



NATIONAL BANK (B)

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Picture a high-pressure pipeline, five feet in diameter, carrying money to dozens of different distribution pipelines. Your job is to make a lot of plumbing changes in the pipes, but you can't shut off the flow of money while you work. If anything goes wrong and the pipe breaks, all those dollars are going to spill out on the floor. In a week's time, you'll be wading around in billions of dollars. You'll be up to your eyebrows in money. Other people's money.

Martin Frost, Senior Vice President of National Bank and the officer in charge of the bank's Operating Group (OPG), was reflecting on the process of change in a continuous-process, high-volume production operation. It was January, and Frost was reviewing the accomplishments of the past two and a half years. On the surface, it was easy to document progress; OPG had numbers to show for its efforts. But Frost was anticipating criticism, too, as he prepared for the policy committee meeting at the end of the month. After all, the group's performance hadn't been perfect. The money pipeline had broken down for the second time only four months ago. Several customer-contact divisions still complained that service and quality levels in OPG were going downhill, in spite of numeric measurements that showed substantial improvement. And the Executive Vice-Presidents and division heads on the policy committee had tenacious memories of OPG's past failures.

Added to his other concerns was a new situation, highly visible to the bank as a whole. Organizers for the Office and Professional Workers Union (OPWU) were handing out thousands of leaflets to workers at 111 Wall Street, OPG's office building. National Bank's pay scales were competitive with other Manhattan employers' rates, but there were some indications of dissatisfaction in the work force. The previous year, for example, 125 employees had walked off the job with a list of grievances; bringing the situation back to normal had required four months' full-time effort by one of OPG's most experienced assistant vice presidents. There was little feeling among top management that unionization was an immediate threat, but still, the OPWU leaflets could not be ignored.

How, Frost wondered, could changes in the bank's back office be evaluated in terms of their impact on the rest of the institution? How could the new nonbanking approach of the Operating Group be made meaningful to the traditional bankers from the market-oriented divisions? For that matter, how could Frost himself picture the full impact of his changes on OPG and on the bank?

He stood at the window of his Manhattan office, high above the early-morning traffic. Behind him, on his huge desk, lay the two documents he had studied the night before. One was a draft of a speech that Karen Creighton, senior vice president in charge of the production areas of OPG, would soon deliver to the American Bankers Association (ABA). The speech outlined the management approaches National had applied to its back-office operations over the previous two years. National's success in gaining control of its transaction processing had attracted industry-wide attention. In the past two years, OPG had handled

substantial increases in volume of work, while reducing its expenditures. The chairman of the National Bank Corporation had been widely quoted as crediting the Operating Group for a major share of the bank's increased earnings. Judging by the numbers, Martin Frost had few reasons for concern.

The second document on his desk, however, seemed to tell a different story. It was a consultant's report, which Frost had commissioned in order to get an outside viewpoint on the effects of the changes he and his colleagues had engineered in the past two years. The report was based largely on interviews the consultants had conducted with some 70 officers of the bank, both inside OPG and in the market-contact divisions. It focused sharply on some undesirable side effects of OPG's changes. The imposition of tight control policies, the report suggested, could lead to anxiety and insecurity in middle management. These fears could lead, in turn, to the establishment of unrealistic goals (as an effort to please the new bosses), and to increased resistance to change (as middle management's effort to protect itself). The consequence of these two factors could be poor performance, seen as missed deadlines and crises, and the perception of top management that still tighter controls were necessary. It was a classic vicious circle.

Placed side by side, the two documents made interesting reading. Frost wondered how OPG could learn from the comparison and how it could avoid unanticipated consequences of change in the future.

CHANGE IN THE OPERATING GROUP: THE PAST TWO YEARS

Soon after his promotion to head OPG two years ago, Frost had faced the question of defining just what OPG was. Was it, as banking tradition dictated, simply a technical support group for the customer-contact offices of the bank? Or could it be seen as an independent, high-volume production operation, a factory, which designed and controlled its own processes and products in the style of a manufacturing organization?

Frost decided that OPG was a factory. As such, it badly needed managers who knew how to run factories, people skilled in planning and controlling mass production processes. Wade Brandt, OPG's vice president for administration and a veteran of 45 years' service with the bank, described the group's first effort to recruit professional production management:

What industries do you think of when you want examples of outstanding factory management? Well, automotives have to be close to the top of the heap. And what companies do you think of? General Motors, Ford, and Honda. The first head-hunter Frost turned loose on the job happened to have his foot in the door at Ford. You should have seen the first person who came in to interview. We really went all the way to impress him. Frost had him out to his home to talk, and so did Gary James (the bank's president). The guy was obviously impressed, and went back to Detroit to think it over. Then he told us "no." His family and his wife's career were well-established in their present location, and they didn't want to come to New York. In fact, his kids had put on a very convincing flip-chart presentation, he told us. Can you imagine it? Frost and James were just incredulous and couldn't believe it. How could he walk away from the opportunity we were offering him? We were flabbergasted.

Subsequent efforts at recruiting production-oriented executives were more fruitful, and OPG began to fill its management ranks with young, aggressive talent. One of the early arrivals was Karen Creighton, who left Ford Motor Company to work as Martin Frost's assistant. For several months, the two worked

intensively to build a specific action framework around the goals of OPG. Then Creighton, supported by other newly recruited executives, two of them from Ford and one from Honda, moved into the line organization to take charge of the transaction-processing responsibilities of OPG's Area I.

TOP-DOWN MANAGEMENT

The draft of Karen Creighton's speech for the ABA explained how the change process began with a fundamental look at the group's whole philosophy of management:

In general terms, we can say that "administering" connotes a passive mode, while "managing" bespeaks an active mode. An administrator is, in a sense, a bystander, keeping watch on a process, explaining it if it goes awry. But managing means understanding your present world, deciding what you would like it to be, and making your desired results happen. A manager is an agent of the future, of change.

The fact is that, traditionally, banking operations are not really managed at all. In a sense, the people in charge are running alongside the processing line, instead of being on top of it, pressing the process levers. All you can do in such a situation is react. At National, we decided that this was unacceptable. We wanted to *manage* our back office, not *administer* it.

There are two critical prerequisites for making this change: conviction and orientation toward results. Each manager must be absolutely convinced that they can control all factors relevant to this operation. That conviction must begin at the top, and must carry with it a willingness to spend for results. I am talking about spending in terms of change to the organization, its structure, its fabric, about the amount of top management time and energy expended, and about the type of people you are willing to accept in your culture.

To ensure an environment that will foster the kind of dedication and commitment we need, we use a pass/fail system as a management incentive. A manager passes or fails in terms of results objectives they have set within the top-down framework. They are rewarded or not rewarded accordingly. No excuses or rationalization of events "beyond one's control" are accepted.

*"I've been treated better in the past three years than in all of the previous nine years."*¹

"Frost has been very fair with everybody who has produced, in a salary sense."

"The feeling was we should do things, especially make or beat budget, and that if we didn't, we should expect to be cut out."

The ABA speech continued:

The style of management we sought was cascading top-down management. Managers set their

¹ Italicized quotations used throughout this case are representative comments of other managers who were involved in or affected by the OPG reorganization, as reported to the consultants whom Frost had hired. These quotations, of course, did not appear in the ABA speech.

objectives for their level by translating objectives set from above. Although people felt initially constrained by a top-down approach, I am fully convinced that it is the ONLY approach. Managers are not only free to exercise their vision, they are expected to do so. They are unfettered by what is traditional, by what is the norm. Nothing is sacred. The real key is that the top-down system *strains* people, but it does not *constrain* them. Good people thrive in such an environment.

"This job is exciting, like working for a glamour company, almost like having your own company. I really like being a 'maverick.'"

"I like the opportunity to work for change, and to have responsibility for it. What I don't like is the incompetence of those who resist."

"I work 10 to 12 hours a day. I guess Frost works 24 hours."

"OPG has lived in crisis for the past six years, but it's worse now, especially the hours and pressure that everyone is under. I spent the whole summer working six days a week and never saw the kids. Well, I called and said I wasn't coming in Labour Day Weekend and that I needed a little time. The people I used to work with say to me now, 'Congratulations,' even though my new job isn't a promotion. They see me as being better off, just to be out of that place."

The speech went on to outline the basic management theories that OPG had formalized and applied to its functions in the past three years. "Taking Control," was the overall theme, and it was simply stated as "knowing *where we are, where should be, and making a plan to bridge the gap.*" Responsible managers were expected to know, in formal terms, the current state of their world and all the processes that were producing their current results; the *desired* state of their area and the processes that would produce *those* results; and finally the changes they would make in today's processes to turn them into tomorrow's processes. "It is not results we are managing, but processes that achieve the results." After defining the current situation of the operating Group and its three goals for the coming year (flat costs, improved service, and elimination of the investigations backlog), the speech proceeded:

What was left was to design the action plan, the processes that would get us to the results we wanted. (See *Appendix A*, which reproduces a slide shown to the audience at this point in the speech.)

We planned to build a strong management team, to hire managers who had the conviction and motivation to control their own operations with management skills as opposed to administrative or purely technical skills.

We planned to cut out all the fat accumulated during the prior 8 years of 18% annual cost rises. At that rate, we knew there was some fat.

We planned to develop and install a financial control system, emphasizing simplicity and the major cost elements, and ensuring that "straight through processing" and supporting technology eliminate human error.

We planned to define processes for cleaning up "rocks," such as the backlogged investigations, so that we could come out from under the crisis environment and get control of our processing. This meant designing the techniques to separate rocks out

from current work so that we could both break down the rock and do today's work today so that the rock would never build up.

In fact, the real significance of the Phase I action plan was that it enabled us to get a handle on the operating environment. With this program, we started to get on top of the back office so as to control and manage it.

"The whole management team was brought in cold, predominantly from Ford. So you had this whole new team applying industrial concepts to transaction flow. It has worked. But it was an affront to some people that these bright young stars were coming along and changing the whole new world."

"The number of people actually severed from the bank was actually very small for the organization, only 179, but the image is very negative."

"The fear of a cut, a layoff, wasn't a very realistic one. In fact, there have been very few, but the perception of it was the important thing."

"The key issue in our part of the bank today is job security."

"There was a language problem, The buzz words used by the new people differed from the language the old managers used and understood."

"Lots of people close to retirement retired early. People at the Assistant Vice-President level are running scared."

"The bank no longer offers security to long-time staff. My chance to become a VP is almost nil, regardless of performance. I just don't have the right background."

"People have really put out a lot of effort in this place, some of them have really worked. But when some old-timers were pushed out, it hurt a lot of us. We said, 'Is that what's in store for us if we keep going here?' Also, when the old-timers who knew other parts of the bank left, we lost a way to get a lot of contacts with the other groups."

To gain control of cost, it was necessary to forecast what our expenditures would be *before* we were committed. We developed a one-page expense summary report based on forecast, rather than on history. The managers are in control of all their variables. We do not recognize any type of expense as uncontrollable or institutional. Forecasts are updated monthly and are met.

"We have a tendency now to try to meet due dates at all costs."

"Due dates for changes are, in most cases, absurd. Time commitments are ridiculous, and the consequences of not meeting due dates aren't made known beforehand."

"People try to be optimistic to please the boss. When they miss the milestones, they get screwed."

But when we set about implementing new technology systems, we learned a very important lesson. We hadn't gone back to basics enough. We found we did not really understand the present processes completely.

So, a second action plan, Phase II, was devised in June. We called it the Performance Criteria System, PCS. What we were aiming at was breaking up the operations into manageable, controllable, understandable pieces. These were the key approaches to defining the back-office dynamics.

1. Define the products/services as recognized by the customer.
2. Develop a customer-to-customer flow-chart and procedures for processing each product/service.
3. Develop the organization to match and support the product definition and process flow on a customer-to customer basis.
4. Develop our physical layout into a closed-room/one-floor layout that matched the flows, procedures, and organizations as to enhance control and minimize movement.
5. Decentralize and move all peripheral equipment, into the customer-contact areas.
6. Incorporate support functions into the responsible line organization.

Our processing had always been conceived of in functions, rather than in system processes. You can visualize the functions along a vertical axis, and the people and time frame along a horizontal axis, giving us a very wide pipe carrying the million transactions per day. If the one pipe breaks, all the work in the pipe before the break stops or spills out. That shouldn't happen often, but when it does, the whole operation stops.

We aimed to divide that pipeline into several smaller lines, each carrying a different product and each supervised by a single manager who controlled every aspect of their process, from the time a customer originates a transaction, all the way through a straight line until we dispatch the results back to the customer.

We began by directing the flow of operations according to our six separate input streams: two flows from our domestic branches, separate domestic and international flows, one flow from our head office department, and one from incoming exchanges. Each of these became a separate processing line. These flows are not mere theory, but documented fact.

"In came flow charting and the product-line concept. We had a flowchart that stretched across the room and back. Creighton had an incredible ability to understand the whole thing, to point to something and just ask the critical question about how something worked, or why it was part of our activity and not somewhere else. The result was a definition of 11 different products, and a full reorganization in one month. It's the only way to run a bank."

"Changes were viewed differently by different people. People started flow charting everything. And Karen Creighton was going over everything, step-by-step. But lots of people got the feeling that they didn't know what to do. They didn't fit into this new environment."

THE BLOW-UP: SEPTEMBER

In August, Creighton decided it was time to act on the new organization of Area I. "We had been talking a lot about reorganizing the flows," she said, "but nothing was actually happening. We had spent months with people, talking about implementation, and we thought they understood. It was time to move."

On a hot Friday evening in September, when the regular work shift went home, equipment crews began the job of rearranging the facilities at 111 Wall Street. By Monday morning, the physical layout was set up for six separate lines, each with its own full complement of peripheral equipment, ready to begin work. And soon after the work force reported on Monday, it became clear that the system had problems. Equipment had been moved and connected, but technicians had not had time to check operations before the equipment went back into service. Some of the computers refused to operate at all. Computer operators, informed on Friday that they would still have their same machines but in different locations on Monday, arrived at work with questions and there were not enough supervisors to answer them. Leftover work from Friday's processing, tucked away in accustomed corners by employees before the weekend, was nowhere to be found. The customary corners were gone.

The money pipeline creaked and groaned under the strain.

As the week wore on, new problems came to light. The three proofing clerks, who had handled three shifts of consolidated front-end operations, could not keep up with the load generated by decentralized work streams. With new people in charge of new areas, proof clerks did not know whom to call to resolve apparent discrepancies; the accumulated variances began to grow alarmingly. By the end of the week, it was apparent that National's problems were greater than just debugging a new system. OPG's managers were inventing new systems on the spot, attempting to recover. By the second weekend of September, the disturbance had grown to tidal wave proportions. National Bank failed to meet the other New York bankers at the 10:00 a.m. exchange, and it failed to file its Federal Reserve reports.

The money pipeline had burst.

Geoffrey MacAdams, the grey-haired head of the proofing operation, walked into the computer room, waving his hands in the air. "Stop the machines," he said haltingly to the computer operations head. "Stop the machines. It's out of control."

"I remember walking through the area and finding a pile of work, out on a desk-top, with a note on the top saying, 'This is out by a million, and I'm just too sleepy to find it,'" said one manager. "There was maybe 20 or 30 million dollars in the stack. At least the employee was good enough to put a note on top of it. We were learning, the hard way, not to put papers like that into desk drawers."

Joel Smythe, operations head for four of the six processing lines, looked up slowly one morning when Creighton greeted him, and he delayed several seconds before showing signs of recognition. Smythe had been at work for 55 hours without a break. Creighton sent him home, with instructions not to let him back into the bank until he was coherent.

In two weeks' time, the new production processes began to work. Within a month of the change, routine operations once more ran routinely. But it was five months before the backlog of work and problems generated by the blowup were resolved.

In early October, as the system began to return to normal, and its managers turned their attention to the problems of cleaning up the side effects of the blowup, Frost set up a meeting with Petite and Creighton. "I wanted to be the first to tell you this news," he said. "The promotions committee met this morning. You have both been named Senior Vice Presidents of the bank." He smiled broadly. "Congratulations."

"The design for change from the top just cannot anticipate all the problems that are going to arise at the first-line supervisor level. Those people have to know more than just the before and after job description."

"I'll tell you why people didn't protest the change, or question their instructions. We were scared, afraid of losing our jobs if we didn't seem to understand automatically."

"The changes were accompanied by a great fear that people would get fired. Most lower managers and clerical workers felt management, that's Assistant Vice-President level and above, as highly insensitive to people."

"Frost and Creighton and the new people know what they're doing. They're good at setting up cost and quality measures and conceptualizing the system. But at the practical level, things haven't worked. In the past, new instructions would be questioned and worked through until they were either understood, or the designer was convinced there was a problem. For example, if I go out there and tell Mary to start writing upside down and backwards on what she is doing, she'll look at me and say 'Why?' because she knows me, and, to her, it doesn't make sense. If one of the new people tells her to write upside down and backwards, she'll do it and not say a word. If anything a little unusual starts to happen, she won't know why it's important, and she won't say a word about it. When the 'Auto Industry' people say do it, people do it. But they're scared."

"It hurt us, credibility-wise, with the rest of the bank. The sharks smelled blood in the water and came at us from all directions. But things are better now, much better."

Just a year later, the system blew up again. This time the problem centered on the back end of the process, where the input and telephone authorization process was being changed to include updated interactive voice-response capabilities. Unlike the earlier crisis, this blow-up affected customers directly and immediately. "The problem looked critical to the branch people, who had customers on-line or standing in line at the tellers' windows waiting for answers that never came. And it seemed critical to account officers in corporate banking, who couldn't post statements for their customers. But it was actually much less serious than the earlier episode, because it didn't involve the proofing system." said Creighton. "We were able to react much more quickly, and we were pretty much recovered from it within a month and a half."

ACHIEVEMENTS IN THE OPERATING GROUP

The draft speech for the American Bankers Association summarized the results of the Operating Group's improvement efforts. By the end of the year, according to the forecast, personnel in the group would be reduced by 30% from 3 years ago levels; overtime would be down by 71%; lost availability would be down by 75%² and the backlog of investigations would be shrunk dramatically. The speech elaborated:

The real achievement here, through, is that we forecasted what we would achieve and then made it happen. Moreover, we *did* put together the kind of management team we wanted, and we *did* get hold of the processes within our shop. At the same time, we developed a control system to measure the two facets of service to our customers: quality and timeliness. Quality measures error rate. It is the number of errors as a percentage of the total work processed in all streams on a daily basis.

² Lost availability is the amount of interest lost if cheques are not cleared on the same day.

We currently measure 69 different quality indicators, and we are meeting standards 87% of the time. When a given indicator is met or beaten consistently, we tighten the standard. We expect to continue this process indefinitely.

Timeliness is the percentage of work processed in a given time period. At the moment, we have defined 129 different standards for timeliness, and we expect that number to continue to grow. Today, we are meeting 85% of these standards. Moreover, we also continually tighten these standards as soon as we prove they can be consistently met. I think it is fair to say that our service performance has improved greatly since we began to hold costs flat, if for no other reason than that now, we *really* know what we are doing.

"In order to make progress, we had to be firm with the other divisions of the bank. We used to interrupt anything in order to handle a special request or exception for a particular client. No more. We're consciously shutting them out, so we could work on the basic processes here. Now we have no people wandering in here to distract us."

Changes were also evident from outside of OPG. Three officers from the customer-contact divisions commented as follows:

"My frustration is that I wish there were more "banker-types" in there and fewer systems and tech types. There is a huge loss of people I can turn to for help in getting things done, people who know banking. Maybe they should keep just a few. Some. Forfeiting a few cents a share might well be worth it."

"People over here say that if those new people are so good, why do they keep screwing up? You'd think they'd learn something in two years."

"In the old days, you knew who to go to. Now we don't know. Even if we find somebody, they'd be faced with a process where they couldn't give special service even if they wanted to."

Creighton's speech concluded: "These, then, were the achievements of two years of fundamental change. They are, I think, substantial, and they provide us with the solid base we need to focus in on the future."

"One of Martin Frost's magazine articles that circulated in here said something about people being replaceable, like machines. That hurt. You lose solidarity."

"Somebody asked me once if I liked it that we were working in what Frost called a factory. That really struck home. So, maybe it is like a factory. Why do they have to say it?"

APPENDIX A

Phase I - Action Plan

- ▶ **Hire The Right “Top Management” People To Build Up A New Style Of Management**
- ▶ **Squeeze Out the “Fat”**
- ▶ **Implement New Information Systems**
- ▶ **Develop A Financial Control System That Forecasts**
 - **People and Annual Salary Rates**
 - **Overtime**
 - **Lost Availability**
 - **Inventory**