were assured of the highest levels of confidentiality and presented with an informed consent form as a means of re-assurance of the high standards of privacy with which the information would be treated.

All of the interviews were conducted at the participants' place of work and this was because of convenience and comfort both for the participant and me. A total of twenty five interviews were conducted and most were recorded. During the interviews, notes were also taken even when the interviews were being recorded. Once all the information was collected, the data was transcribed, coded and analysed. No software programme (like Nvivo) was used in the process that made it time consuming and at times pain staking. The results of this analysis would be presented in the next two chapters.

Ethical matters were also considered in this research process and permission was granted to conduct this research. This permission spells out the treatment of humans and confidential information as part of this research, mutual trust and integrity. These standards were adhered to throughout the entire process and this research has been conducted with the highest standards of morality. As with other projects, I have encountered challenges along the way and recognize that this study has limitations. Some of the challenges that I encountered included securing interviews, exhausting travel distances, not being able to record all of the interviews and having to rely on field notes in some instances. As it relates to limitations, it should be noted that this research is not intended to make generalizations about risk perception or management in all UK

banks but rather it can be used as a gauge for understanding risk in the context of the institutions that participated. In addition, although the results of this research exercise can be used as an indicator for the future, it is not a blanket for the future of risk since perception changes from time to time and another study employing the same method may produce different results in the future.

The next chapter is the first of two findings chapters and presents the results of the data that were analysed from annual reports and other documents.

Chapter 6: Risk Reporting in UK Banks

6.1 Introduction

The philosophical assumptions that underpin social research is paramount in conceptualizing and analysing data (Sarantakos 2005). The last chapter presented a discussion on the research approach in which the philosophical doctrine that serves as a gateway for discerning and contextualizing social research is placed. This research employs a qualitative approach, using Interpretivism and aspects of Giddens structuration theory to help understand banks managers' perceptions and actions as it relates to risk perception and management in UK banks.

This chapter presents the opinions and perceptions of bank managers documented in risk reports, financial statements and other company documents[37]. The views expressed take both qualitative (written words) and quantitative (expressed in numeric form) schemes. Risk reporting involves the disclosing of risk and can be affected by company size, company policy and type of risk exposure (Linsley and Shrives 2006). This chapter discusses risk reporting in the face of the financial crisis that struck global economies over the last few years and begins with an examination and discourse on risk reporting before the financial crisis. Risk in this era was mostly characterised in numeric form and risk reports featured substantial figures, backed by sophisticated computer programmes that determined future outcomes based on estimates.

Regulatory guidance on how banks should report risk enters the discussion next followed by evidence from Penny bank and Glass bank reports. A (slight) move away from the number

[37]Other documents in this case refers to pamphlets, magazines, booklets, sustainability reports and substitute risk related reports that were obtained from the participating banks during the interview process. Most of these were available publicly to shareholders and other prospective investors. While most of these were given to me, I was allowed to examine others on the premises only.

oriented representation of risk to include (other factors mostly ignored before the financial crisis) is noticeable in the financial reports (especially at Penny bank), hence other aspects of risk and other ways of understanding risk after the financial crisis is discussed next. These new ways of perceiving risk were not without regulatory influence and so this chapter comes to a close with a debate on the role of regulation in risk perception, particularly in guiding banks through the risk reporting process.

6.2 Risk reporting before the financial crisis

Historically, risk decisions have been based on a more measurable, calculable approach (Slovic 1987 Moyer 1990, Treacy and Carey 2000, Millo and MacKenzie 2009, Gilles et al. 2013, Wang 2013). This perception of risk presented the notion that enterprise risk management and risk processes can be adequately addressed by making certain the uncertain future through estimates and programs based on past trajectory (Slovic 1987). This view of risk gained traction and popularity mostly on the basis that it better reflects and explains market transactions and can provide a vehicle through which returns can be systematic and satisfy investor requirements. Nevertheless, critics (Wildavsky and Dake 1990, Renn 1998, Power 2007, 2009, Mikes 2008, 2011, 2013 and Wahlstrom 2006) have since cautioned that the exclusion of other factors crucial to a holistic approach to enterprise risk management may undermine the wider scope in which risk decisions are contextualized. For example, Mikes (2009) argues that the implementation and integration of risk strategies throughout BoFIs' needed for a holistic attitude, and the attainment of an acceptable risk appetite may not be explained by the calculable processes that some large financial institutions rely on. There is little evidence from risk records[38] that risk coverage

[38]By risk records, I am specifically referring to risk documents examined (including financial reports), that were made available to me by the participating banks and from my own research. Most of these were more current and

through reporting engaged in a discourse that presented or explained risk as a process or series of activities integrated with human action. In other words, risk systems, were limited to the mechanisms that were involved in producing estimates of future events, and not as an integrated network of human activities comingling with organizational structure. Giddens (1986) duality of structure appears to be absent, as a way of understanding risk decisions, from the discussion that surrounds risk in these reports before the financial crisis.

Despite concerns of the demerits of perceiving risk as a narrow and exclusive calculus, risk decisions and enterprise risk management maintained a prescriptive quantitative appearance that was encouraged by regulation and experts (Woods 2011, 2012). Before the financial crash, reporting risk emerged as a unified method of estimation supported by uncertain guesses that were legitimized in market operations and results (Arena et al. 2010). Little room was left for flexibility of thought in interpreting risk reports that were uniquely tailored to address relevant information supported by the Basel committee guidance (Linsley and Shrives 2009). For example, capital risk was reported as a particular percentage of capital structure, further divided in different types of capital.[39] Hence, it was easy to measure or change capital risk by adjusting the capital base. While this is important for presenting and ensuring strong capital roots, it does very little in explaining how absolute size of capital adequacy, may be relevant in determining how robust the capital structure is. In other words, there appears to be a lack of social discourse,

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presented risk reports after the financial crisis. However, some were documentations before the financial crisis (Between 2001 to 2006).

[39]The Basel committee on banking supervision gives specific guidance on what kind of assets are to be reported in which category of capital. Tier 1 capital, is perceived as the bank's "core" capital assets but other categories include cyclical capital and capital buffers.

as a way of presenting or disclosing risk before the financial crisis. This is evident from the annual report (2001) of one of the participating banks:

> *"The bank's risk management policy is designed to identify and analyse credit risk, liquidity and market risk, operational risk and other risks, to set appropriate risk limits and to monitor these risks and limits continually by means of reliable and up to date administrative and information systems. The bank continually modifies and enhances its risk management policies and systems to reflect changes in markets and products. Training, individual responsibility and accountability and a disciplined cautious and conventional culture of control lie at the heart of the bank's management of risk"*
> (Annual report 2001 p. 96)

The reliance on the market as a guide to handling and negotiating risk outcomes is palpable from the banks' annual (2001) report. Managers, executives and risk professionals, adjust, adapt, manipulate and modify the risk policies and systems in place to reflect changing market conditions, using current available information captured by the bank's *"administrative and information system".* This market-oriented approach continued for (other bank) after the financial crisis. Changes to the bank's risk process were minimal and slow. This is in striking contrast to Giddens (1986) theory of change in a crisis situation. Giddens (1986) asserts that changes to the structure or to the system are evolutionary because they are relied upon and become established as authentic. However, when a crisis situation arises that challenges the foundation of the system or exposes its falsehood, then the old structure is abandoned and a new one emerges that becomes routinized as the new genuine and legitimate system. According to

Giddens (1986) this change is sudden and revolutionary and is part of the production and reproduction of the social system (see table 4.2, from chapter 4). It must be noted, however, that Giddens (1986) was referring to social systems and this particular bank does not believe that risk can be understood as a social construct. This suggests that the concept of social system change, may not be operationalised outside of an environment that is not social (Latour 2005, 2007). In this particular situation, the complexities and resources required to accommodate a revolutionary modification, would be tremendous.

6.2.1 Reporting and the risk process

As outlined previously, the epitome and the perception and management of risk are not always represented by a well-balanced or stable system that follows a smooth process which incites a desired outcome. Although managers and other risk professionals may exercise due diligence, it is inherently difficult to envision all possible risk outcomes especially in the context of a global financial market, where aggression may be required to respond to increased investor demands, changing market needs and heightened competition (Baker 2003). Hence, risk decisions are operationalised as simple mechanisms that are embedded in a series of complex heterogeneous situations, not always captured by the risk process. (Fischhoff 1981), argues that sometimes making a particular risk decision may involve not deciding at all because choosing among alternatives would require an elaborate explanation of each particular aspect and rationale for not electing to take a different path. According to his argument:

> *"Before they can be resolved (risk) decisions must be defined. That process involves deciding whether a decision is to be made at all, and if so, what options and*

consequences are to be considered. The terms of the decision must then be further elaborated into operational form. Each of these predecision decisions can affect the choices that emerge, so much so that the outcome of the decision process may already be determined once its ground rules have been laid" (Fischhoff 1981, p 14)

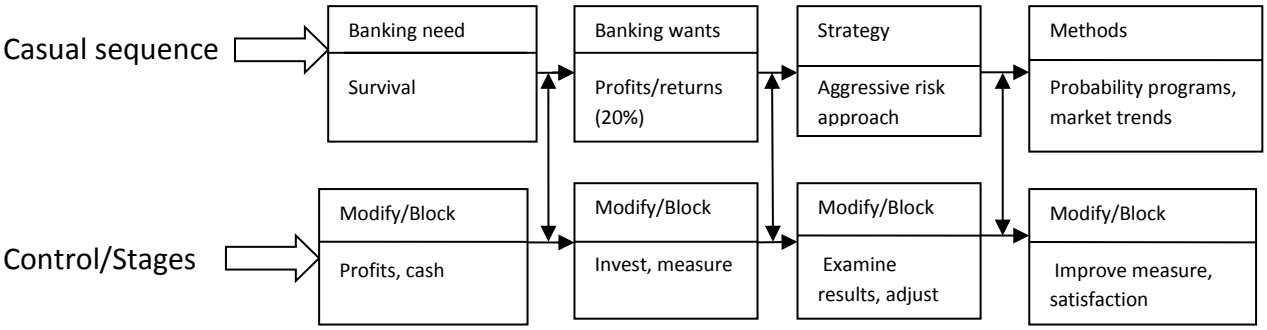
Although Fischhoff's (1981) remarks were in a broader context of acceptable risk behaviour, he outlines some of the crucial elements involved in the decision making process that seeks to realise or attain the optimum output from risk resolutions[40]. Wood (2012) and Mikes (2009) express similar sentiments, declaring the risk process (especially in ERM) as an evolutionary exercise that represents a series of reflexive actions and corrective activities designed to achieve organizational outcome. These actions are often chosen after careful examination of all (or most) available alternatives based on the objectives or risk strategy that the organisation is perusing. The presentation of the risk process as a set of structured activities that follow a particular order was also manifested in communication with a manager from one of the participating banks:

"First you must realise that there are different risk policies for different risks. There is a framework; an operating plan that is mostly stable but evolving slowly. The focus is on maintaining and improving risk so we are constantly evaluating, modifying and changing, not the entire process but small aspects of it to make it more efficient and to help improve the quality of the risk decisions that we make" (Manager, commercial credit operations, Bank A).

[40]Fischhoff (1981) was not referring particularly to risks that affect banking enterprises. However, the risk decision making process that he described was mirrored by some of the managers and risk experts at the banks participating in this study.

Revisiting the risk process and making changes (however small) in an effort to improve it and reflect market activity is vital to the advancement and success of the risk environment (Fischhoff 1981). Figure 6 (reproduced in part) presents Fischoff's diagram of a simple risk decision process and the stages involved.[41]

Figure 6 – Part of the risk decision process



Adopted from Fischhoff and Slovic 1981 p 11

While it is important to recognize the role of changes and adjustments to the risk process as a continuum, it is surprising that reporting risk seems to be absent as an integral part of the risk process.[42] From all interviews conducted, bank managers outlined the risk process as a sequence of structured events that are visited and revisited throughout, before a final decision is made. Reporting the results of these transactions, did not register as a pivotal part of the process itself,

[41]The diagram presented in figure 6.1 is a modified version to Fischhoff's original representation. It was adjusted to reflect a financial risk decision. Fischhoff's version presented the risk of ultimate death.

[42]The full version of Fishhoff's diagram on the risk process did not include any aspect of risk reporting. From all the interviews conducted, only one participant included risk reporting as an integral part of the process. Most participants recognize risk reporting as separate and distinct after the risk decision is made. Also, this diagram is an adaptation of the original one. It has been adjusted to include banking institutions, specifically. The focus here is on the process.

but rather as an external epilogue, that sums the results of the decision made and informs stakeholders of the outcome. A branch manager at Glass bank explained how the risk process works at the bank:

> *"We have a risk framework that guides us, this informs our operating plan and to ensure that it is effective, we stress test it as needed. Before we make a decision to invest, for example, or to lend we examine the plan. What percent return are we looking for? We manage credit risk on a daily basis so if we want a 10% return, can we lend at a 10% interest rate? Can we lend higher? Should we go a bit lower for this particular situation? What are the market trends? Do we need to make a small adjustment to our operating plan to accommodate this customer? The process stops with the decision to lend or not to lend. We make changes as we go along and use the numbers to guide our decisions. We can't just guess, and we can't always rely on judgement or experience because there vary from person to person, but the facts in the numbers are solid"* (Branch manager, Glass bank)

Albeit, the risk decision process is perceived by banking experts as the actions that lead to an informed risk decision and that risk reporting appears to be obscure as a functional part of the procedures, bank managers inadvertently recognize the significance of narrating to investors through annual and other risk reports. Possibly, the absence of reporting as an intertwined element of the risk process, presents an opportunity for further discourse on enterprise risk management. Glass bank, was an exception, and identified reporting as an essential part of its risk atmosphere. According to the manager of risk strategy:

"Our process for risk is unique and it is tested often to ensure that we are on track. This has become more important especially since the financial crisis and we have strengthened this process. We have to assess and re-assess; we have to control it and report it. It is all part of our central framework that gives us direction on our risk decisions. We also have to report this. Not just to our investors but to each other, in a chain of command. Sometimes a decision has to be made that does not fit our model. What do we do in this case? Experience helps but we rely on the numbers to tell us what should be done". (Director risk strategy, Glass bank).

As discussed earlier, Glass bank takes a more numbers-related approach to managing risk, but the inclusion of risk reporting s part of the decision process was also mirrored in their annual reports. .

6.2.2 Risk priority

It is inevitable to include a discussion on the importance of prioritizing risk, especially in a climate of many alternative routes to risk accord and limited resources as mentioned in the argument above. The importance of making a solid risk decision can have repercussions, not only for market operations but for individual wealth and survival as was evident by the financial crisis that began in 2007. Hence, managers and other risk experts must constantly evaluate and scrutinize all feasible options relating to decisions on enterprise risk management. This should include not only discretions that affect the quality of the decision taken (through the risk process) but also the type or kind of risk itself. Most financial institutions (especially banks) rely on a

system that is perceived as relatively stable and hence has become routinized overtime (Giddens 1984). Although changes are necessary, these changes are not usually radical except in a situation of acute crisis (Giddens 1984).

To rely on a stable system, in the context of risk management would suggest that this system has been tested and proven to be the most feasible among the available alternatives (Fischhoff 2012). Bank managers in reporting to investors, seek to vouch for the stringent process in order to lend assurance to investors and lure prospective customers. Since there are different types of risk to manage, and resources are limited for each, it can be a challenging task allocating these resources to the different risk processes. Therefore, assuring stakeholders that the best options were exercised may be manifested in the reporting process. During the interview process, most managers revealed that credit risk, market risk, capital risk and liquidity risk were among the most crucial to the survival of the bank. This is evident from one of the participating banks' annual report:

> *"All of (the bank's) activities involve analysis, evaluation, acceptance and management of some degree of risk or combination of risks. The most important types of risk are credit risk (which includes country and cross-border risk), liquidity risk, market risk, residual value risk, reputational risk, operational risk, pension risk, insurance risk and sustainability (environmental or social) risks. Market risk includes foreign exchange, interest rate and equity price risk"* (Annual report, Other bank, 2006 p 176)

Glass bank also reported the risks that are most paramount to the company's operations in its 2005 annual report:

> *"The (Bank's) Risk Appetite sets out the level of risk that the bank is willing to take in pursuit of its business objectives. This is expressed as the bank appetite for earnings volatility across all businesses from credit, market, and operational risk. It is measured against our broad financial targets, including income and impairment targets, dividend coverage and capital levels"* (Glass Bank annual report, 2005 p 22).

Glass reports its principal risks and its shareholders and investors in its annual report. A part of the risk table is produced below:

Table 6 – Glass bank principal risks:

Principal risks:	**Other level 1 risks:**
Retail credit	Strategic
Wholesale credit	Change
Market	Corporate Sustainability
Capital	Brand Management
Liquidity	
Financial Crime	
Operations	
Technology	
People	
Regulatory	
Financial Reporting	
Legal	
Taxation	

When asked about prioritizing risk based on the bank's perception of their importance, the manager of Penny bank highlighted the importance of risk priority to the continued existence of the bank:

> *"The risk of repayment is most important (credit risk). We would assess a customer no further, if we determine that this customer would be unable to repay. It would be too risky for shareholders and the bank as a whole; it can lead to an issue of going concern. All of our risks are important, but credit is so important that we have one fundamental credit policy across all our sectors. However, we still review each case on its own merit. Security is important but lending on security alone, won't do our customers any good. That's why we are so strong; it's the way we approach our lending. Branch managers have the decision making power, not corporate. In that way, we spread a culture of operationalizing our risk and building trust in our process. We meet the Basel requirement easily"* (Branch manager, Penny bank)

Classifying risks and reporting them as such is essential to BoFI's risk management process. However, it is difficult to establish whether or not any real value is created for the ERM process by prioritizing risks (Knight 1971). Knight (1971) argues that classifying and categorizing risk does very little for the quality of the decision made. According to Knight (1971) the market decides which risks are paramount and interest rates decide the value added:

> *"After investment is once made, we have already observed that the income is simply a matter of the value yield, and the value of the agency is determined by capitalization at*

*this yield at the interest rate determined in the market for free capital". (*Knights 1971 p 169)[43]

6.2.3 Risk reporting at Glass Bank

Before the financial debacle that began in 2007, most BoFI's had a particular characterization of risk that mostly mirrored capital markets expectations and catered to investors' decisions in relation to returns and profits. Glass bank was no exception and the manager of risk strategy described this market-oriented approach this as follows:

> *"We cannot look at risk in isolation. It does not happen like that in the real market. Resource allocation, investor decision, shareholders expectations, are all dependent upon the risks that we take and what the market expects. Our jobs as risk specialists, is not to decide what the market wants; the market does that, but to assess the amount of risk that is acceptable and reasonable to meet the demands of the capital market. And to do that, yes we have to measure it. It cannot be done by guesswork. The entire financial system is dependent, in one way or another on these results and to suggest that numbers may have too much of a significant role in this process is absolutely ludacris"* (Manager, risk strategy, Glass Bank)

The perception of risk as a more numbers oriented concept has been the spine of Glass bank's risk decisions long before the financial crisis and is unlikely to experience any significant

[43]This statement by Knights (1971) must be taken in context of time. Risk and capital were not as complex and sophisticated in the 1970's as they are now. Financial instruments have since evolved into much more than simple agents of investments.

changes in the near future. The reliance of the capital market on financial information provided by BoFI's was not only evident from the risk managers of Glass bank, but from the financial reports that triggered investor reaction and market movements. The bank places heavy emphasis on capital risk and adheres to the Basel guidance on capital structure requirement. Before the financial crisis, management perceives this risk as pivotal to the operation and survival of the bank:

> *"Capital risk is the risk that the group has insufficient capital resources to meet minimum regulatory capital requirements in the UK and in other markets such as the US and South Africa where regulated activities are undertaken. The group's authority to operate as a bank is dependent upon the maintenance of adequate capital resources"* (Glass Bank Annual report, 2006 p 64)

Risk management was not cogently operationalised at Glass bank before the financial crisis. The bank had a top-down approach to risk management with major risk decisions made at the corporate head office and directed downward. Branch managers had no real risk decision power, except to compile risk file, assess it (partially) and send it upward to the corporate office. The risk assessments made were based on a numbers grid that were derived from a computer program based on estimates and market data of future outlook and past performance.

There was little room for judgement calls or unexpected turns in market events that may not be readily explainable by the numbers presented. Glass bank adopted a unique framework that

featured risk management as a process[44]. Although management does not use an official COSO model, Glass bank risk framework resembles the COSO risk approach in that it presents risk management as a holistic approach that occurs in stages working simultaneously, and admits to following the COSO framework in its annual reports:

> *"The internal control framework at (Glass Bank) is aligned with the internationally accepted standard Internal Control – Integrated Framework published by the Committee of Sponsoring Organisations of the Treadway Commission (COSO). The Group's principal risk categories (set out below) are the subject of Board approved risk control requirements"* (Glass bank annual report 2008 p 72).

The Bank does not make its entire framework public; however, a small portion of it was presented in its 2005 annual report, reproduced below in table 6.1.

[44]Although I was not privileged to see the actual risk framework (I did ask to see it), it was explained to me in part, and also presented in part in the financial reports. The bank's risk schema bears some resemblance to the COSO framework presented earlier in this thesis. The manager of risk strategy does not agree that the bank's framework bears any resemblance to COSO's.

Table 6.1 portion of Glass bank risk management framework:

	Responsibilities
Direct	Understand the principal risk to achieving group strategy
	Establish risk appetite
	Establish and communicate the risk management framework including responsibilities authorities and key controls.
Assess	Establish the process for identifying and analysing business level risks.
	Agree and implement measurement and reporting standards and methodologies.
Control	Establish key control processes and practices including limit structures, impairment allowance criteria and reporting requirements.
	Monitor the operations of the control and adherence to risk direction and limits
	Provide early warning of control appetite breaches.
	Ensure that risk management practices and conditions are appropriate for the business environment.
Report	Interpret and report on risk exposures, concentrations and risk taking outcomes.
	Interpret and report on sensitivities and key risk indicators.
	Communicate with external parties.
Manage and challenge	Review and challenge all aspects of the group's risk profile.
	Assess new risk return opportunities.
	Advise on optimizing the group's risk profile
	Review and challenge risk management practices.

Adapted from (Glass Bank annual report 2005 p 72)

The risk management process at Glass bank begins with an understanding of the primaryrisks involved in attaining the bank's goals and objectives outlined in its strategy. This first stage is crucial since assessing, controlling, managing and reporting on these risks are dependent the objectives and strategy that the bank is pursuing, given the risk climate. Risk reporting is fascinating at Glass bank since the bank does not encourage a culture of judgement or social ideals as an integral part of its risk atmosphere. However, according to its annual report (2005), risk reporting is defined as a series of events that needs to be interpreted:

> *"Interpret and report on risk exposures, concentrations and risk taking outcomes." (*Glass bank risk report 2005 p 72).

The supposition of *"interpretation"* suggests an inherent level of judgement that should be exercised when portraying or translating risk. Berger and Luckmann (1971, 1975) argue that interpretation is contextual but carries an innate condition that is of a social nature. If judgement calls are required to interpret or explain risk presentations then perhaps risk exists as an inter-related prodigy that is not completely explained by computer programs and numeric renditions. This ideology was further compounded by one of the branch managers of Glass bank when asked about the meaning of interpretation as it relates to risk reporting:

> *"Look we are human being. And as such there is a certain intrinsic part of us that has to explain everything we do and say. So if I read a document, I interpret it in my own way, you would interpret it in your own way and someone else may interpret it differently from the both of us. It's the same thing with risk. While there is no room for interpretation on*

what our risk decision should be, it is left to our investors, creditors and customers to draw their own conclusions based on what we report. The bank does not interpret for them, we interpret it, measure it, compare it and report it so that others can interpret it as well"(Branch manager, Glass Bank)

According to the manager, a tier 1 capital structure of 7% may be interpreted as good by some investors, strong by other investors or weak by others. This is a matter of personal opinions and judgements that does not affect the decision of the bank to hold a tier 1 capital structure of 7%. Nevertheless, while this may be true, another position should also be considered. If investors coerce the bank to change its capital structure to 9%, based on their own opinions, then would it be safe to assert that this risk decision was muddled with a social judgement call?

6.2.4 Risk reporting at Penny bank

Although most banks in the UK include a report on risk in their annual disclosure, these differ across banking institutions. The varying approaches to risk reporting among UK banks may be a function of size, risk strategy and regulatory guidance. For example, one of the smaller banks in this study, included less details in its 2004 annual report about its risk approach. According to the manager of risk operations, the bank meets its requirements for disclosure under the Basel III accord (see Basel risk reporting guidance, 2003). In this particular case, reporting is perceived as a regulatory requirement that must fulfil the needs of the authorities. This sentiment was common among the smaller banks that are a part of this research:

> *"We follow Basel. Now we have Basel III. As long as they are happy, we are happy. We stress test our capital and liquidity risks according to their guidance. It is not too strenuous for us, but we are at a disadvantage because we are not a huge bank. But our capital requirement and what we report is not different from what the other bigger banks do. Basel is not new to us but we started taking it much more seriously. Quite frankly, I don't see much difference in what we were previously asked to do as it relates to risk disclosure and what we are asked to do now. The only thing, is, we are actually doing it and with more attention to the process"* (Operations manager, Bank B)

However, the bank conceptualise reporting as separate and distinct from the process of risk decision and does not view external reporting as significantly dependent on the internal process. Hence, according to the operations manager, risk management decisions are not symbolic of the external requirements from Basel III and should not be perceived as an indicator for the management of risk.

Reporting risk is an integral part of the ERM process. This is particularly true for Penny bank. The bank has rooted its risk operations on a customer oriented approach. According to one of the branch managers, not much change has been made to the reporting process since the financial crisis. This is because the bank has built a culture of operationalising its risk strategies. The branch manager argues that this prevents a culture of excessive and abusive risk taking. This was also expressed in Penny bank's 2011 annual report:

> *"The accountability of the person taking a business decision is supplemented by local risk control within the various business areas. This ensures that risk taking does not become excessive in an individual transaction, or in local operations, and that transactions are In line with the bank's view of risk-taking. The operations-related risk control assesses risk, checks limit etc. and verifies that individual business transactions are documented and conducted in a manner that does not involve unknown risk. The operations-related risk control, reports to central risk control and also to business operations management"* (Penny bank annual report, 2011 p 80)

Accountability is vital in creating a roadmap for adding value for money, an important concept in financing and long term contract like public private partnerships (Khadaroo and Demirag 2008). Penny bank embraces a practice of risk accountability that is legitimized by de-centralizing its risk decisions to operation managers. In so doing, risk management is diffused across all aspects of business operations and unreasonable or extravagant risk taking is avoided. Nevertheless the true justification for adopting such a system seems to lie in the bank's central risk control function; a fundamental oversight system that all functions of risk are accountable to. Such a reporting structure, where all units of an organization are held responsible for their decisions, can promote a unilateral system that encourages goal congruence and restricts abusive risk behaviour (COSO 2004). Internal risk reporting and communication lines are important in achieving risk objectives and improving ERM within organizations (Wood 2011). However, the more acute question is whether or not these reporting structures or systems, built internally, can support a cultivation of accountability, responsibility and transparency. According to Wood (2011) the involvement of operations managers in the identification of risk threats in the process and the

ability of the reporting system to address these and apply elimination measures are more important than the design of the system itself. If risk errors are not captured or confined by the reporting structure, then the credibility or the integrity of the reporting system may be compromised (Wood 2011).

The importance of the internal reporting structure for Penny bank is manifested in the quality of the risk decisions made and in their annual reports. Shareholders and other stakeholders rely on the judgement of managers and the processes of the bank to make decisions that relay their best interest. Such judgements are a function of social constructs that are crucial in financial reports that investors use to make decisions (Lee 1994, Rutherford 2003). Hence, an internal reporting system must flow to the owners and other stakeholders.

6.3 Risk reporting after the financial crash

As an emerging abstraction, risk is constantly changing to reflect market and customer needs (McCartney and Arnold 2012). This change, according to McCartney and Arnold (2012) began with the re-invention of capitalism from commercial (1700's) to industrial (1800's) to now financial (1900's to present). The transition from an industrialised perception of capital to a financial innovation of markets requires the evolution of economic resources into more complex financial instruments (Toms 2010). Hence, risk was forced to follow a trend of developmental revolution from an earlier time of simple calculation to a present movement of indiscreet speculation (Bryer 2000). Risk measurement became much more sophisticated and initially, a focus on understanding risk was obscured from the process while a populous program of developing new and advanced mechanisms of measuring risk was promoted. This new way of

perceiving risk due to capitalization of markets, changed not risk management and processes but other management accounting practices like budgeting (Verbeeten 2006). Programming and computer models now rules the stage in an effort to satisfy an ever evolving market, where customers lack adequate understanding of their investments and investment managers struggle to balance the ethics of their decisions with the promise of enormous returns (Diebold 1982).

Consequently, in order to maintain congruence with the transformation of capital from a traditional physical existence, to a financial intangible, risk reporting need to evolve to reflect the needs of not only a changing capital market, but also into a more uniform system that supports and enhance internal organizational communications (McCartney and Arnold 2012). However, it appears that the progression of financial markets and the demand for sophisticated capital was more expeditious than the reporting needs that it required (Huber and Scheytt 2013). This led to a gap in the risk reporting needs for investors along with a demand for better internal reporting systems and the capital risks that these represents. Nevertheless, since the financial crisis, risk management has maintained its importance, expanding its complexity into all aspects of business operations. According to Huber and Scheytt (2013) this is because of the power dynamics of managers to conceptualise risk as a resource to wealth appreciation.

The financial crisis may have served as a starting point in acknowledging that ERM requires much more than the development of complex artificial programs that suits the needs of measuring future outcomes against investments (Power 2009). A call for changes to the management of risk has since been extant in accounting literature (Mikes 2009, 2011, Arena et al 2010, Power 2009, Tekathen and Dechow 2013, McCartney and Arnold 2012). Although

changes in ERM practices are not usually readily transmitted into external reporting adjustments, internal processes are adopted to meet the needs of the change. Woods (2011) argues that these internal changes would translate into external reporting variables over time.

Before the financial debacle, some academics (for example Lee 1994, Power 2004, Mythen and Walklate 2006) cautioned that the continued attitude of risk conception as a programmable, measurable variable, simply capable of producing quantitative outcomes, is a missed opportunity to encourage discourse on the social aspects of risk. Lee (1994) and Rutherford (2003) argue that interpretation and meaning are vital in understanding and appreciating the contents of financial reports[45]. These reports contain the representations of processes, practices and procedures that merit organizational success (Diebold 1982). Giddens (1984) argues that as time progress, systems and structures changes in organizations. Such changes are usually diminutive but constant (Hooper and Willmott 1987). This is mostly because structures and systems become *"routinized"* overtime, and evolutionary changes are easy to become adaptive to the established routine (Englund et al. 2011, Giddens 1984, 1986, Ahrens and Chapman 2002). These vested processes manifest themselves in the disclosures of external reports and the well-established internal structures that represent that integrity of the system.

Nevertheless, Giddens (1984) also contends that although organizations are gratified with the ingrained structures that they possess, such a system would experience a radical change in crisis situations (Giddens 1984). The complete transformation on the structure would occur rapidly as

[45]Lee (1994) and Rutherford (2003) were not referring particularly to understanding the social values attached to risk but rather social currents in general that are inherent in financial reports. Their reference is used here in application to understanding the social aspects of risk in reporting.

managers abandon the old system in search of a new one. This spontaneity, according to Giddens is not solely because managers would have lost trust in the old system, but also because managers would be on a mission to find solutions to the crisis at hand. In so doing, a new structure is developed, one that can assure confidence of handling crises and this becomes the new established system. While this may be the case for some organizations, this research does not uncover any evidence to support this assertion in risk reporting. Glass bank, Penny bank and the other banks that were participants of this research have all indicated minor changes to their reporting process, both internal and external. One branch manager of Penny bank expressed how risk is being reported after the financial crisis:

> *"There is not much difference at all in how we report risk after the financial crisis. We don't need to. Internally, within the bank, our process is strong; we test it; we want to know if it can register and resolve a problem if one exists. Externally, we were already doing what our customer and clients expects from us; Basel has some new guidance but we don't bother with Basel much, I have not even read them. Our capital requirement is way above what they were asking for and we focus on satisfying our internal regulations because these are tied to our customer values. So there is no need for us to change our reporting system, it is working fine but we always review it to ensure and to see if there is any way we can improve it"* (Branch manager, Penny bank)

Risk management, in UK banks, was not revolutionized after the financial crisis as Giddens (1984) suggested would happen to organizations in these situations. Perhaps the government bailouts alleviated the urgency for banking institutions to make any significant changes to their

process, not just for the management of risk but also for reporting. Consequently, UK banks[46] returned to business as usual and customers were left to bear the sting (Sikka 2011).

6.3.1 Power dynamics and the reporting process

The nature of the reporting process (especially the internal process) suggests that reporting is a smooth and well followed legitimate channel of activities that works cogently to enhance risk reporting, with structures that function well to deter misappropriations or capture and correct errors before a catastrophe occurs (O'Dwyer et al. 2011, Nielsen and Madsen 2009)[47]. These well designed procedures are almost always deficient in some way in achieving the desired outcome that they were constructed to accomplish (Strathern 2000). This is particularly true with risk reporting, where conflict and power turbulence can alter or create modifications in existing processes (Amstrong 2000, Cooper and Hooper 2007). These conflicts can work to undermine the validity of the reporting process that can produce a divergent system that was unintentional (Tinker and Neimark 1986). Hence, in order to maintain uniformity and a stable, fluid system of reporting, organizations must allocate resources to the agents that possess the power to challenge or disrupt the process (Tinker and Neimark 1986). Glass bank recognises the importance of agential power in denouncing the flow of organizational goals to satisfy their own merits:

> *"The strong principles that we operate by begin with hiring. We have to ensure that we hire people that confirm to our values and our customers' needs. We cannot afford for*

[46]The reference to UK banks here is specifically ascribing to the Large UK registered banks that received bailout monies from the UK government during the financial meltdown.

[47]The authors referred here were not writing specifically on processes related to risk reporting but more on sustainability reporting and reporting on a whole. The logics used are in reference to contrasting it to how risk reporting can be more complex or complicated.

> *our managers or any personnel for that matter to go rogue on us. This will create a disaster for our entire process. Of course every human being is different and maintaining our bank's culture can be challenging for some because we have high standards. However, we recognise that and we frequently undergo training as a form of reassurance that we are a team. Togetherness is important to our vision; not just in financial goals but in customer satisfaction and our approach to problem solving"* (Branch manager, Glass bank)

The resources devoted to extra care in hiring and subsequent training for managers of the bank is testimony that the bank recognises managers as agents with power to sabotage or frustrate the entire system and wants to ensure corporation by all agents in its mission to fulfil financial goals and satisfy customers. If this frustration presents itself in the reporting process, then it can prompt new implications for how risk is managed and the entire risk system itself.

Power as an external force, intricate and ascribable as an imposition that is independent and separate as an agential exterior is one way of conceptualizing power dynamics in organizations. This particular means of understanding power and its role in organizational process it the subject of labour theories and conflict discernment (for example the LPT), which are central themes to social control, grounded in Marxism (Covaleski and Aiken 1986, Ezzamel et al 2004). Glass bank's appreciation of managers as agents with the capacity to corrupt the risk process at will, suggests power as an external dynamic removed from the agent but which the agent can use as a tool to effect organizational change. However, Giddens (1984, 1986) envisioned power as a different phenomenon. According to Giddens (1984, 1986) power is not an external action that is

at the disposition of agents as argued in some of the writings of Foucault[48] (1961, 1973) and Parsons (1964, 1971) but rather an integral part of the ontological need for security that all humans possess and deployed mutually in our every action, activity or response:

> *"There are no two faces of power…Resources (focused via signification and legitimation) are structured properties of social systems, drawn upon and reproduced by knowledgeable agents in the course of interaction. Power is not intrinsically connected to the achievement of sectional interests. In this conception the use of power characterises not specific types of conduct but all actions and power is not itself a resource…..power within social systems which enjoy some continuity over time and space presumes regularised relations of autonomy and dependence[49] between actors and collectives in contexts of social interaction. Domination and power cannot be thought of only in terms of asymmetries of distribution but have to be recognised as inherent in social associations (or, I would say, in human action as such)"* (Giddens 1986 pp 15-16, 30-32)

In this context, risk managers are not conceived as agents with authority to use extrinsic power as a manipulating mechanism, able to disrupt or impair the reporting process, but rather as a

[48]Giddens also recognised Foucault's extended interpretation of power and acknowledged Foucault's influence in his structuration theory in Foucault's endorsement of power as not being *"an inherently noxious phenomenon. Not just the capacity to say no" (Giddens 1984, P 32).* This is particularly important since Glass bank risk executives' associate power in the risk process as a harmful force that can be exercised or abused by agents (especially risk managers) and hence should be monitored, controlled or constantly evaluated.

[49]Giddens went on to acknowledge that this dependence contains resources that subordinates can use to influence the activities or decisions of their superiors. This he refers to as *"dialectic of control"* and involves some aspects of power relations. It is important to note that the structures and systems that Giddens refer to here, are social in nature.

social operative, whose actions and measures are in congruence with satisfying their own ontological needs. Hence, power is inextricably fused throughout the risk process and can only be identified or interpreted by the actions, reactions and social associations of the managers[50]. Penny bank conceives power as two different coercions.

> *"We believe that once our team is happy, then the bank as a whole is fruitful. So for us, it's about ensuring our people are treated well so that they can treat our clients well. Our needs are the bank's needs. We are constantly enhancing[51] our process by putting measures in place to bring in sync our peoples needs with the bank's strategy. Of course we are all humans. And as human beings we are all different. So there are some managers and even executives that I am sure are tempted to go against the bank procedures and they might be in a position to do so. But we have to ask ourselves why a manager would want to do that; well it's because he may see more benefit to himself in a certain decision than to the institution overall. If he does not feel unfairly treated then he may have less incentive to do a thing like that"* (Operations manager, Penny bank)

Making a parallel between banking strategy and agents needs is similar to Giddens assertion that agents exercise power in their actions in an effort to fulfil their own ontological needs. Penny

[50]Giddens explanation of "social associations" involves the actions, communications and connections of human agents among themselves and the influence that we have on the social structure. Other theoretical writings (like Latour 1986, 2007, Callon 1986, 2004, Czarniawska 1997, 2004 and Law 1984, 2004) present social associations and *"the social"* as a different concept. Chapter 4 presented the main ideas of this perception of social associations.

[51]When asked about how the bank is enhancing the process of goal congruence and what measures are put in place to align manager's needs with banking strategy, the personnel manager of Penny bank was unwilling to disclose on grounds of confidentiality; citing that this information is crucial and central to the banks' competitive advantage in the marketplace.

bank operates on the premise that agents are also satisfying themselves when trying to achieve organizational. These goals are embedded in the bank's procedures which solidify the managers' perception that agents are the dominant force in obtaining company objectives. Nevertheless it is also important to recognize that Penny bank does not alienate the acknowledgement that agents can exercise power *"at will"*. However, the exertion of power, intentionally by agents is associated with unfavourable outcomes, when agents are not satisfied, similar to what risk executives as Glass bank believes.

In order to minimize the undesirable effects associated with the conscience exercise of power, Penny bank adopts a philosophy of equating managers' needs with organizational objectives. This approach is ingrained in the banks approach of decentralising and operationalizing risk functions and procedures. According to a branch manager, trust and belief in people is central to this approach. The reporting process then becomes an extension of the central facets of trust, credence and high levels of positive sentiments buttress by an internal system of team-oriented engagement driven by client satisfaction. However, conceiving power in this way, as only a deployment in search of agential gratification, may present a narrow view of this notion and may mean an unnoticed opportunity to include other forces or factors[52] that might be critical in understanding power and how it affects risk management at Penny bank.

[52]Other forces and factors that may influence the perception of dynamics are extensive. Some of these may include the actions of others, knowledge, societal influence, technology and authoritative significance and the concept of freedom (Foucault 1973, Bigoni and Funnell 2014, Neilson 2010, Neimark 1990, Hoskin 1994)

6.3.2 Implications of the new regulatory requirements

To appreciate the role of regulation in the banking sector (especially in the developed world) it is important to understand the context and political and financial environments in which these banks operate[53] (Buckley 2011). Banks, traditionally, are financial institutions, that are regulated by the government in the country that they operate and whose main activities constitute the borrowing and lending of money (Johnson and Kwak 2010). Commercial banking includes business banking, retail banking and corporate banking and conventionally was separate and distinct from investment banking. Investment banks engage in raising capital, trading securities and other financial instruments and providing investment advice for clients and investors (Freeman 2009). Due to the high risk to their customers and to the financial system as a whole, banks are (at least in theory) subject to stringent regulations as it relates to their activities.

However, these regulations are often perceived as extremely political and used as a vehicle for economic (especially monetary policy) objectives while customer and client interests are often misplaced in the process (Sikka 2011). Since banks are considered the major vectors of economic prosperity, they are often the subject of fervent struggles for political and legislative control (Hall 2009, Haney 2010. This is evident in the UK where the tripartite financial regulatory structure was replaced by the Bank of England with the advent of a change in political power.[54] Although this change may have been symbolic, most bank managers[55] perceive the

[53]This section only introduces and discusses the new regulations that were popularized after the financial crisis and its influence and relevance (or lack thereof) on the risk reporting process. A more in depth analysis on the role of banking regulations (both voluntary and mandatory) on risk perception and management would be addressed in chapter 7.

[54] In 2010 the Bank of England was given exclusive authoritative power over the regulatory affairs of the UK financial industry. Before 2010 (from 1997-2009) the regulation of the UL financial industry was overseen by three

change as a reactionary attempt to neutralize the poisonous perception that the UK regulatory structure failed to protect shareholders, investors and customer from the unscrupulous risk actions of the banking industry.

The perception of bank managers on the role of regulatory functions[56] appears to be fused with an assessment of whether or not financial regulation enhances the management and execution of risk:

> *"Regulation is neither good nor bad. It does not matter to us whether the FSA or the Bank of England is in charge. Quite frankly, they are all the same. We abide by the rules and we have our own framework as well that guides us. The big question is: are these regulations doing anything for the management and administration of risk? Some may say that they are, some may say they are not. If they are, then can they go further? And if they are not, how can they improve? I don't have the answers to all these but that would be a good starting point to focus on. Look my opinion is that the banking industry has evolved and has done so rapidly. The authorities, however, seem to be stuck in the 90's. They have to go with the flow of the industry and be the leader not the follower. They are too reactionary and not enough foresight. After the financial crisis, they tried to do*

(3) separate bodies referred to as the tripartite system. These comprised the FSA, the Bank of England and the UK Treasury. See chapter three (3) for more details.

[55]Most bank managers here refer to managers that were part of this research and not in reference to all bank managers in the UK.

[56]The regulations referred to here are the ones developed and mandated by now Bank of England. The perception of voluntary regulatory recommendations (like the Basel III) on the risk management process will be addressed in chapter 7.

something but it's meaningless because we have been doing that since before the financial crisis" (Credit risk manager, Glass bank)

Glass bank's officials were more subtle in their perception of the new regulation as not far-reaching enough with more pro-action needed. A senior risk official at Penny bank took a similar position, but was more adamant in his criticisms and expressed concerns for the future of the UK's financial regulatory authority:

"Regulation? What regulation? They call themselves experts but they have no idea what's happing in the industry. We are a big bank, but unlike the other big banks we don't take advantage of the system and manipulate it for profits. We operate on morals and values. We give no bonuses. Not a single executive, manager or front desk work ever receives any financial rewards from making a risk decision. What we get is the joy and satisfaction from the smiles of our customers and the elevation of our unique brand of banking. The other big banks are using the Bank of England as their toy. They know it's a joke. The capital and liquidity requirements that the Basel is suggesting is a joke too. It's like a drop of water in a bucket!." (Senior risk official, Penny bank)

As it relates to regulation and the reporting process, the manager of risk operations at Small bank, thinks that the local regulations are "ok", but is sceptical about the amount of information that the Basel is suggesting small banks disclose.

6.3.3 Improving the risk process

The management of risk and the monitoring and controlling of risk related activities, continue to be a challenge not just for bank managers in the UK but for the entire financial industry on the world stage (Soin and Collier 2013). The progress that has been registered in the risk theatre has invariably been measured and correlated to its ability to generate returns and raise financial excellence for investors, managers and the industry (Bhimani 2009). Beck (1992) warns that there is a revolution brewing, where customers and investors would no longer accept the managers' explanations as facts but would seek to uncover their own by being more reflective, involved and studious in the risk process. Sion and Collier (2013) contends that the financial crisis is evidence that risk management has crossed the boundaries of health and safety and ventured into an uncharted course of accounting and finance where valuation and measurement are paralyzed facets, unable to explain or provide resolution to risk dilemmas. This, according to Sion and Collier (2013) is because the operational aspects of risk have been largely ignored and the importance of human actions on the risk atmosphere has been neglected over the trajectory of risk management. This is particularly noticeable with Glass bank, where risk management has been represented by a history of measurement and calculation on estimates about future events, grounded in programmable models of numeric embodiment able to predict possible return on investments.

Nevertheless, there has been a call for risk experts and professionals to envision the management of risk as a more comprehensive conjecture encompassing all factors that affect the management and administration of risk endeavour (Mikes 2009, 2011, Power 2007, 2009, Arena et al 2010). This relatively new approach to risk resolve was forced by public perception, that the

administration and management of risk is inadequate in protecting investors and consumers (Sion and Collier 2013). Power (2009) argues that we have very little understanding about the complex nature of risk and a new direction is needed in guiding experts on how to fathom risk. Miller (1994) advises that risk should not be examined just at an organizational level, but rather in its entirety at a larger social and institutional context. Collier et al (2007) caution that we discount risk by examining its role in management accounting, instead of its more expanded duty in organizational accomplishment, and in doing so we neglect an opportunity to better apprehend its application in management accounting. These criticisms, along with the chaos caused by the financial crisis have forced a new approach to appreciating risk especially in a time where regulators and experts alike scramble to respond to wounded investors (Huber 2009).

Changing the way risk is perceived by the financial industry is no easy task (Mikes 2011) and should begin with an appreciation of what the current perception is and a vision of small but steady and continuous adjustments to improving the risk process. Part of this development must include acknowledgement of the role of humans in risk decisions (Sion and Collier 2013) and a more magnified adaptation of risk management to include a holistic approach to risk (Mikes 2011, COSO 2004). There may be justification for a rapid and urgent response to this calamity, but such a reaction can lead to more complications and a quandary of further problems. Although a simple solution may be far from sight (Woods 2009) recognition that the way risk is managed in the world's largest financial institutions needs to be carefully examined, may be a starting point (Arena et al 2010).

This research finds that it is difficult to recommend a solitary solution for improving risk management strategies in UK financial institutions but strides in this direction should include understanding human actions in organizations (Giddens 1984), evaluating all aspects of risk objectives (COSO 2004, Adams 2003), improving communication, information and discourse in the risk process (Woods 2009) and extending the boundaries of risk to include all aspects of operations (Mikes 2009, Walstrom 2009). Adding all of these factors into a single framework may be helpful but challenging. Each bank has its own unique way of handling risk and a single framework for all UK banks can only be skeletal. However, for the five (5) banks that are a part of this study, a suggested framework is proposed in chapter 8, based on the findings of this research[57].

6.4 A duality of risk and reporting

The most foundational and important concept in Giddens structuration theory is the notion of structure and duality of structure:

> *"Let me now move to the core of structuration theory: the concepts of structure, system and duality of structure"* (Giddens 1986 p 16)

Giddens rejects a functionalist approach to structure; in his theory, Giddens (1984, 1986) asserts that a structure is not separate from agent nor is subject separate from object. According to Giddens a social structure is not extrinsic or autonomous to human agents. This is because agents

[57]The framework that is developed and presented in chapter 8 is meant to be a suggestive guide for perceiving and managing risk based on the data collected and analysed in this research. It is in no way meant to be a prescription to solving risk problems nor is it comprehensive enough to include all aspects of risk management.

enact the structure and hence the actions of agents are what produce and reproduces the structure (See chapter 4 section 4.2.2).[58] To place this in context, recall that structures are virtual and consist of rules and resources, but at the same time can be enacted independently of the agent's thoughts. This appears to be a paradox since is it proposes structures to be both non-existent without agents, but yet existing separately from agents. Giddens explains this as *"an intersection of presence and absence"* that can only be explained by codes of meaning.

The duality of structure that Giddens refers to is interpreted as a system of rules and resources that are produced and reproduced by social actions and are the means of the system reproduction. Hence, risk managers in their reporting action and activities are drawing upon practices and social behaviour based on their past experiences (for example how much capital to maintain). In so doing, they are creating a new system of reporting, not just for the risk management process at their own bank but for risk management systems for the entire country and by extension, globally. Then, in return this new system created (like for example changes in capital requirement) determines the actions of the agents that produced it (Like for example, not enough capital was maintained before, so hence new rule on capital maintenance). Therefore, the system of rules and practices cannot exist without the actions of the agent.

This premise of Giddens' was more prominent in Penny bank than in Glass bank. The management of Penny bank endorses a philosophy of self- consciousness in actions and decisions as it relates to risk. The bank recognises the activities of its managers as being crucial to shaping the outcome of the system:

[58]A discourse on duality of structure and examples of how it can be applied to the management of risk is given in chapter 4. This section serves as an extension of structural duality and its application to risk reporting.

> *"If we as managers do what is right, and not take unnecessary risk and stop the greedy approach to profiteering (as is the case in some banks) then the FSA, the treasury, the BoE and even Basel would not have the cause to restrict what we do because there would be a certain level of trust inherent in our behaviour that they would be able to rely on. We at (Penny Bank) exhibit that kind of trust and moral compass. We strive to do the right thing always. However, the other banks and their insatiable appetite, not for the investor, but for themselves is causing a change in how regulators view us; then we all have to abide by what they (other banks) caused"* (Operations manager, Penny Bank)

Here, Penny's bank management is observing the interaction of the social structure and the system that it produces and reproduces and the reliance of one on the other. The resources and rules (like for example regulation regarding external reporting) are used to create and recreate the system that becomes part of it and reliant upon it. This is what Giddens refer to as a "duality of structure", and it occurs in our everyday lives without even our consciousness of it. Giddens sums this up as follows:

> *"One of the main propositions of structuration theory is that the rules and resources drawn upon in the production and reproduction of social action are at the same time the means of system reproduction (the duality of structure). But how is one to interpret such a claim? In what sense is it the case that when I go about my daily affairs my activities*

incorporate and reproduce say, the overall institutions of modern capitalism? What rules are being invoked here in any case?"[59](Giddens 1986 p 19)

However, while structuration theory acknowledges risk managers as being interconnected with the system and recognises the subject-object duality, it does not concede to humans as being able to act independently of the social structures (Boland 1993). Boland (1993) argues that the individual actor has a sense of interpretive power, separate and distinct from the structure that is not acknowledged by structuration theory. According to Boland (1993), human beings go beyond "signs" and can independently generate new meaning without the influence of the social structure. In this context, risk managers are perceived as being able to initiate new rules (for example the manager imposing a rule on capital requirement) without any prior rules to draw from or experiences with the new rules (like for example, no prior rules on capital requirement to use as a guide). Hence, by Boland's (1993) assertion the system does not have to be reproduced, but can be produced without any reproduction.[60]

6.5 Summary and Conclusion

This chapter is the first of two data presentation chapters and analyses secondary data from the participating banks. The analysis reveals that risk management, although an emerging concept, has its roots in a calculable precept that has guided decisions in risk along its trajectory. However, changes to this perception were initiated, with a call from experts and professionals to

[59]Giddens went on to outline what rules are and rejects a narrow definition of rules as being a habit or a routine. Instead Giddens advocates for a broader application of the term "rule" as being applied to its role in constructing meaning and its connections with sanctions.

[60] Borland argues that even Giddens acknowledges this in his argument on context and the importance of individual action and meaning.

take a more inclusive approach to risk execution (Power 2007, Mikes 2009). With the advent of the financial crisis, this proposal was intensified, but political vice and power struggles made it difficult for the Bank of England, the Financial Services Authority and the Treasury to provide exemplary guidance for the sinking banks whose financial tragedy was classified as a mixture of greed and uncontrollable global financial adversity (Sikka 2011).

This research finds that Penny bank has a more social approach to risk than Glass bank does and as a result, elements of Giddens theory of structuration is more evident in Penny bank than at Glass bank. For example, the disposition of power as a connected social action is more palpable in Penny bank in the risk process where managers as perceived as being harmonious with their personalities, character and moral fibres. Hence, hiring and training the right people is paramount to the bank's strategy. One the one hand, power is perceived as an integral part of the manager (agent) that unfolds in his actions and execution of risk decisions as he works to fulfil organizational objectives (As in Penny bank). On the other hand power is conceptualized as an external force, with negative paraphernalia (especially at Glass bank). However, both Penny and Glass bank risk officials recognise the importance of subject-object separation in organizational settings especially as it relates to risk decisions and power. Giddens (1986) argues that the subject (for example the risk manager) is fused with the object (for example the rules and resources used to guide his risk actions) and the two are inseparable. This duality of structure was not so prominent at Glass bank, where the rules and resources used to guide the manager are seen as separate and distinct from the manager himself.

Although Penny bank perceives power as intrinsic, the bank also recognises it as extrinsic to human action, perhaps an element of Giddens (1984) suggestion of an *"intersection of presence and absence"*.

The significance of Giddens motion should not be discounted especially in the context of risk management. If power is to be perceived by UK bank managers in this way, (as a subject-object duality) then the ramifications for risk execution may take the form of satisfying agents' social needs with the intention of influencing desirable risk behaviour in the process. The new regulatory requirements should then focus on the agent (the risk manager) rather than the structure (the risk rules, resource and process). Achieving risk equilibrium with this approach may be too much of a mountainous task for a regulatory authority that is already burdened by political retardation.

Chapter 7: Bank managers' perception and management of risk

7.1 Introduction

The last chapter presented an analysis of risk perception and management using secondary data found in financial statements from both pre and post financial crisis era and from other documents obtained by the participants in this research exercise. The analysis presented in the last chapter process a foundation for understanding and conceptualizing how risk is managed in UK banks. In this particular situation it is critical to establish groundwork on how risk is reported, since it represents the portrayal of risk management and perception.

This chapter presents a continued analysis of bank managers' perception and management of risk by examining responses obtained by the participants through interviews. Analysis of these interviews reveals that although each institution perceives risk differently, there are some similarities across the banking industry. Conversely, Penny bank's management approach to risk is almost completely different to Glass banks' management approach to managing risk. This is crucial is appreciating the different approaches to risk that can lead to rewarding results since both banks are financially robust and neither banks used government assistance during the crisis. Penny bank administers and governs risk at the operational level and perceives risk as a social construct that can only be effectively managed with heavy infusion of agential (manager) leverage and little use of structural (rules and resources) interference. Glass bank is almost opposite in its approach to risk. The bank's risk officials accept the structure as distinct and decisive in their decisions. Here the object that Giddens (1984) argues is with the subject is not very evident. Hence the risk process is managed with a specific preference towards rules and resources.

The chapter begins with an overview of Glass bank and the institutions' perception of risk as a concept. Risk management at Penny bank follows with a discussion on Giddens (1984) agent-structure dynamics and the influence of rewards on risk related decisions. Discourse on the other participatory banks in this research comes next followed by critical arguments on the role of regulation (both voluntary and mandatory). The chapter comes to a close with a summary and conclusion.

7.2 Risk perception at Glass bank

7.2.1 Background and operations

Glass bank began in the 1600's as a trader in gold on the UK market. The bank was so named after its original founder but throughout its history and development, the bank experienced several name changes. Toward the beginning of the 1900's other banks joined the umbrella of Glass bank and this move by the owners and investors, initially was an effort to widen the banks operations and increase its customer base[61] (senior manager, Glass bank). This amalgamation gave the bank an appetite for further growth and in 1938 the bank acquired its first international subsidiary. The years that follow can be characterised as electric expansion through numerous mergers and acquisitions, both locally and internationally, covering the North America, Asia and Africa.

Along its trajectory, Glass bank developed and refined its mode of banking, not just through expansion but also through its unique implementation of technology in banking (Head of operations, Glass bank). Nevertheless, the bank never lost sight of its core operations of

[61]This information was taken from an internal document obtained from Glass bank. The author is a senior manager at the bank and in order to protect his identity, his name was omitted from the citation.

providing excellent financial services to its clients and customers. The evolution of the banks operations required unique resources in personnel and technology. Hence, the hiring process of the bank also progressed from *"being willing and able to perform to competence in banking applications, performance and process"* (Deputy Manager, banking operations, Glass bank).

The transformation of the bank over the years in operations and management has had a lasting and distinguished impression on the management and perception of risk. Initially, risk was mostly confined to specific areas of operations and not conceived as an institution-wide phenomenon. This perception changed overtime and the bank began implementing risk related objectives throughout all aspects of its core operations. In the 1960's and 1970's, after the bank had gone international, risk management took the form and image of the local market. It was not until the early 1980's that a more relaxed approach to risk interspersed into the bank, fuelled by a fervent desire for rewards and customer satisfaction. Nevertheless, this professed customer satisfaction took the form of numeric rewards, measured by returns on investment. Risk management has been revolutionised throughout Glass bank and according to the head of risk operations, it began in the 1980's with a realization that customers were adamant about returns and higher performance, and not with managers' intentions of creating rewards for themselves:

> *"I would say that the bank really began to change its approach to risk in the 80's; I was not here at the time but our history points to that. Technology was on the rise and clients began realising that other banks, even on the international market were promising higher returns on their investments. Of course, these investments are much different than the ones we have today, but the attitude to risk changed. Our need to satisfy our customers*

and investors incited a new approach to risk management. The customer became more aware of what others were offering and if we could not offer a similar or better deal, we would lose them. So in order to meet their demands, we forged alliances, amalgamated and acquired some business unique to goals and strategy that propelled us to where we are today. There is a lot of speculation and rumours that big banks like ours, are the cause of the financial crisis because managers engaged in questionable risk-taking actions that were an object of bonus schemes. This is just not true. These are not the facts. At that time (the 1980's) bonuses were not handed in any amounts that would encourage this behaviour nor was it based on a single approach of a manager but a function of the bank's success and operations during the period" (Head of risk operations, Glass bank).

The dramatic change in risk approach (according to Glass bank) was fuelled by a need to satisfy the customer who was now demanding more from the bank. This is synonymous to what Beck (2008) described in his risk society. According to Beck a revolution is brewing that would trigger a monumental change in risk approach forced by a more participative customer[62].

Glass bank attributes a large part of its success to the moderate to aggressive approach to risk dilemmas that began in the 1980's. However, the bank maintains that this materialised as a response to customer demands for better profitability and was not initiated by the bank. Nevertheless, the more taxing concern during this transition period[63] is not who or what initiated

[62] More on Beck's risk society is found in section 3.3.2 and 3.3.2.1 in chapter 3.

[63]The transition period referred to here, is a period of a more radical and aggressive approach to risk that began in the 1980's, which the Glass bank alleges was fuelled by rising customer expectations for better investment returns.

the revolution but rather what risk management evolved into after the transition period (Beck 2008).

7.2.2 The meaning assigned to risk

The differences in perception of risk among banking officials in the UK has influenced how they manage risk and their approaches to this concept. At Glass bank, risk remains an exposure that can be measured, estimated and controlled, while at Penny bank risk is explored as a social epitome with less reliance on mathematics and numbers and greater emphasis on customer satisfaction. These perceptions of risk drawn from the interviews seem to be uniform among the interviewees from the same bank, although they hold different management positions. This was particularly evident in Penny bank where even the personnel manager, whose expertise in risk management was not as strong as the credit risk manager. There is a culture of learning and conservatism that echoed from each participant at Penny bank. Similarly, Glass bank managers were all adamant about the importance of measurement and wealth creation as a prime objective of risk management.

This social aspect of risk that Penny bank engages in its operations includes judgement, moral values[64] and building customer relationships (Beck 2008, 1992). These two banks present

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This period would not be discussed extensively here, (especially since it was only evident from Glass bank) however, it is important to recognise the evolution of risk approach and the history of risk that is pivotal in appreciating what risk has unfolded into and why the bank's procedures are currently designed the way they are.

[64]The director of risk strategy at Glass bank does not believe moral values and ethics are synonymous. Ethics, he claims is doing what is right and ensuring good, fair and honest banking practices that does not hurt or deceive people. Moral values, according to the director, is an attempt to "be nice" and being nice is not the primary objective of the bank, it is to satisfy investors without being unethical (being good, not being nice).

opposite views of what the risk atmosphere contains and hence their processes and procedures are markedly different in risk approach.

Glass bank characterised risk as an external variable that can be objectively embedded into a risk framework, separate and distinct from social values. Risk, according to a senior executive should be approached objectively and not mingled with personal values, judgement or culture. This was expressed in his opinion when asked about social values in risk decisions:

> "*The whole aim is to avoid that to a certain extent. So we are trying to screen that out. Things like trust and value judgements are not a part of risk. However, we are still human beings and so we learn from our experiences, which may from time to time include a judgement call".* (Director, risk strategy, Glass Bank)

Glass bank has relied heavily on a numbers approach to risk management. Risk is managed from and risk decisions are made at the corporate level. This is also the case for all of the other banks that are a part of this study except for Penny bank. The risk director does not encourage the implementation of policies that promote the integration of social factors (like judgement, trust or moral values) into the credit risk process. The acumen of risk as an extrinsic phenomenon has led to a heavy dependence on quantitative measures in the bank risk management process. This in turn has manifested into more stringent and rigorous policies, especially as it relates to extending credit to customers or potential customers. For example, the bank exercises or advocates an almost "zero flexibility policy" in extending credit or a loan to a customer that does not qualify or falls short of the required criteria. However, the yardstick used to measure the customers'

ability to repay the loan is based solely on a numbers rating system that gauges the customer's financial position that can be objectively verified. Variables like income, past financial history, projected financial future, and credit scores are used to assess the customer. No social or non-measureable factors like honesty, trust worthiness or relationship building are considered. Similarly, when investing or gauging prospective return on investments, the bank relies on computer models that depict market trends, (including past history) and future prospective earnings:

> "*We have very strict guidelines on whether or not to extend credit to a customer. All banks should. The banking sector, because of its nature, has been heavily criticised for the financial crisis, and though I am not trying to alleviate blame, finance experts are the real culprits. So when a customer wants to borrow, we do not bend backwards to accommodate them, because this is what (in part) caused the financial meltdown. We have never been guilty of that. We rate our credit customers and if they pass the test, they are approved, if not, we advise them on how to strengthen their financial position to meet our requirements. The numbers don't lie. It is purely objective. If all the banks take this approach, then our financial system would be much stronger. Managers should not be able to use their own personal opinions or judgements to decide, let the numbers tell you. I don't decide. Corporate does. I create the customer file and do the assessment and forward it to corporate then wait on their decision. They don't even ask me, whether or not I know this customer or if I think credit should be given, they let the numbers tell them; and that's the way it should be".* (Credit Manager, Glass Bank)

7.2.3 Operationalizing risk objectively

The absence of value judgements and other perceived social facets from risk decisions at Glass bank forces a virtual perception of risk as a fully mathematical construct, dependent and reliant on calculable estimates. According to the director of risk strategy, this approach has worked well in the past and has kept the bank strong during the financial meltdown.

> "*We remained strong during the financial crisis although we suffered some heavy impairment losses. Had other banks taken other approach, and not try to manipulate risk into a subjective matter, perhaps the effects of the crisis would have been mitigated. Our capital structure, liquidity ratios and financial asset base are very good in light of what other banks are reporting and its out approach, our system and our professional attitudes toward risk that take most of the credit and this includes not corrupting the objectivity of risk. This is important"* (Director risk strategy, Glass Bank).

The reliance on mathematical estimates in the risk process is evident from Glass bank's financial statements, where risk disclosures are mostly quantified; Credit and market risks are presented as net exposures in numeric form and balance sheet items are presented to reflect the level of risk that the assets and liabilities include. The bank's customers are not a part of the risk disclosures as in Penny bank, and little emphasis is placed on the role of judgement in reaching the calculated numbers presented. Glass bank's approach to risk mirrors a *"factual representation"* of uncertainty (Knights, 1920), with little regard for subjectivity or the social process that resulted in the estimates.

The bank measures it customer satisfaction on a basis of returns it creates for these investors. For Glass bank, customer comfort is a function of protection from unnecessary risk and a reward of moderate to high returns[65]. The senior risk official does not believe that investors are interested in the *"social process"* of risk but are rather concerned by the end results that it produces. Hence, the banks risk management philosophy is designed to place more emphasis on results rather than process. This is akin to the suggestion that Adam et al (2000) framed as an attitude of risk management as a *"rewards"* oriented paragon. Consequently, the perception of risk as a purely measureable attribute can be accredited (as least in part) to the characterizing of risk based on profits and returns (Adam 2003). Hence, for Glass bank, success or failure of risk management, is not a reflection of the experiences of the risk process that may have included reflectivity to risk resolve (Beck 2000), but rather a product of the end result of estimations and calculations made and the extent to which such estimates represents an accurate reflection of market conditions (Buckley 2011). Understanding, perceiving and managing risk from this perspective would include knowledge of banking systems, risk profiling, market conditions and technology[66].

7.3 Risk perception at Penny bank

At Penny bank, risk is first conceived as a function of customer satisfaction. This approach to risk management is unique, since it focuses on social aspects that are considered to be the drivers of the numeric outcomes of risk. Understanding risk management at this bank involves an appreciation of customer gratification, reasoning and social conduct. The risk process begins and

[65]Senior risk executive, Glass bank

[66] Senior risk executive, Glass bank

ends with customer dialogue and personal interaction[67]. There is no formal risk framework that guides the process[68]. According to one of the branch managers, this makes Penny bank unique and different from other UK banking institutions. In addition, there is no conventional numeric system of assessing risk, but customer are rated based on trust, loyalty business approach and strength of management experience (in the case of business customers). One senior risk official (A branch manager) relates how part of the decision process to accept or reject a customer unfolds:

> *"In this bank, there is no credit scoring system; Decisions are intuitive. Not a case of putting numbers in a computer. So the need to understand risk is crucial. Full care and attention is given. A lot more dialogue, a lot of debate and discussion and human interaction. We meet with clients several times before we accept them as customers. We want to know the nature of their business; how long have they been in operation, who their customers are, how their customers are treated, why they want to do business with us. Do they share our principles and ideals? Not all our customers that pass our ratio test are accepted. We need to know that this customer share the spirit of our values, because we are focused on building long-term customer relations"* (Branch manager, Penny Bank).

[67]Branch manager, Penny Bank.

[68]When the FSA has regulatory control of the financial industry, as part of the tripartite group, regulatory guidance supported and recommended a formal risk framework. However, since the Bank of England was re-instated as thesole regulatory authority over the financial sector, some changes were made. While a formal risk framework is encouraged, it is not strongly recommended and there are no penalties for not having a framework.

The non-reliance of a credit scoring system that the branch manager refers to was mentioned by almost all of the participants of Penny bank. This suggests that the perceptions of the branch manager, the senior credit officer and the operational manager are similar as it relates to the culture of the bank and its policies on lending and credit. It also provides merit to the argument made by the personnel manager, that the bank places less emphasis on managing numbers, and more priority on customer satisfaction and customer relations.

The emphasis on the *"softer side"* of risk at Penny bank is unconventional, extraordinary and uncommon.[69] Managers and prospective investors develop a close relationship, in which the manager learns more about the client's operations, intentions and expectations. The customer is introduced to and made cognizant of the bank's strong social values; honesty, truthfulness, trustworthiness and the bank's conservative approach to risk. Risk management is not only a function of attaining an acceptable score but a well-rounded inclusive approach to knowing and understanding the customer's business. Mikes (2009, 2011) argues that an inclusive approach to risk galvanizes a holistic approach to risk that banking institutions are currently embracing. Power (2007) contends that the conventional, routinized, traditional approach to risk has failed our global financial system and that new direction is needed in resolving the management of risk. Perhaps Penny bank may represent (at least in part) a new trend in risk management.

The social atmosphere at Penny bank begins with its employees. The bank places extra care and devotes additional resources in hiring employees that are caring, good at communication, possess

[69]This is according to one of the branch managers.

strong moral values, well-grounded with integrity and properly endorsed by a wealth of work experience. According to another branch manager, employees are the key to selling the bank's values and principles:

> *"Ideally, we would like to know our customers for at least one or two years before doing business with them. Unfortunately, customers can't always wait that long, so we use our experienced staff to learn our customers as quickly as they can: Who are they? Why are they coming to us? Are they greedy? Do they want high returns in a short period? Do they value this relationship? The numbers don't answer these questions, but knowing the customer does. We turn away investors that come to us for the wrong reason. Just last week we had to say no to a customer that met all the criteria numerically, but failed our test of principles".* (Branch manager, Penny bank).

The perception of risk as a social epitome at Penny bank represents a different approach to risk management. Such an approach classifies risk as an amicable understanding between customers and the bank, where trust, integrity, and professional judgement are critical to understanding how investments are made and how markets operate. This slower, more conservative attitude to risk requires in depth knowledge of the social factors surrounding customers during the risk decision process. At Penny bank, existing customers are continually audited, not formally, but through cordial conversations and interactions in order to safeguard the bank's highly guarded reputation as a lending leader and a secure investment institution, based largely on strong moral principles.

As it relates to the enunciation of risk in the annual reports, risk does not form a separate section as with the other banks. Rather, discourse on risk is integrated throughout the report, most mostly reflected in the *"customer care"* section. Penny bank's risk principles are explicit and the bank's low tolerance policies to risk management are clearly stated.[70] Penny bank's risk disclosures take a more qualitative approach with little numbers in the reports[71] and lots of written communication on customers and risk attitudes:

> *"The bank's strict approach to risk means that it deliberately avoids high-risk transactions, even if the remuneration may be high at the time. Lending has a strong local involvement, where close customer relationship promotes low credit risks. This contributes to good risk management and sustaining a high service level, even when operations and the markets on which the bank operates are subject to strain"* (Penny bank, annual report, 2011)

The bank managers at Penny bank believe that the institution's strength during the financial crisis can be attributed to these policies, where the customer protection is adamant and takes precedence over high returns. This philosophy is rooted in the history of the bank and implemented throughout all aspects of its global operations.

[70]The low tolerance policies referred to here are the ones that relate to accepting or rejecting potential investors. Penny bank has a stringent *"rule of law"* that would lead to even wealthy customers being rejection, if the manager perceives that these customers are solely interested in further wealth creation in a limited time period. According to one branch manager, this can lead to risky investments both for the bank and the customer and no one benefits, since this types of investments cannot be reasonably sustained.

[71]Some years had more numbers presented than other years in the reports.

7.3.1 Background and operations

Penny bank was founded in 1920, just after world-war 1 when world economies were experiencing enormous financial stress from the war with an economic depression looming. The bank was founded on sound principles of trust and a unique approach to lending. The focus was on *"the people"* and this doctrine remained with the bank to this day.[72] The significance of the fundamentals and basic foundations of Penny bank is crucial in understanding the banks operations, especially as it relates to assessing and evaluating risk. According the personnel manager, risk is not an isolated construct, dependent on numbers or computer logics, but rather a process that flows through the bank, comprising a mix of *customer needs and superior banking standards:*

> *"We are not like other banks. Our values were not acquired or forced upon us. This bank was founded on a formula of pleasing people based on trust and morals. To this day, we are proud of our unique operations that has kept us and propelled us ahead of the competition. Take for instance, our competition would be busy crunching numbers and trying to determine the asset value as to assess whether or not a potential credit customer would repay. We would get to know the customer, their values, principles and moral attitudes. In other words, we want to know if we can trust this customer to repay. Once there is mutual trust between the bank and this customer then neither party has anything to worry about. The customer is now comfortable that the bank has his best interest at heart and the bank is not only justified in its decision to lend but is also happy to do so. Unlike some of the other banks, (Penny bank), gets its satisfaction not from the returns on*

[72]Personnel Manager – Penny Bank

investments or interests but by seeing and feeling the joy of our customers when we help them". (Personnel Manager, Penny Bank).

The unique approach that the personnel manager is referring to includes the inclusion of the risk environment throughout the bank. Penny bank has adopted an integrated approach to managing risk. In 1923, just two years after the bank commenced its operations, Penny bank was still suffering from continuous losses. However, instead of abandoning its risk philosophy[73] the bank revised its procedures to reflect more aggressive customer engagement. Management stewardship became the focus and transformation of its banking procedures was born. During the 1940's and the 1950's the bank grew extensively by forging alliances and merging with other banks, most of these collaborations were turned into acquisitions, as managers realised that the new partnerships brought human resources that were not harmonised with the philosophy, belief and placid but steady approach to risk management.

"Our history reflects our attitudes to risk. Initially formed alliances but we had to completely buyout our partners eventually and in a few instances separate from them because although we shared the same vision, our program of getting there were completely at odds. We have always had a subtle but forward-thinking approach to risk, and this did not always sit well with our new partners. Eventually, were proven right. We have enormous financial strength, and we are way ahead of the competition, not just financially, but morally and in terms of valuing people, customers". (Personnel manager, Penny Bank)

[73]According the personnel manager, risk was not the only factor that contributed to the bank's initial losses. The bank also suffered from poor investment strategy and a loss of customer confidence that usually accompanies a new business. Customers were uncertain that the bank would survived (being so new) and they opted instead to stay with the banks that they were more comfortable with.

Although Penny bank boasts of its special risk attitude, internal documents indicate that in 1973, the bank had a slight revision of its risk policies and introduced a more quantitative approach when the CEO resigned and the new CEO convinced the board that the current growth rate was too modest for a bank its size. Policies and procedures were essentially the same, but and for the first time profit-sharing based on returns from risk decisions were introduced. This rewards program, was not monetary but in stock options based on growth and surveys of customer satisfaction. The bank continued its modest approach to risk in the years that follow and financial deregulation in the country at that time encouraged and fuelled unscrupulous risk behaviours that led to an eventual collapse of the financial system in the 1990's. Penny bank was the least affected and one of the only three banks not rescued by the government at that time. Currently the bank has over 800 branches worldwide and has resorted to its initial customs on risk approach; the bonus plan was abandoned after the 1990's crisis. To this day, bonuses are not part of the rewards plan for managers. The personnel manager believes that bonus and other financial reward programs can greatly influence perception of risk and risk behaviours.[74]

7.3.2 Financial crisis effect on the risk process

For most of the smaller banks in this study, the financial crisis had a resounding effect on their operations. Two of the banks in this group, ascribed blame to the Bank for International Settlements (BIS) and particularly the Basel committee, for their financial dismay during the crisis. These banks subscribed to the procedures and advice of the Basel II and although they did

[74]The belief that rewards, especially financial rewards can heavily leverage perception and influence risk behaviour is one of the 4 major components of Adams (2003) risk framework introduced in chapter 3. This would be analyzed further in a subsequent section.

not go into bankruptcy, a large part of their asset base was eroded and their capital structure was not robust enough to withstand the financial strain when the market collapsed. The general manager of one of the small banks in this situation related his institution's story:

> *"Generally I am the last person to assign blame. And really there is no single factor that can be separated for us to chastise. It was a collection of bad investments, greedy investors, unscrupulous risk behaviour, and a housing market that was way over-priced. We could also talk about the financial instruments that, up to this day investors do not understand yet they create and use. Selling and re-selling them as if they were gold bullions. But to answer your question, we are a small bank and we believed in the Basel; So much that we followed almost all of their guidance. We kept the capital structure, we passed our liquidity test, we maintained our asset base, but yet we crumbled. Not completely but we crumbled. So now we have to ask ourselves, if even the Basel committee understands risk and the different conditions or obligations for different banks, especially those of our size. It was strenuous for us to keep to the Basel, especially the capital requirement, yet that did not protect us".* (General Manager, Bank C).

In letters of comments on the shortfalls of the Basel committee to adequately guide twenty-first century banking institutions, whose activities and financial reach are both global and diverse, the European Banking Federation, (EBF) prescribe that the Basel should revise the treatment of these highly volatile financial instruments to better reflect financial adequacy while maintaining their invaluable contribution to the market. According to the EBF, regulation, liquidity, capital

sufficiency and generally the resilience of the banking sector should be areas of concern for the Basel committee:

> "*The contemporary risk involved in derivative transactions should be reassessed, without removing their contribution to the effectiveness of the financial markets. The EBF welcomes the willingness of the Basel committee to set a framework of rules geared to improve the resilience of the banking sector. Nevertheless, as regards to the ongoing discussions, reconsidering the overall level of capital and liquidity in the financial sector, the European Banking Federation acknowledges the need for better regulation and improved supervision, which constitutes the bedrock of stability in the financial system. The enhancement of the capital requirements should be implemented once recovery is assured and be proportionate to the risks involved"* (European Banking Federation, 2010).

Like other organisations, (for example the Canadian Banking Association (CBA), the International Banking Federation (IBF) and the Japan Securities Dealers Association, (JSDA)), the EBF suggests that changes to banking procedures as a result of the financial meltdown, should be accompanied with the recognition that the current process of handling financial instruments is deficient. Arguably, the challenge for the Basel and banking institutions, is maintaining financial excellence, without disrupting the performance of market instruments (Hall 2010, Buckley 2011). The recent financial collapse is evidence that this may be a task too mountainous to sustain in the long run.

Perhaps, like Penny bank, more banking institutions can adopt a more cautious approach to risk management; however, the financial industry has been the backbone of many prosperous countries and balancing financial prosperity with economic and social sustenance, is a delicate act (American Banking Association 2010, Arnold 2009). Changing or adjusting risk management processes and procedures to reflect the substance of this equilibrium (both financial prosperity and economic stability) may be a slow process, especially since a substantial part of the emphasis is placed on continued financial prosperity (American Banking Association 2010).

7.3.3 The influence of rewards on risk decisions

Adams (2003) argues that risk decisions are shaped by four major precepts; mainly perception (what the decision maker thinks risk is), accidents (for example financial failures, market failures, company failures), tolerance (ability to take risk and to what extent) and rewards (bonuses, company shares, extravagant physical assets). According to Adams (2003), these four factors create a formula that can help construct a healthy and desirable risk decision or can be a blueprint for destruction. The challenge, Adams argues, is in using the right mix of each in various situations to arrive at the best desired organizational outcome. Of these, however, rewards has been the most heavily influential (Adams 2003). Some academics argue (for example Sikka 2011, Buckley 2011) that rewards that are tied to risk decisions are the major contributing factors to the financial meltdown. The Confederation of British Industries (CBI) in a critique of the Bank for International Settlements (BIS) warned that the promotion of excessive financial rewards for good risk behaviour is counter-productive. According to the CBI, if individuals (managers, risk experts) are showered with financial wealth for making the decisions that they were hired to make in the first place, then the concept of management stewardship is

deceased. Put differently, managers are being rewarded (excessively too) for acting as responsible agents on behalf of shareholders.

Glass bank and Penny bank are almost at opposite ends as it relates to the influence of rewards on risk decisions. Glass bank accentuates the belief that managers are stewards by performing their duties on behalf of shareholders and the bank as a whole. However, exemplary risk behaviour, actions and decisions that lead to increased financial accomplishment, beyond what is the ordinary call of duty should be recognised. According to the director of risk strategy, maintaining a sound and robust banking institution is the work of the manager but building resilience and continued financial growth is above what is required and should be recognised. In the case of Glass bank such recognition takes the form of great financial accolade.[75]

The significance of rewards for exceptional risk behaviour is not a new debate (see for example Moore 1972, Fischhoff et al 1981) and more recently (Fischhoff 2012, Sikka 2011, Buckley 2011). However, in light of the financial crisis, the role of rewards in shaping or preventing unscrupulous risk behaviours has been controversial. Some academics and professionals (Like Sikka, 2011, the Canadian Banking Association 2012) argue that the long term cost of the excessive financial rewards disposed on senior managers and other executives far out-weigh the benefits to the banking system and societies as a whole. Hence it cannot be sustained and if this

[75]The director was reluctant to admit the extent of the rewards given to senior managers when the bank performs well but did indicate that it has been reduced in the wake of the financial crisis. Buckley (2011) and Sikka (2011) argue that the banking industry has not learned the bitter lesson from excessive rewards and have resorted to similar bonus schemes. When asked about the rewards program for good risk behaviour, the director only acknowledged that it exists but gave no further details on it.

continues, then a cycle would develop, in which managers seek to circumvent any regulations to limit excessive risk taking, in search of exorbitant pay-outs at the expense of shareholders[76].

Others (like the ABA 2012, IBF 2012) argue that financial rewards are an integral part of systemic banking and to lower, reduce, or remove it completely is a backward step to innovative risk attitude, as executives are creators of economic growth and expansion and should be rewarded accordingly. The IBF (2012) argues that the Basel III should fervently address the subject of banking stability, not as an outcome of policies of individual banks, but as a holistic approach to financial success by proposing regulations that leads to equilibrium between financial strength, economic abundance, social sustenance and longevity in banking.[77] The ABA (2012) argues that rewards should be included in this mix as an outcome of organization progress, and should be perceived as congruent to banking stability and not adverse to it.

7.4 Risk decisions at other banks

The debate on the role of reward programs is engaging and central to how risk management is perceived by individuals that act on behalf of organizations. As previously noted, Glass bank risk officials believe that rewards are an important aspect of fruitful risk decisions and should be viewed and treated as such. Penny banking officials has a different point of view. At Penny bank, the rewards for excellent risk outcome should be personalized and recognized through the

[76]The ABA and the IBF both perceive managers and executives to be stewards acting on behalf of shareholders and in their best interest (Stewardship theory). Sikka and the CBA regard managers and senior banking officials as agents that seeks their own interests at shareholders expense (Agency theory).

[77]The IBF in their 2012 letter to the BIS, did not elaborate on what they meant by "social sustenance". Taken in context of the research, it is assumed to mean the welfare of investors, corporate citizenship, and well-being of the society in which the bank operates over the long run.

satisfaction and happiness of the customers and investors that managers serve and this achievement should be enough to motivate the manager to excel in his risk endeavours. Hence, it can be argued, that at Glass bank risk decisions are affected or influenced by rewards as a motivator; while at Penny bank customer satisfactory is the benchmark for decisions made. Although these two banks are the largest ones in this research, they are not the only banks that are a part of this study. Four (4) other smaller banks are also included in this research. Risk decisions at these banks were similar in most regards. For example, at small bank A and small bank C, risk is perceived as a mixture of forecast and computer analysis of past market trends and prospective market predictions, and some level of judgement if the numbers fall outside a certain range; The general manager at small bank A explains how part of the process in rendering a risk decision is conducted:

> *"Risk is a complicated thing. And we as a small bank have to do our best to try to make the best decisions for our customers and clients. When rendering a decision on whether or not to give or extend credit, that's a little easier, because we have specific guidelines to follow and if the customer meets those, then we can come to a decision faster. Of course there are situations where the customer does not meet all of the requirements, but we know the customer and we know their particular situation and so we know the risk of not repaying is low, because there is a certain element of trust that goes with it. It's based on knowledge, experience and wisdom. It not just a hard and fast case of yes and no. For the bigger banks it might be, but for us, we cannot afford to refuse people who are genuine and can repay. When it comes to making an investment now that's a bit more tricky. You see, we analyse the prospect of how profitable that investment might be and*

for a large part we use our special risk analysis program. It is not as sophisticated as with the big banks but we look for ranges and trends. If for example, we have been investing in let's say foreign exchange, and we see that all of a sudden there is a prospect for huge profits (based on the numbers) with no real announcement or changes in the economy to that particular currency, then we have to be cautious. So its not just what the numbers say. Experience will teach you what to do" (General Manager, small bank A)

The experience and wisdom referred to by small bank's A manager, is common among the other three (3) small banks in this research and is synonymous to the judgement calls pointed out by Penny bank and Glass bank. The financial crisis made it particularly challenging for the small banks and to some extent, blamed the regulatory authority for their mishaps[78]. This is because these banks believed that they forced themselves to follow the Basel II requirements and expected a certain measure of protection from following the guidance of the world's banking leaders. Nevertheless, one risk official from small bank D, noted that while it is good to follow Basel, the committee did not guarantee that its guidance and suggested policies are fault-proof:

"Of course we are disappointed in Basel; but what can we do? The Basel II is not an error-proof gospel. It comprises of suggestive policies and regulations for building a stronger banking system. They are supposed to be the best, and our own local authority (the then, Tripartite, now the bank of England) is so political and caters so much to the larger giants that we figured the Basel would be better. We meet all our local requirements and the Basel ones too; but look at us today, struggling to rebuild after the

[78]The discussion here on the small banks are in reference to themes and issues that were commonly expressed by managers and other risk officials at the four (4) or at least three (3) of the small banks that participated in this study.

worst banking crisis in our time. We are still lucky to be alive and floating, other banks did not make it through. Luckily we had stocked our retained earnings over the years and that provided us with a buffer, that a lot of other banks our size did not have" (Senior risk official, small bank B).

The emphasis placed on the regulatory authority's inclination to gratify the larger banks at the expense of smaller ones was a common theme among the smaller banks in this research. Nevertheless, one senior risk official at Glass bank (one of the larger banks in this study) noted that the bank did not start out as a financial giant, but very small and grew over the years. Hence, in his opinion, the only factors preventing the smaller banks from growing is their own fear of taking the opportunities that come their way.[79]

7.5 Perceptions of voluntary regulatory requirements

The need to regulate financial services is driven by the notion that customers and investors possess much less knowledge and financial services competence than the managers and other agents at the institutions (Buckley 2011). As a result, mandatory regulatory requirements forces banking professionals to adhere or act in the best interest of their clients, with high standards of ethics and acumen (Ross 2009). In the UK, compulsory banking requirements take the form

[79]The senior risk official at Glass bank added that risk was and would continue to be the most important factor in the bank's success. The bank has not changed its core principles and strategy to risk management and suggests that smaller banks take a more aggressive approach to risk to embrace expansion opportunities instead of denouncing the actions of bigger banks. However, the smaller banks seem to believe that the opportunities that existed many years ago for banks (in terms of expansion) are no longer present today. That the financial market is already saturated and the small banks can either sell or survive.

regulatory bodies[80], the FSA, the Treasury and the Bank of England. While obligatory banking regulators are essential to any advanced society (Hale, 1983) less attention or commitment is given to voluntary regulation. Over the last two decades, there has been no UK voluntary regulatory service to the banking sector except for international banking codes like those of the Basel committee (Lambert, 2013). However, with the advent of the financial crisis, there has been a call for a special voluntary regulatory committee to overseer financial operations of the UK financial sector. This supervisory committee would be called the Banking Standards Review Council (BSRC) and was initially proposed by a former Bank of England senior executive. The role of the new committee is still unclear but pundits argue that it is should be customer focused and would play a crucial role in rebuilding the broken trust and injured confidence caused by the financial crisis.

Some UK bank managers believe that the Basel committee is enough and that the banking industry should not be too heavily regulated if it is to create wealth and prosperity, not just for customers and investors but for economy and society as a whole:

> *"We already have the Basel. They are an international standards committee. They are the experts, we go straight to them. We don't need any local voluntary regulation to distract from the real missions of the banking system. Think about it, the FSA is here, the Bank of England is here, the Treasury is here and plus we have the Basel, why do we need another regulatory body? What can they do that the current ones are not already*

[80]This was before the Tripartite was reformed and the bank of England was given the single authority over the financial services sector.

doing? What value are they adding to the banking sector?" (Trainee risk official, Glass Bank)[81]

The belief that additional voluntary regulation is a hindrance to current banking practices was also shared by risk officials of Small bank A, and Small bank C. Not surprisingly, Penny banking officials believe that managers should always act in the best interest of customers and hence there would be no need for regulation. The problem with voluntary regulation, however, is that its effectiveness may be undermined since there is no disciple or sanctions for breaking or not adhering to the practices. Croucher (2014) argues that the myriad of bad publicity that follows any banking institution for non-adherence is enough to force compliance, but this theory may have been tested and defeated in light of the recent financial crisis, where the entire financial sector collapsed. Individually (a single bank), bad publicity may be conducive in curbing undesirable banking practices (like disregarding voluntary regulation) but collectively (lots of banks, or the entire banking system) bad publicity becomes ineffective.

One of the more significant issues with voluntary regulation, however, is whether a voluntary regulatory body would be free from political corruption and equipped with the expertise and technical capabilities to propel banking into a new and more trustworthy outcome (Roubini and Mihn, 2010).

[81]At the time that the interviews were conducted, the BSRC was not yet a topic of discussion. The interviews were conducted between 2012-2013, and news of the BSRC was released in early 2014. Although the BSRC was not yet a topic of discussion, managers and other banking officials were asked about their perceptions of voluntary banking regulations.

7.6 Perceptions of mandatory regulatory requirements

The perception of voluntary regulatory requirement may be driven by the circumstance that it is virtually impossible to enforce punishment or penalties for disobedience. Reliance on the institutions moral conduct and quest for favourable outcomes are fundamental to cohesion, devotion and success (Croucher 2014). If institutional managers are Stewarts, and perceive voluntary regulation to be valuable for maximizing customer satisfaction and returns, then implementing a voluntary regulatory body for the UK banking sector may be less controversial. However, the more contentious issue with regulation is not so much its need, but what kind of regulation and how much of it is needed (Reinhart and Rogoff, 2009). These concerns may be better explored in the context of regulation as a mandatory construct.

As discussed previously, stress testing is a key regulatory requirement by the UK Financial Services Authority. The dilemma with stress testing, though, as with all other regulatory requirements is that it is very fallible (Buckley 2011). Several banks, credit union houses and other financial services providers in the UK came tumbling down months after passing their stress test assessment (Hall 2010, Sikka 2014). This was even more pronounced in the USA than it was in the UK. Beck (2004, 2008) argues that the new customer is now more engaged with the decisions of their agents and would no longer accept failures as inevitable proxies of the system (Beck 2008). If this is true, then regulatory requirements may need to consider ways to make banking institutions more accountable for their risk decisions. During the financial crisis, risk experts and other executive decision makers, who benefited immensely from reckless risk decisions were not chastised for their careless risk actions and customers were left to feel the pinch (Johnson and Kwak 2010, Sikka 2011). This according to Adams (2003) poses a threat to

the disruption of the smooth flow of crisis management and financial stability, since punishment is a crucial factor in the balance and cohesion of the decision process.[82]

All of the banking institutions in this research have reported meeting all mandatory regulatory requirements. This however, does not shelter them from exposure to failure. Both Glass bank's and Penny bank's officials perceive the local FSA regulation as a simple routine exercise that presents no real challenge to the banks' ability to withstand heavy losses. The smaller banks however, revealed that they struggled to meet the minimum requirements (especially the stress test) and maintaining it (especially the capital structure) was stringent and reduced the amount of capital that can be employed to generate profits. Although none of the banks revealed their exact liquidity requirements, the larger banks did not seem to have any reservations about the importance of having a strong liquid position. This perception on liquidity may have been fuelled by the fact that several banks became insolvent during the financial crisis. Hence, whatever the requirement is, it may not have been sufficient to cushion the effects of the financial crash. Albeit the financial crisis was global, it was not without warning and regulators may have turned a blind eye to early signs that may have helped prevent the catastrophic outcome. Perhaps Buckley (2011) sums it up best:

> *"Regulation of banks and financial institutions left something to be desired. This is an understatement. The exploits of Bernard Madoff and his massive fraud were challenged by financial analysts but regulators failed to find anything untoward, where risk managers in banks discussed their worries with regulators who failed to react, and where*

[82]Adams (2003) argues that punishment for failures is essential to the functioning of the risk decision process. See Chapter 3 for more on Adams framework.

the slow and possibly flawed reactions of accounting bodies who wish to maintain inflexible their mark-to market rules, made matters worse. Regulators were widely guilty of groupthink and their common thought was that the housing boom was set to continue as interest rates seemed likely to remain low. Bankers government and customers were all sucked into this groupthink frame of mind" (Buckley 2011 PP 6-7)

7.7 Summary and Conclusions

There are several issues related to managers' perception and management of risk in the banking industry. This chapter discusses some of the factors that help shape a bank manager's perception and hence management of risk in UK banks. Before the financial crisis, some banks (Like Glass bank) perceived risk to be a concept more analogous to trends based on calculations generated by computer programs. This is particularly important when deciding to make an investment on behalf of a customer for satisfactory returns. To Glass bank, satisfaction is a notion measure in monetary terms and hence risk decisions are centralized at the top level to maximize intellectual capital and minimize errors or weak decisions.[83] The bank did not change the way in which risk has been managed, which indicates that the financial crisis had very little to do with the perception of risk at Glass bank. Adam's (2003) framework assumes risk decisions are affected or influenced by perception, and while this may be true, if perception of risk is unchanged then the risk process or other aspects of risk management ay remain unchanged. This seem to be the case (largely) with Glass bank.

[83]Glass bank senior officials believe that the best risk decision makers are the ones stationed at the top levels of the company's organization chart. Hence a centralised approach to risk is championed, much different from Penny bank where the opposite is true.

Penny bank operationalises risk and has taken a less aggressive approach to risk. There have been more changes to Penny bank's risk management approach but most of these changes surround the customer and were subtle in dimension and depth. For example, the branch managers received additional training on how to improve customer relationships and how to reduce credit risk by getting to know more about the customer, their moral values, and intentions. This is not significantly divergent from the current practices and management risk system in place. Hence, both Penny and Glass bank have continued on risk management paths after the financial crisis, similar to the ones they were on before the crash began. Sikka (2014, 2011 and 2009) argues that this trend is expected to continue as aggressive risk decision yields significant financial rewards for these managers with little or no discipline for failures or preventable errors.

While financial accolade may be a significant factor in the management and perception of risk, it is not exclusive and the many other circumstances that shape risk atmosphere in the banking industry must also be considered. Some of these include the size of a bank, its human resource expertise[84], identifying and capitalizing on relatively safe but fruitful investments, the regulatory environment and the type of risk considered. Nevertheless the IBF (2012) and the ABA (2012) argue that regardless of these factors, risk cultivation should be fuelled by a more stringent approach by regulators (in particular the Basel III), to promote a risk atmosphere that harmonizes wealth creation and economic prosperity with financial sustainability. Discovering that balance may be a challenging journey but crucial in maintaining a global banking system that is solid,

[84]One of the branch managers at Penny bank was particularly adamant about the importance of human expertise in the risk environment. He believes that the failure of the banking system could have been repressed if there were more capable human resource to handle crisis situations. This is especially important in the context of Structuration theory, since Giddens asserts that when a structure or system collapses or is in crisis, agents would abandon it in search of a new one. This was discussed earlier and would be highlighted again in chapter 8.

robust and trust worthy. Equally important is soliciting the corporation of not only the large banks, but the small and medium size banks as well, in working toward that common objective through legislation and enhanced risk policies.

Chapter 8: An unmodified philosophy of risk quantification

8.1 Introduction

The last chapter presented some of the findings on risk management and how bank managers currently perceive risk at their institutions. Bank managers and other banking risk experts perceive risk the way they do mostly because of a followed culture of quantification and measurement. Although, this approach to risk management has its credibility (for example in assessing and measuring returns and assessing and determining economic prosperity) it is arguably, inherently flawed (McGoun 1995) and encouraged a practice of personal wealth creation for managers and expert that is partly responsible for the financial crisis (Adams 2003). This chapter summarizes the findings presented in chapters 6 and 7 with a theoretical view of how risk attitudes and behaviour can be understood in the context of how agents interrelate with a structure created by them to support and validate their perception of risk.

The chapter begins with a synopsis of why risk management has remained largely unchanged even in the face of the financial crisis. This is based on the findings presented in chapter 7. Part of the reason for the continued measurement of risk (with little or no adjustments to the measures being used) is because this method produces a magnitude of financial prosperity for managers with little regard for investors and other stakeholders. This according the Adams (2003) is because the moral code that guides risk decisions has been missing from the risk atmosphere. Thus, the section that follows examines risk as a moral compass to decision making. This moral obligation is part of the agent's influence on the banking structure and this is discussed in the section that follows.

Part of the reason why risk management did not undergo any significant changes after the financial crisis is because of the political nature of risk regulation and the continuing debate about the importance of risk in economic wealth creation (Hall 2010, Buckley 2011). Hence, this chapter continues with a discussion of some of the political upheaval that has stalled regulations in shaping or creating a new attitude to risk management.

Giddens (1984, 1986) argues that his structuration theory is flat and that the structure is reactive (through agents) in crisis situations. Contextually, this means that there are no layers to how it is applied in social research since the interactions between structure and agent is organization-wide, regardless of levels (like micro or macro). The next section presents the theoretical contributions of this research and the context in which the findings can be understood by applying the dynamics of structures and agents.

The chapter concludes with a discussion on what risk management is likely to resemble going forward, based on its history and current trend.

8.2 Understanding risk behaviour and attitudes

McGoun (1995) argues that risk management has emerged with a perception that risk can be accurately measured based on past or historic data as a solid guide for future uncertainty. This approach has worked well in the past for financial experts, who according to Power (2004, 2009) did not seize the opportunity to reform risk management by venturing into other ways in which risk can be appreciated, but rather developed an impetus for conventional risk management by measuring and evaluating almost everything and anything relating to future events and labelling

it risk. Eventual meltdowns of the financial system called into question the risk management practices and policies of financial institutions. While the effects were catastrophic, the crisis presents a new and emerging opportunity for risk management reform. However, this research finds that this opportunity was minimally capitalised. Very little changes, amendments or revisions were done to the system that supports risk decision and risk management. Rather than examine the philosophy of risk management and forging changes, risk experts and managers continued along the kindred path that was blamed for the financial crisis.

But why has there been little or no real change to the system? Not only was the financial crisis destructive (financially) but it was also global. Why then were experts willing to forgo an opportunity for reform (however gradual) and opt instead to follow a similar path that brought the crisis in the first place? This can be partly explained by the findings of this study and Giddens theory of structuration. This research discovers that familiarity with the system and ease of use are two of the reasons for the reluctance to change. This is supported by Giddens theory in his explanation of routinization (discussed in chapter 4 and later in section 8.4 of this chapter). According to Giddens familiarity with the structure invites a reluctance to willingly change, since the structure (which is social) contains "Primacy" an authoritative power that does not require consciousness in routine actions. In context, managers and experts do not want to invest the time, effort and resources needed to divert from the old structure into a new one. This study also discovers (especially in Glass bank) that UK bank managers do not believe that the system is flawed and therefore is not in need of revising. A third possibility for the reluctance to changing the way in which risk is managed is the financial rewards that the current system produces for managers and CEO's with little risk of punishment or disciple for failure or

significant errors. This perception is also validated by Giddens theory that purports agents' use of the structure for their own 'constitutionality'. The structure becomes a means of legitimacy for agents' actions and hence the reproduction is constant and continual since it serves as a medium for agents operations.

The intensification of the same system of managing risk that the financial crisis was perceived to be a result of is an indication of the challenges present in trying to change a system even if it is believed to be flawed. The uncertainty that surrounds the emergence of a new system may be a risk higher than the familiarity of the old one. Numbers and measurement has defined risk for centuries with little incidences. The recent financial crisis was not only a result of risk taking (Hall 2010, the Turner review 2009) but a combination of factors which includes governance failure, greed and immorality (Adams 2003). Hence, managers take solace in the belief that the current system is the best option and a divergence from it would represent a backward step in risk appreciation. This is particularly true and revered by the risk managers at Glass bank. If this perception continues, risk management is unlikely to evolve into anything other than what the current system for risk management supports. This leaves uncharted opportunities for risk to be examined as a moral epitome (Adams 2003) or a social archetype, with more aspects of cultural underpinnings and judgement calls.

8.3 Risk and Morality

In 2003, Adams developed a framework in which risk management and decisions can be understood[85] (see chapter 3). In this framework Adams conceptualizes risk as a network of interrelated workings of the organizational environment, human actions and rewards or sanctions for those actions. According to Adams (2003) risk is a changing embodiment that should be approached and managed integrally with a moral undertone. This argument was mirrored by Power (2003) who contends that risk management is a constructed behaviour, supported by a management system that is idealistic and self-seeking; Power (2003) argues that, the self-seeking interest can be replaced by ethically justifiable behaviours through routine practices and habits that promote the greater good, similarly to what happens in corporations that promote corporate social responsibility. The routine practices and habits that Power describes are comparable to the ones that Giddens believe forms the basis for agent's actions in his theory of structuration. If these actions are to be grounded in a moral archetype, then the organization itself must contain or promote the means to encourage and sustain risk decisions as a moral compass (Garland 2003). Structuration theory suggests that the structure is the medium in which these moral actions can be established, since it is the channel for all human actions.

If morality is to become a part of risk decisions, there are other issues to be considered. For example, who would be responsible for designing and implementing the new moral component of risk? What form would it take? Would it bring any real improvement to risk management? Who would benefit? What would be the opportunity cost of including moral behaviour in risk

[85]Adam's risk framework was presented and discussed earlier in chapter 3. The analysis here forms an alternative way in which risk can be perceived; as a moral code. Adams framework is rounded in risk being perceived as part of a wider moral obligation.

decisions? Garland (2003) and Power (2003) suggest that risk management systems be revisited and revised without the forceful hand of external regulators. However, Beck (2004) disagrees and argues that any real change in the risk management process may be a task too mountainous for voluntary occurrence from management and must be coerced by investors and consumers[86].

Glass bank risk officials believe that the moral obligation of risk is satisfied when investors are pleased with their returns. To glass bank managers, moral behaviour is not exclusive to the objective of risk management, which is to provide satisfactory and above average returns as much as possible. The structure is the focus of the decision, and the agent is a support mechanism to carry out the actions that the structure requires. This sentiment was not shared by managers of Penny bank, who see risk management as a process that involves all aspects of human presence. At Penny bank, the agent is the foothold, and the structure is the means by which agents execute their actions.

Hunt (2003) provides an argument as to why the morality of risk has been excluded from the management process. According to Hunt (2003), the increasing discourse on risk and its effect on everyday life[87] have generated a lot of enthusiasm that has led to the discussion on the morality of risk decisions. However, the expansion of calculative approaches to risk management has prevented any moral conditions from materializing (Hunt 2003). Hunt argues that this is unlikely to change since any change must involve governmental regulation which is too political to be moral.

[86]This argument by Beck (2004) was discussed in chapter 3. Beck was not referring specifically to the inclusion of morality in risk management but any change to risk as a whole that investors' may desire.

[87]Some of the effects of risk decisions to everyday life is presented in the next section.

8.4 Risk and everyday life

The debate on risk has been intensified in recent years (especially as a result of the financial crisis) mostly because of its impact on human life. In the United States, and the United Kingdom almost every citizen was affected in some form as a result of the crisis (Buckley 2011). The discussion on risk management is no longer a matter for experts and professionals but also for the broader society that is affected by these decisions. Giddens (1991) argues that risk is social and that it produces a state of ontological insecurity and anxiety in everyday life. This broken state, according to Giddens, leads to a breakdown in trust not just among individuals but in systems, organizations and orders. Luhmann (1988) contends that any organization or system must contain trust in order to function effectively. If these arguments are to be taken as solid or realistic, then investors, customers and managers must first trust themselves and the process to be representative of the wider society. Retirement funds, education trusts, entertainment savings and monies for everyday living was grossly diminished and in some cases completely lost. Not only did this lead to a reduced standard of living for investors but it also invited an emotional stressful situation that sometimes led to diminished health and in extreme cases death (Buckley 2011). The insecurity as argued by Giddens (1977, 1971) stirred a social disorder and rocked the trust in the entire system.

Most persons were however, affected indirectly by the financial crisis. Investors are part of a family structure that depends on them for security and a strong and stable financial future. When this future becomes shaky or uncertain because of questionable risk decisions then society would react (Beck 2008). This reaction, according to Beck, would take a renewed form of monitoring

and engagement that can cause significant changes in the system that represents the common person. To date, such change is still awaiting to happen as the risk decisions continue to follow a similar path that led to the financial dismay. Perhaps in later years, or with a new generation, the interest that Beck foretold would surface and society would demand better representation from managers and institutions. Currently, it appears that society is being enacted by managers and institutional players whose goals, objectives and interests may not be in congruence with the ordinary investor that they supposedly represent.

The managers at Penny bank, has adopted a customer focused philosophy that appears to be moving in the direction of satisfying the common investor and hence the wider society. Glass bank managers believe in a cultural doctrine that equates profits and returns with investor satisfaction. In both cases, risk is used as a means to an end and the customer is the intermediary between risk and returns. This becomes crucial when their livelihood and, standard of living, their futures and families are pledged.

8.5 Research contribution

Contribution to the academic debate

This research explores risk perception and management in UK banks. It presents empirical evidence on managers' viewpoints on the concept of risk and how it should be managed against the backdrop of wealth creation, investor satisfaction, and agents' interrelationship with the virtual system, regulation and politics. It contributes to the academic debate by offering an avenue for discourse on differences in perception among UK bank managers and how individual banks approach the concept of risk and thus the risk management processes that are in place. The

research borrows from and builds on previous work from Mikes (2009 and 2011) and Wahlstrom (2009) who both examined risk perception in banking institutions. However, it is distinct in the use of structuration theory, to understand the relationship between the manager and the banking structure. This theory however, is not without weaknesses, both in doctrine and application.

This study also contributes to the debate by offering evidence of the changes that were brought to the risk management process as a result of the financial crisis. These changes, which (for the most part) takes the form of an intensification of the old risk management practices, has implication for the direction of risk and follows a trend of risk measurement founded on a flawed system of probability and estimation (McGoun 1995). Although the financial crisis brought with it an opportunity for risk reform and amendments, it is uncertain whether the strengthening of the old measures of risk represents an improved mechanism and the results or evidence that supports the argument for a state of improvement. Hence this generates or enhances the risk conversation and academic discourse.

Contribution to theory

This exploratory research also contributes to the theoretical perspective on the interconnection between agents and structure. Giddens (1984) argues that in situations of crises (like the financial crisis)[88] agents would abandon the structure and actively seek new routines that would become stabilized as the new structure over time (Giddens 1984). However, this research finds that the structure was not abandoned and that agents did not actively seek new habits or routines, but rather the old structure was reinforced, sharpened and exalted. Thus the new structure that

[88]More on crisis and structuration theory in chapter 4.

emerged was an extension of the old one. Perhaps this is unique to risk and banking but it presents a different perspective on how agents react in relation to their reliance on the structure in situations of disaster or catastrophe. This can lead to further debate on Giddens assertion of the ontological needs that the new structure satisfies and the sense of security that it brings.

Another aspect of theoretical discernment that this research offers is the notion of "virtual structure". Giddens (1984), contends that the structure is virtual (a concept of the mind) and is non-existent without the agent. However, the reliance on the structure as a separate and objective construct by agents (especially the managers at Glass bank), seems to suggest the presence of "structural dualism" and not just a "duality of structure" (Layder 1987)[89] This offers a different perspective on how agents interact with the structure and interdependence that leads to the reproduction of structures.

However, the shortfalls of this theory should also be taken into consideration, especially in the context of this research. Structuration asserts a state of an assembled social that human beings draw from and use to suit their situational needs. Hence, experiences and knowledge are key to understanding managers' perception. This state of predisposed perception may not be applicable to situations where the already existing social may not be present. For example, in situations where managers may want to create their own perception at the time that the interview is being conducted.

[89]The notion of structural dualism was presented by Layder (1984, 1986) as a counter argument to Giddens duality of structure. Layder (1986) argues that the structure does exist independently of the agent and can be enacted and operated by the agent by choice. A discussion on this was presented in chapter 4.

Contribution to practice

Although this research was not intended to produce any significant contributions to practice, it can be used as a stepping stone and a guide with practical implications. This study presents the results of how risk is managed in UK banks and other financial institutions (like credit unions) as well as other banking institutions can use it to gain insight on perspectives of risk management decisions and processes as revealed by some UK bank managers. It is not expected that this would lead to a complete metamorphosis of risk but can provide acumen to build on.

8.6 Opportunities for future research

This research can lead to further investigation into risk and human behaviour. One area for possible further research is risk and gender. Human beings are all different and people behave and act differently in various situations. Wodak (1997) argues that men and women analyse, understand and interpret situations differently. Hence, there is an opportunity to investigate or to explore the perception of risk of female bank managers relative to their male counterparts. This can take the form or a comparative study or can be done over a longer time period (longitudinal study).

Additionally, another area of opportunity for risk research is to conduct empirical studies on Adams (2003) framework. Adams contends that the arms of his framework integrate or interact with each other to produce the risk atmosphere in which the risk decision is made. However, Adams framework is not based on empirical evidence. Since perception is one of his tenets in the framework, this research can lead to further work in examining how the four factors of

Adams framework interact (if they do) to create the risk environment, crucial to the outcome (risk decision)

Another area of research that can be examined from this project is the differences in perceptions of operational managers and senior managers. This research found that most of the managers at Penny bank that were risk decision makers were operational managers. However, the managers at Glass bank were mostly senior managers and executives. It is possible that their perception of risk can be as a result of their position and their everyday encounter with the risk atmosphere. Operational managers that are more actively involved with clients and customers are probably likely to have a different perception of risk and its importance than senior managers who make decisions based on the numbers presented to them.

The importance of regulation emerged as a more critical factor during the financial crisis. This research discussed the importance of regulation as revealed by the bank managers that were interviewed. However, perceptions of voluntary and involuntary regulations were not explored in depth. Although regulation is shunned (to a certain extent) by the larger banks (as this study revealed) the smaller banks tend to perceive regulatory role quite differently. This research can lead to further exploration into the perceptions of voluntary and involuntary regulation especially in small banks.

This study uses Giddens structuration theory to understand the perception of bank managers in the UK. Similar research can be conducted using other theories. For example, institutional theory, actor-network theory and agency theory can all be used to provide a basis for

understanding risk perception in organisations. Agency theory may provide a completely different analysis of how humans or agents behave without the consciousness of a virtual structure.

8.7 Summary and conclusions

This research provides empirical evidence on risk perceptions of UK bank managers on the backdrop of structuration theory. The study suggests that risk is an evolving concept but its roots in mathematical measurements make it difficult to welcome or execute changes. The study seeks to explore how UK bank managers perceive risk and whether or not the financial crisis brought any significant changes to the risk process and if not, why. It also examines the risks that are of importance to UK bank managers. The research finds that risk has its early characterization as a function of probability and estimation and that such a calculable approach was encouraged by regulation that required risk to be quantified.

The quantification of risk itself did not pose a threat to the financial system but the measures used were flawed and this led to an eventual collapse of the financial system. McGoun (1995) identified some of the flaws in the measurement of risk (for example using historical data consistently as a mark for future performance and applying probability estimates not designed for business), and warns that these may lead to inaccuracies in risk estimation.

This study finds that the managers and hence institutions rely heavily on the system of measurement and intensified efforts during and after the crisis to solidify their belief and perception of risk. The research also finds that some managers (like the ones at glass bank view

the structure as independent and separate from the agent while other managers (like the ones at Penny bank) perceive the agent and the structure as an interactive effort.

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Appendix A

Sample Letter: Request for Interview

Date

Dear Sir or Madam,

My name is Dominic Roberts and I am currently a PhD student at the University of Essex under the supervision and guidance of Dr. Iqbal Khadaroo and Dr. Ann Christine Fransden. My research involves exploring the perception of bank managers in the UK in regards to risk.

As part of my research work, I endeavour to conduct interviews with bank managers, risk managers and other banking personnel who may be associated with the risk process. In this regard, I would like to solicit your assistance in obtaining your opinion of risk as a banking expert. I would be very grateful if you would agree to an interview to discuss a few issues relating to this topic. In return, I would share my findings with your bank before I submit it as my PhD thesis.

Please be assured that you would not be asked nor required to disclose any sensitive information pertinent to your bank's operations or activities. This interview is solely to gain insight into what you think about risk and risk management as part of my research studies here at Essex University. The interview is expected to last for approximately forty minutes; a list of the questions is attached.

The information obtained would be treated in the strictest of confidence as guided by the university's code of ethics for research studies. Complete anonymity would be maintained and

no name of any person or the name of your bank or any institution would be mentioned in my research.

Thank you for your time, and I look forward to hearing from you,

Yours sincerely,

.....

Dominic Roberts, Msc, MAcc

PhD Candidate, Accounting

Email: darobe@essex.ac.uk

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Appendix B

Informed consent form

Informed Consent From

I hereby consent, freely to participate in a research exercise conducted by Dominic Roberts for the purposes of carrying on research work on the organisation by which I am employed. It is my understanding that all information obtained by me, whether by interview, questionnaire or discussion would be kept confidential, safely secured and reviewed by myself or the interviewer before being published. It is also my understanding that my name nor the names of my colleagues, nor the name of my organization nor any names mentioned during this interview would be publicized.

I am older than 18 years and capable of participation.

Signature of participant Signature of researcher

....

Date: .....

Appendix C

Interview Schedule

Date 2012	**Position of interviewee**	**Length of interview**	**General comments**
Jan 24	Branch Manager	75 Minutes	A few interruptions
Feb 3	Manager, commercial and credit Operations	82 minutes	Several interruptions
Feb 13	Branch manager	62 minutes	Interview cut short re-scheduled for Mar 28
Feb 28	Director of risk strategy	50 minutes	Interview cut short
Mar 1	Branch manager	75 minutes	No interruptions
Mar 19	Manager, risk strategy	90 minutes	Several interruptions
Mar 28	Branch manager	56 minutes	Continued from Feb 13
April 10	Operations manager	68 minutes	No interruptions
August 6	Branch Manager	71 minutes	No interruptions
August 14	Branch Manager	N/A	Cancelled
August 21	Operations Manager	73 minutes	No interruptions
August 30	Credit risk Manager	80 minutes	No interruptions
Sept 4	Branch Manager	N/A	Cancelled
Sept 19	Personnel Manager	63 minutes	No interruptions
Sept 19	Senior risk official	69 minutes	No interruptions

Oct 17	Operations Manager	74 minutes	No interruptions
Oct 17	Deputy manager, Banking operations	48 minutes	Interview cut short
2013 Feb 2	Head of risk operations	58 minutes	No interruptions
Feb 7	Director of risk strategy and risk trainee	30 minutes	Follow-up interview, risk trainee present.
Feb 15	Credit manager	75 minutes	No interruptions
Mar 14	Branch manager	82 minutes	No interruptions
Mar 14	Branch manager	N/A	Cancelled
April 10	Personnel manger	87 minutes	Substitute for the branch manager
April 18	General manager	76 minutes	No interruptions
April 18	Senior risk official	80 minutes	A few interruptions
May 2	Branch manager	74 minutes	No interruptions
May 15	General manager	75 minutes	No interruptions
June 20	Assistant manager, operations	62 minutes	No interruptions

Appendix D

Semi-Structured Interview Questions

General Questions: Participant Background

1. What are your current and previous positions in the organization?
2. How long have you been employed here?
3. What are your formal responsibilities regarding risk taking?

General Questions: Financial Institution

1. In what ways was your bank affected by the Global financial crisis? Meaning, specifically, was your bank rescued by the government?
2. In response to the Global Financial Crisis, in what ways would you say the bank has changed in the way you manage risk?
3. What role did you have in changing and or implementing these changes? Can you tell me some of the difficulties (if any) you encountered in trying to implement some of these changes?

How do bank managers in the UK perceive risk?

1. What does risk mean to you? When you hear the word "risk" what immediately comes to mind?
2. How important would you say your understanding of risk is in making a risk decision?
3. Before the financial crisis, did you envision risk differently than you do now? If so, How?
4. To what extent do you think that your personal experiences, values, culture or norms are a part of the decisions you make?
5. Do you think that there are other possible ways of defining or understanding risk that does not require estimating numbers or equations?

What risks are perceived as important to bank managers?

1. What risks are of most concern to you? Why?
2. If you are to rank these four risk categories (Credit, Market, Liquidity and Operational) in order of importance, in what order would they appear?
3. Do you think that regulations (like the Basel III) influences your perception of what risks are most important?
4. What is your opinion of the new Basel III capital requirements as it relates to risk management? Would you say that the Basel III is very helpful in understanding, monitoring, controlling or assessing risk?
5.

What processes do banks have in place to manage their risks?

1. What does 'risk process' mean to you?
2. What enterprise risk management processes are in place to manage risks?
3. Do you think that more attention should be given to the risk process before a risk decision is made? If so, Why?
4. Have these processes changed since the financial crisis? If so, how have they changed?
5. Would you say that these changes were incremental or revolutionary? Why?
6. How does your bank disclose risks?
7. Are there any means in place to monitor the risk processes?

Closing questions:

1. Is there anything else you would like to share with me as it relates to risk management at your organisation?
2. Can you recommend anyone else I can talk to in this organisation concerning the issue of risk?
3. Can I contact you in the event of a follow up or future research?