Bank Culture:
A Competing Values Framework
(October 9, 2015)

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Over the past many years, I have been working with organizations on organization culture and growth strategy, using a framework called The Competing Values Framework (CVF), developed in OB.
Viewing organization culture as a set of implicit and explicit rules of conduct for employees, we have used the CVF to diagnose and change corporate culture.

More recently, Fenghua Song and I have been working on a new paper, “Bank Culture”, so I will share some ideas from there as well.
TO SUMMARIZE...

The Competing Values Framework

aka The Value Creation Genome
Now and Preferred Culture Profiles

Now

Preferred

Collaborate

Create

Control

Compete
In my paper with Fenghua Song, “Bank Culture”, we consider two types of cultures from which the organization can choose one.
We focus on a bank that hires an employee who must be incentivized to provide unobserved effort. The bank can optimally design its compensation to incentivize the employee, but it is a multi-tasking problem in which the employee must choose: (i) the total effort to expend; and (ii) how to allocate the chosen effort between safety and growth.

Effort allocated to growth increases probability of finding a loan, and effort allocated to safety increases probability of screening out a bad loan.

We also allow the bank to optimally design the managerial wage contract.
Key Results

1. The optimally-designed managerial wage contract in the second-best case has inefficiencies. For instance, in the second-best, more effort is allocated to growth and less to safety than in the first-best.

2. In the second-best, the effort allocated to growth is decreasing in bank capital and increasing in the probability of a government bailout/rescue.

3. With multiple banks, there is “herding”—each bank tilts even more toward growth→marginal value of safety as perceived by banks is lowered in more competitive growth environments. That is, competition for loans makes all banks compete more aggressively for loans in a symmetric Nash equilibrium.
Modeling Culture

- The inability of wage contracting to eliminate distortions (due to multi-tasking) provides room for culture to improve the outcome.

- We rely on the Akerlof-Kranton view of “identity economics” to model culture, i.e., culture determines the “identity” the employee develops and hence the utility he/she derives from choosing the action consistent with the culture. This means a disutility for the employee from choosing an effort that is incompatible with the culture. The stronger the bank’s culture, the larger the disutility.
Key Result

- Strong culture can attenuate herding tendencies and lead to greater heterogeneity in growth vs. safety choices in the cross-section of banks, i.e., culture helps banks resist temptation to tilt excessively in favor of growth.

- This is especially important in banking because the compromising of safety by even lower-level employees has the potential to “blow up” the organization—more so than in non-financials. So both culture and compensation should account for it.
Conclusion

- Culture is not just about integrity, lack of fraud, ethics, etc. There are many different choices of cultural orientation, and each has its strengths and weaknesses.

- A culture focusing on internal processes to enhance safety is in tension with one focused on organic, innovation-based growth. A culture focused on acquisition-oriented growth is in tension with one focused on employee harmony and morale.

- At a very high level, growth-oriented and safety-oriented cultures are in tension, and it is challenging to have both operating effectively.

- Nonetheless, a strong culture can (partially) overcome the limitation of explicit wage contracting in inducing banks to focus more on safety.

- Higher bank capital tilts the scale in favor of a safety-oriented culture, which in turn reduces systemic risk.
Thank you!