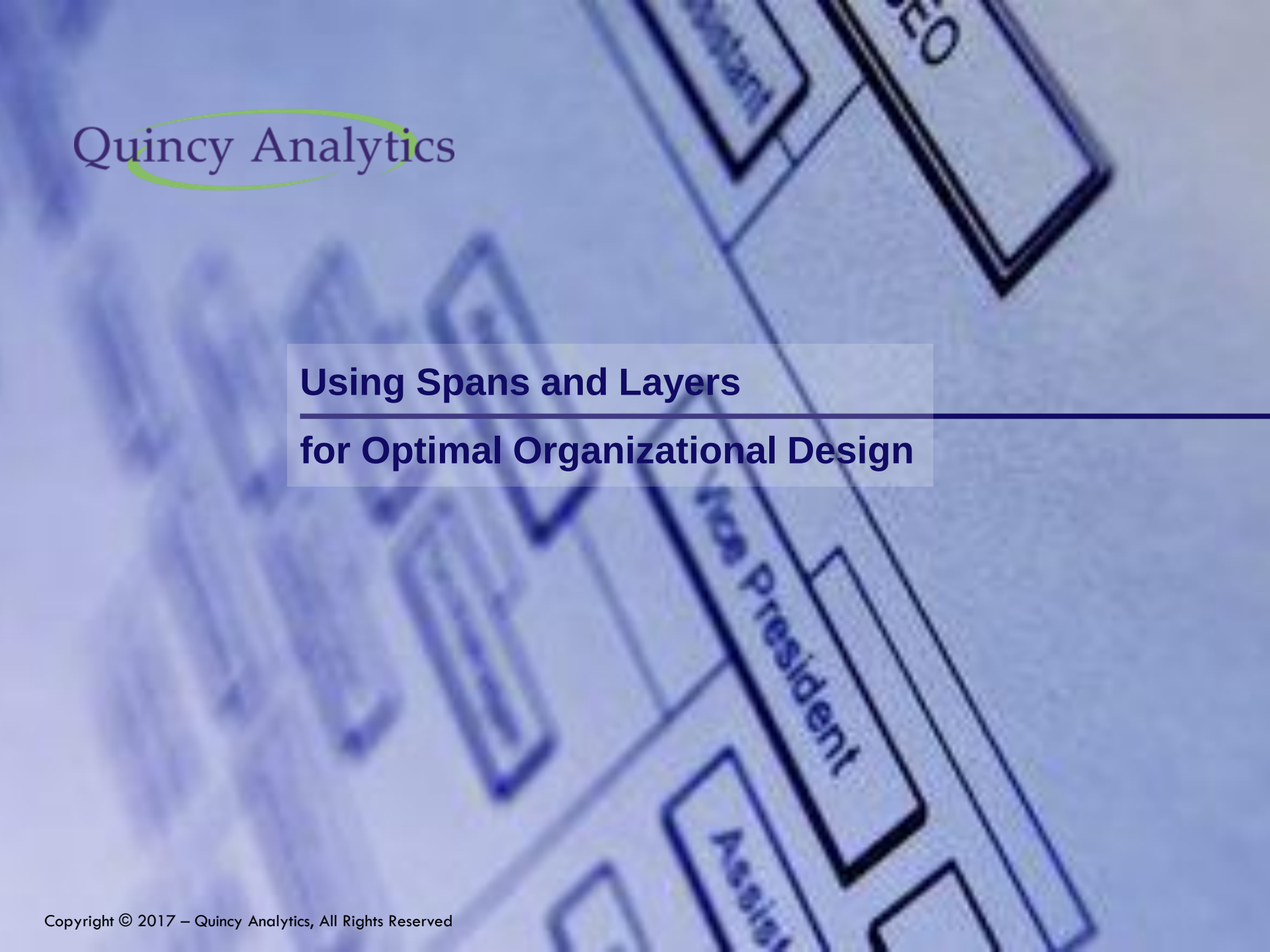


Future State Organizational Design: Spans and Layers

Situation: The combination of two large P&C companies (code named “Able” and “Charlie”) left management with a unique opportunity. Since the deal truly was a “merger of equals,” not only could management achieve synergies by removing redundant positions, but the new organization was in effect a “blank slate” that could be reinvented from the ground up.

Complication: The two legacy organizations had fundamentally different management philosophies and therefore spans of control. “Able” believed managers should also be “doers” and therefore kept spans lower and believed they had far fewer organizational layers. “Charlie” believed managers should “manage” and thus had higher spans of control.

Questions: What are some useful reference points to determine ‘optimal’ spans?

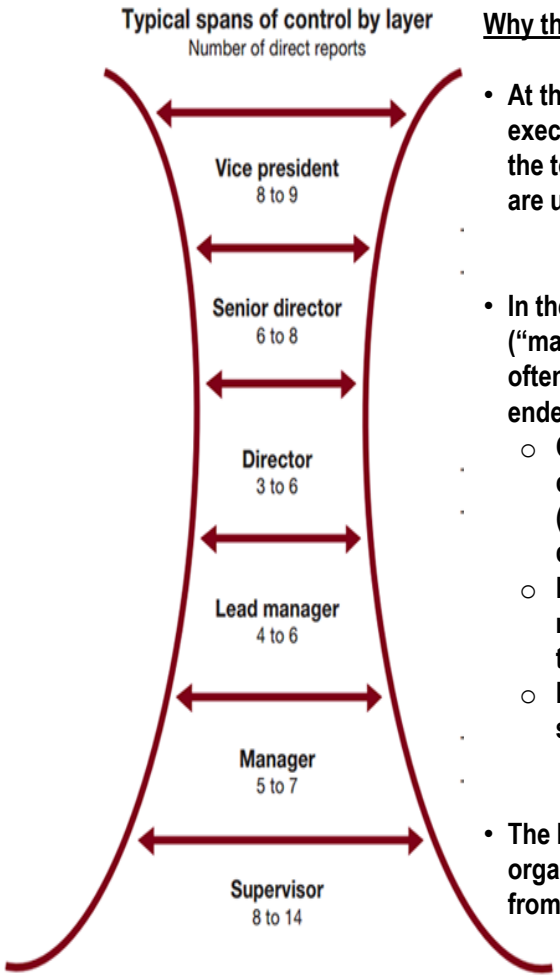
To what extent does performance data of the legacy organizations provide support for any particular span of control arrangement/level?

What are the organizational implications for adopting a different SoC standard, and how might it be implemented during the integration?

Hypothesis: The new company has an opportunity to move to a more cost-effective structure without putting at risk key performance metrics such as loss ratio, productivity/unit costs or customer satisfaction.

On the contrary, moving to a broader Span of Control may yield enhanced performance (as well as lower cost) in such areas as employee communication, satisfaction, customer service responsiveness and productivity

The "Typical" Organization's Dilemma



Why this happens:

- At the top, the senior most executive is well aware of the top few layers, so spans are usually good
- In the middle, low SoCs ("manager" proliferation) often occur to mask more endemic issues:
  - Compensating for chronic poor performers (managers fixing or doing the work)
  - Poor training – managers are on the job trainers, not managers
  - Poor processes or systems
- The bottom of the organization is often lean from traditional cost cutting

Advantages of Higher Spans of Control

- While higher spans obviously yield lower costs, management is often concerned that the higher spans will yield inferior results. *On the contrary, case studies and Quincy Analytics experience indicate that higher spans (within reason) can yield favorable benefits besides the obvious expense/efficiency benefits.*
- Higher spans often result in:
  1. Greater communication efficiencies from top to bottom as layers are removed
  2. Improved employee satisfaction and empowerment as decision-making authority and responsibility are given them
  3. Less perceived management "meddling" and "micromanagement"
  4. Greater innovation as front line observations bubble up with greater ease and speed
  5. Improved customer service as customer issues are resolved without multiple referrals up the chain
  6. Managers focus on most important escalation issues rather than day-to-day activities: oversight rather than 'doing their jobs for them'
  7. Improved quality – fewer 'cooks in the kitchen': multiple redundant layers can result in less effective oversight as successive layers result on their supervisors to catch errors

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Common Initial Reactions/Concerns to Span of Control Benchmarks

"The benchmarks are only for 'managing' employees – our managers are also 'doers'"

The benchmarks provided are for similar organizations and reflect the fact that managers (especially direct supervisors of front-line staff) are often both doers and managers. If managers had no responsibilities outside of overseeing their employees, the benchmark would be significantly higher (say 15-20 SoC). In addition, the benchmarks take notice of the complexity of both the manager's and the subordinate's role being executed (i.e. an Operations benchmark is higher than a Finance benchmark)

"We have poor systems"…."we face a tough regulatory environment"

The companies against which we are benchmarked are not idealized (i.e. they typically have similar systems deficiencies and regulatory constraints), and operate in similarly challenging environments. While systems can always (and possibly will be) improved, that is not a suitable explanation for not improving the efficiency of the organization, especially since managers 1-2 levels above the analyst level generally do not have much direct interaction with any specific operating/IT platform

"We are already swamped with work, if we cut down the size of our organization the work will simply overwhelm us. It's impossible."

While it is true that paring down any organization will lead to more responsibility and accountability for any given employee, eliminating layers does not necessarily entail distributing more work to everyone. When unnecessary layers of oversight are removed, the work coupled with lengthy, cumbersome review processes also disappears. Decisions can be made quicker and more accountability (and authority) is pushed down to the front line staff. As needed, expensive supervisor positions can be selectively backfilled with lower cost resources with a full individual workload

"We have a different business structure – it is impossible to achieve such a high span of control – especially if we have small 2-3 person units"

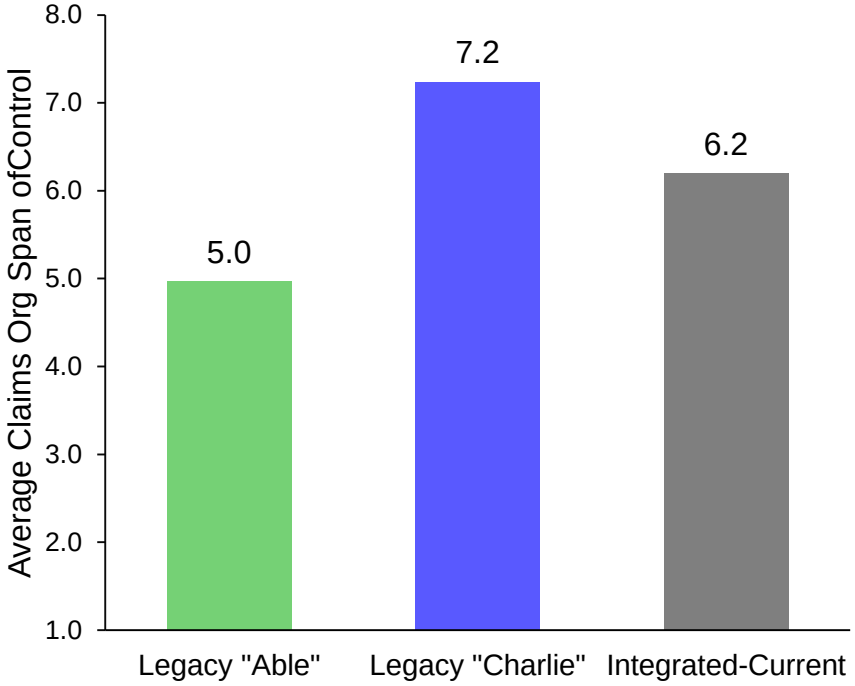
Many times there are valid business reasons for not achieving best-in-class span of control in a particular, small unit. However, it is important to explore alternatives such as putting a single individual in charge of two small units where similar expertise is required. In high volume, high throughput settings this is rarely a significant problem.

Legacy and Future State Organizations

While the Claims organizations had done a good job during integration of identifying staff synergies (6%+ cost savings), management believed there might be additional opportunities by optimizing future state spans and layers. The major concern was ***what should the 'optimal' span of control be and what affect would any SoC change have on the organization, its performance, and – most importantly – the company's stellar brand reputation?***

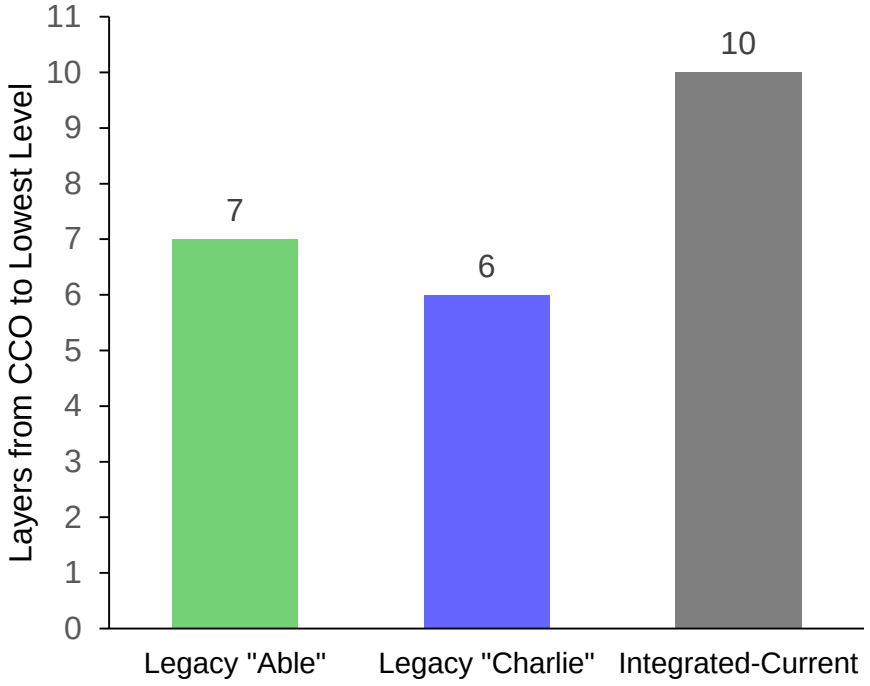
Legacy "Charlie" did have higher spans of control overall…

Span of Control by Legacy and Future State Organization



…but they actually had fewer layers from top to bottom and the new organization has more than both!

Legacy and Future State Organizational Layers (From Chief Claims Officer to Lowest Level)



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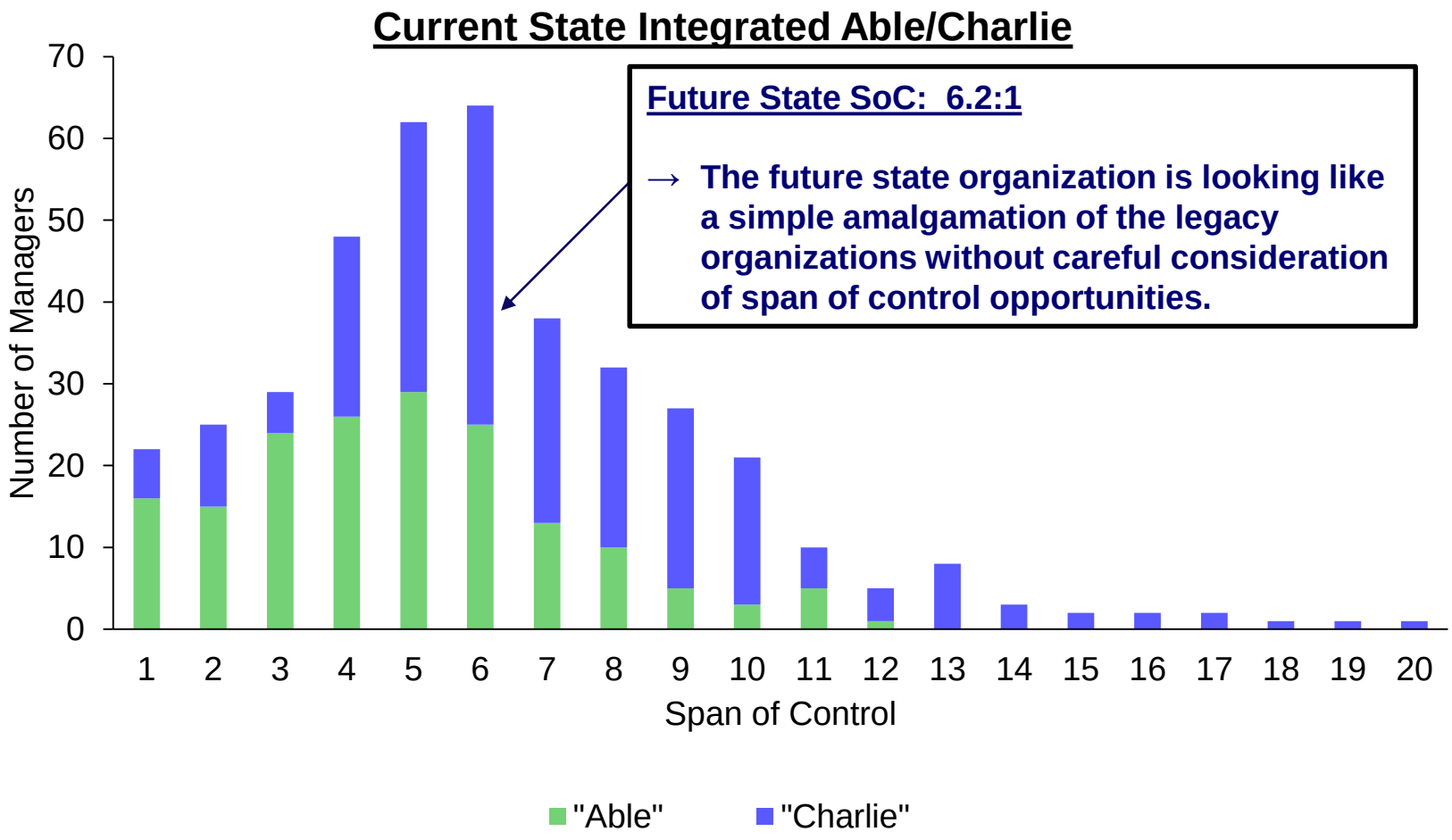
Future State Structure Reflecting Simple Combination of Legacy

Beware of organizational structures that look like this…long tails can be a sign of inconsistency: why can some managers handle such high SoCs while many others are much lower? Why are there so many individual contributors (IC) – SoC 1:1 or 2:1? This first-step, "top down" view always warrants further drill down to identify and understand pockets of opportunity.



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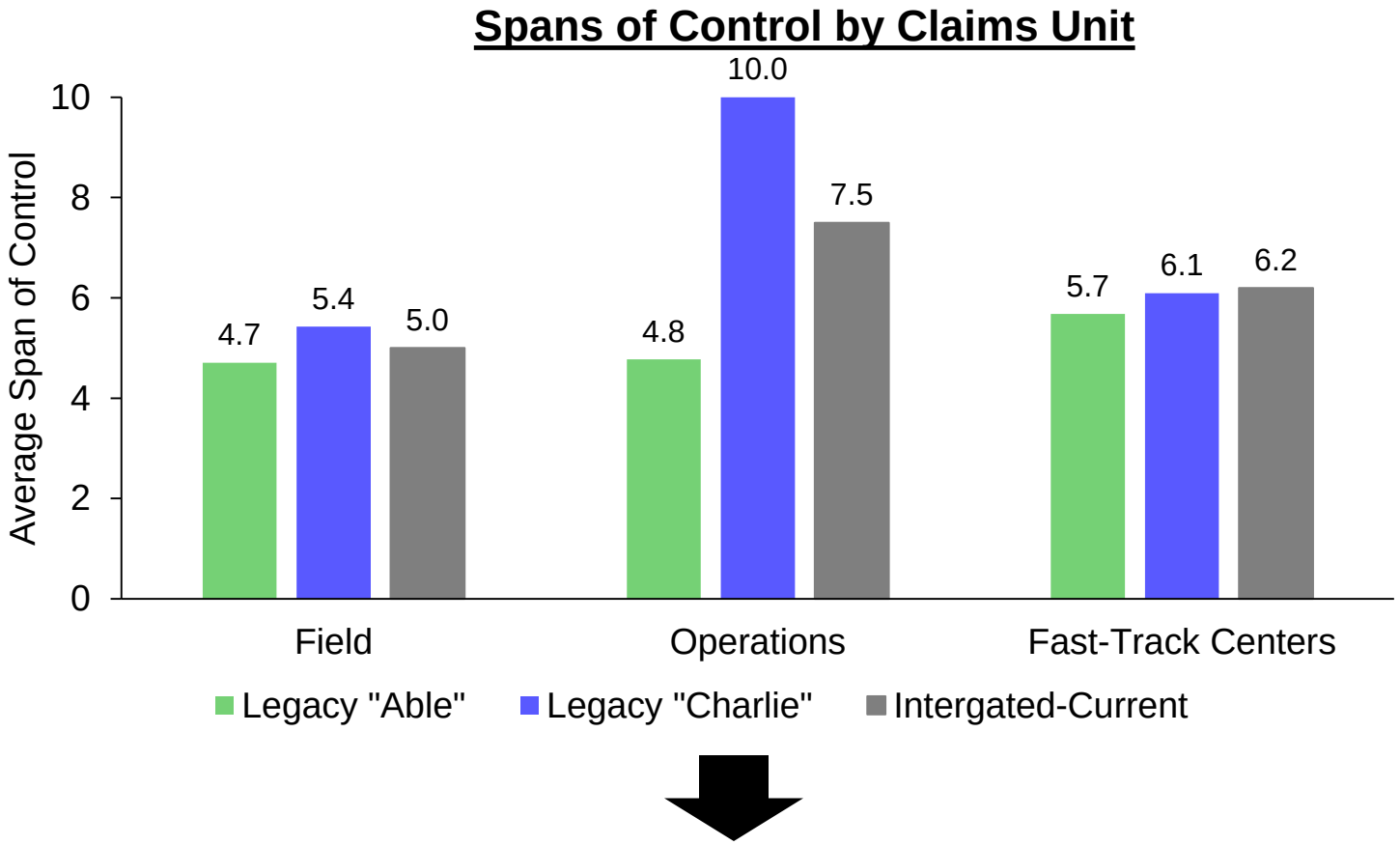
Span of Control by Future State Claims Sub-Unit

Applying a “1-Size-Fits-All” span of control is misguided; drilling down into the organization is vital as some units will warrant higher spans of control and others lower.



In the case of Able/Charlie, the future state organization seems to be migrating to a simple hybrid of the two legacy organizations. Is that optimal? Does it make sense? Will that yield a “better” organization?

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Claims Field Organization: Spans Versus Layer Diagnostic

Utilizing a "Span-Layer Diagnostic," Quincy Analytics can identify concentrated pockets of low spans in middle management ranks and also highly paid individuals (mostly managers) far down the organization: both of these factors help identify specific high-potential improvement areas

Each cell indicates number of employees in each paygrade/layer combination:

	Paygrade													
Layer	**High**											**Low**	**Grand Total**	**Avg SoC by layer**
0	2												2	5.5
1	1	5	5										11	3.6
2		1	10	6	13	3	2	1					36	5.1
3			6	4	30	33	17	13	14	13	8	4	142	4.7
4					10	43	53	39	41	12	19	22	239	5.9
5						12	23	79	39	5	1	6	165	
Grand Total	**3**	**6**	**21**	**10**	**53**	**91**	**95**	**132**	**94**	**30**	**28**	**32**	**595**	**5.0**

Note: using a standard SoC of 7, only 4 layers would be required as opposed to the current 6 layers

Green	Lower paygrade and lower Layered individuals. Results in better oversight and managers being closer to the 'action'. Often a sign of good Span of Control discipline
Gray	Dividing line of where to look for highly paid individuals that are buried deep in the organization
Red	Low Layered, but highly paid individuals – good starting area to identify SoC synergies as these are 'low hanging fruit' with high yield

Do Lower Spans Yield Superior Results?

Metric	"Able"	"Charlie"
Claims Span of Control	5.0	7.2
Loss Ratios		
Cost per Claim		
Closed Claims /Examiner		
Average Severity		
Customer Satisfaction		

 Better  Worse  Similar

- Across virtually every performance metric, the company with the higher span of control had *better* performance results
- Analysis confirmed this was consistent across lines of businesses, operations and all relevant sub-categories as well as in aggregate
- While performance metrics do rely on a number of factors outside of Claims (e.g. pricing; risk selection; mix; marketing; etc.), it does not appear that lower spans are driving superior results

External Span of Control Benchmarks are Closer to "Charlie" than "Able" – in Many Cases, Higher than Both

"Able" & "Charlie" SoC

ABLE	CHARLIE	COMBINED (Current)
5.0	7.2	6.2

External Benchmarks

	Bain & Co. Database**
Average (All Industries)	7.0
"Best in Class"	10-15

	Berlin/Deloitte (2014)
Average (All Industries)	9.7
Large Cos (> 5,000 EEs)	11.4

	Saratoga/PwC
Average P&C Insurers*	8.0

	Quincy Analytics Benchmarks
	L/H Insurers (Aggregate)
Average SoC	7.0
75th Percentile	8.0
90th Percentile	12.0

	Quincy Analytics
	Prior Insurance ***Claims*** Example (L/H)
Claims in Aggregate	**14.7**
Technical Specialists	4.8
Claims Examiners	18.9

* 37 P&C Insurers ranging from $500mm-$17bn in NWP - 2013
** 125 Service Companies (no mfg.) - 2010

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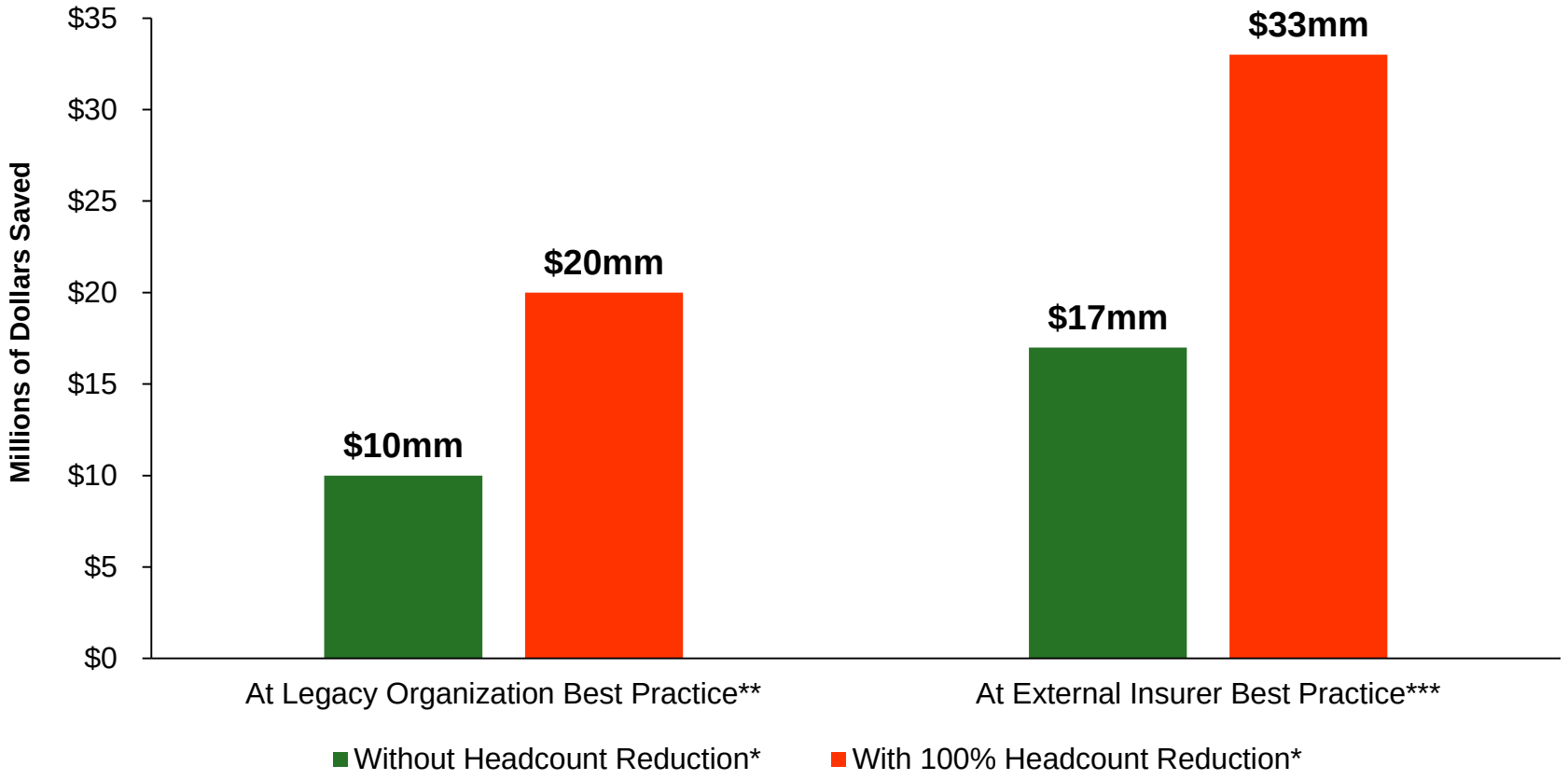
Span of Control Economic Potential (Future State Claims Organization)

A Future State SoC of 7.2 (legacy best practice) would result in $10-20mm of additional savings. This is likely conservative given that typical insurance SoC company-wide is 8-10.



* "Without Headcount Reduction" implies achieving higher SoC target by not promoting "doers" into manager positions; "With 100% HC Reduction" implies eliminating existing management positions to achieve target SoC

** "Best Practice" is by line of business, operations, and fast track units each

*** External BP includes P&C and L/H

Span of Control Optimization

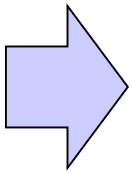
Recognize the Power and the Limitation of SoC

SoC IS

a diagnostic instrument used to identify gaps and improvements in organizational effectiveness

SoC IS NOT

a rigid rule to be applied arbitrarily across the board



Tailor the approach to the needs and priorities unique to your organization and yourself…

…but don't allow this to rationalize poor span of control

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Span of Control Optimization

Key Principles

Start Bottom Up

- Start with the front line – or 'doer' - layer, analyze what functions they perform, how many managers there should be above them, and work your way up using benchmark spans of control.

Eliminate "Busy" Work

- Just because everyone is 'busy' does not mean that there are not opportunities to eliminate layers. Typically many of the layers beget their own workload: additional review steps or additional meetings and conference calls.

Focus on Positions

- A manager with low SoC is not necessarily inefficient or lacking in capability, or should be let go. Instead, understand how many manager 'slots' there should be, then finding the proper managers to fill those slots. A talented person who happens to be in a low span of control position can be redeployed to another position to replace another, less productive individual.

Avoid "Cramming Down"

- Care should be taken to avoid 'cramming down' senior staff into junior positions (effectively removing a lower paid person to make way for a higher paid person). A good test is to compare the compensation of all 'doers' at a certain level and make sure that compensation is appropriate to the role. Another test is to confirm how many current managers are being cut (rather than kept on board in another position).

The Quincy Analytics Approach

Ways in which we can support a Span of Control/De-Layering Initiative:

1. SoC Diagnostic:

Within as little as 10 business days of receiving an HRIS download, we can provide a comprehensive assessment of Span of Control improvement potential in aggregate as well as by senior executive, showing actual SoC by layer vs. benchmark and calculating the savings available by reaching benchmarks. We apply distinct benchmarks for each type of job function performed.

2. SoC Implementation:

We work with senior executives and their management teams to help reach the target SoC with as little disruption to the organization as possible. The likelihood and necessity of headcount reduction can be a difficult process and we have experience supporting and mitigating (e.g. through attrition acceleration and early retirement initiatives) the "painful reality." In addition, we use a variety of techniques such as unit consolidation, bottom up pyramiding, and function/job title consolidation to help executives find the best approach.

3. SoC Support:

We can provide a series of facilitated workshops to groups of individuals to help them deal with the standard challenges and objections to taking appropriate de-layering steps. We highlight the most common concerns and objections and illustrate ways to allay the concerns and counter reluctance to take action. Typically this is done once the diagnostic has been completed and certain individuals have been tasked internally to perform the de-layering work.

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