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# **A Study Of Organizational Structures Utilized In The Annuity Delivery System**

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Mintzberg said all theories are false because although they try to describe reality the theories themselves are not reality (2005, 1). In this short paper I will evaluate a theory of organizational structure that attempts to help insurance companies that sell annuities better cope with the dynamic changes that are beginning to occur in their environment. Unfortunately, I begin this paper with the belief that even my selected solution is, at best, a temporary patch that will ultimately fail. However, I will follow Simon's dictum that one can either discover the perfect solution for a simplified world or a satisfactory solution for the real imperfect world in which we live (2001, 498). For this paper satisficing will have to satisfy.

### **Section One**

My personal theory of organizational design mimics the beliefs of the majority of those scholars I have read and follows these tenets:

#### Marrion's Theory Of Organizations

*1. I believe that environmental change is the largest force or factor determining what will be the appropriate structure of an organization (or at least what the appropriate environment should be).*

Burns & Stalker were among the first to say that the needed organization system changes based on changes in extrinsic factors, and they believe these factors are all rates of technological or market change (1996, 96). Lawrence & Lorsch believed the variables within the organizational structure were involved in a complex relationship with their environment (1986, 156) and said high-performing organizations came nearer meeting the demands of its environment (1986, 124). Mintzberg hypothesized that the more dynamic the environment, the more organic the organization's structure. He notes that it is not the environment itself really, but how the organization comprehends and responds to the environment (1993, 137). I find myself

solidly in line with that part of the Harvard model finding that changes in the external environment – coping with contingencies – are the critical variable in defining needed differentiation and integration, and thus the needed structure.

*2. To get to the correct structure you first need to determine how to divide up the labor and then coordinate its efforts.*

Burns & Stalker said one had to determine the nature of each individual task – whether the task was abstract or realistic – because this also helped you determine the right structure (1996, 121). Mintzberg said an organization's structure is defined as the number of ways labor may be divided into distinct tasks and then by how these tasks are coordinated, with the goal of achieving “an internal consistency or harmony as well as a basic consistency with the organization's situation” (1993, 2-3). Is there a best way? No. Mintzberg said organizations could be essentially grouped by Market (output, client, place) or by Function (knowledge, skill, work process, function) (1993, 53-54).

Mintzberg's groupings enable my theory because the units involved may be readily divided into his categories. In a related note, Mintzberg expected to find the largest unit size in the operating core and I found the same holds true with insurance companies (1993, 70). It was not unusual to find one manager supervising thousands of agents (operating core), while staff supervision had a supervisor for every six to twenty staff workers.

The five basic ways Mintzberg coordinates work is through mutual adjustment, direct supervision, standardized work processes, standardized output and standardized skills & knowledge (1993, 4-5). My research found in the annuity distribution model a standardization of skills & knowledge is assumed because all members of the operating core have been tested and passed a “professional” state administered examination, and are regulated by the state.

My research found insurance companies are mainly grouped by function with departments divided into the different staff function, and the sales function performed by the operating core is defined as a work process. However, I found evidence to suggest that top middle line positions were often grouped by client (bank channel, agent, stockbroker distribution channels), which is in tandem with Mintzberg's anecdotal findings (1993, 63).

*3. The correct structure for an organization is somewhere on a continuum ranging from Mechanistic/Machine Bureaucracy/Mass Production to Organic/Adhocracy/Technical-batch (Tidd & Hull, 2003, 6).*

Burns & Stalker attempt to describe when a particular structure might be appropriate stating a mechanistic structure is best for a stable environment while an organic structure works when problems and action needs cannot be broken down into a hierarchical structure (1996, 119-121).

Mintzberg said any organizational structure could be explained through the use of a basic diagram containing five parts: strategic apex, middle line, operating core, technostructure, and support staff (1993, 11). Mintzberg's basic diagram may be used to explain the annuity distribution system that the case study examines. The strategic apex is the insurance company president, the agent is the operating core, and performing support staff roles are order processing, policy issue and such. These three parts of the diagram have remained fundamentally the same, but there have been big changes in the middle line and technostructure.

Mintzberg said an organization's structure must fit its situation, or to be exact "effective structuring requires a close fit between the situational factors and the design parameters" (1993, 122). The design parameters depend on what the situational factors are. The situational factors that will change organization structure come from changes in the technostructure. Mintzberg

says people in the technostructure serve the organization by affecting the work of others, those “analysts concerned with adaptation, with changing the organization to meet environmental change” (1993, 15). In an insurance company the important technocrat is the compliance officer and the compliance department will lead the changes to the organization structure.

Mintzberg offered a number of hypotheses about how one could fit structural design to the situation, and I found nothing in my research to contradict his beliefs. In the main, the structures were similar in most organizations, and I found examples supporting Mintzberg. Support for his first hypothesis, that behavior becomes more formalized as organizations age, was best illustrated by how requests for “case exceptions” were handled. A case exception might be a situation whereby a consumer age 81 wished to buy an annuity, but the insurer’s internal rules had a maximum issue age of 80. I asked this question of two companies that had been offering annuities for over 20 years, and their procedure was to hand over case exceptions to a standing committee composed of supervisors from order processing, compliance, commissions and the marketing department that met every Friday morning, and they would debate the pros and cons of each case and render a decision by the following Monday.

I also interviewed two firms that had established new annuity departments within the last four years and asked the same question. Both of these firms used a process that differed from the older firms. Their attitude is best exemplified by this quote from one insurer’s new account person, “I look at who is the agent of record and call over the partition wall to [her supervisor] and yell ‘Hey, should we take an 81 from [the agent]’ and she yells back yes or no”. I found it interesting that these new annuity departments had been specially set up by old large insurers in office space away from the corporate office. The head of the annuity department said they were separate to “avoid contamination from the bureaucrats at home office”.

*4. Performance control systems can be used to measure and motivate workers.*

I found Mintzberg's comments about performance control systems and action planning reassuring because I see the same forces at work. Mintzberg says performance control systems can be used to measure and motivate workers (1993, 76) and insurance companies I studied use these systems extensively. Insurers will offer additional compensation to both agents and marketing companies if certain sales goals are hit, and these goals are usually adjusted each year. Performance is often reviewed on a monthly basis to see whether goals are being met. However, although sales related goals are ubiquitous, I have never seen performance controls relating to profitability applied to the operating core. Staff departments are often rewarded for keeping expenses down, but I have never seen the same discipline used on the agent side. On a related topic I found action planning in the insurance world is top-down, as Mintzberg found it was in general (1993, 79).

*5. Organizational culture is extremely important in making the organization work.*

The culture of an organization, what Burns & Stalker referred to as the firm's code of practice, is extremely important. Burns & Stalker say the culture or code is fixed by the head of the organization and is his most important contribution (1996, 252). However, Schein says there are built-in conflicts between the operators (operating core), engineers (staff) and executives (strategic apex) and the organization culture needs to evolve to be able to reconcile these conflicts (1996, 238).

Scott refers to culture as 'institutionalization' which he views "as the social process by which individuals come to accept a shared definition of social reality" wherein workers accept that the organization's method is the "way things are to be done" (1987, 496). O'Neil, Beauvais & Scholl say "The employee's actions are shaped behaviorally by the reinforcement of cultural

norms, such as those regarding the service culture. Cognitively, the behavior is shaped by the belief that prompt and pleasant service is considered to be good performance, and by support from management of the valence of such” (1997, 7).

Mintzberg talks about the role of culture as socialization which he defines as “the process by which a new member learns the value system, the norms, and the required behavior patterns of the society...of which he is entering” (1993, 41). He refers to forced socialization of an organization’s members for its own benefit as indoctrination, and says this is particularly important when jobs are sensitive or remote (1993, 41). I believe the lack of suitable indoctrination, and reinforcement thereof, in the organizational culture is causing many of the problems associated with my case study.

## **Section Two**

A quarter century ago annuity distribution by insurance companies was coordinated based primarily on the mechanism of Direct Supervision. Staff workers in the various departments, whether they were order processing, policy issue or compliance, reported to a supervisor that reported to a manager that reported to an operations vice president. Marketing & Sales had the insurance agent reporting to the branch manager that reported to a district manager that reported to a national sales manager. But Mutual Adjustment did occur. For example, if order processing needed another form from the agent the order processing clerk would not route the request up the hierarchical chain through her manager to the operations vice president, who would then hand it over to the national sales manager for downward movement, but instead the clerk would send the request directly to the agent.

The primary unit was the insurance agent. The insurance company defined the task of the insurance agent as doing the work process of selling annuities in this model, and relied upon

a standardized work process. Annuity distribution was a very stable environment – complex and competitive true, but centralized and bureaucratic with standardization of processes. The annuity distribution model was Mintzberg’s Machine Bureaucracy and it worked.

However, paying insurance agents in lean times as well as fat, and paying for offices and overhead, raised expenses. Insurance companies began cutting loose these tightly supervised agents and gave them more money and more freedom, but not a regular paycheck. The coordinating mechanism of Direct Supervision on the agent position changed, for most of the industry, between that time and now. Direct Supervision gave way to coordination by Standardized Skills & Knowledge reflecting the state testing that all agents needed to pass to sell annuities, but the insurance company still needed someone to provide training and support. Enter the marketing company.

Using Mintzberg’s terms, the middle line that used to be the branch manager-district manager-national sales manager became, for most insurers, the marketing company. The old Direct Supervision Model is still used in whole or in part by 19% of the insurance companies, but over 80% of the all insurers have a structure wherein marketing companies now perform some, but not all, of the old middle line functions (Marrion, 2005, 12).

Marketing Companies act as a “super-sized agency” with thousands of agents and are between the insurer and agent in the supervisory chain. They, at least in theory, provide training, supervision, and work with the insurer’s support staff through coordination by mutual adjustment. They have the authority to hire and fire agents for the insurer (but a fired agent may usually go down the street to another marketing company and get reappointed with the same insurer). Marketing Companies became the new middle line. However, whereas the insurance company branch manager and district manager is a product of the culture of the insurer and has a

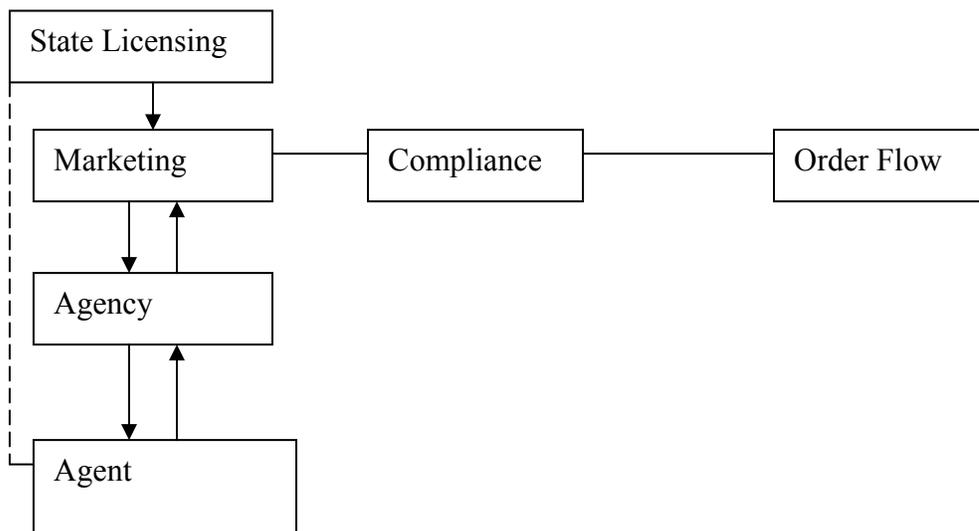
vested interest in the long-term performance and stability of a company for future paychecks and promotions, the Marketing Company is only loyal to the insurance company as long as the insurer continues to produce annuity products that can be sold today.

The Marketing Company's only revenue is the share of the commission it receives when the agent sells an annuity, thus the Marketing Company has no long-term interest in the consumer buying the annuity.

The Marketing Company may act as a middle line for dozens of insurance companies, and since typically the Marketing Company is only paid when an agent makes a sale, there is little concern whether the sales was appropriate for both the consumer and company.

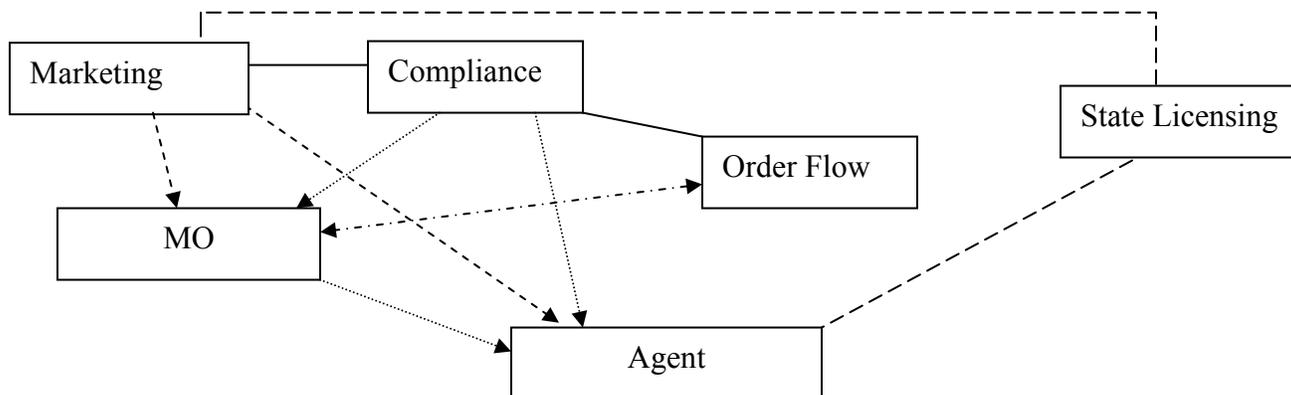
There is very little loyalty between the Marketing Company and the agent. As I mentioned, if the agent does not like the Marketing Company they can go down the street to a different Marketing Company and usually get reappointed to the insurer they were using, or sell similar annuity products from dozens of other insurers. A typical agent is affiliated with three to four marketing companies at all times (Marrion, 2003).

### Supervisory Chart Of Yesteryear



All of this meant the agent was not indoctrinated by the insurance company, nor was the agent exposed to culture of the insurer. The conflicts that Schein mentioned did not get resolved and the reinforcement of positive values did not happen.

### Current Supervisory Chart



The machine bureaucracy of 25 years ago has morphed into a professional bureaucracy and technically meets the definitions of one. The professional bureaucracy uses the standardization of skills and its associated design parameters, training and indoctrination for coordination (Mintzberg, 1993, 190). It is designed for a complex and stable environment. The operating core has a great deal of control over how they do their job. Mintzberg says the professional defines the customer's need, which defines the solution required, and the solution is then executed (1993, 192). The operating core in this paper also determines the customer's need and then pigeonholes the customer into one of several preselected solution boxes. All of this is true in the agent arena.

Mintzberg says the technical system is not too sophisticated or highly regulating in the professional bureaucracy (1993, 203). The professionals in this annuity world only need a pen to do their job, and rely on their training and experience to conduct their work. The insurance

company/agent relationship meets the definition of a professional bureaucracy, and is working as such, and that is causing problems.

A professional bureaucracy relies on standardization of skills and knowledge. The agent must pass a state administered test of competency to sell annuities and the insurer has accepted this standardization. However, Mintzberg says standardization of skills fails to cope with many of the needs and the pigeonholing process causes conflict. He also says, “the Professional Bureaucracy cannot easily deal with professionals who are either incompetent or unconscientious” (1993, 207). He goes on to say that the freedom of these professionals allows them to ignore the needs of their clients and the needs of the organization (1993, 208). The concerns Mintzberg mentions are occurring.

There is growing evidence of a persistent minority of agents that are either incompetent or unconscientious. In the last year I counted approximately two-dozen lawsuits that have been filed against annuity agents for inappropriate sales practices. Due to rising complaints by retirees the National Association of Insurance Commissioners passed a rule last year requiring annuity sales to those over age 65 to be suitable for the consumer’s needs. And the NASD has asked the Securities and Exchange Commission to make some of the annuities unavailable to the average agent unless additional testing and training is completed.

I believe the main problem with the professional bureaucracy model in this situation is primarily a cultural one. Mintzberg says organization indoctrination is important where jobs are sensitive or remote (1993, 41). Under the old branch manager system agents learned the insurer’s value system and required behavior. Under the marketing company system the agent is not indoctrinated and there is very little training. The only norms agents would be exposed to would be a few ethics and insurance law questions on the state insurance exam. The current system

does not provide needed indoctrination and the only culture the agent comes in contact with is the marketing company, which is a model of rewarding short-term profits and not long-term relationships.

How do you solve the problem? My initial response was to impose new work rules and turn the model back into a machine bureaucracy, but this results in “satisfying the standards instead of serving the clients” (Mintzberg, 1993, 211). Mintzberg concludes that you cannot impose harsh technocratic controls because they do not improve bad behavior, but simply transfer responsibility to the organization (1993, 212).

The machine bureaucracy approach has been forced onto stockbrokerage firms regulated by NASD. Every time an ethically-impaired stockbroker finds a new way to cheat the consumer the NASD writes a new rule to cover that particular situation. This has resulted in a regulatory body with thousands of new rules and a regulatory body that defines how well it does its job by how many violations of the rules it finds and the amount of fines it collects, rather than whether the consumer is protected, which was the original purpose for the NASD.

Mintzberg is very specific. He says complex work processes cannot be formalized by rules and regulations, and cannot be effectively performed unless it comes under the control of the worker (1993, 211). Turning the clock back and attempting to force the insurance company-agent relationship into the confines of a machine bureaucracy is not the answer.

The least unacceptable model is continuing with the professional bureaucracy. Mintzberg says the only long-term solutions to the problems I mention are improving the professionals involved by tightening entrance requirements, and improving training both before they enter field and on a continuing basis thereafter (1993, 213).

Insurance companies have relied on a level of standardization of skills and knowledge associated with the passing by agents of a state insurance exam. However, qualifications to take and pass the exam are minimal. In the state of Missouri a high school diploma or GED is not required to become an insurance agent and no training is required before the license is issued. On the Missouri Department of Insurance web site <http://www.insurance.mo.gov/industry/faq> in response to the question “Can I still get a license if I have a criminal conviction?” the answer is “You are not automatically disqualified from obtaining a license if you have a criminal record.” My research indicates about the only way for an agent to lose their insurance license is to be caught stealing money. I believe it will be a long, long time before the state imposes barriers to dissuade the incompetent or unconscientious from remaining in the industry.

The failure of the state to act would not preclude action by the insurer. The insurer should establish minimal standards for accepting agents. This could include requirements for evidence of additional initial and ongoing annuity training conducted by a third party approved by the insurer, or the insurer could do its own training. In addition, minimal standards of conduct would be required, such as the insurer stating no felons may be accepted, or not accepting agents with more than three agent complaints. Improving the professionals is the correct long-term solution, but I am concerned that state regulators may not be satisfied with the slow progress of this solution and impose, in effect, a machine bureaucratic one. Therefore the insurers need to take immediate action with a faster approach.

A significant change in horizontal decentralization needs to occur. Mintzberg said horizontal decentralization was a power continuum of four stages going from individual power to analysts’ power to knowledge power and then power to everyone (1993, 105-106). In the insurance world power needs to go to the technocrats in the compliance department, and their

power needs to increase in the years ahead. There will be a loss of power from the operating core (agent) and effectively the power of the top and near-top insurer managers will increase.

The goal is to increase compliance department power without turning this model back into a machine bureaucracy. I would have the compliance department become more of an Integrating Manager. The compliance officer would have formal power to approve sales materials, investigate consumer complaints and recommend solutions, refuse new business if he believes it is of questionable quality, and veto a new agent hire (but this could be appealed to the general manager). Galbraith says after you create a lateral process it needs to be reviewed and held accountable (1994, 84). The Integrating Manager would report to the general manager. However, since an overly zealous compliance officer can destroy revenues by being too restrictive, any policies proposed by the compliance office would be reviewed by the marketing and order processing people with their comments forwarded to the general manager.

Performance control systems would be expanded to be more than just a carrot for bringing in more sales. Agents would also be recognized for “clean” business and penalized for less desirable business. For example, suitability becomes a greater issue as the annuity buyer ages and juries tend to award more dollars to older plaintiffs. A performance control system could offer higher income to agents with lower average age buyers and less income to agents targeting octogenarians.

The right culture, indoctrination if you prefer, is a key ingredient in making this work. My concern is the integrating manager could force undesired centralization, but “the existence of strong institutional environments may...reduce...the amount or elaborateness of organizational structure” (Scott, 1987, 507). Scott says cultural controls can substitute for structural controls.

The insurer needs to attempt to impart their culture to the agent. The insurer should tightly control the training to ensure the correct message is sent to the agents. The general manager must send a clear and consistent message about what the company's values are. The firm must quickly and publicly terminate those individuals that do not uphold company norms.

A combination of increasing the technostucture bubble to improve compliance, using the compliance officer as a lateral manager, and working to impart culture to the agent, will hopefully rein in outlaw agents and keep away regulatory centralization for awhile. All the while, the insurance industry will steadily improve the professionalism of their professional bureaucracy.

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