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# Managerially Speaking: The Suboptimization of Optimization By Function

by Marcel Gingras

Every corporation must decide how to best organize specific functions within its organizational structure. At one end of the spectrum, very small organizations have little choice but to have several functions performed by the same person, as sometimes there may be only one person in the organization. At the other end of the spectrum, very large corporations have a variety of choices as to how best position specific functions within the organization. Companies may choose to have small units perform several functions, such as application software development and accounting, as part of their overall mission. Alternatively, they may choose to extract all functions that appear to be common to several units and move these to one area specialized in that specific function. Then, this area services all units or a subset of units within the corporation.

Every organization has to decide on the optimal mix for all common functions and it will vary depending on the needs and characteristics of the organization and it may need to evolve over time. It is my view that for some organizations, the mix of centralized versus decentralized functions has moved too far in the direction of centralization.

This article reviews examples of centralization decisions being made, the appeal for greater centralization, the reasons why centralization may not always be as optimal as it appears to be and, as a conclusion, how you should decide what is right for your own organization.

## Examples of centralization versus decentralization decisions

For the purpose of the following examples, let us assume a three-level structure, such as company level divisions representing the major operating units, support areas such as finance and human resources and lastly departments representing functions within divisions.

**Example 1—Technology:** Most organizations tend to provide architecture and network support at the company level. However, application software development and maintenance support may reside at the department level, the division level or at the company level. Sometimes organizations move this function to the company level in order to gain greater efficiency.

**Example 2—Shared services:** Many organizations have moved to a shared service model, sometimes on a national basis, quite often on a North American basis or on a global basis. Again, the logic behind this is that greater functional centralization will lead to greater efficiency and lower costs.

**Example 3—Outsourcing:** Outsourcing has existed for a long time. However, over the last few years, we seem to have witnessed an increasing trend toward outsourcing of major functions such as software development, network support and entire human resources transactional functions. In many cases, the basis for such decisions may be a desire for greater efficiency that will be reflected in short- to mid-term savings through very appealing financial arrangements.

## The appeal for greater centralization

There are several reasons why organizations choose to centralize functions to a greater level than they already exist. Several of these reasons may be quite legitimate and may result in real efficiency gains while some of the reasons may be more open to challenge.

1. Greater efficiency. Essentially, the belief is that by moving specific functions under one specific individual, this function will be performed much more effectively than if the function resides under several individuals who may be wearing many different hats.



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## The Suboptimization of Optimization By Function

2. Greater uniformity. By having the same function, such as technology, delivered under one organizational umbrella, it may cause greater uniformity in process and tools.
3. Easier training. Again, by having the same function performed by one part of the organization, it is felt that it will be easier to put together training programs that can be better leveraged than if each department or division has to train its own people.
4. Greater access to professional development opportunities. In many organizations, professional people believe that they may have greater opportunities if they work in large departments with several similar people. This would be true of finance, technology, legal, actuarial and human resources staff among others.
5. Greater control. Many people believe it is easier to control quality through centralization of as many processes as possible and by assigning responsibility of that function to a division head responsible to deliver that specific function.
6. Cost savings. Last but not least, an important driver for centralization, in my mind, is the appeal for real or assumed cost savings due to some of the factors listed above, mostly short- and mid-term savings.

### Why optimal is not always optimal

There is no argument that some level of centralization is required. The issue is not whether centralization is desirable, but rather whether excessive centralization may be hurtful to the organization, despite the obvious appeal for greater centralization.

In my view, several factors explain why some of the centralization decisions are made for the wrong reasons:

1. Typically, functional decentralization involves double line reporting to a divisional boss and to a functional boss. Not everybody can evolve in this environment.
  2. Linked to the first factor, heads of functional units such as technology, legal and finance may prefer to have maximum control and may therefore resist sharing the
- power with heads of operational divisions and functional heads within these operational divisions.
3. Typically, more well-rounded people are required to operate in a decentralized environment, i.e., managers and workers need to have a better understanding of diversified disciplines than under a functional centralized model where depth of functional expertise is favored.
  4. It is easier to measure the functional improvements created through centralization than it is to measure the inefficiencies created by the additional complexity of integrating various functions within a centralized organizational model.
- Centralization decisions sometimes ignore the following factors:
1. A decentralized model tends to favor greater team accountability, i.e., accountability resides closer to the people performing the work.
  2. Decentralized models tend to foster greater creativity, i.e., people can see their way through implementing new ideas more easily. Points of decision tend to be fewer and closer to the action. Theoretically, the organization model should make no difference when it comes to creativity. However, my past experience indicates that it makes an enormous difference; however, few people can measure it, let alone understand it, so it tends to be ignored.

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## Senior Executives: What ARE They Thinking?

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### How do you get non-actuarial leaders to listen to you?

The first step is to appreciate and respect them and the skills they bring to the table. They know things and can do things you can't. Work to understand their perspective. Also, speak in a language they understand. Most of you probably don't know what a "Ben Duffy" is, but your sales people do. So why should we expect them to know what a CSO is? Build relationships with these people before you have to "get them to listen to you." Finally, help them understand why what you have to say is important to the

organization and important to them (not why it is important to you).

### What advice do you have for young actuarial professionals?

Be curious, try new things, volunteer for new assignments. Realize that there is more to being successful than just passing actuarial exams. You need to be able to work with others, communicate to non-actuaries and accomplish things through others—all skills that you need to develop in addition to being technically strong. □

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3. Centralized models sometimes ignore the fact that clients are looking for greater integration as opposed to optimal efficiency by function. Clients tend to favor single points of contact with single points of accountability. Centralization sometimes goes against this flow. Centralization does not automatically result in lesser client integration, however, depending on the fluidity of the organization, it often seems to result in greater difficulty in integrating delivery to clients.

4. People often minimize the difficulty involved in integrating the various elements required to shape an organization into a uniform mindset or way to approach situations. For operational divisions, multiplying the number of points of contact outside their own organization will often result in additional points of friction. It is only natural that dealing with functionally centralized units, shared service units or external outsourcers, will increase the likelihood that some of these functional units will not be aligned in priorities, attitude, responsiveness, etc. There is no argument that

some or all units outside the division can be well integrated with operational divisions; however, there are more organizations that claim to be able to achieve it than there are that can effectively do it.

### How much centralization is right for your organization?

Obviously, there is no universal answer to this question. The answer will always depend on the state of your organization, its history and the human and technological capabilities of your organization. It will also depend on the mindset of the organization. For a variety of factors, some organizations have a culture such that centralization does not work very well. In other organizations, the reverse may be true.

In my view, the proper outcome is that centralization/decentralization decisions should be made with a proper understanding of all the factors involved, not just factors that can be measured with a short-term financial focus in mind. Such decisions can only be made by people at the top of the organization with appropriate input from the various players involved. □

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