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Corporate governance and strategic human resources management in the UK financial services sector: the case of the RBS

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In this paper, we outline a new configurational framework linking different models of corporate governance to their associated ethical, strategic management and strategic human resources management (SHRM) policies and practices. We draw on this framework to analyze the role played by HRM and leadership in the rise and spectacular failure of the Royal Bank of Scotland, the Scottish headquartered financial services group, which grew to be one of the largest and most successful banks in the work prior to the global financial services crisis (GFC) but had to be rescued by British taxpayers following a failed acquisition during the GFC. Drawing on published accounts and interviews with senior RBS HR staff, we also analyze how a post-crisis shift in corporate governance, ethics and strategy is shaping organizational climate and HR policies at the bank to provide the HR function with a greater opportunity to exercise an influence on the corporate governance regime. However, the global nature of the financial services industry, the needs to satisfy financial markets and the desire of the UK government to return RBS to private sector ownership has placed strict limits on the potential for the emergence of a stakeholder model of corporate governance and HR, which many critics anticipated would be one of the few positive outcomes of the GFC.

Keywords: corporate governance; financial services; strategic human resource management

Introduction

The 2007–2009 global financial services crisis (GFC) has caused financial services organizations, particularly the banking sector in developed economies, to suffer from an unprecedented decline in their reputations with the general public (Smallman, McDonald and Muller 2010; Reputation Institute 2011). This decline, driven by public perceptions of poor corporate governance and ethics, human resources management (HRM) and leadership (Cooper 2009), and films such as 'Inside Job' and 'The Flaw', matters a great deal because financial services companies rely heavily on their reputations to generate new business (Reputation Institute 2011). Consequently, some academics and companies are beginning to look beyond the dominant shareholder value model of corporate governance that characterized American and British financial services from the 1980s onwards (Davis 2009) to alternatives to rebuild their reputations with key stakeholders. On this issue, a choice is typically posited between shareholder value and stakeholder theory (Freeman 1984), in which there has been a resurgence of interest (Agle et al. 2008; Jensen 2011). However, we argue that this choice is incomplete because it is too restrictive. Other models are available that are less polarized between the competing tenets of shareholder value and stakeholder theory (Aguilera, Filatochev, Gospel and Jackson 2008)

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and are potentially more capable of capturing the reality of corporate governance in financial services. We also argue that current corporate governance and strategic HRM (SHRM) theory is incomplete because it glosses over the relationships between these different models of governance and organizational/SHRM variables. Thus, we believe this present study helps readers to gain insights into what alternatives need to be incorporated into choices among governance models and how they relate to business ethics, SHRM, organizational climate governance and the role of HR. We do so by outlining a simplified version of a new configuration model (Martin, Farndale, Paauwe and Stiles 2011) and show how it can shed light on the current crisis in financial services in the UK drawing on a case study of the Royal Bank of Scotland (RBS), which was the most dramatic of a series of British bank failures following the GFC in 2008. This case highlights the strengths and limitations of our configuration framework, so making a contribution to theory and practice in SHRM generally and the financial services industry in particular.

A framework for linking SHRM to corporate governance in the global financial services sector

Recent corporate governance research has attempted to broaden its focus from shareholder behavior and board composition, etc. to understand the 'mechanisms (used) to ensure that executives respect the rights and interests of company stakeholders, and that those stakeholders are held accountable for acting morally and responsibly for the *generation, protection* and *distribution* of wealth invested in the firm' (Aguilera et al. 2008, p. 475; Aguilera and Jackson 2010). It is clear from cases in the UK financial services sector that some companies and executives have failed to act responsibly and/ or ethically in balancing their wealth creation and wealth protection roles, in much the same way as their American counterparts (Filatochev 2005; Davis 2009; Smallman, et al. 2010; Kerr and Robinson 2011). Moreover, trends in executive pay have resulted in debates over distributional issues, especially over whether extraordinarily high bonuses for senior executives and traders can be ethically and economically justified (Core and Guay 2010; Filatotchev and Allcock 2010). Yet, with only a few exceptions (e.g. Legge 1995/2005; Spector 2003; Farndale, Paauwe and Boselie 2010; Filatochev 2005; Pfeffer 2010; Boxall and Purcell 2011), the mainstream HRM literature has been relatively silent on these topics. Instead, it has had an arguably myopic focus on economic performance (Ghoshal 2005; Boselie, Brewster and Paauwe 2009; Pfeffer 2010) and the employee attitudes, behaviors and HR governance models that underpin it (Wood 2009).

To help fill this gap, we introduce a simplified version of a new framework (see Table 1), which classifies literature linking corporate governance to SHRM according to answers to a general question concerning the future of market economies and the applicability of the US business model to global financial services companies (Davis 2009; Whitley 2009), the nature of corporate leadership (Hamel 2007), 'sustainable' organizations (Pfeffer 2010) and the nature of SHRM (Boselie et al. 2009; Huselid and Becker 2011). This question is: what is the correct balance that organizations and their boards should seek between economic performance and social legitimacy (Reich 2007; Davis 2009)?

The traditional answer has been framed as a choice between two options. The first can be characterized by Milton Friedman's (13 September 1970) classical dictum that companies maximize social welfare by using resources and engaging in activities that maximize profits over time, so long as they do so 'in open and free competition without deception or fraud' (p. 4). This position is closely linked with the traditional *shareholder value model* of

Table 1. Linking main theories of governance through business ethics and strategic management to SHRM (adapted from Martin et al. 2011).

Theories of governance	*Business ethics perspectives*	*Underpinning strategic management theory*	*Implications for SHRM and organizational climate governance*	*Implications for role of HR*
Traditional shareholder value model Aim: to explain how shareholder maximize returns on their investment	Egoist Ethics, focusing on maximizing self-interest and desires of markets and senior executives	Neo-classical economics and classical strategic management	Unitary view of firm Focus on returns on human capital and 'hard' HRM, including cost to income ratios and flexibility 'Exclusive' talent management policy Leader-centric view of organization	HR as guardians of talent management and advisers on value-adding core employees No/limited role in board selection, development and remuneration HR focus on cost control, with limited strategic role
Newer shareholder value theories *Stewardship theory and enlightened shareholder value model* Aim: Concern to rescue shareholder value	Egoist Ethics tempered by: Kantian duty to treat people with human dignity, and morally correct actions on the part of senior executives	Dynamic capabilities Resource-based view of strategy	Essentially unitary theory of the firm Leaders as guardians of shareholder value, but with duties to act as steward 'Soft' HRM privileging employee engagement Balance between 'exclusive' and 'inclusive' talent management policies Reputation of firm as employer seen as key issue Relaxed business case for corporate social responsibility (CSR)	HR as guardians of enlightened/sophisticated approach to HRM HR as guardians of corporate culture HR as guardians of leadership development and potential role in board development

(*Continued*)

Table 1 – *continued*

Theories of governance	*Business ethics perspectives*	*Underpinning strategic management theory*	*Implications for SHRM and organizational climate governance*	*Implications for role of HR*
Stakeholder theory Aim: Broader understanding of effectiveness by recognizing wide range of legitimate interests in firm over economic and non-economic goals and values	Utilitarianism – the greatest good for the greatest majority Importance of upholding social contracts	Institutional theory and new institutional economics Contingency theory	Essentially pluralist theory of the firm Focus on employees as key stakeholders with rights and as 'subjects-within-themselves' Soft and hard power and HRM can both be justified in different circumstances Fairness and tolerance as key principles Distributed leadership model Reputation of firm for social legitimacy as a core concern	HR as promoters of pluralism, including economic and non-economic goals HR as promoters of corporate citizenship and ethical policies HR as promoters of distributed leadership
Context-dependent organizational theory Aim: To show that different corporate governance practices and goals may be more or less effective/acceptable in different contexts No universal governance practices	Relativism, with morality and ethics seen as context dependent	Organizational sociology Contingency theory and national business systems theory Resource-based theory and dynamic capabilities Open systems	'No one best way' of organizing corporate governance and HRM	HR needs to be sensitive to context and contributors to cost effectiveness, contingent and complementary HR policies and practices

corporate governance, which emerged in the 1980s. This model drew on the economic tenets of agency theory, which proposed the use of 'high powered' incentives to align managerial agents with shareholders (Jensen and Meckling 1976), and on transaction cost theory and the efficient markets hypothesis to justify market-based forms of governance structures (Williamson 1985). In essence, these were arguments for the importance of *equity capital* and largely unregulated financial markets that dominated economic thinking and board governance until the GFC (Donaldson and Preston 1995; Davis 2009).

The second option, stakeholder theory, which has its origins in criticisms of unfettered free markets (Daily, Dalton and Canella Jnr 2003; Ghosal 2005; Laplume, Sonpar and Litz 2008; Cooper 2009), suggests that sustainable economic performance of organizations rests on company boards' role modeling virtuous behavior by meeting changing societal expectations, thus creating 'soulful' (Wirtenberger 1969; Davis 2005), 'altruistic' (Jones, Felps and Begley 2007) or 'sustainable' organizations (Pfeffer 2010). These theories raise social obligations, especially to employees and society, to the same (or even greater) plane as short-term economic performance. In essence, this is an argument for *patient capital* and for greater regulation of financial markets and sustainability (Ferrary 2009). This position is closely linked to a stakeholder perspective on governance and organizations, which is found in certain varieties of capitalism and seeks to widen the scope of claims made on the firm to include any group or individual who can affect or is affected by an organization (Freeman 1984).

However, while much of the governance research has been restricted to comparing these two options, recent work has argued that other choices or perspectives are possible. Thus, Clarke (2007) has discussed an *enlightened shareholder value* perspective, which became popular post-Enron. Though still committed to shareholder value, this perspective was adopted by organizations as a means of rescuing or re-imaging the traditional shareholder value model. This model reflects executives' desires to temper pure self-interested, egoist ethics with Kantian moral duties to treat people with respect (Greenwood 2002), to see them as a key resource in strategic competition to be invested in and to be managed through the application of 'soft power' (Courpasson 2000) and sophisticated HRM (Guest et al. 2003).

More recently, Aguilera et al. (2008) have proposed a fourth option – a context-dependent model. Thus, firms may choose different corporate governance approaches for different parts of their business or at different times, depending on how successful or acceptable they are in different contexts. This is a more contextualized hybrid model, based on a relativist ethical position and, an embedded-in-context strategic management approach (Whittington 2000). It also draws on a range of SHRM, organizational climate, and leadership approaches, often using a mixture of soft and hard power and HRM techniques.

We believe our configuration framework contributes to the literature by showing how these four options have different implications for SHRM (including leadership philosophies and approaches), the governance of organizational climate, and the role and governance of the HR function in financial services. However, this relationship is a reciprocal one. Just as the shareholder value model of corporate governance, which dominated financial services in the US and the UK from the 1980s until recently, has had implications for talent management by selecting, developing and rewarding executives whose values fit an organizational rationale based on maximizing share price, these same executives did a great deal to create performance-oriented organizational climates and corporate governance frameworks in their own image (Adams, Licht and Sagiv 2011). It should be noted that these configurations are ideal types in the sense of being theoretical abstractions rather than normative models, allowing reference to a more complex reality to be established for the purposes of contrast and comparison of ideas for research, in this case in the financial services sector. So, can such a framework help us analyze the implications of the GFC for SHRM and vice versa?

Developments in the UK financial services sector: RBS as a case in point

To assess the relevance of our framework to the GFC, we have used a single case study approach, drawing on an interpretivist philosophy (Burrell and Morgan 1982) and qualitative research methods using semi-structured interviews. We have also used archival methods to provide a historically grounded case, from a review of academic literature mentioning RBS, press reports and official RBS documentation. The case has been chosen because it represents the most high-profile impact of the GFC on the UK banking sector and one of the most spectacular corporate failures in the British economic history. In 2007, RBS was one of the world's most successful private sector banks ranking fourth in the world in Tier 1 capital but had to be rescued by the British government in 2008. At the time of writing (November 2011), it was 83% owned by the UK taxpayer and has slipped to 14th in the Tier 1 rankings. The case also provides a real-time, 'soft-test' of our framework in Table 1 by examining: (1) the extent to which the case can be analyzed and explained by changes from one configuration to another, thus validating the integrity of three of our configurations – traditional shareholder value, enlightened shareholder value and stakeholder models – as analytical abstractions, and (2) the conditions under which a context-dependent configuration might provide a more useful explanatory insight.

In-depth interviews were conducted with eight former and current senior RBS HR executives, who have provided unique insights. Data analysis combined an inductive focus to identify categories of meaning with deductive theoretical questioning (Richardson and Kramer 2006). The interrogation of literature and interviews addressed the impact of changes in ownership on ethics, strategy and SHRM in RBS. During the interviews, we asked questions relevant to our framework concerning leadership, organizational culture and SHRM approach prior to the crisis, how these related to governance, ethics and strategy, whether the overall configuration changed because of lessons learned or government directives, and if so how and why? We also wanted to know whether the HRM function had become stronger or weaker as a result. Interviews were transcribed and analyzed for key categories of meaning that emerged from interviewees' accounts of the changing nature of HRM in the company. Four such categories became apparent: the attribution of impact by different CEOs on organizational culture and HRM; the focus on 'strategy execution'; changes in performance management and human capital management; and changes in leadership development.

RBS prior to the GFC

RBS was founded in 1727 in Edinburgh but remained a small local bank until the 1990s. It was firmly rooted in the Scottish economy and its executives were part of the Scottish establishment (Kerr and Robinson 2011), pursuing paternalistic welfare policies toward employees. The model of governance resembled an early version of enlightened shareholder value, with shareholding narrowly held by local private investors, which more or less pertained for 250 years. However, deregulation of financial services in the UK in the mid 1980s made RBS a prime candidate for acquisition by ambitious banks and other financial institutions. As a consequence, the board, led by chairman Sir George Mathewson, embarked on a 'high-leverage' strategy by running lower than industry average levels of capital to fund an expanding portfolio of new loans and off-balance sheet investments, an approach that ultimately contributed to its failure along with many other financial institutions (Nelson 2010). Such a strategy was built on hiring more entrepreneurial managers deemed capable of fulfilling the Mathewson vision of expansion in Britain and overseas, and diversification into related financial services. Reflecting on this strategy, one former senior manager suggested it depended on 'stretching every pound and running with fewer deposits in the core banking business than was comfortable to generate revenues and investment capital'. However, in line with much academic criticism (Core and Guay 2010), another commentator suggested it was more the work of 'spivvy' managers responding to huge incentives than to follow risk-adjusted strategies.

The fulfillment of this 'growth-through-acquisition' strategy was placed in the hands of CEO Fred Goodwin, who had been informally recruited at a party by Mathewson in 1988 as deputy CEO. He led a well-documented takeover of the London-based NatWest in 1990, a bank nearly three times its size, earning him a near-heroic reputation among the global financial community (Kennedy, Boddy and Paton 2006). Effectively, RBS ran down its capital to 'dangerously low levels' to purchase NatWest in a bitterly contested battle. This acquisition was intended to increase revenue and profits by leaving the NatWest brand and branch network intact while undertaking aggressive cost cutting, job losses and rationalization, especially in integrating back office functions and a proliferation of IT systems into the RBS platform or 'manufacturing division' (Gratton and Ghosal 2005). RBS's integration model worked spectacularly well, with the acquisition of NatWest producing $4 billion of enhanced profits and success in merging two bank cultures (Groysberg and Sherman 2008). It also proved to be the making of Fred Goodwin's high-profile reputation.

The NatWest purchase and integration became a prototype for a series of later overseas and domestic acquisitions (Nohria and Weber 2005). During this period, RBS also developed a greater presence in investment banking, a trajectory that became common among retail banks seeking rapid growth. The move into investment banking, primarily through its US subsidiary RBS Greenwich Capital, which led to taking on riskier loans in the American sub-prime market during the period 2005–2007, was also to prove significant in RBS's subsequent decline.

The final acquisition was the Dutch bank, ABN AMRO Holdings, in October 2007, a bid that RBS led as part of a consortium with Fortis and Banco Santander. This purchase was the largest ever in financial services history and was intended to help RBS diversify further into (1) retail banking in the US, Asia Pacific, Chinese and Indian markets, and (2) build greater capability in banking services and financial solutions to major corporate and financial institutions, investment banking and international financial management. As a consequence, RBS became the world's fifth largest bank by market capitalization and largest corporate and institutional bank in Europe employing 171,000 people in more than 50 countries, so achieving Mathewson's and Goodwin's vision of a global bank (Groysberg and Sherman 2008; Martin and Hetrick 2010).

Until the ABN acquisition, the company's senior management team was widely applauded by the global financial community. However, the financial press and some RBS institutional shareholders began to question the sustainability of, and motives underlying, the board's acquisition strategy and the lack of short-term returns to shareholders. Moreover, specific criticisms were made about the decision to go ahead with the purchase of ABN when LaSalle, one of the Dutch bank's key lines of businesses in the USA and an important justification used by the RBS board for pursuing ABN in the first place, was sold by to another buyer. The RBS board's response to these criticisms was to push ahead regardless, although they publically stated that ABN would be the last major acquisition and that RBS would concentrate on organic growth in the future and on improving the cost-to-income ratio that impacted directly on returns to shareholders.

Leadership, organizational culture and HRM in RBS during the growth period

By combining published accounts with certain themes raised by interviewees, a coherent storyline emerges, which focuses on the interrelationships between strategy, leadership, culture and HRM, of RBS's success until 2007. These relationships embraced not only a traditional shareholder value model in terms of ethical underpinnings, focus on hard HRM and leader centricity, but also elements of the enlightened shareholder value configuration that characterized its earlier years, for example in the focus on development and engagement. The specific features of leadership and organization culture that were used to account for success were (1) Goodwin's directive, micro-leadership style, which held executives personally accountable and touched every aspect of organizational culture, (2) 'strategy execution', embodied in the strapline 'making things happen', (3) performance management and reward systems, symbolized by a sophisticated human capital management system that signified a focus on hard data and (4) later on, a major investment in leadership development of the top 300 executives to reinforce certain key messages concerning the importance of leadership for innovation. The success that followed led to a growing internal and external confidence in the personalized, directive leadership style and decision making of Goodwin himself and, to a lesser extent, his senior executive team. Such over-attributions of organizational success to individual personality rather than situations have been a core feature of the transformational leadership literature, resulting in what has been labeled a 'romance with leaders' (Meindl and Erlich 1987; Grint 2010). One senior HR manager summed up this 'fundamental attributional error' as follows:

> He (Goodwin) was probably given too much credit on the way up and came in for too much criticism on the way down . . . he came to symbolize all that was wrong with banking and the credit crunch. (Interviewee 1)

Nevertheless, there is little doubt that the financial press and the UK government were influential in shaping external and employee perceptions of Goodwin's impact on the organization. Among other accolades, he was named the Best Bank CEO by Reuters and was knighted by the UK government in 2004. Goodwin's personal impact was also a dominant recurring theme in interviewee accounts, though interviewees also reflected on its longer term dysfunctional consequences.

Leadership in RBS – the Goodwin imprimatur

Perhaps the most important symbols of the RBS leadership approach were the 'signature' morning meetings instituted by Goodwin and his attention to detail. These have been well documented by Gratton and Ghoshal (2005), who described how these meetings signaled Goodwin's intent to micro-manage a global organization by holding senior executives directly accountable for strategic and operational results. This 'signature process' involved Goodwin and his executive team meeting every morning, either face-to-face or through video conferencing. A senior member of the RBS board explained the nature of these meetings:

> Fred loves the morning meeting. It is his chance to put his imprint on whatever is happening . . . . Fred is more rigorous as a manager than anyone I have ever met. He is extraordinarily demanding. For example, in the morning meetings, he will look at a budget and go straight to page 23 and ask about it. He is very rigorous about apparently small things

> and this pervades the company. People say, 'If Fred sees this, what would he say?' (Gratton and Ghoshal, p. 55)

While Gratton and Ghoshal argued these meetings had great symbolic value in reinforcing the bank's core values of respect, egalitarianism, straight-talking and practical action-orientation with 'accountability at the heart of how the morning meeting is conducted' (p. 56), a senior HR interviewee offered a more hybridized account of Goodwin's style and the impact of these meetings on creating a paternalistic organizational culture and centralized decision making:

> When I joined the organization it felt quite ambitious. Externally it was perceived as aggressive but internally it didn't feel like that at all. It felt paternalistic in many ways ... there was a desire to look after people in a controlling sort of way, a kind of parent/child relationship, we-know-best way ... Decision making was also quick, up and down, which I think worked well when the organization was relatively small ... but less so when the organization began to grow rapidly (reference to the ABN takeover). (Interviewee 3)

High energy and the focus on strategy execution were also common themes in interviewees' descriptions of RBS culture (see also Gratton 2008). One interviewee attempted to capture the energy redolent in RBS:

> There was an awful lot of talk about improving 'clock speed' of anything and everything – from mowing the lawns outside to doing acquisitions .... There was a culture of responsiveness, people moved fast around the building, there was a culture of speed – running, moving, fast ... something that Linda Gratton noticed in her book. (Interviewee 6)

Interviewees also accounted for success by focusing on the ability of the company to create a machine-like bureaucracy that slipped into gear to implement centrally taken strategic decisions. Once a decision was taken to acquire a new business, questions on strategy were played down and the speed and rigor of 'execution' played up:

> In line with the making things happen strapline, you know, I guess this was where RBS was so successful ... decisions were taken centrally ... the vast majority of people were just pushed into execution, the machine just cut in. And because RBS had such great processes, we could focus on execution ... the role of senior managers and, indeed, my role was on execution, rather the extent to which you were able to shape or influence strategy ... and that came from a very focused CEO who had a clear view of what the strategy should be. (Interviewee 7)

> I've never known an organization like it. There was an obsession with execution ... where a logo – making things happen – actually reflected how an organization operated (laugh). (Interviewee 3)

One important issue that emerged during interviews was the nature of strategic objectives handed down to the HR function. Again, these focused on the growth strategy and on managing the pervasive cost to income metric, which were critical to profitability and shareholder value though this connection was not always made. A senior HR executive explained:

> The cost to income ratio was always being talked about in HR. There was a phrase that was used extensively – 'managing the jaws'. Yes share price and shareholder value got a mention, but these were created by growth, new business opportunities, by the cost to income ratio .... However, it never felt like cost control, no that's the wrong word, there was a big focus on investments, it was never about cutting costs. (Interviewee 2)

A focus on measurement

Interviewees emphasized evidence-based management, metrics and performance outcomes as a key feature of the organizational culture, pointing to numerous stories of Goodwin's attention to detail and pre-occupation with measurement and his impact on other managers.

> he had an obsessive attention to detail, and his managers copied his style to get on. For example, he would ask about the (evaluation) scores on Course code xyz (in the new Business School). What's the average score, what's the trend? ... He wanted to know why we were using a case on Tesco on the (executive development) courses ... I saw a hand-written note from Fred, querying this ... and his acolytes would mirror Fred's style. (Interviewee 8)

> There was a focus on data. Data was everything. I remember Fred coming along to an HR conference and saying I have only three words to say to you – attrition, attrition, attrition. He wanted to know why there were 23–24% attrition rates in turnover in the first year (of employment in a particular division). (Interviewee 6)

The human capital strategy

This last quotation shows the importance of human capital on strategy. RBS's HR team became known internationally as a benchmark for excellent HR practice through its sophisticated approach to human capital metrics and leadership development. Much has been written about RBS's human capital strategy in practitioner-oriented articles (e.g. Groysberg and Sherman 2008), which represented the apogee of rationality applied to the measurement of leader performance and impact on organizational effectiveness. Annual employee, surveys, regular 'pulse' surveys and benchmarking of employee engagement with other financial services and global high-performing companies were developed in the late 1990s, revealing different drivers for employee engagement in different regions. However, the focus on leadership and its impact on engagement, customer service and cost to income ratios was common. A Leadership Index, using standardized metrics across the RBS Group, revealed a significant correlation between leadership performance and outcome measures of performance. This combination of measures was turned into a Human Capital Toolkit to help managers and HR business partners 'diagnose issues, develop interventions, share best practices and measure the effectiveness of their people strategy ... ' (Groysberg and Sherman 2008, p. 10) and rolled out into their international retail banking sector. These Harvard academics claim it is one of the most impressive online tools anywhere linking people management, sales, customer service and financial performance metrics. Importantly, managers were measured, made accountable and rewarded on how well they met key metrics, including employee engagement and satisfaction. The metrics also provided the basis for talent management segmentation and performance assessment, which became extensively used for career development purposes.

Interviewees also suggested that 'delivery' and 'getting things done' were the most valued leadership competence.

> What RBS was always good at was making things happen, integration, meeting targets, big program management, with a set of measure deliverables ... the key competence was a burning drive for results, and that was by far most important. (Interviewee 1)

Thus, RBS's approach to human capital management became one of its signature processes and the benchmark for UK companies in all sectors to follow. Data from the constant surveys of employees also highlighted how success, supported by investment in people, was leading to a growing confidence in the organization:

> RBS as an organization became very confident organization from its execution of the NatWest acquisition, and you could see why. It was a very successful acquisition . . . . Having been on the NatWest side, I would say they did incredibly well in integration . . . . What came with that was investment . . . . People drew on the confidence and energy of the organization. (Interviewee 5)

During the period 2003–2007, employee perceptions of key indicators rose significantly, particularly leadership, internal beliefs about the external image of RBS, innovation, communication, respect and diversity, and employee engagement. They also enjoyed high 'favourability' scores on employment security, working relationships and recognition and reward against the global financial services norm, a benchmarking measure developed by a consulting firm. Significantly, however, employee engagement scores were below the financial industry norm, interpreted internally as problems with leadership style in the organization, to which we return in the following sections. Nevertheless, the general thrust of the metrics provided substantial evidence that the overall HR strategy was effective and improving over time.

A focus on leadership development

As already noted, the metrics pointed to leadership quality being the most important driver of employee, customer, sales and financial performance. For example, beliefs by employees that their business was well managed ranked as the most important factor in explaining variations in employee engagement scores in different countries (Martin and Hetrick 2010). Thus, providing leadership development became a key element in RBS's talent management strategy. Consequently, it established a state-of-the-art business school in 2006 in Edinburgh to develop its most promising senior executives, in which Goodwin took a close interest because he believed he could use it to further shape the corporate culture. RBS established links with leading US schools, such as Harvard, to deliver executive education programs rather than UK schools. This was intended to reflect the global nature of the company and to meet the increasing aspirations of its 'top talent' segment to be associated with a major global company. A senior executive explained in an interview conducted in 2006:

> RBS is now a global organization. It needs to ensure that it has the best senior execs to work internationally . . . Executive education must have a global perspective . . . . The Scottish business schools are too UK-centric . . . . Our senior executives expect to work with the best schools in the world. (Interviewee 2)

Reflections on RBS during its growth period: the problems of shareholder value

Reflections on leadership

By 2007, it became clear that this romance with Goodwin's leadership style and perceptions of his positive impact were waining. Reflecting an important theme in the leadership literature concerning the dysfunctional consequences of managerial hubris, narcissism and executive overconfidence (Hiller and Hambrick 2005; Shipman and Mumford 2011), the collective self-confidence in RBS, built on Goodwin and his executive committee's reputation for making 'the right calls', was increasingly seen internally as collective arrogance. Interviewees linked it to the centralized, directive, micro-management style of Goodwin and his executive team and impact on organizational culture, and on a general unwillingness of his direct reports 'to speak up to power':

> I would say that confidence became more arrogance, with each successive acquisition . . . the one thing that concerned me was the growing arrogance, and that generated a lot of personal agendas, which started to override team, or organizational or functional agendas . . . . I think

> the personal agendas came from the attributes that were rewarded, things like 'burning drive for results', things like 'creating tension to catalyse change'. These were key aspects of the behavioural leadership model, which were seen as probably more important than some of the other, perhaps softer management or leadership skills. (Interviewee 5)

Another interviewee suggested that this was the point he became convinced that confident judgment became arrogance:

> If you look at the later stages ... the ABN takeover, the transaction originally had the LaSalle piece in it ... that fell through, but by that stage RBS was so close to the deal and had made such a big thing about beating Barclays, it still went full steam ahead. Analysts were saying pull away, but they didn't because of that arrogant streak .... it seems like they just wanted the deal done ... I think to show it had the strength and ability to say, sort of, look, we've done it again, despite what people say. (Interviewee 7)

Published and interviewee accounts also highlighted the corrosive impact the morning meetings had on leadership style throughout the company. For example, a BBC (18 October 2011) analysis proposed that the morning meetings were Goodwin's method of maintaining tight control behavior and to set the tone and boundaries for legitimate leadership in RBS. According to one interviewee, 'ritual humiliation' was seen as a 'right of passage'. Two former senior HR managers described how these meetings negatively influenced leadership style throughout the organization:

> I would sum up the RBS leadership style in a few words, it was a bullying culture ... it was very command and control, get things done, really carrot and stick approach. This came directly from Goodwin himself. This was his style, which his senior management team emulated ... in one sense they had to get on. People conformed to Goodwin's style. It was considered OK to bully people; his behavior legitimized it. (Interviewee 8)

> It became quite a cool thing to do, to be seen to be seen in a meeting, to be quite abrasive, to be seen at times perhaps, you know, to push people back, to stand people down ... I think at times it bordered on bullying. (Interviewee 6)

Other interviewees, however, pointed to the lack of 'responsible followership' (Kellerman 2008) in standing up to power, thus helping sustain Goodwin's personal impact:

> 'Outside of the senior management group, there was probably limited ability to challenge decisions ... I think from Fred and his team, but in reality Fred himself. His direct reports were clearly influenced by Fred's own agenda. He was very capable, very clever, but he was also feared. (Interviewee 6)

> It was fantastically paradoxical. It was a mono-culture all built around Fred Goodwin, he was the driver .... He wanted people to challenge him, but when they didn't come forward, I guess stand up to him, he just 'steam-rollered' on.

This resulted in further negative aspects of strong cultures built around a single leader or small leadership team:

> Coming from (a highly respected professional services firm) I found RBS to be very insular from the rest of the world outside, a kind of 'we've always done it this way, so why change' culture. This came from the very top .... I don't think it was as entrepreneurial as people made out. (Interviewee 8)

Reflections on performance management, metrics and HR

These reflections on the dysfunctional consequences of the overall approach to management in RBS also extended to the performance management system, the human capital system and to rewards.

> Performance management was very strong in the Bank, but it was very subjective ... I would say there was a great deal of misuse of the 'Bell Curve' (the practice of forced distribution to

> ensure that performance reflected a normal distribution), so that people fitted the curve. It didn't really matter about absolute levels of performance, managers were forced into relative performance. Nor did behaviours matter, what counted was achieving targets and that is what people were rewarded for! (Interviewee 8)

This attention to detail and measurement was seen positively and negatively.

> The HR engagement survey was treated very seriously, every year each manager was rated on engagement and the scores were literally placed on the door. Managers as they trooped into the auditorium could see the red, amber and green scores on the door, and knew who would be in for a hard time. One of the real paradoxes in RBS was Fred (Goodwin) shouting – 'you will be good to your people' (laughter). Maybe that explains the high response rates. (Interviewee 4)

RBS after GFC: a more enlightened shareholder value configuration?

Reasons for failure

As previously noted, RBS entered into a joint venture with Fortis and Santander in 2007 to acquire the Dutch bank, ABN AMRO, which had presence in 53 countries. The bid was successful and they acquired ABN for $106 billion in October 2007. However, there were early warning signals when some analysts portrayed as 'price-aggressive' and overpaying for the deal. Nevertheless, RBS had gained confidence through its history of successful acquisitions and expected the ABN takeover to be equally successful if they applied the same strategic integration formula. Unfortunately, the purchase took place just when the GFC began to bite, which, according to most analysts, was the beginnings of a 'perfect storm' facing RBS. In the summer of 2007, negative signs of a recession were clearly visible as a consequence of the 'credit crunch' associated with the sub-prime mortgage-backed securities (collateralized debt obligations) in the USA. ABN was heavily exposed to these toxic US securities, for which RBS was subsequently criticized for not exercising due diligence.

The RBS response to this crisis was to undertake a £12 billion rights issue, at the time the largest in the history of any company. This move turned into a source of humiliation for CEO Fred Goodwin and his board, and led to further questions over the justification of the ABN AMRO deal. The rights issue failed, so after decades of success in the UK banking history and having become one of the biggest banks of the world, RBS went into free fall in 2008 and within no time reached the brink of collapse. The UK government had to step in with massive cash injections, so the Bank rapidly became effectively state owned. In October 2008, the Bank's board asked Sir Fred Goodwin to retire to avoid being sacked. The bank was then taken over by the UK government, which intervened to shore up the collapsing UK financial system; RBS alone recorded losses of £24 billion in February 2009. Sir Fred Goodwin and Sir Tom McKillop (the Chairman), along with other senior bankers caught up in the crisis, were questioned by a Treasury Select Committee of MPs at Westminster in February 2009. These bankers were forced to apologize for their behavior, admitting that the purchase of ABN Amro was a 'bad mistake' despite their defense that it was the credit crunch that had been the cause of failure. (*The Scotsman*, 11 February 2009). McKillop admitted they had overpaid for ABN, reflecting that they had 'bought at the top of the market', and what they had paid 'was not worth it'. One of the major causes for RBS's failure, and indeed all of the British banks, was deemed to be the executive bonus culture that encouraged overly risky behavior, a point born out in recent research.

A change in leadership style

A new CEO, Stephen Hester, was appointed in early 2009 because of his previous experience in leading a turnaround at another large UK financial services firm. His appointment also led to a new board being appointed, with only two former directors remaining by May 2009. This executive group is currently faced with trying to keep talented people in the business and restoring employees' faith in senior managers while trying to reduce the company's overall size, restore it to profitability and to private sector ownership. EU requirements following the GFC led to RBS selling off its insurance companies, 318 retail banking branches and part of its investment banking business over a four-year period. The consequences were significant job losses, with 19,700 being made redundant since October 2008, of which 13,700 were in the UK. As a result, employee engagement levels 'tanked', as one interviewee commented, which were poorest in the lines of businesses most affected, for example, insurance and investment banking.

Moreover, there was a widespread feeling among many employees that the senior leadership had let them down (CIPD 2009). The, former HR Director, explained:

> I think a number of people felt let down. Also, we had very high employee share ownership and a lot of people are unhappy about that [because the share price crashed]. There are a lot of people who were hurt, whose pride was hurt, and many people were disappointed in the leadership. (CIPD, 3 Deccember 2009, p. 2)

Thus, Hester and his board sought to signal a more appropriate leadership style and organizational culture. They developed a group-wide strategy comprising five new themes: a 15% return on equity; top-tier competitive position in leading customer franchises, proportionate use of balance sheet risk and funding, organic growth, and a new customer charter (CIPD 2009).

Leadership and HRM in a new environment

The RBS board and the HR function have faced significant challenges in rescuing the failed bank and keeping staff engaged so that they work toward its revival. The RBS corporate sustainability report, which records key 'scores' from their human capital survey, showed a significant decline of 12% and 16% in job satisfaction and engagement, and employment security in 2008–2009. Our interviews, however, showed that lessons have been learned that resulted in changes taking place. Nevertheless, their story was of continuity as well as change, reflecting cultural inertia in certain parts of the business and tensions in what is regarded as a temporary change in ownership, since both the UK government and the RBS board are keen that the company returns to private ownership as soon as is practicable. Equally important, however, RBS had developed a reputation for excellent HR practice prior to the GFC. As one interviewee succinctly put it:

> It is easy to say that before crisis, RBS was this and after crisis, it was that, but that is too simple. Obviously things went wrong, but there was and still is a lot of very good practice in HR and that hasn't changed overnight. (Interviewee 1)

We reflect on these changes raised by our HR interviewees who remained with the business after the crisis, the most significant of which were in leadership style and its impact on organizational culture, best characterized as a move from the use of 'hard' to 'soft' power (Courpasson 2000). Hester and his board were seen to signal a new culture of open and regular communication so that employees could engage with senior leaders over the RBS's future. The new CEO immediately introduced a system of conferences and calls between himself and his most senior managers, requiring them to cascade information throughout the organization. This change was informed by data that highlighted failings in the previous leadership culture according to the human capital metrics. As one senior HR manager explained:

> It was very obvious from the data that the leadership style was very delivery focused, we had the data to prove it, we brought it along to meetings, saying if you compare us with global high performing companies, our leaders are going to need more collaboration, more influencing skills. They are going to need the ability to, you know, manage tensions. This is the gap and we have put in a big program of work to fill that gap, to send signals that other things are important . . . (following prompt) a more balanced scorecard approach. We saw a spike in (name of division) where they had a spike around 'burning drive', which we have been working on a lot. (Interviewee 3)

These changes in leadership were partly attributed to the role modeling impact of Hester, and his chairman, Sir Philip Hampton, who provocatively declared that RBS was 'paying big salaries to staff who are not worth it'. The former Group HR director, in a published interview in 2009 suggested that:

> Stephen has a very different style to Fred [Goodwin] . . . . A little bit less formal, a bit more relaxed. Both were interested in results, but he is much more focused on communication and performance management. (CIPD, 3 December 2009, p. 1)

Another senior HR manager pointed to the importance of restoring faith in senior leadership:

> Change starts from the top, this is always necessary. It isn't just the Chief Executive, but undoubtedly there is a different role modeling going on at very senior levels and that gets cascaded down into the organization . . . . The messages from the Group Executive now are much more about the need for new behaviours, we never used to talk about behaviours, we never really used to talk about values . . . we are starting to talk about these a little bit more now. (Interviewee 2)

Changes in values, talent management and leadership

However, these changes have been unevenly spread throughout the organization. Attesting to the importance and strength of local subcultures, another interviewee explained:

> What we began to do in other parts of the business, still hasn't affected (x division) . . . So if I look at the leadership index in other divisions, there is still a spike around a burning drive for results. (Interviewee 2)

Changes were also evident in the emphasis on values supporting RBS's new customer charter and its social responsibility pronouncements. Again these changes were attributed to the new board of RBS. However, the following insight also highlights a key dilemma faced by the company in meeting its stakeholder obligations:

> What we also talk about more is the core purpose of the organization and the social good it does. But it's talked about in a fairly subtle way because there is still a challenge over how you present the organization externally at the moment . . . I think we need to fix things first, sort things out before you start these sorts of things . . . (asked to elaborate). Well I mean at group level it's not the right thing to be coming up with values because we are in the middle of a five-year plan, to get to the point where we have to stand alone as a business. Until you've got that, well that's what we've got to deliver for the taxpayers and quite rightly so, to get their money back essentially, and that's got to be our number one priority, but there is also recognition . . . a very clear signal that there is a different style of leadership, a more open style, a more collaborative approach, you know, a more considered, thoughtful approach. (Interviewee 3)

These changes were reflected in new approaches to performance management emphasizing the means of achieving results as well as the results themselves. Such a change is indicative of a change in business ethics from egoism to a Kantian morally correct duty to treat people as ends in themselves. It is also backed by the influence of new external regulation from the Financial Services Authority (FSA):

> (Following probe) To give you some examples, we are using behaviours for performance assessment .... It's not just about what you've delivered but how you've delivered it.
>
> There is a big focus on performance management and the need for personal development for leaders – we have 360 degree for that, so that behaviours measured through the appraisal system ... All executives and direct reports are to get a 360 degree. (Interviewee 3)
>
> It is different now, yes, I think things like the FSA regulations require our executives to have ... have completed a performance review. This is just good practice, but now we have to evidence it. (Interviewee 2)

According to interviewees, the focus on a new approach to talent management and leadership development has also been noticeable. One of the most important of these changes in policy has been a move away from recruiting externally to developing people internally:

> We also have a new leadership framework for behaviours, what we expect of our leaders, and people are being measured against them. That's a key change, but it depends on the business. I don't see it as an enormous change from previously in the division I was previously in, but in other parts of the business, it is a big change. (Interviewee 5)

Another documented change was a greater focus on innovation, with leadership development in the business school being used to generate new ideas, especially in retail banking. Sessions have been introduced into the leadership development program, which have led to new revenue streams. Leadership development has also focused on creating more effective leaders at all levels in the organization by helping them gain the skills to teach, based on the belief that you cannot know something until you have to teach it (Mostyn 2010).

HR as 'an un-indicted co-conspirator'

Finally, an internal and external debate has taken place over HR's role in RBS being 'part of the problem' or even helping cause the problem (Spector 2003). The former Group HR Director, in a published interview of HR Magazine (October 2010) answered his many HR critics in the blogosphere:

> I'm not absolving myself totally ... (but) I can't see what HR could have done. Lack of money was not an HR issue, the portfolios our businesses kept was not an HR issue; none of them were. I wasn't running the bank ... the CEO makes the decisions, not me. People think HR runs companies. I say stop getting carried away. HR is a support function, no more, no less important than sales or IT. HR critics are way ahead of themselves ... He (Stephen Hester, when he took over) said he didn't see HR as part of the problem. (2010, p. 1)

He further asserted:

> Culture issues were secondary issues, not primary ones ... HR isn't responsible for the culture of the business; the board and its customers are. It's the business environment that sets the culture ... I've always thought pay in this sector is mad ... a lot of staff were angry with the leadership and their bonuses and rightly so. (2010, p. 2)

However, some interviewees suggested that the ability of the HR function to absolve itself from blame and for responsibility for organizational culture may be changing, since Hester has already gone on record to say that *'Shareholders have raised concerns about our ability to keep and motivate good people ... (this is) our single greatest problem'*.

Thus, as one interviewee stated that while in some divisions it was asked to hold up a mirror to senior executives and encouraged to do so, there was a feeling that the new senior management team was asking the function to become guardians of the corporate conscience:

> The HR function wasn't too blame for what had happened in the past, or wasn't powerful enough to prevent excesses, but now it was being asked to be more responsible and accountable its role for hold up the mirror, in some parts of the business at least. (Interviewee 2)

Conclusions

In this study, we have outlined a new framework linking corporate governance to SHRM and used it to analyze the case study of RBS as an illustration of the GFC's impact in the UK financial services sector. We believe that both shed new light on a wider range of corporate governance configurations than the traditional shareholder value-stakeholder dichotomy that dominates the literature, and on the relationships between these alternative models of governance and their ethical, strategic, SHRM, leadership, organizational climate and HR governance concomitants in financial services and other sectors. The configuration model has helped us to map out and analyze relationships among these variables and to show how changes in governance regimes often move in tandem with changes in ethics, strategy, SHRM and climate governance, and the role of HR. However, as the case of RBS shows, these configurations are only theoretical abstractions that do not quite capture the complex reality found in cases of the large-scale organizational change brought about by the GFC in UK banks.

One possible reading of the case is of RBS changing from a traditional shareholder value configuration to enlightened shareholder value after GFC, which for some people represents one of the few positive outcomes of the GFC. The Mathewson–Goodwin era can be characterized by a traditional shareholder value-hard power model that was in tune with the financial economics of the period, the opportunities created by deregulation of financial services and the strategy to grow through acquisition to satisfy shareholders and executive aspirations for a global business. The organization pre-GFC was characterized by egoist ethics, a focus on measurement, human capital and leader centricity, with the HR function playing a limited role at board level. The case also reveals a weakness in the HR function's ability to help leaders to reflect on their leadership style and organizational culture to bring about change.

After GFC, it is possible to read into the case a more enlightened shareholder value configuration, with senior leadership, organizational climate and SHRM more consistent with a corporate governance regime and change in ethics that was demanded by a change in ownership to the UK taxpayer. RBS was forced to respond to its wider obligations, which was reflected in a new customer charter emphasizing obligations to customers, the community and employees. It was also used as an arm of government policy to change banking culture, especially the bonus culture and what the government regards as excessive pay, with overall pay levels being held to the median for the industry. The case suggests that the RBS board has sought to portray an image of itself as stewards of the wider interests represented within the firm, especially those of taxpayers and government. There is substantial evidence that the egoist ethics of self-interest have been tempered with the appointment of Hester and his management team, the exercise of soft power, and a form of sophisticated HRM privileging employee engagement, extensive communications and involvement. Arguably, even this short-term change in ownership has resulted in lessons being learned on the problems of over-confident, heroic leadership style, a need for HR professionals to 'speak up to power' by helping leaders reflect on their style and ethical behavior (Shipman and Mumford 2011), and over distributional issues such as bonuses and pay (Core and Guay 2010).

However, contrary to the predictions and hopes of some academics and practitioners, the GFC has not resulted in the end of shareholder value and its replacement by a stakeholder model of governance in this case due to lack of a receptive context for such radical change. Despite what some had expected from left-of-center government ownership, the demands on banks such as RBS to compete globally in both product and executive labor markets and, in this case, the government's desire to return the company to private shareholding ensured that no significant attempt was made to enforce a pure stakeholder configuration on RBS. Thus, the case might also be interpreted as providing evidence of a context-dependent configuration in two ways. First, the intent of the UK government to return RBS to the private sector as soon as practicable and the extent to which RBS and financial services in the UK more generally are part of a global industry rather than a nationally bounded one suggest important contextual limitations to the application of stakeholder theory in this case. Second, internal factors, including the business orientation and the natural instincts of the new leadership team at RBS to promote 'shareholderism' as an ideology governing decisions (Adams et al. 2011) and shareholder value as a model of governance, are also important influences. Third, RBS has had to promote an image of hard power and commercialism externally, especially to financial markets, the business press and, perversely, to government, while exercising soft power internally and paying large bonuses to key professional and mobile groups. Thus, different parts of the business and segments of the workforce are likely to be managed very differently, which is also evident from the case. This, less optimistic, reading suggests that the GFC is likely to have little significant impact in the long term on RBS or most other financial services organizations that remain in business.

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