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How do risk managers become influential? A field study of toolmaking in two financial institutions

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ABSTRACT

This paper, based on a five-year longitudinal study at two UK-based banks, documents and analyzes the practices used by risk managers as they interact and communicate with managers in their organizations. Specifically, we examine how risk managers (1) establish and maintain interpersonal connections with decision makers; and how they (2) adopt, deploy and reconfigure tools—practices that we define collectively as *toolmaking*. Using prior literature and our empirical observations, we distinguish between activities to which toolmaking was not central, and those to which toolmaking was important. Our study contributes to the accounting and management literature by highlighting the central role of toolmaking in explaining how functional experts may compete for the attention of decision makers in the intraorganizational marketplace for managerially relevant information. Specifically, as risk management becomes more tool-driven and toolmaking may become more prevalent, our study provides a more nuanced understanding of the nature and consequences of risk management in contemporary organizations. An explicit focus on toolmaking extends accounting research that has hitherto focused attention on the structural arrangements and interpersonal connections when explaining how functional experts can become influential.

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Men compete with men today not by teeth but by tools... (Gilfillan, 1935, 63).

1. Introduction

Risk management as a technical discipline has been present in financial institutions for more than 50 years; however, its separation from insurance and corporate finance is a more recent phenomenon (Butterworth, 2001). Fuelled by regulators' and market participants' long-held demands for "good management," since the late 1990s, risk management has been advocated as a corporate governance and management control practice applicable across all industries (COSO, 2004; ISO, 2009). Reports of practice and emerging empirical research indeed reveal risk management as a more visible and prominent practice in many organizations (Mikes, 2009, 2011; Beasley et al., 2011; Deloitte, 2011, 2012; PricewaterhouseCoopers, 2012; Jordan et al., 2013; Tekathen and Dechow, 2013).

However, despite evidence of risk managers' increased visibility and prominence in organizations, the global financial crisis of 2007–2009 and continuing risk management failures, such as the one implicated in J.P. Morgan's multi-billion dollar loss in 2012 (Rose, 2012), call for an examination of the nature of the influence that risk managers might actually have on decision making in

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financial institutions. In fact, we have little empirical evidence about the ways in which risk managers affect executive decision making in their institutions (Bookstaber, 2007). Although the presence of prominent risk managers in a financial institution does not necessarily mean that excessive or unnecessary risk taking would be avoided, by improving our knowledge about *how* risk managers interact with managers, we can add another dimension to our understanding of the potential effects and unanticipated consequences of risk management. Specifically, we suggest that by understanding the "influence activities" (Howard-Grenville, 2007) through which risk managers become part of the executive decision-making processes, we will gain valuable insights into how risk experts identify events, developments and trends that constitute the emerging risk management agenda in their organizations, and how they bring these agendas to the attention of others.

One of the salient features of risk management is the ubiquitous presence of tools such as value-at-risk software, risk-adjusted capital models, risk maps and risk reporting frameworks. Field study evidence indeed highlights that risk managers in banks develop a variety of such tools and deploy them in different ways (Mikes, 2009, 2011; Arena et al., 2010). Jordan et al. (2013) recently provided a detailed empirical account of how, in a non-financial setting, a specific risk management tool, the risk map, was central to the management of a prolonged and multifaceted project by facilitating the creation and communication of different representations of the project. Surveys also document the rising visibility of quantitative tools-based techniques such as economic capital calculations and stress testing (Deloitte, 2011; KPMG, 2011; PricewaterhouseCoopers, 2012), which are deployed in communication between risk managers and different stakeholders. Such risk management tools collect information from business units about the "riskiness" and corresponding capital requirement of their activities (including past activities and estimates about future activities), and then produce and disseminate tool-generated assessments of the risk implied in these activities back to those business units and, crucially, to executives who (supposedly) make decisions using these assessments. Risk managers frequently have strong affinity with risk management tools: they develop and deploy them, take part in reconfiguring them and, importantly, can depend on the tools for connection with, and a potential point of influence on, senior executives. As such, the practices that connect risk managers, tools and other organizational actors present a potentially fertile ground for examining the dynamics of risk managers and their (potential) impact on corporate decision-making processes.

This paper, based on a five-year longitudinal study at two UK-based banks, documents and analyzes the practices used by risk managers as they interact with executives and other professionals in their organizations. Specifically, we examine how risk managers practice their expertise and communicate it to others through the development, operation and deployment of tools, and through weaving those tools into the fabric of organizational activity. Our research, thus, centers empirically and analytically on the observed practices by which experts adopt, adjust and reconfigure tools that embody their (and potentially others') expertise—practices that we define collectively as *toolmaking*.

Our research makes two contributions to the literature. First, we provide a detailed empirical account of an important, but hitherto understudied part of organizational decision making: how risk managers incorporate their expertise into the routines and practices according to which decisions in financial institutions are being made. As criticisms leveled at "missing" risk management during the recent financial crisis emphasize (Bookstaber, 2007), such analysis is important because assessment of the effectiveness of risk management would benefit from a better understanding of how risk managers become involved in, and potentially have an impact on, decision-making processes in financial institutions. In particular, our study addresses directly this gap in the current accounting and risk-control research by showing that toolmaking is central to risk managers' interactions with other managers. This insight resonates with a wider body of managerial research highlighting the key role that tools play in communication processes between experts and others in organizations (Bechky, 2003a; Carlile, 2002; Kaplan, 2011b; O'Mahony and Bechky, 2008). Our focus on toolmaking provides a further perspective on how tools can be studied in organizations because it focuses attention on the development and on-going adaptation of tools, how this process interacts with the expertise of the functional expert and the business managers, and its links with the ways in which functional experts can become influential in organizations. Our focus on examining the specific ways in which risk managers operate in organizations also resonates with calls to move beyond standardized risk management approaches to uncover the potential for more fine-tuned and creative approaches to risk management (Huber and Scheytt, 2013).

Second, we contribute to the literature on organizational influence gathering by examining in detail the dynamics between functional experts and managers. This contributes to prior research in management accounting that has examined changes and transitions in the roles that accountants can play in organizations and the tensions that arise as management accountants aim to fulfill the dual role of the "bookkeeper" and the "business partner" (e.g., Morales and Lambert, 2013; Baldvinsdottir et al., 2009; Byrne and Pierce, 2007; Jarvenpaa, 2007; Mouritsen, 1996; Granlund and Lukka, 1998). In particular, Morales and Lambert (2013: 233) recently examined how management accountants "attempt to strengthen their business orientation," however, they find that the notion of "business orientation" is highly ambiguous and open to interpretation and contestation.

In the following section we discuss the relevant literature, drawing on both management accounting studies and wider managerial research. The third section describes our research methods. The fourth and fifth sections present the two case studies. The final section discusses our findings and develops a conceptual framework on the roles of toolmaking in explaining the dynamics between experts and managers and, in particular, focusing on the instances where experts seek influence.

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