RECORD OF SOCIETY OF ACTUARIES
1983 VOL. 9 NO. 4

INSURANCE COMPANY ORGANIZATION FOR SURVIVAL

Moderator: LAWRENCE V. DURLAND, JR. Panelists: W. RANDOLPH ADAMS, L. JAMES ELLSWORTH**. Recorder: JOSEPH J. HOGAN*

What can an insurance company do organizationally to support its strategic and marketing plans for the next decade?

- Organizational attributes that facilitate changes in strategic direction

- Analyzing the current organization

- Changing the organization

MR. W. RANDOLPH ADAMS: Most of my background has been with financial institutions outside the insurance industry, so my examples will be banks, savings and loans, securities firms, and financial congenerics such as American Express. There are lessons, though, that are common to all segments of the financial services industry. I will address the approaches being used and some of the difficult issues being faced in designing organization structures.

Designing organizations for financial service companies today is a very complex matter. What works well for one company may not work well for another company--even in the same industry. You must tailor your structures to your own business.

Also, consultants are often asked "Which is more important, organization structure or people." Obviously, the answer is people. Good people can make any structure work; however, structure can help people work better at times. As organizations get bigger and more complex, structure becomes a more critical issue in the performance of an organization.

I would like to briefly cover some changes that are occurring in the financial services industry. Basically, I see a series of new freedoms for the participants in the industry, caused by deregulation, new technology, and just plain old innovation.

*Mr. Adams, not a member of the Society, is a Vice President of Cresap McCormick & Paget, the General Management Consulting Division of Towers, Perrin, Forster & Crosby.

**Mr. Ellsworth, not a member of the Society, was formerly associated with Surety Life, Allstate and Dean Witter Reynolds. He is presently managing his own firm.

Products or Services

The first freedom is new forms of traditional financial products or services. There are four basic types of products: credit, deposits or payment products, investment products, and risk management or insurance. In many cases, traditional products are being either repackaged or linked together but those basic forms are still recognizable. There are some genuinely new products for the consumer or commercial customer. For example, in the risk management area, some financial institutions are now hedging with futures, which they could not have done before unless they created their own hedge through money trading.

Markets

The second freedom relates to new markets. Bankers, in particular, are now free to offer services to new customers--they can go across geographic lines, in many instances, and constraints for interstate banking are breaking down. Savings and loans are jumping across state lines very easily now. The securities industry has had quite a bit of freedom. You will now find bankers selling stock and stock brokers collecting deposits or money market funds.

Pricing

The third freedom relates to pricing. A number of these industries have been regulated to differing degrees, but the rates which they can charge for assets or liabilities are now much more free. Even the term structures of some of their products have changed. There is more freedom in setting the length of a commitment, either deposits or loans, or in setting rates. For example, there are now many variable rate instruments in the market.

Associations and Linkages

And, finally, there are some new associations and linkages in the industry. Everybody is aware of the mergers and acquisitions that are occurring but less visible are the linkages such as joint ventures. Banks have started service bureau organizations to help service some of their back office functions. The joint Automatic Teller Machine (ATM) networks are another example of the joint ventures. Also, an increasing number of companies are acting as third party providers of private label products in the financial service industry. The most visible examples in the banking industry are the credit card associations--VISA, Master Charge and even American Express, which sells its gold card through banks. But, there are some other products--cash management for both corporations and individuals, discount brokerage services and even some insurance companies are offering private label products through banks.

There are several areas of change resulting from these new freedoms:

1. Changes in economic structure. The net interest margins which created a source of their basic revenue have been narrowed--the spread between what they charge for money and what they pay for that money. As a result, there is more emphasis on fees and some non-credit service and, furthermore, there is a very strong movement to reduce non-interest expenses or increase the productivity of the organization in terms of people, equipment, use of technology, etc.

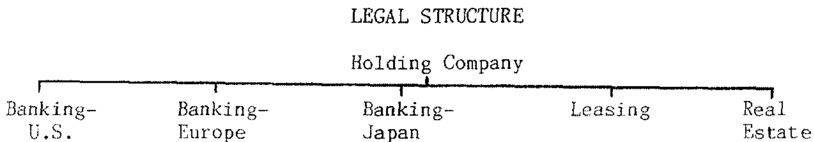
2. Changes in marketing. A number of these industries were regulated and, as a result, the marketing function was often very immature. They are now facing the need to unbundle their products and have explicit pricing. They are dealing with irrational pricing by competitors in the early stages of deregulation. There are some new distribution approaches. Banks and S&L's have traditionally relied on branches, but they are now learning more about the use of agents or intermediaries, something the insurance industry has long used. They are also learning more about customer self-service. The use of ATM's is an early example, but some more visible or more futuristic things would relate to bank at home, bank by phone, or self-service totally through telephone and mail. One company that a lot of people don't think about doing this is American Express. They have, in their credit card division, well over 5 million card holders and they service those customers without one single branch outlet. It is true they have American Express Travel Offices and you can go get a replacement card there, but 99.5% of that service comes either by telephone or by mail.

3. Unfamiliar risks. Most financial intermediaries, banks, and savings and loans in particular, have focused, primarily, on credit risks. But in the last couple of years, as everybody is aware, interest rates have changed and there is an interest rate risk exposure which they are learning to manage. They must establish that control function inside their organization. They are also dealing with foreign exchange and country risk which, too, has organizational implications. And, finally, they are dealing with an old risk which keeps materializing in different forms--liquidity. Some financial organizations have too few liabilities or deposits and they are also trying to find sources of those deposits. Some others, today, are complaining they have too many and are wondering where they are going to place these funds--where can they get earning assets.

4. The economies of scale. A number of companies are offering some standard products on a mass production basis. They're driving the cost structure down on these products and changing the basic competition in the marketplace for their products. Mergers and acquisitions are occurring for a number of reasons. Some organizations are attempting to increase the size of their basic business so they can get to what they think is a minimum scale of operations. The question is, what is a minimum scale and what is driving it. In the banking industry, a number of people are beginning to think that the minimum scale relates to the operations or back office functions - how can you justify all the investment in systems. Some others are merging outside their industry and are diversifying in an attempt to offer a wider range of financial services to their customers in the hopes of gaining cross sell opportunities. I'll have more comments about that, later.

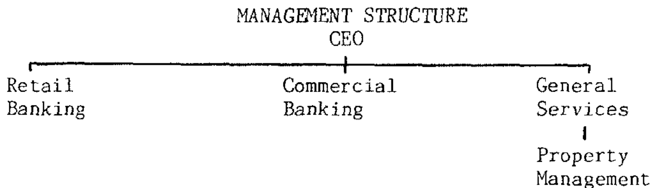
All these changes are forcing financial institutions to rethink their current organization structure. Many of the current structures are designed for either one product or one customer segment. The new organization structures may have to foster either the cross sell or other kinds of synergies or, possibly, help absorb the growth even within a single industry to obtain some true economies of scale.

Let's turn to some basic organizational structures that various financial organizations are looking at. I would first like to start by making a clarification between the legal or corporate structure of an organization and the management structure of an organization.



This is a hypothetical bank holding company organization. These examples are simple but are designed to only illustrate the point I'm making. This corporation has a commercial bank in the U.S. based in New York City. They have a bank corp operation in Europe, probably a merchant bank. They have an operation in Japan which is a limited service facility because of the restrictions in that country. They have a leasing subsidiary which is serving commercial customers and a real estate subsidiary which might simply be a shell to own the property that the bank owns.

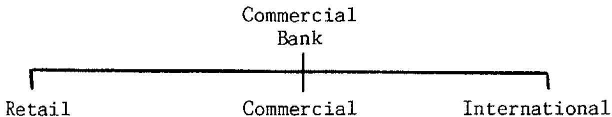
The management structure might be quite different in the same company.



Retail Banking would be the functions that serve the consumer. The Commercial Banking operation has a manager responsible for commercial banking in the U.S., Europe, and Japan. The third entity is General Services and underneath that is Property Management which is related to the properties functions I referred to.

The focus of our discussion today is on the management structure. Many companies, particularly smaller ones, tend to view the legal structure as binding and build the management structure around it. That's not necessary, and it doesn't help you focus your management attention on the issues that your business is dealing with.

There are several basic options for designing the management structure. The two broad categories would be structures that have a market orientation and those that have functional orientation. Within the market orientation are organizations that focus on either the customer, geographic territories, or products. These options seem very obvious but, ironically, when customers of ours try to design organizations, they tend to start confusing where the primary focus is. The functional orientation, obviously, has some basic entities in it that you are familiar with--sales, production, some of the internal support control functions, and there are variations on these. Let's look at some simple examples.

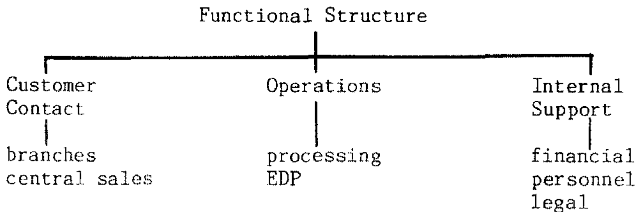


The first structure is a customer driven organization. A commercial bank has divided its customers into three groups--retail or consumer, the commercial area, and the international area. Underneath each of those functions would be all those activities needed to sell and support the products offered to those customers.

A geographic structure, which is uncommon in banking and other financial intermediaries who have traditionally been restricted by regulatory constraints, would take an organization and divide it into territories. This is more common in the insurance industry although territorial division may only surface in a marketing part of the organization, and they may still have centralized operation. In its pure form, though, it's quite possible to have the marketing and operation functions reporting to a geographic head. The only place I've seen this really occur thus far in banks is in the international area where you will find all the activities in Europe housed under one person and all the activities in Australia under another person, etc.

The third form now emerging more often is product structure, using the four basic types of products I referred to before: credit, deposits, investment and risk management. There's a big difference between this and the customer driven structure. The product structure assumes that cross sell between customers will be fairly limited, or that it will have to be coordinated across these organizational lines. The customer structure assumes that cross sell would be a major focus. In its pure form, the product structure has some high cost elements to it. Each of these products would have separate sales or distribution systems and probably their own separate operating support functions. You can literally have a situation where two product groups have branch offices across the street from each other in the same city. There's a strong temptation to say, "Why can't we put them in the same office?". That focus on efficiency and economies of scale undermines the basic thrust of the product structure which is to maximize the revenue that you are going to generate with each product.

Now, there are some permutations of these, obviously. No one uses these structures in a totally pure form. It's quite common to see a customer structure with geographic divisions underneath the first layer, or a functional structure with geographic divisions under the sales part and centralized operations. Another variation is the use or concept of profit centers. A number of people have tried to set up performance centers called "profit centers" or "profit contribution units" or "strategic business units"--there's no perfect definition of what these all are. Basically, they tend to be driven around either customer groups or product or geography. It's unlikely to see a "strategic business unit" in a functional organization, at least one that's primarily structured around function.



This is an example of the functional structure. There are three basic parts. Under operations would be those functions that don't have direct contact with a customer and internal support would include areas which support both the other parts.

In looking at these structures, there are some basic trade-offs in the design. Management will never get everything and they intuitively or explicitly address these trade-offs. Some of the structures will help maximize revenue more than control costs. Others will help focus on reducing costs. Obviously, a centralized and functional structure brings things together and establishes economies of scale, and frequently, will help reduce costs.

The market driven structures have some inefficiences built into them. There are also some trade-offs between centralized and decentralized control. If you allow somebody to control the resources to serve a market and make the needed decisions, you may be driven to more decentralized control. But in a deregulated business, it's difficult to get decentralized units to change quickly if there's a major change in your business environment. The airlines have been pulling decision making back into headquarters--in a highly volatile environment, it may be preferable to go to a centralized structure.

There are some trade-offs between established and flexible structures within the organization. When building new products or establishing new ventures, some people are tempted to create an organizational unit. Others will not build that unit, but instead use task forces or temporary work groups to perform a function. The temporary work group is more flexible--it doesn't always fit, though, in an established structure.

The final trade-off is the degree of standardization that is required in your business. If you're operating in a number of geographic areas, there is always a question of how much standardization of products will be required in every market. In a centralized operation, it's more difficult to tailor the products to individual markets. On the other hand, some businesses, particularly multi-bank holding companies, have allowed the same product to look different in different markets--different name and even, in some cases, a different logo on the business.

Now, let's turn to some specific issues that everybody's wrestling with beside these trade-offs. In a highly volatile environment or deregulated environment, where new products are added or whole lines of business are added, organizations need to consider whether the organization structure they're using is supporting that business. Many Chief Executives are now trying to change that structure so they can better manage it. What is often misunderstood is the extreme difficulty of changing an organization. It's not just simply sitting down and drawing boxes and lines and trying to tie them together. You are changing values, habits, and operating procedures and these kinds of changes don't occur very quickly. You have to, in many cases, think about staffing changes if there's going to be a major redirection in a company. People have to learn their responsibilities, learn who they work with, how to communicate with them. In my judgement, a major change in organization can take well over a year or two before it even starts functioning very effectively. There's an article in the current Fortune which I think is excellent. It describes some of the culture studies that some of my peers are doing in certain corporations. They are examining how to make people work well in a structure after the structure is changed, and the difficulty of achieving that result.

A second issue is integrating mergers and acquisitions. Once again, people tend to underestimate the difficulty in this. I know it is a difficult process to find a merger candidate, to woo them and bring them on board, but a lot of chief executives think of that part of the job only. They don't think about all the activities that have to occur after the merger has occurred. There are some basic policy questions that have to be addressed. One of them is how much integration is really required. Some people have tried to get standardization--full integration into a functional organization. If they are bringing two businesses together, they may be trying to blend oil and water. Their cultures may be just incompatible. When full integration is justified, and there are two industries that are compatible, most people have found that they have to start planning the operations side of the integration process first. Marketing always seems to come second. When they start with marketing, everything stops until they find out what they are going to do with operations. I think the multi-bank holding companies in Texas, Illinois and some other states have shown some interesting lessons. Full integration isn't absolutely necessary and some companies would do well to consider a limited degree of integration. These multi-bank companies have allowed various banks to retain their local name, they've allowed local decision making and pricing, product offering, etc. It's created several benefits: the shock of merging organizations is lessened, they can slow down on the amount of work needed to bring together pieces of the organization, and they can add on more pieces quickly. Finally, there's a very tangible

benefit if a company is in an active acquisition mode. It can keep some chips on the table for the CEO of the acquired company. A lot of these people want to retain their titles but if you have an integrated structure, there's only going to be one president. In a multi-bank structure, you are going to have a number of presidents.

The third issue is the increased importance of the factory. By the factory, I'm talking about those operations functions which have non-direct customer contact--transaction processing, customer records, billing, etc. In a deregulated environment a number of people are finding out that they can get the customer in the door the first time with marketing, but getting them back the second and third time relates to the quality of the product and services they have. That quality relates to the quality of the operations function. Some basic plans are coming to a halt as companies realize that their operations functions cannot keep up with some of their marketing ideas, or planning, or that they're not getting the innovation in these functions they need.

The fourth issue involves the three broad approaches to distributing products and services to customers -- using the branch, using an agent or an intermediary, or using selfservice. Most important here, at least in banks and S&L's, is the cost of maintaining the distribution system. It is really coming home in the last couple of years what this costs and, furthermore, that they are not getting full payment for this cost from their customers. As a result, some major changes are occurring; not only is there explicit pricing of services, but they are now talking about closing down branches. Bank of America has a program that cut back their branches about 15 or 20% and I wouldn't be surprised if five years from now that percentage was increased.

The nature of a branch is changing. More limited service outlet, store front operations are occurring; stand alone ATMs are the ultimate in limited service in terms of the people cost. But there are some trade offs there to be made. There is a fine line between service and efficiency. A number of banks don't know what the customer will tolerate and are trying to maintain a minimum level of service while reducing the cost. I think the customer can tolerate much more than people believe but this trade-off and how it is addressed in each organization varies considerably.

Another issue to be dealt with in the distribution area is handling redundant distribution systems. If you have offices across the street from each other, for example, a mortgage banking office, a consumer finance office and a deposit collection office, it's very tempting to bring them together because of the potential economies. But the manager of the consumer finance office may be ready to close up if business dries up. He may want to be able to open up and shut down offices quickly. On the other hand, the deposit person wants to have a continued presence in the community so his customers have a sense of stability. Those two different attitudes about what the branch system means to the customer and the flexibility required may mean you have to tolerate some separate and redundant distribution units.

A fifth issue that organizations are dealing with is how do you manage products. There are really two parts to this issue. One is the building and development of new products and how that process is managed, and then secondly how do you manage the products you have. Regarding the first, a number of organizations have built financial service products in an ad hoc manner, relying on the operations people to design those products. Later on they moved to a task force approach when they realized that marketing issues are involved, legal issues are involved and so on. But they are still having trouble managing these task forces because it is a matrix management issue and very few organizations have been able to cope with that. A few have even gone further and established product development managers with permanent project managers in the organization. That concept works for some but the location and the role of these people is a difficult issue to work with in designing a structure. Obviously many people are now thinking about and installing the concept of product managers; they are borrowing this concept from the consumer product companies. But this is not working as well as some people might hope. Bankers, in particular, have not thought through what a product manager is and how he operates in an organization. In Proctor & Gamble he works in a matrix structure and has no direct responsibilities or authorities--it is all based on his personal influence. That role does not always work in a new organization.

Another issue with the product managers is what decisions can they influence. Many people still think of product management as advertising and promotion yet to be effective these people have to think about pricing, the life cycle of a product, whether to kill a product if it is no longer effective, product profitability, ways that the product can be sold and how they can influence the distribution system.

The final issue that seems to be difficult to install in organizations is how to control risks in a structured organization sense. I mentioned some of the risks that people are dealing with earlier--I will talk about one of them and the complexity of installing that control process in an organization structure. You probably have heard the term asset/liability management; in banks it represents the management of the interest rate sensitivity exposure of an organization. The easiest example of that is in the S&L's, where their mortgages were fixed rate and their cost of funds was variable and all of a sudden they were in a negative spread in the last couple of years. There are a lot of analytical tools to examine your exposure, measure it, and there are some tools to control it. But the process of making that analysis and selecting an option to control it ultimately involves some change in the balance sheet or some change in your pricing policy, either on the asset side or the liability side. Those policies can affect a managers' ability to control a product, to control a geographic market and so forth. People have recognized the importance of those decisions and created Asset/Liability Management Committees. Once again, these committees work well in some organizations and not in others. A committee structure raises questions about who is involved and what is their decision making authority. In some cases the committees have degenerated into debate societies with no action. The next step is to give more power to the chief financial officer and there you're wrestling with issues of how much line influence or authority over line units you're going to give to your chief financial officer in reshaping your balance sheet. There are no right answers; it's just an issue that everybody is facing. The same kind of tradeoffs come up in some of the policy making committees in banks dealing with country risks.

I would like to conclude with a brief comment about financial supermarkets. This is an issue that everybody talks about, and there are many advocates for it. I don't think the concept will be very successful. There are some basic problems. First I think there is a myth about cross sell. Everybody assumes that the customer can be sold a wide range of products but these products are really quite separate and distinguishable and people underestimate the intelligence of the customer to make that distinction. Customers have quite a different set of perceptions about price and quality and what they want for each service. I think there is limited cross sell in the organization. We've done some studies for S&L's, for part of American Express, and some commercial banks and some obvious cross sells that you would think would be high actually turn out to have very low percentages.

The second problem with this concept is the limited capacity of their distribution system. Customer Service representatives, agents or branch people have a limited capacity--not because of ignorance but just human capacity to understand a wide range of products and sell each of them effectively. Most sales people focus on one product because they understand it and know it well and they sell that one. All others are secondary. The proof of this occurred in the airline industry about two years ago when all the pricing changes were very vulnerable--I don't know what your experience was but I could not get a straight answer from a reservation clerk when I called to find out the fare on a route, or how to get there--yet in a reservation center in an airline where people have all the tools in the world available to them, sophisticated CRT screens with all the pricing options available to them, they couldn't even call up the menus on the screen to get the information.

The third problem with this concept is the incompatibility of merging different organizations and cultures. A company offering a credit card and another company offering installment loans are really in two different businesses. A commercial bank and a discount broker--with two different sets of customers and two different types of operations--have different marketing strategies and in some cases different compensation schemes for their people. An attempt to link these cultures together or force the linkage just won't work in many instances. As a result, I think many of the "supermarkets" are going to disappear or narrow their range of service. In the early '70s bank holding companies went rushing out to buy mortgage banking companies, consumer finance and so on; many of those banks later sold off those companies because they found they could not manage them and the cross sell that they assumed would somehow materialize just didn't come to be. I do think there are some scenarios that may last, however, one of which is there will be some cross sell to very narrow customer segments with some basic products. I think Sears has a genuine possibility of working if they stick to a middle market customer and offer some simple basic products. The other thing I think you're going to find is that some people will become what I'm going to call financial department stores; that is, they offer the shelf space and the customer access and a third party comes in and places the product on the shelf. But once again, those are going to be standard products that the third party people offer.

MR. LAWRENCE V. DURLAND: In the insurance consulting side we've been working recently with other financial institutions, non-insurers, interested in getting into the insurance business. I've even talked to some insurers who would like to get into the banking business. I keep telling Randy and his associates in the financial institution practice about many of the things that exist in terms of environment, unbundling, irrational pricing, new distribution systems, merging, acquisition - he said the same thing about the banking and financial service industry that we would be saying about the insurance business. However, there was no way that I would have dreamt he would have stood up here and told us how to manage the C-3 risk.

Every organization - no matter how appropriate it is when it is installed - has a useful life. And even beyond that, organizations are much like people. They are not self-correcting creatures. There are internal norms and values which pull and push at them, in addition to external forces. And organizations, like people, occasionally need analysis before change. The more severe the change desired the more intensive the analysis. To talk to us about analyzing the organization is Jim Ellsworth. Jim, in his career, has been the Chief Executive Officer of Surety Life Insurance; Executive Vice President of Dean Witter Reynolds organization and Executive Vice President and a member of the Board of Directors of Allstate Life Insurance. Jim is now managing his own firm and will talk to us about analyzing the current organization.

MR. JAMES ELLSWORTH: I will be basing my remarks on my experience - seven times in my career the total corporation has been reorganized by myself, or by a CEO that I was reporting to. I hope my experiences can be helpful to you whether you're a CEO, a planning officer for the company, or one of the people affected by the reorganization.

When reorganization takes place, there is going to be some discomfort. Everyone likes to avoid discomfort, especially the CEO and the senior people, to avoid the tough decisions and the difficult things that have to be done to get to where you want to be. Often the CEO will agonize over the knowledge that the right players aren't in place and that changes will have to be made and becomes so concerned about the discomfort of those other people that he will have forgotten his own self. Only when the changes are made will the burden be lifted. It is important for the CEO to realize that he should not bear too much of this discomfort and he should make the decisions and move ahead. Many people have skills and we hire them for their skills yet many times we terminate them because of their personalities and their relationships with people. People often can do what you would like them to do technically but do not have the personal skills to carry on what should be done.

The Reorganization Process

1. Who should be involved? The executives that are going to be affected should be interviewed. I believe very strongly in a one-to-one interview with each one to determine their expectation levels. George Odiorne, author of Management Decisions by Objectives, once told me that one of the biggest problems in most corporations is expectation levels -

the employer/employee relationship. At the outset of any reorganization make sure you understand what the expectation levels of those senior people are in relationship to your own expectation levels; what they think their job is, and what they think the company's responsibility is in their job. You'd be amazed what you would find out if you spoke with some of your senior people and found out what their expectation levels were. As you do this interviewing try to assess their strengths and weaknesses, and then emphasize their strengths. Be sure that you learn their feelings about how the company ought to be organized and what the future holds. I caution you to stay away from talking about personalities and weaknesses of other executives. It could be very detrimental if individuals reporting to you know that you're talking about someone elses weaknesses in performance or personality. That can be very damaging, leading to a credibility gap with your people.

2. Should consultants be used? I believe that as you are going through this process it is very helpful to have a consultant to listen to you, to help you arrive at decisions and to give you some assurances that you are taking the right steps. It's important that in that relationship the expectation levels are spelled out, so that the consultant understands exactly what you expect of him and that you understand what he is going to do. You should fill any gaps and not be left thinking the consultant would take care of the organization for you or tell people about the changes. Problems can be created if you don't spell out up front what the expectation levels are.

3. What is the role of the position analysis? It's very important that you look at the company's current situation and where it has been. Too many corporations spend a great deal of time looking at where they want to go before they've really analyzed where they've been and where they are currently. You will have thought through those decisions much more thoroughly if you've done a very good position analysis. It's too easy to sit in a meeting and want to jump at a conclusion before having gone through the process of identifying the real strengths and weaknesses, what has been done in the past and what is being done now. Find what has worked before and use it. Build upon those things that work well in the organization and add if you possibly can. You should examine the management of the Company; what kind of style do they use, is it authoritative, is it participating team building; examine the strength of these specific executives you've interviewed, examine the strength of the present organization; examine the decision process, are decisions postponed, are they delayed, is there a good frame work for making decisions, do things move along or do they slow up and bog down, are decisions being made at the lowest possible level; examine communication; are things communicated well - upward as well as downward - to the organization. The team building concept; how well is your company performing in the areas of team building and helping people participate together in making effective plans and objectives and strategies.

4. What are the objectives of the corporation? Before you reorganize you must identify your mission. It is important to make these objectives realistic, yet tough enough to be excited about. Your team and your management organization must have a dream, something to strive for, it must be exciting for them. Are your objectives measured by revenue or by profit? Motivation is a very important part of running any organization. Doctor Frederick Herzberg, an authority on motivation, talks of satisfiers and dissatisfiers. Many corporations are terrific on taking care of the dissatisfiers: salaries are good, the workplace is fine, and the fringe benefits are great. All those things are taken care of, you can't really say it's a bad place to work. But, what about the satisfiers? This is where we get into objectives and dreams and being excited about what you are doing, what you are accomplishing. That's the key to having a very effective organization.

5. What are your strategies? What kind of strategy are you using, does it fit with the parent? Often corporations design organizations, structures and objectives that in no way relate to their parent and what they're doing and what they're trying to accomplish. If you are the parent, you must be sure the organization structure is going to effectively fulfill the strategy which you want to accomplish.

6. How will you establish accountability? As you establish accountability bear in mind that it's very important that you give people a chance to fail. Is there going to be ownership in the organization, for decisions, for getting results? Is there going to be entrepreneurship opportunity within the corporation? If you're giving people accountability for certain things, are you giving a control of the variables which affect that? People may put together objectives in organizations and set them for individuals and yet not allow control of the variables which affect the performance of their objectives. That's a very difficult, frustrating position to be in.

7. What is the work style of the CEO? Keep in mind the work style of the CEO; does he like to use staff, or like a strong line organization or like being involved in details. Is he well organized, or do you need someone else in a staff position to help him organize. It is important to really look at what the CEO enjoys. If the structure doesn't fit with what the CEO wants he may go off and do what he wants to do anyway. If the CEO wants to spend about 70% of his time in industry and community endeavors, you better organize the other 30% of his time well: don't have fifteen people reporting to him and no staff help. Know what the boss really wants to do as you organize.

As you go through this process explore all the alternatives. There are many ways to organize, not just one best way, but you must decide on one. Set an objective and a strategy as well as an organization to live with. It is important that the CEO understand up front who he wants reporting to him. Move quickly once you decide. If you have thought it through and you know what you want to do-- move quickly and make it happen in a hurry. If you don't uncertainties and rumors can damage the organization.

In summary, reorganizing a company is a challenging and painful process but one which has great rewards. Begin with a position analysis of where you've been and where you are currently. Understand the people involved, and their strengths. Draw upon those strengths and those of the current organization. Have a clear definition of the objectives and the accountabilities as you go through this process. Above all, be sensitive to the feelings of others and express your honest feelings to them.

MR. DURLAND: Randy Adams made the observation that it takes from one to two years for a new organization structure to really get up and running. The first thing that came to mind is that has some interesting implications for companies that are on an annual reorganization cycle much like their annual planning cycle and I'm sure we all know some of those.

Part of the reason that it takes so long for an organization to settle into place is that when we first look at an organization redesign, we tend to focus on boxes. You think about how the boxes fit together and who will be in them. Implementable organization design is more than boxes; it considers structures and in the larger sense, measurement, rewards and staffing.

We'll start with this statement very commonly made, structure follows strategy. But I think of structures in a much larger sense. Structures begin with individual job content: what are individuals within the organization doing. As the company changes strategically, this can change. A benefits specialist can be a functional processor but another job can exist at the same level: a Customer Service Representative, dealing with all the transactions of the customer. At another level in terms of job design is the concept of the product manager. These individual jobs must be brought together into sub-units. If you've decided to be customer organized at the first level, and have created a functional organization one level down, you are going to find the problems of the functional organization now popping up not in one place, the total company, but in four or five places because you've got four or five smaller functional entities.

Structure also includes the location of authority: are you centralized versus decentralized, is the authority held at the top or pushed down? Another structure is the bureaucracy. Every company has to have a bureaucracy. Those are the rules, procedures and policies. In designing the organization how many of those rules, procedures, policies are going to be specified? The more you specify the more you have created the bureaucracy which can fight against the very organizational direction you want to go.

Finally, there are temporary structures, through the use of task forces and committees. If you are using task forces and committees now, are they being used to pull things together or are they being used to work around the existing organization? Is your committee and task force structure perhaps a more appropriate embryonic state of a useful organization than that which you have on paper? Structure does follow strategy but in defining structure you have to remember to consider all of the pieces.

The second item that goes into organization design is measurement. We are trying to answer the question--are we meeting our objective? That starts at the company level, the unit level, the manager level, it works its way down to the individual level. There are quantitative measures and qualitative measures. The foremost quantitative measure is, of course, financial. As you are defining the financial measure, seek to match your current strategy and get the information you need to appraise the performance of the organization. More and more companies are realizing that the performance measures should follow strategy as much as structure should follow strategy. For example, your strategy could be to limit losses from the erosion of the existing block or to develop new sources of value within new markets. You may have both of those strategies in place at once but you should have them within distinct organization units and you should be applying different measures. The use of different measures is going to move you away from the definitions that the industry operates on based on the annual statement. This can move you away from line of business and toward measurements based on markets. You may move away from bottom line profit to measuring those things you really have to do to implement your new strategy. We really have a triangle with strategy at the top, structure being driven by strategy and measurement being driven by strategy. Make sure that there is a correlation between the structure and the measure.

When defining performance measure, we have found three common dimensions; organization units, lines of business or markets and performance modules, such as marketing, administration, investment and risk. All of those add to profit, but at any given time the strategic direction of the company may be emphasizing one and de-emphasizing or assuming a loss on the other. If you can break your profit apart into those pieces you can then plan for those pieces, recognizing where you are anticipating losses due to growth and where to get the excess profit to support that. If you then bring it together, you can say this strategy results in this set of numbers based on these measures and we will now measure the organization based on that. In summary, the intent should be to measure for strategic change as opposed to measuring bottom line, current state, conditions.

The third item under the general heading of organizational design is rewards, both in terms of what type and how are they determined. There are really two types of rewards in my classification. One is tied to measures, reflecting the drive of your strategy and the other is tied to the past, based on seniority or education. If you are changing the direction of the company and trying to mold its future, it may be inappropriate to have reward systems tied to the past.

The fourth item of organizational design I'll touch on briefly is staffing: selection, training and development. Randy talked about the importance of people over structure. We are not only organizing work flow, we are organizing human resources. Even if you have defined the appropriate organization chart, you still need the right people. This is a combination of skills and motivation. You may find you do not have the right people. You may have developed people based on your current functional organization and strategies. When you decide to go in a new direction, after new markets with new products, the first question you have is who is going to do this? That may require going outside and it may require some terminations.

In summary, not only should you build your structure for strategic change, but you should be able to measure that strategic change, you should be willing to reward people and you should staff. All of those pieces have to come together before you can say you have an organization design which is appropriate. I use the word appropriate because there are several choices as you go through the process. Part of those choices are based upon the analysis of the organization you've done, part of the choices are based on your future strategic direction. When you have made those choices and you have developed what is now the appropriate organization, remember that you may be changing that organization down the road.

This concludes our prepared remarks. I now open the floor to questions.

I have one question for Randy: What does it take to establish product management in a financial institution? You were talking about it being a form of matrix management which we did not discuss.

MR. ADAMS: First of all you have to have limited expectations. It took Proctor and Gamble 30 to 40 years to build the product management concept in their organization. A financial organization is not going to build it overnight. Nevertheless, if the CEO and top management truly believe in the need for this, you can start it. You need to use good people, put them in a position where they can influence the various levers that are going to affect a product, and clearly define the authority. What position is best for the product manager, for example, whether he should be placed in a marketing organization, a line unit, or in operations, depends on the culture of the organization and the way you operate. Clearly define the authorities of that person in the policy issues that they have a right to speak on and influence. For example, will the product manager be able to challenge the basic pricing of a product. You must get the right person in the job. Financial products are different from consumer products. They are not only marketing, but operational in content. A lot of people, Citicorp in particular, tried to use product managers from General Foods or General Mills or Proctor and Gamble. These guys bombed--very few of them were successful. They weren't successful for two reasons; first, they didn't understand the operational content of the product, the basic systems such as the deposit-accounting system that underlies a checking account, and second, they had come from cultures where the product manager concept was established. Creating that concept and operating when the concept is established is sometimes quite different.

MR. A. ANTHONY AUTIN, JR.: The banking and life insurance industries are going through a period of change. Companies may feel unsure about where they're headed and may not be prepared to establish strategies to get there. Is there a particular structure which would be more appropriate than others for managing through the next several years?

MR. ADAMS: One of the issues is the amount of change that a company expects to experience and how ambitious they are in trying to get into different markets and changing the product mix. The more ambitious you are, the more likely you are to encounter change. That's the hardest part. A company

that reorganizes and then changes their business plan may have wasted that reorganization. It hasn't even settled in. If you are facing a lot of change you've got a trade-off. You need central control to move the organization quickly. The airlines are an example of this. Everything is being done by top management, whereas before they used to delegate to region managers. But at the same time you've got to be able to build new businesses and nurture them. You may have to have some greenhouses or separate business units underneath that you can control with strong monitoring systems.

MR. ELLSWORTH: I think that it's important for most companies to really do what they do well and continue to do it. It is easy to get caught up in the things that American Express, Sears, Merrill Lynch, Citicorp and the others are doing. Rather than competing with the banks, perhaps we should work with the banks, but we need to find out what we do well and do more of it.

MR. DURLAND: I believe you were asking how do we organize when there is so much external turmoil that we can't have a future strategy in place. You have a strategy, which is a rear guard strategy; but what can be done so that when new strategy is defined we can most efficiently take off in that direction. Often companies in that situation become so locked in to the process and the organization that was originally defined on a temporary basis that when the time comes to go off in a new direction they have to change it again. It may be best to leave the existing structure and organization in place and start up a brand-new, very small, organization, keeping it away from the existing one in terms of policies and procedures. You can make a fresh start in a new direction and meanwhile you have addressed the problem of day-to-day operations until that new direction is defined.

MR. SAM GUTTERMAN: Cross selling is something that many people have talked about, yet very few have been successful. You suggested products be kept simple, yet when you're dealing with the commercial market that's not a viable alternative. Is there anything in terms of organization, structure or anything else you have commented on to lead to success in cross selling?

MR. ADAMS: First of all, I would assume you can't cross sell. If you can get past that, then I would create separate product organizations. A couple of the money-center banks have taken what they call non-credit products, such as cash management products, lock boxes, and reconciliation plans and created mini factories for each of them, including separate sales forces. They have not worried about whether they're cross selling with their credit relationship. The traditional lending officer does not sell the non credit products very well, and they have found that the extra expense of the separate factory and the certain amount of redundancy in marketing and so forth more than pays off in added revenue.

MR. ELLSWORTH: In 1976 a company that I was running was acquired by Dean Witter and we were very excited about the possibility of selling life insurance through their distribution system. We did a thorough analysis of that distribution system. They had at the time over 300 different products

that the Dean Witter account executives could sell. When we looked at the top 100 salesmen and analyzed their production and where it came from, over 90% of their production came from one product. This confirms what Randy was saying; people tend to stick to one product.

MR. SOLOMON GOLDFINGER: I have two questions for Mr. Adams: Is the cash management account a cross sell? If it's not, to what extent is the need for communicating the variety of products a client might have in one form important in the future? Also, you mentioned that you felt a centralized organization can change faster. Some of us might have felt intuitively, at least in the organizations that we've dealt with, that decentralizing allows you to respond faster. Can you comment on that?

MR. ADAMS: The cash management account is a limited cross sell among a number of deposit related products - they're all tied to payments in one form or another. It is less effective linking those customers who have a credit relationship and those customers who want payment services. In the banks where I've seen cash management sell well to commercial customers they usually have a separate sales group. To use an IBM analogy, they start off with a customer rep and a tech rep; the customer rep would be the bank officer and the tech rep would be the cash management service officer. Very soon they found they had customers who didn't care about credit; they just wanted that cash management product and the tech rep began selling directly to the customers. Most of the successful banks who have major market share in cash management have separate sales forces now. There is cross selling, they don't ignore it, they're always wrestling with how can you expand your opportunities and links, but the fallacy occurs if you assume that one sales person can sell all the products. They have had to train separate and redundant sales forces.

On your question about centralization; in a decentralized environment, different parts of the organization are given a sense of where the overall corporation is going, they are given a mission to perform in that overall plan, and they have certain objectives that are set up for them. Everybody plays by certain rules and they understand what those rules are; when the ballgame changes, and top management needs to move quickly, it is hard to change the criteria that has been set up for all the decentralized units. Not only do they have to change the measurements, they have to change the rewards. They have to communicate with those people that they are going in a different direction, and those communications have to go over and over until people finally hear them. I prefer a decentralized structure, it's much easier to manage, and there are a lot of benefits. But when you have a radical change, top mangement controls the real levers that are going to implement that change. One of the big levers is allocating resources, and that needs to be controlled by a very tight group.

MR. JAMES HARLIN: Other than products, what advantage does the banking industry see in the insurance industry - what strength do we have that they would like to tap into?

MR. DURLAND: Having worked with several banking organizations, I feel that attraction is novelty: insurance is something they've never been able to do before. As we start to explain the insurance industry, we find that banks are really risk averse. When you start defining products where they will take the risk, they will say that's too risky.

MR. ADAMS: Usually, they are trying to link a certain kind of insurance product, whether it be casualty or life, to some other specific service, but most of them are speaking in very general terms and they have no idea of why they are doing it.

MR. ELLSWORTH: I think primarily its just asset management. They see the insurance industry accumulating assets rapidly through pensions and annuities and group; they don't understand where it is coming from or the profit margins but they see asset control.