Challenges in Change Management in Central Banks

(Based on the Systemic and Process Approach to Total Quality Management and Operational Risk Management)

Progress is impossible without change, and those who cannot change their minds cannot change anything.

George Bernard Shaw

The best way to predict future is to create it.

Peter F. Drucker

People don’t resist change. They resist being changed.

Peter Michael Senge

Abstract: Someone said long time ago that everything is subject to change and that change is the only constant. If changes, as occurrences of long duration, are viewed through their temporal dimension, we will see that they are unstoppable. This is how it has always been and how it will always be. What is a novelty, however, is that changes have accelerated over the recent years and this trend could continue in the future. Scientists have been warning that this acceleration of changes should be taken very seriously because these are not some kind of sporadic and accompanying occurrences of limited effects and duration but ongoing and dynamic processes taking place in every sphere of social life to varying degrees. Successful change management, therefore, has been increasingly gaining importance and becoming the conditio sine qua non for a sustainable development of organisations and, therefore, of financial and banking institutions. Although I tried to focus on central banking here, it could be said that the key challenges in change management in central banks are much alike challenges that arise throughout the financial and banking system from which they are inseparable. Certain specific
features that are characteristic of a central bank are primarily determined with the importance this supreme monetary authority has not only in the financial system of a country, but also in the entire society. The main task of a central bank is the preservation of price and financial stability, and indirectly and keeping in mind the global interconnections, even broader than that. Acceleration of changes in all spheres of social life calls for not only the need to question the traditional understanding of change management in central banks, but also to redesign and innovate the existing models thereof. If central banks change following the principles of quality management and if they successfully manage risks and become more committed, powerful and transparent in strengthened their role in the area of social responsibility, they will have the opportunity to go down the road of success, regardless of all temptations that will be waiting for them on this road.

Key words: change management, systemic approach, process approach, total quality management, operational risk management, financial and banking system, central banks

JEL classification: E58, M00

1. Introduction

In order for institutions in the financial and banking systems to successfully manage changes, they must create an environment that will allow the application of the systemic and process approaches to management. These approaches promote full customer orientation, continuous improvement and innovation, team leadership and teamwork, and in particular, full involvement of employees in all work processes and, as required, in decision-making. However, this is easy to say but not that easy to implement because the systemic and process approaches to organisation management are very complex and demanding tasks. These approaches inevitably require certain changes in order to create awareness in organizations, not only of those who manage and work in these organisations but also of their customers and stakeholders. These approaches allow for effective and efficient achievement of sustainable success because they are beneficial to the organisation and its overall improvement. It is very important that people who manage organizations realise on time that it is much better to meet ever accelerating changes than to lag behind them because changes are inevitable and everyone will face them, sooner or later.

Although central banks are conservative institutions by nature and not prone to rapid changes, we cannot say that these are not dynamic systems that do not change to the extent inherent to their purpose of existence. Those who work in these institutions for a long time consider this to be an advantage not a handicap because they have seen in practice that any accelerated change, and in particular radical ones in conservative organisations such as a central bank entail a big risk. Fast-paced and extensive changes can cause functional disturbances in
its numerous and diversified subsystems that would not change synchronously. Practice has shown that too rapid changes greatly reduce the possibility of synchronous effectiveness and efficiency. All this could lead to some disintegration of the system, and this means many different problems and conflicts. This, however, should not be an excuse to the financial and banking sectors to fail in timely anticipation of changes, their creation, improvement of their work processes; in other words, failure to give full and ongoing attention to changes. This sector, as one of the most important subsystems in the social and governmental system and its bloodstream, should have to be more aware and up to date with changes in the environment, and in certain segments to be changing faster than the system itself.

Let us remember the financial crisis that erupted in late 2008 and is still ongoing, and which consequences will be long felt. The financial, and especially the banking sector, have been blinded by enormous profits and failed to timely anticipate, create and innovate; simply put, they did not adequately manage changes. When the crisis already emerged, stereotypical contingency plans were being prepared but without any significant results. Many early warning mechanisms that had already been in place failed to detect danger in timely manner. Moreover, they proved to be insufficiently functional and ineffective, which means that change management was unsuccessful. Joseph Stiglitz links the causes of the crisis to untimely and inadequate change management, defining them as follows: “Sins of both commission and omission – most notably, excessive deregulation, a failure to effectively enforce the regulations that existed, and the failure to adopt new regulations reflecting changes in financial markets – made the economies of the United States and, to some extent, Europe vulnerable to collapse. These failures led to the crisis and have continued in its wake” (Blanchard, Romer, Spence & Stiglitz 2012, p. 31).

Although the creators of the financial boom at the beginning of this century have been identified as the main culprits of the current economic and financial crisis, its severe consequences have been suffered by everybody else other than those who caused it. Paul Krugman believes that “the fundamentals of the world economy aren’t, in themselves, all that scary; it’s the almost universal abdication of responsibility that fills me, and many other economists, with a growing sense of dread” (Krugman, 2012). Such an approach to the rapidly changing world should be changed everywhere, even in these institutions, but this will not be easy because it is necessary to change the awareness and it is most difficult to change. All the aforesaid could apply to any organisation, but here we focus on the financial and banking sector, including central banks, as in these turbulent times of crisis, much greater social responsibility for overcoming the crisis is expected from cen-
Central banks as well as financially (and not just financially) powerful institutions than from other institutions. We have often witnessed that these institutions are the ones that are often the target of numerous discontent people worldwide. And if life problems of people are not quickly and adequately addressed, such occurrences may be more frequent and more dramatic as time goes on and people find it increasingly difficult to get by. But ‘profit and profit only’ are the words that are often heard in the business world. Ichak Adizes worryingly notes: “Profits should not be the goal. They should be the constraint: Of course we do not want to go bankrupt, but the goal should be to make a better world. The benefit must be higher than the cost — and I’m talking about the cost not just to the company but also to the world, to society, to our children” (Adižes 2011a, p. 155).

Accelerating changes and the current economic and financial crisis have made all advantages and disadvantages of the global society whose backbone is the “digital world” come to surface more clearly than ever. Another issue has also emerged here and it is not exactly encouraging: How come that in the informational, technological and in every other sense we are more developed than we have ever been, yet we are not able to successfully cope with many nowadays problems? Many have lived in the illusion that the “digital world” can solve everything quickly and efficiently. Such thinking is very dangerous for young people but also to all others who think alike and are addicted to it. The virtual world can be intoxicatingly imaginary, yet the life is inevitably realistic. Economic problems will not be solved either by the “virtual consciousness” dictated by the information capital or by economic theories offered by “virtual economy”. People need fast, clear and concrete solutions from a real human and not from some “virtual” character. Something they will truly believe.

Someone has wittily said that there is no difference between theory and practice - except in practice. Theory is necessary, but it predominantly remains in the sphere of imagination. If it were only to theory and theoretical considerations, there would never be a crisis because everything is mostly thought out in theory. Life, however, is different. We should learn lessons from life, and not just those of yesterday but those experienced by many generations before us and which we call historical lessons. Have the institutions in the financial and banking sector, including central banks, drawn lessons from the recent crisis? Even in the full swing of the crisis, Krugman viewed this through the prism of preventive actions “Everything that needs to be regulated in a financial crisis, because it plays the key role in financial mechanisms, should be subject to regulations in normal times with a view to preventing excessive risk-taking” (Krugman 2010, p. 200). The philosophy of change management, as well as risk management, should primarily aim at preventive acting. In order to successfully manage both changes
and risks in crisis times, these should be much better managed in normal times. As vividly noted by R. S. Kaplan and A. Mikes, “A firm’s ability to weather storms depends on how seriously executives take risk management when the sun is shining and no clouds are on the horizon” (Kaplan & Mikes 2012, p. 58).

2. Systemic and process approaches to change management in central banks

Everything in this world is a system. The Earth is a system as well - it is divided internally, but externally it is round and complete. And each system, by its nature, is composed of subsystems. The Earth, as a perfect system, consists of numerous and various subsystems such as continents, countries and cities. The rule, therefore, is universal and applies to every system, every organisation regardless of the business it pursues, including financial and banking institutions and central banks as well. Since anything that consists of subsystems at different levels is considered a system, everything is subject to change. When a change occurs, however, subsystems do not change synchronously. A lack of synchronization creates gaps that manifest themselves through what are initially called problems, and later a crisis, if the problems are not tackled in timely and appropriate fashion but are left to expand and erupt.

It may sound paradoxical, but while on one hand we develop owing to changes, on the other hand, the very same or new changes will make us stagnate sooner or later. And so this goes on forever because this is the road that has no end. John Harold Johnson was obviously right when he said: “Whatever has made you successful in the past, won’t in the future”1. While it is necessary and cannot be stopped, any change ultimately leads to both integration and disintegration as the respective roots of every success and every failure. Why is this so? Because a lot of things change before people realize that benefits brought by the old changes have well worn. And despite all kinds of progress, not only that the problems have not disappeared but they have merely changed appearance, becoming more complicated to deal with and expanding their range substantially.

From one reason or the other, neither people nor organisations are eager to make changes. Why is the resistance to change so deeply rooted in people’s minds so they feign them rather than truly implement them? A funny yet insightful answer to this question was given by Peter Michael Senge: “People don’t resist change.

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1 John Harold Johnson is an American business and publicist.
They resist being changed!" (Sengi, 2003). However, if they must change, people rather choose small over big changes. Small changes require less effort, entail fewer problems, speed of change is less conspicuous, expectations are low, and everything is much easier to be “put under control”, including trials and surprises. Big changes, however, represent big challenges to any system, its management and employees. Nevertheless, they also represent a great opportunity and entail a big risk.

Why is this so?

Because there has to be a good judgment of timing the changes, it must be determined in advance who is going to lead and carry them out at each level, support forces, and what is more important - how and at what pace they should be implemented (extremely carefully, thought out, programmed and controlled and not without a “brake”, without synchronization, “mindlessly”; organically rather than mechanically). Bearing in mind that changes are constant, the foundations have to be extremely strong so that they could stabilize, build into the system and their infrastructure consolidated, as well as make them functional and effective. All this, in one way or the other, is necessary to repeat the entire life. Adizes advises that whenever we are faced with a change that requires us to behave differently, we ask ourselves these questions: “Who needs to change? (and here you start from yourself). How big is the change? Is the commitment to change proportional to the size of the change? Is the price you are willing to pay proportional to the size of the changes you want to make? Are you launching big ships in shallow waters or in sufficiently deep waters?” (Adižes 2011a, p. 128).

Peter Drucker warned that before you go on with a change you take a good look at the steps you can take “in order to change and to stabilize the change.” When you make a decision or implement the change, ask yourself “Who should be informed about it?” He says: “For me the tension between the need for continuity and the need for innovation and change was central to society and civilization” (Draker 2006, p. 40, 45). What does this mean? It means that there is no point in starting everything all over again like nothing has existed or has been good before you, which, unfortunately, often happens in this region. Where executives are alternating per political or any other directive, discontinuing practices of the previous management in all aspects and at all costs can be detrimental to successful management of changes. Precious time can be wasted on experimenting with what in general should not have been experimented with. It is necessary to change only what is not good and continuously improve and innovate everything else. And not to forget that after the occurrence of the change it has to be incorporated into the system to avoid system disintegration process instead of integration.
It is the nature of people to feel safest in a familiar and stable environment, which is not characteristic of changes since they bring along uncertainty and unease, as well as numerous problems. People, as we have already said, do not bother about changes that happen to others, but they reluctantly accept and implement them if they refer to themselves, especially if they are to interfere with the privileges they have acquired. Simply put, both people and organisations would like to live and work peacefully and avoid problems. But this is not possible, and even if it were, it would not be good for neither of them. People and organisations could temporarily avoid problems if, temporarily, they would be able to stop changes - but their systems would inevitably die out. For changes, in fact, make life. Where there is no life, there is no change. The same applies to organisations of any profile, so in that sense, central banks as well.

In order for both people and organisations to become more sustainably successful, they must build their own system of success and continuously improve and innovate it, especially its weakest parts because the system is only as strong as its weakest link. Brian Tracy believes that you cannot reach the results you want if you think like a layman so he says: “You must have a system. Without a system that will enable you to integrate ideas that you’ve learned, you are like a person trying to put together a jigsaw puzzle without having seen the picture of what it represents. Any system or blueprint for success is better than none at all” (Trejsi 2005, p. 36).

People need to be meticulous in developing and preparing their plans of changes since changes do not include only progress but also problems that need to be addressed. Many problems arise from our failure to adapt to changes. If managed timely and adequately, there is no need to fear changes and problems they entail. Ichak Adizes claims that problems induced by changes can be proactively tackled because their causes are predictable, which means that every phase in the change management has a predictable chain of events as well as predictable problems (Adižes 2011b, p. 237).

In addition to this, there are no changes that are linear and that progress in a straight line, especially those that are rapid and radical. Even if they are skilfully managed, you cannot go only straight forward, but you must also go backwards. Usually you must take a few steps forward and at least one step back. As time passes by, the distance between these steps reduces, leading to the escalation of problems as well as conflicts. Constructive conflicts do not represent problems because they are unavoidable in the process of change management and can often be beneficial, unlike destructive conflicts that may occur if there is insufficient mutual trust and respect for proper conflict resolution in an organisation. Full
significance of the human factor – both of the management and employees – is best recognized in change management. It is unreasonable to expect that organisations can perform better if people who manage them fail to change for the better. On the other hand, employees can give a full swing to an organisation with their latent creative abilities and energy, balance the systems and processes, and effectively work on continuous improvements.

Decision-making should be based on the principles of quality management and risk management, paying particular attention to their synergistic effects as the key segments (Luburić, 2012). If central bank employees successfully manage operational risks whilst managing processes based on total quality principles, they will also be able to manage changes.

As a paradigm of business excellence, total quality management has the ability to stabilise and strengthen the key prerequisites for development and sustainable success of central banks, regardless of all limitations. Operational risk management, on the other hand, is predetermined to be an indispensible managerial tool that allows central banks to survive in all circumstances. The focus is on a comprehensive and continuous improvement and innovation of the system and processes, with the participation of all employees and their full commitment to preventive actions in emergency and unforeseen situations such as natural disasters and the like (Claudio, 2011; Woods, 2011).

Total quality management represents a philosophy that is based on continuous improvements and efforts by all employees in the organisation aimed at understanding, meeting and exceeding requests, needs and expectations of users. It also represents a learning system and a collection of several methods, techniques and tools needed to meet the needs of users, employees, business partners and stakeholders. Quality acts as a pillar that supports this corpus of approaches and participants in the system, and in addition to other management systems, it is especially complemented by risk management. Total quality management relies on several approaches, but essentially depends on efficiency of implementation of the process approach and involvement of employees (Hubert, 2010). As pointed out by O. Rentzhog (2000, p. 17-18, 42) “the result never gets better than the process that forms it, and therefore, working with process is a key principle.”

3. Leadership and change management in central banks

Talented persons, that is, leaders of changes are crucial for the successful changes in all organizations, in particular in central banks (Peter F. Drucker). They have a
chance to survive in times of fast structural changes, precisely due to their capability to see the chances and possibilities and not only threats and danger. To the leaders of changes, as well as to those who are not leaders, Peter F. Drucker sent the following message: “Do not “master” people. People should be guided. The goal is to make special virtues and knowledge of each individual productive”. In particular, Peter F. Drucker thought that managers, in general, make bad decisions related to the promotion of employees: “Percentage of good decisions does not exceed one-third. In the best case, one-third of decisions turn to be good, one-third is very efficient while one third is completely wrong. Other management areas do not have that bad result”. In addition, Drucker claims that the most important decision is in relation to the top position, which is the most difficult decision to be cancelled: “If we do not spend four hours on appointing a person, we will spend four hundred hours on correcting our own mistake”. Drucker was amazed how “completely innocent” people, become bosses: “The largest waste of resources I have ever seen in all organizations was wrong decision on promotion” (Draker 2003, p. 68).

If management wants to be successful, it has to take proper decisions as well as to implement them. This is not an easy task, since each management consists of people with different personalities, which means different management styles. In order to bring proper decisions, in addition to competences and moral qualities, managers have to work as a team, to cooperate and be devoted to reaching goals. However, this is not always the case, since all managers do not share same interests. Maybe the goal is the same in the beginning, but as time goes by and changes speed up, different interests emerge not only among managers, but also among employees. Therefore, mutual trust and respect are the keys for a successful change management and for the success of every organisation, including banking and financial institutions as well as central banks. Faster and more radical changes generate more complex problems, which calls for mutual trust and respect.

Team work and team leadership play special roles in change management in central banks. Top management has critical responsibility, while activities of middle and lower management, including all employees, play very important roles. Team work in change management in central banks is not only a precondition for its establishment and development but also for its survival. Managers and people we work with represent the key to our success or our failure. According to many management theoreticians, the most important decision is the decision on staff selection, which is confirmed in practice. Management is a very complicated process – it represents skills, science, privilege, profession, knowledge and talent. In reality, it represents managerial skills. Ability to engage staff for different tasks
represents the base of the management. For example, if a governor and his/her team in a central bank do not emphasise the importance of change management and processes improvement, no one will pay any special attention to this. Bad examples are followed primarily by those who are closest to them despite the effort not to do so.

The first responsibility of the management is to show results, thus, imputation of guilt to others is not a good choice. Thereby, this is not an easy task. On the contrary, “a manager must, so to speak, keep his nose to the grindstone, while lifting his eyes to the hills – quite an acrobatic feat”, as Peter F. Drucker once explained. Managers should be at a high enough level to have the authority to make a decision and on sufficiently low level to know the details. Finally, a successful management requires competences rather than formal positioning. In many organizations, especially in central banks, a typical hierarchical and functional approach is still dominant and this creates difficulties in focusing on main tasks, creation of values for beneficiaries. Thus, it is necessary to focus more on beneficiaries than on hierarchical structures, although this is much easier to say than to implement in a traditional (and still transitional) society.

Success in central bank operations depends mostly on its managers. Thus, it is very important for them to be honest, competent and responsible. Employees should contribute to success as well by working hard, by being loyal to the institution in which they earn much more than employees in other institutions, and by loving their job. Anyhow, we should be realistic – few organizations were closed down due to incompetent employees, but many of them collapsed due to incompetent managers! For those who are just initiating changes aimed at successful management and those who already reached success and want to maintain this level as much as possible, I tried to create twenty guidelines towards this goal based on discoveries and life experience of many eminent scientists, philosophers, traditional wisdom, as well as on my own research and life experience, convinced of their efficiency in organisations such as central bank. However, feel free to judge for yourself … (Luburić, 2010).

1. Focus should always be on people. Search for the best among them, which primarily refers to honest, competent and hard working ones. Haters and schemers are not welcome especially as associates or, even worse, as friends.
2. Make an effort to make good decisions regarding staff, otherwise you will take risk of generating worse results. You are risking your reputation as well as the reputation of your institution.
3. Be open-minded and do not stop the process of hiring young, competent and talented people. You cannot have too much of such people. Nevertheless, do not estimate life experience – experience is everlasting life coach.

4. Support women in organizations, you will not regret. Foster adventurous spirit as it stimulates changes, and considers enthusiasm as a driving force of your organization. Do not hobble imagination. Your future will be limited only by limits of your own imagination!

5. If you haven’t done this already, introduce team work, do not suffocate creativity and individuality. Create opportunities for leadership on every level. The one who tries to do all work by himself and to take all credits for it will never be a good leader. A good leader is the one who works on making himself replaceable.

6. Lead by trying to win people over and command them only if necessary. Manage facts. You should know this as well – keep your friends close but your enemies even closer, if you can recognize them for who they are. But don’t despair. Greatness of the many was paved by their enemies…

7. Keep an open dialogue with your associates and subordinates and point to the importance of respect and trust. Try to help them whenever you can. To have is to give – the hand that gives is above the hand that takes, and life gives you back only what we give to others. Communication is one of the most important elements of success.

8. You have to set up goals because if you do not have your own you will be forced to work on achieving the goals of others. Goals are not destiny; they represent directions and a road. Live in harmony with nature and ethic principles, and let your inner peace become your ultimate objective.

9. Always welcome changes, choose priorities, and delete the unnecessary from your life. There is nothing so useless as doing efficiently something that should not be done at all.

10. Never ignore your “inner voice” and intuition. They transcend knowledge.

11. Follow business trends and be forward-looking. Business, as any other game, has its players, language, rules, controversies and rhythm. The best thing is when money works for you and not when you work for money! And remember: the one who knows when enough is enough, will always have enough.

12. Praise and encourage people skills, especially innovation and innovators. Innovations should be assessed according to their contribution to the market and buyers. Thus, make an effort to make sufficient investment in innovations in order to be prepared for the day when you profitable business becomes outdated.
13. Set very high standards and introduce a quality system. Cheap quality is expensive, good quality is cheap.
14. Improvement, improvement, improvement (this refers to the entire organization). You cannot improve your products if you do not improve yourself.
15. Use benefits of the digital technology – but keep your soul. In the digital world, information flow is your bloodstream. Not only that the big eat the small, but in many cases, the fast eat the slow.
16. Always have time for your family, especially for your children. They represent the measure of your success and they will be your future judges.
17. Preserve health. A healthy person has thousand wishes, and a sick person only one – to get well. Therefore, keep smiling – smile heals soul and follows success.
18. Whenever you reach success celebrate it with your family, co-workers and friends.
19. Find the measure of perfection if you can as nobody has found it yet. If you don’t succeed, always strive for perfection. This means you should make and effort to be as perfect as possible. Perfection represents an attempt to be better than others. Therefore, in order to become successful, work hard and in order to stay successful, work even harder!
20. Finally, try not to miss the goal when you get so close to it; so, be as careful at the end as at the beginning. Don’t forget your failures in the moments of success or your benefactors. And pray that success does not come before you are ready to deal with it.

Conclusion

This paper has focused on challenges in change management in central banks in times of accelerated political, economic and technological changes, more frequent natural disasters, terrorist attacks, and other external events. Our analysis is focused on systemic and process approach to total quality management and operational risk management, since these are two very compatible and complementary approaches which synergic effects may substantially contribute to a more successful change management in central banks. Comprehensive but gradual and continuous changes designed as small steps in which all employees are participating and which are based on continuous improvements may give better results than when they are fast and radical, and they are much more applicable in institutions such as central banks, even if they are very limited in coverage and time.
For change management to be adequately implemented in the financial and banking sector, specialised knowledge in finance, banking and central banking is not sufficient any more. This also requires many other interdisciplinary knowledge, experiences and skills. The world in which we live and work is more advanced than it has ever been, and at the same time it is becoming more and more complicated, complex and unsafe place for living and changing much faster than we could have imagined it. Looking at the big picture, the world is a large and complex system consisting of many subsystems. When subsystems do not change simultaneously and do not coexist for the sake of the entire system, disturbances occur that lead to disintegration and problems. If these problems compound and are not resolved in timely manner, various turbulences and crisis are bound to occur. Why do we link all this to the financial and banking sector when it has “survived” the crisis, continues to make profit, and even follows the same old patterns of behaviour? Because risk and change management in these sectors have proved to be unsustainable and unacceptable in many aspects, especially observing from the aspect of social responsibility. These institutions should anticipate changes in timely fashion, create and manage them properly, which is, de facto, the most complex part of this task.

If financial and banking institutions, in particular central banks as the regulators and supervisors act as self-sufficient isolated islands lagging behind changes instead of anticipating, creating and managing them in a proper manner, if they fail to work on fast-paced introduction and implementation of the systemic and process approaches to management, especially change and risk management, if they do not realize that accelerating changes also change our environment and that external events may have disastrous effects if they fail to ensure timely and proper response, they will find themselves on a slippery and foggy road – with much more severe consequences than in the case of the existing crisis. The sooner they realize this the sooner they will be facing numerous challenges arising from the accelerating changes. However, we should have in mind that starting with timely changes does not represent any reliable guarantee of success, even if they are properly managed. But, this is certainly one of the key and inevitable preconditions for reaching success. In simple words, if organizations do not manage changes successfully, they will not be able to manage anything with success, even if these are central banks.
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