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LEADERSHIP, CULTURE AND EMPLOYEE DECEIT: THE CASE OF THE NATIONAL AUSTRALIA BANK

ABSTRACT

The National Australia Bank (NAB), one of Australia’s largest banks, announced losses in 2004 of AUD$360 million due to unauthorised foreign currency trading activities by four employees who incurred and deceptively concealed the losses. The NAB had in place risk limits and supervision to prevent trading desks ever reaching positions of this magnitude. However, the risk management policies and procedures proved ineffective. The purpose of this paper is to analyse the deceit, via a content analysis of official investigative reports and other published documents, to determine the extent to which the Bank’s culture and leadership may have influenced the rogue traders’ behaviour. The findings suggest that cultural issues, and the role played by the Bank’s leaders, were influential in creating a profit-driven culture that ultimately impacted the Bank’s foreign exchange operating activities.
1. INTRODUCTION

On 12 January 2004, the National Australia Bank (NAB), one of Australia’s largest banks, announced losses of AUD$360 million due to unauthorised foreign currency trading activities. Four traders in the Bank’s foreign currency options trading room incurred and deceptively concealed the losses from foreign exchange (FX) trading. Trading losses of this magnitude are rare in the Australian banking environment, making this case one of the most significant cases of deception in Australian banking history. The NAB had in place risk limits and supervision to prevent trading desks ever reaching positions of such magnitude. However, the risk management policies and procedures proved ineffective. Even though the losses incurred by the NAB were the result of unauthorised trading activities, this paper hypothesises that the traders’ behaviour was influenced in part by the Bank’s culture and the role played by its senior management. The Australian Prudential Regulatory Authority (APRA) identified a number of limitations with the Bank’s internal control framework and claimed that “cultural issues were at the heart of these failings” (APRA, 2004, p.6).

This paper relies on a theoretical framework of organisational culture developed by Schein (1985, 1992, 2004) to analyse the relationship between organisational culture and leadership. Schein’s pioneering work on culture and leadership established a relationship between the two variables and claimed that they were so intertwined and that one cannot be understood without the other. According to Schein (2004), leaders rely on six primary mechanisms to embed and reinforce organisational culture. The six mechanisms identified by Schein (2004) provide the model adopted in this paper to analyse the loss incurred by the NAB. Applying Schein’s (2004) model provides a comprehensive and formulated understanding of the role played by the bank’s leaders.
in influencing the culture at the NAB and its relationship, if any, to the events leading up to the losses incurred by the four rogue traders.

The remainder of this paper is structured as follows. The literature review, discussed in the next two sections, examines the different perspectives on organisational culture by using theoretical typologies that summarise and categorise the literature that form the “culture debate”. The literature review also presents a comprehensive framework based on Schein’s (2004) analysis of organisational culture to analyse the events that occurred at the NAB. The fourth section describes the method of data collection followed by the fifth section, which outlines the facts that comprise the NAB case. Section six provides a detailed analysis of the case relying on Schein’s model of organisational culture and the final section outlines the conclusions and limitations.

2. THE CULTURE DEBATE

Traditionally, discussions on organisational culture have been restricted to views that emphasise culture as a set of important understandings, often unstated, shared by members of a community (Sathe, 1985; Louis, 1985). According to Sathe (1985), different people think of different slices of reality when they talk about culture. Since the 1980s, competing theories on organisational culture have evolved. However, a generally accepted conceptual framework for analysing organisational culture is yet to be developed. Consequently, the discussion below focuses on understanding the various dimensions of the “culture debate,” then turns to Schein’s (2004) theory on organisational culture as a framework to analyse the case of the NAB.
2.1 Organisational culture: variable or metaphor?

Arguably one of the most important cultural divides is that of Smircich’s (1983) distinction between culture as a variable and culture as a metaphor for organisational life. Smircich’s (1983) distinction is based on two perspectives of organisational theory, classified as functionalism and symbolism. According to the symbolic view of culture, the organisation and culture are one and the same and cannot be separated (Smircich, 1983). Symbolism works as a root metaphor for understanding the human constructs and expressions in organisations (Schultz, 1994). The focus of cultural research is on interpreting the symbolic meanings associated with cultural forms such as rituals and physical arrangements (Martin, 2002) and how such interpretations relate to actions (Smircich, 1983). While culture as a metaphor acts as a lens for studying organisational life through continued processes of human interaction, it lacks practical insights on how to manipulate or influence culture to achieve organisational goals.

The functionalist perspective views organisations as possessing a culture and therefore culture is one variable among many, such as structure, tasks, actors and technology that impacts on how an organisation functions (Schultz, 1994). There are two widely used culture scales: strong and weak; and efficient and inefficient. A culture scale based on strength, measures and evaluates the power of cultural consensus amongst employees. A strong culture will influence employee behaviour to become increasingly congruent with the organisational values. A culture scale based on efficiency measures evaluates an entity’s culture in relation to fulfilment of goals and strategy. An efficient culture is likely to achieve organisational goals more effectively, whereas a weak and inefficient culture is less likely to adapt to the
external environment and integrate its internal processes, therefore jeopardising the survival of the organisation (Schultz, 1994; Denison, 1990). Culture as a variable, and its scales as noted above, implies that it can be mapped, which offers managers the promise of positive outcomes such as greater productivity and profitability (Martin, 2002). In order to better understand culture as a variable, Martin (1993, 1995, 2002) provides three additional perspectives on culture depicted in Figure 1: the integration perspective; differentiation perspective; and the fragmentation perspective.

2.2 Perspectives on organisational culture as a variable

The integration perspective constitutes the dominant body of theory in organisational culture. In this perspective, organisational culture is a unified phenomenon shared by all organisational members and, according to Schultz (1994), culture is the glue that holds an organisation together. Core values form the focus of culture and therefore culture is clear, measurable and pervasive, and consensus within the entire organisation is assumed. The focus of investigations in this perspective is on the manifestations of a culture that have mutually consistent interpretations. Any form of ambiguity, such as misinterpretations or deviance, is trivialised and excluded from analysis. Additionally, in this perspective, top tier management is considered the most influential factor in setting organisational values, which in turn determines the culture that influences members’ behaviour. The strength of an organisation’s culture determines how much control it has over its employees.

In contrast to the integration perspective, the differentiation perspective emphasises a lack of consistent cultural manifestations and consensus among the organisation’s members. The basic underlying assumption in the differentiation perspective is that
different sections of an organisation possess separate identifiable cultures. Unlike the integration perspective, which focuses on the organisation as a whole, the differentiation perspective typically views organisational culture as a series of subcultures. Subcultures may exist in harmony, independently or in conflict with each other, but they nonetheless exist. The subcultures are clear and identifiable but the differentiation preservative recognises cultural diversity and thus a potential for conflict between identifiable subcultures (Martin, 2002).

The fragmentation perspective, arguably the most controversial of the three perspectives, places ambiguity rather than clarity at the core of culture, thus limiting an analysis and understanding of organisational culture. According to the fragmentation perspective, cultural manifestations are neither clearly consistent nor clearly inconsistent; rather they are ambiguously related to each other (Martin, 2002). Consensus, divergent views and confusion coexist and do not conform to a consistent pattern. When consensus forms it is likely to be issue-specific rather than culturally-based (Frost et. al., 1991). Proponents of the integration perspective reject the existence of a fragmented culture and describe a fragmented culture as a very weak culture, or possessing no culture at all (Martin, 2002). In contrast, an integrated culture is one in which the whole organisation shares a single set of assumptions and a differentiated culture contains powerful subcultures, whereas a fragmented culture has many subcultures with no single set of shared assumptions.

[Insert Figure 1 about here]
Analysing culture using symbolism may provide a deeper understanding of an entity’s processes and constructs; however, its apparent lack of measurement does not provide a formula for analysis, change, or improvement. Simpson (2004) observes that people cannot manage what they do not understand and therefore researchers, as well as practitioners, rely on the functionalist-integrative view of culture to understand the nature of culture and how it may be managed to advance the goals of the organisation. This functionalist-integration view of culture, shared by former and current executives of the NAB, forms the basis of the APRA and PricewaterhouseCoopers (PwC), both of whom conducted formal investigations into the Bank’s trading losses.

The functionalist-integration perspective emphasises factors which pervade the whole organisation. However, it’s possible the foreign currency options trading room, in which the NAB incurred its losses, was a separate subculture to the organisation. Therefore, the Bank’s trading room is arguably a subculture to the organisation, suggesting that the rogue traders may have been operating in a functionalist-differentiation culture. However, as Martin (2002) points out, a study focused on a single subculture (in this case the foreign currency options trading room) is adopting an integration perspective, but at a lower level (subunit rather than organisational) of analysis. A differentiation perspective is more effective in analysing the relationships between multiple subcultures with inconsistent cultural manifestations, rather than focusing on one particular subculture. Therefore, a functionalist-integration perspective is as applicable and effective in analysing a culture in one department as it is on a firm-wide basis.
3. LEADERSHIP AND CULTURE

Schein (1985, 1992, 2004) defines organisational culture based on three elements; artifacts, values and basic assumptions. Schein (2004, p.36) states that: ‘…the culture will manifest itself at the levels of observable artifacts and shared espoused values, norms and behaviour … [but] to understand a group’s culture, one must attempt to get at its shared basic assumptions’. Therefore, artifacts and values are the observed manifestations of basic assumptions which form the deepest level of culture and the essence of culture. Thus, in order to understand an organisation’s culture, one must first learn its shared basic underlying assumptions and the processes by which they come into being. The six culture embedding and reinforcing mechanisms listed in Table 1 are the source of the basic assumptions underlying an organisation’s culture. Leaders apply the mechanisms and, in doing so, reinforce and encourage behavioural and cultural norms. Therefore, by applying the mechanisms, leaders are responsible for cultural successes and cultural failures, as well as being the source of cultural change.

[Insert Table 1 about here]

3.1 Cases on leadership and culture

The link between leadership and culture using Schein’s primary mechanisms has been examined by Sims (2000) and Sims and Brinkman (2002, 2003). These authors demonstrate how mismanaging organisational culture can have devastating effects. Sims and Brinkmann (2002) examined the case of Salomon Brothers and the role played by John Gutfreund, the CEO of the investment banking division at Salomon Inc. at the time of the company’s bond trading scandal in 1991. The authors link
Gutfreund’s irresponsible leadership style to a “win-at-all-costs” culture at the bank, which led to the unethical and illegal behaviour of its members. The authors conclude that Gutfreund’s leadership failed the bank and its employees because he: (i) focused his “attention” on short-term profits and disregarded long-term implications; (ii) lied, and covered up ethical and legal transgressions when “reacting to crises”; (iii) as a “role model”, he set an example for secret deals and unethical behaviour being tolerated and hidden; (iv) promoted those with similar values – lacking ethical principles; and (v) had vague policies on “criteria for selection and dismissal” that confused employees and resulted in some ambitious employees crossing ethical boundaries to get ahead.

Sims (2000) relies on Schein’s mechanisms to describe how Warren Buffett, who in replacing John Gutfreund as the CEO, successfully changed the culture at Salomon Brothers after the bond fiasco. However, the culture that Gutfreund fostered was so ingrained at Salomon, that simply removing Gutfreund was not enough. Further steps based on Schein’s mechanisms were necessary to turn the culture away from a short-term win-at-all cost attitude, to that of a responsible corporate citizen. Changes to the firm’s compensation system proved to be the most difficult for Buffett to manipulate. Salomon lost many of its best performing members and the remaining employees had to be assured that their positions were secure.

Sims and Brinkmann (2003) conducted a similar analysis on the Enron failure and the results were very similar to the Salomon Brothers case. The authors had no reservations blaming the top executives for the unethical behaviour that took place within the company, which eventually brought down one of the world’s largest and
seemingly successful organisations. The authors conclude that “……in retrospect, the leadership of Enron almost certainly dictated the company’s outcome through their own actions by providing perfect conditions for unethical behaviour” (Sims and Brinkmann, 2003, p.250).

4. DATA COLLECTION AND ANALYSIS

This paper relies on two in depth reports resulting from official investigations into the foreign exchange (FX) trading losses at the NAB: the PricewaterhouseCoopers (PwC) Investigation Report; and the Australian Prudential Regulation Authority (APRA) Investigation Report. The reports are analysed to test the link between leadership, organisational culture and the deceptive behaviour of the rogue traders.

The NAB’s former CEO, Frank Cicutto, appointed PwC to investigate and report on the Bank’s foreign exchange losses. The report, released on 12 March 2004, includes a section dedicated to organisational culture. The investigation involved a combination of formal and recorded meetings with over 45 bank staff and many informal interviews with bank staff and third parties. The investigators reviewed several thousand emails, numerous reports and a database of some 10,000 transactions. In addition, PwC accessed and analysed the Bank’s tapes containing recorded telephone conversations of the foreign currency options trades in the dealing room. APRA, a government regulatory body responsible for overseeing the integrity of Australia’s financial institutions, released its report on 24 March 2004 — two weeks after the release of the PwC report. The report was similar in scope to the PwC report and relied on the same data sources. The APRA report also listed 81 special remedial actions required to be undertaken by the NAB.
A book written by one of the four rogue traders, David Bullen, titled “Fake: My life as a Rogue Trader”, is the third source of data used in this paper. Bullen’s book is a tell-all recount of the incidents that led to the losses, which the NAB attempted to ban from general release. Bullen’s book was written through the lens of his own experiences, which may not accurately reflect actual events, nor may it be representative of the Bank’s culture, or the opinions of the other traders. Therefore, the book needs to be interpreted with caution. Nonetheless, the book provides a rare opportunity to obtain an uncensored look into the experiences of a key figure at the centre of this deceit, including the dynamics of the relationship between the traders, colleagues and leaders. Lastly, the data source includes relevant media articles and public announcements, which were particularly useful in the period following the release of the investigation reports. Incidents occurring in the aftermath, such as the boardroom scandals following the release of the investigation reports and the board renewal process that followed, were vital to gaining a fuller understanding of the Bank’s organisational culture.

5. THE CASE OF THE NATIONAL AUSTRALIA BANK

The rogue traders

The four traders involved in the currency options trading losses were Luke Duffy (Head of FX Options), Gianni Gray (Senior FX Options Trader), David Bullen (Senior FX Options Trader) and Vince Ficarra (Junior FX Options Trader). The team of traders were supervised by Gary Dillon, the Joint Head of the Global Foreign Exchange operations.

How the losses occurred
The official investigations traced small losses from 2001 — the starting point of the period of official investigations; however, the practice of smoothing profits and concealing losses may have started as early as 1998 when the traders were initially appointed. The losses occurred principally because of increasing risk-taking trading activities, combined with unexpected adverse currency movements. In general, the currency options desk failed to anticipate and protect its positions against a sustained and significant rally in the Australian currency (AUD). In an effort to recoup the losses, and contrary to the Bank’s policy, the traders gambled heavily by taking out massive unhedged positions anticipating an increasing US dollar (USD). However, in September 2003, the USD declined and with a weakening USD, the traders maintained their strategy in anticipation of the USD reversing its position. Eventually, “……. with significant declines in the value of the USD against the AUD, the desk incurred major losses that were never recovered” (APRA, 2004, pp. 14-15).

**Extent of the Losses**

The investigations revealed that the majority of the losses occurred in the final quarter of 2003, escalating rapidly in December. In December 2003, the USD once again went into rapid decline as it had done in September 2003. By this time, the desk increased its exposure and was counting on the USD rallying back after its September decline. Once again, the traders miscalculated the direction of the change and in this short period, the desk’s unhedged position incurred losses of AUD $49 million. In 2004, the situation did not improve as the USD fell further against the AUD and by 9 January 2004 the portfolio’s net USD position incurred further losses of AUD $85 million. The deceit was finally revealed on 13 January, when the NAB announced it had experienced a loss of AUD $180 million from unauthorised dealing within its

How the losses were concealed

The traders were able to conceal their activities primarily due to a weakness, accidentally discovered by one of the traders, in the end-of-day procedures carried out in the back-office. This weakness was referred to as the “one-hour window” (PwC, 2004, p.13). The weakness centred on the end-of-day processing of transactions, which occurred in the morning following the day’s trading activities. The traders entered false transactions before the end-of-day close. This information was then used to prepare management reports and ultimately the Bank’s financial statements. The traders then had a “one-hour-window” of opportunity between 8.00 a.m. and 9.00 a.m. to reverse the false data entered into the system and avoid the system’s internal checks (APRA, 2004, p.16). The traders regularly used this practice to process false trades or deal rates and rollover losses. The “one-hour window” eventually became routine morning behaviour. The fictitious transactions produced profits for the trading desk, resulting in the traders receiving bonuses for 2003 totalling AUD $790 000 and ranging from AUD $120 000 to AUD $265 000 to individual traders (PwC, 2004, p.17).

How were the losses uncovered?

Around 7:00 am on 9 January 2004, a member of the currency options team “blew the whistle” to another member of the team, by expressing his concerns about the true position of the desk. This information was then relayed to Gary Dillon (Joint Head of
FX), the traders’ supervisor, around 11:00 a.m. the same morning. Investigations proceeded over the weekend of 10/11 January, including various conversations between the traders, the analyst and Gary Dillon. Late on 12 January Ron Erdos (Head of Global Markets) was informed of the events. On Tuesday 13 January, the Bank publicly announced the losses and suspended the traders (PwC, 2004, p.20).

The aftermath

In June 2005, the former head of the FX trading desk, Luke Duffy, pleaded guilty to three charges of dishonestly using his position to gain advantage for himself and others and is serving a minimum of 16 months in jail. Gianni Gray, also pleaded guilty and was sentenced in April 2006 to 16 months jail, with a non-parole period of eight months. David Bullen and Vince Ficarra pleaded not guilty and were ordered to stand trial on a number of deception charges. In 2006, Bullen was found guilty of 17 of 19 charges for gaining financial advantages for himself and others, along with one count of gaining financial advantage by deception. Vince Ficarra, was found guilty of all 12 charges against him — gaining financial advantage for himself and others, and one charge of gaining a bonus dishonestly. Bullen was sentenced to jail for a term of 44 months with a minimum of 30 months and Ficarra was sentenced to 28 months in jail with a minimum of 15 months.

The NAB suffered greatly from the scandal. In addition to the known losses of AUD $360 million, the desk was shut-down for 15 months; a new chief executive, John Stewart, was appointed; 30 senior personnel were removed or re-assigned; and the Bank was faced with 81 special APRA remedial requirements, which were expected to be dealt with by the Bank well into 2006 (Myer, 2005). With its reputation in
decline and a shrinking market share, the Bank embarked on a process of rebuilding its culture which, according to the Bank’s executives, may take as long as five years to restore (Moncrief, 2005). The next section examines the Bank’s culture at the time of the deception and the extent to which its culture influenced the actions of the rogue traders.

6. ANALYSIS AND DISCUSSION

This paper relies on Schein’s theoretical mechanisms to analyse the effect that leaders had on one of Australia’s largest financial deceptions. The data contained in the various reports and print media are analysed using the six primary mechanisms that leaders employ to embed and reinforce organisational culture (Schein, 2004).

6.1 Attention

This facet of the Bank’s culture was commented upon most frequently by the investigation reports and later through the media. Leaders’ attitudes appeared to be profit-focused and sacrifices in ethical behaviour were acceptable in the name of profits. APRA’s (2004, p. 6) concerns on leadership values are captured in the following statement:

“Despite some worrying signals of irregular practices on the currency options desk, these were ignored. ‘Profit is king’ was an expression frequently heard in our interviews with corporate and institutional banking staff. As long as the business unit turned a profit, other shortcomings could be overlooked.”

The phrase ‘profit is king’ denotes a dedication to short-term revenues above long-term considerations and creates a climate where unethical behaviour thrives (Cooke,
1991; Trevino and Nelson, 1999, 1995). It also promotes an unrealistic belief that everything is about making money and rules of morality merely act as obstacles and impediments along the way (Wolfe, 1988). Bullen provides the following insight as to how the leaders at the NAB managed the balance between risk and profits:

“When risk starts growing like it was for us, management would normally exercise some control, but it seemed that as long as we were making money, they really didn’t want to upset anyone on the (trading) desk and risk that income stream. So we were pretty much left to our own devices, with minimal interference” (Bullen, 2004, p. 24).

In another passage, Bullen states:

“In the meantime, limit breaches were being sent to us every day. There seemed to be no problem having them signed off and I didn’t hear that we should have the risk reduced in any way. The desk was up over 16 million in December and Mark (Luke Duffy) suggested to me that they wouldn’t do anything, or hassle us in any way, when we were seen to be making good amounts of money……. I had no contact with management above me except Mark, or with other areas of the bank, but Mark was keeping me informed on how we were viewed around the group. He suggested that we were seen as the heroes at the moment and that our desk was thought of as a growth area” (Bullen, 2004, p. 103).

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1 Bullen used pseudonyms in his book when referring to colleagues. Actual names are provided in brackets by the authors of this article. Actual names were determined by relying on Bullen’s descriptions of key characters and then matching these descriptions with the official investigation reports.
The Bank’s leaders appeared fixated with profits and anybody who created profits was unassailable. Even though management did not condone or partake in any of the fraudulent behaviour, they appeared to create an environment for it to flourish. In sentencing Bullen, Judge Chettle said: “I accept that your offending occurred in a culture of profit-driven morality” (AAP, 2006).

6.2 Reaction to Crisis

The crisis at hand, once discovered by top management, appeared to be handled professionally and ethically. The Bank announced the losses immediately and commissioned an external consultant (PwC) to investigate and discover the root of the scandal. The behaviour of the leaders under such difficult circumstances communicated to organisational members a commitment to openness and honesty. However, this was undone in the board’s actions following the release of the investigation reports. The problem initially began with Catherine Walter (ex Chairman of the Audit Committee) who objected to the independence of PwC to investigate the deceit. PwC had been retained by the Bank to be its internal auditor and had reported on risk management matters (APRA, 2004, p.59), and concluded that the Bank had appropriate internal controls (Turnbull, 2006). APRA (2004, p.59) noted that “…….a review of this report in hindsight may conclude that this work is flawed”. Understandably, this caused considerable angst amongst the other directors of the board, as they regarded her claims to be irresponsible and to reflect adversely on the board. Seven of the non-executive directors went as far as proposing an ultimatum, whereby they would all resign unless Walter stood down. Walter claimed that she was made a scapegoat and refused to resign unless the entire board came down with her (Dey, 2004). With the feud threatening to spill over into an
extraordinary general meeting (EGM), the boardroom battle attracted unwanted media attention. The EGM, scheduled to exclusively resolve the issue, was eventually cancelled with Walter agreeing to resign on the basis that other directors also resigned at a latter date to renew the board (Turnbull, 2006). The scandal was embarrassing to the Bank and further tarnished its already wounded reputation.

6.3 Resource allocation

The creation of budgets and decisions among projects competing for limited resources reveals a leader’s underlying assumptions and impacts on the corporate culture. However, resource allocation did not appear to be an issue that was relevant to the unethical behaviour of the rogue traders.

6.4 Role modelling (how leaders behave)

The PwC report identifies management style that focused on processes, documentation and procedure manuals, rather than understanding of the substance of the issues and resolving them by accepting responsibility. The traders were operating within an organisationally-wide ignorant and bureaucratic culture. The traders were attuned to management ignorance and used it to their advantage.

“In my experience at the bank, I had no contact with any management above the level of the currency options desk head. I had never even met Sam’s (Gary Dillon) boss, for example, and there appeared to be a ‘leave it alone’ attitude as long as all seemed to be well. This was a little ludicrous, with all the managers up the tree happy to believe what was told to them from the level below. Management at higher levels seemed preoccupied with running the business and took little interest in what was going on below them unless they
were forced to get involved. This was politics, pure and simple. Tell the people what they want to hear and no one will rock the boat. Give no one reason to doubt and they will look no further” (Bullen, 2004, pp. 84-85).

On one occasion when the market risk managers questioned the traders about a suspected undeclared $12 million AUD loss, the traders replied that the transactions were complicated and the loss couldn’t be calculated by multiplying 2 million by 6, which of course it could. The risk managers accepted this explanation without further investigation. This sort of behaviour was considered a great source of amusement by the traders as noted below.

“We joked often over the following months, if the bank had people who knew how to multiply 6 by 2 million and believe the result, we would all be cut down to size at the least, if not marched out the door” (Bullen, 2004, p. 50).

Bullen’s (2004) account of such events is consistent with the PwC report highlighting an abrogation of responsibility amongst management, stating that management only “passed on” responsibility rather than assuming it (PwC, 2004, p. 32). Additionally, leaders had a tendency to closely manage the flow of information so as to discourage the escalation of noticeable issues reaching the Board, or downplaying the gravity of the issue. “Managing the message was frequently given equal, or greater, priority than dealing with the underlying issue” (APRA, 2004, p. 74). For example, the 2002 and 2003 review letters from APRA were not circulated to the Board. The 2003 review letter was circulated to the Board’s Audit Committee but only after a member of the committee enquired about it. Even then, the letter was accompanied by a memorandum that was dismissive of the issues raised by APRA. Responses to such
letters were generally prepared by the market risk department without any higher management participation or endorsement (APRA, 2004, pp. 74-75).

6.5 Allocation of Rewards

In general, the traders were rewarded with year-end bonuses, which were substantial in comparison to their salaries. At the time the losses were announced, bank policy required a minimum 15 percent risk management component to be included in a structured performance management system for all trading room staff (APRA, 2004). APRA’s investigation found that these measures were neither respected nor applied by management surrounding the currency options desk. In fact, even when a performance appraisal for one of the traders identified excessive risk-taking as a concern, no action was taken. Bullen (2004, p. 39) notes that bonus negotiations extended for at least four months and created excitement amongst the traders. Normally, management asked each trader personally for their opinions on appropriate bonus amounts. This provided the traders with an opportunity to predetermine their profits. The PwC report uncovered the following in regard to bonuses:

“Various taped conversations between three of the traders in September and October 2003 included comments about the need to make budgeted profits for the year to 30 September 2003, and for losses to remain concealed to ensure that their bonuses would not be affected” (PwC, 2004, p. 17).

The absence of penalties is equally as effective on employee behaviour as it is from the allocation of rewards. The unethical behaviour and attitude of the traders toward other divisions deserved the strictest form of discipline. The APRA report notes how management failed to control the domineering and bullying behaviours of the traders.
APRA identify repeated personal and professional attacks and aggressive behaviour towards market risk and internal audit staff. In fact, APRA states that there was “……clear evidence on occasion of senior front office management being at the forefront of such attacks” (APRA, 2004, p. 73). So, not only did the leaders fail to discipline the traders, leaders also participated in such behaviour. Bullen provides many other examples of inappropriate behaviour that went unnoticed or was consciously ignored. For example:

“Another one of the more amusing parts of working on the desk was the mockery wall. We had a ladder on the wall marked with the jub ranking (the word the traders often used to describe people at NAB they considered stupid) and a list of names. The names moved up and down the ladder depending on what people did that seemed stupid. There were also derogatory remarks placed on them which were designed to mock the bank” (Bullen, 2004, pp. 36-37).

The mockery wall, with employees watching on, continued until the traders were eventually asked to remove it. However, the traders never faced disciplinary action or punishment. As Bullen (2004, p. 103) stated, “……we were the ‘heroes’ of the bank; we could do whatever we pleased as long as we were bringing in the profits “(Bullen, 2004, p. 103).

6.6 Criteria for Selection and Dismissal

The Bank recruited traders who, with hindsight, demonstrated a total disregard for anyone other than themselves. The Bank also sought traders who had the ability to create outstanding profits and how they created such profits appeared irrelevant. Gary
Dillon, who was recruited to re-establish the Bank’s flagging currency options desk, was responsible for recruiting the four traders (Bullen, 2004, p. viii). However, APRA contends that Dillon was irresponsible and arrogant in dealing with this task. Dillon chose to circumvent the formal recruitment process by not carrying out standard procedure, such as conducting external reference checks (APRA, 2004, p.76). Dillon also ignored suggestions not to hire Bullen, which were made by other trading room staff. Bullen commenced his career with the Bank in 1993 when he accepted a position in its graduate recruitment program. During this period, Bullen describes his boss as someone he “……didn’t see eye to eye with on a number of issues” (Bullen, 2004, p. viii). A few years later, Bullen accepted a position with an American bank in Singapore. In 2000, Dillon recruited Bullen to the NAB as a Senior Currency Options Trader. Bullen described his first day back at NAB as follows:

“The surroundings – and many of the faces – were familiar, but not comforting. In my first stint at the NAB, ……. I had obviously rubbed people up the wrong way. The impression must have lasted …… I shrugged it off … In the past I hadn’t given a sh*t about anyone except me, and hadn’t hidden it very well. Probably nothing had changed either” (Bullen, 2004, p. 1).

Promotions within the currency options team only further perpetuated the Bank’s problems. For example, the Bank promoted Dillon to Head of Global Foreign Exchange and Dillon was given the responsibility to select the successor to his vacated position. Dillon promoted Duffy on the grounds that he worked with Duffy longer than any of the other traders. The other traders often disagreed with Duffy on the levels of risk associated with his trades and for this reason Bullen questioned Duffy’s leadership ability. Bullen believed Duffy was excessively ambitious and
would put his own wellbeing ahead of others. As observed by Bullen (2004, pp. 79-80) “…there is evidence that Dillon also didn’t agree with the ethical nature of some of Duffy’s trades but he choose to ignore this when promoting him to Head of FX.”

Finally, Bullen’s personal behaviour and lifestyle outside of the bank did not appear to cause concern amongst management. Bullen (2004) regularly refers to his abuse of alcohol and drugs and recalls times when he would go to work directly from the pub and how the drugs taken at weekend dance parties hadn’t worn off in time for his Monday shift. It is also evident that that his disturbing habits were made apparent to his colleagues as “…he was often referred to as ‘pill boy’ on the trading desk” (Bullen, 2004, p. 31). Bullen eventually underwent a lifestyle change that saw his nickname change from ‘pill boy’ to ‘Buddha boy’ in his search for enlightenment through Zen Buddhism (Bullen, 2004, p. 74). Bullen recalls how he would sit on his desk disinterested in his work, while reading books on ‘enlightenment’ (Bullen, 2004, p. 76). To the extent that Bullen’s behaviour may have been noticed or brought to the attention of his superiors, where one would normally expect a response, even if pastoral in nature rather than punitive, it appears that it was ignored thus giving sanction to his achievements as a trader.

7. CONCLUSION

This paper has conducted a study of organisational culture that was operative within the NAB (particularly the FX trading room) during a period in which four rogue traders incurred and concealed losses of AUD$360m. The purpose of this paper is to determine the extent of influence on the traders’ behaviour from the Bank’s culture. According to Schein’s (2004) mechanisms, the Bank’s attention emphasised profit;
the Bank’s reaction to the crisis sent confusing signals when the board’s integrity plummeted with in-fighting over the independence of PwC Report; role-modelling by the Bank’s leaders was dismissive and focused on form over substance; the allocation of rewards to the traders encouraged risk taking beyond prescribed limits; and the Bank appeared to have recruited traders that had a reputation for creating outstanding profits. Consequently, such mechanisms developed a culture that not only condoned but possibly encouraged the deception.

Leadership themes at the NAB appeared to focus on profit, processes, abrogation of responsibilities and impediments to the escalation of problems that portray a dismissive management style. Issues were ignored or deferred to another and, in doing so, management neglected their responsibility for rectifying the identified problems. Such leadership reduced the chance of detecting and dealing with the traders’ behaviour and may have inadvertently fed the traders’ delusion that they could conceal the losses just long enough for their trading fortunes to turn round. This false sense of hope eventually created an irrecoverable AUD$360 million loss. As it turned out, the Bank was fortunate that a colleague took it upon himself to blow the whistle. Even though the leaders never participated in any of these deceptive activities, they arguably fell short of their responsibility to prevent such incidents. In fact, the ‘ethical climate’ they created implicitly encouraged the traders’ behaviour.

Changes at the Bank since the announcement of the losses include the resignations of various staff and board members. The more notable departures have been that of the CEO Frank Cicutto, the Chairman of the Board, Charles Allen, and the Chair of the Audit Committee, Catherine Walter, who, as mentioned earlier, left somewhat
reluctantly. The new leaders at the NAB have had to make a conscious effort to implement cultural change. The new CEO, John Stewart, has declared in a recent speech that:

“…the PwC report made comment of the NAB culture and it said there was much more of a focus on process than the substance of the issue and, in some ways, that’s probably true. The other thing it said was that there were not, within the organisation, clear accountabilities and responsibilities and that’s something we can fix. And also, the report said that we have a good news culture. Now a good news culture is fine apart from if it prevents bad news coming up and I think it does. And that’s something that we’re addressing just now because, obviously, everyone wants to know when a problem is a small problem; you don’t want things to blow up. Now, if you add those issues from the PwC report to the fact that we’ve got a rather bureaucratic culture and we’ve got a tendency to over complicate, you can see how by improving the culture of the organisation we can make quite a difference.” (NAB group, 14/5/04, Address to the Securities Institute by John Stewart).

Cultural change requires a deep and personal commitment. Stewart will need to consider himself more as a ‘Chief Ethics Officer’ than anything else (Trevino, et al., 2000). He will need to communicate a strong and strict ethics message that will genuinely and personally commit his co-leaders. The leaders will need to be quite knowledgeable and understanding of their powers and responsibilities. Only when the leaders at NAB have established these characteristics can they proceed and systematically address the issues discussed in this paper in the context of Schein’s six primary mechanisms. Only then, can the NAB move forward.
8. REFERENCES


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Figure 1: A classification of culture as a variable.
<table>
<thead>
<tr>
<th>Mechanism</th>
<th>Description</th>
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<tbody>
<tr>
<td>1. <em>What leaders pay attention to, measure, and control</em></td>
<td>Attention is concerned with communicating signals to employees on important values. Lower-level staff will continually align their focus with their leaders by being alert and interested in their leaders concerns, satisfactions and criticisms.</td>
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<td>2. <em>Reaction to crises</em></td>
<td>The manner in which leaders and others <em>react to a crisis</em> reveals important underlying assumptions and creates new norms, values and working procedures. Even though a crisis is a matter of perception, Schein (2004) asserts that an organisational crisis tests a leader’s values and makes them visible for everyone to see. Schein (2004) further states that heightened emotional involvement increases the intensity of learning such values because people vividly remember emotionally-charged situations.</td>
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<td>3. <em>Resource allocation</em></td>
<td>Employees’ behaviour and attitudes and their personal goals are influenced by the leaders’ decisions on where and how they allocate the resources are and how the resources are expected to be utilised.</td>
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<td>4. <em>Role modelling</em></td>
<td>Role modelling is concerned with how leaders behave and the example they set for others to follow. Leaders’ visible behaviour communicates assumptions and values to subordinates because employees will often emulate leaders’ behaviour and look to their leaders for cues on appropriate behaviour (Sims &amp; Brinkmann, 2003). Colloquial phrases such as ‘actions speak louder than words’ and ‘walk the talk’ is the premise that underlies this mechanism.</td>
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<td>5. <em>Allocation of rewards</em></td>
<td>An organisation’s leader can quickly communicate priorities, values and assumptions, by consistently linking rewards and punishments to particular behaviours (Schein, 2004, pp. 259). Members of an organisation learn from their experience with promotions, performance appraisals and discussions with superiors. The similarities between <em>rewards and status</em>, and <em>attention</em> are evident, yet they are not the same. The allocation of rewards and punishments crystallises employees’ impression of important values communicated by leaders.</td>
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<tr>
<td>6. <em>Criteria for selection and dismissal</em></td>
<td>Selection of employees who resemble present members in style, assumptions, values and beliefs, reinforces the leaders’ preferred values. Selection and dismissal is described by Schein (2004) as a subtle but potent method, in which culture is embedded and perpetuated by the organisation’s leaders.</td>
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2 Resource allocation was added as the sixth mechanism in Schein’s (2004) edition, being an addition to the five mechanisms advocated in the earlier versions of Schein’s work (1985 and 1992).