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PERSPECTIVES

ORGANISATIONAL RESILIENCE IN BANKING: TOWARDS A CULTURE 'STRESS TEST'

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The financial crisis in 2007-2008 triggered a recession that is considered by many economists to have been the worst financial crisis since the Great Depression of the 1930s. Financial institutions failed and entire countries ached under the burden of debt that was necessary to prop up markets and bail out banks that had appeared previously to be 'too big to fail'. The resilience of the entire sector was called into question.

In today's volatile, uncertain and complex world, understanding what it takes to achieve organisational resilience is more challenging than ever. That is why a recent collaborative research project between Cranfield University and the British Standards Institute examined 50 years of thinking on organisational resilience to identify how organisations can anticipate, prepare for, respond to and adapt to incremental change and sudden disruptions to survive and prosper.

Our research identified two core drivers of organisational resilience: organisations must have a defensive mindset to stop negative things from happening and to protect results. Yet, to ensure long-term survival in a completive marketplace, they must also have a progressive mindset, thereby and generate positive results. There are two ways to achieve organisational resilience: organisations need to be consistent by standardising policies, processes and behaviours. Yet they must also be flexible by

fostering diverse ideas and perspectives, creative problem solving and innovation to cope with and thrive in a dynamic environment. These four aspects of organisation resilience were synthesised into a holistic framework with four organisational resilience archetypes, as outlined below.

First, preventative control. Organisational resilience is achieved by means of controlling risk, building redundancy (spare capacity) and ensuring backup systems are able to protect the organisation from threats. People, from this perspective, are thought to be unreliable, so there is also a strong focus on standardised procedures, compliance and regulation.

Second, mindful action. Competent people make a positive contribution to organisational resilience by noticing problems, reading unfamiliar or challenging situations, reacting rapidly to problems and avoiding, trapping or mitigating threats.

Third, performance optimisation. Organisations will not be resilient unless they continually improve by refining and extending existing competencies, generating efficiency gain, enhancing existing ways of working and exploiting current technologies to serve present customers and markets.

Fourth, adaptive innovation. Organisational resilience is achieved by means of disruptive and transformation change. Radical change requires innovation and the creation of new products, technologies and markets to stay ahead of competitors.

Our research found that a singular preoccupation with any one of these dimensions of organisational resilience can create blind spots that can result in the organisation sleepwalking into disaster. This drift into failure occurs when, over time, signals are ignored and deviance is normalised. In reality, every organisation needs a blend of these four types and they need to find a 'fit-for-purpose' approach that is appropriate for their situation. For example, the profile of a nuclear power station would be very different to the profile of a small entrepreneurial startup, yet both require an effective blend of all four types. The demands of a dynamic and volatile environment may also require an organisation to reshape its resilience profile over time. Defining what profile works in which circumstances and why is a core leadership challenge.

A culture audit of many financial institutions prior to 2007-2008 may have found a strong emphasis on adaptive innovation (risk taking and the creation of novel financial products to create new markets), performance optimisation (repacking products to exploit and optimise existing markets and customers) and mindful action (allowing individuals to make discretionary decisions to respond to dynamic market conditions). The pursuit of innovation, profit and the discretionary actions of individuals outstripped and outmatched preventative control – the defensive capabilities of the financial industry to monitor, control and ultimately contain the adverse effect of a gradually inflated housing bubble.

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Unsurprisingly, following the financial crisis, we witnessed a 'knee-jerk' retrenchment into preventative control. In the aftermath of any crisis, the focus shifts from shock and dismay (what happened?), to causality (why did this happen?), to attributing blame (whose fault?) and eventually to remedy (how do we stop this happening again?). Externally imposed change, often by a regulatory body, is usually introduced when emotions are still running high, heightening anxiety and resistance. Under such adverse conditions, organisations often experience so-called 'threat rigidity effects' – rigid thinking and actions, reverting to prior, known processes and adding more rules and governance. The challenge is that bolstering preventative control is often achieved at the expense of efficiency, responsiveness and adaptability.

One mechanism of preventative control in the finance industry is the process of stress testing, which is used to model hypothetical scenarios where a range of factors, such as unemployment, stock prices and house prices, are altered to test a bank's viability and survivability. Some recent modelling in the UK has revealed, for example, that UK banks may withstand a worst-case Brexit scenario in which GDP slumps by 4.7 percent, unemployment increases to 9.5 percent, interest rates are hiked to 4 percent and house prices plunge by 33 percent. Often value at risk (VaR) is typically used by modellers to gauge the amount of assets needed to cover possible losses. Such stress testing tends to focus on the capital requirements of a bank. While laudable, one concern with stress testing is that positive outcomes can create a false sense of security among senior managers and regulators. A second concern is that stress testing can only take into account a limited range of variables that underline the modelling risk scenarios. Yet, the 2007-2008 collapse was brought about by a multitude of factors, including the culture of financial institutions. So how can organisations supplement a stress test of capital requirements with a holistic stress test of organisational culture?

Toward a holistic cultural stress test

When organisations struggle to achieve organisational resilience, it is usually always down to culture. For example, many sectors have suffered from the recurrence of disasters; iconic examples include NASA and the space shuttles Challenger and Columbia, BP and the Texas City and Macondo Well Disasters and Haringey Social Services and the deaths of Victoria Climbié and Baby P. While these events are very different, they share two disturbing similarities. First, the cycle time between crises was less than 10 years. Second, the inquiries concluded that it was the failure to address cultural problems that resulted in these organisations sleepwalking (back) into disaster.

Changing culture means changing the ways people think and their established ways of working. It stands to reason that this can be hard. A holistic stress test involves examining the cultural health of an institution based on all four dimensions of organisational resilience. Real change requires a deep understanding of present challenges and transition paths toward potential future states. We identify three critical steps, as outlined below.

Cultural audit. Many organisations struggle to know where to start when faced with somehow trying to shape a culture which will more effectively support the successful delivery of organisational resilience. An organisation-wide survey tool can be used to measure the key factors that need to be in place for organisational resilience. A survey can be used to explore an organisation's resilience 'fitness' across a range of core elements. The survey can help to identify the current paradigm and the desired future culture, and can reveal blind spots. Through analysis, the scores on the cultural audit can be used to predict individual business unit performance. A cultural audit also goes beyond data capture and diagnostics by enabling within and across sector comparative analysis and benchmarking.

Cultural agenda. Once available quantitative and qualitative data has been gathered it is possible to analyse the data to pinpoint the most pertinent cultural problems. The results of the cultural audit are best used as a starting point and a means to an end, rather than an end in itself. They facilitate dialogue to explore tensions and differences, aligning and engaging people around the desired profile, creating a guiding coalition, based on a sense of urgency, assigning accountabilities to action plans, activities and programmes that focus on new practices and behaviours.

Cultural change. To shift the organisational resilience profile requires the design and piloting of interventions to make the culture change happen. Change requires collective action that is sensitive to specific cultures, interests and values. Culture change requires commitment by engagement and cooperation while managing the emotional and highly political dynamics of change. It is important to ascertain what effective changes will work in a particular context. Given that human behaviour is so hard to predict, the effectiveness of any proposed solution should be piloted by conducting rigorous experiments before scaling them up. Change can then be rolled out and embedded, while continually evaluating and refining potential solutions by testing and incorporating feedback. Finally, progress is monitored to ensure that objectives and deadlines are achieved. R&C

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