When institutions go bad

Reflections on governance and leadership arising from the Australian banking industry

To everything, turn, turn, turn

There is a season, turn, turn, turn

Pete Seeger

(Ecclesiastes 3:1-8)

A paper from Dalmau Consulting

Tim Dalmau

When institutions go bad

Reflections on governance and leadership arising from the Australian banking

Tim Dalmau is CEO of Dalmau Consulting with over 36 years experience in helping leaders transform organizations throughout the world as a trusted business advisor.

Introduction

Recently, I accepted an invitation to a meeting of like-minded people concerned about leadership. A colleague of mine conducts Big Ideas Leadership lunches on a regular basis and timely topics to discuss. The topic for this recent lunch was the current Australian Royal Commission[1] into the banking sector .

For weeks now, this Royal Commission has been front page news. Donald Trump has been relegated to the back pages on more than one occasion as the media take us through case after case of scandalous and unconscionable impropriety, disregard of customer needs and breath-taking instances of unethical behavior. Two days we learned that one of Australia's largest banks and some of its executives are about to face criminal charges. Today we learn of a AUD$700m fine imposed on another bank for failing to prevent a system breakdown that allowed for the possibility of money laundering and support of terrorist activities.

If you live in Australia and are a literate, thoughtful person then it would be hard not to feel some sense of shock and shame at what is being revealed on a daily basis. If you live outside Australia you might have even heard the collective gasp of a nation as it was told of cases where banks continue intentionally to charge dead people for non-existent services, of a Board Chairman actively falsifying regulatory documents and other equally curious misdeeds. Social researcher and academic Hugh Mackay suggests these developments are part of a wider societal fragmentation and loss of trust in our institutions.

This, it seems, is the tip of a very large iceberg. If you are reading this in the USA think of the Wells Fargo fraud scandal and then widen it to include most of the major banks across a nation behaving similarly. As expected, there have been scalps: some executives, and the odd CEO and Chairman have resigned. On the other hand, if you live in some African countries or Indonesia then what is referred to in this paper might all be somewhat passé.

For some this represents a crisis of trust in the banking industry. For the industry itself it represents a PR nightmare at the very least. For our Big Ideas Leadership lunch it was great fodder for conversation about leadership, values, ethics and the nature of organizations.

The topic is close to my heart - five of the banks appearing before this Royal Commission are, or have been, clients. But it is deeper than this, for the daily media feed raises questions of what makes for effective governance in listed and non-listed companies, and what makes for effective leadership. Deeper still it challenges us to define the elements of a system that will deliver effective governance and leadership and ensure the gross abuses being revealed through this Commission are no more.

Range of responses

There have been a range of explanations and reactions including

- Search for a fix that will remove the issue altogether
- Bemoan the lack of certain core values

1. Technically called the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry

among senior executives

- Suggest those involved lacked some fundamental ethics
- Blame a bad culture in the industry and its organizations
- Suggest tougher regulation or laws will remove the problem

I must admit to being less shocked than many and somewhat resigned about the issues. These revelations are not unexpected nor abnormal. I find it hard to feel the outrage that so many to feel at the moment. On the other hand, each extra day of Royal Commission hearings does raise my eyebrows one more notch.

A pervasive pattern

It is suggested that the range of dysfunctional human behavior and poor leadership uncovered in the Australian banking industry through this Royal Commission is neither extreme, specific to the financial services sector, not unexpected and certainly not restricted to Australia. Moreover, it is suggested there is no silver bullet to prevent this recurring.

The Wells Fargo matter and the alleged fraud at the center of Lloyds takeover of HBOS in the UK are testament to this pattern of behavior crossing many geographical boundaries among banks. The 2013 Royal Commission into Institutional Responses to Child Sexual Abuse, and the recent conviction of an Australian Catholic archbishop for hiding sexual abuse in the past indicates the same behavior crosses community sectors. The investigation by the U.K. Serious Fraud Office into Rio Tinto's dealings in the West African nation of Guinea are testament to the pattern spanning different economic and industrial sectors.

Then there is my own direct and personal experience of working with CEO's of government departments here in Australia who subordinate due process and fair treatment for the whims of the political party in power of which they are active card-carrying members.

Finally, the allegations surrounding the White House and the Kremlin illustrate its presence at the highest levels of government.

A macro perspective

Looking back, this inquiry into the Australian banking system is not the first and nor will it be the last. Robert Kay and Chris Goldspink, using the work of Crawford Holling, provide a very useful metaphor for what they describe as a cycle of phases through which organizations travel. This cycle may well apply to a whole sector, such as banking. They suggest the phases are best thought of as a repetitive cycle of four phases.

During the ***Conservation*** phase the focus is on consolidating the organization's position in the market and aligning organizational investments and processes to service it in an increasingly efficient manner.

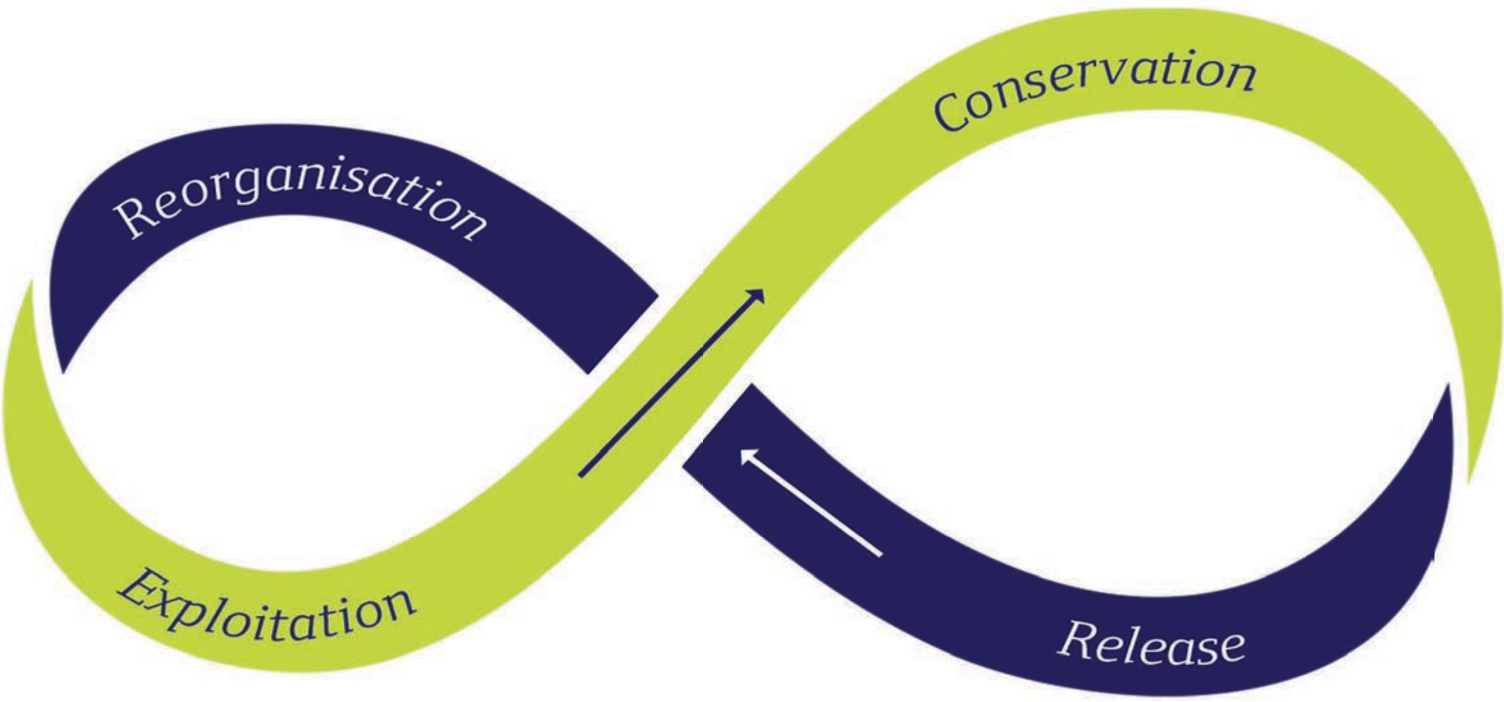
This is typically the longest lasting of the four phases and, in terms of responding to and harvesting a market opportunity, could span many decades. We might say the banking industry has been enjoying this phase for some time in Australia.

The next phase, ***Release***, is usually triggered by a disruption and this can be caused simply by poor management, inter alia. Poor management and poor leadership are the kindest words one might apply to the Australian banking sector in the light of recent revelations.

As the next phase, ***Reorganization***, occurs we see existing assets and systems are abandoned or sold, high levels of innovation, uncertainty and instability. Old business models are yet to be replaced by a new, dominant approach.
In the fourth phase of ***Exploitation*** the multitude of small activities that characterized the Reorganization phase are reduced to a few dominant models that prove most effective at capturing the available resources and maximizing value from the environment.
Using this metaphor and the work of Holling, Goldspink and Kay we might view the Royal Commission as a stimulus or agent of change for the whole banking sector, tripping it out of a comfortable period of the Conservation Phase into the turbulent phases of both Release and Reorganization.
If this were the case then we can look forward to new expressions of organization, governance and practice as those charged with leadership create new forms and systems. As such this transition is to be welcomed, but not welcomed unconditionally, for as sure as the sun rises tomorrow there will be the need for another period of Release at some time in the future.

The unethical banker

Just below the surface of the despair and outrage at the banking revelations is a belief that this would not have happened if executives at the top of these organizations had a proper set of values and behaved ethically. You see this in the sub-text of reports in newspapers, the holier-than-thou words of television commentators and the conversations over dinner tables.
It is also there when these same three social spaces consider the behavior of church leaders convicted of covering up sexual abuse. It was there when the collusion between some Arthur Anderson auditors and Enron executives was made public in 2001.
Putting aside the cases where organizations are led by psychopaths, there are three alternative and potentially useful perspectives that can bear on these "unethical" individuals.
Firstly, a core presupposition about human



As per Kay and Goldspink (2015)

behavior from that body of knowledge known as neuro-linguistic programming (NLP) is that *we all do the best we know how with the resources we have available at the time, given that our intention is self-caring.* This presupposition is, in my experience universally true and suggests that, far from being ethically bankrupt or incompetent managers, these individuals were, in fact, acting in a manner that could be described as the best they knew how.

But whether they knew how to behave appropriately and whether they possessed the requisite technical competence and leadership resources to act and decide in the valid interests of their customers are other and very valid questions. In this regard they are no different to every other person.

Secondly, the work of Chris Argyris and Donald Schon over decades illustrates that each of us regularly espouses one set of values and yet is seen to practice another. Though not always true of all of us all of the time, it is true for most of us most of the time and especially when stressed in one way or another.

As humans we are incongruent creatures and companies' espoused values are displayed more often in the breach than adherence. The banks, the churches, the glass towers of large corporations, our community institutions - all have espoused values and all are different from the values-in-use we see each day – none are immune from this discrepancy.

In this context, bemoaning the absence of "proper" values in the leaders of banks is a futile endeavor.

Thirdly, it was Meg Wheatley who stated that ethics are the shared set of values of a community. Whilst true, it is instructive to ask which community?

The community of the front page of newspapers, the community of our own social group, or indeed the community of executives in banks? Yes, they are a community, at least in the sense of a sub-culture with its own mores, artifacts, perspectives and values.

Using the work of Dexter Dunphy and his colleagues, Viv Oates and I once proposed a model of six different ethical levels or sub-cultures:-

- Level 1: Rejection. Exploit, use and abuse others, and especially their relative disadvantages, for your own gain, without any regard for consequence.
- Level 2: Non-responsiveness. Operate from a position that measures success only in terms of one's own gain; exploit others where there is a power or monetary gain to be had, and have little real concern for the law of regulation.
- Level 3: Compliance. Do the minimum required by the relevant law of the land, and continue to exploit others, but minimize consequential risk. In other words, don't get caught out.
- Level 4: Efficiency. Regard yourself as a good citizen (individual or corporate), and act in a manner that respects and upholds the morals, values, regulations, customs and styles of wider society; act in a holistic, integrated way across all areas of activity.
- Level 5: Proactivity. Be a proactive agent for values-led leadership in the context of wider society in all areas of activity, recognizing this as a point of personal or corporate distinction. Or, be a role model by going "above and beyond."
- Level 6: Sustaining. Recognize one's place in the grander scheme of things, and the interconnectedness of everyone as well as everything, and act as a coevolutionary element to foster greater effectiveness for the whole.

Against this scale, it is clear that the Australian banks have been espousing an ethic that is at Levels 4 or 5, and occasionally the odd instance of Level 6, but in fact the Royal Commission has laid bare a sub-culture among various

groups of executives reminiscent of Level 2.
It is not so much that individuals within these institutions could be described as unethical people (as some in the media have sought to do) but rather within their "group" this Level 2 mindset is the norm – they have behaved ethically at the level and in the manner set by their reference group.

Intentionality

Ian Sampson has commented it is hard to imaging how some of the practices uncovered in the Royal Commission could have been carried forward without a deliberate and intentional disregard of the harm executives knew they were doing (or knew colleagues were doing) to others *and* the knowledge they had about the self serving benefits they would derive as a result of that harm to others.
In general, I see the world in similar terms, though I am aware of two instances where the CEO's engaged in fraudulent (and in one case) psychopathological behavior without any member of the respective Boards or the shareholders being aware until far too late.
The behavior being revealed each day by the Royal Commission into banking represents conscious intentional choices made by executives and, in a few cases, Board members - sins of either commission or ommission, but intentional ones nevertheless. Where the law has been breached, where the espoused values of the organization have been clearly violated then consequences should follow regardless of whether they have behaved consistently with the ethic of their sub-cultural cohort.
It goes without saying these choices made by executives and leaders are unacceptable. It should also go without saying that the banks of Australia are no different to other large organizations in this regard. Within all organizations, especially large and complex organizations, sub-groups and sub-cultures often develop an ethic operating at a very different level to that

espoused to the public.

The folly of culture

In a parallel investigation Australian Prudential Regulatory Authority (APRA) released a report recently into one of the large banks. Damming in its judgements, the immediate response of the organization was to proclaim that the new CEO would have a free hand to change the culture of the organization. This is such a common response in Australia whenever reports are published criticizing the performance of large institutions. It is also the first recourse of politicians who seek simple and publicly palatable pronouncements on such matters.
Regardless, it is a folly based on two logical fallacies: firstly, that organizational culture is the *cause* of behavior and secondly that it is possible to intentionally *engineer* a change to this culture. Despite knowing for over four decade- from the fields of both anthropology and sociology that both these presuppositions are false, those who write speeches for Board Chairmen and CEO's, cling to them as if they were self-evident facts. I have written in detail elsewhere about the factors that create these two follies, but to put it simply …

- Culture is largely an output not an input – it is not a causative element as much as it is a reflection of other multi-layered and complex organizational dynamics. It is these behavioral, systemic, procedural elements and processes that must be the focus of change.

- Engineering intentional cultural change is an oxymoron: organizational culture has many layers, some of which are non-rational and reside in the collective unconscious of the sub-groups and the whole organization. Being unconscious and non-rational they are not subject to rational intervention, the preserve of those who try and sell to executives the belief that it is possible to engineer cultural change. Indirect influence is possible at best.

How to think of a response?

There is no doubt that some deep, and pervasive change is needed in governance, leadership and management of the banks in Australia if they are to regain a modicum of positive regard in the community.

The same can be said of the churches and other similar institutions who have been exposed of late. Yet, I am reminded of the adage that says *to every complex problem there is always a simple solution .... and it is always wrong!*

The Kay and Goldspink work suggests this is a very opportune time to consider the requisite elements for the banking system if individual bank organizations are to move from the Release to the Reorganization phase in the Holling Cycle.

The required transformation has seven components (at least):-

- A *new paradigm* of governance and leadership, one that takes a more strategic and comprehensive view of the whole financial and human systems in which banks and their employees operate
- Within and among banks there is need for a fundamental *re-arrangement of the way different departments, groups and functions inter-relate* to foster high levels of inter-dependence and consequence
- Transparency of *information flow and reporting* within banks and especially

with and to customers will need a serious overhaul for any permanent remedy

- Alongside these three core requirements there is a need for a complete re-think of the *fundamental goals* these institutions pursue – mercifully, across the western world we see corporations slowly coming to terms with the idea that they exist for more than increasing shareholder value. It might, indeed should, be possible to craft a new image of the fundamental goals for which they exist. One innovator already down this track somewhat is Bank Australia.
- But all this will be futile without *real consequence and real accountability* for those executives and managers who operate at Level 1 or 2 of the ethical spectrum described above. The same is true for banks as whole business entities. The corporate regulator the Australian Securities and Investment Commission (ASIC) needs to improve its game in this regard.
- One time-limited Royal Commission will not be able to canvass all the known issues, dilemmas, and deep-seated problems that have contributed to this debacle. Within banks, and the industry as a whole, there will be need for a *mechanism or process by which further problems are discovered and addressed*. What form that takes will represent a particular political conundrum to solve.
- Any solution or set of recommendations must include a re-writing of the *fundamental rules of engagement* for banks with their executives and managers, and for all employees with their customers. The way this evolves will probably need to be on a company by company basis but within some minimum set of non-negotiables established at the suggestion of the Royal Commission.

These seven high level requirements, if met, would produce the type of transformation necessary to ensure we no longer come back to this particular and ugly cul de sac of customer service and ethics.

Each has a parallel equivalent application to those organizations such as the churches whose gross abuse of children has been exposed of late.

They are not easy to implement and require a complete rethink by many, of the nature of governance and the nature of leadership within the bank sector.

A new model of team

To illustrate this with one example … The word *team* is probably one of the most over-used terms in the last 40 years of literature on organizational behavior and leadership. It received a huge boost with the popularity of Katzenbach and Smith's publication The Discipline of Teams in 2005 and their coining of the term High Performance Team.

But Kay and Goldspink's work on researching effective governance has extended this meaning significantly.

In their study for the AICD of 100 organizations throughout Australia they found effective governance was a team sport with its primary process being one of collective sense-making. But what is the team? Their research suggests effective governance sees the team as a single unit of analysis comprised of the Board and the executive leadership team where the Board provides the reflective capacity for the executive in order to improve the quality of decision-making.

My own experience in working with Boards and executive leadership groups suggests this collective identification and shared governance/leadership is not the norm. Rather self-serving backside-protecting political strategies so common in the upper echelons of large companies quite easily allow for, if not foster, the gross abuses of customers and other stakeholders now seeing the light of day for the banking sector through the Royal Commission.

This is especially the case when you consider another of Kay and Goldspink's key findings, viz: that independence is not a structural phenomenon measured by how many independent non-executive directors there might be on the Board, but rather it was overwhelmingly viewed as a mindset and characteristic of the individual by those they interviewed.

Individual independence of thought and perspective are rare commodities in highly politicized environments such as those found at the top of large banks, and against this background many of the recent revelations of abuse and poor governance should not be that surprising.

On the other hand, Kay and Goldspink provide us with a view that all is not lost, that there are organizations well governed and led effectively for whom Level 4 or 5 ethical cultures are the norm.

Reprise

Thank you to Ian Sampson and Ben Baldwin of The Leadership Foundation for their invitation to a Big Ideas Leadership lunch and thank you to Dan Smith, Tanya Olsson, Wendy Burns and Andy Arthurs for their contributions, comments and the thoughts they triggered for me.

I am looking forward to my next Big Ideas lunch – I wonder what it will be about?

Tim Dalmau

May 2018

Dalmau CONSULTING

PO Box 283 Samford Village
Queensland 4520
Australia

Tel: +61 7 3289 2133
Email: info@dalmau.com

www.dalmau.com