



Contents lists available at ScienceDirect

Information and Organization

journal homepage: www.elsevier.com/locate/infoandorg



Inside banks' information and control systems: Post-decision surprise and corporate disruption



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ARTICLE INFO

Article history:

Received 15 July 2014

Received in revised form 6 May 2015

Accepted 9 May 2015

Available online 23 June 2015

Keywords:

Surprise

Decision-making

Routines

Reliability

Collective mindfulness

Mindlessness

Information technology

Learning and accountability

ABSTRACT

In response to the catastrophic outcome of the 2008–2009 Financial Crisis we report on a qualitative study of decision maker surprise in the banking industry. Banks use a remarkably sophisticated ensemble of information technologies for supporting their management control systems and enabling oversight by government regulators and industry watchdogs. Banks depend on a global network of data processing and information systems to provide their core banking services and to manage the complex financial and macroeconomic elements of their environment. They are also subject to federal and/or state oversight, which includes on-site examinations and quarterly financial data monitoring, to reaffirm their safety and soundness. Yet, the financial crisis caught them unawares. To get behind the headlines of the crisis, we opted to not study crisis decisions overtly, but rather to explore bankers' general ability to interpret the data that they were receiving via their information technologies and observations and to follow a number of crisis and non-crisis decisions that had surprise outcomes for them.

Our focus is on understanding the context, process and patterns of decisions that resulted in surprise outcomes for bankers. We interviewed 23 senior executives from banks in the southeast who recounted fifty-one post-decision surprises that had occurred between 2008 and 2010. From analyzing those interviews, we found that they attributed surprise outcomes of their decisions to specific behaviors, including their complacency and over-confidence, their over-trusting of others, their deviation from protocol, their habitual information reporting and decisioning efforts, and their deficient detection of warning signals. In addition they tended to rationalize surprise outcomes by diverting blame to others. Combined, these symptoms reveal a chronic organizational and cultural susceptibility for being surprised. It was evident from our analysis that the bankers exhibited a narrow focus of attention and a reduced sense

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of inquiry, refrained from calibrating their mindfulness with the complexity of their decisions, limited their sense of accountability and experienced rigidity in procedures from bank routines and information standardization. Together, these elements nurtured less-mindful behavior and triggered surprise outcomes. Given the important role banks play in our financial world and the ineffectiveness of their elaborate information support systems for reliable management control the results are disturbing.

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1. Introduction

Managers do not deliberately set out to hamper firm success by accepting excessive risk or by making decisions with negative outcomes. Yet, the banking industry has recently been challenged by the consequences of just such actions. This is amply demonstrated by the way that the banking industry was caught unawares, ill-equipped and unprepared for the global 2008–2009 Financial Crisis. The gravity of the crisis is clear from the decline in banking industry earnings as reported by the Federal Deposit Insurance Corporation (“FDIC”). Their data for 2006 showed banking industry net earnings to be \$145 billion, dropping to a dismal \$4.5 billion in 2009 with 32% of the 8025 U.S. banks reporting financial losses. These results are surprising because banks¹ are considered to be operationally progressive, technologically advanced and managerially responsive to their operating environment.

1.1. Research question

Our study asks a deceptively simple question.

How do bankers experience the sensing of problems or opportunities, the inquiring about those problems or opportunities, and the making of decisions concerning them, that result in surprise outcomes?

We address this question to bankers primarily from leading community banks, which are categorized as having assets under \$1 billion and include the vast majority (90%) of commercial banks located in the USA. Our sample banks had an average \$350 million in assets, which is in line with the industry average.

1.2. Bank information and control systems

Even though our banks are small in asset size and perhaps less advanced in proprietary technologies than mega money-center banks such as Chase or Citi, when considered from a “core operating routines” perspective (e.g. deposit gathering, check clearing and branch servicing – what bankers would term the “fundamentals”), these regional community banks are technologically sophisticated and highly trusted organizations. The industry-wide adoption of information technologies² and advances in global data networks have been important enablers of bank core operating routines. In 2013 ACH electronic payments volume reached some \$39 trillion dollars, credit/debit card payment volume for Visa, MasterCard and American Express reached \$6 trillion dollars; and bank loans totaled \$8 trillion dollars attesting to the banks remarkably efficient computer based collection and payment systems.³ In addition, ERP systems have been embraced by banks to replace piecemeal software. Overall, banks are characterized by exceptionally high volumes of transactions processed

¹ For an overview of commercial banking see Federal Reserve publications, practitioner banking publications, banking textbooks, and academic journals in banking, economics and finance. This overview relied primarily on Gup (2011 and 1996); Gilbert (1984), Mishkin (1992), Santomero (1984), and Spong (1990).

² *IT* in this context refers to any form of computer-based information system, including mainframe, microcomputer, and intra/internet applications (Orlikowski & Gash, 1994; Powell & Dent-Micallef, 1997).

³ For volume detail refer to the National Automated Clearing House Association, commonly referred to as NACHA, and the Federal Reserve Payment Study, 2013.

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