UNIVERSITY OF CHICAGO GRADUATE SCHOOL OF BUSINESS
ALUMNI GROUP ANNUAL MEETING

Chicago, Illinois
December 3, 2001

Cultural Transformation at the Chicago Fed

Thank you for that kind introduction.

I'm very glad to be here tonight to share with you some thoughts about organizational behavior and the cultural transformation that has taken place at the Chicago Fed. Afterwards, I'll be happy to answer any questions you might have.

I'm quite certain that all of you understand, as GSB alumni, the impact that the culture of an organization can have in determining its bottom line. And even in public sector organizations, culture can play a dramatic role in overall productivity. Clearly, we're not the first organization to go through a change process. But transforming the culture of a unique institution like the Fed presented some unusual challenges.

Transforming a culture requires common sense, clear links to sound business strategies, and a bedrock commitment to change, even when progress seems agonizingly slow. At least, that's what we found at the Chicago Fed. So I'd like to tell you why we are transforming our culture, how we've gone about it, and what we've learned along the way.

First, a bit of background about the Fed itself. We're a unique institution in many ways — a hybrid. We're a quasi-public institution, but we have some features similar to a private-sector company. And though we're a central bank, we have a regional structure. The Fed System consists of 12 regional Reserve Banks and a Board of Governors in Washington, D.C. The Chicago Fed serves the Seventh District, which consists of all of Iowa and most of Illinois, Indiana, Michigan, and Wisconsin.

As part of the Federal Reserve System, the Chicago Fed helps set monetary policy nationwide. So, like a university, we're engaged in serious research and analysis. At the same time, we're a regulatory agency, responsible for supervising 1,300 banks and holding companies in our region. In addition, we sell financial services like check processing to commercial banks. We compete against companies in the private sector in selling these services.

So the Chicago Fed has many roles, many customers and stakeholders and many challenges. And by the mid-1990s, it was becoming increasingly difficult to meet those challenges.

Why?

- Our environment was changing — driven by globalization, consolidation and deregulation

- Our customers and stakeholders were changing — demanding continual improvement in how we serve them. Banks were consolidating, which required Federal Reserve Banks to work together to provide them with more seamless services

- Our competition was changing — becoming more aggressive, using new technology

- And the Fed System itself was changing in response — centralizing some functions while leaving others decentralized

But, frankly, the Chicago Fed was falling behind — we weren't positioned to meet the challenges of a future that was different from our past. So in 1995 we took a fresh look at ourselves. We saw many admirable qualities. Our integrity was unquestioned. Our employees were loyal and knowledgeable. We were very effective in guarding valuables and in providing reliable electronic services. We had a solid record in supervising the banking sector and contributing to monetary policy.

But we found some flaws, too. We were slow to change, bureaucratic. Our penchant for careful analysis — which is essential for developing monetary policy — had carried over into all of our activities. We tended to over-analyze every decision. We were risk-averse to a fault. Our conservative culture was affecting productivity, morale, and our ability to succeed in a changing world.

The challenge was most visible in financial services, where our performance can be quantified similar to that of a private-sector firm. Our efficiency in providing financial services ranked 11th out of 12 regions within the Federal Reserve System.

What's more, the Bank's influence within the Federal Reserve was severely diminished. One indication was our lack of success when we applied to lead national programs for the Fed System. Among our peers, we weren't seen as a leader.

We knew we needed to improve ourselves. A key step was articulating a vision for the Bank. We developed a very ambitious vision, including setting the standard of excellence in the Fed System. With that vision as our foundation, we established cross-functional teams to help develop new business strategies for each functional area.

Then we surveyed our employees and customers to get their views on how the Bank's culture affected our ability to achieve our vision and business strategies. The results were sobering. It was very clear that we had to transform our culture if we were going to be a high-performing organization and fulfill our vision.

We identified several areas requiring immediate action.

One of the most important was service to our customers. Our financial services customers had to deal with too many different people. Customers who wanted a new service faced a maze of more than 200 possible forms and contracts. So we reengineered our processes. Now, we have an easily accessible call center where customers can get the information they need.

We also thoroughly reviewed our administrative and support services. Cross-functional teams took a close look at these operations and identified opportunities for gaining efficiencies through consolidation and outsourcing.

Another challenge was reducing our layers of management. While our employee base had decreased over the years through attrition, our officer ranks had increased. So, after a comprehensive review, we reduced official staff by 13 percent. I must confess that this was one of our most difficult decisions, but it was absolutely necessary to show how committed we were to increasing spans of control and streamlining the organization.

Acting swiftly in these areas got people's attention and signaled to employees that change could and would happen.

While these changes were underway, we assembled a cross-functional team to develop the "roadmap" for getting to where we wanted to go. The team's plan provided a foundation for our transformation efforts. The Bank focused on seven bank-wide cultural initiatives and developed specific plans to put them into action. These initiatives involved:

- Leadership
- Customer focus
- Communication
- Performance management
- Empowerment
- Skill development
- Diversity

They cut across department lines and gave staff at all levels an opportunity to help reshape our culture. I'd like to talk in more detail about four of them.

Number one was leadership. First, we thought carefully about the characteristics we needed in our leaders to build a more strategic organization and communicated those expectations to all staff.

Then, we instituted a 360-degree feedback process, whereby managers are reviewed by their boss, by their peers and by their staff. We began at the highest level within the Chicago Fed—our Management Committee. Every member of the Management Committee, including me, learned how our behavior compared with the desired leadership characteristics.

Eventually, all managers participated in the process. The results are not part of evaluations for raises or promotions. Instead, managers use them to decide how to develop their leadership skills.

The 360-degree reviews were not a one-time event. Managers have repeated the 360 review to track their progress over time. In fact, the entire Management Committee is now taking part in another 360 review. While these reviews are not part of evaluations, our leaders are held accountable for adopting the desired leadership characteristics. Living our vision for leadership is a key factor in decisions on promotions, hiring, pay, and work assignments.

Another key initiative was customer focus. For a public institution like the Fed, customer focus is complicated. Our customers and stakeholders include financial institutions that we supervise and to whom we sell our services; community groups; and every one of the 280 million Americans who feel the effects of our monetary policy. But we've worked very hard to be more responsive to our diverse constituencies.

For example, many of our employees, including the Management Committee, spend time with our customers and stakeholders to learn more about their needs. And we set ambitious customer satisfaction goals and measure our progress in accomplishing these goals on a regular basis.

We also focus on customers in developing our strategy and allocating resources. Demonstrating customer focus is a key hurdle for obtaining project approval. A proposal for a project that won't have a direct positive impact on customers is much less likely to get a green light.

Increased communication also was a critical element. Like most traditional, hierarchical organizations, important information was shared mostly on a "need to know" basis at the Fed. And usually the presumption was you didn't "need" to know.

We turned that attitude around by creating more face-to-face forums where leaders and staff met together. At one time, certain information was accessible only through the grapevine. Now we have box lunches, town halls, focus groups and departmental meetings. As part of this effort, I have regular breakfast meetings with staff at all levels. I invite people to share anything on their minds in an off-the-record session and I act on what I learn whenever possible — without, of course, violating any confidentiality.

We back up the increased face-to-face contact with more timely written communications. One example is an electronic publication we call Dateline Daily. It covers Fed news each day via our intranet, including what happened at the latest meeting of our Management Committee or board of directors. Now we can provide information quickly to our staff, and that enabled us to eliminate a glossy employee publication that was attractive but outdated.

The final cultural initiative I want to talk about is performance management. We are now more rigorous in our performance evaluations. Before, the tendency had been to seek a "happy median." If you looked at a stack of performance reviews, you might have concluded that the Fed was like the mythical town of Lake Woebegone — where "all the children are above average."

Now, our appraisals are connected to the Bank's strategic goals and are more likely to reflect differences in individual performance, although we need to make continued progress. We apply the same philosophy to pay. Managers make more meaningful distinctions when they decide on salary increases.

Having shared with you some of our initiatives, let me tell you why I think the effort has paid off.

On a very practical level, we re-established our competitiveness in financial services.

- In 1995, our efficiency in providing services was near the bottom of the Reserve Bank rankings
- We now rank in the top quartile
- We still face stiff competition from other providers in the market place
- But we're more efficient and well positioned to succeed in a very tough environment

Beyond the purely financial results, we have improved in other areas as well, such as increasing the quality and quantity of our economic research.

And, we've made great progress in System leadership.

- Back in 1994 we were passed over for some major leadership positions in the Fed System.
- This year, we were selected to lead the System's customer relations office, which includes national sales and marketing.
- Also, our Supervision and Regulation department serves as a knowledge center on merchant banking for the System.
- And the Bank is now responsible for developing and coordinating national initiatives to further develop the leadership skills of junior and senior Fed officers.

As a result, and maybe most important of all, there's a palpable increase in pride, energy and enthusiasm within our workforce. The Chicago Fed is a more compelling place to work. We're more informal and open to new ideas. We give more responsibility to staff and encourage them to think in ways that will move us all out of our comfort zone. Clearly we're not perfect, but compared to the past we're more focused on ideas rather than indecision—on action rather than analysis.

So what have we learned along the way? Again, I can give only an abbreviated answer. But from our experience, several key lessons come to mind.

Lesson one: Make sure everyone understands the need to change.

To engage people in change, you need to create a sense of urgency. People need to know what is wrong—and the consequences for the organization of not changing. In most organizations, factors such as market share, productivity, or customer satisfaction provide a clear signal. When Xerox's share of the U.S.

photocopier market dropped from 90 percent to 15 percent in just a few years, it wasn't hard to convince people that the house was on fire.

The situation was more complex for the Chicago Fed. How should we judge our effectiveness in supervising banks or contributing to monetary policy? The need for change was clear, but it wasn't something easily boiled down to a sound bite. So we worked very hard to explain to staff why it was important to transform our culture and we did it repeatedly. As part of that effort, I took part in face-to-face meetings with the Bank's 2,100 employees in six locations. We knew the effort would eventually fail if staff did not accept the need for change.

Lesson two: Involve everyone.

Commitment to change has to start with the leadership. If it doesn't, no one will take it seriously. Leaders cast long shadows—the eyes of an organization are on its leaders to see if they are truly changing.

At the same time, input must come from all levels throughout the organization — not just on cultural transformation but on all work-related issues. Not all the ideas will be good ones. But the more an organization taps the ideas of all staff members, the stronger it will be. An organization should be open to ideas and advice from outside experts, too. At the Chicago Fed, we received very helpful guidance from carefully chosen experts who had gone through this process with other organizations and provided a useful external perspective.

Lesson three: Use new staff to help forward the change process.

Each year, the average organization has turnover of about 10 percent. In other words, ⅓ of a typical organization's workforce has three years or less experience with that firm. So every organization needs to hire new staff who reflect attributes needed in the desired culture and who can serve as ambassadors of change.

This is particularly true for those assuming leadership positions. At the Chicago Fed we fill key leadership positions from within and from outside. The common element is that all of these new leaders embrace the new culture and are willing to make changes to further the cultural transformation.

Lesson four: Create and celebrate role models.

At the Chicago Fed, our best role model for change was one of our highest-ranking officers, who recently retired. Over a 42-year career, he worked his way up in the organization to become chief operating officer. You might think such a veteran would resist change, but he embraced it. His attitude was infectious, inspiring.

Cultural transformation is difficult work. But it also can be liberating, even exciting. And when highly visible role models exemplify that idea, commitment to change becomes contagious.

Lesson five: Communicate strategically.

In retrospect, we realized that we were guilty of trying to communicate too much, too soon. It simply was too much for people to absorb. So our advice is, use a variety of media — especially face to face. But focus your communications on one or two key messages, and make sure the messages are consistent throughout the organization.

Lesson six: Take a long-term view.

Transformation simply doesn't happen in a hundred, or even a thousand, days. You've heard it said, and it's true, "Transformation is a journey, not a destination." So help people set realistic expectations.

While we had some "quick hit" successes at the Chicago Fed, we knew it would take three to five years for change to begin to reach critical mass. And it would take 7-10 years for a high-performance culture to become the norm. We communicated this timetable to everyone in the organization, so they wouldn't become complacent or discouraged. But we also said from the beginning that the transformation process is, by definition, continuous. And that's probably the most important lesson of all.

We're still working very hard to improve ourselves. Earlier this year, we began a major program to measure and enhance the level of engagement of our staff. Simply put, an organization achieves better results when staff members are more engaged.

Another important effort is our mentoring program, which is an outgrowth of our diversity initiative. I should add that this highly successful program is currently being considered for use as a case study by a major competitor of the U of C.

These efforts and others are integral to our process of continual improvement.

A truly transformed culture is always evolving. At the Chicago Fed, we've made great progress. But we're still not where we want to be. We'll never be totally satisfied. Some people find that prospect unsettling. Others find it invigorating. But, together, we're building an organization that will not only survive, but truly thrive in the decades to come.

There's a bumper sticker that sums up most peoples' feelings about change. It says: "Change is good. You go first." I'm proud of the men and women at the Chicago Fed who've had the courage and conviction to do just that.