Stability to profitability: managing interdependencies to meet a new environment

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Abstract

Management control systems represent what is believed to be an important element in managing internal and external interdependencies. The case study we present in this paper is an attempt to provide additional information contributing to the understanding of the influences on and the roles of management control systems in managing interdependencies. The management control systems were used to deal with changes in the internal and external interdependencies in the domains of strategy and structure of the organization, the organizational field, and the state. The role of the Chief Executive Officer was a key element in both defining the internal and external interdependencies and the employment of the management control systems.

1. Introduction

Management control systems represent what is believed to be an important element in managing internal and external interdependencies (Euske, Lebas, & McNair, 1993; Kloot, 1997; Otley, 1994). Internal interdependencies can be categorized as relating to controlling the relationship of management and workers, the separation of ownership and control, and the division of labor among different levels of management. External interdependencies relate to a wide range of relationships such as with the state, customers, and suppliers (Fliedstein & Freeland, 1995). There are, however, multiple conceptualizations of the role the control systems play in managing the interdependencies. One view of the systems posits that they are planned entities that provide for an economically effective and efficient use of resources within the organization (Anthony, Dearden & Govindarajan, 1992). Other work describes multiple causes and roles for the systems all of which may not be the direct result of attempting to achieve economic efficiency and efficacy (e.g. Ansari & Euske, 1987; Hoque & Hopper, 1994). The rapidly changing environment in which the organizations and the management control systems operate also may be modifying the roles of the systems (Otley, 1994).

The understanding of the role of management control systems in managing interdependencies is less than complete. Gathering the information to broaden the understanding of such systems is in the domain of case research (Otley & Berry, 1994). The case study we present in this paper is an attempt to provide additional information contributing to the understanding of the influences on
and the roles of management control systems in managing interdependencies. Given our goal to enhance the understanding of the influences on and roles of management control systems, we sought an organization that would likely be faced with the need to adapt its management control system to changing internal and external interdependencies (Glaser & Strauss, 1970). An organization that met this criterion was Credito Italiano (Credit) one of the largest Italian banks. In 1993, Credit was one of the first large state-owned banks in Italy to be privatized. The privatization altered external interdependencies and quite likely internal interdependencies. Additionally, the financial markets were changing both within Italy and world wide affecting interdependencies with the market (Desario, 1995).

To us trying to understand the role of the management control system in managing internal and external interdependencies within Credit meant studying the role of the system in the privatization process. Initially, we focused on and looked for information and relationships relating to the topic. During our early interviews, we heard how the management control system evolved to help ensure the success of the privatization. However, as we became more familiar with the organization and the information presented to us, we gradually became aware that what we heard was not what we were being told. Our predisposition to hear information about the role of the management control system in the success of the privatization resulted in an initial filtering out of relevant information. The story at Credit was not only one of the role of the management control system in the privatization process; it was also the story of the role of the management control system in an organization that was changing to meet a new and different competitive environment. Not only was Credit being privatized but the state was redefining the parameters of the market.

### 2. Perspective on the evolution of credit

From an institutional perspective, one would argue that in order to manage external interdependencies, management would try and make the organization isomorphic with the prevailing institutional logic of the organizational field (DiMaggio & Powell, 1983). The prevailing institutional logic provides the rules, norms, and ideologies that legitimate the organization (Meyer & Rowan, 1977) and provides the social framework within which organizational efficiency is defined (Fligstein, 1990). This institutional perspective provides a means to help explain the apparent homogeneity of organizational forms and practices (DiMaggio & Powell, 1983). However, organizations and organizational fields change. Institutional researchers such as Fligstein (1991) have sought to provide a means to explain the change from the perspective of institutional theory. He focuses on the factors that fashion the organizational field and the role of actors in influencing change.

Fligstein (1991) argues that for organizations there are three important institutional domains in which “rules are created, meaningful actions occur, power relations are formed, and concrete forms of social organizations are set in place” (Fligstein, 1991, p. 312). The three domains are: “the existing strategy and structure of the organization, the set of organizations comprising the organizational field, and the state” (Fligstein, 1991, p. 312). The three domains are a primary concern of the manager of the organization. The domains represent primary elements that provide definition for the organization field and the organization. Once a given set of relationships and rules are established managers will expend effort to maintain relationships and rules unless there is some occurrence to disrupt a consistent pattern of action. From this perspective, the manager is seen as seeking stability and attempting to conceptualize the environment as simply as possible in an attempt to gain control of the internal and external interdependencies. Because the environment is murky, managers must interpret the available data to delineate the contexts and determine what change, if any, is necessary. In stable environments, the expectation would be that there would be little need for change. However, if a change or shock is perceived as coming from the state, other organizations, or macroeconomic conditions, management will likely take actions to adapt. The
manager must have both “a perception of a new strategy and the power to act upon it” (Fligstein, 1991, p. 316) for a change to occur.

The individual actor or manager who leads the organization is extremely important in this conceptualization of the institutional perspective. The top manager is the focal point for maintaining control of interdependencies, both internal and external, and has the resources to deal with the inertia of the organization and to initiate change (Fligstein & Freeland, 1995). Underlying this interpretation of the environment and the organization is the manager’s world view that provides a context in which events are interpreted. In this context, the manager interprets the information from the murky environment and neither accepts it as neutral information as a rational individual nor acts upon it as an “over socialized” individual. Explicitly recognizing the importance of the manager as decision maker can help to explain the decisions made in adoption of structures and processes by the organization (Tolbert & Zucker, 1996). The interaction of the manager as decision maker and the broader institutional forces operating on the organization highlights how the control systems are influenced by and to some degree the products of broad social-political forces and not just the immediate concerns of the managers of the organization (Bhimani, 1994; Hopwood, 1990).

Other perspectives could also be useful in analysing the evolution of management controls at Credit. As Tolbert and Zucker (1996) note different theories can explain the same outcomes in an organization. For instance, resource dependency and efficiency theories could also be used to “make sense” of the case data. Our intention in this project was to try to understand the role played by the management control system of Credit in managing internal and external interdependencies. Our choice for the use of institutional theory was ex-post based on its applicability to explain what we observed in a firm that had a high need for social legitimacy in a highly-regulated industry. The applicability of the theory to such environments is well documented in the literature (e.g., DiMaggio & Powell, 1983; Scott, 1987).

3. Research method

The data for this study were collected over a 25 month (August 1994–September 1996) period during six visits to the headquarters of the organization and 15 telephone interviews. We conducted 23 hours of face-to-face interviews and five and one-half hours of telephone interviews with six members of senior management. The positions held by the individuals interviewed over the course of the study were:

- Director General
- Director of Banking Operations in Italy
- Central Co-Director, previously he was responsible for domestic banking
- Director of Organizational and Professional Development
- Corporate and Group Controller
- Manager of Planning and Control
- Co-Director inside the Organizational and Professional Development Department

The agreement with the organization was that we would not record the interviews. Our documentation of the interviews consists of our notes taken during the interviews and debriefing sessions after the interviews. In addition to the interview data, we collected supporting financial and non-financial archival data. To help control for researcher bias, we incorporated two specific mechanisms: First, the research team was composed of an Italian and a non-European academic. This had multiple benefits. Having a team member who was part of the culture and environment in which Credit operated minimized the chances of missing cues or signals that are encrypted in the data coming from that environment (Schein, 1988). Having a non-European team member provided the opportunity to see those aspects of the environment that are taken for granted or not seen by those who are part of that environment (Zucker, 1983). To some degree the design of the

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1 One of the interviewees was promoted during the time period of the study. There is, therefore, a discrepancy between the number of individuals interviewed and the number of positions held.
team achieved what Boland (1981) suggested as a way to be able to understand an organization and its environment — that is to be both part of it and not part of it at the same time. Second, our analysis was reviewed by at least one staff member of Credit to insure that, at least from that individual’s point of view, we did not misrepresent reality.

4. The evolution of Credit Italiano

In the 1960s and early 1970s, two phenomena occurred that affected the interdependencies of Credit: (1) The state began to alter the banking environment in Italy. (2) The effects of industrial globalization were beginning to be felt. Although change in the environment was beginning to occur, the change was gradual and did not significantly impact the stability of the environment. In 1969, Sig. Rondelli became the Chief Executive Officer of Credit and remained in that position until 1990 when he retired. This stability in leadership was and is almost unique among Italian banks providing the opportunity for an individual, Sig. Rondelli, to interpret and attempt to maintain control of the internal and external interdependencies. During this time of relative market and internal stability, Sig. Rondelli began to formulate changes to the existing strategy and structure of the organization. He apparently saw the initial changes in the organizational field and the interdependencies with the state changing in such a way that continuing to act in a consistent fashion would not have been beneficial. The reason he made the changes is open to interpretation. On the one hand, Rondelli could have been reacting to a gradual shift in the definition of success for banks in Italy. On the other hand, by making the changes Credit would become increasingly isomorphic with the efficiency-oriented business environment of the North, thereby distancing itself from the state banking regulators in Rome. In either case, becoming more efficient and increasing the legimacy of the bank meant that the banking regulators would have less reason to intervene in the operations of the bank (e.g. replace top management). New budgeting, cost, compensation, and reporting systems were developed that were more congruent with what one would expect to find in competitive organizations. However, actual implementation of the systems was relatively slow. For instance, even though a new cost accounting system had been developed, the legally required fiduciary reporting system was used as the primary accounting system until after privatization. The relatively rapid development of the systems coupled with the cautious implementation could be interpreted as Credit attempting to provide the appropriate symbols to maintain its legitimacy. That is, the development demonstrates to external constituencies a recognition of the need for and value of the new system. The cautious implementation provided a means to decouple the external image presented from the actual workings of the organization. (Meyer & Rowan, 1977) and maintain the interdependence with the state. Alternatively, the slow implementation may have been a manifestation of the limits on the ability to change the internal interdependencies (Fligstein, 1990). For Credit, it appears that both decoupling external image from internal workings and limits on the ability to change the organization were factors. However, as the Italian government continued to alter the competitive environment, the initial changes became necessary tools in the market environment. The criteria for success in the redefined environment were unambiguous. The new accounting and control tools were the accepted means to measure success. These systems which could be seen as symbolic up through the mid-to late-1980s became necessary operating tools in the efficiency oriented Credit of the 1990s. What was initially decoupled from the operations during a time of state control when success was defined in terms of managing risk within well-defined procedures became an integral part of the operations when success was defined as managing risk to produce a profit. From the 1960s to the 1990s, the state helped to redefine the organizational field and the accepted definition of success. This redefinition altered the conception of what to control and how to do so.

Although the period of the 1960s to the 1990s captures a period of marked change for Credit, previous periods were not without change. Credit
was founded with German capital in 1870 as a privately-owned bank called the Banca di Genova. Banca Commerciale, the other bank that had been privatized in the 1990s, was also founded as a privately-owned bank with German capital. Banca di Genova changed its name to Credito Italiano in 1895. At that time, it began to expand its activities outside the region of Liguria. In 1933 the Italian government nationalized Credito Italiano (Anon, 1993), Banca Commerciale, and Banca di Roma. Credit, along with Banca Commerciale, both headquartered in northern Italy, has long had a reputation as being the most "commercial" of the Italian banks. Other banks such as Banca di Roma were seen as being more involved in the social, economic, and political goals of the Italian government (Cuneo, 1994).

In December 1995, Credit ranked fifth among Italian banks and 88th in the world as measured by total assets (Anon, 1996). Credit's headquarters are in Milan with branches throughout Italy. In 1995, the bank had approximately 9% of the Italian corporate and 4% of the retail banking market. At the end of 1995, it employed 15,230 people. Net equity was $3.57 billion. Total loans were $44.08 billion. Total assets were $64.51 billion. Its operations were mainly focused on domestic banking, working both in the corporate and in the retail sector. The bank had 647 branches organized into 11 territorial units. Credit's operations abroad were in the corporate sector and focused primarily on supporting Italian clients. The evaluation of the bank by the managers interviewed is captured by the comment of one of the managers, "Credit is a very well run bank". This comment is consistent with what was said by the other interviewees.

The banking environment in which Credit operates in Italy can be traced to legislation passed in the 1930s and more recently in the 1980s and 1990s. Legislation passed in 1936 created the basis for Italian banking law (i.e. legge ancaria). The legislation transformed the banking system into an explicit instrument of economic policy. The aim of the reform was to ensure a stable connection between economic policy and the state's credit policy (Frigerio, 1990). Also, legislation created a governmental body, the Interministerial Committee for Credit and Savings (i.e. Comitato Interministeriale per il credito ed il risparmio) to supervise the savings and banking system. The committee had the goal of maintaining the stability of the banking system to avoid the repetition of past financial crises. To help promote the stability of the banking system, structural controls to were put in place such as restrictions on granting loans, accepting deposits, and opening new branches (Onado, 1996). Additionally, the market was segmented to provide for Ordinary Credit Institutions that operated in the short-term market and Special Credit Institutions that operated in the mid-and long-term markets. In this way, banking law helped provide a relatively stable environment for the banks into the 1970s. In this environment the banks experienced constant growth (Bianchi, 1988; Forestieri, 1989; Masini, 1988; Riccaboni & Ghirri, 1994).

4.1. The beginnings of change — the 1960s

In the mid-1960s competition was increasing and the industrialists in Italy were questioning the efficiency and effectiveness of the banks, nevertheless, there was no major change in the banking industry (Ostinelli & Toscano, 1994; Riccaboni & Ghirri, 1994). During the 1960s, the bank operated with a 9–10% spread. Profitable operations covered inefficient operations. Given the tightly controlled market environment for Italian banks, there was little reason to focus on efficiency and effectiveness. The focus was on managing risk within the bureaucratic process defined by the regulatory body in Rome. The information system was geared to external regulatory reporting. At that time, regulatory reporting requirements were a major factor in the design of the information systems down to the branch level. The commercial code of 1882 and the banking law of 1936 defined the structure for external reporting for the banks. They were required to file a monthly operating report with the Commercial Court and publish annual balance sheet and income statements. In 1942 legislation was passed that relieved the banks of filing the monthly report with the Commercial Court. However, the Interministerial Committee for Credit and Savings continued to receive the monthly report using it as a primary monitoring
tool in the supervision of the bank. The report contained items such as loan volume, assets, and total deposits. The use of the information by the regulatory body influenced the structure of the reporting system within the bank.

Credit was centrally controlled and this continued through the 1970s. All of the functional areas reported to the two chief executive officers (i.e. Amministratori Delegati). This was typical for an Italian Bank in the 1960s (Airoldi & Decastri, 1983; Coda, 1969; Masini, C., 1975; Saita, 1982).

Although there was no major change occurring in the banking industry in the 1960s, the first major change that we identified was implemented at Credit in the 1960s. In 1965, Credit was one of the first banks to establish a career program for individuals with college degrees. Graduates with the highest grades from the best schools of economics and law in the country were interviewed. After a rigorous selection process, candidates were entered into a four-year education program which included theoretical and practical training. Those who successfully completed the program were given access to a career track that offered relatively rapid promotions. Testoni (1991a) states that although there was not an immediate need to develop personnel within the banking industry before the mid-1980s Credit was working at developing its human resources. These early changes are consistent with Credit’s image as being one of the most commercial banks. In a relatively stable and conservative environment, Credit was one of the more progressive organizations.

4.2. The mid-years — the 1970s

The last half of the 1970s can be characterized as a period of greater change than the previous 30–40 years. “At the beginning of the 70’s, the oil crises, and problems in the currency markets and labor markets caused a major restructuring of the Italian industrial system” (Desario, 1995, p. 17). Credit’s organizational field was changing. Foreign banks opened branches in Italy. With the foreign banks came financial innovations and new competitors. Competition in the banking industry became more intense. Also, the Italian government was offering short-term government bonds at relatively high interest rates. As a consequence margins were beginning to decrease. These changes pressured the banks to set prices in accordance with production costs. This encouraged the banks to become concerned with developing systems to identify the costs of various products and services. However, the actual design and implementation of such systems was not wide spread (Arcari, 1988; Balossino, 1987; Bergarin Barbato, 1988; Ostinelli & Toscano, 1994).

Even with these changes in the banking environment, success as a bank employee was tied to seniority through the mid- to late-1980s. Development of individuals was not given much emphasis in the highly controlled environment. The primary focus for human resources planning within the organization was to predict turnover and the impact of technological changes.

In the mid-1970s, Credit took at least three steps toward refocusing the organization. The managers interviewed said that these changes resulted from Sig. Rondelli’s perceived need to adapt to the changing competitive conditions. They said that by adapting to the competitive environment the bank could maintain its success in the market place and avoid intervention by the banking regulators. The coercive force of the state had become a factor in prompting Credit to become more isomorphic with its environment.

First, Credit developed the branch budgeting system in 1974. The personnel at Credit contend that they were one of the first banks in Italy to have a branch budgeting system. Although branch budgeting was not a new concept, we could not identify another bank in Italy that had a branch budgeting system that predated Credit’s. To meet the evolving interdependencies with the market and the state, Sig. Rondelli adopted a system found in the evolving organizational field, thus contributing to the diffusion of branch budgeting into the Italian banking industry.

The branch budgeting system that was implemented contained approximately 40 targets. The
targets were a set of financial volume measures or margins. A few non-financial administrative and promotional targets were also given to the managers. The manager responsible for domestic banking gave the targets to area managers who in turn gave the targets to the manager of each group of branches (MGB). The targets of the group and those of the manager coincided. The MGB divided the targets among the managers of the branches of the group and the lower level managers. Progress toward meeting the targets was reviewed at mid-year and at a year-end meeting. During the year, the budget and the targets could be changed. Normally, changes authorized by corporate headquarters could be expected every six months. On rare occasions the changes occurred on a three-month cycle.

Credit had an accounting system at the branch level prior to the implementation of the budgeting system. The accounting system was, however, focused on reporting the past to provide information for the regulatory bodies. One of the managers stated that under the old branch accounting system, managers were measured not with respect to targets but, more generally, according to the results they achieved, without any clear comparisons with pre-defined targets. That system was fine within its context, the owner (Istituto per la Ricostruzione Industriale (IRI)) was pleased with the results. They didn’t press us much. They took the dividends (i.e., staccava la cedola). Stability more than profitability was the focus of control.

Second, Credit opened the Management Education Center in 1975. The Center was a demonstration of Credit’s commitment to the development of the human resources of the organization. As an indication of the quality of the training program, interviewees said that in many cases managers who left Credit became top officers of smaller banks. Their comments are congruent with the commonly held view in the Italian banking sector that Credit was a source of officers for smaller banks. This was also part of a larger role that Credit, Banca Commerciale Italiana, and Banca Nazionale del Lavoro played in the banking industry. One rather high level example of such a move is Sig. Testoni who left his position as Director of Human Resources at Credit to become the president of a smaller privately held Italian bank. As one of the managers explained, the movement of personnel happened at all levels, not only managers, but also clerks and officers. Credit and Banca Commerciale Italiana, have been the two largest banking schools, with Banca Nazionale del Lavoro third. For the other banks it was useful to take advantage of it by offering higher salaries or promotions. This was usually done by small and middle-sized banks but it also happened with large banks.

Third, a work group was created at Credit to try and cost the various portfolios and processes in the organization. The work group was established in the part of the organization that was in charge of data processing. The first products to be costed were checks and bills of exchange. The analysis found 600 different products. The timing of the initiative places Credit at the forefront of such efforts in Italy (Ostinelli & Toscano, 1994). However, the effort did not produce a new system and could be described as collapsing of its own weight. As one manager described the effort, the problem was addressed through the use of pedantic, cumbersome operations research techniques. The results were significant but not implementable in any practical way. A lot of statistical analysis without a general vision — analysis without synthesis.

Another manager describing how the effort became so focused on doing analysis said that “They studied the sex of angels.”

One of the managers interviewed stated that the initiation of these changes at Credit represented the start of management control focused on output and performance rather than narrow procedures. In other words, to be successful was being redefined from meeting requirements mandated by the central regulatory body to performance in the
marketplace. The management control system was beginning to change to address the evolving external interdependencies. In the process internal interdependencies were changing. The new budgeting system, education center, and costing initiative began to redefine the division of labor and the relationship of management and workers. Such changes in structure in an institutional environment are not simply the by-product of organizational activities but rather the result of purposeful action (Tolbert & Zucker, 1996). In this case, the changes were the results of actions taken by Sig. Rondelli and his senior management.

4.3. Multiple changes — the 1980s

During the 1980s the banking system underwent additional changes. Some of those changes were the direct result of implementing the European Community Directives 77/780 and 86/635. Presidential decree no. 350, 27 June 1983 enacted Directive 77/780 on banking coordination. The decree emphasized the banks as enterprises operating in a market environment and less as an instrument of economic policy (Ciampi, 1993). As part of this market emphasis, greater freedom was given to the banks to open new branches. Directive 86/635 resulted in both the requirement for a standardized balance sheet and income statement for banks and the publication of explanatory notes to the published accounts. Previously, neither a balance sheet in a standard format or explanatory notes were required (Golia & Marchesi, 1991). The government and the authorities supervising the banking industry tried to liberalize the industry and stimulate greater competition among the banks while trying to maintain the stability of the financial structure of the banks. The changes were enacted within the original banking law of 1936. In what had been characterized as a highly regulated and restrictive — albeit stable — environment, the regulators were attempting to reduce mandated market segmentation, allowing more branches and territorial expansion, and gradually abolishing the barriers to the entrance of new financial intermediaries. The state was redefining its relationship to the banks and the relationship of the banks to each other (Desario, 1995; Ostinelli & Toscano, 1994; Riccaboni & Ghirri, 1994). The state, through its legislated authority, altered the rules of the game and in effect coerced the banks to change. With decreasing regulation of the banking industry and the arrival of additional competitors, the sophistication of the products increased. This, in turn, created a need for a greater emphasis in the industry on human resource planning and development within the organization (Testoni, 1991b).

In the mid-1980s, Sig. Rondelli, in response to the initial changes in the regulatory environment (Testoni, 1991a), developed two thrusts within the bank: (1) develop a new managerial culture that would involve all managers and (2) find a way to give targets to middle- and lower-level management and incentives to top management.

The intent for the change in culture was to move Credit from a traditional emphasis on the making and the technical management of loans in the corporate sector to one of managing the bank in the retail and commercial sectors. The traditional focus was exemplified by the training at the educational center.

Credit was a typical bank focused on firms and making loans to firms. Loans were an important part of the culture of the organization. Training at the educational center was focused on loans and their technical aspects. For a long time, the Corso fidi, that is the course on loans, was the top one (Credit Manager).

The manager explained that

The culture of the bank had always been that of making loans, loans were at the center of everything. One of the top managers had an opportunity to work abroad and to see our business in a wider way, less traditional. . . . In 1988 they tried to change that focus, the emphasis was to have the bank as whole look also at the retail sector not just loans to the corporate sector. . . . The new focus required communication; training can be very effective in doing that. . . . The objective was that officers trained at the center would take the new culture to the branches.
A top manager of Credit stated that “The seminars were a means to provide a uniform transfer of the culture—the new managerial culture”. The program at the education center changed. Another manager said that “The training on managerial issues increased greatly. . . technical was 80 percent of the total, five years later it was 50 percent. Managerial went from 20 to 50 percent.” The training was extensive both in the number of managers trained and in the topics covered. The same manager stated that the courses for 2,300 managers were on the changes just introduced: new strategy, structure, an MBO system, a renewed emphasis on the development of human resources.

As part of the change, the bank moved from an authoritarian organizational structure to one where managers had increasing responsibility. Before 1988 Credit, like other Italian banks, was functionally organized. As shown in Fig. 1, the directors of personnel, organization, accounting, credit, international, market relations, and all the MGBs reported directly to top management (i.e. the President, the chief executive officers, and the single or functional area directors). Specific reporting responsibilities and accountability were not well defined. The MGBs reported to the functional area directors on issues relevant to that director. As a consequence of this reporting structure, no one, with the exception of the MGB, had an overall view of the entire business of the Groups of Branches. However, the structure was successful. It provided a means to help ensure a focus on the functionally oriented procedural regulatory requirements and sufficient flexibility in the relatively stable marketplace. When the environment started to change, the management of Credit worked to implement new structures and processes within the organization. For instance, the Groups of Branches were organized into geographical areas, with a manager for each area answerable to the director for domestic banking. Fig. 2 shows the new position of director of domestic banking. Management roles were redefined at all levels. Greater emphasis was placed on results and not just technical skills. Also, the incentive system, which is discussed below, was changed. The managers interviewed interpreted these changes as a response by Sig. Rondelli to changing market conditions. In a paper written about Credit, Sig.

![Fig. 1. Credito Italiano: pre-1988 organization chart.](image-url)
Mazzanti, one of the interviewees stated that these changes "were the product of a more turbulent and competitive environment...the bank had passed from a strategy of maintenance of its competitive position to one of market penetration and development" (Mazzanti, 1995, p. 188).

After 1988 management of the organization placed greater emphasis on results rather than procedures. The focus was now on generating more revenue and not on procedures such as how efficiently the reconciliation was done. In an attempt to focus managers on results, the directors at corporate headquarters, the 45 MGBs, and other top managers (capiservizio) were included in a Performance Assessment System (PAS). In the PAS, each manager was evaluated according to:

- budget results
- human resources management
- quality

No direct salary increase was linked to a positive evaluation. PAS was used for long-term career evaluation and the fixed compensation associated with future positions.

Additionally, a reward system was implemented and there was an attempt to tie the rewards to performance. Traditionally, discretionary bonuses were given to managers from the branch to the top levels in the bank based on a comparison of initial and final positions for the period using the accounting information developed for external reporting. The system provided information by branch and not by client or product line. The rewards were not based on pre-defined goals; the rewards were based on subjective evaluations. The new performance-based system was similar in structure to Management by Objectives (MBO) systems found in the Italian manufacturing industry (Riccaboni, 1999). The plan had two main features:

- The system placed the business risk on the shoulders of each MGB.
- The amount of the incentive was automatically determined by the rules of the system.

For MGB, targets in the incentive system were a subset of the 40 some budget targets previously...
discussed. The five to six MGB targets were quantitative and stated in terms of volumes or margins. Each area manager, in turn, had as his or her target the sum of the targets given to the managers of the groups of branches that reported to him or her. The area manager was also given a few qualitative targets related to administrative changes or promotional campaigns. From about 15 days to a month after the budget was passed to the MGB, a letter was sent with the five to six targets. The targets were the same for all the 45 MGBs; only the relative importance of the targets and the range of acceptable performance changed. Each was a crucial financial target (e.g., gross operating profit, total deposits, total loans, non-performing loans). None of them were changed during the year, the risk of uncontrollable events and changes in the environment was given to the MGB. If the MGB was lucky and the targets were achieved with little or no effort, the MGB could receive the incentive pay. However, the PAS evaluation could be negative. The manager could receive the incentive pay but lose ground in terms of career.

The directors who reported directly to Sig. Rondelli also had performance targets. The minimum level of performance rewarded was usually higher than the budget target, the minimum level of performance to be rewarded was given 80 points. The maximum number of points that could be achieved was 120. If the manager got a score between 80 and 120, the manager would receive incentive pay that was between 5 and 12% of the individual's annual salary. An average bonus of 8% was given to 60–70% of the participants.

As stated previously, below the MGB, no performance-related incentives were given. Only discretionary bonuses were given if positive performance was demonstrated. The overall performance evaluation for the lower managers focused on results and behavior based on meeting budget and non-quantitative targets. At the end of the year, each MGB was given an allotment of funds for bonuses. The manager would award the discretionary bonuses within specific ranges defined by hierarchical level. Corporate headquarters had to be informed of the amount of the bonuses. In 1996, the system was changing to limit the discretion in providing the bonuses. This was influenced by the belief that the new management control system enabled management to identify responsibility for results (i.e., sales) by specific client or account.

Also at the central headquarters, starting in the mid-1980s, each Central Director had money to distribute. A bonus of approximately 5–10% of the annual salary was given to about 20–30% of the individuals on staff. Bonuses could be and were awarded to some of the same individuals from year to year. This bonus system continue to be used through 1996 for individuals not directly involved in selling activities.

Fig. 3 summarizes the evaluation and incentive system at Credit. The overall purpose of the three part evaluation and incentive system was to focus managers on results. To measure results, the managerial accounting system was refined to obtain the necessary information for management control. The cost of providing the main products and services was to be computed for the first time. Profitability down to each window5 (i.e., sportello) would be developed. The new system was designed to make it possible to track direct costs from the smallest branch to the highest level at the top of the bank. Costs and revenues would be booked at the time of the sale. Multiple internal transfer rates would be used to cost the funds used for the various products and services. Also, management started to analyze how to charge headquarters costs to the operating departments. At headquarters indirect costs were charged to managers. The changes and initiatives helped to make managerial accounting information and results measurement more accepted tools. In 1990, the system generated its first profitability reports.

Also in 1988, there was significant turnover in top management. Four out of the top 15 managers (i.e., the head of domestic banking, the securities and stocks portfolio manager, the head of organization and resources department, the head of the personnel department) retired or simply left the organization. Sig. Rondelli and the manager of the

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5 Sportelli are small local branches that report to a local main branch.
human resources department at that time, Sig. Testoni, used the opportunity to introduce different management tools and techniques. The change in personnel became an opportunity for Sig. Rondelli to help insure that the redefined internal and external interdependencies were the realized interpretations by management and not merely symbolic changes.

Managers consider 1988 to be a crucial year. One manager viewed the changes that occurred or were initiated in 1988 as being like changing wheels on a truck while it was moving... The period 1988–1990 is when Credit changed from being an institution to being a firm. Before 1988 our competitors were only Banca Commerciale Italiana, Banco di Roma, Banca Nazionale del Lavoro and San Paolo di Torino. Afterwards (1990), we competed with all the banking system, working on short- and long-term and with non-bank financial intermediaries.

The changes brought an increase in profitability but they also brought a “short-term” focus which caused problems. One of the managers explained that to offset the focus on the short-term, the bank began to “keep managers in a single location for a longer period. Traditionally, moving up the organization meant frequent relocations. In recent years, moving often has not been as important for career advancement.” From 1988 through the first part of the 1990s Credit focused on absorbing the changes made and refining the tools that had been introduced.

In 1988, the changes in the organization started as a top down initiative with the development of a new strategic orientation and a new organizational structure. These initiatives were met by “a push from the bottom, as local managers were stimulated to ask for more autonomy because of the incentives tied to results and a growing recognition of their own capabilities” (Mazzanti, 1995, p. 188). Sig. Mazzanti’s observation was corroborated by the interview data.

Sig. Rondelli retired in 1990. After his retirement, actions to cut costs were taken such as reduction in the use of external consultants. Personnel costs were seen as excessive. The new leader began to redefine the interdependencies resulting in a reallocation of resources. Also, with worsening economic conditions, the number of non-performing loans increased influencing the character of the operating environment. During the period from 1990 to 1994, while Sig. Rondelli was retired, there were moments when the momentum for change within the organization decreased and the organization behaved more as state-controlled rather than a market-controlled organization. For instance, there was an increase in lending to public organizations (e.g., INI, IRI, EFIM).

4.4. The years of privatization — the 1990s

The 1990s brought new elements to influence change in the banking industry in Italy:

- market globalization, with new competitors and the need to support clients in their international activities;
• deregulation by the Bank of Italy, thereby eliminating some administrative constraints and controls;
• a new banking law giving all the banks the authority to operate in any financial sector.

As indicated previously, until the 1990s, the Italian banking system had two types of credit institutions: Ordinary Credit Institutions that had a short-term focus and Special Credit Institutions that had a mid- and long-term focus. Ordinary Credit Institutions included:

• Public charter banks (istituti di credito di diritto pubblico)
• Banks of national interest (banche di interesse nazionale)
• Ordinary credit banks (banche di credito ordinario)
• Popular co-operative banks (banche popolari cooperative)
• Savings banks (casse di risparmio)
• Pledge banks (monti di credito su pegno)
• Rural and artisan banks (banche rurali e artigiane)
• Central institutions for each type of bank (istituti centrale di categoria)
• Branches of foreign banks (filiali di banche estere)

The banking reform of the 1990s gave each bank the opportunity to operate in the short-, mid-, and long-term markets (Riccaboni & Ghirri, 1994). The new legislation supported changes promulgated in Economic Community Directives (primarily Directive 89/646). The legislation supported the de-specialization of the institutions, strengthened the powers of the supervising authorities, and underscored the neutrality of the supervising authorities with respect to the structure adopted by the banks. These changes in effect made survival as a financial institution much more performance based than it had been in the past.

Credit was one of the three banks of national interest along with Banca Commerciale and Banca di Roma. At the beginning of the 1990s, these three banks accounted for approximately 13% of the total banking activity in Italy. By law a bank of national interest needed to be a joint-stock company (i.e., Spa) whose shares were quoted on the stock exchange. Before privatization, the majority of the stock of these banks was owned by IRI.

Linked to political changes and a large public debt, the Italian government started a privatization process that included the sale of two of the banks of national interest, Credito Italiano in 1993 and Banca Commerciale in 1994. By making the privatization decision the state redefined the environment and definition of success for the banks. The new context now required more emphasis on results, including an acceptance of some emphasis on short-term goals.

The redefined environment made the need to determine and use reliable cost-of-services information more important than it had been previously. Knowing which products generated the profits and losses was now crucial to the banks survival. Although the new managerial accounting system had been producing profitability reports since 1990, the internal reporting system used until 1992 was based on required regulatory accounting procedures, which did not provide operating results for specific services and market sectors. Starting in 1994, only the new full-cost, internal-reporting system was used for internal decision making. As one of the managers said, “Before we were focused on the clients, now we are focused on the clients and the shareholders”. Much more attention needed to be given to efficiency and effectiveness defined in terms of returns to the shareholders. Shareholders, particularly the major ones, were concerned with bottom line results.

In March 1994, with the first general meeting of the privatized company, Sig. Rondelli was back again as president of the bank. From October 1992 until the return of Sig. Rondelli, Sig. Bruno held the position of Chief Executive Officer. Upon Sig. Rondelli’s return, Sig. Bruno acquired the additional title of the vice-president of the bank. Sig. Bruno was a “man of the bank” who had started as a clerk in 1954. He is important in the evolution of Credit because he provided continuity in the leadership of the bank during Sig. Rondelli’s absence and provided the technical knowledge to bring the bank from the stable state-owned
environment to the new competitive environment. He is seen within the bank as the individual who made the transition possible, the ferryman (i.e., *il traghettatore*).

The organizational chart was redrawn during June 1994 and twice in 1995, during April and June. See Figs. 4–6. According to one of the managers, the changes that occurred in June 94, April 95, and June 95 were changes aimed at bringing the bank closer to the clients...Starting in April 1994 different units reported to the CEO: domestic banking, international banking and finance, organizational development, information systems, administration, planning and control, investments. Domestic banking was divided into retail, areas, and corporate.

Performance-related rewards continued to be given by corporate headquarters down to the level of the area managers. Each area manager in turn gave performance-related rewards to the nine to ten managers of groups of branches who reported to him or her. Below the level of manager of a group of branches, the branch manager could award a bonus if a clear positive result was achieved.

In late 1994, key stockholders backed the appointment of a new Corporate and Group Controller. The new controller Sig. Profumo came from a publicly-traded insurance company which was a major stockholder in Credit. After seven months with Credit, he was promoted to a new position of Managing Director. Sig. Profumo represented to the stockholders an individual whose understanding of the broader organizational field of financial institutions — rather just the Italian banking industry — would bring a sharp focus to the interpretation of the interdependencies with the market.

In April 1995 the bank’s operations were divided into two business areas: domestic banking (the core business) and international banking and finance. Domestic banking now included retail and private banking, corporate, and the branch network (i.e. *rete*).

In order to be closer to the clients: The corporate sector was divided into enterprises and key accounts for high level clients. Retail and

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**Fig. 4. Credito Italiano: June 1994 organization chart.**
private banking was divided into two separate organizations. The Italian branch network was still divided into five areas, including 45 Groups of Branches, to which the branches report, and windows (i.e. sportelli). Four tiers later reduced to three (Credit Manager).

With these changes, the distinction between the retail and the corporate operations became deeper in the branches to allow Credit personnel to become more specialized and be closer to the clients.

A few weeks later a tier of middle management was eliminated and 11 new territorial directors (direzioni territoriali) were created redefining the roles and responsibilities of the old area directors. The position of the Head of Groups of Branches was abolished. The new territorial directors were given the authority to act "as a managing director of a local bank". These directors had resources to
promote sales activity in their territories and were sufficiently high in the organizational hierarchy to be able “to produce globally and to sell locally”.

The managers of the 11 direzioni territoriali are given a great deal of autonomy and report to top management. They will run the direzioni as if they were autonomous companies. The target is to become rooted in the local environment. To do that we have changed one of the main rules of the HRM in banks: instead of moving among diverse locations, managers will develop in narrower geographic areas (Bruno, 1996).

Credit had just acquired Credit Romagnolo (Rolo) a bank with a very strong market position in north central Italy. Rolo was seen as being representative of, if not a model for, the territorial units. Credit explicitly was mimicking the structure of a successful, albeit smaller, privately held organization.

In 1995 the planning function was changed so that the strategic plan included not only the input of the planning staff and a few of the highest level corporate managers but also high-level line managers. The staff input to the process decreased. Top management of the organization met for a series of Saturdays at the Management Education Center to develop the plan. The effort required setting income goals in terms of return on equity (ROE) and having each of the top managers take responsibility for meeting some portion of those goals. The plan was then presented by the Chief Executive Officer and the Managing Director to the managers in each of the 11 territories. Once the top management agreed on the plan, it was then presented to all of the managers at Credit. Historically, only top management were privy to the strategic plan.

With all of the changes that have occurred, the interviewees continue to express a desire and need to continue to adapt to the changing environment. The areas of concern to the managers included:

- a need to involve all members of the organization in the life of the firm
- a need to stimulate the branches
- a need to better understand productivity and quality in the units of the bank
- extend the management control system to foreign branches
- current risk management was defined as not generating bad debts
- a need to do more benchmarking

5. Concluding comments

There are at least four issues that are evident in the Credit (Credito Italiano) case. The first two are directly related to the motivation for this paper and the other two are tangential to the paper.

First, in regard to the specific events at Credito Italiano, a key if not the fundamental element in the use and evolution of the management control system in the management of the interdependencies was the role of Sig. Rondelli. He delineated the context and defined the changes during his term as Chief Executive Officer. The inertia from his efforts continued after his retirement. However, the new Chief Executive Officer brought a redefinition of interdependencies. For example, the focus on the reduction of personnel costs and the increase in loans to public entities. As Fligstein (1990) argues, the role of the top manager is critical to the definition of what is to be controlled and how to control it. In addition to Sig. Rondelli’s leadership, progressive thinking “old guard” and “young Turks” injected into the organization provided important leadership for the change. The “old guard” provided an understanding of the core values of the organization, the characteristics of the interdependencies, and the steps necessary to address the status quo. The “young Turks” brought a familiarity with the redefined organizational field and the corresponding definition of success. To some degree the changes that occurred were the result of broader socio-political forces (e.g., changing regulatory environment, globalization of financial markets). However, whoever was the Chief Executive Officer would have provided a definition — either in an active or reactive mode — of what was to be controlled and how to control it. Sig. Rondelli’s actions provide evidence to support the view of
the manager as decision maker in an institutiona-
ilized environment and not just as an “over-
socialized” individual.

Second, the management control system dealt
with changes in the internal and external inter-
dependencies in the domains of strategy and
structure of the organization, the organizational
field, and the state. Addressing strategy and
structure, the new branch budgeting system was
designed to emphasize specific performance goals.
The incentive system was adapted to reward
meeting specific budgetary goals. A subjective
evaluation was used as input for long-term career
and compensation decisions. The accounting sys-
tem shifted from one that focused on providing
information for regulatory control to one that
focused on measuring success defined in terms of
return to stockholders. Cost and profit reporting
systems were developed to meet the new market
and owner focus. In regard to the evolving orga-
nizational field and relationship with the state, the
control system was used to minimize the depend-
ence on the regulatory body and to demonstrate
the adaptability of the organization in meeting the
evolving competitive environment. The training and
education programs provided a vehicle to foster the
image of a well-trained sta/C128 and to demonstrate
that the organization accepted its socially defined
role as an educator of bankers. The management
control system appeared to be a flexible tool in the
management of the interdependencies.

Third, the case supports previous research
(Euske et al., 1993; Merchant & Riccaboni, 1992)
that found internal culture and the market context
may be more important than national culture in
explaining how management control works. That
is not to say that cultural differences may not be
important. This study was conducted in one orga-
nization, over a relatively short period of time that
included a major change in the market environ-
ment. Other work (e.g. Catturi & Riccaboni, 1996;
Chow, Kato & Merchant, 1996) provide evidence
that at some level cultural differences matter in the
design of management control systems. However,
at Credito Italiano it appears that the context,
history, and personalities seem to provide the data
to explain much of the behavior of the use and
evolution of the management control system.

Finally, the case of Credito Italiano provides
evidence that a state-owned enterprise can change.
Initially, Credito Italiano was not under strong
pressure to change. The initial change, facilitated
by an environment with relatively low levels of
competition, seemed to have some importance in
the creation of the internal momentum to develop
and to adapt the management control system. The
case study points to the importance of manage-
ment’s role in the design and implementation of
the management control system in privatization
and not only the financial, juridical, and eco-

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