

# Risk Culture – Making the Unmeasurable Measurable?

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During the last financial market crisis, banks' risk culture became the focus of increasing attention from companies, regulators and researchers. For guidance, the FSB divides the risk culture into four areas, all of which have to be taken into account to ensure successful management. This article addresses the question of which of these areas banks can effectively measure and manage and where there is a need for further action. The analysis comes to the conclusion that banks are faced with major challenges, particularly in promoting transparency and managing open communication.

## Communication as part of risk culture and as a measurement challenge

After the last financial market crisis, risk culture became the focus of increasing attention from regulators. In its 2014 "Guidance on Supervisory Interaction with Financial Institutions on Risk Culture", the Financial Stability Board presented four cornerstones of a sound risk culture. They include leadership culture (tone from the top), employee responsibility (accountability), targeted incentives (incentives), and open communication and critical dialogue (effective communication and challenge). To establish an appropriate and sustainable risk culture in banks, the content of these cornerstones must be measurable or at least verifiable.

Most banks meet the prerequisites for many of the aspects required by regulators, as they can be addressed using established bank management instruments. These include a clearly defined risk appetite, the existence of guidelines to implement it, its link to risk and business strategy, rules for dealing with violations of the risk strategy or guidelines, design of appropriate incentive systems and governance structures, as well as equal prominence for back office and trading activities.

By contrast, it is much more difficult to manage the necessity stressed by the FSB of promoting open communication that facilitates alternative perspectives and a critical dialogue. This dimension of risk culture cannot be directly influenced by typical bank instruments and is very challenging due to its complexity.

On the one hand, the **employee perspective** has to be taken into account. Firstly, employees' organisational commitment plays a role here, i.e. their identification with their company, as this is the source of motivation to act in the company's interests [e.g. see Steyrer et al. 2008]. This leads to a willingness to develop their own area of activity and to tackle problems. Secondly, they must feel sufficiently secure in their working environment to believe that raising problems and putting forward alternative perspectives will not disadvantage them in any way. Thus, they must be able to act without fear [e.g. see Kish-Gephart et al. 2009]. Thirdly, open communication by employees will only be established in the long term if their concerns and comments are actually taken on board and lead to perceptible changes. Employees must feel that they are genuinely able to influence things [e.g. see Lin et al. 2019]. Alongside these motivational aspects, which promote a willingness to communicate problems, employees must be placed in a position where they are able to express their concerns, for example through structured processes or access to their managers.

These prerequisites on the employee side result in requirements for the behaviour of **managers**. They have to create opportunities for their employees to actually contribute different perspectives and to express concerns, for example through open discussions in team meetings. In addition, managers also have to actually recognise these concerns and process them correctly, in other words this communication must not be viewed as a personal attack and should be received constructively. The manager must then have the willingness and the opportunity to resolve the problems discussed.

## Transparency in communication as a prerequisite for management

Banks often address the issue of openness in their own communication culture using employee surveys based on quantitative questionnaires. They will ask whether open communication is possible, what methods for communicating alternative perspectives are available or how the current communication culture is perceived. Yes/no answers or multi-level Likert scales can then be used to translate the assessment of the communication culture into numerical values. A method based on employee surveys is a useful starting point for obtaining a systematic overview of a company's communication culture. However, empirical social research indicates that this kind of method is subject to certain limitations that need to be taken into account.

Firstly, using a questionnaire to collect information that may be critical to the respondents, for example an assessment of their own communication behaviour, always involves a risk of socially desirable response behaviour [see Krumpal 2013], in other words employees attempt to answer questions relating to themselves in the way they think is expected of them. This can obscure problems that actually exist. Secondly, an open communication culture is only revealed by direct interaction between employees when specific problems arise. A quantitative survey cannot pick up any communication deficiencies that occur in interaction as data is collected separately from the actual interaction situations. Thirdly, quantitative questionnaires deliver heavily aggregated information that does not provide specific starting points for improving the communication culture by addressing the behaviour of relevant managers and employees.

To counter the disadvantages outlined, empirical social research recommends a qualitative method. A combination of participative observations and in-depth interviews is reasonable. Participative observations involve the person gathering the data becoming part of the normal work process. They attend meetings and take part



in the day-to-day work process. On the one hand, this prevents socially desirable response behaviour. After a period of familiarisation, the observer is no longer noticed and employees carry out the work processes in their normal way. On the other hand, the actual communication processes can be captured and certain types of behaviour of managers and employees can be observed in specific situations involving disclosure of alternative perspectives. The results of these observations can then be translated into specific suggestions to support individual managers/employees in improving the communication processes. Furthermore, in-depth interviews with individual employees can foster a more complete understanding of the communication culture as perceived by the employees.

### Summary

Although the use of participative observations and in-depth interviews goes a long way towards mitigating the disadvantages of an employee survey, it is time consuming, requires specially trained personnel and, as a result, cannot normally be used for the whole company and with a high frequency (for example annually). Nevertheless, targeted management of the communication culture is only possible if the assessment of a company's communication culture covers all relevant dimensions and is as objective as possible. Therefore, banks should not rely exclusively on the commonly used instrument of the employee survey, but should utilise additional instruments, at least in certain areas (for example for particularly risky processes). By doing this, they cannot only create transparency regarding the prevailing communication culture, allowing them to change it to meet the regulatory requirements, but they can also use it to generate productivity gains and long-term competitive advantages.

### Literature

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