Journal of Business Research 67 (2014) 2671–2683

Contents lists available at ScienceDirect

Journal of Business Research

# When an irresistible force meets an immovable object: The interplay of agency and structure in the UK financial crisis ☆

Simon Ashby [a,*], Linda D. Peters [b,1], James Devlin [b,2]

[a] University of Plymouth, UK
[b] Nottingham University Business School, Jubilee Campus, Nottingham, NG8 1BB, UK

ARTICLE INFO

*Article history:*
Received 1 June 2010
Received in revised form 1 February 2011
Accepted 1 October 2011
Available online 12 April 2013

*Keywords:*
Financial crisis
Risk management
Crisis management
Structuration theory

ABSTRACT

The study sheds light on why certain financial institutions exposed themselves, and the financial system as a whole, to excessive risk. The study examines the human side of the crisis and its relationship to certain organizational and sector-wide practices dominant at the time. The study draws on pre-existing insights from the field of crisis management, and use structuration theory to explore the inter-relationships between the micro- and macro-factors that contributed to the crisis. Structuration theory allows exploration of how the irresistible force of human agency and the immovable object of situational imperatives together provide an understanding of how and why the crisis occurred. The study argues that the crisis was largely due to failures in the implementation of certain risk management processes. The research findings challenge the notion that greater regulatory prescription and capital requirements are required, or that simple solutions such as caps on bonus payments will prove effective. Rather, implementing enhancements in the risk management and governance practices of financial institutions and their regulators is necessary, together with facilitating mechanisms that support cultural change.



## 1. Introduction

Investigations into the causes of the financial crisis and the lessons the crisis teaches us are plentiful (Brunnermeier, 2009; Congressional Oversight Panel, 2009; de Larosière et al., 2009; Lewis, 2010; Turner, 2009). A common theme from these investigations is that the cause of the most recent financial crisis, like many before, was a series of macro-economic temptations. These temptations (i.e., low interest rates, booming housing and securities markets, and high levels of market liquidity) drove banks (and a few insurers) toward excessive market, credit, and liquidity risk. Examples include heavy exposures to collateralized debt obligations, excessive sub-prime lending, and an over-reliance on short-term funding. Financial institutions were unable to control these risks effectively because of weaknesses in their corporate governance frameworks (for example, excessive reliance on staff bonus payments which promoted moral hazard) and risk management arrangements (for example, holding insufficient levels of capital and liquidity).

While such factors undoubtedly played their part, and are likely to do so again, these analyses contain a key flaw. Explanations of why some financial institutions exposed themselves to excessive levels of risk, while many others did not are imperfect. As Borio (2008, p. 14) states, "…while it is tempting to address the most conspicuous problems highlighted by the present turmoil, there is a risk of focusing too much on the symptoms, rather than the underlying causes."

Limited research exploring the different behaviors of financial institutions is a key barrier in understanding the many complexities of the crisis. Traditional economic theory currently employed lacks the necessary theoretical techniques addressing these behavioral aspects, as such theory uses mathematical deductivist modeling which, "…can provide limited insight at best into the workings of the economy (or any other part of social reality)" (Lawson, 2009, pp. 759–760). By contrast, more behaviorally oriented analyses of the crisis provide some interesting insights into the human foibles encouraging precipitation (Müßig, 2009; Tett, 2009; Walker, 2009). However, these lack the theoretical and ontological pedigree of the economics-based literature.

To date, the literature includes no explicit attempt investigating the interplay between the macro-level factors that determined the structural features of the financial services sector prior to the crisis (for example, economic boom and high levels of liquidity) in conjunction with the social practices of financial institutions and the behaviors of their managers and directors (the agency of individuals).

☆ The authors thank the anonymous JBR reviewers, Christine Ennew (Nottingham University Business School) and Ken Starkey (Nottingham University Business School) for their comments on earlier drafts of the paper.

* Corresponding author at: School of Management, University of Plymouth, Drake Circus, Plymouth, Devon, PL4 8AA, UK. Tel.: +44 1752 585720.
*E-mail addresses:* simon.ashby@plymouth.ac.uk (S. Ashby), Linda.Peters@nottingham.ac.uk (L.D. Peters), James.Devlin@nottingham.ac.uk (J. Devlin).
[1] Tel.: +44 115 84 66098.
[2] Tel.: +44 115 95 15264.

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http://dx.doi.org/10.1016/j.jbusres.2013.03.015

The study seeks to fill this void and contributes to the literature on the crisis in two ways. Firstly, the study draws on pre-existing insights from organizational crisis management. Most commentators on the current crisis do not apply this approach, but the method provides a wealth of information on the common underlying causes of crisis (financial or otherwise). Secondly, the study explores the inter-relationship between macro- and micro-factors (structure and agency) using structuration theory. The insights from structuration theory allow exploration of how the irresistible force of human agency and the immovable object of situational imperatives (organizational routine, structure, and the wider economic and regulatory environment, for example) together provide an understanding of how and why the crisis occurred.

Using the insights that follow from structuration theory, coupled with data collected from interviews with 20 risk management and financial service professionals, the study indicates that the current financial crisis was largely self-inflicted and was due to managerial and cultural weaknesses within financial institutions and government regulators. Thus, the irresistible force of human agency (in both managerial action and decision-making) may not only be a positive or negative force in its own right in relation to the emergence of financial crises, but can also interact with the immovable object of structural features and situational factors, in terms of constraints such as regulation and competition. The study also provides evidence that structural features at the institutional and industry levels (for example, compensation arrangements and the prolonged economic boom) can hinder individual reflexivity and critical evaluation and help to reinforce the natural tendency of individuals to pursue their own self-interest by making extreme risks seem both acceptable and desirable.

Following the introduction, Section 2 provides a critical review of the established literatures on organizational and financial crises in order to highlight the value of structuration theory as a means for understanding the evolution and management of the global financial crisis. Section 3 covers the research method. Section 4 presents the findings from the interview data. Section 5 expands the discussion's theoretical and practical implications. Section 6 concludes.

## 2. Understanding crisis

### 2.1. Organizational crises as a process

Though established in the English vernacular, the notion of crisis is hard to define from an academic perspective (Boin, 2006; Roux-Dufort, 2007; Smith, 2006a). Many observers define organizational crises as extreme events that impose immense instability, uncertainty and cost on those caught up in them, whether financial, reputational or physical (cf., Gregory, 2005; Jaques, 2009). These attributes appear to define the global financial crisis very accurately. However, such crisis events (even multi-organization global financial crises) can also serve as valuable turning points, where those organizations prepared to learn from them can achieve beneficial outcomes, often by addressing previously unknown or underestimated weaknesses and inefficiencies to reduce the likelihood and severity of future crises.

The development of a deeper conceptualization of crisis is a key theme in the literature on organizational crises and their management. An emerging view is that understanding and managing crises in a holistic manner, one that reflects the causal (before), operational (during), and recovery (after) phases, is necessary. Such a conclusion follows from understanding these phases, constituting the process through which crises form, manifest, and their rationalization (Coombs, 2001; Roux-Dufort, 2007; Smith, 2005; Smith & Elliott, 2006: Section 2; Toft & Reynolds, 2005). As a result, the literature seeks to move away from the traditional event-centered perspectives, whose focus is on business continuity planning and recovery. This shift occurs because a narrow and reactive approach to managing the operational phase of crises alone can mean that organizations fail to appreciate their underlying causes and hence do little to learn from them.

The trend towards a holistic view of crises is instrumental in developing a clearer picture of how and why organizational crises can emerge, and at times intensify their effect. One common element is weaknesses in the human-system interface. These typically emerge due to interrelations between the following:

- Cultural and human factors (management risk perceptions, organizational safety and risk cultures, internal politics, and power dynamics).
- Organizational design and structure (the complexity of an organization's structure and associated management systems).
- Economic and strategic imperatives (external social, political, economic and competitive pressures).

A more holistic view also reveals that the most visible and operational phase of any organizational crisis is usually the tip of the iceberg. This merely represents the manifestation of a long-standing incubation process through which causes develop and interact such that some form of major failure is inevitable. Neither is this phase the end, with the process of recovery and organizational learning continuing long after the operational phase.

Although the literature on organizational crises provides some invaluable insights into crises and their management, a lack of robust theoretical models remains a constraint (Smith, 2006b). This observation results in calls for a regeneration of the study of organizational crises in order to address the under-theorization of the concept (Roux-Dufort, 2007). A resultant problem is that almost all of the research within the field of organizational crises involves the analysis of discrete crises and disasters, often relying on publicly available secondary sources, such as the results of public enquiries and accident investigations. Hence, the discipline became the (social) science of the exceptional, with little empirical evidence available to prove the general validity of its findings. The problem is especially acute in the new world of the trans-boundary crisis (Boin, 2009; Rosenthal, 2003), where crises are far more likely to be systemic in nature and cross both national and functional boundaries (as in the case of the most recent global financial crisis) rather than being restricted to a single organization and its stakeholders.

### 2.2. The study of financial crises

While criticisms exist of the literature on organizational crises for its lack of theory building and empirical evidence, such criticisms do not apply to the literature on financial crises. This work possesses a long history of association with the discipline of Economics, drawing its legitimacy from a range of established economic theories and empirical methods.

The financial crisis literature's ability to explain systemic events is a particular strength. Such events represent an Armageddon scenario for financial institutions and markets, which can lead to large-scale financial losses that not only cross over into non-financial markets (housing and manufacturing, for example), but also damage the economic wealth of nations on an international scale. The key driver for systemic risk is contagion, where financial interdependencies among institutions mean that the losses of one translate into losses for many others, or where a loss of confidence among investors means that they all try to withdraw their funds at the same time.

Many studies are available into the causes and management of financial crises, and these studies benefit from comparisons among a wide range of different historical cases (Eichengreen, 2002; Goodhart & Illing, 2002; Kasuya, 2003; Laeven & Valencia, 2008). In the main, these studies found that financial crises are largely economic phenomena, with market-level factors as driving forces, such