

The Impact of Risk Culture on the UK Financial Services Sector
A Dissertation

Property of Acadex (A Division of Shagore Neel Pvt. Ltd.)

Abstract

This research study engaged in the examination and analysis of risk culture in UK financial service organisations, with particular regard to its implications on organisational working, as well as the future of individual organisation, as well as the industry as a whole.

The study was carried out with the help of a detailed literature review and the application of a Mixed Method Model of research with both positivist / quantitative and interpretivist / qualitative elements. The conduct of the research study revealed that the risk culture of UK financial service organisations had eroded significantly in the years preceding the financial crisis of 2007-08 for a variety of reasons. There has however a sea change in perceptions towards risk in recent years because of governmental regulatory intervention, the industry wide realisation of the need for better risk control and improved corporate governance in banks. Whilst substantial further improvement is required, especially in areas of risk assessment and measurement, there is little doubt that risk culture in the financial services sector will become more robust and strong in the coming years.

The results of this research project may be limited to some account on account of absence of qualitative information from members of the senior managements of financial service organisations in the UK; appropriate recommendations have accordingly been made.

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Chapter 1: Introduction

This dissertation aims to engage in a detailed and critical examination of the issue of risk culture in modern organisations, with particular regard to its impact on the UK financial services sector. This introductory section provides an overview of the research issue, defines the research problem, clarifies the aims and objectives of the study and explains its purpose and benefits.

1.1. Overview

There is little doubt of the importance of risks in the conduct of business activities (Green & Figlewski, 1999). The assumption of risk is integral to business activities and the overwhelming majority of entrepreneurs and business leaders are expected to be risk friendly and ready to take business risks as and when required to do so (Green & Figlewski, 1999). The conduct of a business organisation entails continuous exposure to diverse types of uncertainties, both in their external and internal environments (Green & Figlewski, 1999). The need to work in and cope with uncertain conditions requires organisational managers to respond with appropriate strategies and policies, which may or may not be successful and thus entail the assumption of risks of various levels (Horcher, 2011). The Institute of International Finance (2009) stated that business organisations are continuously exposed to different types of risks, including marketing risks, operational risks, financial risks and reputational risks amongst others. Their success in the identification, assessment and management of risks, plays an extremely important role in the achievement of competitive advantage and business success of their firms (Institute of International Finance, 2009).

Organisations develop internal cultures over the years; which play an important role in determining their organisational strategies, policies and actions (Fang & Wang, 2006). Such cultural characteristics, manifested in various externalities like organisational hierarchies, promotion and remuneration policies, reporting structures and communication methods, also influence organisational approaches towards market expansion, innovation, internationalisation and risk (Fang & Wang, 2006). Risk culture can thus be described as the broad organisational system of diverse types of behaviours and values that influence and shape decisions that are associated with risks (Mikes, 2009).

All business organisations, both public and private have their specific approaches towards risk (Mikes, 2009). The Institute of Risk Management (2017) has in fact created a risk culture framework that is influenced by risk-free disposition, personal ethics, behaviours and organisational culture. The following diagram depicts the various elements of the risk culture of a business firm.

Chart 1: Different Elements of the Risk Culture of a Business Firm



(Source: The Institute of Risk Management, 2017, n.p.)

The financial services sector in the UK is one of the most important of the country's service sectors; it has over the years developed a reputation for high levels of competencies, skills and abilities and London is now recognised as one of the most important of global financial centres (Power, 2009). The sector includes a broad range of businesses engaged in money management, i.e. banks, insurance companies, credit card firms, credit unions, accounting companies, investment funds and stock brokers amongst others; the sector contributed approximately 124.2 billion GBP to the country's economy in terms of gross value addition in 2016, 51% of which was provided by London (House of Commons, 2017).

1.2. Definition of Problem

Organisations engaged in financial services face diverse types of risks (Ashby *et al.*, 2012). Ashby *et al.*, (2014) stated that the financial services industry has evolved tremendously in recent years and is vulnerable to various hazards, some of which are (1) alternative sources of finance, (2) increasing electrification of markets, (3) breach of security of data, (4) professional conduct / misconduct of employees, (5) effectiveness of payments and (6)

regulatory arbitrage. Financier Worldwide (2015) stated that financial services organisations face risks that are systemic and interconnected across global landscapes. Compliance governing risks have increased significantly since the introduction of several new regulations in the wake of the financial crisis (Financier Worldwide, 2015).

The risk culture of modern financial organisations was subjected to intense criticism in the post-mortem period of the financial crisis; it was considered to be responsible, to a large extent for the enhancement in risk assumption by these firms through the use of unsustainable lending practices, the creation of extremely high levels of leverage and the indiscriminate use of credit derivatives, securitisation and specific purpose vehicles (Bernstein, 1996). Policy makers and bank regulators took cognisance of existing inadequacies in the risk cultures of these organisations by introducing extremely severe and demanding regulations in various areas of operations (Bonisch, 2012). The imposition of such regulatory provisions have been subjected to significant criticism by numerous market participants, who have argued that it will stifle growth and expansion in the provisioning of diverse types of financial services sector and thereby lead to economic slowdown and stagnation (Bonisch, 2012).

Interest in this aspect of organisational activity has grown immensely after the financial crisis of 2008 (Buckley, 2011). The ways in which risks culture can enhance organisational growth and expansion, as well as lead to adverse and even disastrous organisational consequences thus provides an extremely interesting and rewarding area of research (Buckley, 2011).

1.3. Aims and Objectives

This research dissertation aims to examine the drivers and influencers of risk culture in financial services firms and the impact of such culture on the working, profitability, safety, security and sustainability of these organisations.

The objectives of the study are detailed below.

- To examine the ways of measurement, definition and assessment of risk culture.
- To examine the ways in which risk culture is driven, perpetuated and spread within firms, as well as the mechanisms and processes that help it in its entrenchment in organisations.

- To examine the impact of risk culture upon the growth and operations of financial services firms, as well as the broader sector in which they operate.
- To examine and assess the regulatory interventions, at macro, meso and micro levels for addressing the embeddedness and entrenchment of risk culture in firms in the financial services sector.

1.4. Purpose and Benefits of Research

The development of systemic risk across the financial services sector became an issue of immense worry and concern after the development of the financial crisis of 2008 and the devastation created by the ensuing economic downturn (Wahlström, 2009). It was in fact one of the major causes for the development of lack of credibility and disappointment with banks, financial institutions and other financial services sector participants in the wake of the financial crisis (Wahlström, 2009). The Libor associated manipulations carried out by large and well known banks and financial institutions aggravated this perception and brought about the feeling that modern banks were essentially unsafe, with particular regard to the handling of the monies of their depositors (Cornett *et al.*, 2011). Policy makers and regulators also appear to share this perception and have introduced stringent and severe regulations to curb the risk taking propensities and tendencies of bankers and safeguard their monies (Cornett *et al.*, 2011).

This dissertation engages in a detailed examination of the characteristics of the risk cultures of modern UK financial service firms, the drivers of such risk cultures and the impact of such culture on organisational operations, sustainability, safety and growth. The outcomes of this dissertation should thus be educative, useful and relevant for all people interested in banking, management and the safety and security of modern day banking operations.

1.5. Dissertation Structure

The structure of this dissertation has been developed in a sequential manner to facilitate ease of reading and comprehension. This introductory chapter has provided a brief overview of the research issue, defined the research problem, outlined the aims and objectives of the study and explained its purpose and benefits.

- The second chapter provides a detailed literature review of the research issue, developed with the help of publicly available information; it provides a theoretical framework for the study and identifies information gaps that can be addressed through the conduct of the dissertation.
- The third chapter details the research method used for this study, as also the reasons for adopting it.
- The fourth chapter contains details about the data obtained in the course of research.
- The fifth chapter contains a detailed analysis of the information obtained during research, compared and contrasted with the data obtained in the course of the literature review.
- The sixth and final chapter contains a summative conclusion and recommendations for further research.

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Chapter: Literature Review

This review of literature aims to develop a clear and detailed understanding of the research subject, generate a theoretical framework for the study and identify information gaps that can be addressed in the course of research; the information for this review has been obtained from focused online search with the help of appropriately chosen keywords and phrases (Williams & May, 1996; Murray & Brubaker, 2000). Care has been taken to ensure that all the information sources are reliable, relevant for the study and contemporary, with regard to date of publication (Bryman & Bell, 2007; Northedge, 1990).

2.1. Organisational Culture

Organisational culture has been described by various experts as the combination of diverse types of organisational beliefs, values and norms, which are shared by organisational employees and influence their attitudes, approaches and behaviours in the workplace (Cameron & Quinn, 2011; Fang & Wang, 2006). Cameron & Quinn (2011) stated that organisational culture has several important aims, objectives and functions. It firstly provides employees with a sense of belonging and identification with their firms (Cameron & Quinn, 2011; Fang & Wang, 2006). It secondly reinforces organisational values, beliefs and practices in their minds (Sims, 2002; Miroshnik, 2002). It thirdly enhances their commitment to their organisation and to the satisfaction of their objectives (Sims, 2002; Miroshnik, 2002). It also finally serves as a control mechanism for shaping and influencing organisational behaviour (Sims, 2002; Miroshnik, 2002).

Trefry (2006) informed that the cultural norm of an organisation becomes strong and entrenched over time and affect all individuals who are involved in it. Whilst these norms are often suppressed, they are nevertheless present and determine the actions and behaviours of employees in various aspects (Trefry, 2006; Luthans & Doh Jonathan, 2015). Often latent in nature, organisational culture is nevertheless physically manifested through a variety of totems and symbols, including dress norms, communication practices, organisational hierarchies, reporting structures, group activities, reward policies, and status symbols within the organisation (Trefry, 2006; Luthans & Doh Jonathan, 2015). Ideology is considered to be an important part of organisational culture (Trefry, 2006; Luthans & Doh Jonathan, 2015). Schrodt (2002) stated that

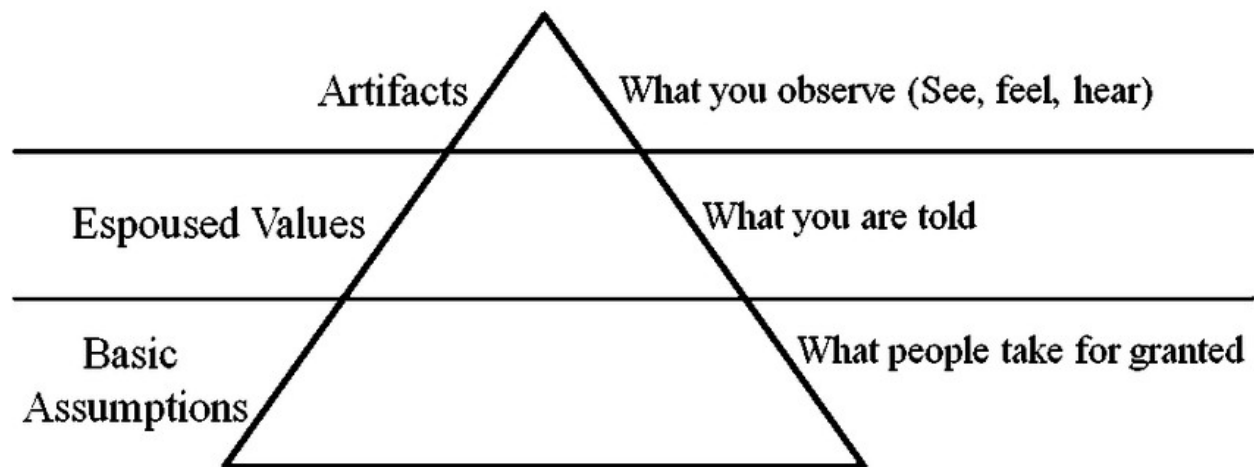
it could be stated as the set of beliefs held by a company, with regard to its operations and its growth. Ideology comprises beliefs, values and morals, which in turn form the basic foundation for organisational culture. It moderates the actions undertaken by employees in their everyday activities in accordance with organisational targets and objectives.

Schein (1985) developed a model of organisational culture that has come to be widely accepted over the course of the last three decades. Schein (1985) stated that the culture of a specific organisation is not formed in a short period of time; it develops overtime as organisational members experience diverse developments and alterations in their workplace, adapt to their surroundings, resolve their various problems and difficulties, obtain knowledge and understanding from their past experience and use such knowledge regularly, thereby creating the culture of their workplace. New employees also strive regularly to adjust to the cultural ambience of their organisations (Schein, 1985).

Schein (1985) stated that organisational culture was manifested in three specific levels, i.e. (1) artefacts, (b) values and (c) assumed values. The following diagram illustrates the various elements of Schein’s organisational culture framework or triangle.

Chart 2: Schein’s Organisational Culture Framework

Schein’s Triangle Model on Organizational Culture



(Source: Schein, 1985, p 7)

Artefacts, constitutes the first level of organisational culture (OC) and is evidenced physically through diverse externally manifested factors like organisational vision and mission,

office layout, furniture and fixtures, canteen facilities, employee behaviour and employee dress code. Artefacts are by and large unique to organisations, differ from business to business and help significantly in the definition of workplace culture (Schrodt, 2002; Fang & Wang, 2006). Some organisations are characterised by employees who engage in formal dress and work in strict accordance with the instructions of superiors, whilst other firms are characterised by an open and enquiring culture, informal communication and casual dress (Putnam, 2003; Cameron & Quinn, 2011). Organisational values, which constitute the second level of organisational culture guide the thought processes, approaches, attitudes and behaviours of employees and impact the ways in which business activities are carried out within the firm (Putnam, 2003; Cameron & Quinn, 2011). The third level, i.e. the basic underlined assumptions is deeply entrenched and is by and large experienced as unconscious and self evident behaviour (Greenberg, 2003; Miroshnik, 2002). Hill (2012) stated that assumptions are frequently hard to recognise even from within.

The three levels of Schein's OC model are occasionally represented as an onion model on account of its different layers (Schein, 1985; Putnam, 2003). The outer layer, i.e. artefacts and symbols are not difficult to change or to adapt to (Schein, 1985; Putnam, 2003). Cultural traits are however more entrenched and deeply embedded with increasing depth and becomes increasingly difficult, both for adaptation and for change (Modaff *et al.*, 2011; Cameron & Quinn, 2011). The core of the onion, namely assumptions, is the most entrenched and difficult to change (Modaff *et al.*, 2011; Cameron & Quinn, 2011). Organisational culture is considered to be critically important for the achievement of organisational effectiveness because of its role in influencing organisational approaches and actions in specific areas like market aggression, internationalisation, innovation and risk friendliness, as well as in factors like hierarchical working, bureaucracy and business conservatism (Luthans & Doh Jonathan, 2015; Sims, 2002). Organisations with risk-unfriendly and innovation-averse cultures do not encourage fresh ideas or thinking from their employees, which in turn results in organisational stagnation, as well as lack of new products, services or ideas. Such businesses, on the flip side avoid any sort of risk taking activity and are thus better at sustaining their present organisational activities (Luthans & Doh Jonathan, 2015; Sims, 2002).

Deal and Kennedy (1982) classified organisational culture into four segments, i.e. (a) the top-person macho culture, (b) the work and play hard culture, (c) the process culture and (d) bet-your-organisation culture. These cultural attributes also play a major role in terms of risk friendliness and speed of response or reaction (Hill, 2012; Trefry, 2006). Schein (1996) stated that organisational cultures can significantly influence the working, effectiveness and performance of business organisations; they provide employees with a strong sense of identity, augment organisational commitment, and improve workforce stability. They can conversely also increase change resistance and work as barriers to the creation of organisational diversity on account of workforce insularity (Goodman *et al.*, 2001; Modaff *et al.*, 2011).

With the cultures of different forms often being extremely different, important M&A deals, like for example, the one between Chrysler and Daimler Benz, have failed because of the difficulties in the merging and working together of the two cultures in the post merger organisations (Fang & Wang, 2006; Nahavandi & Malekzadeh, 1993). One of the main tasks of incoming CEOs, especially of troubled organisations is to bring about distant and required changes in cultural characteristics (Hill, 2012; Trefry, 2006). Such changes are often imperative for the adoption of new working methods and the purposeful discarding of old ones (Miroshnik, 2002; Schrodt, 2002).

2.2. Risk Culture

It has been widely recognised that issues with organisational culture played an important role in the financial crisis which developed in 2007-2008 and ignited a global and sustained economic slowdown (Brooks, 2010; Power *et al.*, 2013). Risk culture has in fact become an important area of focus in discussion by regulators, policy makers and management academics (Brooks, 2010; Power *et al.*, 2013). DeLoach (2016, n.p.) stated that risk culture was “a set of encouraged and acceptable behaviours, discussions, decisions and attitudes towards the taking and management of risk within an institution”. Developed by the Risk Management Association and Protiviti, the definition is applicable to all organisations, profit, not for profit, public and private (Protiviti Inc, 2016). Risk culture is considered to be the adhesive glue that brings together all the elements of risk management within an organisation; it effectively reflects the shared targets, objectives, values, practices and mechanisms for reinforcement that entrench risk

into the decision making processes and risk management of an organisation; it is essentially a determinant of organisational risk reward tradeoffs and the propensity for risk taking in individual organisations (Ashby *et al.*, 2012; Waring & Glendon, 1998).

The risk culture of an organisation is reflected by several factors, including (1) organisational tone, (2) the physical mechanisms that drive risk culture, (3) the internal attributes that drive risk culture, (4) the external attributes that motivate risk culture and (5) subcultures that might impact risk management (Davidson *et al.*, 2012; Miihkinen, 2012). Organisational tone is concerned with the collective effect of the tone of the top and senior management, the middle management and lower managers on areas like compliance, responsibility in business behaviour and risk management (Davidson *et al.*, 2012; Miihkinen, 2012). Diverse types of communication from the top are likely to have very little impact if organisational employees are fed with different messages from their immediate seniors (McConnell, 2014; Brooks, 2010). Greater levels of organisational layers are likely to result in higher chances of incongruities between the top, middle and bottom organisational tones (McConnell, 2014; Brooks, 2010). This is also likely to increase the possibility of lack of awareness in the executive management about the occurrence of serious operational, compliance and financial risks that may be well known to lower employees and middle managers. Information is thus frequently distorted and corrupted as it travels up and down the management chain (Deloitte, 2011; McConnell, 2014).

The physical mechanisms that drive risk culture shape and influence organisational tone and incorporate several things that comprise risk governance structure, including statements corporate values, codes of conduct, ethical standards, policies and procedures, reward, remuneration and incentive programmes, risk assessment processes, risk committee oversight, risk indicator reporting and performance reviews (KPMG, 2009; Davidson *et al.*, 2012). They also include the risk dialogue of the board and the executive team and the definition of risk tolerances and limit structures (KPMG, 2009; Davidson *et al.*, 2012).

The internal attribute that drive risk culture, includes the core values, the belief systems and the attitudes and approaches that drive behaviour and guide regular organisational decision making activities, with particular regard to the pursuit of entrepreneurial opportunities (Waring & Glendon, 1998; Davidson *et al.*, 2012). Whilst these attributes are not covertly visible, they require close attention (Waring & Glendon, 1998; Davidson *et al.*, 2012). The behaviours

associated with risk management and internal control are frequently manifested in the ways in which people respond to audit issues, address weaknesses in control and escalate and resolve important issues (Institute of International Finance, 2013; PWC, 2010).

Institute of International Finance (2013) stated that the timeframes in which such activities are conducted provide important information about organisational risk culture. The reaction or lack of reaction of the executive management to warning signs emerging from independent risk management functions also provides significant insights into organisational attributes that drive risk culture (Institute of International Finance, 2013; PWC, 2010).

External attributes on the other hand include factors like customer expectations, investor needs and regulatory requirements (Miihkinen, 2012; Ashby *et al.*, 2012). The degree to which organisations search for these requirements and align their business processes through appropriate working modifications provides significant insights about organisational risk resilience (Miihkinen, 2012; Ashby *et al.*, 2012). The presence of several subcultures also provides important information about organisational reaction to environmental alterations, agility in resolution of problems, the sharing of knowledge and the serving of customers (Power *et al.*, 2013; Institute of International Finance, 2013). Such subcultures can also conversely result in rogue and risk taking behaviour that can ultimately result in adverse organisational consequences (Power *et al.*, 2013; Institute of International Finance, 2013).

Improvement of Risk Culture

Brooks (2010) stated that several contemporary organisations are making concerted efforts to improve their risk culture in order to develop organisational risk resilience and face future uncertainties with greater confidence and success. The development of such a culture requires organisational to become proactive in the recognition of unique opportunities and use such knowledge to evaluate options before other firms and seize the initiative (Brooks, 2010; Power *et al.*, 2013). The development of such cultural characteristics would give organisations the advantage of time and greater decision making options (Brooks, 2010; Power *et al.*, 2013). Miihkinen (2012) added that a desirable risk culture should maintain a healthy tension between the creation of enterprise value, as also the protection of enterprise value, and ensure that both of them are balanced and not disproportionately strong with respect to the other. McConnell (2014) informed that organisations could impose audit and assert risk culture, identify areas of

improvements and thereafter make efforts to ensure that they become areas of priority and are embedded in organisational working.

Power *et al.*, (2013) informed that many organisations develop risk programmes in the form of awareness campaigns, training sessions and policy communication. These individual programmes should however be merged into comprehensive risk management procedures that align appropriate risk taking with roles, responsibilities, compensation structures and performance expectation; they should reinforce critical features of the desired risk culture (Institute of International Finance, 2013; PWC, 2010). It is also important to engage in periodic evaluation of progress and be alert for signs of change, both for better and for worse (Institute of International Finance, 2013; PWC, 2010). It is important to keep in mind that every organisation is different, which makes it imperative for organisational managers to avoid a one-shoe-fits-all approach, formulate individual risk cultures and make the required adjustments to shape it over time, in response to necessary environmental changes (Davidson *et al.*, 2012; Miihkinen, 2012).

2.3. The Financial Services Sector and its Risks

The financial sector in the UK is amongst the most liquid and largest markets in the world. The finance and insurance sectors in the UK contributed approximately 7.2% of the country's Gross value added (GVA) (Brechmann *et al.*, 2014). The UK banking industry provides support to the national economy, with its diversity in banking institutions and its concentration of private credit (Brechmann *et al.*, 2014). The UK banking sector has become far more aware of risk and the need to manage it after the global financial crisis of 2007-08 (Barros & Torre-Enciso, 2012; Chernobai & Jorion, 2011). UK banks and financial service companies however face several types of risks that need to be investigated and discussed for the purpose of this dissertation (Barros & Torre-Enciso, 2012; Chernobai & Jorion, 2011). Some major risks faced by these organisations are elaborated below.

Credit Risks

The Bank of International Settlement (BIS) defined credit risk as the likelihood of a bank borrower or a counter party failing in meeting its obligations in accordance with previously agreed terms (Institute of Risk Management, 2017). Credit risk is mostly caused by banking engagement in the following activities, (a) loans, (b) interbank transactions, (c) acceptances, (d)

trade financing, (e) foreign exchange transactions, (f) financial futures, swaps and bonds, (g) extension of guarantees and commitments and (h) the settlement of transactions (Cumming & Beverly, 2001; Cope *et al.*, 2012). A financial institution faces a credit risk if a person or an organisation taking a loan from it is not able to pay it back for any reasons whatsoever (Tong & Wu, 2012; Brechmann *et al.*, 2014). Banks respond to such credit risks by increasing the rate of interest for suspect borrowers (Tong & Wu, 2012; Brechmann *et al.*, 2014). Credit risk is determined on the basis of factors like lack of steadiness in income, type of employment, low credit score and quality of collateral assets (Tong & Wu, 2012; Brechmann *et al.*, 2014). Whilst some credit risks arise on account of macro forces that affect the economy of specific markets, they can also stem from the emergence of deliberately committed frauds (Gourier *et al.*, 2009; Moosa, 2007).

Market Risks

Market risk has been defined as the likelihood of losses in the trading books of a financial services organisation due to alterations in factors like (a) equity prices, (b) interest rates, (c) credit spreads, (d) commodity prices, (e) foreign exchange rates and (f) other factors, whose values are determined in public markets (Hess, 2011; Barros & Torre-Enciso, 2012). The BIS defined market risks as the risk of losses in on-or-of-balance sheet positions, which can arise from shifts in market prices (Institute of Risk Management, 2017). Such risks are mostly prevalent amongst financial service organisations that are engaged in investment banking and are thus active in capital markets (Cope *et al.*, 2009; Galloppo & Rogora, 2011). Such organisations include Goldman Sachs and J.P. Morgan, amongst many others (Cope *et al.*, 2009; Galloppo & Rogora, 2011). Institute of Risk Management (2017) stated that market risks could be segmented into three types, as elaborated under.

- Interest rate risk: Fluctuations in interest rate can result in potential losses.
- Equity Risk: Volatility in stock prices could result in potential losses.
- Commodity Risk: Volatility in prices of commodities, like for example wheat or iron could result in potential losses (Gourier *et al.*, 2009; Moosa, 2007).

Operational Risks

The BIS, defined operation risk as the possibility of loss that could develop from inadequate or flawed internal processes, systems and employees, as well as diverse types of

external events (Institute of Risk Management, 2017). Operational risks include legal risks but exclude reputational and strategic risk (Chernobai & Jorion, 2011; Jobst, 2010). Operational risks can occur in financial service organisations on account of human errors and mistakes and can be classified as below.

- Human Risk
- Process Risk
- IT/System Risk

Whilst operational risk may not appear to be dangerous, it caused the collapse of one of Britain's best known bank Barings in 1995 (Chernobai & Jorion, 2011; Jobst, 2010). With banks becoming increasingly digitised and making greater use of IT for automation of processes, operational risk has become an important factor for continuous and careful monitoring and action (Chernobai & Jorion, 2011; Jobst, 2010).

Liquidity Risks

Liquidity risks have been defined as the risks that can stem from inadequacies or difficulties of marketability of investments; challenges in their quick purchase or sale can result in the incurrance of losses (Galloppo & Rogora, 2011; Chernobai & Jorion, 2011). The crystallisation of such risk can affect the liquidity of banks and prevent them from engaging in routine day to day actions (Galloppo & Rogora, 2011; Chernobai & Jorion, 2011). It needs to be kept in mind that the crystallisation of liquidity risk in Northern Rock resulted in its collapse and its takeover by the UK Government (Galloppo & Rogora, 2011; Chernobai & Jorion, 2011).

Reputational Risks

Reputation risk has been described as the possibility of erosion of organisational reputation, image and brand (Brechmann *et al.*, 2014; Hess, 2011). A financial services organisation, like other institutions, is vulnerable to reputational risk, which can be crystallised by the bank's engagement in certain activities, lack of compliance with regulations, inadequate customer service, poor customer experience and evidence of data manipulation (Brechmann *et al.*, 2014; Hess, 2011). The operations of banks are routinely judged and assessed by its clients, investors and stakeholders, who collectively create and mould its reputation and public image (Brechmann *et al.*, 2014; Hess, 2011).

Business Risks

Business risks have been described as the likelihood of an organisation earning lesser than anticipated profits or experiencing losses (Moosa, 2007; Cumming & Beverly, 2001). With regard to banks and other financial service organisations, business risk is likely to be associated with lack of satisfaction of long term banking strategy, failure in satisfaction of estimated budgets and forecasts and lack of flexibility and adaptability to market conditions (Jobst, 2010; Gourier *et al.*, 2009). It is important to note that whilst several banks collapsed during the crisis of 2007-08, many banks were able to find their ways out of their difficulties (Jobst, 2010; Gourier *et al.*, 2009).

Systemic Risks

Systemic risks are concerned with hazards that can affect the whole financial sector, rather than single banks or financial institutions (Cope *et al.*, 2012; Galloppo & Rogora, 2011). They were at the centre of the global crisis of 2008 and are associated with cascading failures, where the collapse of a one big entity can result in extreme difficulties for other connected organisations (Cope *et al.*, 2012; Galloppo & Rogora, 2011).

Moral Hazards

Moral hazard come about when banks or financial institutions engage in diverse types of risks, knowing that other individuals or entities will have to face the consequences of such risks, it has been described as a situation, wherein one person engages in a decision about the quantity of risk that can be assumed, whilst someone else has to bear the cost when things go wrong (Brechmann *et al.*, 2014; Hess, 2011). Moral hazards have been described as one of the most important causes of the subprime crisis of 2007-08 (Brechmann *et al.*, 2014; Hess, 2011).

2.4. Risk Culture in the Financial Services Industry

The global financial crisis resulted in a spurt of interest in the concept of organisational culture, the element of risk, resilience and management in such cultures and the ways in which risk culture could be improved, managed and made resilient (Apostolik *et al.*, 2009). Several experts concluded that culture played an important role in the driving of the crisis and that cultural change was necessary, first to restore trust and second ensure the prevention of the

recurrence of such a crisis (Apostolik *et al.*, 2009). Stephen Hester, the CEO of RBS in 2012 stated as under.

“Banks must undergo a wholesale change in their culture and refocus their behaviour on meeting the needs of customers to restore trust in the industry.” (Scuffham, 2012, n.p.)

Kannan and Thangavel (2008) stated that culture was not an industry level challenge or restricted to the global financial crisis. The examination of failures of particular banks and other participants in the financial services sector, both after the occurrence of the financial crisis and with regard to recent events, like the Libor scandal and rogue trading revealed several micro level cultural difficulties and weaknesses within particular organisations (Kannan & Thangavel, 2008; Fadun, 2013). The Institute of International Finance in fact stated that the development of an appropriate risk culture throughout an organisation could possibly become the most important tool for effective management of risk (Kannan & Thangavel, 2008; Fadun, 2013). Whilst widespread interest has been evinced in the concept of culture and there is a growing acceptance of the relationship between organisational culture and risk associated decisions, several issues continue to remain unanswered (Chernobai & Jorion, 2011; Jobst, 2010). The role of culture in a financial services organisation in risk taking and control decisions continues to be shrouded in ambiguity (Chernobai & Jorion, 2011; Jobst, 2010). Opinions are also divided on important factors, like for example reporting structures, remuneration or professional ethics, which help in converting organisational culture into effective risk management and governance activities (Hess, 2011; Barros & Torre-Enciso, 2012). It is also not clear whether risk culture can be differentiated from other aspects of organisational culture and whether strong risk cultures can be differentiated from weak ones (Hess, 2011; Barros & Torre-Enciso, 2012).

Brechmann *et al.*, (2014) stated that whilst there was little doubt that risk culture has grown to become the dominant feature of the debate on recent financial scandals and crisis, it was not clear what activities and objectives should be pursued by financial organisations in this place. It also remained unclear with alterations in specific aspects of risk culture can help in facilitation of better risk taking and control decisions. Notwithstanding the existing ambiguity on risk culture, its attributes and its challenges, several organisations and experts have carried out extensive research on the subject; these efforts have also resulted in the development of some important guidance (Tong & Wu, 2012; Brechmann *et al.*, 2014).

Investigations into the risk cultures of various banks and financial services organisations resulted in some important revelations (Tong & Wu, 2012; Brechmann *et al.*, 2014). Barclays (2013), commenting on Barclays, stated that the organisation's strategies were characterised by edginess and a strong desire to achieve swift success. The organisation has sometimes been perceived as operating within the letter of the law but outside its spirit (Barclays, 2013). Its strategies were characterised by stress on short term financial performance, strengthened by reward and remuneration strategies that aim to revenue generation, rather than benefit clients and customers (Barclays, 2013). It appeared that senior managers did not wish to hear bad news and expected employees to solve problems (Barclays, 2013).

The Parliamentary Commission on Banking Standards (2013), commenting on HBOS, stated that the board strategy was primarily responsible for the organisation's downfall. HBOS developed a strategy for aggressive and asset led growth for a sustained period. The strategy involved the embracing of risk across the divisions of the group (The Parliamentary Commission on Banking Standards, 2013). Whilst many of the organisational strengths of the two brands within HBOF continued at the level of branches, the strategy resulted in a new culture at senior levels (The Parliamentary Commission on Banking Standards, 2013). This culture was characterised by the belief that HBOS's growing market share was primarily due to its special skills, which its competitors did not have (The Parliamentary Commission on Banking Standards, 2013). Campbell (2013), reporting on the problems faced by Mid Staffordshire National Health Trust, observed that culture played an important role in the development of problems faced by this trust. This culture was distinguished by introspection, the absence of insight, the lack of self criticism, the rejection of external criticism, and dependence on external praise (Cope *et al.*, 2009; Galloppo & Rogora, 2011). A culture like this does not develop overnight but is rather a manifestation of a lack of effective and positive direction at all levels for a sustained period of time (Cope *et al.*, 2009; Galloppo & Rogora, 2011).

Cope *et al.*, (2012) stated that the management of risk culture required its reduction and simplification to specific properties that could be observed, audited by others, like for example regulators and acted upon. Chernobai & Jorion (2011) stated that such an approach was rather narrow and that both culture and risk were complex and multidimensional concepts and that whilst some organisations may fit risk culture profiles, others may not. This issue was likely to

be specifically acute in the financial services sector, which was characterised by the presence of a wide variety of firms, working in different markets (Chernobai & Jorion, 2011). Barros and Torre-Enciso (2012) stated that risk culture could be perceived to be an area of multiple tradeoffs. Line managers and supervisors have to regularly select between meeting deadlines and cutting safety corners. Whilst the majority of such shortcuts do not result in adverse organisational consequences, gradual and progressive reduction in risk margins renders organisations increasingly vulnerable to accident causing factors (Barros & Torre-Enciso, 2012; Chernobai & Jorion, 2011). The survival of an organisation thus depends upon the achievement of a balance between production and protection issues (Barros & Torre-Enciso, 2012; Chernobai & Jorion, 2011). Such a balance is however likely to be continuously subject to changing environmental factors, as well as changes in the availability of financial resources (Barros & Torre-Enciso, 2012; Chernobai & Jorion, 2011).

2.5. Regulatory Measures for Control of Risks

There is wide acknowledgement that the regulatory regime in the years preceding the financial crisis focused extensively on self regulation of risk by banks and assumed that market forces would take care of structural imbalances (Nahmias, 2016; Cornett *et al.*, 2011). Such a perception changed significantly after the occurrence of the subprime crisis and the development of systemic risk across the banking sector (Nahmias, 2016; Cornett *et al.*, 2011).

Regulators have very clearly come to the conclusion that bank regulation has to be for more severe and stricter to eliminate the development of systemic risk and protect the interests of depositors and investors (Wehinger, 2013; Buckley, 2011). The European Union, the USA and the UK have all taken specific action to regulate the financial services sector (Wehinger, 2013; Buckley, 2011). The Basel Committee has also formulated new regulations under the Basel III regime and this is being progressively implemented by banks in the European Union and outside to ensure its complete adoption by 2019 (Duffie, 2012; Nahmias, 2016).

The recommendations of the Vickers Report and the Central Bank's prudential requirement also impose stricter regulatory requirements (Kotlikoff, 2012; Horcher, 2011). UK banks not only have to comply with the new European and International regulatory requirements but also adhere to the recommendations of the Vickers Report (Kotlikoff, 2012; Horcher, 2011).

They have to ring fence their retail banking activities in the UK by separating retail and investment banking operation (Horcher, 2011; Wehinger, 2013). Retail banks shall not be allowed to engage in market activities (Horcher, 2011; Wehinger, 2013). Investment banks outside the ring fence entity would also not be authorised to collect deposits from individuals for amounts less than 250,000 GBP or from SMEs (Duffie, 2012; Nahmias, 2016). These regulatory measures are expected to lead to major consequences on the business models of UK banking groups, especially by way of enhancement in cost of funding for corporate and investment banks (Duffie, 2012; Nahmias, 2016). Such costs will increase on account of reduction in customer deposits and higher risk premiums (Cornett *et al.*, 2011; Kotlikoff, 2012). It is also relevant to keep in mind that the new provisions of Basel III have resulted in the requirements of greater capital, lower leverage and higher liquidity by banks (Cornett *et al.*, 2011; Kotlikoff, 2012). It is expected that the adoption of all these measures will help in reducing the risk profiles of UK banks and increase the safety and security of bank customers and depositors (Nahmias, 2016; Cornett *et al.*, 2011).

2.6. Summary

This review of literature aimed to examine various aspects of the research issue in order to obtain a clearer and comprehensive understanding of the subject, develop a theoretical framework for the research project and identify information gaps that can be addressed in the course of the study. Information for this review was obtained from various online sources accessed through careful keyword based search. The examination focused on specific areas, especially organisational risk, organisational culture, risk culture and the relevance of risk culture in the UK financial services sector (House of Commons, 2017). Modern businesses face diverse types of risks, which can be categorised into some specific segments, namely marketing risks, operational risks, financial risks, reputational risks, business risks, systemic risks, liquidity risks and moral hazards (Cope *et al.*, 2012). It is thus the duty of organisational management to identify these risks and take appropriate steps to manage them in order to protect the safety, security and sustainability of business operations (Moosa, 2007; Cumming & Beverly, 2001). Organisational culture is a shared system of values, beliefs and thoughts that guide organisational strategies, policies and actions in various ways. Risk culture is an integral part of organisational culture and determines organisational approaches to the assumption of risk (Power *et al.*, 2013).

Whilst organisational and risk cultures should by and large protect organisational activity from diverse types of business hazards, the problem arises when managers at various levels assume diverse types of risks for specific reasons (Cope *et al.*, 2012; Galloppo & Rogora, 2011). Such risks could be assumed because of organisational indifference towards risk, lack of communication and coordination between different managerial levels, the deliberate neglect of various types of risks and the specific assumption of risks in the pursuit of diverse types of management objectives, including growth, profitability, personal advancement, power and remuneration (Galloppo & Rogora, 2011; Chernobai & Jorion, 2011). The crystallisation of such risks results in organisational hazards and various types of adverse consequences (Galloppo & Rogora, 2011).

The financial crisis of 2007-08, revealed that several financial services organisations in the USA, UK and Europe showed readiness to accept very high levels of risk, primarily on account of their pursuit of profits, as well as an exaggerated sense of belief in their knowledge, skills and competencies (Jobst, 2010; Gourier *et al.*, 2009). The ensuing systemic risk crisis and the financial disaster of 2007-08 resulted in the opening of a Pandora's Box and diverse investigations into the risk approach and risk culture of financial services firms across the developed countries (Cope *et al.*, 2009; Galloppo & Rogora, 2011). More recent incidents like the Libor Scandal and the involvement of important and large British financial service organisations like Barclay's Bank in it revealed that organisational propensity for risk and risk culture continues to be an important element in modern day business (The Parliamentary Commission on Banking Standards, 2013).

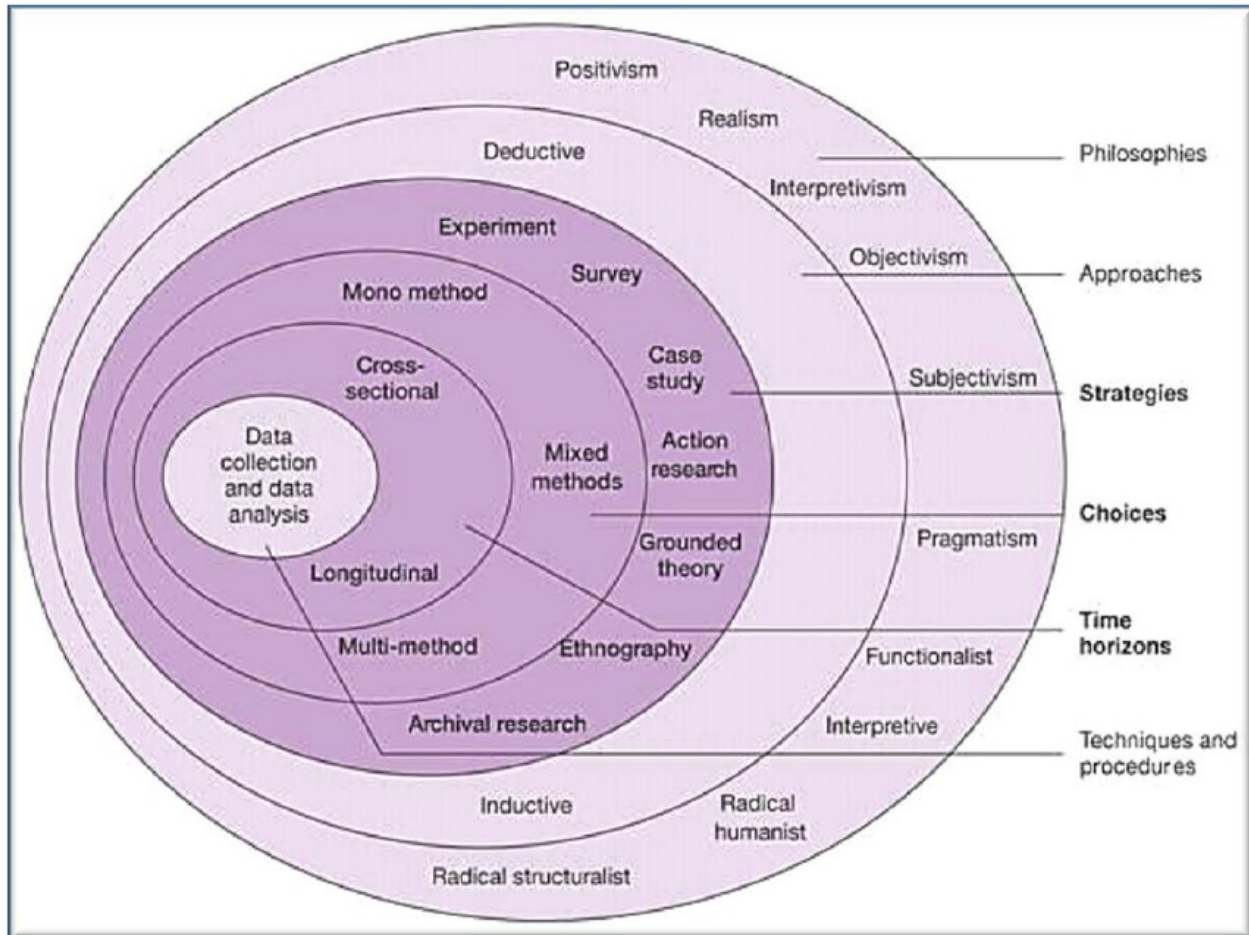
This review of literature has made use of various theories, including financial management, risk management, business and other risks, organisational culture, risk culture, managerial approaches and the agency theory amongst other things. All these theories and associated models thus comprise the theoretical framework for the study. Whilst the review of literature revealed that significant discussion, debate and investigation has taken place on the subject issue, comparatively lesser investigation has occurred in the area of empirical research on risk culture in the financial services sector in the UK. This constitutes the information gap for this study and shall be pursued in the course of further research.

Chapter 3: Research Method

The adoption of a research method constitutes a critical element in the conduct of a research study and has to be carried out with great care and thought (Saunders *et al.*, 2012; Bryman & Bell, 2015). With social research being a complex area with different and often contrasting tools and techniques, the selection of an inappropriate research method can result in incorrect and invalid research outcomes (Saunders *et al.*, 2012; Bryman & Bell, 2015). Saunders *et al.*, (2007) stated that the adoption of a research method, for best possible results, should be carried out in a sequential and logical manner. It should commence with the framing of appropriate research questions or hypotheses, followed by the examination of research theory, tools and techniques and information sources (Saunders *et al.*, 2007).

The conduct of such a study should help the researcher in deciding upon the most appropriate theoretical and logical approach, as well as the selection of appropriate tools and techniques and the choice of the best possible information sources (Hair *et al.*, 2006; Saunders *et al.*, 2012). The adopted research method should provide clear details about the use of specific research tools and techniques for collection of data, the approach to be taken for examination and analysis of data, and the methods for elaboration of final outcomes (Hair *et al.*, 2006; Saunders *et al.*, 2012). The research method should finally incorporate details about the ethical standards to be adopted in the course of a research project (Gomm, 2008; Bryman & Bell, 2007). Saunders *et al.*, (2007) formulated a research onion, which provides a graphic illustration of the elements involved in the development of a research method. The Saunders onion is detailed below.

Chart 3: Research Onion



(Source: Saunders *et al.*, 2007, p 11)

3.1. Research Questions

The research questions for this study, formulated and developed in accordance with the aims and objectives of the study and informed by the findings of the literature review are detailed below.

Research Question 1: How can risk culture be measured and assessed in the financial services sector?

Research Question 2: What are the ways in which risk culture is driven, perpetuated and spread within firms; what are the mechanisms and processes that help it in its organisational entrenchment?

Research Question 3: What is the impact of risk culture upon the growth and operations of financial services firms, as well as the broader sector in which they operate?

Research Question 4: What are the regulatory interventions at the macro, meso and micro levels for addressing the entrenchment of risk culture in the financial services sector?

These research questions are essentially “What, How and Why” in nature, which indicates the need for interpretivist / qualitative research.

3.2. Research Epistemology

Social research theory has been largely shaped and influenced by two contrasting and competing epistemologies, i.e. positivism and interpretivism (Cohen *et al.*, 2013; Ghauri & Gronhaug, 2005). The positivist approach, which has developed from scientific research tenets, posits that social research, if it is to be meaningful, has to very clearly make use of the physical or sensory observation of facts and figures, followed by the clear detailing of such observations and their careful analysis with the help of acknowledged numerical or statistical tools and techniques (Cohen *et al.*, 2013; Ghauri & Gronhaug, 2005). The positivist epistemology makes use of deductive logic for the elaboration of research questions / hypotheses and specifically cautions against the views of subjectivism or baseless and exploratory interpretation (Babbie, 2007; Saunders & Lewis, 2014). It is essentially grounded in rationale, logic and objectivity (Babbie, 2007; Saunders & Lewis, 2014).

The interpretivist epistemology, which emerged as a reaction to the severity and harshness of positivism, states that whilst the positivist approach can occasionally lead to useful outcomes, it is by and large not adequate for the investigation and analysis of complex, multidimensional and multilayered research issues that are not amenable to numerical examination and analysis (Gunter, 2000; Marshall & Rossman, 2014). Advocates of interpretivism thus recommend the use of exploratory and open ended research tools and techniques for the investigation of research questions developed through inductive logic (Crowther & Lancaster, 2008; Gomm, 2008). Interpretivism recommends the selection of small samples and their multidimensional and in-depth analysis to arrive at true insights and outcomes (Bryman, 2015; Marshall & Rossman, 2014).

3.3. Research Tools and Techniques

Positivism being based upon deductive logic and associated with logic and objectivity makes use of clear and specific quantitative tools and techniques for the investigation of research issue (Bryman & Bell, 2007; Murray & Hughes, 2008). The use of quantitative tools and techniques more often than not entails the application of specific sampling methods for the creation of manageable samples from the larger populations under study (Bryman & Bell, 2007; Murray & Hughes, 2008). The use of sampling techniques, which can be random or purposeful in nature leads to the generation of an appropriate sample (Creswell, 2009; Nachmias & Nachmias, 2008). The members of this sample are then subjected to careful observation, followed by the detailing of observations and their analysis with appropriate quantitative tools and technique (Creswell, 2009; Nachmias & Nachmias, 2008). Quantitative researchers also make use of methods for validation of results in order to arrive at representative and generalisable outcomes (Creswell, 2013; Hair *et al.*, 2006).

The application of interpretivist tools and techniques, on the other hand calls for the use of qualitative tools and techniques (De-Vaus, 2013; Bryman & Bell, 2015). Qualitative research involves the selection of a limited sample of subjects, followed by their investigation with the help of diverse open ended techniques like content analysis, thematic analysis and case study analysis (Creswell, 2013; Hair *et al.*, 2006). Qualitative analysis is extremely detailed, exploratory and often makes use of subjectivity, narratives and interpretation to arrive at appropriate and in-depth outcomes (Gunter, 2000; Bryman & Bell, 2015).

It should be kept in mind that both positivist / quantitative and interpretivist / qualitative tools and techniques have their individual benefits and limitations (Miles *et al.*, 2013; Saunders & Lewis, 2014). Qualitative techniques involve answering questions that are “How, What or Why” in nature, whilst quantitative techniques answer questions relating to “when or how many” (De-Vaus, 2013; Bryman & Bell, 2015). Quantitative techniques have proved to be extremely helpful in the investigation of large populations, especially in marketing, consumer and electoral research (Marshall & Rossman, 2014; Denscombe, 2010). Such approaches have however proved to be inadequate for multidimensional, multilayered and complex research subjects (Marshall & Rossman, 2014; Allison, 1996). These are better served by interpretivist approaches, which however are more expensive and take more time, compared to quantitative methods and

can be used only when small populations have to be studied (Miles *et al.*, 2013; Saunders & Lewis, 2014). Many modern researchers thus make use of both positivist and interpretivist methods for the study of complex and difficult subjects (Miles *et al.*, 2013; Saunders & Lewis, 2014). Such an approach, known as the Mixed Method Model of research is becoming increasingly popular in social research (Marshall & Rossman, 2014; Denscombe, 2010).

The examination of the research subject reveals that the use of both positivist and interpretivist approaches can be of help in the conduct of this study (Bryman & Bell, 2015; Miller & Neil, 2002). A positivist approach could help in obtaining information on specific aspects of the research study from diverse people engaged in the UK financial services sector. The complexity of the subject, especially the dimensions of risk and the drivers of risk culture, especially the motivation of managers and employees to assume risk on the other hand calls for the use of interpretivist and exploratory methods of investigation and analysis.

3.4. Information Sources

Social research entails the study of various information sources. These information sources can be segmented into primary and secondary sources (Bryman & Bell, 2015; Miller & Neil, 2002). Primary sources comprise information that is obtained by the researcher on his or her own through the study of official documents and the conduct of interviews and group discussions (Bryman & Bell, 2015; Miller & Neil, 2002). Primary information is considered to be extremely relevant for a project but is expensive and time consuming to obtain (Denscombe, 2010; Smith, 2015). Secondary information sources on the other hand comprise the substantial amount of information available on the research issue in the public domain; whilst such information is available easily and without much cost, it has to be tested for relevance and reliability (Allison, 1996; Smith, 2015).

3.5. Adoption of Research Method

The examination of various aspects of research theory, studied side by side with the requirements of the research subject, reveal that the research effort can be helped by empirical evidence on the issue from people actively engaged in the UK financial services sector. This calls for the adoption of a positivist / quantitative method of enquiry and analysis, preferably

with the help of questionnaire surveys (Institute of Risk Management, 2017). Bryman & Bell (2015) stated that the use of questionnaire surveys can help significantly in the obtaining of important quantitative information on a research issue and its appropriate investigation.

It is however also clearly evident that the risk culture of an organisation, as well as the propensity of managers to assume or limit risk is influenced by diverse factors, including their personal objectives with regard to growth, power, remuneration and reward, their beliefs in their own abilities and competencies, their regard or disregard for other internal and external stakeholders, existing regulatory regimes, the actions of credit rating agencies and internal risk control and regulatory mechanisms (Cumming & Beverly, 2001; Cope *et al.*, 2012).

It is, in light of these circumstances, appropriate to adopt a positivist approach to research, supported by qualitative analysis (Nachmias & Nachmias, 2008; Saunders *et al.*, 2007). The research has thus been carried out with a Mixed Method Model, making use of a questionnaire survey for obtaining primary data, followed by analysis that makes use of (a) descriptive statistics, (b) analytical statistics and (3) qualitative thematic analysis (De-Vaus, 2013; Bryman & Bell, 2015). The adoption of this triangulated method of research and analysis has helped in the validation of information, as also in the generation of in-depth and insightful analysis (De-Vaus, 2013; Bryman & Bell, 2015).

Information for this study has thus been obtained through a quantitative survey of employees in the financial services sector (Nachmias & Nachmias, 2008; Saunders *et al.*, 2007). The researcher has made use of his personal contacts to approach three major banks in London and obtain their agreement to apply a questionnaire survey to 10 of their employees from different levels and departments. The sampling method chosen for this is purposeful, rather than random. Care has however been taken to ensure that the respondents chosen for this exercise are diverse in nature with regard to their gender, their period of employment with their organisation, their experience and their official responsibilities (Nachmias & Nachmias, 2008; Saunders *et al.*, 2007). Saunders *et al.*, (2012) stated that the use of purposeful or discrete sampling when carried out in a carefully planned manner can result in the creation of a truly representative sample and help in the development of valid outcomes.

The questionnaire survey has been prepared with the help of both multiple choice questions and Likert Style five stage queries. The answers to the questionnaire survey have been

analysed with the help of both descriptive and analytical statistics, substantiated with qualitative analysis in order to arrive at valid and in-depth conclusions (Gomm, 2008; Bryman & Bell, 2007).

3.6. Ethical Issues

Efforts have been made to adhere and comply with the ethical standards and norms required of social research (Nachmias & Nachmias, 2008; Saunders *et al.*, 2007). All respondents for the interviews have been informed about the purpose of research and their agreement has been obtained in writing (Nachmias & Nachmias, 2008; Saunders *et al.*, 2007). They have been informed about their rights, with specific regard to privacy of identity and information and the prerogative of not answering some or all of the questions and of withdrawing from the research project at any time of their choosing (Cohen *et al.*, 2013; Ghauri & Gronhaug, 2005).

Efforts have also been made to ensure total lack of bias in the research of information and the conduct of the analysis and the determination of the outcomes (Davies, 2007; Saunders *et al.*, 2012). All information sources have furthermore been suitably acknowledged (Murray & Hughes, 2008; Richards, 2009).

Chapter 4: Collection of Data

The data for this research project has been obtained through primary information sources accessed by the application of an appropriate questionnaire survey on employees of three important London based banks / financial services organisations. Ten employees have been chosen from each of these organisations with care taken to achieve diversity by way of gender, age, period of employment with the organisation, department and position. The names of the institutions, as well as the respondents have been kept strictly confidential in accordance with their requests. The questionnaire used for the survey is detailed in Appendix 1. The answers to the questionnaire survey are provided below. The answers to the questions have been presented below in a manner that facilitates both descriptive and analytical statistical analysis.

4.1. Results of Questionnaire Survey

S. No	Question	Answers					Total
		1	2	3	4	5	
1.	Do you have individuals engaged in risk culture work in your organisation? Yes / No	23	7				30
Percentage		77	23				100
2.	Do the people engaged in risk culture work interact frequently with organisational employees? Yes / No	8	22				30
Percentage		27	73				100
3.	What do you think is the risk appetite of your firm on a grading of 1 to 5? 1 to 5						
Percentage							
4.	What level of risks do you think are undertaken by your organisation? Very low, Low, Neutral, High, Very High	3	7	5	7	8	30
Percentage		10	23	17	23	27	100

5.	Do you think that assumption of risks results in profits? Absolutely Wrong, Wrong, Neutral, Correct, Absolutely Correct	4	7	3	8	8	30
Percentage		13	23	10	27	27	100
6.	What in your opinion is the best method for measurement for risk? Organisational leverage Compliance with Basel III Reduction of Special Purpose Vehicles Assessment of internal risk control mechanism	5	12	3	10		100
Percentage		17	40	10	33		30
7.	Do you think that the risk management provisions of Basel III are very strict? Absolutely Wrong, Wrong, Neutral, Correct, Absolutely Correct	7	7	5	8	3	30
Percentage		23	23	17	27	10	100
8.	Do you think that compliance with Basel III will help in reduction of risk? I do not agree at all I do not Agree Neutral I Agree I Agree Fully	2	3	3	12	10	30
Percentage		7	10	10	40	33	100
9.	Do you think that ring fencing will increase customer safety? I do not agree at all I do not Agree Neutral I Agree	3	3	2	13	9	30

	I Agree Fully						
Percentage		10	10	7	43	30	100
10.	Does your bank have adequate internal risk control mechanisms? I do not agree at all I do not Agree Neutral I Agree I Agree Fully	7	8	3	11	1	30
Percentage		23	27	10	37	3	100
11.	Does your organisation have an appropriate risks assessment and quantification system? I do not agree at all I do not Agree Neutral I Agree I Agree Fully	7	8	2	4	9	30
Percentage		23	27	7	13	30	100
12.	Does your bank have adequately internal regulatory mechanisms to prevent risks? Absolutely Not, No, Neutral, Yes, Very Much so	2	3	4	8	13	30
Percentage		7	10	13	27	43	100
13.	Do you think that greater risk appetite results in lack of control? Absolutely Not, No, Neutral, Yes, Very Much so	4	7	3	8	8	30
Percentage		13	23	10	27	27	100
14.	Please rate your Degree of internal risk control on a scale of 1 to 5? 1 to 5						
Percentage							

15.	Does your organisation respect the public objectives of risk regulators? Absolutely Not, No, Neutral, Yes, Very Much so	2	3	1	11	13	30
Percentage		7	10	3	37	43	100
16.	Has your organisation had to suffer losses on account of its poor risk culture? Absolutely Not, No, Neutral, Yes, Very Much so	4	5	3	8	10	30
Percentage		13	17	10	27	33	100
17.	Do you feel frustrated in your work on account of the poor risk culture? Absolutely Not, No, Neutral, Yes, Very Much so	7	9	3	5	6	30
Percentage		23	30	10	17	20	100
18.	Do you think your organisation should engage in stricter internal risk control? Please rank your answers from 1 to 5? 1 to 5						
Percentage							

4.2. Answers to Question on Risk Appetite of Firm on Grading of 1 to 5

	Bank A	Bank B	Bank C
	1	4	2
	1	4	2
	1	4	2
	2	5	2
	2	5	3
	1	3	1
	1	3	1
	3	3	2
	1	4	1
	2	5	3
	1	4	1
	2	5	3

4.3. Answers to Degree of Internal Risk Control on a Scale of 1 to 5

Bank A	Bank B	Bank C
3	2	3
2	2	2
2	1	3
1	1	3
4	4	3
3	2	3
2	3	2
3	3	2
3	5	1
2	1	1
1	2	1
4	5	4

4.4. Should Organisations Engage in Structure Internal Risk Control Grading in 1 to 5

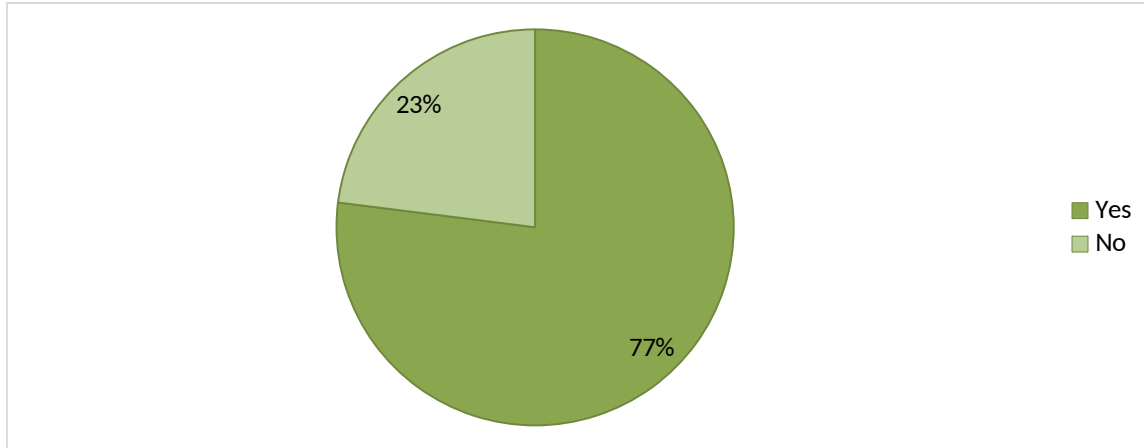
Bank A	Bank B	Bank C
1	3	1
2	3	1
2	3	1
1	2	2
1	1	2
1	1	4
4	3	4
5	4	1
3	2	1
3	2	2
3	2	2
2	1	2

Chapter 5: Analysis of Data

The data obtained from the questionnaire survey have been analysed, both through the perspective of descriptive statistics, as well as analytical statistics.

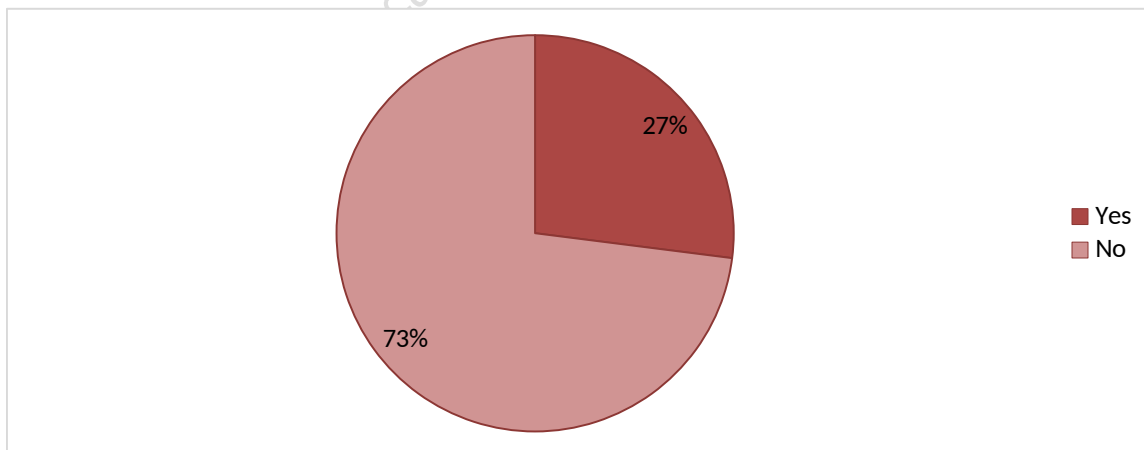
5.1. Analysis of data obtained in the course of the Questionnaire Survey

1. Do you have individuals engaged in risk culture work in your organisation?



More than three fourths of the surveyed population stated that their organisations did have people who were engaged in development of organisational risk culture.

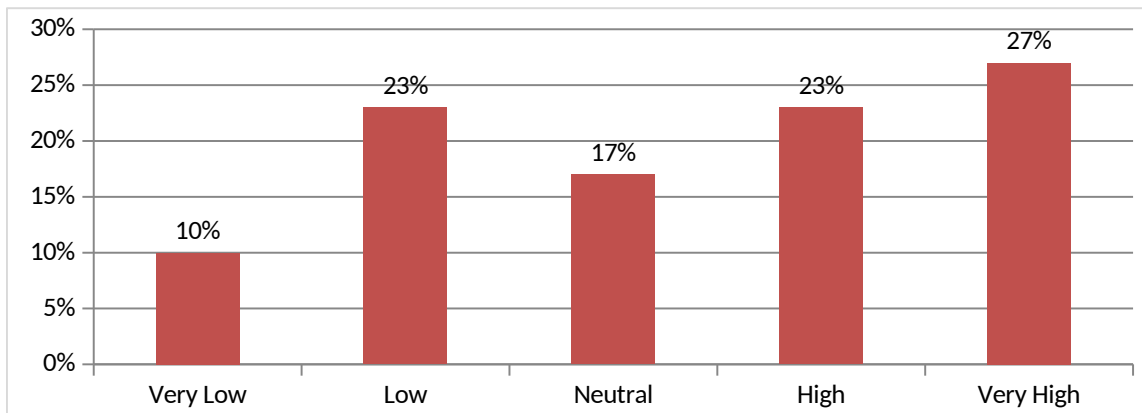
2. Do the people engaged in risk culture work interact frequently with organisational employees?



The answers to this question however support the answers provided to question 1 and reinforce the fact that modern financial service organisations are engaged in the entrenchment of a suitable risk culture.

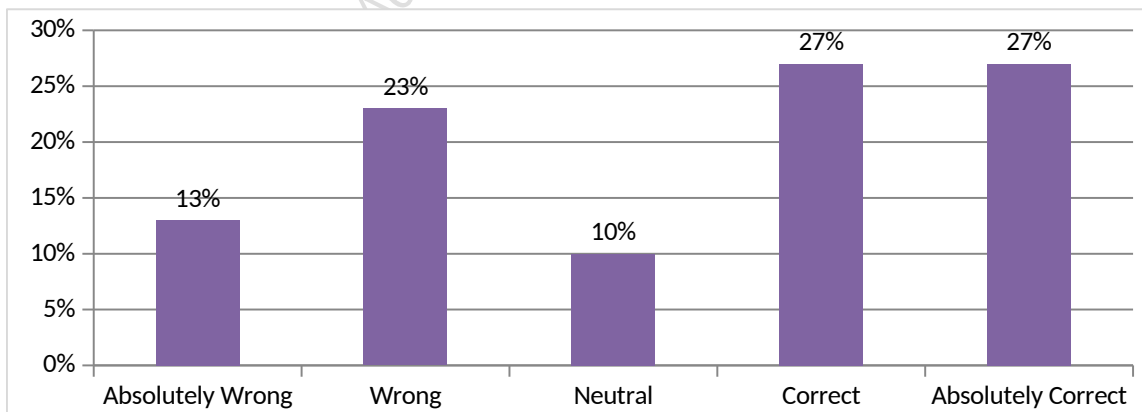
3. This question has been statistically analysed later.

4. What level of risks do you think are undertaken by your organisation?



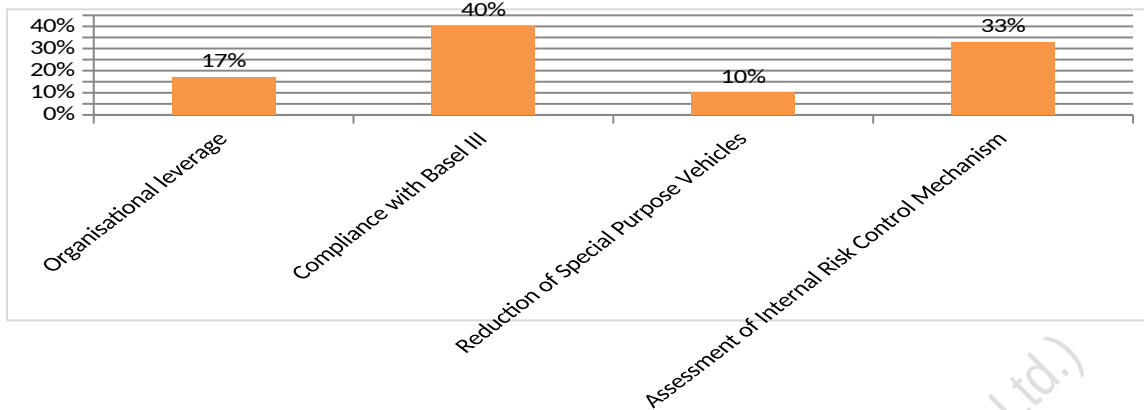
The answers to this question revealed that fifty percent of the respondents feel their organisation engages in high or very high level of risks. This is a disturbing finding and indicates that the employees are not fully convinced about the risk approaches of their firms.

5. Do you think that assumption of risks results in profits?



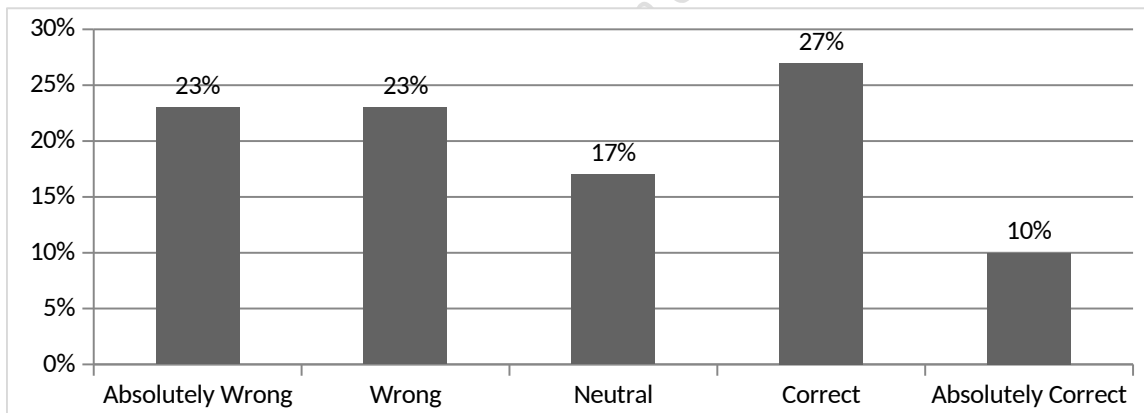
More than fifty percent of the respondents feel that assumption of some risk is essential for achievement of profits. Thirty six percent of the respondents adversely feel that profits in financial services can be achieved without assumption of risks.

6. What in your opinion is the best method for measurement for risk?



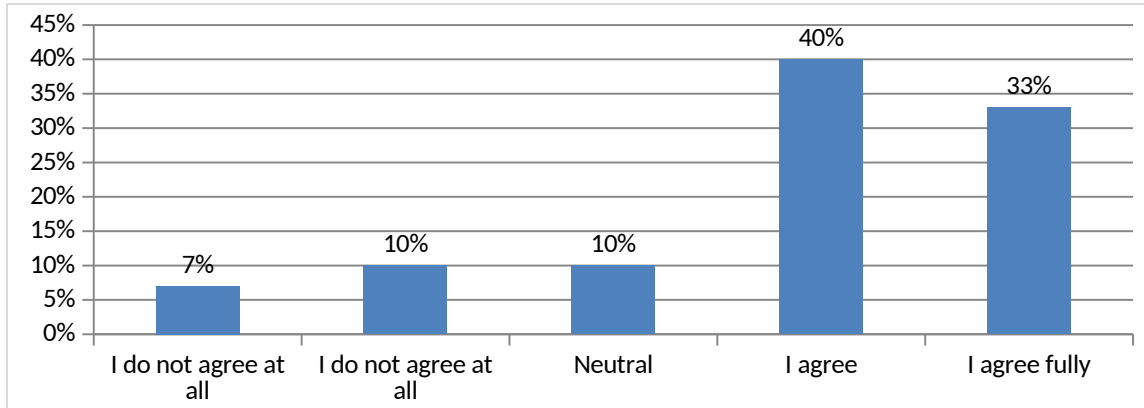
More than seventy percent of the respondents feel that the level of compliance with Basel III and assessment of internal risk control mechanism is the best method for risk measurement in business firms. Assessment of organisational leverage is also seen to be an important indicator of organisational risk.

7. Do you think that the risk management provisions of Basel III are very strict?



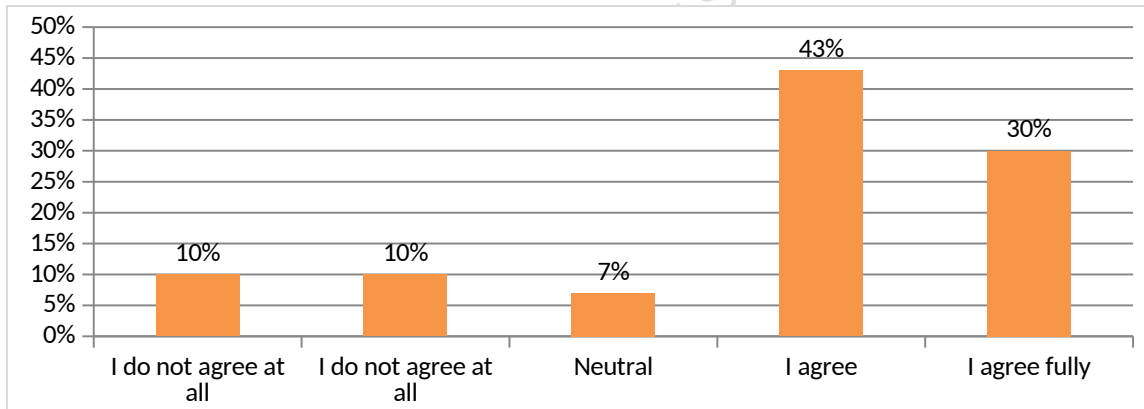
The responses to this question are by and large evenly balanced with half the respondents feeling that Basel III needs are very strict and the other half feeling that they are not.

8. Do you think that compliance with Basel III will help in reduction of risk?



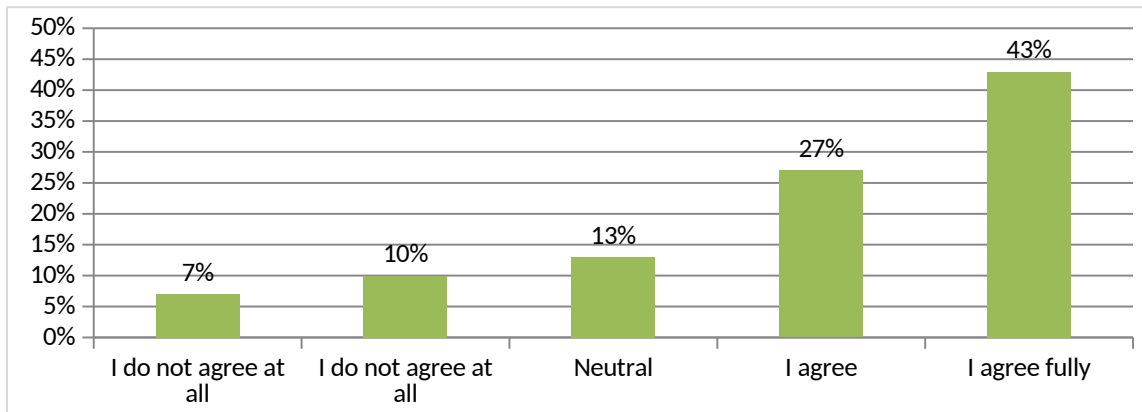
Practically seventy five percent of the respondents feel Basel III to be useful for the control of organisational risk. This is an encouraging sign because Basel III has otherwise been criticised for the imposition of extremely harsh and profit adverse conditions on banks.

9. Do you think that ring fencing will increase customer safety?



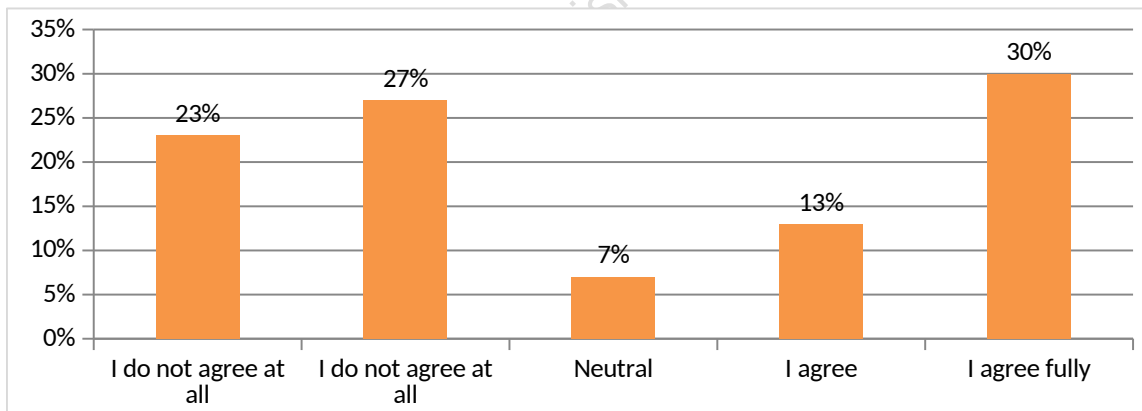
A similar percentage of respondents feel that the adoption of ring fencing in the UK financial sector will help in enhancement of customer safety. This answer conversely indicates that the earlier system of practicing investment and retail banking in the same organisation was conducive to enhancement of business risk and customer hazards.

10. Does your bank have adequate internal risk control mechanisms?



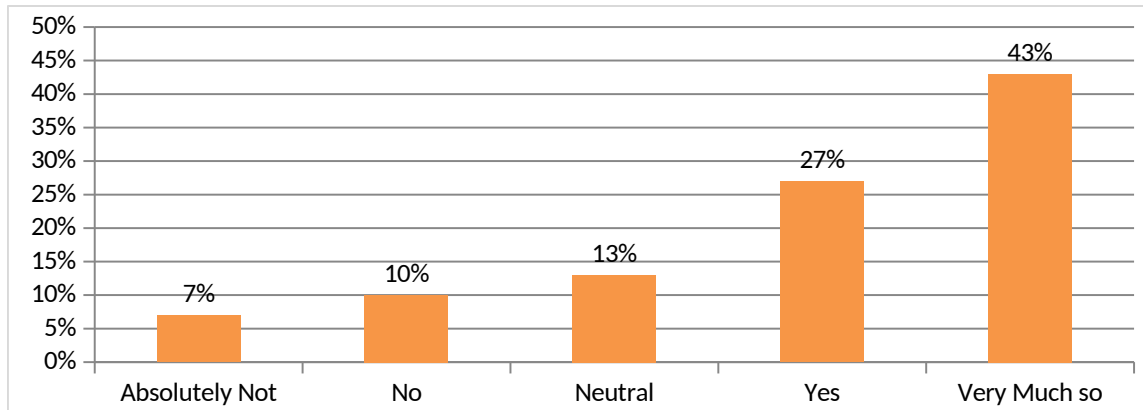
Seventy percent of the respondents agree that their organisations have adequate risk control measures. It is however somewhat worrying that seventeen percent feel that significant improvements can be made.

11. Does your organisation have an appropriate risks assessment and quantification system?



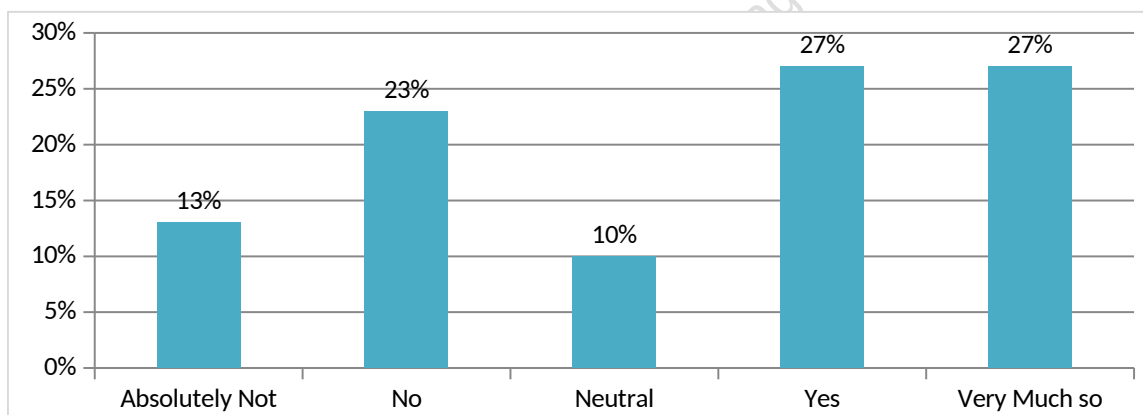
It is a matter of worry that half the respondents feel that existing systems for risk assessment and quantification are inadequate and should be improved.

12. Does your bank have adequately internal regulatory mechanisms to prevent risks?



Seventy percent of the respondents nevertheless feel that internal regulatory mechanisms appear to be adequate for prevention of risk.

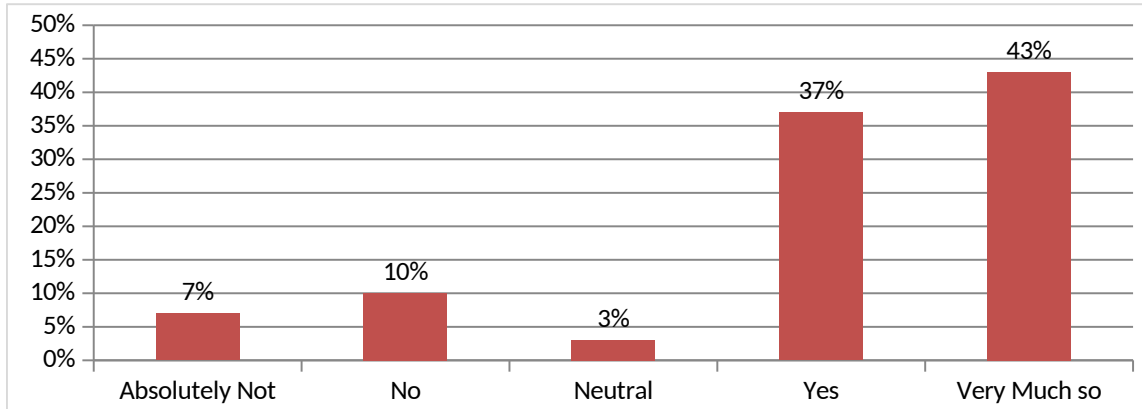
13. Do you think that greater risk appetite results in lack of control?



More than half the respondents feel that greater risk appetite results in lack of control. It is thus necessary for banks engaging in risk to develop stricter regulatory mechanisms.

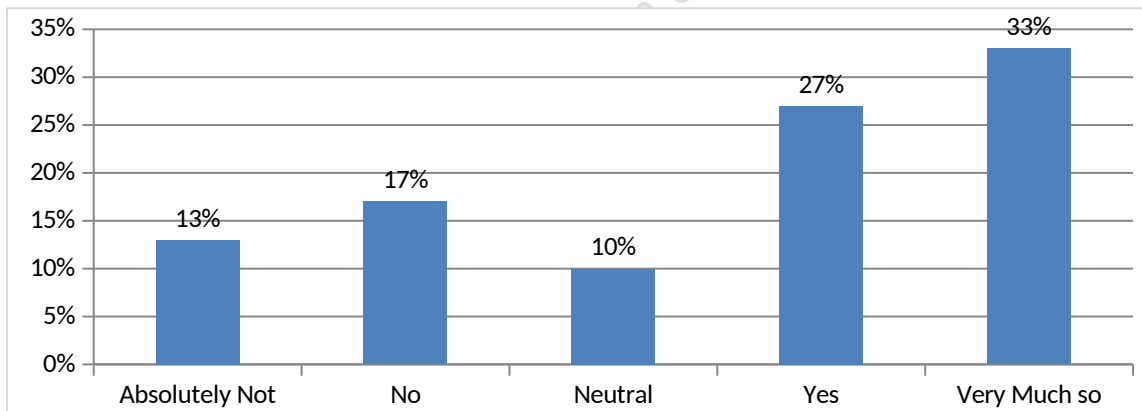
14. This question has been statistically analysed later.

15. Does your organisation respect the public objectives of risk regulators?



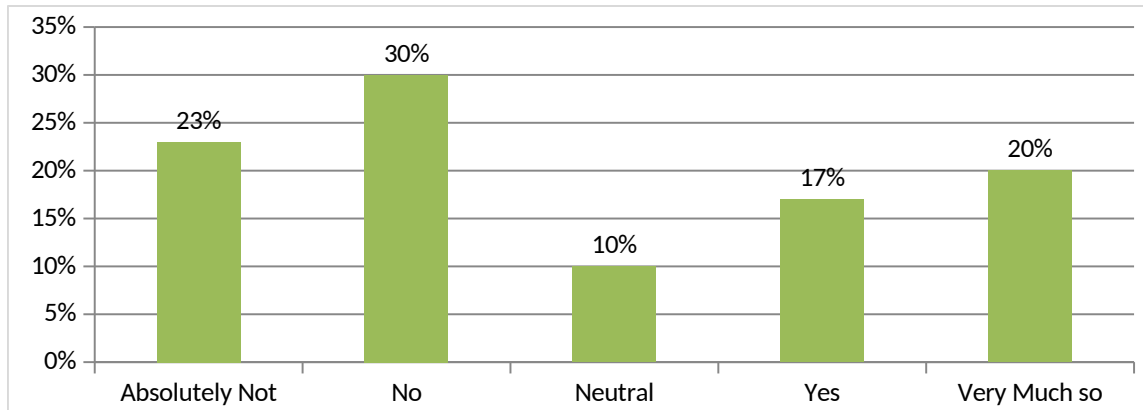
It is heartening that eighty percent of the respondents feel that their organisations are in agreement with the public objectives of risk regulators. Such feelings enhance the introduction of appropriate risk cultures.

16. Has your organisation had to suffer losses on account of its poor risk culture?



Sixty percent of the respondents feel that their organisation has suffered losses in the past on account of its poor risk culture. Such a feeling is likely to make them eager to ensure enhancement of risk culture in future.

17. Do you feel frustrated in your work on account of the poor risk culture?



Approximately 37% of the respondents still feel that risk culture needs to be improved further.

18. This question has been statistically analysed later.

5.2. Analysis of Correlation Coefficient

5.2.1. Risk Appetite of Firm on Grading of 1 to 5

Correlation between Bank A and Bank B = **0.2551**.

Correlation between Bank B and Bank C = **0.7349**.

Correlation between Bank A and Bank C = **0.5952**.

5.2.2. Degree of Internal Risk Control on a Scale of 1 to 5

Correlation between Bank A and Bank B = **0.5539**.

Correlation between Bank B and Bank C = **0.1066**.

Correlation between Bank A and Bank C = **0.4616**.

5.2.3. Structure Internal Risk Control Grading in 1 to 5

Correlation between Bank A and Bank B = **0.6355**.

Correlation between Bank B and Bank C = **-0.4128**.

Correlation between Bank A and Bank C = **-0.0429**.

These correlations have been calculated with the help of available online software and cross checked with excel (Pearson, 2017).

Chapter 6: Discussion

The information obtained from primary research, and analysed with the help of both descriptive and analytical statistics has been compared and contrasted with the literature review and discussed thematically in this section. The thematic analysis has been carried out in accordance with the aims and objectives and the formulated research questions.

Theme 1: Measurement and Assessment of Risk Culture in the Financial Services Sector

The examination of the literature review revealed that financial service organisations, both in the USA and the UK engaged in high levels of risk in the course of the years building up to the financial crisis of 2007-08 (Davidson *et al.*, 2012; Miihkinen, 2012). The propensity to take risks was evidenced through various parameters including the development of unsustainably high levels of leverage, risky lending practices, with specific regard to extension of loans to people with inadequate payment capacity, high levels of securitisation and use of special purpose vehicles (Protiviti Inc, 2016; Ashby *et al.*, 2012). The review of literature furthermore revealed that organisational risk assumption was dependent to a great extent upon the attitudes and approaches of the senior management, their tendency to work within the letter, rather than the spirit of the regulatory regime and their lack of respect for feedback from external stakeholders, as well as from employees at junior levels (Deloitte, 2011; McConnell, 2014).

The information obtained from primary research revealed that the respondents considered that the levels of organisational risk could be assessed by examining the compliance of organisations with existing regulatory measures, i.e. macro level regulation, the formulation of an internal regulatory environment, i.e. the micro level and finally the extent of leverage assumed by particular financial service organisations. Respondents were also asked questions on the degree of risk appetite of firms and level of internal risk control. The correlation in the answers of the respondents between the three banks was uniformly positive and more so between Bank B and Bank C with regard to risk appetite and Bank A and Bank C with regard to internal risk control. It thus appears that all respondents also agree that the degree of internal risk control functions is an important measure for the assessment of risk culture in their organisations.

Theme 2: Enhancement and Perpetuation of Risk Culture in Financial Services Organisations

The review of literature revealed that numerous organisations in the financial services sector had engaged in excessively high levels of risk prior to 2008 (Institute of International Finance, 2013; PWC, 2010). This erosion of risk culture was primarily due to two important factors, namely (1) the presence of an easy regulatory regime that expected bank managements to manage their own risks in a responsible manner and (2) the desire of bank managements to make use of the economic and housing boom in order to increase revenues, profits and their own personal profit related bonuses and remuneration (McConnell, 2014; Brooks, 2010).

The regulatory regime has been tightened severely in the UK in the years following the financial crisis through measures by regulatory authorities, the UK government and the Bank of England (Kotlikoff, 2012; Horcher, 2011). The new provisions for ring fencing and Basel III have tightened the macro environment in substantial measure and imposed significant restrictions on the operations of both commercial and investment banks (Duffie, 2012; Nahmias, 2016). Rules for capital and liquidity have also been made far stricter (Duffie, 2012; Nahmias, 2016).

The examination of the information obtained from the respondents reveals the following.

- Financial service organisations are now actively engaged in development of risk culture.
- Level of risk being undertaken by organisations is being limited.
- The compliance with Basel III should help in reduction of risk.
- Implementation of ring fencing should increase customer safety.
- Banks are progressively implementing risk control mechanisms.
- Risk assessment and quantification needs to improve.
- Greater risks have to be accompanied by more control.
- Poor risk culture can be very frustrating.

The analysis of correlation coefficients indicates some disagreement between the respondents on the need to bring in stricter internal risk control. Such disagreement implies that the respondents of some banks feel that stricter risk control is needed, whilst others do not agree with them. It can thus be concluded that risk culture is progressively becoming entrenched in UK

financial service organisations and that the majority of employees are concerned that risk culture should be entrenched further through compliance with macro regulatory restrictions and development of internal regulations, both at the meso and the micro level.

Theme 3: Impact of Risk Culture upon Growth and Operations of Financial Services Firms

The review of literature informed that organisational managements in financial service sector firms had undertaken high levels of risks primarily to achieve fast organisational growth, greater profits and accretion to personal managerial wealth through profit and growth related bonuses and rewards (Barros & Torre-Enciso, 2012; Chernobai & , Jorion, 2011). The erosion of risk culture and the assumption of higher risk however resulted in the creation of systemic risk across the banking system and to the creation of a huge financial crisis with numerous adverse consequences (Brechmann *et al.*, 2014).

The information obtained from the respondents resulted in the following important findings.

- Reasonably high levels of risks are still taken by financial service firms.
- Assumption of risks does help in growth and profits.
- Compliance with external regulatory requirements and development of internal risk control mechanisms helps in management of risk.
- Risk assessment mechanisms need to be improved.
- Poor risk culture results in organisational frustration.

The information from the literature review leads to two main implications, first some engagement in risk is essential for organisational growth and profitability and second the imposition of a risk culture is essential for organisational safety but will dampen organisational growth to a certain extent (Miihkinen, 2012; Ashby *et al.*, 2012).

Theme 4: Regulatory Interventions for Entrenchment of Risk Culture in the Financial Services Sector

The review of literature as informed earlier revealed that a reasonably easy regulatory environment and the existence of economically favourable conditions resulted in organisational desire for achievement of growth and profits, the purposeful neglect of risk culture and the

development of risk control mechanisms, the enhancement of organisational and systemic risk and the financial crisis (Nahmias, 2016; Cornett *et al.*, 2011). Several regulatory methods have been taken in the UK, as well as the EU and the USA for enhancing risk culture entrenchment in their financial services sectors (Wehinger, 2013; Buckley, 2011). The UK has in fact experienced the restructuring of risk control accountability at the regulatory level, significant enhancement in the power of the Bank of England, the implementation of the Vickers Recommendations, separation of commercial and investment banks and compulsory compliance with Basel III provisions by 2018 (Wehinger, 2013; Nahmias, 2016). Enhanced corporate governance across financial service organisations has also resulted in audits of industry wide and organisational risk control mechanisms and their tightening for purposes of improvement of risk culture (Wehinger, 2013; Nahmias, 2016).

Notwithstanding the Libor scandal, information from the respondents to the questionnaire survey also reveal that organisations are taking specific steps to ensure better risk control and the feeling that risks need to be monitored and controlled, despite their restricting impact on growth and profitability is growing steadily. It thus appear that risk culture is becoming entrenched at the macro (government and regulatory), meso (industry wide) and micro (organisational) levels.

Chapter 7: Conclusions, Limitations and Recommendations for Further Research

7.1. Conclusions

This study aimed to examine various aspects of the risk culture in UK financial service organisations, its implications for organisational growth and its development in future. The study has been carried out with the help of a detailed literature review and a Mixed Method Model of research with use of both positivist / quantitative and interpretivist / qualitative research and investigation methods.

The conduct of the literature review revealed that the development of a good quality risk culture has become an area of immense importance in the UK financial service sector, especially after the financial crisis of 2007-08, incidents of rogue behaviour and the Libor scandal (Institute of International Finance, 2013; PWC, 2010). The review revealed that risk culture in the sector witnessed significant erosion in the years preceding the financial crisis for some specific reasons.

- An easy and organisation oriented regulatory regime
- The continuance of an economic and housing boom
- The desire for achievement of high levels of organisational growth and profitability, as well as accretion in managerial income and wealth
- Disconnect between the senior management and other employees
- Arrogance and a feeling of superiority in organisational managements, with particular regard to business competence and achievement of profitability (Miihkinen, 2012; Ashby *et al.*, 2012).

Such feelings resulted in the development of individual and systemic risks and their crystallisation in the form of the financial crisis. Numerous regulatory changes have been brought about in the wake of the crisis in order to limit the risk taking abilities of individual managements and to protect both organisations and clients from the adverse consequences of high levels of risk assumption (Nahmias, 2016; Cornett *et al.*, 2011).

Information from primary research revealed that UK financial service organisations have seriously taken up the issue of advancement and entrenchment of risk culture through compliance with the macro regulatory regime and industry wide norms, as well as the development of internal risk control measures. There also appears to be a strong feeling amongst respondents that risk control is important and more needs to be done in this respect, even if it

results in restriction on growth and profitability. The use of both statistical and qualitative analysis confirmed these findings.

7.2. Limitations

It is important to keep in mind that risk culture and risk reduction are essentially complex issues that are determined to a great extent by the attitudes and opinions of decision makers, which can often be subjective and differ extensively from firm to firm. It is thus felt that the use of open ended semi-structured interviews, which are considered to be of great help in the generation of critically important qualitative information, could have helped in adding to the extent and quality of outcomes.

7.3. Recommendations for Further Research

It is thus recommended that the accessing of qualitative information from the senior managements of financial service sector participants, especially through the conduct of semi-structured interviews should be carried out as an addendum to this research project. The information obtained from such reviews should add to the quality of the outcomes of this research paper.

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Appendices

Appendix 1: Questionnaire

1. Do you have individuals engaged in risk culture work in your organisation?
2. Do the people engaged in risk culture work interact frequently with organisational employees?
3. What do you think is the risk appetite of your firm on a grading of 1 to 5?
4. What sort of risks do you think are undertaken by your organisation?
5. Do you think that assumption of risks results in profits?
6. What in your opinion is the best method for measurement for risk?
7. Do you think that the risk management provisions of Basel III are very strict?
8. Do you think that compliance with Basel III will help in reduction of risk?
9. Do you think that ring fencing will increase customer safety?
10. Does your bank have adequate internal risk control mechanisms?
11. Does your organisation have an appropriate risks assessment and quantification system?
12. Does your bank have adequately internal regulatory mechanisms to prevent risks?
13. Do you think that greater risk results in lack of control?
14. Please rate your Degree of internal risk control on a scale of 1 to 5?
15. Does your organisation respect the public objectives of risk regulators?
16. Has your organisation had to suffer losses on account of its poor risk culture?
17. Do you feel frustrated in your work on account of the poor risk culture?
18. Do you think your organisation should engage in stricter internal risk control?

Please rank your answers from 1 to 5