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Panel 31.4 The Baltic states: The East-European sub-prime?

WORK IN PROGRESS –DO NOT QUOTE OR SPREAD

Organizing finance

The case of the Swedish banks in the Baltic states

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Introduction

Despite periods of “de-regulation” in a neo-liberal fashion, transnational regulation has been recorded as an exploding activity (Djelic and Sahlin-Andersson, 2006) that seem to go hand in hand with globalization. Standard bodies, international organizations, transnational regulation bodies issue various kind of rules for others to follow. Indeed, organizations and organized activities seem expand at the same time. We live in an organized world (Ahrne and Brunsson, 2006). Financial markets are often brought forwards as an example of globalization, yet the organizational dimensions of financial markets are less focused on in the current post-crisis debate. Even though the financial capital is global, the organizations in the markets are embedded in the national economy. This is particularly the case of banks.

Indeed markets for credit, capital, risk, or simply the pricing of money- is a truly global phenomenon. These markets have fuelled globalization, since money is a fluid and global good. The internationalization of capital is not only beyond states, but can be described as being beyond the interstate system (Sassen, 1998). At the same time however, the major actors in financial markets, investment and commercial banks are subjected to national regulation and supervised by national authorities. These authorities coordinate their activities transnationally (the Basel II framework is a typical example of such a coordination), yet it is the Swedish Financial Supervisory Authority that inspects the activities of Swedish banks. Thus, even though the object of inspection (capital, credit and risk for instance) is as global as it can be – the organizational structures in which this inspection is embedded and enacted is strongly connected to nation-states. This organizational aspect of financial markets became rose to the surface in the Baltic Sea region during the financial crisis: the Swedish

banks were embedded in the Baltic economies and regulative structures, however it was the Swedish state (i.e. taxpayers) that would act as a lender of last resort in case of a collapse. Taking the regional interplay around the Baltic Sea of the financial crisis as a point of departure this paper argues for an increased focus on the organizational dimensions of financial markets.

The financial crisis of 2008 has been described and analyzed by many. A general conclusion is that states need to agree transnationally on how to regulate and supervise financial markets in a more efficient way, in order to prevent crisis in the future. Debates among politicians, economists and the media have picked up on the topics of supervision and transparency. The regulative responses on national and transnational levels have focused on the financial instruments and activities that are seen as central in the financial markets: securitization, hedging instruments, ratings etc. A major problem of the markets is depicted as the complexity and opacity of these instruments and activities. They evolved in such manner that they became difficult price in a correct way for the market itself - the market could not perform its central task, or so the story goes. Discussions in international fora such as at the G20 meetings, Basel committees, IMF conferences have lead to several packages of new or revised standards, regulations and principles. These are directed towards these various *activities* on the financial markets and products created.

Regulative responses in the aftermath of the crisis can be summarized as being about enhancing *transparency* in the financial markets. What we need in order to avoid a new crisis is to have more data, and better information about the financial markets it has been claimed (ref). For instance that is the message of the IMF and the Basel committee. This way these markets will be better controlled. Risks have to be assessed in a better way. As an example the Financial Standard Board (FSB) advocates more macro-prudential regulation, which is about assessing the vulnerabilities of the whole financial system. The idea is thus that because financial markets are interlinked all over the world, this creates systemic markets risk. The pre-crisis regulation and risk assessing models were not sufficient, we need more. The “solution” is thus framed as being about collecting more data about the markets. More supervision is needed in order to “reveal” or make “visible” activities that were previously obscure.

However, even though they are appealing as ideas, in order to have any practical relevance they have to be translated and enacted in the financial practice. This practice to a large extent takes place within in the banking system. Banks are central actors in financial markets, this becomes particularly obvious in times of financial crisis. Do bankers agree with the picture presented? To what extent can transparency and supervision be a solution and what do these ideas actually mean in the organizational financial practice of banks? This paper will draw on an investigation of the crisis in the Baltic Sea context, focusing on Sweden and the Baltic states.

Despite inspection bodies and regulations to prevent crisis, a remarkable feature of financial markets is indeed their repeated crashes. Economists talk about “bubbles”, and can show with figures and numbers their frequent existence. A financial crisis in it turn is often blamed on insufficient regulation and lead to re-regulation. That is what we are witnessing today: a general cry for more supervision, regulation and “transparency” in order to prevent a similar crisis as the 2008 one to happen again. The European Union is creating new transnational regulatory frameworks and supervision bodies in order to be better able to scrutinize the financial markets. The opacity and complexity of the financial markets, and their models and numbers are seen as a primary cause of the crisis. To prevent future crisis remedies thus focus on supervision. This paper suggests that the financial markets in general and the financial crisis in particular, can also be interpreted in organizational terms.

Banks are here viewed as organizations acting on and shaping financial markets in transforming states, they are thus central actors on a changing field of international governance. Less than 20 years ago Baltic states did not have any developed financial system. After intense years of transformations and adaptations to western models, to a large extent orchestrated by external financial institutions (the IMF and the World Bank in particular), the countries became regarded as “fully fledged market economies” with “functioning financial markets” (EBRD transition reports). Yet, the global financial crisis put these new markets, and economies to a severe test.

Global and European financial organizations as well neighboring states and private organizations have been important actors in creating and restructuring this field. But it is not enough to analyze the actors as such, to understand the developments one needs to question and investigate how these organizations came to play the roles they are playing, and through which practices they organize and shape their environments. Studying the activities of the Swedish commercial banks in the Baltic states, which includes decisions taken in board rooms in the 1990's as well as the monitoring activities in the countries after crisis, the paper argues that a different elements organizing need to be taken into account to understand the changes in the field. The study of the Swedish banks in the financial markets of the Baltic states is also used to make a more general claim: there is a need to study practices in organizational “micro” levels to understand the broader “macro” phenomenon such as financial crisis.

Organizing markets: theoretical backdrop

The internationalization of markets is a development that has spurred globalization of the economy. Globalization in its turn is one of the main driving forces for regulation on the international level. It has been claimed that an important feature of globalization is the creation of transnational fields of governance populated by “others” such as international organizations that tell “actors” such as states, multinational companies how to act (Meyer, 1996). In these fields new actors appear and old actors get new roles. In order to understand how globalizations happens we need to understand the processes of organizing taking place on the transnational arena (Djelic and Sahlin-Andersson, 2006). Organizing need to happen only within formal organizations but can take place on transnational arenas of various kinds. It is also possible to think of organizing outside of organization by using the term organizational “elements” as coined by Ahrne and Brunsson (2009).

Financial markets can be taken as an example of a highly organized form of market. First, many formal organizations (both private and public) populate these markets, as in most spheres of social life. Second, financial activities are organized, also outside of the formal organizations. To claim that markets in general can be viewed as subjected to organization.

Callon (2007) argues against a view of markets as non-organized. His arguments focus on stating that markets: are organized (1) and that this organization should be a topic for discussion and decision-making (2). Callon claims that it is important for society to acknowledge the fact that markets are organized and that they can be organized in different ways. Thus, researchers, politicians, well society in general ought to engage in a discussion concerning how “we” should organize markets. The organization of markets is treated as something that can be steered from “outside”: it is not the market that organizes itself, this is a political act, an act that should be informed by researchers. (Cf Callon and Muniesa, 2005; Barry and Skater, 2002)

Focus is put on markets as arena of exchange, and it is this exchange that we can choose to organize in different ways, depending upon our preferences. According to Callon, markets can be seen as political

tools, they are objects that can, and should be focused upon as controversial: there is no single way to organize markets. The organization of markets should be opened up for debate and for scrutiny so that we can opt for a good type of organization of the markets in question. Depending upon the type of exchange and its role in society, different types of organization might be more or less fit. What Callon does not do is to discuss what the organizing of markets consists of. The focus is not on the content of organization or what different types organizational option or structures there might be. How can we understand the mechanisms of organizations at work on markets? In order to get an insight in the organization of markets, it might be a good idea to start from knowledge about the organizing of organizations. This is what Ahrne and Brunsson (2009) do when they develop a framework for studying organization outside of organizations, for instance on markets.

Ahrne and Brunsson (2009) on the contrary start from theories about organizations and develop a framework to study organizing outside of formal organizations. The main argument can be summarized as follows: formal organizations are decided orders, which in order to be “complete” (i.e. what we would call formal organizations) need to have certain organizational *elements* present. Five elements are identified: hierarchy (1), membership (2), rules (3) that are monitored (4) and positive and negative sanctions (5).

However, order does not exist only inside of organizations. By using one or several of the organizational elements outside of formal organizations, order can be created. This is what Ahrne and Brunsson (2009) would call “partial organization”. These elements can be present outside of formal organization, one by one or in other constellations. For instance, if we take financial markets as an example: they present several of the elements of organization. There are rules created especially for the financial markets. There is a lot of monitoring in the financial markets: financial supervisory bodies and central banks monitor actors such as banks on the financial markets. There are also sanctions coupled with the rules on the markets. Taking organizational elements as a point of departure we could thus perhaps move a step further in analyzing *how* markets are organized.

This framework does not relate directly to financial markets but could be used to study any market. Another Swedish scholar, Jesper Blomberg, proposes an “organizational perspective” on finance (Blomberg, 2005). Blomberg sees society as becoming increasingly “economized” partly due to the growth of the financial markets. It thus becomes a duty of organizational theory to study financial markets in order to understand the development of society. Further, as many other spheres in society financial markets are populated by various organizations. The actors within finance are organizational and studies of these actors ought to be informed by the findings of organizational theory. We ought to direct questions about the structure and culture of places such as the stock-market, investment banks etc. By analyzing the organizations that are active within financial markets we will get a better understanding of the financial markets. The actors are not rational as is presumed by mainstream theories of finance. Rather, we can expect them to be boundedly rational, guided by norms, values and organizational (and other) culture. The organizational perspective on finance here adds up to studying the people that work within the formal organizations present on the financial markets.

Rather than dichotomizing between the ideal types of “market” and “organization”, we might need to start studying how financial markets are organized, both inside and outside its formal organizations. Perhaps organization is neither a “perspective” that can be used to understand financial markets nor an assemblage of elements? What if organizing is actually at the core of financial markets?

A practice that is highly present in financial markets, and that has an organizational power is the collective trust in numbers. One could even claim that financial markets are numbers, since the

tradable commodity (be it money or risk) materializes through numbers. In fact financial markets, having no tangible commodity, could be depicted as a market for numbers. To put it bluntly, financial markets create money out of money, and this money is made visible through its appearance as numbers on various screens and sheets. If we stop trusting in the figures, there is not much left, is there? The financial crisis can be understood as a crisis of trust. Activities such as risk-ratings and others that create trust in numbers can thus be seen as central organizational elements of financial markets. Financial markets are great illustrations of objects that are shaped, depicted and organized by a collective agreements and trust in numbers.

The use of numbers and ratings can be seen as a regulative mechanism. Several mechanisms of regulation have been identified, “monitoring” is one that has an important mechanism of transnational regulation (Jacobsson and Sahlin-Andersson, 2006). Monitoring can be connected to explosion of an “Audit Society” (Power, 1997) in which an increasing set of organizations and organized activities are made fit for monitoring, or made “auditable” (Power, 1996). This enhanced scrutiny in various forms (it may come in the shape of accrediting, rankings or ratings) goes hand in hand with a collective trust in rationality (Meyer et al, 1994) and a trust in numbers (Portland, 1994). Financial markets are great illustrations of objects that are shaped, depicted and organized by a collective agreements and trust in numbers. Finance would not be possible to make sense of it weren’t for calculations and numerical models. One could even claim that financial markets are numbers, since the tradable commodity (be it money or risk) materializes through numbers. Financial markets thus illustrate the mechanisms at work in an Audit Society: a trust in rationality and in the visibilities such as numbers. It is thus not a surprise financial crisis – which as crisis in trust in general and in the trust in numbers in particular – has lead to a call for enhanced transparency. And it is commonly presumed that better and more monitoring and supervision will create more transparency.

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Yet, the literature of from the Audit Society (Power, 1997) field shows, this type of scrutinizing activities do not create transparency in any straight forward way. What is to be “made visible” (i.e. transparent) has to be constructed first to be possible to “see”. Or with other words, there is no such thing as a performance external to the process of auditing. Auditing constructs performance. Transferred to the financial market crisis context, there is a need to explore the practices that create the numbers in which we trust. Enhanced and new kinds of supervision will probably create new practices “fit for monitoring” rather than making old ones more visible. Here research can fill an important role, by unconditionally exploring and making sense of what the actors in the market actually do, what they measure and monitor. How do bankers make sense of rating risk and of their risk models? What do they mean in practice? By entering the processes of organizing and going beyond, or should one say below, the numbers, organizational research can provide important insights about financial markets.

Further, the internationalization of markets is a development that has spurred globalization of the economy. Globalization in its turn is one of the main driving forces for regulation on the international level. It has been claimed that an important feature of globalization is the creation of transnational fields of governance populated by “others” for instance international organizations, that tell “actors” such as states, multinational companies how to act (Meyer, 1996). In these fields new actors appear and old actors get new roles. Several mechanisms of regulation have been identified in previous reserach, “monitoring” has been depicted as an important such mechanism of transnational regulation (Jacobsson and Sahlin-Andersson, 2006). Monitoring can be connected to explosion of an “Audit

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Case study and method

The Baltic states offer a critical example of an institutional context where financial organizations (commercial and investment banks in particular) have been active in shaping the markets – indirectly the states – in general, and the financial markets in particular. Global and European organizations as well neighboring states and private organizations have been important actors in restructuring the Baltic states to become EU-members and functioning financial markets (Jacobsson, 2009). But it is not enough to analyze the actors as such, to understand the developments one needs to question and investigate how these organizations came to play the roles they are playing, and through which practices they organize and shape their environments (Czarniawska, 2010). Therefore the empirical story starts already in the early 1990’s, when the Baltic states proclaimed their independency, which was followed by years of adaptation to become “European”. These changes included the creation of a functioning market economy in which financial markets are central, massive foreign direct investments and active national policies to become fit for EU-membership and fit for the Euro. At the same time as the Baltic states opened up and started their transformation journey, the Swedish banking system underwent a major change: the banks became international and started growing by acquiring foreign banks to an extent that had not be seen before. To enter the new countries (markets) across the Baltic Sea was suddenly an excellent strategy for growth.

Modern organizations have been described as “black boxes” (McKenzie, 2005). Mc Kenzie takes banks as an example of a black box organization: there is an input and an output and we do not know much about the process of transformation that takes place inside of the bank. Another feature of a black box brought forward by the author is that we can interact with a bank without knowing anything about what goes on inside, or anything about the persons we interact with. Recognized expertise is similarly a black box according to this point of view, the basic argument being that we “routinely place our lives in the hands of surgeons, pilots (...) of whom we have no personal knowledge” (Ibid, p.557). Global finance in particular can be viewed as composed of numerous black boxed organizations and activities. Not the least because of the great impact of modern financial economics and its calculative models. The focus of this article is however not to open the black boxes of the models as such, but rather to have a look inside the organization and describe the views from those inside the box. The aim is not to evaluate their views but to attempt to make sense of the crisis by entering and conveying a piece of their reality.

Interviews have been conducted in local and head offices of SEB and Swedbank, but also with experts within the banking sector with no immediate connection to the banks, former executives and boardmembers. Several observations at major regional conferences with a financial or economic focus, as well as topical workshops on the financial crisis from a Swedish and Baltic perspectives have also feeded in to the empirical investigation. A workshop with Latvian and Swedish bankers and economist has also been organized to gather empirical material. The interviews and the workshops have been tape-recorded and transcribed. Material has also been collected through media and various other reports on the financial crisis. The arguments developed in the paper finally also draws on an older case-study of how financial institutions monitored the Baltic states (Dahl, 2007).

Independency, market economy and the birth of financial markets in the Baltic states

When in 1989 the "Iron Curtain" that had divided Europe for almost half a century disappeared, a period of rapid and revolutionary changes began in Estonia, Latvia and Lithuania. They changed from being centrally planned economies to becoming "market economies". They applied for membership in the EU. In May 2004, after years of intensive adaptation processes, the Baltic States, together with seven other countries, became members. Over a period of ten years, they had been "transformed".

This radical transformation was not the result of a natural development, nor did it take place on the countries' own initiative. On the contrary, international organizations and old, Western countries played an active role in the transformation of these new countries. Administrative structures and regulations were introduced, motivated by a dream of EU membership and massive economic support from the outside. International "monitoring" was the routine. A large number of organizations scrutinized the countries' performances in the areas that were considered important to their success as EU members. Transition economics had a boost, indices, rankings and opinions depicting the countries progress towards becoming market economies abounded (further analyzed in 2007). The Baltic states in particular were singled out as success cases in being able to shift from Soviet to European, from planned economy to market economy.

At the outset, soon after independency, the financial markets were prioritized: without functioning finances, no sound nation-building. At an early stage, the International Monetary Fund (IMF) and the World Bank engaged themselves in East Europe, offering expertise and resources, loans and stabilization packages. The "new neighbor" on the other side of the Baltic Sea, Sweden, was engaged in the development of the Baltic markets, not the least through FDI in the financial sector.

Indeed the Baltic Sea Region, the financial markets have been held up as stellar examples of successful "regional integration". The economies of the region's countries have been more closely interlinked, not least through large Swedish banks' direct investments in the Baltic States. As was to be expected, however, the global crisis 2008, soon exerted regional impact around the Baltic Sea. Latvia, together with Iceland, was put on the global map for reasons that weren't predicted in any forecast about transition. The invitations for the "graduation" party of the former soviet states planned for 2010 by the European Bank for Reconstruction and Development (graduation from planned to market economies) is no longer the topic of the day. The success story about economic integration, growth, tiger economies transformed into stories about crisis, economic collapse and blame. In particular the role of the Swedish big banks which by now have a long history in the Baltic states shifted. The credit crunch in the Baltics became a doubled edged sword that threatened the Swedish economy through the heavy exposure of the Swedish banks in the Baltics.

The Baltic states offer a critical example of a context where financial organizations (commercial and investment banks in particular) have been active in shaping the development of a market economy in general, and the creation of financial markets in particular. The reasons for the economic crisis in the Baltic states are manifold, but clearly financial actors, in particular banks, have played a role. In the beginning of the 1990's the Swedish commercial banks discovered a "new home-market" in the Baltics that they entered en masse. Indeed, the past decade Swedbank, Nordea and SEB have been competing forcefully for market shares in these countries.

The financial crisis in the Baltic states

The global financial crisis of 2008 took a particular twist in the Baltic Sea Region: entangling the market expansion of Swedish banks in the Baltic states with the aspirations of these latter to become member of the euro zone. Together with Iceland, Latvia was put on the world map as one of the most severely hit countries. From being stellar examples of well functioning market economies and efficient financial markets the Baltic states found themselves in a severe economic downturn. Contrary to many other countries, the Baltic states have not been able to pursue expansive “neo-Keynesian” policies to hamper the downturn of their economies. Indeed, since 2008 economic policies have all over the world been expansive, partly due to the fact that governments found themselves in a liquidity trap: not even a zero interest rate was enough to fuel the economies during the worst crisis in modern times. In that sense Keynes has re-emerged. There is an agreement that this expansive Keynesian policies have contributed to hindering the recession to develop into a great depression à la 1930.

There is however also one exception to this picture: in the Baltic states, policies have been pro-cyclical and restrictive. The reason is that the Baltic states since long have as their goal to qualify as euro members, in need to fulfil the Maastricht criteria. One of these criteria is a fixed interest rate towards the euro. However, to peg the currency means that monetary policies cannot be used to uphold the balance in the national economy.

In the Baltic states this meant that the interest rates became too low compared to the growth rate and inflation. According to the textbook in economics, in this situation financial politics should take on a greater responsibility for the stability of the country and set higher interest rates, which the Baltic states did not do. Having just liberated themselves from a communist planned economy, the Baltic states had small public sectors and a strong aversion against high taxes: instead they put an honour in having as low taxes as possible. A more restrictive financial policy was simply not a political option: monetary policy was decided in Frankfurt by ECB whereas the financial policy had capitulated.

In practice it was foreign banks (among them Swedish) that supplied the Baltic economies with capital. The Swedish Central banks and financial inspection realized too late that they in practice had become responsible for the financial stability of the Baltic states. As put by a representative of the Baltic division of one of the Swedish big banks, the growth in the Baltic was to a too great extent enabled by debt in the form of bankloans where there should have been equity, in the form of risk capital. Thus the demand for adaptation was put on the private banks. De facto, the Swedish daughter companies (subsidiaries?) came to act, against their will, as a sort of quasi-centralbanks. One result was that the responsibility for financial stability in the Baltic states ended up between chairs. This does not excuse the overly expansive credit from the banks, but it explains why it became so aggressive.

As the crash came, the pegged currencies in the Baltic states got the reverse effect. Then monetary policy was blocked from stimulating the economies. The urgent crisis in trust forced financial policy at the end of the day – in this new economic situation – to be restrictive in order to back up the currency policy. The total effect was strongly contractive. It can be debated whether the Baltic states chose the right strategy, but once they had chosen to prioritize euro-accession and gone through a lot of pain to reach it, it is not that difficult to understand that they opted for sticking to this policy. Anyway, the fixed currency regime has without a doubt contributed to enhance the economic downturn in the Baltic states. The combination of a fixed currency regime with previous extensive credit expansion in the Baltics thus aggravated the crisis.

In a small growing country such as Latvia, credit hunger over-took the incentive to scrutinize lending from a bankers perspective. As one interviewee puts it, “everybody were clapping their hands”

because Latvia “needed the cash” and the Swedish banks new markets. Further, the Swedish state is responsible for an eventual bail-out in case of bankruptcy of its banks, not the Latvian, which led Swedish politicians to describe the situation of the Swedish parliament being held in “hostage”. It even went so far as for the Swedish finance minister to blame his Latvian colleagues for not having kept their budget in order. To some extent, what had started out as a fairytale of regional economic integration, turned into a nightmare of blame and shame.

In the spring of 2009, the Swedish economy and financial markets were considered as threatened. The government was nervous, and preparing for a collapse of the biggest Swedish banks, which in turn might have had devastating effects on the Swedish economy. This was during the times of the most severe global financial crisis in modern history. But what did the threat against the Swedish financial markets consist of? It was not the US subprime market that made the Swedish financial system shiver. Neither the collapse of Lehman Brothers. Not in any direct way. The threat consisted of the potential devaluation of the Baltic currencies against the Euro. If the Baltic states would have used the same strategy as Sweden did during the banking crisis in the early 1990’s – namely devaluation – this would have led to immense losses for the Swedish banks. And soon for the Swedish economy since the state would have needed to bail out the banks. However, the Baltic states never did any devaluation of their currencies, they kept their currencies pegged to the euro (instead Latvia for instance did an “internal devaluation”, and cut down salaries by 40%). The Swedish Minister of Finance could eventually relax. The banks lost great amounts of money (40% during 2009 for Swedbank) due to their heavy exposure in the Baltic states, but the catastrophe – a collapse of the Swedish banking system – never happened. Whether the energy spent by Swedish economists and politicians in warning the Baltics against devaluation mattered is here left unsaid. However, the case of the Swedish banks in the Baltics creating an interlinkage between the Baltic and Swedish economies reveals organizational interlinkages of modern transnational financial markets.

Banks as complex organizations under transformation

Banks can be viewed as complex organization in between states and markets: on the one hand they are private companies that aim at maximizing profit, and need to constantly expand their businesses in order to increase share-holder value on the stock market. On the other hand, they are organizations that fill a central role in the structuring of a society, and are subjected to various regulations and state supervision. These two roles may not always be at odds as the case of the Swedish banks in the Baltic states will show. Further, banks are subjected to rating by rating agencies and these ratings are crucial for the business of the banks. At the same time banks engage in risk-rating of their own customers and markets of operation.

During the past decades banks have changed organizationally by becoming international. Banks used to be a typical example of a local organization – the old saying goes that a bank need to be close to its customers to know them, but these were the times before the liberalization of capital markets, intense globalization of the economy. Old US banking legislation, forbid banks to work outside a well defined narrow territory. In some cities the territory of a bank was restricted to one block of buildings. Nowadays, banks have through mergers and foreign direct investments become actors over state borders. Studies of the Swedish banks have shown that they have followed the internationalization of Swedish companies (Lönnborg et al, 2006). The past decades banks have thus undergone organizational changes, as a consequence of globalization and liberalization of capital markets. Changes in bank regulation have also led to organizational changes within banks and a reshaping of financial markets. An important such change was the abandoning of the Glass Steagall act created after the depression in 1933. Glass Steagall dictated a clear separation between investment and

commercial banks. In 1999 the provisions that prohibited bank holding companies from holding other financial companies were repealed. In practice this meant that the difference in activities between investment and commercial banks became blurred. On a more general note, banks are central actors in financial markets and can be viewed as organizations in the middle of “chains” of processes of organizing, in particular processes of scrutiny such as supervision, rating, monitoring and audit. In times of financial crisis these processes become objects of change. Indeed the recent financial crisis has led to a cry for transparency and enhanced supervision, especially in countries that were struck hard by the crisis, such as the Baltic states. We would thus expect the bankers to be concerned about issues such as transparency, monitoring and regulation.

Organization rather than risk-rating?

The past decades banks have thus undergone organizational changes, as a consequence of globalization and liberalization of capital markets. As a former CEO in one of the big Swedish banks put it, before the deregulation of financial markets, the role of the bank was to “be restrictive and not to take any risk at all”. This is as far as one can get from the credit expansions of the Swedish banks in the Baltic states in the 1990’s and 2000’s. In the words of a former Swedbank boardmember: “it was all about gaining market-shares, if we didn’t take them, they [other banks] would”. From being risk-averse banks became risk-takers. As an interviewee puts it, one problem in the Baltic states was that this “old fashioned banking” was not in focus. As quoted from the same former boardmember of Swedbank:

“Rule number one in banking is to know your customer. And that rule was obviously forgotten at some point.”

Rather than being close to the customers banks have to an increasing extent been relying on risk-rating according to standardized models. These models are now under scrutiny again. During the years of transformation in the Baltic states a new framework for riskrating was developed: Basel II. The example of the organization of Swedish banks monitoring of the Baltic states in the aftermath of changes of the rating schemes in the context of the Basel II regulative frameworks, provide interesting insights in the numberification and rationalization practices of actors in a field under reconstruction. An important consequence of the agreements within Basel II is that banks were allowed to create their own rating systems, rather than using the same model as everybody else. This also led banks to develop different rating systems depending upon the country in question. The rating system developed by the bank had to be approved by the financial inspection authority. For instance this led the Swedish banks to develop entirely new systems to evaluate risk in both Sweden and the Baltic states. Previously to the Basel II agreements, there were not much of a rating system in the Baltic states for instance. Basel is by some seen as a step forward to a better assessment of foreign markets. The organization of the risk-rating is highlighted as one of the causes of the credit losses in the Baltic states. In the words of a risk-analyst:

“Before there was hardly any system in order to rate the Baltic states. Perhaps the people over there (in the Baltics) would not agree with that, they probably believed they had something, but it was very rudimentary. Then we applied for the Baltics [within the Basel II framework] and now we have a serious rating system over there”.

However, the risk analysis department in Swedbank surprisingly little has changed according to an interviewee who would have expected much more to change after the crisis. “People are not even a little upset or angry, which I had expected”, as she puts it. This is somewhat surprising from an organizational point of view. It may seem as that the credit losses have not caused any bigger turmoil

inside among risk analysts. It seems as the crisis in the Baltics is made sense of in other terms than risks, at least by people who work in the area right now. The quote above singles out the “people” over there as being different from “us” the Swedes. Perhaps “they” believed they were into some serious risk-rating but it was in fact “rudimentary”. This point is developed further by another banker, in another bank, below.

Indeed, analyzing the narrative of the bankers, a central issue that appears is the construction of the Baltic states, and people as the “other”. With other words, as someone who is not like us (Swedes) and as someone that we cannot understand or identify with. In the words of a highly placed banker working towards with the Baltic parts of the organization at the Head office in Stockholm:

“I thought I knew a lot about cross-culture and problems faced by multinational organizations [...] but I have seriously underestimated that component. I never really understood how complex the problem was when I started with this [Credit analysis of the Baltic states within the bank]. I think it is something that everybody has misjudged. Six months ago I decided to learn Russian because this [the Baltic states] is extremely influenced by Soviet. ‘Homo Sovieticus’ lives inside of everybody. I think that many Estonians, Latvians and Lithuanians think that they have left the Soviet time behind, they do not understand how much their minds are scripted, their ways of taking responsibility, or not taking it, their ability to take initiatives, it is all influenced by....the fright of Gulag”.

To make this point further the interviewee claims that “this [the crisis] has nothing to do with risk, it is all about organization”. This can be seen as a way to construct the crisis as something a-technical. The problem was according to this view not mainly to be found within the operations of the banks but in the culture of a society, or of a “people”. One reason for this type of explanations can be found in the history of how the Swedish banks became part of the financial markets in the Baltic states. The Swedish banks entered the Baltic in the 1990’s. Back at that it was no controversy, the Baltics were hardly discussed extensively in the Board of Swedbank as shown in the quote below for instance:

“There were no intense discussions [about the Baltics]. The recurring issue was if we checking the creditworthiness, that the loans were backed up with securities, that there were no troubles in that sense (...) many different people came to the board meetings...auditors came and said everything was in order, the credit executive officer came and said everything was in order, the financial inspection visited at some point and said everything was as OK” (interview with former Swedbank boardmember, my translation)

The Baltic states were compared to Sweden, “it was the safety we in the board wanted” (my translation) as a former boardmember explains. It was important that there was a Swedish evaluation of the credits, a “Swedish supervision” already back at the time when Swedbank was a majority owner of Hansabank. However, the everyday work of the board was not about creditworthiness or risks. The everyday works was about how to enhance share-holder value and to decide upon expansion and “collect the profits”. Discussions about credits are only held once in a while “every 15-20 years when there is a crisis” as explained by the interviewee. It is only when there is a crisis that one looks at securities. Otherwise it is all about “getting market-shares in the housing sector”.

The bankers discourse about the Baltic states seem to have gone through a radical transformation compare to pre-crisis times. The young, bright, hard-working and talented people in the Baltic states are reconstructed as people that the Swedes do not really understand. Obviously this shift in discourse can be seen as a way for the foreign banks to put the blame on someone else. However, the Swedish banks are also going through a post transition shock: from being “home-markets” the Baltic turned out to be a threat. As the “music stopped playing” (i.e. the countries were drained of credits) and the

crisis arouse. This can also be interpreted in organizational terms: hierarchies were reinforced. As long as the banks were earning money the Baltic parts of the bank organizations were left to operate autonomous entities. And as one now attempts to integrate the bank, differences in understandings, culture and organization appear.

Hierarchy and legitimacy through national references

The development of the Swedish banks in the Baltics is made sense of as a problem of hierarchy. Even though the Swedish head-offices were organizationally in higher hierarchical position than the Baltic branches, it seems like this hierarchy was not always reflected in practice. In hindsight, Swedish bankers see this as one of the problems of the organization. Therefore an integration and more pronounced steering of the Baltic offices becomes a solution. One reason for the lack of steering can be found in the history of how Swedbank acquired Hansabank. This is at least how the expansion is made sense among bankers within Swedbank.

Mergers and acquisitions were also part of a survival strategy of Swedbank. As one interviewee puts it, it can be questioned whether Swedbank would still exist if it hadn't been for several successful acquisition of other banks. Probably it would then have been bought by another, bigger bank. This shows us important features of the organizational realities of banks, as with many other business firms of today: growth is all that matters.

How come then, that Swedbank acquired the number one bank in the Baltics, Hansabank? The first cooperation started early in the 1990's: "two freshly bakes Estonian students" contacted Swedish banks, wanting to develop their newly created bank that they "hosted in some kind of basement". As the story goes, they made the tour of the Swedish banks and happened to meet with "the right people" at the Savings bank (Swedbank) and at SEB. The first investment was thus made in the early 1990, soon after the independence. In 1997, SEB and Swedbank (merged into "Föreningsparbanken"), competitors on the Swedish market, realized that they "couldn't own the same bank in the Baltic". Upon that realization followed a fierce bidding of the shares of Hansabank. Against the odds, Föreningsparbanken (Swedbank) won the bidding. Back then this bank was new on the Stockholm stock exchange and in a "little brother" position vis a vis SEB. Filled with "revenge" from loosing the bidding, SEB compensated by acquiring other banks. Since there has been a constant "competition over market shares" in the Baltics, between Swedbank and SEB.

According to an interviewee the reliance on consultants played an important role when the board of Swedbank decided that the bank should enter new markets in the east to gain market shares:

"When it comes to Ukraine, I regret that I did not oppose that decision more than I did. But you know, you tend to think that the people that sit in all these boards of listed companies, that they make all the decisions...but in fact everything is very much driven by consultants. These big consultant firms, McKinsey and those ones, they were courting the top management on a daily basis with proposals for new business: 'now you ought to grow here'. And with Ukraine at that point, the analysts were asking, every morning kind of, 'how are you going to grow, how will you expand?' Eventually these questions triggered the decision to enter Ukraine..."

"Then one could claim that we should have calmed ourselves down in the Baltic states. But I react upon that, because if we had calmed down that hadn't changed anything because then SEB, and especially Nordea, would have granted exactly the same credits, and driven the housing bubble exactly as much [as we did]."

Swedbank employees describe their bank as the "old fashioned Swedish farmers bank". One of the common stories, within the bank, of why Swedbank have been experiencing more credit-losses in the Baltics than the SEB draws on this picture of the bank as being influenced by legacies from the past when it used to be a network of local banks present on the country-side. Hansabank is described as the best bank in the Baltics, where all the top students wanted to work. In the same way as the SEB was the number one bank in Sweden. But what happened through the bidding was that Swedbank bought the number one bank in the Baltics, whereas SEB got to settle for "number 2". As one employee put it: the "dull farmers of Swedbank were simply not comfortable with steering the cool Hansabank people". And the Hansabank employees in their turn would have preferred being acquired by their counterparts in Sweden, namely SEB. This in turn led to a loss of confidence among the middle managers of Swedbank who didn't interfere nor even seriously learn much about the new markets, operated by their subsidiary, Hansabank. SEB on their hand, didn't have this problem of lack in confidence since in their case the status of the mother and subsidiary was the opposite: the Swedish owner had a higher status than the bank they acquired. The Swedish SEB bankers were thus relatively more actively involved in the Baltics than were the Swedish Swedbank bankers. This in its turn could partly explain the differences in success (or in losses) during times of crises. Or so goes (one of) the stories from a Swedbank perspective. Worth noticing is that employees at SEB also describe their organization as typically "Swedish". The Swedish way of doing things is a like a tacit knowledge, "it is in the wall" as one employee explained.

As long as the branches in the Baltic states were making profits they were not integrated organizationally to the Swedish headquarters. Rather, the Swedes were perceiving them as "Swedish home-markets". But as problems occurred, re-organizations were seen as a solution. For instance all the Baltic offices were integrating under one division in SEB. In Swedbank the credit analysis function was re-organized in the three Baltic states. Tying the Baltic branches closer to the Swedish headquarter is thus used as a way to gain enhanced control over the banks in the Baltics. The solution to the crisis is thus taking an organizational form: through re-organizing problems will be solved. This type of solution is common in many types of organizations and is the most common way for the organizational leaders to act.

The crisis is viewed as connected to supervision. The Swedes did not realize they had to supervise the Baltic colleagues closely, not seeing them as different, but rather supposing they were thinking the same way according to interviewees. For instance the peer-review culture is mentioned as an example. In Sweden the bankers consult each other before closing important deals, in peer-review meetings the bankers present projects to each other and get the view from the colleagues. This practice is presented as a way to ensure that projects are in line with a common view and culture of what is accepted within the bank. These meetings also create this common view. As the Baltic offices were being more closely looked into, the Swedish officers realized that their Baltic colleagues did not practice this peer-review meetings as they had been "told to do", according to a Swedish banker. The difference is explained as having to do with national culture, in the Baltic states it is not common to expose one-self to peer-review. As explained by the Swedish banker, they always came with different excuses why they had not been enough time for having a peer-review meeting. This type of explanations point at a lack of learning from the crisis or can be seen as a way to rationalize the banks activities.

Discussion

The findings of this study so suggest that banks refer to organizational dimensions such as hierarchy and monitoring as solutions to the crisis, rather than more technical measures that would enhance transparency such as risk-rating. This does not correspond to the general debate and analysis of the crisis, which would tend to focus on the latter.

Indeed the focus after the crisis has largely been on the *activities* on the financial markets rather than on its *actors* - its organizations. In general, the organization of financial markets is hardly any focus in the current debate. One reason for this is obvious: the debate is being held within the very organizational structures of the financial markets. It is mostly economists and people trained in financial economics that have a say in the debate. It is obviously difficult to problematize (or even visualize) the organizational structure in which one is embedded.

Organizations are seen as objects for regulation in their capacity as performers of certain activities. For instance once the “triple A” rating of securities was singled out as “cause” of the crisis, spotlight was put the rating agencies. The banking system has been singled out as a villain in the game, because of their boosted balance-sheets and frivolous expansion of credit to households. The regulation has focused on certain activities but not on the general organizational structures in which these activities are embedded.

Drawing upon the main arguments from scholars that have been studying auditing processes, we know that monitoring does not create transparency in any straight forward way (Power, 1997 and 1996). Quite on the contrary. In order for there to be an audit (or a supervision) the evidence that is to be under scrutiny needs to be constructed. To put in other words, number need to be created in order for performance to be measured. This does not mean that the prerequisites for an audit (i.e. “performance”) is false or inaccurate. But one could question if it is more numbers and information that is really needed in the financial markets. The discourse of transparency sometimes hides more than it reveals. To use a popular terminology, there is a risk with trusting in monitoring and supervision systems. Or in something called “transparency”. In the financial markets pre-crisis, trust was largely put into “stress tests”, “ratings” and “risk-assessments”. Trust is nowadays shifted towards “monitoring”, “regulation” and “transparency”. While new regulatory bodies and principles on a transnational level are seen as a remedy against current problem in the financial markets; still people within the same organization do not seem to trust each other, as the findings from the Swedish banks show, nor people in other organizations active in the markets. But perhaps there is where trust is the most needed. This paper suggested that the financial crisis has an important organizational dimension, exemplified by the Swedish banks in the Baltic states.

Organizations do not only act upon markets, acts of organizing constitute markets. Without analyzing that organization, we not only miss important explanations of the crisis, but we also miss out central elements of how financial markets work. The case of the Swedish banks in the Baltic states proved to be not primarily about risk assessments, it is about organization expansion and about the creation of hierarchies through foreign ownership on newly created markets.

Financial markets are depicted as the engine of the world economy, at the same time they are often treated as disconnected from that economy: the financial markets are seen as operating according to a logic of its own, a logic understood by those inside the financial system. A sign of this is the distinct separation between the academic discipline of economics and that of *financial* economics. Accordingly the crisis is made sense of in financial terms and is primarily seen as having to do with imperfections of existing financial systems. Even though some scholars have anticipated a “paradigm shift” after the financial crisis (Soros, 2008), this does not seem to be happening so far. The same

institutional arrangement prevail, new rules are added, but nothing fundamental in the financial system is changing: the same organizations are still in place. If we take banking regulation as an example: Basel II will be accompanied by a Basel III, but there is no revocation of the whole Basel committee system as such.

Somewhat forgotten in the debate, yet a central feature of the development of the financial markets since the 1970's, is the creation, expansion and transformation of the organizations acting on the market. One such organization that has undergone a tremendous change at the same time as the markets became global and de-regulated are banks. Banks have transformed from local, to national to international. Traditional banking, which used to be the core activity of these organizations is nowadays a fraction of their activities. Banks have grown in size both by expanding their scope of activities but also by merging with other banks. Banks have become more tightly linked to each other independently on where they are situated on the globe. Clearly the development of financial markets can be told as a story of organizational change. If we admit that the crisis has something to do with the organizational structure of financial markets rather than solely its instruments, the organizations and the elements of organization that are structure the financial markets ought to be studied and understood if we want to understand what this financial crisis is about.

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