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Crisis Management Strategy in Handling Financial Sector Scandals in the Digital Transformation Era

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Abstract

This paper provides empirical evidence of how scandals could affect financial institutions in terms of market stock price, yearly returns, and the length of time it took to regain the public's trust and ultimately recover in the long run. Moreover, we carefully examine the importance of dealing with crisis management in the digital transformation era's financial service sector. We specialize in crisis management, which aims to mitigate the destruction of companies' public crisis in existence. Finally, based upon investigating scandals in public and private financial sectors in the United States, we list 21 strategic crisis management plans at the end of the paper to handle financial services sector scandals in the digital transformation era.

Keywords: Crisis management; Strategy; Scandal; Digital transformation; Financial crisis 2008-2009; Regulatory technology; Wells fargo bank.

1. Introduction

In today's digitized world, a financial company must not only be able to maintain its reputation but deal with an emerging crisis that could severely impact its future and standing in its industry. The digital age allows financial companies to minimize their risk and enjoy the opportunity to achieve better returns on investment, increased net profits, and higher revenues. However, the digital age also means that bad news regarding a financial company can travel faster than ever before, which could hurt the company's stock price on the financial markets causing shareholders to lose a substantial part of their investment. The United States has seen its share of financial sector scandals through the years, but with the advent of the digital age, bad news about a financial company travels faster and further than ever before.

The aim and purpose of this paper are to compare and examine how companies in the financial sector handle scandals in the non-digital transformation era and digital transformation era, therefore, find solutions in mitigating the destruction of financial institutions' public crisis in existence.

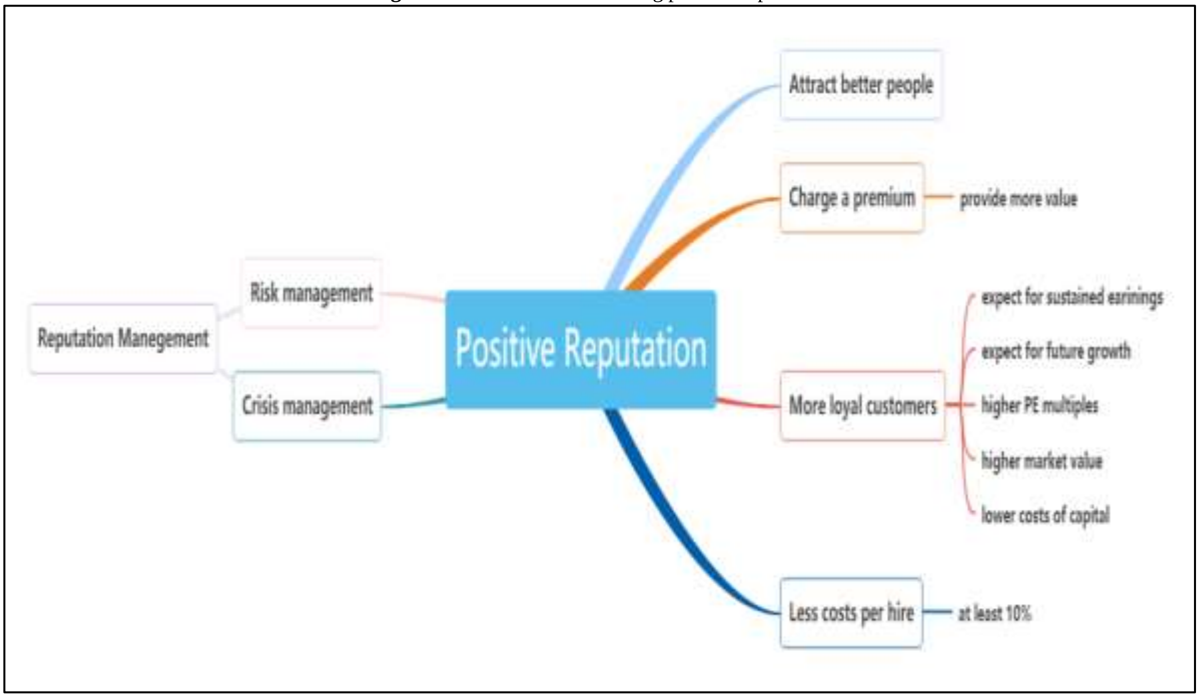
The key elements of this article include:

- The importance of dealing with reputation management in the financial sector in the digitized world
- A review and analysis of the Financial Crisis of 2008-2009
- Wells Fargo bank's account fraud scandal
- Strategic management plans in dealing with financial sector's scandals in the digital transformation era

2. The Importance of Dealing with Reputation Management in the Financial Sector in the Digitized World

Reputation management consists of both risk management and crisis management. Risk management stands for managing the risks in particular which will impact a company's reputation while crisis management aims at mitigating the destruction of companies' public crisis in existence (Robert *et al.*, 2007). Reputation, as a company's intangible asset, is difficult to measure. However, it plays an essential role in today's competitive business world. According to research by Robert *et al.* (2007) and Wade (2016), there are benefits that a positive reputation would bring to a company (Figure 1).

Figure-1. The benefits of a strong positive reputation



Reputation management is crucial for every company that wants to obtain an excellent social and public image or reputation, especially with the generous use of computers and information technology (IT). The financial sector would be more vulnerable with weak crisis management strategies if eventualities happen, which could threaten the reputation they have long been built compared to most other industries due to the trust-based culture. A crisis management strategy is the collective framework of decisions and choices that an organization makes to respond to a crisis (or the perception of one) (Andy, 2020).

Digital transformation changes significantly in the ways companies communicate with their clients and the resources they employ (Irik, 2016). Digital transformation impacts largely in today's business world by changing most industry's front organizations elements in their business models and customer's value. Tolboom also finds that digital transformation improves the customer's communication and interaction with organizations. Customer awareness of products and services are rising significantly in the market. Organizations have changed dramatically in the ways they communicate with customers and the resources they use. Therefore, organizations such as financial companies are urgent to develop more customer focused models, find ways to better communicate with their clients, and improve digital capabilities to meet the challenge in this age.

The faster and broader spread of information by social media makes it even harder for companies to conceal information and retain a positive reputation when negative instances happen. The general public has been empowered by digital technologies which has changed the way people get and spread information. Pamela (2020) writes that social media usage increased by 21 percent in March 2020 due to the coronavirus pandemic. In 2021, an increased number of consumers have used social media as a tool for connecting with families and friends, researching products, getting news coverage, and spending hours of distracting entertainment. Besides, it is reported by MarketingProfs (2011) that bad news about brands travels faster than good news. MarketingProfs further explains that "75 percent of the general population say when they've had a bad experience with a product or service, they advise friends and family. That surpasses the 42 percent who say they always recommend a product or service they really like and the 67 percent who say they love telling people about something new they've learned."

3. General Financial Market Crisis

3.1. The Financial Crisis of 2008-2009

While the Financial Crisis of 2008-2009 was of a different set of investing practices, in certain ways, it was similar to the stock market crash of 1929. It was still the culmination of bad investing practices that became the norm among average investors who did not realize the consequences if the worst-case scenario should occur.

The Financial Crisis of 2008-2009 had its origins in an asset that had long been considered safe, secure, and stable in terms of return in the long and short term for investors. That is residential real estate. While private residential homes were never really considered investment assets such as common stock, corporate bonds, or derivatives, due to the change in the financial marketplace in the early 21st century, they now became regarded as a financial asset that could be leveraged in order to take advantage of its ever-appreciating value. To bet against the residential real estate market in the United States was considered a bad financial investment since the value of homes had been appreciating through the decades since the end of the Great Depression of the 1930's at a stable, reliable, and conservative rate. While the primary reason for Americans was to purchase a home to raise a family, it was also to have a long-term investment in which its appreciation could mean having extra funds for retirement or passing on to the next generation. But with the start of the 21st century, homeownership took on an entirely different venue that ultimately affected the American financial markets and the international markets and caused a global economic downfall.

The American housing market became a financial bubble in the early 2000's for several reasons. First, the United States' stock markets experienced a severe drop due to the collapse of dot.com, high tech, and biotech stocks listed on the NASDAQ. These stocks were selling at inflated prices that were high above their fair present values based upon investors' expectations that these companies would bring new promise in the fields of technology and computer science. Investors overvalued the market price of these companies' stocks even while their accounting value, cash flow, and profitability were nonexistent. The expectation was that these companies would thrive regardless of poor financial management and unsound accounting fundamentals that were prevalent. Investors poured billions of dollars into these companies, the NASDAQ became overinflated, and the bubble got bigger and eventually popped, resulting in phenomenal losses. These caused a recession in the early part of the 2000's. As a result, investors took their money and put it into something they could feel, touch, hold, and were very familiar with: their homes. Investors were greatly helped by the Federal Reserve Bank, headed by Alan Greenspan, which kept interest rates low in order to get the American economy back on its path of economic growth.

As more money was put into residential homes, their prices kept going up. Potential home buyers were eager to purchase a home regardless of whether it was new or needed a great deal of restoration. They were able to get financing from commercial banks and mortgage brokers, who made obtaining a loan easier than it should have been. Homebuyers could get mortgages from originators even if their credit score did not meet standards that were normally used ten or fifteen years earlier. Buyers who had low credit scores were not denied the opportunity to get a mortgage. The lack of proper documentation such as pay stubs, tax returns, and even a down payment was not an obstacle to acquiring financing to buy a home.

Another key factor in the American housing market becoming a financial bubble was that almost all commercial banks originating the mortgage did not hold the loans until they matured. At one time in the United States, financial institutions that made mortgages would hold the loan until it matured. This resulted in holding a mortgage for twenty-five to thirty years, until it was paid off. But the risk was that if interest rates went up and the mortgage was a fixed rate, then the financial institution was locked into a long-term contractual obligation at a lower rate than they wanted. But eventually, commercial banks were able to sell their mortgages to either other banks or financial institutions or structured investment vehicles (SIVs). These instruments are off-balance-sheet special purpose vehicles (SPVs) which permitted financial institutions to avoid capital requirements set forth by the Federal Reserve Bank. These mortgages were bundled together along with other similar types of loans as bonds or mortgage-backed securities (MBS), which were then sold to investors such as mutual funds, hedge funds, pension funds, and insurance companies. This process was known as securitization that gave commercial banks greater cash flow by liquidating mortgages and decreasing their risk in holding the loan until maturity. The lure for these investors was the high-interest rates, the distinct possibility of long-term cash flows, and the assurance that there was little to no chance of default due to the stability and appreciation of the American housing market.

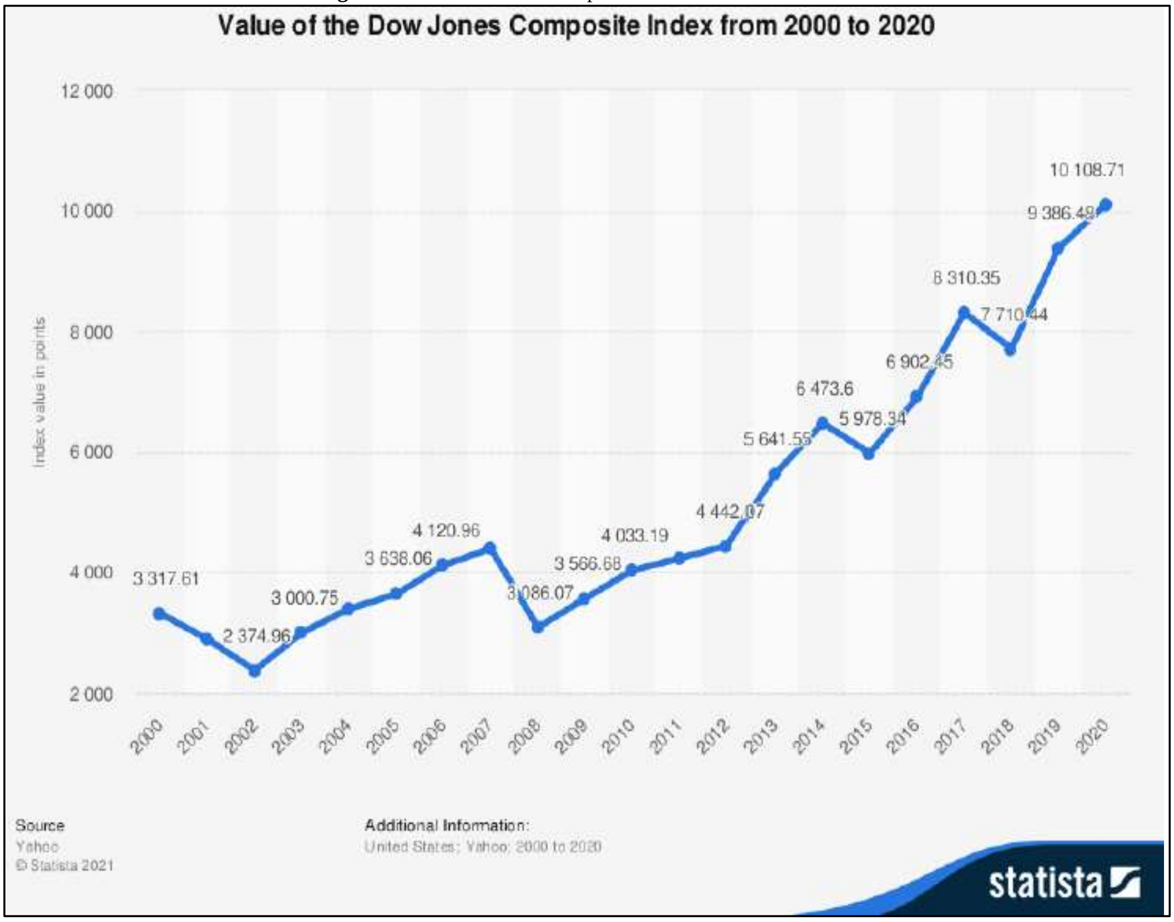
The risk still existed that an MBS bond could go into default. The introduction of credit default swaps (CDS) helped to reduce this risk. The role of a CDS was that bond investors could purchase a lower-rated bond, such as a C rating, and the instrument would receive a AAA rating due to the CDS. The problem was that these purchases were not regulated as over-the-counter transactions. Due to the lack of regulation, bond investors were purchasing riskier assets than they normally would.

The problem also was that home prices started to decline in 2005. The decline continued into 2006, and in 2007 the situation only got worse as interest rates climbed higher than borrowers could afford on their mortgages. The borrowers who were hurt worse were those who had adjustable-rate mortgages (ARMs), subprime mortgages, and interest-only mortgages. This led to subprime lenders filing for bankruptcy, mainly in 2007, since their borrowers could no longer afford to maintain the payments on their mortgages. The problem only became worse since the MBS bonds that held subprime, ARMs, and interest-only mortgages started to experience a greater number of defaults, causing the bonds themselves to default ultimately. The year 2007 saw a peak in the prices of residential real estate prices, and then a drastic drop in 2008 and 2009. This touched off a severe financial crisis that resulted in a national unemployment rate of approximately 10 percent and a massive bailout by the Federal Government and the Federal Reserve Bank of major commercial banks. The fear among policymakers was that the collapse of a major bank would start bank runs not seen since the early 1930's.

3.2. The Stock Market's Responses to the Financial Crisis

For the Financial Crisis of 2008-2009, the response time for the stock market occurred relatively fast, also. The Dow saw a collapse start to occur in 2007 as it went down in value from 14,164.53 on October 9 to 6,547.05 on March 9, 2009 (Figure 2), the date when it reached its nadir. In the period between October 9, 2007, and March 9, 2009, this represented a drop of 54.1 percent.

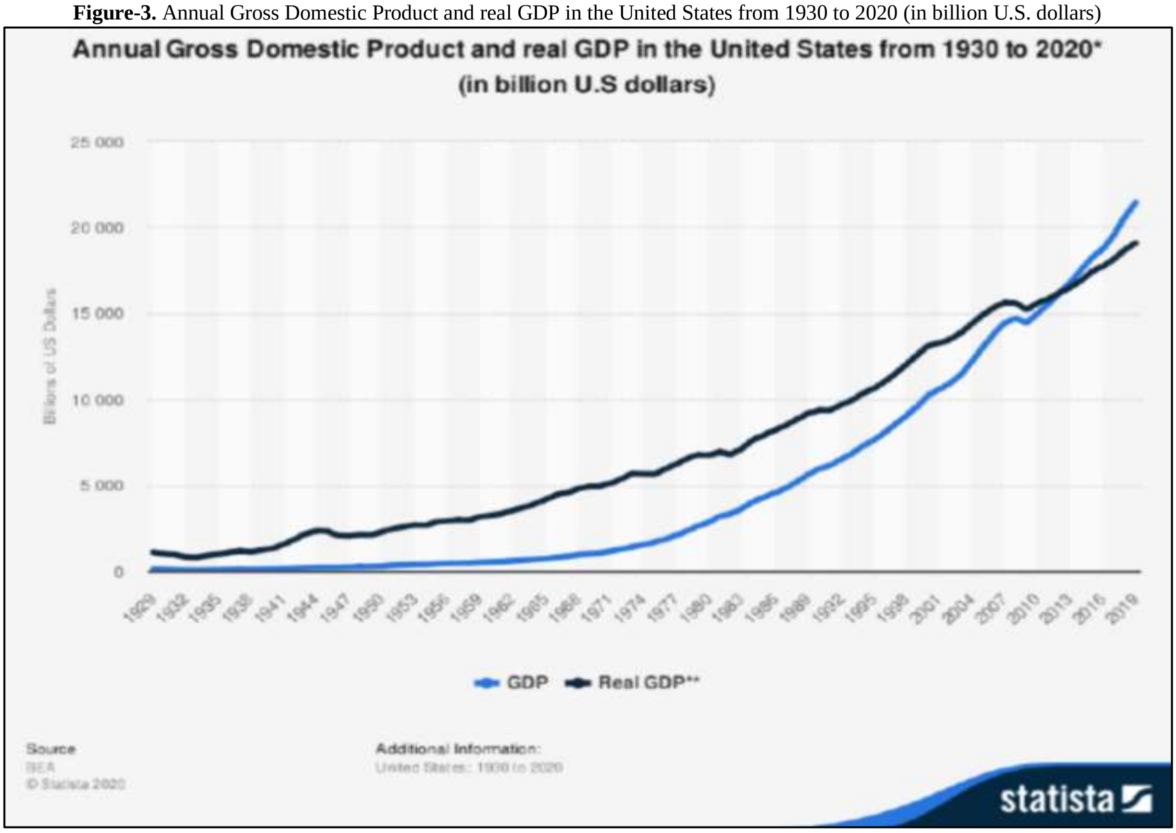
Figure-2. The Dow Jones Composite Index from 2000 to 2020



Source: Statista

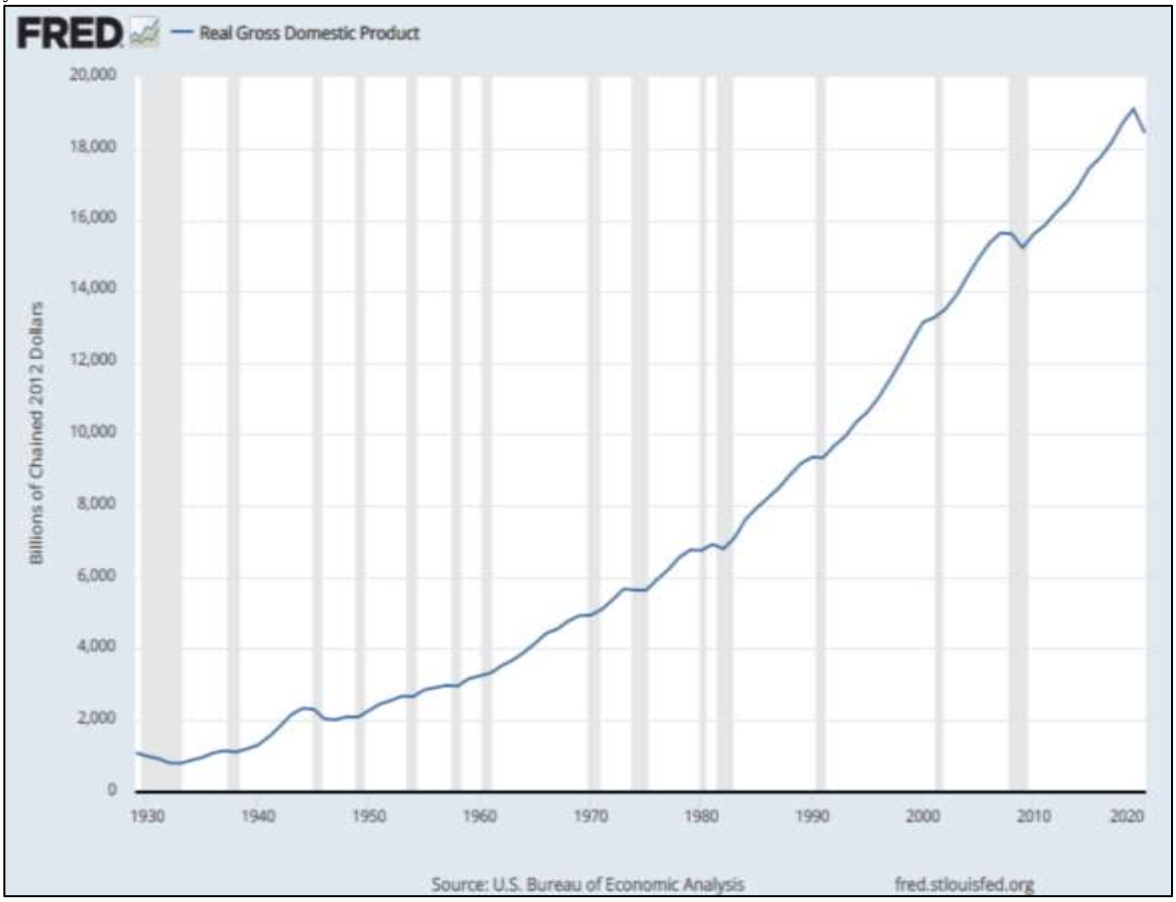
The width of the stock market crash of 2008-2009 had devastating impacts on the American macroeconomy. There was also a drop in GDP in the United States. As can be seen in Figure 3, the GDP of the United States was growing but experienced a sudden and sharp decrease from 2009 to 2010 due to the financial scandal in the residential real estate market as well as the drop in the Dow (Figure 4).

Figure-3. Annual Gross Domestic Product and real GDP in the United States from 1930 to 2020 (in billion U.S. dollars)



Source: Statista

Figure-4. Annual Real Gross Domestic Product in the United States from 1930 to 2020 (in billion U.S. dollars) Source: U.S. Bureau of Economic Analysis



The consequences of the Financial Crisis of 2008-2009 saw the fall of the residential real estate market in the United States that had not experienced such a widespread downfall since the 1930's. The residential real estate market in the United States had always been considered as a reliable, steady, and fairly conservative financial environment. But due to the lack and disregard of lending regulations by federal authorities, the residential real estate market became a new frontier for investors who took advantage of uncharted financial territory. Combined with exotic and unique financial instruments, the possibility of unknown consequences became very real if the residential real estate market took a slight downturn. When the residential real estate market was experiencing a collapse, the consequences were felt coast-to-coast in the United States and eventually globally due to the use of the exotic and unique financial instruments that were based on residential real estate mortgages. The length of the impact was felt until 2015 when the stock market, residential real estate, and the macroeconomy of the United States started to recover. The depth of the damage was felt well into the late 2010's as many Americans lost faith in the concept of homeownership and felt that renting was a better alternative. The stock market rebound took about six years to occur as investors saw the Dow achieve a higher and faster return rate than homeownership.

3.3. Acts of the Federal Government to Rebuild Trust after the Financial Crisis of 2008-2009

The Federal Reserve Bank performed one important method to rebuild trust by the Federal government by implementing the Quantitative Easing Program, a two-prong approach by the Federal Reserve. The first method dealt with the lowering of interest rates by the Federal Reserve, which meant reducing the federal funds rate to near zero percent in order to make it much cheaper for member banks to borrow from one another. The goal was that the lower rates would be passed on to the bank's clients for borrowing purposes. While this prong helped, a second method was needed.

The second prong dealt with the Federal Reserve becoming an active participant in the bond market. The Federal Reserve actively purchased debt instruments such as Treasury bills, notes, bonds, Agency debt, and corporate bonds where necessary in order to put money into the American economy. The Federal Reserve was most concerned with creating higher amounts of liquidity so that money was circulating in the American economy and preventing an economic collapse. The problem already was that the credit markets had shut down and that lenders in the marketplace were holding on to their funds since they feared the chances of default were higher than ever. The Federal Reserve saw it as their opportunity to step in when others would not. This non-traditional manner of stimulating the American economy in, at that point in time, an unconventional way was the best way to keep funds circulating, make money cheaper, and encourage consumers and businesses to spend. The strategy paid off as firms eventually started to rehire workers, and consumers commenced to spend in the long run.

For example, the Federal Reserve, along with other central banks, were able to purchase $2.5 trillion of government debt and troubled private assets from commercial banks. This was regarded as the single largest injection of cash into the credit markets at that point in time to create a higher degree of liquidity. In October 2010, the Federal Reserve also injected $600 billion into the United States commercial banking system to encourage them to make more loans and refinance mortgages. Again, the premise was to put money into circulation to get the credit markets to lend again.Another method used by the Federal government to rebuild trust was the use of regulatory moves that would address consumer protection, executive compensation, bank capital requirements, expand regulation of the shadow banking system as well as the impact of financial derivatives. The result was the passage and signing into law in 2009 of the Fraud Enforcement and Recovery Act and 2010 the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act). The Dodd-Frank Act ultimately involved the implementation of the Volcker Rule that dealt with regulations placing limits on the ability of commercial banks to engage in proprietary trading.

The Federal government's acts to rebuild trust after the Financial Crisis of 2008-2009 did not involve a great deal, or perhaps any use, of digital tools to get the American economy back on track. The methodology used by both the Federal Reserve Bank and the Federal government was putting financial capital back into the American economy and simultaneously enacting legislation that would restore trust in the financial system.

The problem is that comparatively speaking, it is now more difficult to regain trust in the financial system given today's environment. Through the use of social media, it is much easier to spread disinformation, distortions, innuendos, and falsehoods than ever before. Members of the general population will be more likely to believe disinformation, distortions, innuendos, and falsehoods without verifying whether they are true or not. This environment makes it much easier for such actions as a run on a bank due to the speed at which such news could travel. The speed of such news would travel faster than what occurred in the early 1930's in the United States when a run on a bank was a much more frequent occurrence. The only advanced form of technology used by the general population was a landline telephone. Today, it would be much faster and easier to spread disinformation, distortions, innuendos, and falsehoods through social networking platforms such as Twitter, iPhones, Zoom, or texting which would result in even greater financial harm and catastrophe than policymakers could handle.

4. Wells Fargo Bank's Account Fraud Scandal

The reputations of organizations are thus in great danger of tarnishing. Concerns have been raised to those individual financial organizations which have been involved in public financial scandals about the crisis management strategies those companies have implemented and how effective they are by measuring the reactions of the market in the digital transformation era. In the following paragraphs, we list some scandals of companies whose main business is providing financial services to the public. We investigate the scandals and the aftermath of the consequences. Meanwhile, we will also examine what these companies have done to deal with the crisis and how well they have managed the public scandals to rebuild their reputation according to the market reactions. We then analyze the general public's anticipation in those companies' responses to regain trust from clients and investors after a specific type of crisis has occurred.

One of the biggest scandals of financial institutions in the digital age happened to the banking giant Wells Fargo (NYSE: WFC) which was accused of creating 3.5 million unauthorized accounts for its clients. The financial services industry has been in fierce competition due to the global market, technology developments, macroeconomic pressures, and deregulation of the sector (Luann and Cameron, 2017). Such a competitive environment has led companies like WFC to be involved in immoral and unlawful corporate management practices. What WFC has done in its illegal sales practices set a typical example of sacrificing customers for the sake of compensating senior managers, pleasing shareholders, and other related groups.

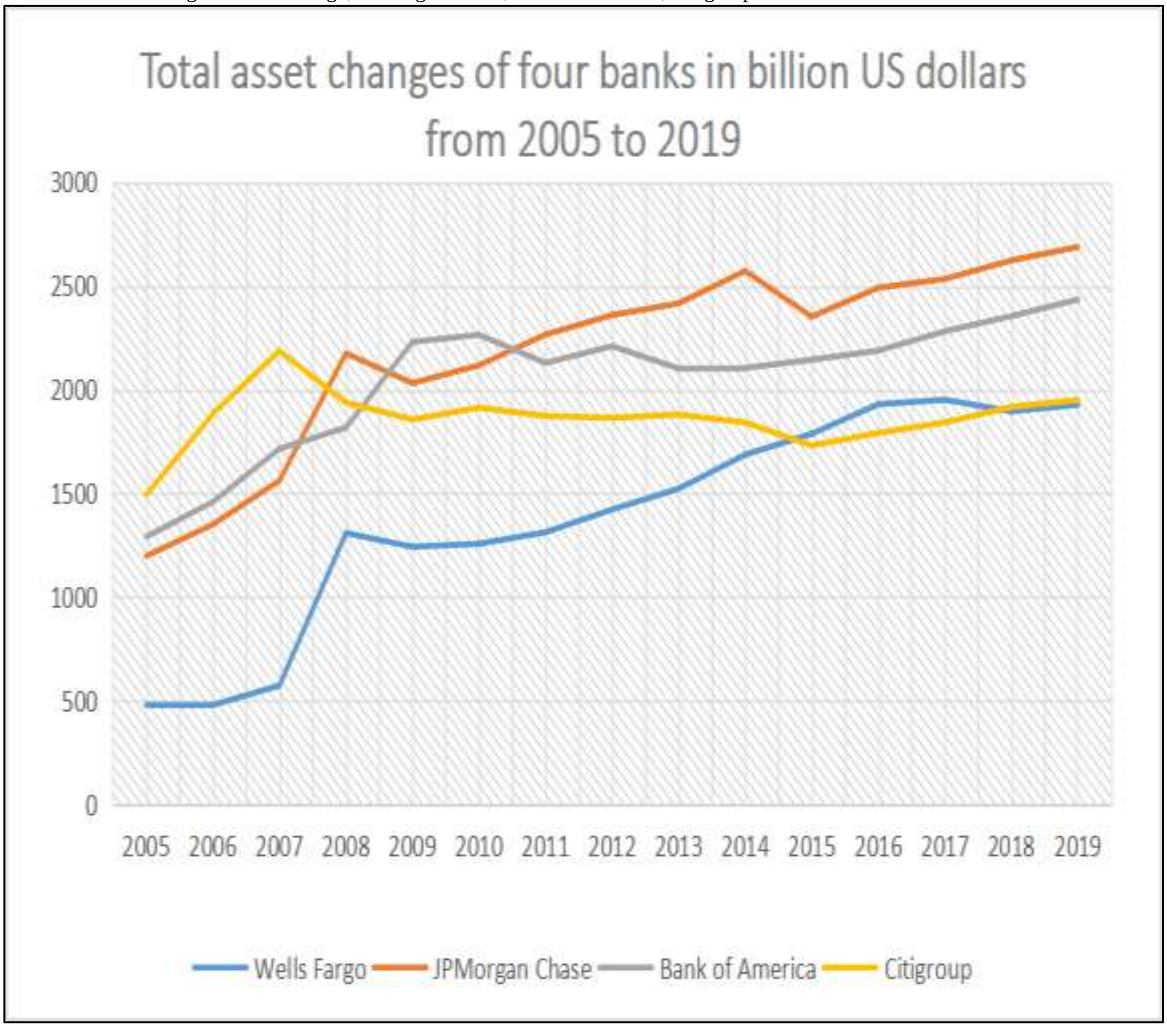
Wells Fargo & Company's Bank, established on March 18, 1852, is a San Francisco based commercial bank which holds a good reputation for sound management by safeguarding itself through the financial and economic depression of the 1930's and served the United States during World War II. Moreover, it gained enormous trust from prudent management during the 2008-2009 Financial Crisis until the phony accounts scandal came to the forefront in September 2016. WFC's senior management pressured thousands of its employees with unrealistic sales goals from 2002 to 2016 (Alexander and Justin, 2020). Overly aggressive sales targets of living up to its employees' reputation of being the best cross-sellers were set in 2010 by Chief Executive Officer (CEO) and Chairman John Stumpf. Cross-selling refers to signing existing customers for additional products (Luann and Cameron, 2017). As a result of meeting the sales targets, employees were under enormous pressure to open substantial amounts of fraudulent accounts and charge various fees without the consent of the company's existing clients (Venable, 2017). U.S. federal regulators confirmed that Wells Fargo had opened phony accounts for clients without permission from 2011 to 2015.

John *et al.* (2016), proved that governance practices and financial incentives could reinforce corporate culture. Corporate culture is viewed as one of the three most important factors in valuing companies by executives. Nevertheless, they point out that rewards granted to employees to meet a metric without valuing their actions will negatively affect a company's culture. They continue to conclude that institutional culture is set by current CEOs who are elected by the board of directors. However, John Stumpf's over-powering leadership in holding CEO and Chairman's dual positions, along with WFC's compensation scheme, greatly incentivized him to push up earnings without legal and ethical hesitations. What WFC did in the account scam does exactly the opposite to WFC's stated vision and values: "Our vision has nothing to do with transactions, pushing products, or getting bigger for the sake of bigness. It is about building lifelong relationships one customer at a time. … We strive to be recognized by our stakeholders as setting the standard among the world's great companies for integrity and principled performance. This is more than just doing the right thing. We also have to do it in the right way."

Emily (2015) reports that John Stumpf was awarded a $19.3 million compensation package in 2014. This compensation package consists of $2.8 million in base pay, $12.5 million of WFC's shares as a bonus which is mostly tied to the company's performance, and a $4 million cash bonus. He has been compensated for the same amount in 2013, and $22.9 million in 2012. The 2012's payment package for John Stumpf made him the highest-paid CEO in the banking sector that year. His 2014 compensation package was second to the most extensive pay package among banking sector executives of Goldman Sach's CEO Lloyd Blankfein's.

In 2015, WFC hit a record high in market capitalization of approximately $287.9 billion before WFC's account fraud scandal became public in 2016. According to Figure 5, total assets in 2015 was $1787.632 billion, surpassing Citigroup ($1731.21 billion), ranked third for the first time since 2005 to be among the largest four banks in the United States. The other two were JPMorgan Chase ($2351.698 billion) and Bank of America ($2144.287 billion). WFC’s capital expansion started in 2007, and before this year, its total assets were far behind the other three banks. The 2008-2009 Financial Crisis slowed down the massive capital expansion slightly due to the dire economic environment. However, its total assets increased steadily from 2009 to 2016.

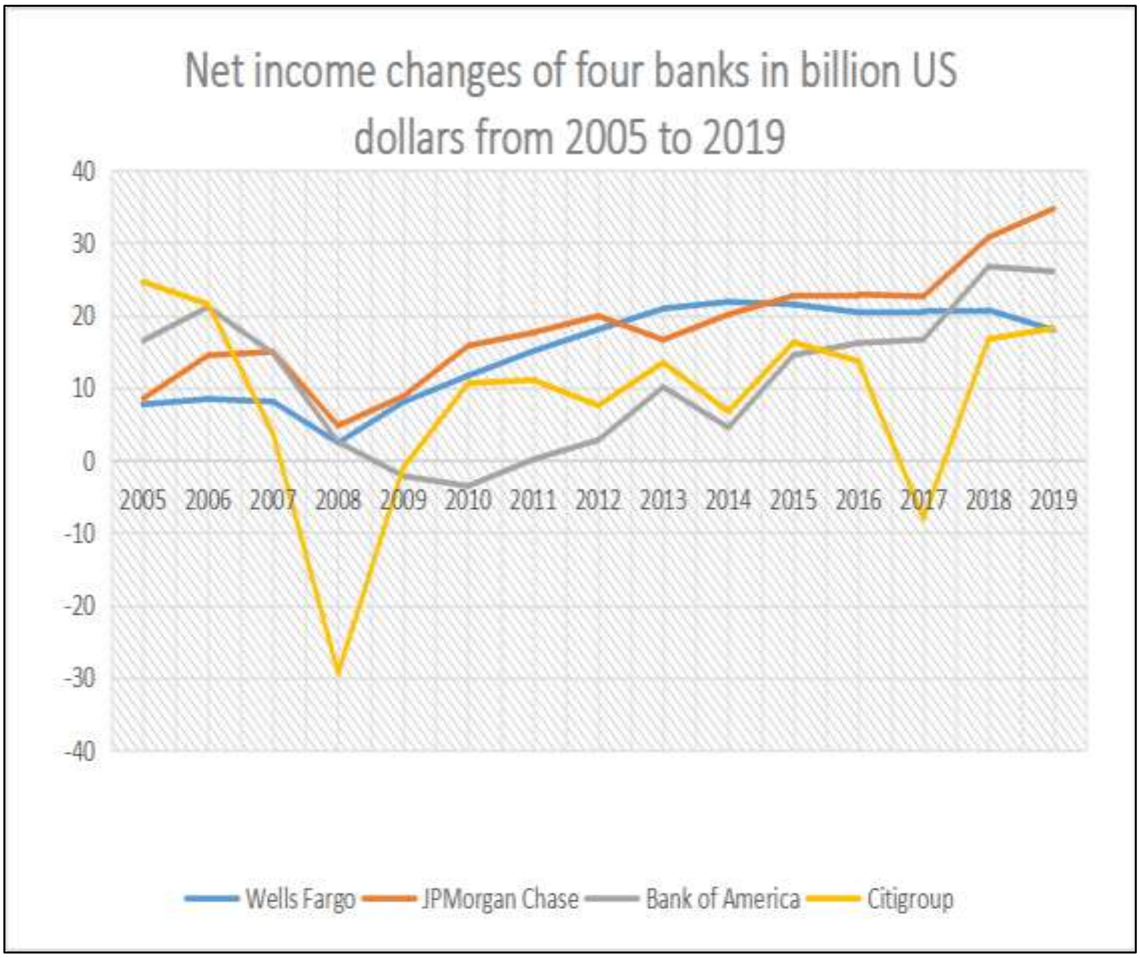
Figure-5. Total asset changes of Wells Fargo, JPMorgan Chase, Bank of America, Citigroup in billion US dollars from 12/31/2005 to 12/31/2019



Data source: Macro Trends

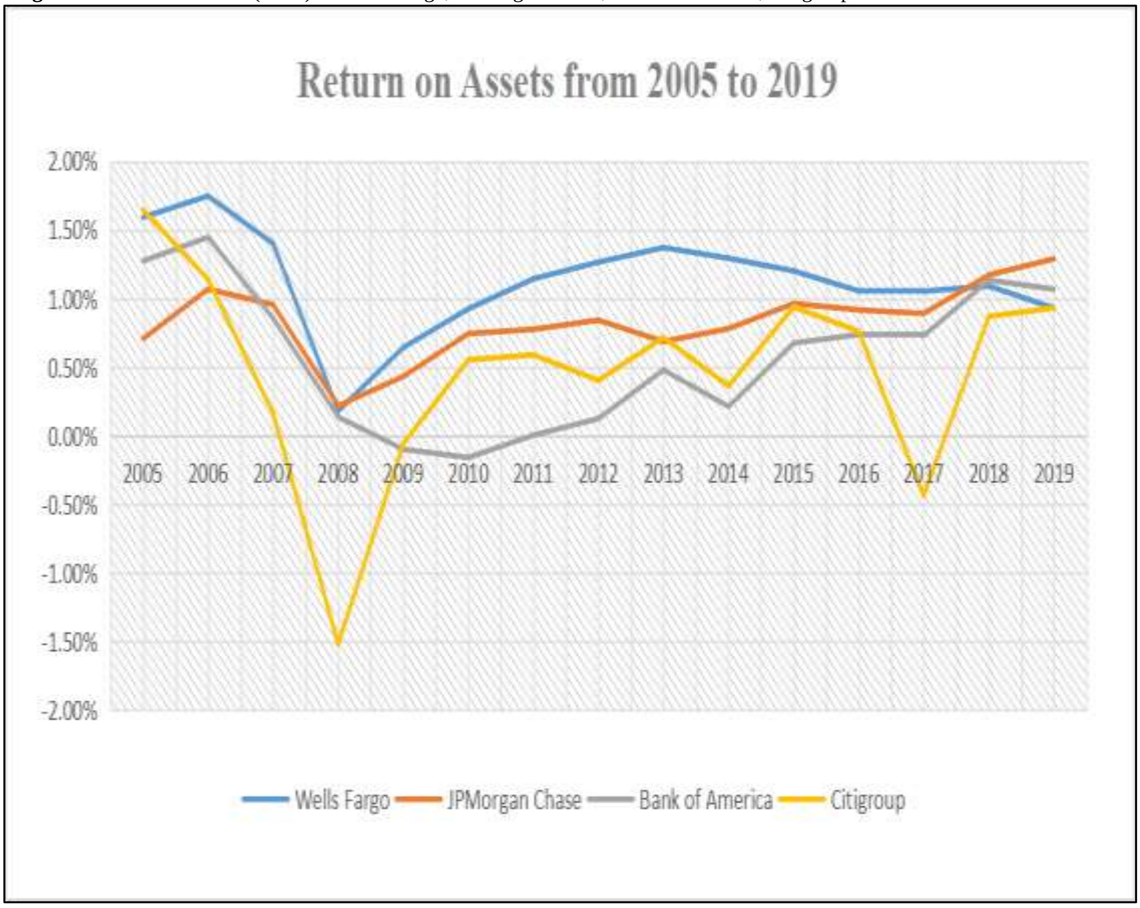
WFC gained a positive reputation from being among the most prudent and valuable banks in the United States by successfully navigating itself through the 2008-2009 financial tsunami. In contrast, many financial institutions in America and worldwide suffered from severe losses due to the subprime mortgage loan crisis. According to Figure 6, WFC's counterparties, the other two biggest of the four banks in America, Citigroup and Bank of America, witnessed dramatic net income losses during the financial recession. Some large financial corporations such as Lehman Brothers, Washington Mutual, and Franklin Bank even went bankrupt during the international banking crisis. Unlike most financial firms who took a substantial risk in the toxic subprime mortgage market and reported significant losses in net income afterwards, WFC's ROA rose quickly and steadily after 2008. Despite being the fourth largest bank in America, except for 2013 and in 2014 being the third, its ROA outperformed all other three banks from 2008 to 2017 (Figure 7). As a result of strong financial figures and indicators under the unethical management administration, WFC outperformed the SPDR S&P Bank ETF (KBE) significantly and enjoyed an enormous and continuous stock price growth (Figure 8) starting from the end of 2011 to mid-2015 until WFC was embroiled in generating massive fake accounts and charging excessive unauthorized fees. KBE stands for an American publicly traded fund whose objective is to replicate the performance of S&P Banks Select Industry Index.

Figure-6. Net income changes of Wells Fargo, JPMorgan Chase, Bank of America, Citigroup in billion US dollars from 12/31/2005 to 12/31/2019



Data source: Macro Trends

Figure-7. Return on Assets (ROA) of Wells Fargo, JPMorgan Chase, Bank of America, Citigroup from 12/31/2005 to 12/31/2019



Data source: Macro Trends

Figure-8. One-month stock price changes in percentage of Wells Fargo (blue) in comparison with KBE (pink) from Dec. 2005 to Dec. 2020

Source: Yahoo Finance

Kayla (2017), Brian (2019), and Chris *et al.* (2020), revealed the timeline of how WFC's account scandal was brought to the public forefront and the settlements WFC made with authorities to those victims involved in this criminal act (Figure 8).

Based upon the scandal unveiling timetable displayed in Figure 9, Figure 10 depicts the impact on the stock market reactions in conjunction with the illegal sales practices related issues due to an efficient market generated by digital tools. The stock price was fluctuating and kept a downward trend since WFC received class-action lawsuits from the courts in mid-2015. Its stock price then dropped to the lowest of $44.28 per share on September 26, 2016 from a peak of $57.94 on July 13, 2015. Dan and Elizabeth (2016), analyzed the two hours after John Stumpf announced he would leave his position and the result was that Wall Street witnessed a 2 percent rise in WFC's trading price. The stock price then experienced a sharp rise from October 31, 2016.

Figure-9. Timeline of exposing Wells Fargo's account fraud and fines

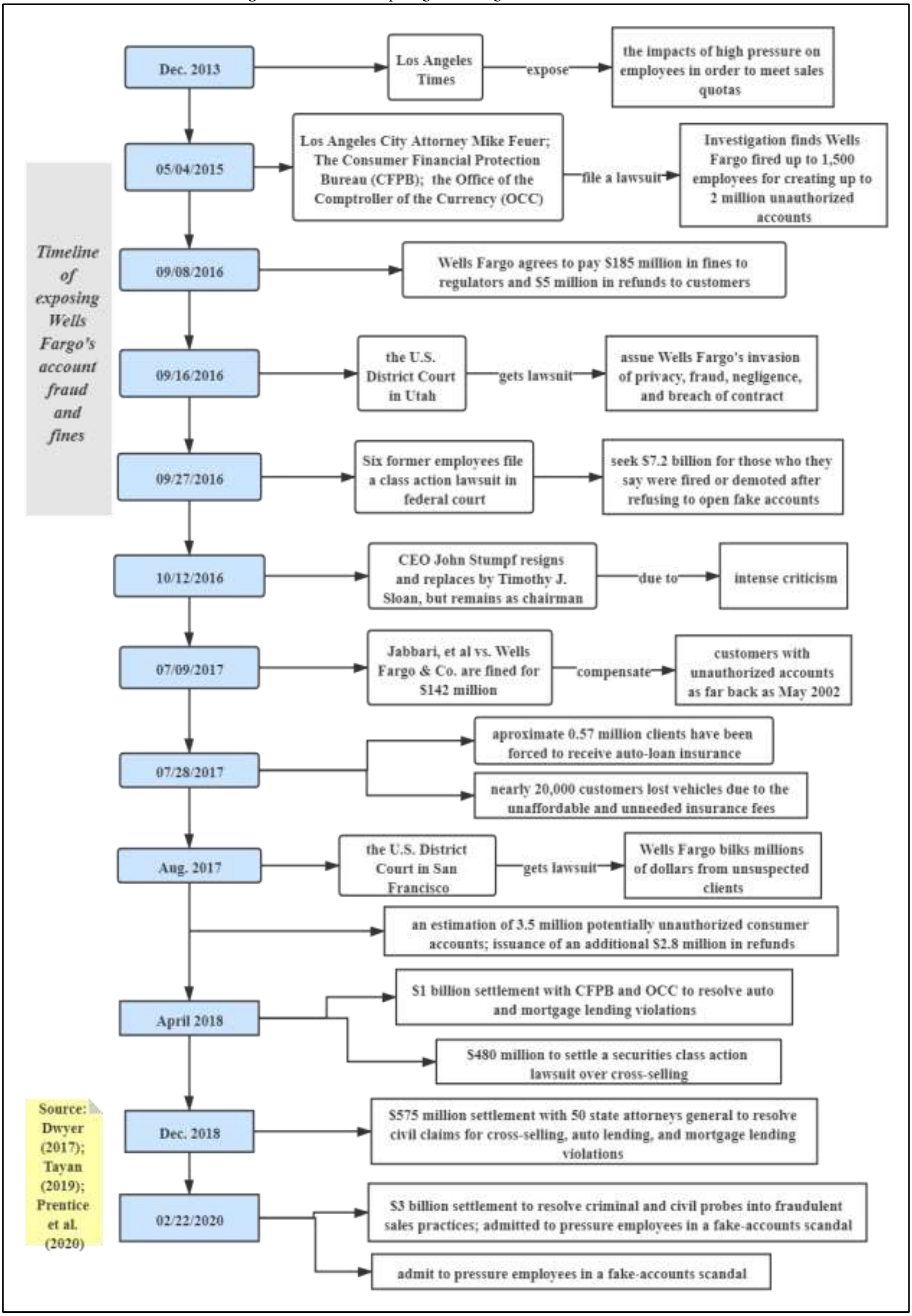


Figure-10. Stock price changes in percentage of Wells Fargo from January 2015 to December 2016.

Source: Yahoo Finance

5. Strategic Crisis Management Plans in Dealing with Financial Sector's Scandals in the Digital Transformation Era

Strategic crisis management plans for financial services organizations are based on the combination between real industry practices (as examined in the previous sections) and academic evidence in the digital transformation era. All the following suggestions have a common goal of repairing and regaining trust from the public for the financial services industry in this digital transformation era. Crisis management requires not only financial institutions' short-term response and actions but also long-term planning for rebuilding trusts and brands.

5.1. Developing and Optimizing Regulatory Technology (RegTech) to Form Efficient and Rigorous Regulations in the Financial Services Industry

The financial services sector is seeking more efficient compliance as regulations are becoming stricter and changing extremely fast since the 2008 global Financial Crisis. Meanwhile, regulators and regulatory authorities are looking for ways to streamline compliance and increase financial regulation efficiency. Regulatory Technology (RegTech) is making those people and entities' anticipations come true. RegTech is an emerging technology that uses big data, machine learning, and artificial intelligence (AI) to help companies reduce risk and meet their regulatory requirements (Aiyesha *et al.*, 2019). RegTech enables efficient and effective companies' risk management in controlling non-financial risks such as financial crimes, reputation loss, and regulatory compliance in financial companies. Eva and Anna (2020), describe RegTech as 'a game changer' which produces technological solutions to facilitate financial regulation generated by advanced computer science. They emphasize that "RegTech could enable the regulators to supervise the entire population of regulated entities relying on deep evidence delivered in real-time. It could free up regulatory capital or remove the need for it altogether."

5.2. More Precise Regulation for Key Areas of the Federal Government's Financial Sector

An important, yet controversial, argument regarding the cause of financial scandals is whether the Federal government had enacted the proper rules, regulations, and laws to have possibly prevented such situations. It has been argued that if there had been better rules and regulations regarding buying common stocks on margin, even if the Federal Reserve Bank set them, the stock market crash in 1929 would never have occurred. Better rules and regulations regarding buying common stock on margin probably would have prevented the stock market from going as high as it did in the 1920s. Without a stock market bubble, a crash could have been avoided, and the macroeconomy would not have gone into a major economic depression that took ten years to recover.

It took the Federal government's intervention by creating the Securities Exchange Act of 1934, the passage of the Glass-Steagall Act of 1932, and the creation of numerous securities and banking laws in the 1930s and subsequent years to create stability where none had existed. More precise regulation helped create a level playing field for important banking industry areas and the securities field where none were considered. These regulations allowed bank clients, such as private individuals and companies, both large and small and those in between, to rely on these commercial financial institutions for their money's safety. These regulations reduced the risk through the insurance of deposits, rules on the amount of cash contained in the safe of a bank branch, and those commercial banks could not become involved in investment banking.

These rules and regulations worked at creating a degree of financial stability that endured until the late 1990s with the repeal of specific laws such as the Glass-Steagall Act. The situation worsened in the early to mid-2000s when rules were not enforced regarding the granting of residential mortgages. Such regulations were enacted to protect banks from overextending themselves when underwriting mortgage applications from home buyers, applying for a second mortgage or a home equity loan. But when the Federal Reserve Bank did not properly enforce such regulations, banks were underwriting mortgages to borrowers who really should not have been allowed to take out such a financial obligation. To make matters worse, commercial banks, finance companies, and mortgage brokers were offering mortgages to unwitting borrowers who were not aware of the risks that such obligations entailed. The parties providing such exotic mortgages did not explain to borrowers that such loans worked as long as the housing market was booming and that the nation's economy was healthy. The lack of regulation can be deemed as being just as harmful as too much. However, more precise rules could have prevented not only the Great Depression in the 1930s but also the depression of a smaller scale in 2008-2009.

5.3. Apologies with Positive Emotions to the Public after a Scandal Erupts

Whether a financial institution has been involved in illegal or immoral activities, apart from fines from the regulators, immediate responses should be made when a scandal erupts. These fast responses include apologies to the public with positive emotions and words of commitment to change from the company's senior managers. It is evidenced by Ma *et al.* (2019) through a psychological experiment that apologies from transgressors build trust in receivers where perceptions of the transgressors' trustworthiness mediate the relationship. Moreover, only fewer negative emotions of apologies improve perceptions of counterpart's trustworthiness.

5.4. Arranging Annual Meetings; Listing Matters to Vote by Shareholders Urgently After a Scandal; Empowering Shareholders to Vote on Corporate Policies

It is crucial for a company that is facing ethical or illegal issues to arrange an annual meeting and list important matters for shareholders to vote in the meeting urgently. For example, in the Wells Fargo case, after the illegal sales scandal erupted in 2016, the bank arranged an annual meeting in April 2017 with the primary concern to re-elect Wells Fargo's board members by shareholders. Furthermore, allow shareholders to vote on the companies' corporate policies. Oliver and Luigi (2017), argue that one way to facilitate shareholder welfare maximization is to let shareholders vote on corporate policy's broad outlines. By doing this, stockholders believe that the organization has changed or continues to focus on increasing their welfare.

5.5. Revealing Convincing and Positive Economic Signals to Declare Companies' Fiscal Confidence in Public

A financial company involved in immoral or illegal practices is expected by existing and potential investors to give continuous positive financial assertions. Top managers from these financial institutions should articulate publicly how these signals would bring promising fiscal futures to the institutions. It is notable that the features of these positive economic signs are favored with the contribution to the financial institutions' core business due to the gains from companies' core business are weighted more than non-essential business by investors.

5.6. Shifting from Maximizing Market Value to Shareholder Value

It is observed by Merugu *et al.* (2019), that the most crucial objective in today's competitive business environment to maintain a long-term relationship with the investors is shareholder value creation. However, investors today seek more for social responsibility and ethical concerns than profit maximization under the condition if those companies' profit-making and damage-generating activities are inseparable or if the government fails to internalize all externalities, shareholders are prosocial. Stockholders often favor maximizing shareholder value or welfare rather than maximizing market value (Oliver and Luigi, 2017). Shareholders of financial services companies are aware of immoral or illegal practices that would generate severe social ramifications despite these unethical and unlawful activities that might significantly increase their economic benefits in the short term. To maintain shareholders after a scandal, an immediate action in revising mistakes and a commitment in changes from a company's top management team would transmit confidence to its investors in believing it cares about shareholders value creation in the future. By doing so, an institution or even a government could avoid massive market value decrease or financial panic in a short period.

5.7. Improving Customer Experience by Technological Innovation

Santiago *et al.* (2020), proved that increased spending on technology, particularly on digital technologies, directly improves the customer experience in the banking sector. Zhuming *et al.* (2017), state that "Technology power" is a core competitive element for financial organizations in the digital transforming era. They suggest financial institutions such as the Industrial and Commercial Bank of China (ICBC) should refine their mobile internet platform as mobile internet finance is the future of the banking industry. It means much more for the customer experience of the financial services industry today than in the past. Customer experience nowadays stands for clients' feelings from accessing an account from multiple channels, getting a question immediately answered by a chatbot or robo-advisor, and receiving automated real-time notifications rather than only from physical financial services firms. A market digital transformation survey conducted by BDO Company indicate that customers from the financial services industry anticipate personalized financial solutions and value their experience from simplicity, efficiency, and transparency perspectives. They will not tolerate even the slightest possibility of a data breach. Customers want to manage all their finances through only one place without physical engagement. Thus, comprehensive and organized online and mobile platforms are crucial to clients in financial services firms in digital transformation. Complicated financial management systems, scattered accounts, and un-notifying payment-due information reduce customer experience, resulting in bad customer relationships and weakening customer loyalty.

5.8. Actively Deploying Social Media to Communicate Efficiently With Clients

Digital transition has been at the forefront of almost every industry, including the financial services industry. New forms of media have been rising over the past decades, threatening the traditional media exceptionally. Wipro and Efma, a global not-for-profit organization that brings together more than 3,300 retail financial services companies, write in the Global Retail Banking Digital Marketing Report 2013 that technological reform will affect the financial services industry more than any other sector. These new media types, such as Facebook, Twitter, YouTube, online-newspapers, etc., are continuously making the traditional media like radio, newspapers, televisions, etc., become obsoleting. As one type of today's new media, social media plays a vital role in managing financial services companies' customer relationship. Lisa *et al.* (2014) state that social media can contribute to customer relationship building in the financial services industry. They point out three potential purposes that financial institutions are utilizing social media: customer acquisition, engagement, and retention. The authors find evidence that some financial institutions adopt social media to engage with and apologize to clients for their difficulties. Simultaneously, some use social media to answer customer’s questions on a one-to-one basis for customer service. If financial institutions can appropriately operate these tactics, social media could help them regain trust from customers.

5.9. Compensating Clients for the Trouble That the Financial Institutions Have Caused

When operating their business, financial institutions may cause problems for their clients intentionally or unintentionally. For example, customers may be intentionally added to some insurance plans that cause them to suffer financial or credit loss, leading to a client’s psychological distress. When financial institutions are involved in such a situation that brings trouble to their clients, it is strongly suggested to compensate customers. The Financial Conduct Authority (FCA) Dispute Resolution Rules recommend several types of compensation plans a financial institution needs to carry out and choose from when causing trouble for its clients. First, the exact amount of monetary payback to a customer who has lost financially. Usually, it is clear how much a customer has lost financially. Second, awards to customers for causing distress, inconvenience, pain, and suffering damage reputation due to a financial institution’s illegal, immoral, or careless practices. Third, customers need to get interest rewards calculated from the day they should have had the money until they get paid. Fourth, financial institutions should consider a fair amount of compensation to reimburse customer’s reasonable costs. Fifth, complainants should also be rewarded in a non-financial way, such as revising clients' credit profiles.

5.10. Creating Visualized Multimedia to Rebuild Trust Based on Storytelling Content

The data visualization which helps massive data streams transfer into maps, graphs, audios, videos and so on is more natural and comprehensive to human beings. It generates eye-catching effects for the audiences and more challenging for them to forget the visualized information compared to the information based on numbers and letters. Meanwhile, Subarna (2018) describes multimedia as computer information that can be represented, stored, transmitted, and processed digitally through text, graphics, drawings, audio, video, animation, and any other media types. Therefore, an eye-catching and innovative visualized multimedia broadcast obtains audiences great attention through various media tools. Many industrial practitioners’ evidence that storytelling content builds trust with customers and prospects in the business world. Additionally, storytelling has psychological power over audiences which could be tracked in ancient times (Pamela, 2011). Although technology changes fast in the modern era, the human brain has been developing on a slow evolutionary trajectory which remains to respond to content by looking for the story to make sense out of the experience.

5.11. Measuring Customer Satisfaction and Fast Reactions to Customer Feedback

Winning back customers trust is complicated, but one thing is for sure that financial institutions should not ignore their customer’s voice and feedbacks. They need to take accurate measurements about customer satisfaction and fast response to customer’s dissatisfaction. As proved in the academic world, customer satisfaction positively affects organizations' profitability and customer loyalty and retention (Harkiranpal, 2006). Suppose proper and robust measures could be implemented to examine customer satisfaction in an early stage. In that case, financial companies could be warned of unhappiness or frustration resulting from poor financial services which the customers have received. On the one hand, customers are keen for their voices to be heard by the business they are involved with, which makes customer feedback a key among business components. On the other hand, 91 percent of customers are reluctant to express their dissatisfaction due to the careless and slow response from their business counterparts. Companies must take fast reactions to customer feedback as 81 percent of clients claim that they would provide their feedback if their complaints could be responded to immediately (Drew, 2019).

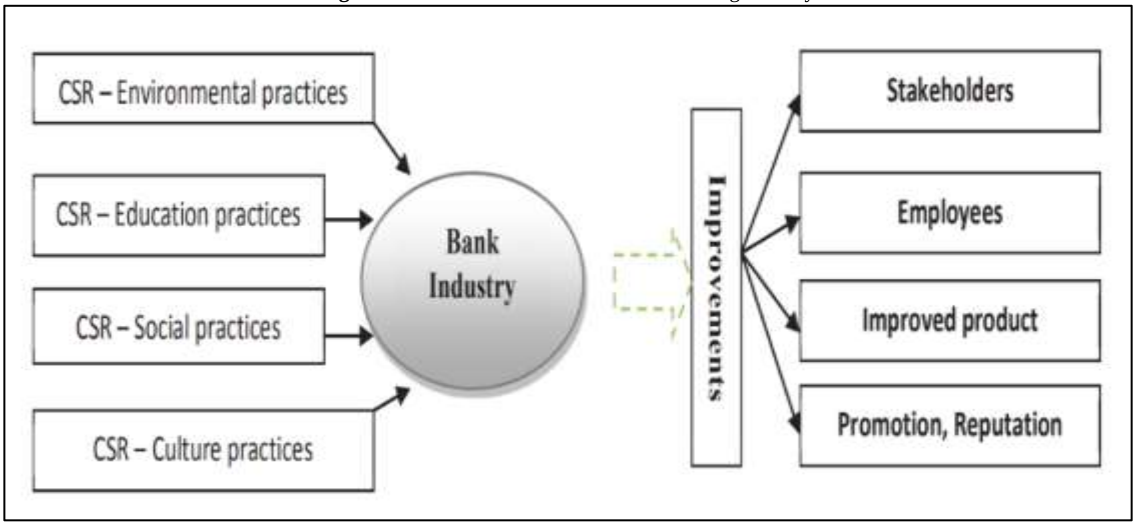
5.12. Committing and Keeping the Commitment of Changing Malevolent Practices and Corporate Visions, Values and Goals

According to the Commitment-Trust theory of relationship marketing developed by Robert and Shelby (1994) that the following four characteristics of companies are requisite to have in order to form competitive advantages over their peers in the global marketplace where commitment and trust are critical: "(1) providing resources, opportunities, and benefits that are superior to the offerings of alternative partners; (2) maintaining high standards of corporate values and allying oneself with exchange partners having similar values; (3) communicating valuable information, including expectations, market intelligence, and evaluations of the partner's performance; and (4) avoiding malevolently taking advantage of their exchange partners." In this digital transformation century, the financial services industry is in fierce competition. Based upon exchange partners' commitment and trust, losing any one of the above four characteristics in the real business world would result in deadly ramifications. Therefore, to rebuild the trust and commitment after scandals occur, financial companies are posited to commit to change both from words and actions to stop taking advantage of their counterparts. These changes should also include the financial organizations' corporate visions, values, and goals to change the corporate culture, in this way, fundamentally, so that it builds hope for the public. Moreover, financial organizations need to keep the commitment to rebuild trust and loyalty from their exchange partners.

5.13. Pouring Efforts into Corporate Social Responsibility (CSR) Practices and Generating CSR Reporting

Dozens of research studies have been conducted regarding the relationship between CSR and financial performance among financial institutions. Marian *et al.* (2015), suggest that CSR practices create value in the banking sector globally, both during economic stability and unstable periods. They conclude that CSR's deployment generates the rise in economic efficiency, company reputation, employee loyalty, communication between the banking industry and society, creating new opportunities and organizational commitment. The authors have developed a practical CSR model for the banking sector, shown below in Figure 11. Figure 11 depicts the four dimensions of CSR practices that banks should invest in, which significantly generates improvements in four aspects. Coincidentally, the theory has also been proved accurately by Romanian scholars Ionica *et al.* (2020). Additionally, they sustain a positive connection between CSR reporting and financial performance at the organizational level in Romania. CSR reporting could further help organizations move towards corporate sustainability and improve financial institutions' financial performance. Bento *et al.* (2017), indicate that CSR could develop competitive advantages for companies in the current environment.

Figure-11. CSR model of the Romanian banking industry



5.14. Examining and Restructuring Financial Institution's Leadership Structure, Clearly Determining Roles of Board Directors and Organizational Project Managers

A weakly designed top management structure and incompetent top management team could cause severe problems to a company's clients, investors, staffs and other interest related entities. It is critical for a financial institution to regularly raise awareness in regularly accessing its senior managers' performance and examining if the leadership structure is appropriate. On the other hand, suitable organizational structures improve the leaders' influence on their subordinates' behavior, performance and work, thus increasing customer's satisfaction (Neubert *et al.*, 2016). Regarding managing risks in financial corporations, it is required to separate the persons in the CEO and Chairman roles. Joseph and William (2020), summarize that the two jobs of CEO and Chairman in a one-person model would deny organization talent at the top and lead to blind spots resulting in increasing corporate risks. Corporations would easily go astray when checking top executives since it becomes hard in the two job-one person model. Moreover, the board of directors should decrease outside duties to govern the companies effectively, and an effective company strategy implementation requires more clarity about each director's responsibility. Irja (2016), states that the board of directors' duty is to administrate and adequately organize the company's operations, while the organizational managing directors manage the company according to the board's guidelines.

5.15. Increasing Efficiency Related to Material News Disclosure

The general public nowadays could get information from various channels, which include digital, print and broadcast newsrooms, individual reporters and editors, consumers, financial and news portals, websites, news syndicators, bloggers, social media networks, and more. Effective press release distribution is a challenge more than ever before. Because a sea of loud and noisy information surrounds the public, financial services companies' news, announcements, and advertisements are extremely hard to reach its targeted audiences without the help of advanced digital technology such as big data analysis and effective social media networking. Financial institutions need to find ways to distribute their latest news regarding decisions and reactions more efficiently and precisely to their targeted audiences and communities. It is wise for them to either establish their social media networking system or deploy a professional media company to maximize their material news disclosure to reach their key targets.

5.16. Being Explicit About the Financial Companies' Strategic Management to the Public

A company's adoption of actions and allocation of necessary resources towards its long-term goals and objectives are defined as a corporate strategy (Alfred and Chandler, 1962). It shows a company's responsibility by conceiving the global direction of the organization. Explicit planning of adequate actions and resource allocation are described as strategic management (SM). SM adds value, creates, finds, reinforces, and overcomes a company’s competitive position, indicating specific actions to achieve goals. Moreover, the formulation of strategies helps companies stand out in the long run and define a company’s internal management, thus achieving success by generating the best competitive environment (Guillermo *et al.*, 2020).

5.17. Stipulating Employee Behavior Expectations and Measuring Employee Behavior

Employee behaviors are a vital component in achieving financial institution's success; this is because financial institutions are highly relying on their employees to deliver high-quality financial services to clients. Setting clear employee behavior expectations and carrying out employee behavior measurements can reduce or eliminate the confusion of what employees are expected to do and increase the possibility of employee self-achievements at work, therefore, generating better financial services to clients. Employee behavior expectation could be defined as broad goals for behavior or the specific ways aligning different aspects that a company expects its employees to act. For example, some companies require their employees to follow the rules they set up for employee integrity. Employees are expected to meet ethics, compliance and attendance requirements where all the standards are designed and measured by financial companies' management team.

5.18. Redesigning Financial Organizations' Incentive System

Apart from behavior expectations and measures that affect financial firms and employee behaviors, an incentive system could be another powerful influencer. Many cases have occurred in the business world in which incentives could have a negative effect in driving staff and financial firms to imprudent and unethical practices. Destructive behaviors caused by poorly designed incentive systems generate significant risk exposures and market excess and erode trusts in financial firms. Redesigning a sound incentive mechanism to combat financial institutions' immoral or illegal practices to rebuild trust from the public is extremely important to prevent duplication and escalation. Some implementations adopted by real businesses that demonstrate incentives should align and be consistent with desired behaviors. These revised incentives include reducing incentives related to services and sales, increasing base pay and benefits, and restricting stock rewards for senior managers.

5.19. Emphasizing Organizational Strengths and Writing Progress Reports to Inform the Public

After illegal severe or immoral practices occur, financial institutions are not supposed to keep silent and wait for the public to forget the scandal gradually. A negative response to the rising problems could not solve the problems but only push exchange partners away. Instead, financial institutions should actively inform the public of every progress they have made to revise their behaviors and stipulate them in progress reports and other forms that could easily reach their audiences. Usually, the public loses confidence in the financial institutions after which they have committed illegal and immoral practices. Therefore, emphasizing organizational strengths could help investors rebuild trust and preventing investors from leaving the financial companies, which could result in causing severe financial problems.

5.20. Self-Regulation by Companies in the Financial Services Industry

While self-regulation is necessary, it is also the most difficult to achieve. The key reasons that most companies in the financial services industry will more than likely be lax in the types of rules that should be passed and in their enforcement. The problem is that industry, such as financial services, does not want to punish themselves for being aggressive in selling the products and services to make them the most revenues and profits. As these companies see it, self-regulation will hurt their ability to grow in market share, the number of clients, and ultimately size. These firms have always been aggressive in their sales tactics and have pushed their sales force to close every sale even if it may not benefit the client. The problem is that self-regulation would stymie their aggressiveness and reduce earnings for their sales force. Self-regulation can only occur if the financial services industry is willing to admit that their past techniques can no longer be used and that the client must benefit from programs, products, and services these companies offer. Self-regulation is necessary and can only be fully achieved if more organizations such as the Financial Industry Regulatory Authority (FINRA) are created with more authority than ever before.

5.21. Designing New Marketing Methods in Selling Financial Products and Services

Clients' role is vital since financial service companies generally will abide by what is demanded. Financial service companies know that clients will take their business to companies that are ethical in providing services, offering financial products, and maintaining relationships in the long term. Financial service companies are like any other business in that the last thing they want is bad public relations and a dishonest reputation. Financial service companies must abide by what clients demand and pay attention to any actions clients may take. These demands could be better service, lower fees, and more flexibility in the services being offered. Clients' actions would be complaints to Congress and the Securities Exchange Commission about how financial service companies treat them. These complaints could turn into legal actions in federal court or possibly in arbitration hearings. But either way, financial service companies know that the result would be bad publicity, which would get more attention than the good things these companies were doing for their clients. If there were terrible publicity, it would probably stay in the public's mind longer than noteworthy publicity.

6. Conclusion

There are essential elements that every firm must be aware of, especially those in the financial services sectors that should be regarded as timeless. The first of these is the importance of trust from their exchange partners. The perception that the general public has of a financial company could mean either success or failure. Suppose the general public has a positive perception of a company. In that case, it can be assured that it has competitive advantages in gaining more market share, revenues, net profits, and grow its reputation over time. While quantitative factors are important, qualitative aspects play a key role which includes managing its reputation. A company must defend its reputation through how it operates the business, its honesty, and the public's general perception as a trustworthy company. If a company in the financial services sector cannot maintain the vital element of trust, it faces a massive public relations failure.

The element of trust also ties in with a cause of the Financial Crisis of 2008-2009. A key reason for the financial crisis was that many financial institutions were more concerned with revenues, profits, and market share than helping their clients acquire a proper mortgage to purchase a home. In this instance, financial institutions such as commercial banks and mortgage companies were more focused on making sales than fitting their clients with the best loan program. The result was that millions of mortgages were made for all the wrong reasons and subsequently lead to a severe financial crisis in which the residential real estate market collapsed. Not only did millions of people lose their homes to foreclosure, but to bail out the commercial banking industry would cost the American taxpayer hundreds of billions of dollars. All because the financial services sector was no longer a trustworthy industry.

The same could be said of the scandal that engulfed Wells Fargo Bank as it sold financial products to their clients without authorization. Wells Fargo created 3.5 million unauthorized accounts for its clients just for the sake of making revenues through selling various financial products. Not only did the scandal cost Wells Fargo millions of dollars in legal fees, but also to settle huge class-action lawsuits. Wells Fargo is still in the process of attempting to regain the trust of its clients and that of the general public. When and whether that will ever happen remains to be seen.

Strategic crisis management is a short-term remedy. Only prudent risk management of reputation to prevent more scandals from happening in the future could be the ultimate goal of any companies in the financial industry. Therefore, there is a need for changes in the financial services sector. Whether it will come about by the industry and making significant self-imposed changes will be very difficult to accomplish. The changes will need to be strict and, in some cases, harsh. But if they are not done, then strict rules and regulations must be imposed by the Federal government, whether the financial services industry likes it or not.

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