

CAPÍTULO 4

Dilemmas and limitations in minimizing management risks in banking

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Resumo

Este capítulo tem por objetivo constatar se os sistemas de controle de gestão e *compliance* são suficientes ou não para assegurar uma governança responsável e a redução dos riscos no setor financeiro. São relatadas entrevistas a diretores de bancos com o objetivo de entender a sua perspectiva em relação à robustez e às fraquezas do sistema de controle e *compliance*, assim como os fatores-chave que podem mitigar os riscos no setor financeiro. Conclui-se que um bom sistema de controle e *compliance* não é suficiente para evitar riscos no setor financeiro. É necessária uma cultura organizacional orientada ao cliente, que salvguarde os interesses dos distintos *stakeholders* de forma justa e prudente. Isso pode ser alcançado complementando o sistema de controle e *compliance* com uma boa equipe de alta direção que comunique os valores e a cultura pela palavra e pelo exemplo.

Introduction

In this chapter we explore the perspective of senior management regarding the strengths and limitations of the management control systems to minimize the management risks in the banking sector. We interviewed ten executives from seven banks operating in Portugal, Angola and Brazil, as well as two members of supervisory bodies. We also investigated the relevance of ethics and company culture in banking. We tried to understand executives' perspective on the role and effectiveness of management control systems to foster ethical behaviour in banking.

We start with a brief review of the literature to support this research. Then, we report the interviews, highlighting the aspects that relate to management control, ethics and governance, and we analyse the data gathered during interviews. Finally, we summarize the main findings of this study.

4.1 Literature review

In the management control literature it is common to find the perspective that good strategy communication and strategy control determines the success of the organization (e.g., AGBEJULE; JOKIPII, 2009; SIMONS, 1995, 2000). For example, Simons (1995) presents a management control model in which the comprehensiveness and complementarity of the instruments ensure its effectiveness – ever since the strategy is well designed and well implemented. The author seeks to create a framework that balances control and empowerment. He recognizes, on one hand, the importance of border lines – behavioural and strategic –, and on the other hand the need to innovate and manage ambitiously. Considering unlimited opportunities contexts and limited management time, the author argues for the importance of managing by exception, using key performance indicators. This model also recognizes the existence of contexts of uncertainty and change, where employees' learning ability and spirit of innovation are critical. It argues in defence of interactive control systems, where multi-functional and multi-hierarchical teams frequently interact on a face-to-face analysis of activity (e.g., FRANCO, 2014).

Control tools such as the budget (see HOPE; FRASER, 2003a, 2003b) or the balanced scorecard (KAPLAN; NORTON, 1996a, 1996b) can be used in Simons' model, leading us to believe that risks can be mitigated while maintaining an atmosphere of learning and innovation. Literature presents frequent applications of these models and tools in the financial sector (e.g., INNES; MITCHELL, 1997; WU; TZENG; CHEN, 2009), usually relating it to the performance of the institutions.

Despite what has been said before, and the ability of financial institutions to use the most sophisticated models and tools for strategic thinking and management control, in the recent past we've witnessed a profound instability in the financial sector and the collapse of large financial organizations (ADMATI; HELLWIG, 2014; REINHART; ROGOFF, 2009).

We are led to question why the models recommended in management control literature did not produce the expected effects when applied to the financial sector. We can ask if it was a failure of the control and audit systems or if it was a failure in terms of the behaviour of people – illegal or technical violations. In this chapter, we also question whether rigorous technical and legal compliance is sufficient to avoid similar situations in the future. Or, what are the factors that in practice contribute to enhance the effectiveness of the management control systems to mitigate the risks inherent in the financial sector activity.

4.2 Bank executives' interviews

4.2.1 Bank one

Most of Bank One's business is in Brazil. The number of its customers exceeds 57 million and it has more than 5,000 branches and service points. Equity exceeds € 25,000 million and

total net assets are over € 280,000 milion. In 2014, net income surpassed € 5,400 milion. That year, Bank One had more than 93,000 workers. We interviewed a senior executive who worked in this bank for more than 30 years. He held several management positions; he was vice president and president for more than eight years.

This executive believes that, to minimize risks inherent to the financial sector, the most important thing is to develop a strong culture of transparency and continuity. His organization started after the First World War, with just one agency, and became market leader. He noted that the sector environment has always been of great aggressiveness and many competitors act in a less correct way. There was several times where they lost deposits and customers by saying “no” to less correct solutions from an ethical point of view. In this respect, he told:

When I was just starting working in Bank One, the bank manager introduced me to the financial manager of company [... name X]. I asked why didn't we have applications there, and he told me that the financial manager received side payments to accept time deposits. In fact, we were not the only ones to act that way, Bank [... name Y] also did. When the country entered in the great crisis, the two major banks that survived were Bank One and Bank [... name Y]. Everything else disappeared. All banks that committed irregularities disappeared.

He maintains that a culture of transparency and ethical values doesn't appear just because you have a letter of principles or values. He noted that, to convey values, it is crucial to give personal example and continuous training. In this regard, he argued: “It's not enough to say what to do and what not to do. What is needed is to live what you should do and not to live what you shouldn't do”.

Besides considering how decisive is the culture of an organization, in this case “the way of being” of Bank One, he stressed the importance of the control and auditing system: “As an organization, I have to make sure things are in order, not only internally but also externally. I can't just trust a person. I have to show I took all precautions to know if this person really deserves my trust”.

He also noted that penalties for serious disorders were very severe and left no room for that to happen again. He gave an example that illustrates it:

One time, there were rumours about a department head that worked in the bank for a long time and was over 50 years old. An employee had complained of sexual harassment. Speaking with other employees, it was found that the testimony of this lady was true and the head of department was immediately fired.

In his point of view, the independence of the board is critical. Board members should not have stocks or stock options. Rewards for good organizational performance should be distributed by all employees, without distinguishing those who are more “attached to numbers” and for whom it is easier to work on financial gains. About the schema of the

level of gases released by Volkswagen cars, discovered in 2015, he said that this had been done “to earn more, to get better results and have greater distribution of earnings” and “it is distorted; the obligation of the executive is to give as much as you have”.

Finally, although considering that ethics alone is not enough – stating that “the sustainability of a bank is not only a result of ethics, a bank can be very ethical and go bankrupt because of bad management” – he believes ethics to be a necessary condition for sustainability, noting that

the reputational issue today in a financial institution is crucial and reputation arises not only from texts that are written, it comes from real life” and “ethics is dependent of people, human conduct; there can be no ethics in an institution if the people who manage it are dishonest people who want to blow up the results to benefit from it.

In short, his perspective regarding codes of ethics as a management control tool is: “In my appraisal, these codes of conduct do not mean anything, because they are just copies of each other”.

4.2.2 Bank two

Bank Two operates in Europe and Africa. It has over 1,300 branches, about half of which in Portugal. Its equity exceeds € 5,800 million and consolidated net assets exceed € 76,000 million. Users exceed 5.2 million. Due to the financial crisis it had losses. In 2014, consolidated net income was negative and above € 220,000. With regard to solvency ratios, it has a TIER 1 of approximately 12%, due credits corresponding to 7.5% of the total, but covered by impairment in value above 80%. The liquidity ratio is greater than 18% and the transformation ratio below 110%.

We interviewed a former administrator and founder. For him, the main objective was to create a culture of trust, accountability and awareness of the cost of resources, in particular the cost of people. In this regard, he said:

Admitting an employee and sit him, give him a computer station, a table, etc., has a cost. It costs ‘X’ per month, irrespective of the money they take home to support the family, which is their remuneration. As a consequence, everyone has to be aware that it is his obligation to contribute to the institution.

The culture that he sought to motivate in the bank was one of freedom and creativity in order to serve the customer having in mind the interest of the bank, guiding the acting of employees by the culture of the organization and not by a manual of rules or by a control that would be paralyzing. In this regard he said:

People know what they can do and what they should not do. For example, I never said that bank employees had to come with tie and jacket and ladies had to come modestly dressed. [...] There was no need to talk, they just understood it. [...] The bank’s culture

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was not written, we lived it. I always said that if the driver did not understand the culture of the house, either the house had no culture, or he had never received a clear message.

As what concerns management control in terms of commercial activity, he said that the objectives were clearly defined and everything was controlled with the respective KPI and a sophisticated information system. The organization's interests were above personal interests of each employee. He considers that his "great strength was to introduce the idea that the culture of the person is a little below the institution's culture".

He also mentioned that liquidity was the critical issue in the banking sector and not the equity shareholders capital, as at present has been defended. If you require more shareholder capital, it requires more profitability, in order to attract this additional capital. He puts it that way: "if I have the cash, I do not go bankrupt [...]" but if I have a lot of capital, how will I attract it if I don't give the proper return?"

With regard to ethical behaviour, he considers that it means that employees are aware they are managing customer funds for purposes that are useful to society and must do it responsibly. He also mentioned that ethics does not depend on norms or codes but depends on people and their objectives. He summarized this way his view on the ethics of a bank:

It's the same thing as a shoemaker. [...] There is a commodity that comes in, which requires confidence in the house that hosts it. In a bank, that commodity has to be transformed into credit facilities, loans, [...] and this has to be done carefully; conscious that we borrow money from the customers themselves, we don't even borrow money from shareholders.

He elucidated that when they detected frauds or irregularities perpetrated by employees, they never exposed it, not to impair the image of the institution. They were strict with these employees and publicised internally those cases – maintaining anonymity – in order to discourage such behaviour. The bank also resorted to training to promote ethical behaviour of employees, always believing in the good will of the staff. In this regard he explained:

We gave example and we gave training about certain values. [...] In the bank and out there in society, [each employee] had to have an inspiring behaviour that would promote trust [...]. It may happen that someone inspires confidence and deceives you, but we have to take the risk, we shouldn't create a monitoring system so tough that these things can never happen.

Speaking about means to build a culture that positively motivates employees, he told about the tutor methodology: from the first day he entered the bank, each employee had a tutor, a top manager who never was his immediate superior. This person had a very important role to support and train employees: "It was a cover that the person had [...]. It was a confidant [...]. It was a person who would find a solution [for each employee's problem or challenge]".

Managers met annually in a 'personnel committee' and sought to find solutions to problematic employees. This former CEO and President explained how they did it: "We would have his photo on the screen. There were people who would say 'This gentleman has no future.' And there would be another one that said 'No, in my area he will thrive'. And we agreed on how to change him to another sector".

Although the bank rewarded good performance based on quantitative measures and the achievement of the objectives, they also made a qualitative assessment in order to measure and reward the effort.

In short, this executive sought to create a culture of personal confidence and limited risk in the bank, in order to encourage a fluid, ethical and responsible action, oriented to results, protecting the image of the institution. He described it that way:

You have to take the risk and trust in people, and obviously fit, rank, computerize [...]. You shouldn't bar peoples' initiative and the corresponding risk [...]. The ethical process is the process of breathing: either you breathe ethically, or you imbibe carbon and one day it ends [...]. My view is that personal ethics is the one that prevails, there is no perfect system to replace personal attitude [...]. The truth is that great houses were made with people that trusted [and deserved trust].

4.2.3 Bank three

Bank Three carries out its activity in a country in Western Europe and in two countries in Africa since the 1980s. It has more than 830 branches and about 8,500 employees. Consolidated equity exceeds € 2,500 million and net assets are in excess of € 42,000 million. Consolidated net results were negative, over € 160 million. With regard to solvency and liquidity, it has a TIER 1 of more than 10%, and its liquidity ratio is over 25%. The transformation ratio was below 85%. Overdue loans were less than 5.5% and about 82% of this value was covered by impairment charges.

We interviewed the President of this bank who exposed a strategic goal of being a bank that would support economic activity with an investment bank mentality, while also acting as a retail bank. The bank has also the objective of gaining market share and be profitable, looking after their image of reliability and soundness.

They have a special caution in the management control mechanisms at various hierarchical levels, starting with executive management. The bank has internal and external supervisory bodies. In order to try to avoid conflicts of interests, there are limits to the stocks of each shareholder and its participation in the executive management. The presence of institutional investors with relevant international presence pursues a source of knowledge and access to international financial markets and a strengthening of the bank's management control mechanisms.

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The management control system and the executive management pay special attention to some indicators considered critical for good performance, growth and bank stability. The manager finds it especially important to monitor costs, market share, reputation, attracting talent and credit risk.

This manager considers that “the most relevant risk inherent to the bank’s activity is the credit risk”; he also thinks that it is the cause of many problems in the sector. The bank has several strategies to minimize credit risk. The first is an independent and binding analysis of credit risk. When an operation is rejected on that analysis, management has no power to change it; when the operation is not rejected, it can be approved or not in commercial management. Another strategy is the independence of the executive management, in order “not to favour any client [in credit analysis] because he is also a shareholder”.

He advocates a simple model of banking, calling it the ‘bread and butter’ model. He explained his idea with the Canadian example:

The only country with a developed banking system that had no problems with the 2007-2008 financial crisis was Canada, because it has a banking system that does what the economy needs. The economy primarily needs that there is someone who captures the savings it generates, and then someone who invests it, with very controlled risks, to be sure that he will have the money back.[...]. Managing a bank, particularly a traditional bank, is an activity that requires a great rigor in risk assessment and in the way it serves society.

In his opinion, the bank’s culture of appraisal of each person, which is reflected in promoting stable and long careers in the bank, is very important for stability, customer trust and service. As he puts it, “we are interested that people have a good curriculum, but it is especially important to see the human dimension of people”.

He maintains that it is very important for employees to have sound ethical standards: “To have ethical standards is to manage having in mind the interests of the institution, respecting professional codes, with common sense, with discretion, and also with flexibility, because believing in people is very important”. At the same time, he considers that ethical behaviour is characterized by technical rigor and attention and respect to customers.

The bank sought to ensure ethical behaviour with the stimulus of the example and the culture of the company, and also by controlling and auditing and penalizing behaviour that violates the established norms. They don’t put particular emphasis on formal training.

Finally, he said that the significant increase of control by entities that oversee the financial sector has been positive, although sometimes blocking. It seems to him that the most effective way to minimize the risk of fraud is the ethical dimension of employees,

directors and administrators. As he remarked, “the most important aspect of all, is peoples’ integrity; [...] someone who hasn’t a totally clean living can’t be a bank manager”.

4.2.4 Bank four

This bank from Austral Africa was created in the last years of the 20th century. It is almost entirely of State property, therefore less than 10% of the capital is held by private investors. The network of branches and agencies covered 140 locations throughout the country, with the largest presence in the capital city, though in the 2014 financial report this number went down to 120. It is ranked between the 10th and the 15th bank in the country. In 2014, net assets were over USD 1 billion. That year, the bank closed with negative liquid results of circa USD 50 million. The solvency ratio was around 9%. The proportion of loans in default by customers benefiting from credit fell in 2014 as well as provisions for those same loans in defaults – fulfilling principles of prudence.

The main purpose of the bank has been to present the best financial solutions to its customers. The critical factors of success are modernization and organizational efficiency, that is, to be able to operate better and with fewer resources. The manager we interviewed also mentioned the sense of belonging to the institution and recognition of performance of employees. Meritocracy is the system – paradigm – adopted at the behavioural level.

This manager considers that ‘organizational modernization’ is important to mitigate operational risks, because it increases electronic security and reduces human intervention. It also reduces the human presence in the agencies, which contributes to the minimization of costs.

The granting of credit for personal or business projects has different levels of decision according to the amount. It can escalate from the agency domain to area directors, then credit committee or the management board. It is as in other banks in the country, he said. Customer information is centralized, although the respondent mentioned the importance of personal knowledge of customers – the value of relationship banking. In this bank, to minimize credit risk, credit managers receive a success fee depending on the recovered credits. The risks associated with the commercialization of sophisticated products are less important due to the incipient state of the financial system, he said.

This manager considers that the existence of rules is essential for the robustness of the control system. He said that one can’t trust exclusively on values that people embrace, there must be disciplinary measures. People tend to act beyond the limits that are established. In this bank, disciplinary proceedings occur especially with employees with more basic functions, e.g., accounting. If it is proved that there was a fraudulent conduct, the culprit is immediately fired.

For this executive, the control system is fundamental to the bank management and should focus on human behaviour. He commented that people hired have the required

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technical competencies, but, most of the times, lack behavioural skills. The bank gives them internal training focused on the bank's culture, but it is 'minimal' and clearly still 'not enough'.

4.2.5. Bank five

This bank differs from all others in several respects. It is a bank directed to the agricultural sector and rural areas, with an agency and eight workers. Its equity is over 5.5 million euros and total assets don't exceed 38 million euros. It is a bank that has always presented positive results for 26 years, and especially after the years of crisis in the financial sector, specifically since 2009. It has a TIER 1 ratio above 22%, performing loans below 6% of the total credit granted, with overdue credit fully covered by provisions. Transformation ratio is below 81% and liquidity ratio is above 25%. It is therefore a bank of micro size but with solvency, liquidity and profitability.

We interviewed the general manager of the bank (single branch), who has over 26 years of experience in the financial sector. He said that the objectives of the bank are profitability, solvency, own resources, control of credit risk, the ratio of efficiency and customer satisfaction. He remarked: "these results can only appear from the moment that there are loyal customers, who feel that we stand up for them and who are with us".

He believes that the secret of success is to be close to customers and to have an in-depth knowledge of their ability to repay. As he referred, "I do not like to grant credit based on collateral. I think that when we grant credit, it should be because we believe that the client can pay, it is not because it has an asset attached to it. We must believe he can release sufficient means to pay" and "customers' personal knowledge, the relationship, it is very important".

He said he was witnessing a great pressure from the central services to the merge of small institutions and to the centralization of decisions. In his view, although in some cases this is justified in order to have certain functions to which people are exclusively dedicated – particularly in risk analysis and auditing –, it also hurts the relationship with the customer. He justified it by saying that "the fact that we are small allows us to better know the customers". Besides, he commented on the difficulty that central risk analysis services have to accept the local view on customers: "I know [that] who is in the central services find it difficult to accept this, but to me there should always be a local [knowledge] component to accept the credit".

On the potential risk of extending credit to customers in an improper way due to excessive proximity to the customer and loss of independence, he noted:

in [this] bank, I've never had a relationship with anyone – proximity, even favours – because it always means messing-up, sooner or later; you can see it in the police, you can see it [in many contexts]... we have to be satisfied with what we have; I am an employee

of the bank, and I always thought that way: what for do I have to fight? I have to fight for them to pay me two or three thousand euros plus, if they can afford it; it's just that, I do not have to get parallel business.

He considered local autonomy in the decisions to be very important, stating that “despite the financial crisis, we have always had positive results; and this phenomenon is due to local autonomy, to the knowledge of the customer database and of their behaviour”.

He assured that the bank's culture created a climate in which sellers do not exceed certain limits in granting credit or selling complex and risky financial products. In this regard, he said: “We assume it is that way, for us it is already a culture. We live in a small environment, everyone knows everything”. Speaking of the importance of the small size of the bank and autonomy of decision, he said that those circumstances allowed to do more commercial work, and to do it responsibly. He commented that although they provided online banking services, they did not promote it, because he liked the personal contact with their customers, approximately 2000. With regard to vending machines in the branch, he said: “We don't have; we could have, we have room for it, but we believe it is better not to”, because if the client “doesn't come here, he won't do business”.

As far as control and auditing are concerned, he explained they have three types of audits: internal, external – shared services of the association of the same profile banks – and the chartered accountant. The central bank also makes regular monitoring, remotely, using the information they send. With regard to control, he concluded: “We are well monitored”.

About the financial system's failures in 2009, he commented that, in many cases, the problem was at the level of directors and the board; it was due to the excessive ambition and performances without ethical criteria. As he expressed it, “quite honestly, the problem is man's ambition, immoderate ambition. Starting with the directors; there is always big fish in the troubles”.

For this manager, ethics in his organization – he considers it “priceless” – is “the way we are in the market”; it is “to operate capably and be responsible”. Leaders have a great responsibility because many people inside and outside the institution look up to them as a reference: “We are references to people; the worst thing I can do to people – partners or customers – is to disappoint them”. On the need of employees to have discretion in giving advice to customers, he said: “a ‘No!’ [answer] said at the right time, can be critical for things to go well in the future”.

He also commented that “it's not enough to be good technically. You must think quickly and decide ‘Yes’ or ‘No’, but your ‘Yes’ or ‘No’ must be based on a good judgement”. People working in a bank need to know the customer, his needs and his limitations, and to have good sense to decide well and quickly.

4.3 Analysis

Most executives stated profitability as the first objective for their organization, stressing the importance of the credibility or reputation of the institution. The goal of being market leaders or the aim to increase market share were also identified. For these executives, the performance was associated with the importance of equity returns (shareholders' value) and the continuity of the institution. These motivations – which they called sometimes “excessive ambition” or hubris – were indicated as the cause of the recent problems in the banking industry. One of the banks – which turned out to be bailed out and heavily restructured – had two digits growth targets for credit granted.

All the executives interviewed expressed that the two major risks of the banking sector are the risk of credit – granting loans to customers that will not pay – and the risk of reputation loss. In most cases, the loss of reputation was mainly associated to money laundering. Some statements reinforce recent studies that found that “safeguarding reputation is the primary motivation when companies seek to establish and embed ethical standards” (HAGEL, 2015).

Most of the opinions are in line with the literature on trust and monitoring, as managers are aware of “the problems with, on one hand, simple ritualistic monitoring and, on the other, simple trust” (BÖSTROM, 2015). The executive from the African bank had more confidence on the predictable effects of ‘classical’ control mechanisms alone, while in the others we perceive a shift to the ‘new’ control mechanisms, in line with the aim to “foster self-regulation by the internalization of a strong culture” (COSTA; DUARTE; PALERMO, 2014).

Almost all mentioned the importance of the committee for credit risk analysis. Executives of institutions with lower ratios of overdue loans and better profitability indicated clearly that the negative assessments of the credit risk committees were not overtaken by sales managers, even if decision makers were at the level of executive committee or board members. In these institutions, the negative assessments of the credit committee impeded absolutely the granting of credit; on the other hand, the favourable credit risk analysis could be rectified at the commercial level, management bodies, or boardroom, eventually to derail the credit granted. Executives from banks targeted by financial authorities for intervention or restructuring said that even when the technical analysis of credit risk was unfavourable, the executive steering committees could decide favourably in granting credit. Moreover, in relation to this topic – with implications for the governance model – two executive presidents consider that the independence of the board of directors in relation to shareholders and customers is essential.

Stock-based compensation is not a pacific issue, in the interviews as well as in the literature (see MATSUMURA; JAE YONG, 2005).

Executives of institutions that remained stable in the market over several decades – and still maintain autonomy and independence – said that transparency and organizational

culture are very important. This is related to the notion of ethical climate (VICTOR; CULLEN, 1988). In this context, transparency means the attitude of accepting to be unconditionally submitted to authentic management control; i.e., the executives' mindset of being accountable for their decisions, whatever the level of their responsibilities; e.g., the account manager who interacts with the customer as well as the member of the executive committee.

We also understood, from the interviews, that for these executives the organization must build a culture where accountability of managers is not limited to act in the interests of shareholders, remunerating adequately the equity capital invested. They are also responsible to protect customers' assets and savings, as well as the creation of wealth and employment through responsible lending to entrepreneurs and projects of interest to the society, as stakeholder theory proposes (FREEMAN; EVAN, 1990).

The executives interviewed said that the management control system and the various audit mechanisms and compliance regulations aren't sufficient to ensure the minimization of risks in the financial sector. These executives considered the behavioural aspects – the values and attitudes of employees – as key success factors for the protection of the interests of different stakeholders and in particular the interests of customers. Most agreed with the idea that “corporate responsibility cannot be practiced if various personal attributes do not exist in the individuals within the company” (MOSTOVICZ; KAKABADSE; KAKABADSE, 2011).

Example from top management, or integrity – meaning ‘consistency between words and actions’ (PALANSKI; YAMMARINO, 2007) –, was often mentioned as a requisite for a sustainable ethical culture.

As one would expect (WELLS; SCHMINKE, 2001), formal training in ethics is present in the major banks.

Although “ethic codes (ECs) are one of the instruments most used to design and institutionalise a scheme of ethical behaviour, and are widely used at the global level” (GARCÍA-SÁNCHEZ; RODRÍGUEZ-DOMÍNGUEZ; FRÍAS-ACEITUNO, 2015), there are strong doubts about its real impact on peoples' behaviour, which reinforces the finding that “codes of ethics in the financial industry seem to be of notably poor quality” (GAREGNANI; MERLOTTI; RUSSO, 2015).

We understood that supervisory institutions focus primarily on regulation and approval process of the board members. It also seemed to us that the supervisory authorities seek and promote scale in financial businesses – through mergers or acquisitions – such that they can accommodate more easily shocks and market risks. This is the ‘too big to fail’ argument. Another thing that transpired from the interviews was the appreciation of supervisor entities to reduce human intervention in the banking processes and operations in order to minimize operational risks.

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The overall tendency to mechanization and automation in the banking sector contrasts to the perspective of the executive from the smaller bank operating in rural area. For him, the personal relationship and mutual understanding is an essential and complementary aspect of credit risk analysis as well as a regulator in marketing and sales of complex financial products. The result of this bank-customer personal knowledge is the propensity of customers to ask for credit in accordance with their financial capabilities – therefore complying with their obligations – and the bank employees to promote the services and financial products tailored to customers’ interest – minimizing asset losses associated with risky investments. In this bank-customer transparent relationship, the social image of bank and the personal reputation of customers act as implicit control factors and stimuli to behave aligned with and in the interest of the clients – thus minimizing the risk of credit and the commercial risk of complex financial products marketing.

Conclusion

Our research shows that management control, auditing and supervision in the banking sector are not by themselves sufficient to minimize the risks inherent to the sector.

Adverse events that occurred in Europe after the 2009 crisis led regulators to significantly increase the control and regulation of the financial sector. These changes in supervision improved risk control but conveyed increased costs, operating blocks, distance and mechanization in the relationship with customers. Some executives reported that the creation and constant revision of legislation had significant consequences, namely the increase of employees dedicated exclusively to audit and compliance services, increased technical and human resources devoted to the study of legislation and the constant technical training and updating of employees. Despite the intensification of control and audit, there continues to be a significant number of irregularities in employee behaviour – in Portugal, there are about ten annual events per 1,000 employees.

The executives interviewed consider indispensable the ethical dimension and personal values of employees to minimize the behavioural risks in the financial sector. They believe in training, codes of conduct, and in information technology applications for ensuring technical and human training of employees. They also understand that values can only be effectively transmitted, assimilated and lived in a context of a strong organizational culture, supported by the example of the management team and in particular the behaviour of top executives. Training schemes in compliance and ethics are not enough for banks to regain trust.

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