

NABIL RAAD

NAVF: A Change Management Strategy for Developing a Pricing Capability in Indirect Lending

North American Vehicle Financing (NAVF) is a company that provides automobile dealers with access to consumer loans that they offer to potential car buyers in order to facilitate vehicle sales and financing at dealerships. In 2007, NAVF started facing intense competition from other financial institutions and was losing market share (**exhibit 1**). To address this threat, the organization decided to improve its ability to set the interest rates it offers on car loans. The management team concluded that pricing loans more analytically was critical to NAVF's future success. To this end, it launched a multi-million dollar project to implement an advanced pricing approach that sets interest rates on a loan-by-loan basis using mathematical optimization based on a customer's credit history, type of vehicle, down payment, payment capacity, and down payment.

Two years after launch, the project was floundering and was only implemented in 5 out of 36 market segments that comprised the North American market for NAVF. In early 2010, Bruce Blankenship, the president of NAVF asked Stuart Watterson, Director of Risk Management, to assess the project and instructed him to either complete it within a year or terminate it immediately, if no competitive and strategic benefits are expected. After spending two weeks interviewing various stakeholders to understand why the project had stalled, Stuart returned to Bruce and recommended to fully implement the project by the end of 2010.

This is the second part of a case study in strategic change management in the area of optimized transactional pricing. The first case study, "NAVF: Organizational Barriers to Implementing Optimized Transactional Pricing in Indirect Lending", provides an account of the interviews that Stuart conducted to understand the factors that caused the project to stall. This case study describes the change management strategy that Stuart pursued after he recommended to Bruce that NAVF should complete the project by the end of 2010. To fully understand this case study and its background, the reader is encouraged to read the first case study first.

Over the next two weeks, Stuart dedicated his time to thinking about and developing a change management strategy. He felt that some parts of the strategy should be well defined while still leaving enough flexibility for adjustments to emerge. His expectations were that, given the company's consensus driven approach to decision-making, he needed to be flexible and adaptable. He knew that all functional heads would be curious to find out about his proposed strategy but that not all of them would support it with open arms. Some might not even want the project to succeed. On one hand, Stuart was concerned that if he were to disclose a detailed strategy, he would be setting specific expectations that would not give him enough flexibility to reprioritize implementation schedule and experiment with different analytical techniques, should business needs change. On the other hand, recommending a high-level strategy is likely to be met with skepticism and a host of questions. He was not sure how to achieve the right balance but recognized the importance of proceeding with measured steps, especially in the early stages of the project. As he thought about the project he wandered: "How can I convince all functions to fully support a project where value is hard to measure and cause and effect are separated by time lags?... Do I have enough credibility with the other directors to generate commitment?"

The Guiding Principles to Stakeholder Alignment

A pricing optimization project steering committee was formed at the beginning of the project but was ineffective due to lack of member engagement, poor understanding of the project, and limited consensus on direction. The committee had full decision making authority about project direction and deliverables and was established to sustain stakeholder alignment, as pricing capabilities are developed and value is delivered. It was composed of directors from Finance, Analytics, Operations, Sales, Marketing, and Information Technology but many directors rarely attended committee meetings and usually sent representatives instead. In particular, Sales, Marketing, and Finance have commonly sent a supervisor or an analyst.

At NAVF, Sales has accountability for profits and losses while Finance is responsible for the execution of on-going pricing decisions. The directors of these two functions had attributed their absence from the committee to day-to-day pressures for delivering on monthly business objectives. The IT director was often represented by a manager who advocated for the solution to be built in-house as opposed to being purchased through a vendor. Although the Operations director attended on a regular basis, he did not seem engaged. Most discussions tended to be between the Marketing and Risk directors, who focused on understanding the results of various marketing initiatives that involved special interest rates on automobile loans. Figure 1 highlights the key concerns of each member of the pricing optimization project steering committee.

After much reflection, Stuart decided that a good place to start was to hold a special one-day off-site meeting of the pricing optimization project steering committee. The purpose of the meeting was to agree on critical guiding principles that would bring alignment and commitment to a series of directional goals. In particular, Stuart wanted the committee to establish a shared understanding of when and how the project can deliver value. By defining what value is, how to measure it, and when to expect it, Stuart believed that this would provide him with a clear and flexible framework for better managing the dynamics of the project. The directors of Finance, Sales, and IT were not pleased to attend a day-long offsite as they felt it was not an efficient use of their time. Stuart knew he had initial support from the NAVF's president. However, he was keenly aware that he had limited political capital to spend on getting the directors to follow his direction and commit the necessary resources.

On a sunny Friday in February, the committee gathered at a local country club to begin the process of establishing alignment on project fundamentals. The mood was cordial but somewhat tense as the directors gathered around a large round table. Toni Penneli, the outspoken Director of Sales jokingly said "This project has been stuck in the mud for the last couple of years. If it was really viable, we would have fully implemented it by now..." He concluded by saying "Well, let's hope for a miracle!"

Stuart kicked off the meeting by saying "I know how busy you are so I'm hoping that investing in this intensive one-day session will save us all many hours of re-alignment downstream and help create a stronger direction for our staff. After spending a few weeks talking to all of you, I think that I understand your concerns and expectations". Stuart continued, "I don't expect us all to agree on every single aspect of the project. Each one of us must be ready to make a few compromises as we agree on a direction. I know all about the tension between short-term and long-term objectives. We must run the business well so that we can survive into the future but we must also change how we operate today so that we can

flourish in the future. Once the direction is agreed to, we should not debate it anymore. Instead, we should fully commit to execution.”

On one side of the table, Stuart could see Tony’s poor attempt at hiding a sarcastic smile. On the other side, Pamela Brown, the director of Finance was visibly annoyed as she rolled her eyes and released a deep sigh of frustration. She did not need to utter any words to demonstrate her lack of support for this meeting but she knew that she had to be there to demonstrate to Bruce, the President of NAVF, that she was a good team player.

The director of Analytics, Tina Pavlova, tried to help Stuart with a candid and self-deprecating statement “I agree with Stuart, our expectations must be more aligned and I’ve been part of the problem by having strong uncompromising views”.

“Let’s talk about the expected value of this project for a few minutes”, added Stuart, as he acknowledged Tina’s support with a friendly smile and slight nod. “Do you all remember the innovative business solutions we launched over the years?” He turned to Pamela and said, “Do you remember the forecasting system we implemented about 10 years ago?” Pamela replied with an inquisitive look, “Of course Stuart, what about it?” Stuart paused a bit and said with a soft voice “In the first year of implementation, our forecasting capabilities were not what you might call stellar but we stuck with it and kept improving it. Today, it’s one of our core competencies in Finance”. Without waiting for a response from Pamela, Stuart turned to Tony and said “Also, about 20 years ago we switched to a statistical model for credit scoring as a replacement for the old manual system. Again, it was not reliable at first and was not any better than the manual subjective rating system. We debated its merit for months and many of us continued to question its accuracy for years. But, we made the decision that it held promise and we continued to evolve it and improve it over time. Today, it’s the crown jewel of our underwriting system and a key competitive advantage...”

Tony interrupted briskly “But wait Stuart! These are good examples of incremental improvements of our operational capabilities but pricing is different”. “In what way?” asked Stuart. With a confident tone Tony replied “The fundamental difference is that the market dictates the price. We can improve our credit scorecards and forecasting capabilities because we have control over them. We simply don’t control the market. After almost two years, the actual rates recommended by the optimization solution are very similar to the ones we produce manually, which are based on our understanding of the markets and competitive intelligence in each of the areas we operate in. At least, we understand the assumptions that go behind the manual process. With optimized transactional pricing, the analytics are so complex that nobody can explain them or tell me the rationale for setting an interest rate at a specific level.”

Most of the directors were nodding approval; Stuart felt like a soldier who had gone to war unprepared. His initial confidence was somewhat shaken but he collected his thoughts and replied, “You have a point in that we don’t control prices in the market but we should be able to improve our profits through better pricing.” Stuart continued, “This will take time and continuous adjustments. I agree that we need to do a better job in explaining the assumptions behind the analytics but we also have to trust each other. We have to trust that an analytical model is based on a solid understanding of the business and that the analytical team is competent and aligned with business experts to the point where they can develop a reliable model. We don’t have to understand every aspect of the model in order to confirm that it will be reliable. The analytical team has a strong model governance structure to ensure that we manage model risks in the most rigorous manner. At the same time, when an analytical model is judgmentally adjusted based on business knowledge, we trust that collaboration between the business and the analytical function will produce a more robust implementation. Analytical methods have become more sophisticated and we are hiring the best analytical minds to support this effort. Analytical solutions should not be a black box and we need to make sure we understand the business rationale for why the Analytics team is

recommending a particular approach. Again, we will not necessarily have all the answers initially but we need to continue learning. Sometimes, learning means making mistakes along the way. We will learn by making mistakes on a small scale by using controlled experiments. Other companies are investing heavily in analytics and we can't afford to be left behind. ”

Pamela quickly added “Stuart, when we have a variance between actual and expected ROE from the manual pricing model, we can do a quick analysis to understand the variance. This has not been possible with the optimized solution.” “As you know, analytical sophistication does not mean incremental business value.” She added “On a different note, we should also consider the fact we are under strict cost constraints for the five-year business plan due to profitability pressures and we can't afford to go over budget.”

“That's a valid point”, added Vidya Singh, VP of Information Technology. “You see, the variance analysis challenge can be mitigated by developing the pricing solution on our own databases and systems.” She continued, “We are relying on the vendor's database and it's not easy to replicate the same level of analysis because we don't have access to the internal variables of their model”.

Stuart felt trapped but he was at least satisfied that the issues were being discussed openly. “It's good that we are discussing our concerns candidly and I sincerely appreciate it. These are concerns we need to address. The solution is not set in stone and we have considerable influence over the vendor. Please keep in mind that the reason for going with an outside solution is to learn from the experience of others but this should not necessarily be the longer term strategy. The points you raise suggest that we should not stay with the vendor longer-term, as we develop more experience with the technology. I agree. At some point, we need to bring the solution in-house so let's make this one of our key guiding principles.” All directors were nodding, as Stuart looked around the table.

The back and forth discussions lasted through the mid-afternoon. The team debated points about who to measure benefits, the timing of benefits, uncertainty around the market and the need to be flexible in how the project evolves, ability to control costs, and how to allocate resources in a balanced way to support short-term and long-term goals. Stuart was spending a lot of time and effort steering the conversation to a productive and practical outcome. He felt that the directors had expressed their frustration and views long enough. Immediately after returning from a short break around 3:30 p.m., Stuart said, “Let us get back to the fundamentals. There are three key questions we need to have full alignment on. The first is how do we measure the benefits of the project? The second is when do we expect to start seeing the benefits? The third is how do we implement the project to make sure that we obtain answers to questions 1 and 2?”

Finally at a little past 8:00 p.m., Stuart summarized what the team had achieved that day. He said with an enthusiastic but tired voice, “I think we've accomplished what we came here to do and we all agree that this is going to be a journey of learning, experimentation, and continuous improvement. Our business environment is always evolving and we must have a solution that allows us to adapt quicker than the competition.”

Stuart continued “First, the benefits will be measured by four key metrics; profitability, ROE, market share, and the number of loans. We all agree that pricing strategies can rarely help us achieve incremental benefits simultaneously in all four metrics. What's important is to be clear what we need to preserve at any given point in time. This is a battle where determining the optimum trade-offs between these four metrics will allow us to be more deliberate and competitive. Second, we expect benefits to be relatively flat over the next 2 to 3 years as we evolve the solution and learn how to better price for improved profitability. Once our own internal solution is developed, it's critical that we maintain a culture of experimentation through a champion-challenger approach where the existing pricing strategy, labeled

champion, is challenged by another pricing approach that we call challenger. Then, we should start seeing accelerating value going into years 4 and 5 before value levels off again. We should expect change management efforts to continue to increase and peak around year 4 as we try to institutionalize the solution as an organizational capability. We can't possibly foresee all the specific techniques and capabilities we need to develop today and must leave our options open for additional approaches to emerge as we develop greater competency in the area of analytical pricing. Third, we will look at the vendor's implementation as a bridging solution. With the help of Analytics and IT, we will start developing our own capabilities in 1 year but continue with the vendor for the next 2 to 3 years until the internal solution is developed. Also, we will implement the vendor's solution across all North American regions using a treatment and control approach. We agree that the journey will be filled with small successes and failures and that the failures, are part of the learning process will not lead to project termination."

As part of the agreement, the reporting capabilities of the vendor will not be utilized. Instead, IT will develop more flexible reporting capabilities than the vendor's solution so that Sales and Finance can have more customized reporting. This will allow them to analyze and monitor the progress and results of pricing capabilities as they develop. This approach has the added benefit of enabling the IT and Analytics teams to better understand the pricing data and be able to begin more advanced analysis and modeling activities. Vidya, the VP of Information Technology, felt comfortable that the reporting output could be developed in the next 6 months.

Stuart added "The strategy will have discipline owners to ensure that we continue to be aligned across functions. For Finance, we will assign a discipline owner who will make sure that the pricing process is acceptable to Finance. For Sales, the discipline owner will ensure that we are measuring the four success metrics so that we track benefits. This will require close collaboration with Finance, Analytics, and IT. The IT discipline owner will ensure that the solution is consistent with IT's overall enterprise architecture and that there will be a seamless integration with existing applications so that pricing data are easily analyzed and used in operational applications."

Feeling exhausted and drained, Stuart left the offsite directly for home. As he drove, he had mixed feelings about the accomplishments of the day. He tried to clear his mind, thinking about a relaxing weekend with his family. Still he wandered, "What should I have done to be better prepared for the meeting? Could we have agreed on more guiding principles or was this a good balance? Will there be any new surprises in the future or did I cover the right fundamentals?" As he pulled into his driveway, Stuart noticed many cars parked outside his home and bright lights emanating from the house. This jolted his memory as he remembered that tonight was his daughter's 12th birthday. He was more than one hour late for her party and felt terrible as he tried to forget about the events of the day.

The Pricing Capability Team

Although Stuart had concerns about whether the commitment of the directors was genuine, he felt that the guiding principles provided a good foundation to build on. The agreed principles were simple and unlikely to generate confusion and debates. Over the weekend, Stuart managed to create a slide (Figure 2) that schematically summarized the guiding principles of the project. Upon his return to work on Monday, he asked his admin to create a poster version of the slide and send copies to all the other directors. He placed one copy in his office and another one in the meeting room where the pricing optimization project steering committee meets. In Stuart's mind, this was the project's roadmap and that he needed to hold the other directors accountable for its delivery. He also knew that there would be times when the roadmap would need to be adjusted but he viewed future changes as adjustments that would not undermine the project's fundamentals.

That Monday, Stuart sent an email to all the directors to thank them for their time and attached a copy of the slide. He also copied Bruce, the President of NAVF. Stuart's email read as follows:

“On Friday, I believe we achieved a significant breakthrough by agreeing on a project roadmap that represents an operational promise to this organization for developing analytical pricing as a capability. We agreed to general principles that set expectations about the strategy, and the project timeline. I will ask Mike from my team to administer project management activities and work with each of your functions to develop a detailed project plan. Before the end of the week, please send me the name of one individual from your respective functions to act as a project subject matter expert. These individuals will represent your functions in detailed planning, requirements development, design, and testing activities. Again, thank you and let's proceed together in doing what's right for the organization.”

About a week after the offsite meeting, Stuart met with assigned representatives from each of the functional areas and presented the guiding principles of the project. In that meeting, Stuart indicated that the representatives were now part of a working-level team with responsibilities that included identifying detailed business requirements, developing detailed system design capabilities, testing pricing components, and facilitating the communication process within and across functions. He particularly stressed that the role of the team was to bring hands-on subject matter expertise and energy to the project in order to deliver visible results.

At one point during the meeting Stuart made a few comments that were not consistent with the hierarchical nature of the NAVF culture. Some employees raised their eyebrows in surprise, others chuckled with an air of mischief, and two of them looked very skeptical. “Let's face it” Stuart said, “One of the reasons why the project has been lacking progress is because we are leaving it to the pricing steering committee to make detailed design decisions. They are not in a position to help develop detailed specifications because they are either very busy or they may not have sufficient expertise.” Stuart continued. “Your role is also to support the pricing optimization project steering committee through updates and proposals. In doing so, you'll have to be careful in deciding what level of detail to share. The committee cares about results. My suggestion to you is to take ownership for design decisions and inform the committee at a high level about what you're doing. Don't ask for permission to complete each step of the project and don't engage the committee in detailed design discussions. Otherwise, we run the risk of slowing progress through endless debates.”

Stuart suggested that the team meet on a weekly basis and collaborate very closely. He indicated that he would like to meet with them every other week to review progress and obtain updates and to discuss any challenges that might face. He subsequently engaged them in a discussion to select a name for the team. Consensus was quickly reached, with subtle guidance from Stuart, that the name of the team should be the “Pricing Capability Team”. Stuart felt that the name of the new team represented what it stood for, which is not a project team that will be disbanded when the solution is implemented but rather a permanent team engaged in an on-going dialogue to develop and sustain pricing as an organizational capability.

All of the team members of the Pricing Capability Team were in their twenties and Stuart wanted to leverage their tech-savvy nature and social media orientation. The average tenure of the team was about 4 years but all members were technically competent and enthusiastic about using the latest techniques. In a move that surprised several of the team members, Stuart added “I don't think that there's a need to appoint a leader for this team. All of you are experts in your particular domains so I expect you to collaborate. John, you represent Finance so I expect you to take the lead in developing a pricing process that is compatible with the new analytical techniques and systems being developed. Emily, you represent Sales so you need to make sure you keep your focus on the four key metrics. Let's say you want to develop a presentation to the pricing project committee, what you can do is to develop it jointly on the

project's website. Each one of you can add or modify the presentation as you see fit until all of you feel that it's ready. I only ask two things though. The first is to put a time limit for completing the presentation and the second is to review progress in your weekly meetings. I will attend the meeting and play a support role in case you have any obstacles that you can't overcome."

Jenny, the team member representing Analytics said. "Stuart, you mean we should develop presentations and proposals to the pricing project steering committee using a wiki-like approach?"

"Yes" replied Stuart. "Let's see how this will work and we can adjust accordingly. This should be fun too and maybe you can start a new way of collaborating within the company." Stuart felt that this approach was needed as he wanted every member of the team to be highly engaged and he also wanted the team to speak with one voice. Stuart knew that his approach was a two-edged sword. A problem in working-level consensus could quickly translate into a lack of support from the pricing project steering committee.

Stuart concluded the meeting by saying "The fate of the project and the pricing capability is in your hands. Your role is to collaborate, innovate, and influence up. The directors are too busy with day-to-day activities and they need you to bring clear updates, proposals, and analyses of results that continue to move the project in the right direction. You are the experts and this is an expert-driven initiative."

Stuart continued "After working with the vendor for one year, you will have developed enough insight to begin working on the design of the internal solution. You're in it for the long run."

Rough Waters

The team was genuinely excited about this opportunity. They started meeting weekly and providing updates to Stuart every other week. Stuart hoped that a working level team is not likely to be engaged in politics, at least not at the same magnitude of the directors.

Four weeks after the team was formed, on a cold and day in March, Tony stormed into Stuart's office and indicated that he was annoyed Stuart had formed this working-level team without getting consensus from the steering committee. "Stuart", said Tony "You know that this is not the way we do things work around here. We make decisions in groups. We are a consensus-driven organization and your move to establish a working-level team is inconsistent with the way we work. Plus, we never talked about this as being part of the guiding principles."

Stuart was not surprised about Tony's fury. He knew that Tony would be angry because it was generally important for him to be in control and call all the shots. Stuart replied. "Tony, the team is working well together and we are making progress that we had not seen before. Forming the team is very much consistent with the guiding principles because it promotes collaboration cross functionally at a working level."

Before concluding, Stuart said "May be I could have involved you and the directors in the decision but what part of it do you not like? Do you think that forming the team is a bad idea?"

Tony replied in anger as he left Stuart's office. "It's the principle that was violated. We make decisions together Stuart and I wonder what you will do next."

Marcos is an intelligent young man with a master's degree in Finance from an Ivy League school. He represented Finance and started contributing to the objectives of the Pricing Project Delivery Team

from day one. About a month after establishing the team, Stuart started sensing that Marcos was back-peddling on a few decisions. He started missing his commitments and seemed much less engaged than before. About the same time, the Sales representative, Mary Anne, started demonstrating a similar behavior. All other members were fully engaged but Stuart could see that the team was not functioning as smoothly as it used to. Something had changed...

A few days later, Stuart walked into Tony's office for a pre-scheduled meeting. Tony greeted him with a smile and said "Good morning Stuart, Mary Anne tells me that the Pricing Project Delivery Team is making progress in proposing the approach to launch the vendor's solution nationally. That's really great!"

Stuart replied. "I think you're right Tony but Mary Anne does not seem to be as engaged as before and I sense that the pricing project has become a lower priority for her. Has her workload increased?"

Tony was quick to reply. "You know Stuart, when you formed this team, I'm not sure if you discussed with any of the directors about the time commitment that was required from each representative. We thought that you needed someone that you can go to occasionally for subject matter expertise but it seems that we now have a full-time cross functional team brainstorming together almost daily and working on detailed design. Don't get me wrong, I think this is good but Mary Anne has another full time job."

Tony continued as Stuart listened with disappointment. "If you need this team to be engaged at the current level, we should talk about increasing the funding for the project. Will Bruce approve it? I don't know. Even if the funding is available, I still can't afford to have Mary Anne be dedicated at the same level as she is today because her job of completing daily pricing activities and working with our sales team is too complicated for anyone else to be trained in less than three to four months. Assuming we find a replacement for her, she will need to focus on transitioning out of her current role. Again, this will take three to four months, at minimum"

Stuart felt trapped but knew that Tony had aggressive sales targets for the quarter and was under pressure to deliver but he did not appreciate the lack of open and proactive communication from Tony. Instead of quietly reducing support, Tony should have been more forthcoming, thought Stuart.

As Stuart left Tony's office he knew that he would probably receive a similar excuse from Pamela Brown, the director of Finance, about the recent lack of commitment that Marcos has shown. Sure enough, Stuart received the same message from Pamela day later.

That same day, as Stuart sat in his office pondering; he thought to himself. "These experts are the key to the success of the project and I can't afford to let them go. Yet, I know that Tony and Pamela need them to support a very busy quarter. In fact, I would not be surprised if this pattern continues quarter after quarter. At the same time, I don't think that Bruce will agree to increase the level of funding in order to establish a dedicated and on-going Pricing Capability Team. In fact, Bruce was adamant that the project must continue within budget and I assured him that this was possible."

"I must think of a cost effective and sustainable solution", continued Stuart with a worried look on his face. "What should I do next? How do I obtain commitment for resources to still have flexibility without incurring additional costs? We've made progress on many fronts but there's still more to be made if the project is to succeed" continued Stuart as he gazed at the guiding principles poster.

Figure 1 - Pricing Optimization project steering Committee: Members and Primary Concerns

Function	Director	Primary Interest/Concern
Finance	Pamela Brown	Concerned about losing control of the pricing process. Pricing is a core competency that had been done in a specific way for over 50 years. Originally, the pricing project was conceived by Pamela's predecessor, Helen Darias who was promoted to the CFO role of the parent company, Credit International Bank (CIB).
Analytics	Tina Pavlova	Concerned about not being given enough time and resources to develop and prove the value of analytics. There are many competing priorities in analytics and their main focus is on keeping operations as efficient and effective as possible.
Operations	Victor Ramirez	Concerned about IT and analytical resources being diverted away from projects that support Operations. Tends to focus on the short-term.
Sales	Tony Penneli	Accountable for delivering on profit and ROE objectives. Concerned about losing control of setting pricing, especially if the application of analytics makes pricing a "black box".
Marketing	Angela Brentwood	Focused on quick results and believes that automobile loans is a commodity where interest rates are market-driven and there's little profit to be had from setting interest rates on loans more analytically. Her view is that more accurate targeting of campaigns is more beneficial than optimized transactional pricing.
Information Technology	Vidya Singh	Would like the pricing solution built in-house instead of using a vendor-based solution, under the argument that it provides greater integration with existing systems.

Figure 2: Pricing Project Guiding Principles Agreed to during the Director's

