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Stand out for the right reasons

Why you can't scare bankers into doing the right thing

Creating excitement about winning, rather than a fear of losing, is the key to increasing innovative and ethical behaviour across the sector.

PwC and London Business School research June 2015.

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Contents

A get-tough approach to poor performance in financial services is creating a climate of fear. And that risks breeding more unethical conduct, not less – exactly the opposite of what regulators, businesses and the public want. The threat of fines, bonus clawbacks and even prison won't on its own prevent further misselling and market-rigging scandals.

That's because anxiety disrupts people's capacity to make good decisions, often leading them to behave less ethically.

This is the clear implication from our research with London Business School. Just as clearly, the findings show that if businesses pay more attention to creating excitement about competition, they can help employees be significantly more innovative. We believe the research also suggests how the industry can stop the cycle of bad news and negative publicity that's dogged it since the financial crisis.

- Just by changing how they communicate, *rule makers* can create a more positive climate in financial services and individual businesses, while still being clear about sanctions for bad conduct.
- *Leaders* can play a vital role by putting the spotlight on the positive outcomes of good behaviour rather than the penalties for behaving badly.
- *Recruitment* and *rewards* can help foster the right kind of competitive culture.
- And by changing the emphasis of *management information* systems, businesses can encourage innovation and creativity as well as spot warning signs of bad behaviour.

'No passion so effectually robs the mind of all its powers of acting and reasoning as fear.'

Edmund Burke (1729-1797), writer, philosopher and statesman

The research, and what it shows

Do you prefer avoiding punishments or earning rewards?
Imagine it's coming to the end of the business year. You're lagging behind your colleagues. If you don't do better than them you'll lose your substantial bonus. How does that make you feel? And might it tempt you to push a big client towards an investment decision that increases your profits, rather than one that gets them the best result?

Now imagine that instead of being told about losing a bonus if you do badly, you're told how doing a great job can enhance your bonus. The underlying situation is exactly the same. The only change is the way it's been presented. It seems a small difference, but it has an enormous effect on how people feel and act.

How competition makes people feel
We worked with London Business School to study this effect, surveying 2,431 managers working in insurance, wealth management and banking (retail and corporate). We were interested in the choices people make when they're competing with colleagues for bonuses, pay rises and promotions.

The survey presented three realistic work scenarios. But for half the managers we described them in terms of avoiding losses, and for the other half we described them in terms of winning rewards. In each case, we asked people how excited or anxious they'd feel, and what they'd do. The actions they could choose included creative responses, like working in new ways, as well as unethical responses, like maximising the bank's profits at the client's expense.

We also asked how they felt their company handled things like performance management, bonuses, recognition, promotion and firing. And we asked about their own preferences: their attitudes to rewards, and how much they enjoy competition with colleagues. They answered anonymously, so they could be as candid as they liked.

How people behave when trying to avoid a loss

When we presented situations as potential losses, managers were:

15%
more anxious than excited, leading them to be:

>2x
more likely to behave unethically

That's compared with the managers presented with the same situations, but with the positive outcomes of success highlighted. They were correspondingly more excited than anxious, leading them to be more than twice as likely demonstrate innovative behaviour.

What this means for the industry

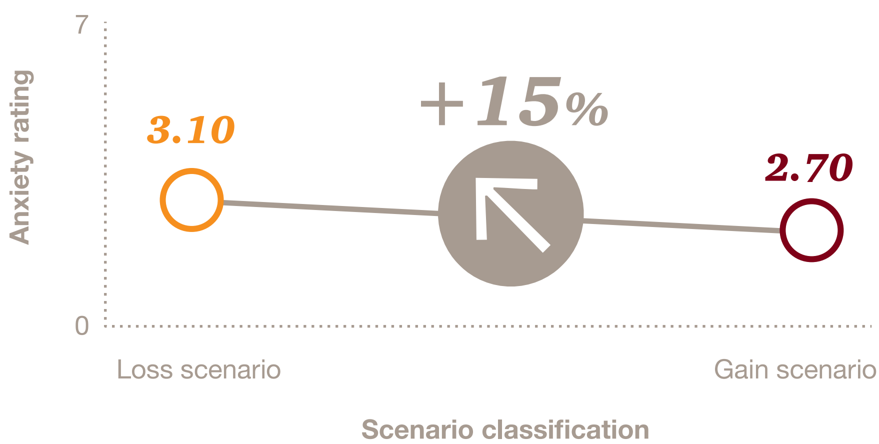
Setting the rules, setting the tone

We aren't suggesting this research means we should abandon rules or abolish penalties for bad behaviour. The systemic conduct issues present in financial services are serious and need to be addressed. It's essential that people understand what's acceptable and what isn't – and that wrong-doers at all levels are appropriately sanctioned. However the focus on sanctions, aimed at punishing the minority of people who are prepared to commit deliberate fraud, breeds anxiety in those who are seeking to do the right thing, but who now head into work every day fearful of making a mistake. These kinds of pressures have the potential to push ordinary well-meaning people into behaving less ethically than we, or they, would like.

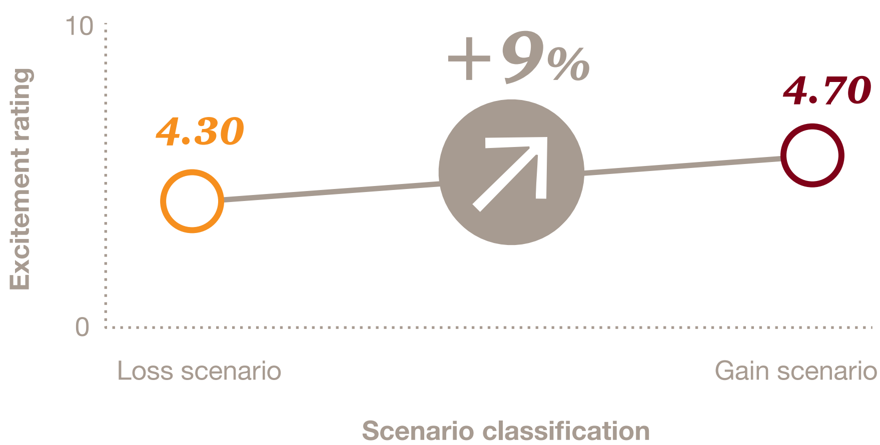
We think regulators can set a positive tone. For example, when they talk about new rules, they can focus more on the good behaviour they want to promote than the bad behaviour they want to stamp out. And they can give examples of companies or individuals already doing the right things.

And rule makers in businesses can reinforce the effect by identifying their firms' purpose with what the rules stand for.

Loss Framing (making a negative career outcome salient) results in anxiety levels that are 15% higher than gain framing based on mean scores



Conversely, Gain Framing (making a positive career outcome salient) results in excitement levels that are 9% higher than loss framing based on mean scores



Leading people into the right emotional state

Our research clearly shows people who are competing with their colleagues are more likely to behave ethically when they're excitedly pursuing rewards than when they're fearfully avoiding punishments. This matters for leaders in firms and regulatory bodies. They play a big role in deciding whether companies habitually frame competition positively, in terms of benefits, or negatively, in terms of penalties. That has a huge influence on the emotional state of the people who work in financial services. By presenting competition in a more positive way, leaders can create a culture of excitement rather than fear, and help people behave more ethically.

In fact, leaders should see creating the right climate and the right culture as being a central part of their role.

Experiences matter more than policies

They need to recognise that their firm's culture isn't just about its official rules and policies, but the kind of behaviour the business values and rewards. In our survey, people's beliefs about the basis for promotion and bonuses varied very widely, suggesting no relation to the companies' actual policies.

We found that the more people believe promotions and bonuses are based on how they behave, rather than just the numbers they've achieved, the more likely they are to respond creatively in order to beat their colleagues. In fact, when they believed their bonus was based on how they behaved, it correlated with a near-50% increase in creative responses.

So if leaders publically promote good behaviour, they lead their companies out of the climate of fear. And they encourage their employees to find more creative ways of getting results.

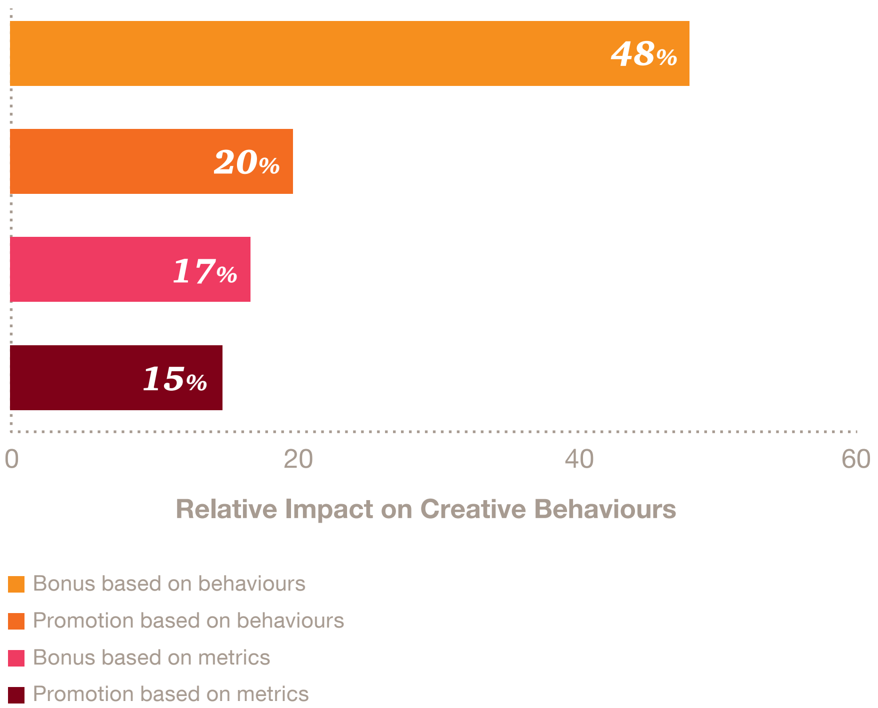
A culture of excitement doesn't mean bigger bonuses

Moving towards a culture of excitement doesn't have to mean paying bigger bonuses – more likely the opposite, in fact. To feel excited, people have to genuinely see their bonus as an extra. That suggests their base salary should feel like it's enough on its own. Otherwise, people will tend to feel their bonus is a standard part of their pay package, something they rely on and so fear losing.

But when it comes to bonuses, size isn't everything. We asked people how their company's approach to performance evaluation and reward made them feel. When it made them feel anxious, they tended to say money was one of their key motivators. They also tended to take more risks and act in ways that would draw least attention to themselves, as well as being more likely to make unethical choices. On the other hand, people who said their company's approach made them feel excited were less driven by money. Instead, they were more likely to be motivated by approval from their bosses, colleagues and clients – which is to say, by doing a good job.

All this has implications for companies' remuneration policies and how they're communicated – including in the recruitment process.

The greater the perception that bonus and promotion is based on behaviours versus metrics, the greater the creative / innovative behaviour



Keep on recruiting competitive people – and women

There are other implications for recruitment. Our survey doesn't suggest that competitive people are part of the problem: people who said they enjoyed competition were no more likely to make unethical choices. Nor is competition itself a bad thing. It creates emotional arousal, which people can experience either positively, as excitement, or negatively, as anxiety. What matters is the competitor's emotional state.

But competitive people were more likely to make creative choices. So were women, while men were more likely to choose unethical options. In what's still a male-dominated industry, that's food for thought for recruiters.

The next step – management information and monitoring

Can we back all this up with longer-term positive action to make company cultures healthier? In every other area of management, when we want to change something, we measure it. Progress usually consists of the cumulative effects of many small changes, and we need data to see whether they're working.

Capturing new data

Human emotions are hard to measure. But that doesn't mean we shouldn't try. The social sciences have made huge strides in the last five or ten years in finding cheaper, easier and more reliable ways to assess how people are thinking and feeling as they go about their daily lives, thanks to researchers like Daniel Kahneman and Paul Dolan (authors, respectively, of Thinking, Fast and Slow and Happiness by Design).

It should be possible to develop our management information systems to capture and report on this kind of data. Current systems tend to push us in the wrong direction. That's because they're based on risk-management techniques, mostly geared to looking out for the warning signs of bad things happening.

Learning from other industries

But financial services should learn from the experience of other sectors that have focused on changing their risk culture, like the nuclear, oil and gas, and chemical industries. They've already found that focusing on bad behaviour creates a blame culture, which tends to make people behave less well. That's because the metrics make everyone focus on the things they're not meant to be doing. And so long as you're not doing any of the bad things, then the extent to which you're doing the good things is irrelevant.

The warning signs of good behaviour

To get people to act in the spirit of the rules rather than just the letter, they need to be paying attention to the good things they're meant to be doing, and the positive outcomes of achieving them. To help them, we need to get better at spotting what good looks like (including good emotions). And we need to adapt our risk and management-information systems so they pick up these signs, measure, report and reward them.

Meanwhile, if you see a financial services leader going out of their way to promote good behaviour and positive outcomes, then publically encourage more of this. After all, research suggests it's the best thing to do – it will encourage excitement and innovative behaviour. And it is much more effective than using fear.

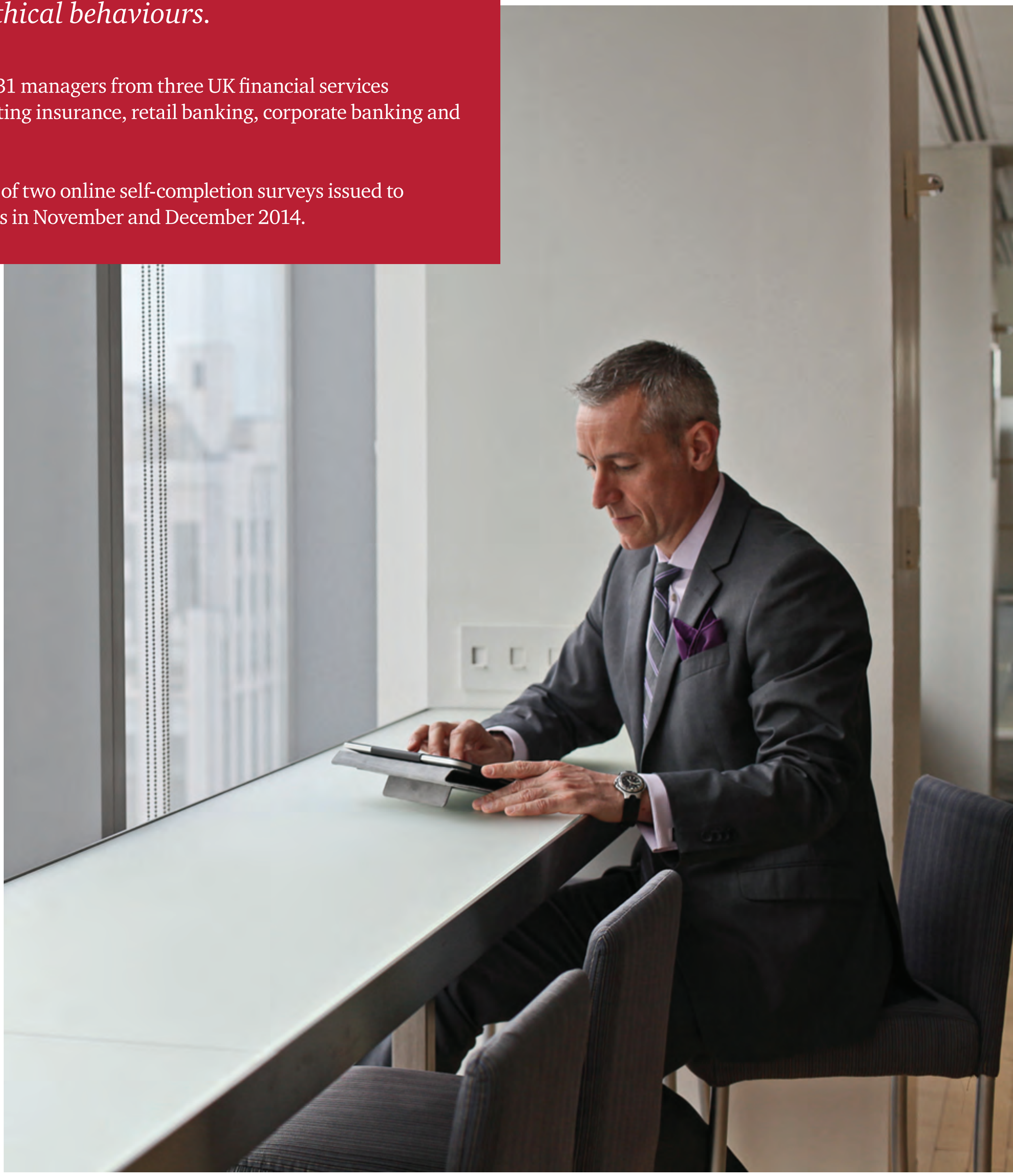
‘To get people to act in the spirit of the rules rather than just the letter, they need to be paying attention to the good things they’re meant to be doing.’

Methodology

The research study was designed to investigate the role of emotions in determining when and why employees try to beat internal competitor using creativity versus resorting to unethical behaviours.

The study involved 2,431 managers from three UK financial services organisations representing insurance, retail banking, corporate banking and wealth management.

The research consisted of two online self-completion surveys issued to participating employees in November and December 2014.



Stand out for the right reasons

Financial services risk and regulation –many see it as a problem, we see it as an opportunity. An opportunity to shine. An opportunity to grow. An opportunity to build trust.

The company that overcomes risk and adversity is the company that people remember. The organisation that understands how to protect itself is the one that customers will turn to.

At PwC, we work with you to redefine the way risk and regulation is seen. Actively embracing change is a powerful way to enhance your reputation, secure long-term growth, sustainable profits and to deliver value to customers. With our help, you won't just navigate around potential problems, you'll also be positioned to get ahead.

To achieve this, we support you in four key areas.

1

Alert

By alerting you to the financial and regulatory risks you are exposed to we help you understand the position your business is in and how to comply with the regulations. You can then turn risk and regulation to your advantage.

2

Adapt

Adapting your business to achieve cultural change can pay dividends. Doing the right thing for your customers and your people will continue to transform your business. By equipping you with the insights and tools you need, we will help you be better prepared to turn uncertainty into opportunity.

3

Repair

Even the best thought-through processes or products can sometimes fail. We help you to act swiftly to repair any damage so you can ensure that you build even greater levels of trust and confidence in your business.

4

Protect

Preparing for issues such as technical difficulties, operational failure or cyber attacks is an important way to protect your business. We advise and support you to design and implement the systems and processes that can make your business resilient, reliable and effective.

Working with PwC will help you to get a clearer understanding of where you are and where you want to be. Together, we can develop and help you to implement transparent and compelling business strategies that customers, regulators, employees and stakeholders will buy into. By adding our skills, experience and expertise to yours, your business can stand out for the right reasons.

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Design Services 29170 (06/15).