Transformational Leadership in Banking – Some Regulatory Perspectives[1]

At the outset, I share my deep condolence and grief on sudden passing away of Shri Jyoti Kumar Pandey, Senior Program Director for this event with everybody else who knew him. His not being here today is something which is difficult not to feel every moment.

Introduction

It is always a privilege to be amongst officials assuming leadership role from both sides of the regulatory line. Firstly, I presume, there is no participant in the room who completely subscribes to inborn leadership theory or at least, the institutions deputing them for this program certainly do not. Secondly, regulation has absolutely no explicit bearing on leadership in banking and you will scarcely come across the word 'leader' or 'leadership' in any of the regulatory directions issued by RBI. Management experts, however, often say that self-regulation is key to leadership effectiveness and excellence. Self-regulation comes from the right kind of self-cultivation which is a lifelong process. Combining these two postulates, the weeklong program on banking leadership is expected to be a right pivot to transform managers to leaders and leaders to more effective leaders by scrubbing the path of self-cultivation through actionable insights. Transformational leadership could be one of the most over-used and mis-used term since it's coining in 1970s. We all tend to learn, even before learning mother tongue, to categorize the world around us and leadership styles are no exception. If anyone has not heard about different categories of leadership styles, you have to wait until last session on Day-4 of your programme; transformational leadership being one. Regulatory perspectives of its applicability to banking can only be triangulated from various contexts and regulatory intents or expectations. The psychometrics of transformational leadership and its contrast with transactional leadership, which most bankers are, best left to experts. I will attempt to enumerate select buildouts relevant to both regulators and the regulatee for transformational leadership.

[1] Keynote address by Jayant Kumar Dash, Executive Director, Reserve Bank of India in CAFRAL Financial Sector Leadership Program in Mumbai on January 6, 2025. The views presented are not necessarily that of RBI.

2. In an era of constant disruption, noticing the most demanded ability to lead transformation and drive change is unmissable. Transformational leadership is basically premised on the fact that everyone can lead, and particularly in transformative moments, everybody contributes to, and cocreates, the organisation they are part of [i]. In ideal form, it trains on transforming followers into leaders through positive changes in their working lives. As per the transformational leadership theory, tapping into the followers' self-concept and inner motivations, transformational leaders drive commitment to success. In leadership training, the term typically crops up in the context of change management and strategic planning to develop and deliver a specific vision for a team or the institution, or to change the culture of the institution via breakthrough changes in followers' attitude. Transformational leadership is decisive in any fast-paced industry like banking as it drives change and innovation. At the core of transformational leadership are four orienting concepts - being, relating, knowing, and doing, that assist in the framing and development of the organisation[i]. Further, transformational leadership is made up of four separate elements[ii], called four I's, of (i) Idealized Influence; (ii) Intellectual Stimulation; (iii) Inspirational Motivation and (iv) Individual Consideration.

Banking Regulation and Mediating Effects of Transformational Leadership

3. Regulation, with its stress on rules, controls and compliance processes developed on past experiences / crisis is effective in generally static context and environment. However, in a dynamic operating environment today, 'pacing problem' becomes increasingly discernable. Regulatory requirements are often complex and porous at the same time, falling short of achieving regulatory goals of long-term safety and soundness. Rules tend to incentivize banks to follow it in letter and not the spirit, often finding bypasses through loopholes. Resultantly, regulations have a tendency to multiply as they ease the responsibility for deciding what's right or optimal, unless consciously managed. The notion that control and compliance alone equal good banking may not be the whole truth as banking leaders are often ambushed by their inattentional blackouts, or strategic blind spots. Hence, the importance of creating effective, future-adaptable regulation needs to be iced with effective self-regulation and that is where the transformational leadership comes in. Such an approach is expected to cover both known knowns and known unknowns.

4. Most participants might be aware of the concept of ‘net regulatory burden’. Rules, compliance and control processes imposes costs and resource ‘burdens’ on banks. The ‘controlling’ or ‘checking’ approach of regulation inherently runs counter to ‘enabling’ approach under quintessential transformational leadership. The degree and dynamics of regulation in the context of transformational leadership depends on maturity level of both the regulator and regulatee. In theory, net regulatory burden can be significantly minimized through transformational leadership. Interchange of regulatory constructs with transformational leadership can be, in the current environment, analyzed through mediation of certain correlative aspects such as organizational culture, governance, and human capital reforms and innovation, which I propose to discuss:

: Organizational Culture and Conduct

5. While attention to culture in the banking context by regulators is a recent but welcome phenomenon, organisational culture is a well-recognized concept for long. The relationship between regulation and culture is more nuanced than simply being a choice between the two approaches to build better banks; seen as complementary or competitive in different dimensions:

(i) Accountability and Governance: Accountability is an inalienable aspect in the relationship between regulation and culture building. Regulation globally holds the individual as well as the institution to account. The leaders, unlike regulator, tend to manage culture even if they cannot measure it very well.

(ii) Asymmetric nature of influence: Under twin peak model of banking regulation, it will not be uncommon to find a dichotomy between regulatory requirements and customer delight. Even innovations in banking need to pass through sand boxes. Culture, however, is more symmetric in its influence. Hence it is never a choice between regulations and culture but a great culture is essential for transformational leadership even when focus is on regulation.

(iii) Locus of control: Regulation is externally imposed unlike culture building. The tendency of leaders to credit achievements to own efforts and failures to external factors is not uncommon. Internal choice works better than external imposition in transformational changes making culture better suited to challenges of building great banks. Regulators can help such process by building platforms and research infrastructure for best or effective practices and making culture a part of supervisory review process.

6. Postmortems of Global Financial Crisis of 2007-08 often attribute it to internal and external governance failure on multi-fronts and institutional / corporate culture was often under regulatory spotlight. De Nederalndsche Bank (DNB), the prudential supervisors for banks in Netherlands studied the behavior patterns and cultural aspects of the banks since 2010 essentially on three premises viz. (i) increasing rules and regulations for banks are not enough; (ii) banks' connection with public trust and financial stability and (iii) behavior and culture being part of sound business operations[iii]. Regulators across the world have increased attention to conduct and risk culture, representing a departure from historically quantitative-based prudential supervision. Indeed, some financial regulators are making efforts to determine what would this imply in terms of the skills and capabilities of regulatory resources and their traditional approaches, as well as their own internal cultures and practices. Several regulators have taken an optimistic view of this issue and have been experimenting with alternative approaches. DNB, for instance, hired psychologists to observe and analyze bank cultures. The Singapore Monetary Authority. on the other hand, is establishing AI and data analytics capabilities.

7. Examples of regulatory initiatives in this direction can be seen in quite a few global jurisdictions. In the UK, the Banking Standards Board conducts an annual assessment of the culture and conduct of banks, providing participating banks with valuable benchmarking data regarding how they compare to peers. The Fixed Income, Currencies, and Commodities Markets Standards Board has introduced actionable standards on behavior and statements of good practice. Since 2015, the Financial Stability Board has coordinated international initiatives aimed at reducing misconduct risks, most recently releasing a toolkit for institutions and supervisors to improve corporate governance. These tools address cultural drivers of misconduct, enhance accountability and personal responsibility, and address the phenomenon of "rolling bad apples." Culture, however, continues to pose the challenge to regulator as it cannot be regulated and enforced in traditional ways. Promoting culture through industry level

strategic interventions and institution-based interventions is one option. Strategic level steps mean cultural assessment like prudential management, governance practices and risk management in supervisory review process. A 'culture of culture' is considered to be the operating environment of which compliance is the core part. Accountability may be another dimension of regulatory options. At individual institution level, looking at assessment of HR functions, understanding the running culture and future destination and institutional process to record critique and learn from cultural failings may yield useful outcomes.

8. Culture is never an option as it bootsteps itself anyway with each bank's culture being almost unique. No user manual or a short-term engineering project can set up culture but only the key role played by leadership works. So dynamic, culture compels a switch from linear thinking of simple cause and effect relationships to a holistic perspective by identifying and correlating the whole system of visible and invisible interacting parts. Focus on risk-management and compliance processes in banking culture is often regarded as risk averse and control-oriented resulting in standardization and rule-intensity. Cultural markers such as management failures, malignant leadership failures, challenged governance, institutional or systemic governance failure can often be easily linked to various stages of governance challenges. In the context of transformational leadership, the cultural trade-offs to regulation are generally analyzed in different pairs of dimensions[iv]. These pairs include values as a wealth-driver vs as a protector; being open to mistakes vs. zero tolerance; leadership vs. fellowship; conformity vs. challenge; independence vs involvement; enforcement vs. avoiding or exploiting regulation; common sense vs. runes and regulations; empowerments vs rules and tight rules vs. loose rules; qualitative measures vs quantitative measures; innovation vs. control; risk-seeking vs. risk-avoiding; trust vs. accountability; profit vs. public value; human capital vs. human cost.

9. Values create commonality, but beliefs create differentiation. Employees tend to focus on their present values and beliefs generally unmindful about what they valued or learnt in previous situations. The chronicles of the financial services industry would show that a narrow view of values creates polarizing behaviors and remissness to other values groups with varying governance systems. Often, structures, decision-making, accountability, rewards, or risk management approaches are guided by a

different belief influenced by the dominant values group. A universal approach to bank culture may be about connecting values from across all the values groups into the governance system. Evidence of continued governance failures demonstrates that leaders work from their own perspectives and experiences rather than integrating a multi-values-group approach. Indian work culture is generally seen as status-quoist value predisposition rather than transformational outlooks. This emanates from clan orientation, hierarchical orientation, emotional orientation and more focus on strength of thoughts rather than action[v]. Studies to show that millennials like to work in organizations which provide freedom to take initiative, opportunity to experiment and express views, performance-based recognition, equity and fairness and opportunities for learning and development[vi]. These findings have implications for the type of leadership which Indian banks need – may be a shift from the typical hierarchical orientation to more egalitarian approach combined with a mentoring and reverse-mentoring compounded.

: Governance and Human Capital

10. Board level governance is the key for delivery of transformational leadership in sophisticated and business-critical manner. The time horizon for which the board needs to think and guide decisions increasingly become larger than tenure of any individual board member. As a long-term steward, board should guide management in direction of increasing significance of a digital age and an increasingly connected world with more regular geo-economic risks requiring decision in the face of uncertainties. In today's environment, backward-looking indicators of risk might be misleading[vii].

13. Human capital is the x-factor in bank governance[viii] and application of HR principles to board matters and functions make significant difference in transformational leadership. The performance of the banks under multiple regulatory oversight underlines the crucial existence of soft factors like personal ethics and institutional culture. Leaders breaking down organizational barriers, taking new approach to talent, developing incentive structure that delivers, cultivating digital culture and being purposeful through better say-to-do ratio have seen more success. Crucial HR reforms may be fundamental to bring about changes in the quality of talent and a strong

leadership pipeline. Constant reorienting of resources through upskilling, scaling up new skilling to work with machines and creating new forms of value may answer the need of the hour. HR space often remains less-attended or sub-explored at the higher echelons of banks, somewhat departmentally relegated which result in a mere transactional view of human capital rather than its applicability in improving transformational contribution [iv].

: Innovation

14. To quote Satya Nadella, longevity in this business is about being able to reinvent yourself or invent the future. Transformational leadership, with its power to inspire and motivate the realizers toward a shared vision, is central to driving organizational innovation. However, the specific mechanisms through which it influences innovative work behavior in the banking sector still need to be fully understood. A study[ix] to examine the mediating role the four dimensions of psychological capital—self-efficacy, hope, resilience, and optimism—play in the relationship between transformational leadership and employees' innovative work behavior indicated that transformational leadership was related to employees' innovative work behavior directly and positively. Furthermore, the results showed that hope and self-efficacy partially mediated the relationship. The results imply that to be innovatively effective, organizations need to manage both employees' contextual (transformational leadership) and psychological (psychological capital) resources to enhance their innovative work behavior. An intricate relationship exists among transformational leadership, creativity, and innovative work behavior within banking organizations.

15[x]. Transformational Leadership style has been evaluated as the strategic tool to enable innovation. It plays a key role in developing the process, structure and climate for banks to become innovative through a team attitude and spirit for the generation of new ideas. Practices of transformational leadership stimulate employees to perceive the new task as a challenge that may foster creativity. It acts as a fuel for innovation by promoting idealized influence (ID), inspirational motivation (IM), intellectual stimulation (IS) and individualized consideration (IC) among an organization's members. Although it may impact innovation directly, this direct effect may be enhanced by the mediating role of several constructs, specifically, knowledge sharing.

Converting knowledge into a configuration that can be integrated and applied by others can be a force multiplier. When transferred, received knowledge helps banks to generate a new knowledge base enhancing innovative activities. A note of caution here would be about striking the right balance between innovation and compliance. Transformational leaders should be adept in navigating complex regulatory environments while still pushing the envelope on technological advancements. Managing the tension between risk and innovation is often the challenge.

Differentiators of Transformational Leadership

16[xi]. When practiced consistently, five differentiators underpin a capability for leading ongoing transformational agenda. They are: (a) making sense of the world as a basis for reimagining how the bank is going to create value in a new, more complex system; (b) setting radical ambition, committing to help address a significant problem and compelling the organization to undergo fundamental transformation to achieve it; (c) achieving promised outcomes, getting personally involved in reconfiguring the system to enable the organization to go beyond what it knows how to do and fulfil its ambition; (d) acting as a catalyst, attracting and bringing together the very different capabilities and talent needed to solve the problem the organization has set out to address; and (e) powering the engines, so leaders and their teams remain energized, grow, and develop throughout the transformation, and beyond.

17. In the context of transformational banking leadership, some personal traits that need nurturing include design thinking by putting customer first; not losing focus on business conduct, risk thinking, engaging and communicating, taking decisions in the face of conflicts and dilemma, acquiring cultural intelligence, making connections, offering rigorous challenges, encouraging reflection, systems thinking, learning and anticipation. It will be relevant to make a mention of the cognitive bias WYSIATI[xii] (what you see is all there is). Decision-making by leaders is often not entirely based on rational thoughts, but on automatic reactions based on heuristics, or rules of thumb, that are developed or have hard-wired into brains. Hence, the transformational leaders must have bandwidths to focus on 'enabling capabilities' rather biased by 'availability heuristics'[xiii].

Strategy for Transformational Leadership in Banking

18. Peter Drucker famously said culture eats strategy for breakfast. Culture, therefore, should be at the center of reform process focusing on regulation, rules, controls and compliance to reverse a stage of diminishing return. A unique characteristic of cultural transformation is the change from fixed mindset (accepting constraints as a given and fixed/limited possibilities for improvement) to growth mindset (exploring different ways to improve through engagement of employees , new vision and innovative thinking[xiv]. When this cultural change happens, change becomes self-sustaining in nature and sets off a chain reaction of positivity and alignment to bigger cultural goals. Given that other approaches such as regulation, control and compliance have already been tried, the three strategic actors in the banking industry I.e regulator, government and boards/CEOs should now encourage transformational cultural change and transition from fixed to growth mindset in banks. Strategies for transformational leaders for success include proactive new mental models; working the edges of the organization rather than only from the centre to pick up weak signals of change; sharing leadership more systematically and make empowerment live up to its promise[xv]

19. As a mediation to what I mentioned in the context of board governance, transformations are often, but not always, initiated and led by the apex or the center. Proximity, i.e close relationship with customers, understanding their deepest challenges, is critical, given the mercurial nature of sentiment and behaviors. Hence, before ensconcing at the center, reaching out to customers, partners, and employees on the front line to understand their needs, frustrations, and problems for a meaningful diagnosis is desirable. For leaders which don't have their finger on the pulse of those at the "edges", being transformational may be difficult. Research suggests that people have two distinct hedonic self-regulatory systems, promotion self-regulatory focus and prevention self-regulatory focus. Individuals in promotion focus are sensitive to the presence of gains and positive results. Promotion focus will significantly influence job satisfaction through moderating transformational leadership. Further, promotion focus is positively related to job satisfaction, and promotion focus has a significantly positive influence on transformational leadership[xvi].

20. Leaders who over-prioritize commercial growth and profitability above their duty of care for customers are likely to eventually fail in regulated environments, often more catastrophically than in other sectors. Leaders who move from successful careers in non-regulated sectors frequently struggle, finding their entrepreneurial instincts reined in[xvii]. They can become frustrated by what they see as unnecessary control. They need to quickly develop their ability to judge which controls are indeed too burdensome, and which are needed to prevent risks or demonstrate compliance. Many such leaders appear dismissive of the concerns of regulators, who then place their institutions on higher monitoring. Leaders need to learn the rules of their new game quickly, and judge carefully when they need to be disruptive, without being dangerous. These incomers must build a relationship with their regulators, given their familiar styles.

: Digital Strategy and Leadership

21. Digital leadership has become the new lens to transformational leadership. It implies a combined compact between digital technologies and strategy influencing the transformational leader. In India, 'clickaracy' i.e keypad literacy is much higher than ordinary literacy or numeracy. A fuzzy discipline like strategy differs between structuring under traditional and digital technology led context. Platforms and eco systems operate on a different strategic basis than the traditional or conventional business of banking. Digital tailwinds add a new dimension to leadership, regardless of the stated digital maturity of a bank as the banking strategies effective in last decade may no longer be valid - warranting a focus on a new operating models and governance. Starting from the current extent of digitalisation and the degree of needs to be led strategically and culturally would influence the strategy in broader and deeper ways, including through new business models. Addressing strategic dilemmas, such as value creation or value capture and cost minimization or differentiation, implicit in traditional strategy literature would need to be treated as distinct processes[xviii].

22. The construct of digital culture is a different, not being an overcasting layer or part of the existing culture. Mere implementation and use of new technologies can easily come a cropper without an effective digital culture. Planting the seeds of digital cultures to make banks to be futureproof irrespective of tomorrow's technologies. Certain estimates suggest that around 66% to 84% of digital transformation efforts fail

to deliver the expected value and 70% companies in a reported minimal or no impact. Another survey found that the top 10% of digital companies were growing revenues at five times the speed of laggards.

: Customer Orientation

23. Traditional forms of customer inertia is a passe; traditional paradigm of banks owning customer is under threat as customer expectations are changing with financial services becoming part of broader transaction or lifestyle events. Good banking today is also about ‘enabling’ capabilities around customer focus, innovation, and effective risk management processes. The biggest threats and dangers banks face in business are the ones that are not seen – not because they’re secret or invisible, but because leaders are wilfully blind[xix].

Effectiveness and Limitations of Transformational Leadership

24. Despite being an influential leadership style, the effectiveness of transformational leadership varies according to the context. It may thrive in dynamic, creative, and adaptable environments, but it may not be the best fit in stable, structured or status-quoist contexts. When the economic outlook is positive, then transformational leadership is a preferred approach. However, in times of crisis, a transactional leader with focus on getting the company back on track may be more effective. In other words, the leader does not need to be either transformational or transactional but needs to be able to cater to the external driving factors of the banking business. While both traditional transformational and transactional leadership, have their places in different situations, best leaders can change their style suitable to the changing situation and demands. Leadership is a skill and not a position.

25[xx]. Transformational leadersh has positive effects on various performance outcomes of employees; however, its productivity has been called into question because of a relative neglect of its negative aspects. This paradoxical perspective indicates that conflicting positive and negative effects of transformational leadership can coexist. Integrating the principle of diminishing marginal utility and the “Too-Much-of a-Good-Thing (TMGT)” effect, some research discovers an inverted U-shaped relationship between transformational leadership and employee task performance. The inverted U-shaped relationship between transformational leadership and employees' task performance is generally moderated by employees' proactive personality.

26. Excessive focus on the leaders and not the team often leads to unintended consequences. The financial services industry is often constrained by limited resources by contracting margins, increasing regulation, or time constraints that inhibit the rollout of new ideas. Further, cost minimization approach limits the ability of a transformational leader to make necessary changes to keep the business competitive. However, smart prioritization and creative leveraging of existing assets can also lead to fresh approaches and positive change. Trying to balance changes in operations and strategy while meeting immediate needs can lead to a challenging leadership fatigue. Resistance to change from employees or clients is another challenge that many transformational leaders face. By spelling out the "why" behind new initiatives and creating a culture of transparency, transformational leaders can help abate resistance and stimulate an environment of growth.

Conclusion

27. Transformational Leadership is an important component for any organization in the financial services industry. It is nobody's case that regulations are not necessary, but regulations should neither be the only way to build safer and better banks or an end unto themselves for transformational leadership. Culture is an alternate way to build self-driven and stronger banks, particularly when the features of new-age banking are baked in. The future of banking will be driven by new technologies, newer business models, complex and interlocked ecosystems, a multi-generational work force, and novel economic / financing needs. Transformation leadership in banks need to be driven by flexible cultures that have initiative and risk taking, experimentation, organic structures and collaboration as their dominant features. A culture based on rules, controls and bureaucracy is not well adapted to this new age banking and is likely to encounter new risks and failures [iv]. Banking industry needs to exit a transactional banker mindset and apply itself to the challenges of the commercial goals and not meeting leadership gaps through short term and ad hoc or floating plans. Understanding the key principles of transformational leadership, along with its

advantages, challenges, and limitations is crucial for those seeking to implement it in their organization.

As I conclude, I wish the sessions during the rest of the day more transformational for the participants. Thank you.

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[i] Handbook of personal and organizational transformation – Alfonso Montuori and Gabrielle Donnelly, 2018
[ii] Transformational Leadership Theory of Bernad A Bass
[iii] Supervision of Behaviour and Cultures – Foundation, Practice and Future Developments, De Nederlansche Bank (DNB)
[iv] Culture and Chanelling Corporate Behaviour, A research project by ACCA and ESRC
[v] Organizational transformational agenda for Indian Banks by Late Pritam Singh and Asha Bhandarker
[vi] Millennials and the workplace: Challenges for architecting the organization of tomorrow by Pritam Singh, Asha Bhandarkar et al
[vii] Elizabeth McCaul, Member of Supervisory Board, ECB, April 2023
[viii] Human Capital and Ethical Banking Governance: Some perspectives from India, Anil K Khandelwal
[ix] The Role of Transformational Leadership in Developing Innovative Work Behaviors: The Mediating Role of Employees' Psychological Capital by Saeid Karimi, Farzaneh Ahmadi Malek, Ahmad Yaghoubi Farani, and Genovaitė Liobikienė
[x] Does Transformational Leadership matter for innovation in banks ? The mediating role of knowledge sharing – Sherine Al-Ahmad Chaar and Nasser Fathi Easa – Beirut Arab University.
[xi] Transformational Leadership for extraordinary times - by Peter Brown, Mahadeva Matt Mani, Blair Sheppard, and Nicole Wakefield of PWC
[xii] Daniel Kahneman, Book "Thinking Fast and Slow", 2011
[xiii] Availability: A heuristic for judging frequency and probability, Tversky and Kahneman, 1973
[xiv] What Having a "Growth Mindset" actually means – carol Dweck, HBR, January 2016
[xv] HBR, May 2021, 4 Actions Transformational Leaders take by David lancefield and Christian Rangen
[xvi] Regulatory Focus, Transformational leadership and Job Satisfaction by Huang Jingjing and Hao Yingqui
[xvii] Leadership under the Microscope, Beth Ahlering and Gary Storer
[xviii] Building a Digital Organization: Strategic, Cultural and Leadership Imperatives – Institute for Advance Studies in Complex Choices
[xix] Willfull Bliandness, Margaret Hefferman
[xx] Is Transformational leadership always good for employee task performance ? Examining curvilinear and moderated relationship by Yashuo Chen et al , December 2018