



Short Circuiting the E-Commerce Department at Sigma Funding

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Introduction

"This is ridiculous, Ann," shouted Robert Rose, Director of E-Commerce to his boss. "This Company is going nowhere with e-commerce and new technology. I think it's time I reconsidered my position."

Sigma's Business

Sigma Funding Corporation (name changed at the request of the company) was a sub-prime mortgage lender. Sigma's loans were primarily first mortgages on one to four family residential properties, made to borrowers who do not fit the government's standards of a "prime" borrower (i.e., either their credit was blemished, or their debt ratios did not work, did not have provable income, etc.) Sigma Funding serviced all of the loans it made (i.e., it did not "sell off" its loans to other banks.)

Sigma obtained its business primarily from mortgage brokers in twenty-six states – unlike Champion or Money Store, it did not advertise directly to the public. Sigma also bought pools of loans from other lenders, called correspondents.

In 1996, Sigma went public on the NYSE. Sigma Funding created a parent company, called Sigma Financial as a holding company in order to go public. In 1997, Sigma purchased a mortgage broker, First Class Mortgage, as its retail arm (i.e., First Class goes direct to the public). This was done to enter the retail market without creating a channel conflict with the mortgage brokers Sigma serves. In other words, the purchase of First Class meant that by appearances, Sigma was not competing with the mortgage broker for the side borrowers. First Class Mortgage operated in states in which Sigma Funding was not saturated and did not have brand equity (primarily the mid-west and the south).

Sigma's History and Growth

Sigma Funding was founded in 1982 by Sam Mills and originally was a 5-person corporation. Sam had three sons: Harry, Mark, and Lewis. Upon the graduation of each from his



respective colleges and law schools, each son became employed in the family business. Harry Mills became President and CEO of the Company, in 1984, which was then a 15-person Company. Sigma Funding experienced a dramatic period of growth as Harry pushed the company into sub-prime lending vigorously (the sub-prime market emerged in the mid-80s, and skyrocketed in the late 80s).

***Note: Herbert Sherman is the author of the teaching note for this case and is not a coauthor of this case.**

By 2000, the Company employed around 100 people, and 90% of its business came from the New York Metropolitan area, with 79% of its business coming from New York State alone.

At the beginning of 2001, Sigma Financial, Sigma Funding and First Class together employed over 1400 people, and represented a national lending force, with Sigma Funding having been one of the largest sub-prime lenders on the eastern seaboard.

Sigma Funding had been profitable in each of its years of operation. As of 2000 it had over \$3 billion in its servicing portfolio, and originated and purchased about \$2 billion a year in mortgage loans. Sigma Funding suffered a loss of business in the fourth quarter of 1998, from which it managed to insulate itself due to its conservative practices. This alone would not have been a terribly significant financial factor for the Company. However, Sigma again suffered a serious loss of business due to the lawsuits brought against it. Business for the last 3 months of 2000 was down 20 to 30%.

Another drain on Sigma's financial resources occurred with the acquisition of more office space. These plans were started and committed to before the market trouble began. Due to this expansion, Sigma suffered more outlays of cash and correspondingly, lower profits.

Environmental Changes

In the fourth quarter of 1998, the market turned very sour for sub-prime lenders. Two years prior, a new kind of loan product, the 135% loan to value (LTV) loan, was introduced. Giving a 125% loan meant that the lender was willing to lend the borrower 125% of the value of the loan – actually making loans for 25% more than the property was worth – so borrowers could make improvements to their properties, etc. in exchange for higher interest rates. It took about two years to analyze the performance of a mortgage loan and at the end of those two years, 125% LTV loans proved to be non-performing, with a higher than usual rate of foreclosures and delinquencies. Lenders who were greedy in making these loans suffered, with some going out of business.

The sources of these loans, which provided sub-prime lenders such as Sigma Funding with the funds necessary to make the loans, became concerned and either drastically cut the warehouse lines to sub-prime lenders, or eliminated them, leaving lenders with no funds coming in to make more loans. At the same time, the lenders were selling their loans and became wary of the loan pools they were buying, afraid that they contained non-performing loans. Therefore



not only did lenders not have funds coming in to make more loans, they could not sell the loans they had made in order to originate more loans.

Sigma Funding, a conservative lender who never made 125% loans, weathered this storm, but still suffered its effects and a subsequent downturn of business.

In early 1999, the news media created human interest by introducing a hot topic called “predatory lending practices.” These “practices” meant that mortgage brokers or mortgage lenders took advantage of borrowers by giving them loans that they could not pay back, resulting in the foreclosure of their homes.

Sigma Funding, being the largest sub-prime lender on the eastern seaboard, was an easy target. A borrower of Sigma’s who was in the process of being foreclosed on, was directed by Social Services to the Brooklyn Legal Aid organization, a special interest group in New York City. Needing other borrowers to make a stronger case, the Brooklyn Legal Aid organization solicited other Sigma borrowers in the same situation – either having gone through foreclosure or in foreclosure with Sigma Funding. Brooklyn Legal Aid then contacted a reporter for the New York Times, who took up their cause, and began a series of investigative reports. In 1999, a scathing article appeared in the New York Times which then generated negative TV stories as other reporters jumped on the “predatory lending” bandwagon.

This caught the attention of the New York State Attorney General, Elliot Spitzer, who found “predatory lending” to be a perfect political platform, as he wished to run for governor. The New York State Banking Department, run by Governor Pataki, was the banking regulator that lenders such as Sigma Funding must answer to. In order to appear effective, the New York State Banking Department also stepped into the fray. As a result, Sigma Funding was sued by both agencies for predatory lending practices.

The negative publicity and lawsuits resulted in a downturn of business for Sigma Funding, as the loans Sigma originated were all being scrutinized by these governmental agencies. Likewise, mortgage brokers who originated these loans and brought them to Sigma were also under investigation. To avoid getting into trouble themselves, the brokers sent their loans to other lenders, not under such heavy scrutiny. To make matters worse, the market for sub-prime loans dipped (the lending market is cyclical, and this happened to be a downturn in the cycle for this decade.)

All this resulted in heavy legal fees for Sigma Funding, who eventually reached a global settlement with both government agencies in 2000, resulting in heavy fines and fees on top of their legal fees. However, Sigma’s legal woes continued with other law firms bringing class action suits against Sigma on behalf of groups of borrowers. Also the shareholders brought suit against Sigma Funding.

These external problems resulted in Sigma’s top executive team spending an inordinate amount of time on lawsuits, and not on the business or the Company’s internal operations.



Individuals and Organization Chart

Harry Mills, President and CEO

Harry attended a small college in Pennsylvania, and immediately upon graduation, as all the Mills boys, Harry went to work for his father, Sam, in the family business. Sam eventually faded from the picture, becoming less and less involved in the business, and, although his title was Chairman, Sam acted merely as an advisor. There was an intense rivalry between Sam and Harry. Although Harry constantly sought a sense of approval from others, and his parents, he enjoyed “being better than” his father. At the same time, Harry was very insecure.

1999 was the worst year of Harry’s life. While enduring major problems in business, almost causing him to lose his business entirely (the business which his father started and handed over to him), Harry’s marriage fell apart, and he was in the midst of a divorce.

Harry was brilliant in his knowledge and understanding of the sub-prime market. Loyalty was key to Harry, no matter what the price. It is very difficult to gain Harry’s trust – it usually takes 5 or 6 years. Harry loved salesmanship and selling, and the sales-driven nature of Sigma Funding (as opposed to market-driven) was a direct reflection of this. Harry appreciated people who worked long hours, and took that as a sign of loyalty.

Rudy Michno, Executive Vice President – Sales

Rudy’s background was heavily sales oriented. Prior to joining Sigma Funding, he was a mid-level sales manager in a mortgage corporation.

He, too, was having problems with his marriage, but they were passive. While Rudy was not in the midst of a divorce, his wife was a survivor who dealt with the situation through use of alcohol. Rudy’s 9-year-old son felt the neglect of his father. Rudy was not a people-person, and tried to repair the damage suffered by his son, but he did not quite know how. Rudy enjoyed being on the road 3 weeks out of every month.

Rudy entered Sigma just at the right time (1995). Rudy was perceived to have contributed a great deal to the increase in sales at Sigma Funding (when, in fact, much of that success was due to the good market conditions at the time of his joining Sigma.)

Harry respected Rudy because of his perceived prowess in sales. Harry also constantly sought emotional approval of Rudy. Harry, not understanding the work force or “what’s out there”, truly believed that he could not replace Rudy. The threat of Rudy leaving the company frightened Harry since he believed that Rudy’s absence would further bring a significant loss of business to the company.



Chad Dunn, Executive Vice President - Originations Operations

Chad was highly educated, and had been with Sigma Funding for the last 12 years, rising through the ranks of Sales and Underwriting. He was highly trusted by Harry, who considered him his best friend.

Chad tended to be highly detail oriented, and many times could not see the “big picture”. Chad had trouble delegating and was a control freak. Chad and Rudy Michno had a high level of rivalry.

Terry Park, Vice President – MIS

Terry was not married. She has been with Sigma Funding for 7 years, and was the first MIS person ever hired by Sigma. Terry did not attend trade events, read trade publications, or keep abreast of relevant and current MIS issues. As a result, Terry was very much behind in her field, and considered by many, including her own department as being incompetent. She was a control freak, and very much enamored of power. She realized her incompetence, and was always trying to hide it from others. She did so by surrounding herself with her staff wherever she went, took credit for their innovations, assigned blame to members of her staff for any mistakes, and resorted to heavy technical jargon in meetings when threatened.

Terry had over 50 people reporting to her. This was about twice the normal ratio in the banking industry norm of a MIS person per employee.

Ann Atlas, Vice President - Advertising, Marketing Communications, Public Relations and E-Commerce

Ann had been with Sigma for 5 and a half years. A 12-year veteran of Madison Avenue, Ann started the Advertising Department from scratch. She was its sole member for a year, until the company grew astronomically. The Public Relations and E-Commerce areas were a direct outgrowth of the Advertising Department. She had 15 direct reports.

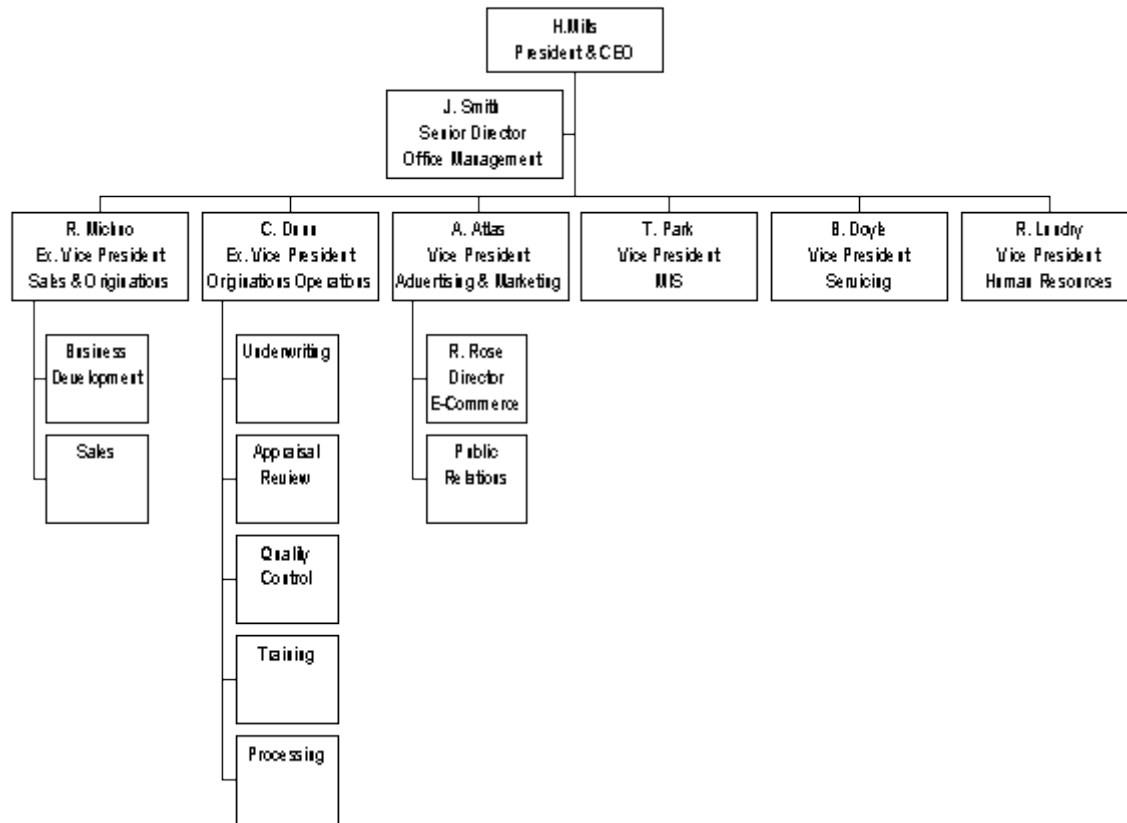
Originally, Ann reported to Rudy Michno, until Harry and Ann agreed that she should report to Harry. Ann has been working under Harry for 3.5 years.

Robert Rose, Director of E-Commerce

Robert was an entrepreneurial spirit who had a happy family life and a new son. Robert left college just 12 credits short of his degree to start his own successful Internet business that he ran prior to joining Sigma Funding. Upon business disagreements with his partners, he left and just completed dealing with lawsuits from his ex-partners resulting from his departure from that company. Highly competent, Robert understood both the business and technical issues of his position.



Figure 1
Organizational Chart of Sigma Funding Corporation



Restructuring

In August of 2000, Sigma Funding went through a restructuring of the organization. In order to allow the President and CEO, Harry Mills, to focus more fully on his role rather than the day-to-day operations of the Company, a restructuring occurred by having some of Harry's subordinates report directly to others.

The restructuring was achieved by creating a new level of executives. Whereas previously, the highest rank under President was Senior Vice President, in August, the level of Executive Vice President was created.

Rudy Michno, previously Senior Vice President and National Sales Manager became Executive Vice President of Sales, and Chad Dunn, previously Senior Vice President of Underwriting became Executive Vice President, Originations Policies and Procedures, and Training. What this in effect did was take the entire Originations end of Sigma Funding and roll it up under two people, shifting the control from the President to these two people. For practical purposes, one can view Sigma's structure as being split up into two parts: Originations and Servicing. Originations had to do with initiating the loans, such as business development and sales (i.e., loan officers). Servicing, on the other hand, dealt with activities after the loan was originated, such as processing, customer service, quality control, etc. (See Figure 1.)



As part of the restructuring and advancement of Sigma Funding, in 1999, Harry purchased a new loan processing system called Unify that was supposed to become operational in June of 2000. After starting in November, MIS was in the process of working through all the problems. For example, whereas Unify was supposed to increase efficiency of loan officers by 30%, it had slowed them down to a crawl, taking 3 to 4 times longer to process loans in an industry where speed counts heavily.

The Move to E-Commerce

Also as part of advancing Sigma's technology initiatives, in April of 2000, Harry decided to move forward with the creation of an E-Commerce (EC) portion of his business. First Class Mortgage had been getting its business primarily through telemarketing and direct mail, both of which had been decreasing in effectiveness for the last two years. Obviously, the Internet seemed a natural solution towards generating more business. In addition, Sigma's competitors were quickly moving toward generating loans online, which eroded Sigma's market share. Sigma had come late to the Internet party and Harry decided that it was time to enter the electronic arena.

To spearhead the transition, Sigma hired its Director of E-Commerce (EC), Robert Rose, in June of 2000. Ann and Harry discussed this hire at length. As part of the hiring process, Harry introduced Robert to other key members in the company, including Terry (Vice President of MIS).

The details of Robert's hire included that he was compensated by Sigma for about half of what he was worth. When the employment agency asked for an additional \$1,000 for Robert's salary, there were over a dozen e-mail exchanges between Harry and Human Resources, and ultimately the request was denied. Robert also asked for an extra week's vacation in his package, wishing to spend more time with his newborn son. Again, his request was denied.

The Turf Battle

Prior to Robert's hire, it was agreed that E-Commerce was an outgrowth of the Advertising and Marketing Department, and as such, Robert and his department would report to Ann. Therefore, Ann handled the entire search. Ann also suggested to Harry that a CIO/CTO (Chief Information Officer/Chief Technology Officer) be hired, to further Sigma's technological advancement. Harry replied that despite what the other managers think of Terry, she, if anyone, was Sigma's CIO.

After Robert's initial meeting with Terry, Harry extended an offer letter to Robert. In the meantime, Terry presented control issues to Harry separately. Harry sent an e-mail to Ann about reporting structure, saying that, after hearing Terry's concerns, Robert would have a dual reporting structure, as Terry wanted control over Robert's programmers, who would be working with MIS, and Harry saw the dual reporting structure to himself and Terry as a solution.

Ann presented her view that asking an EC person to have any reporting link to MIS would result in the EC person not joining the Company. From her sources in the industry, Ann discovered that EC people considered themselves more marketing-oriented than computer-



oriented. Also, if Robert was to staff his department properly, he must maintain control over his staff. In addition, the FCC regarded the Internet as “advertising”. Web-sites had to follow the same rules of any other advertising: print, broadcast, outdoors, etc. Therefore, E-Commerce was a function of Advertising not MIS.

Harry agreed, and then said the reporting structure would be that Robert’s staff would report to Robert, who would report to Ann, and Robert would consult with Terry on any issues affecting MIS. To placate Terry, Harry issued a companywide e-mail announcing Robert’s hire, and stating that while EC is under Advertising and Robert reports to Ann, Robert would report to Terry on MIS issues.

In the months that ensued, Robert, Ann and Terry had many differences of opinion. The lines between MIS and EC were often blurred and Sigma’s EC effort did not advance as planned. Harry had several meetings between MIS and EC in order to resolve these issues.

Harry often asked Robert’s advice on technical issues, including the Unify transition, which was going miserably, and asked Robert for his help on several MIS issues, to which Robert promptly and efficiently responded. Not understanding technical issues or their jargon, Harry often relied on Robert to “interpret”. Robert not only explained in business terms Harry could grasp, he provided proof in the form of data and research to support his opinions. The more Harry relied on Robert for all technical issues, the more uncomfortable Terry became.

Subsequently, Terry increased her open displeasure. There were disagreements over shared equipment, control issues, etc., which led Harry to try to set boundaries regarding functions between the departments. However, Harry continued to seek advice from Robert on projects MIS was handling. While Robert and Ann continued to work out their operational problems, Terry called Harry every day to complain that she was being treated disrespectfully. Instead of gathering any other information or points of view, Harry took everything she said at face value, and Robert was branded as “slightly arrogant.”

In order to placate MIS and show goodwill to Harry, Ann and Robert allowed MIS to continue to control functions, which were clearly EC functions, such as the Sigma Intranet and the on-line store. They felt they had enough work to do in making Sigma’s website an interactive one and resolving channel conflicts. Harry was amenable to this, and relieved that he would not have to work through the problems that would ensue had he transferred control of these projects to EC.

Three months into Robert and Ann’s work, Harry finally realized what all his managers have been telling him – that Sigma’s MIS department, instead of being one of, if not THE strongest department in the company, as it needed to be, was truly the weakest, and that Terry was completely incompetent. However, in Harry’s quest to appear infallible, after supporting Terry for so many years, there was no way he could admit to this mistake. Ann also discovered that Terry, since she was with Sigma in its early stages, knew of some of Sigma’s “dirty laundry”. With Sigma under such scrutiny from governmental agencies, Harry’s paranoia kicked in. He could not allow any leaks.



After 3 months, Ann again approached Harry asking that a CTO be hired. While Harry agreed that it was a good idea, he did not want to make the change until the year 2001. After 5 months, Ann asked that Robert be promoted to Vice President. This request was also denied, but Harry agreed that he would “seriously consider this” sometime in 2001.

Since June, due to the lawsuits, the Executive Team of Sigma Funding, primarily Harry, could not and would not focus on MIS. Harry had not read the EC Business plan Ann gave to him prior to Robert’s hire, nor had he read any of the 5 updated versions that followed.

Also in October 2000, Harry announced to managers that layoffs would ensue to protect Sigma’s cost of originating loans, which was now the highest in the industry.

The Disappearing Leads

Robert and Ann worked diligently to resolve the conflicts with Sales. The perception of Sales was that the creation of the EC department would erode their commissions. Robert and Ann worked diligently to dispel this myth, and asked to have an E-Commerce Summit – a meeting with top people in Sales, Originations, and MIS in order to present their business plan and explain exactly how the EC effort would benefit all concerned. This meeting was put off and never occurred because top management was preoccupied with the lawsuits.

Robert and Ann then sought out a multi-lender site Sigma could get listed on, which would generate loans through their own site and forward the leads to Sigma. This was only temporary while EC would attempt to build Sigma’s own interactive site. The cost was nominal, and Harry agreed. Robert and Ann thought that when the business started to come in, it would force Sigma to resolve the conflicts as to who would handle these leads, the commission structure, etc.

Instead, the leads pretty much sat, collecting on a database. An interim solution was proposed by Chad that these leads simply go to the salespeople responsible for that territory, and the commissions remain status quo until a permanent plan could be put in place. This plan was followed, but Rudy displayed enormous apathy toward it. His lack of enthusiasm rubbed off on his salespeople and the leads again just sat on a database.

Robert and Ann then proposed to Harry and Chad that a separate stand-alone EC unit be created. The group would be non-commissioned, and given bonuses based on the performance of the group as a whole. The team would be comprised of correspondent underwriters, which the company was looking to lay off or re-train to work in other areas of the company, and a handful of processors. These people would have additional customer service skills, since they would be required to work with borrowers directly. To avoid the commissioned mind-set (which would have resulted in the “easy” loans to be worked on first, and the troublesome ones or least profitable ones to be ignored), the team would be more of a customer service type entity than a sales driven one.

Harry initially agreed to this plan. However, he left it to Chad and Rudy to resolve. Rudy insisted that the leads should go to him. He stated, “After all, my area is Sales,



and Chad, you should pay attention to your own shop.” Rudy further indicated that all leads must go to the California office (Rudy had relocated from California as part of accepting his job with Sigma Funding, and still maintained a home there).

Harry agreed to this solution, with the exception that leads east of the Mississippi remain with the New York sales office, until such time the lawsuits were finished, and he could focus more on the development of how the leads should be handled. Harry also had ideas about letting First Class handle these leads, to supplement their dwindling business.

With the failure of the advancement of their idea, Robert and Ann approached the salespeople directly, explaining what the leads were, how they could be worked, and how they could be profitable to them.

In a few weeks after their presentation, Robert and Ann discovered that the salespeople were working the leads, and the results were starting to show. Loans generated from the Internet were starting to close, especially for the New York office.

Then, the California office simply dried up. In speaking with the loan officers from the California office about why they did not work their leads, the loan officers complained that they would work them, only to have the loans re-assigned to another loan officer by Rudy Michno. Robert and Ann investigated this and found that Rudy was taking internet generated leads, re-entered them in the system as coming through traditional channels – the Business Development Reps – and assigned new brokers to those Business Development Reps. The Business Development Reps made commissions off of these loans, and Rudy received an override. Before, only the loan officers made commissions off of Internet generated loans, as they did not require attention by Business Development Reps or Rudy.

Robert and Ann presented their findings to Chad, who was originally assigned the authority to work with Harry on creating the separate standalone EC unit. Chad tried to confront Rudy with the findings, and was told to mind his own business. Chad confronted Harry with this information, but Harry was so distracted at that point that this issue did not gain his attention.

In addition, Rudy Michno was never enamored of EC from the start, and, when he was not ignoring this effort, he would put a negative spin on it. Rudy did not attend any meetings as far as how originating mortgage loans over the Internet would affect and help his Sales and Business Development Departments, nor did he delegate this to any of his staff.

The Meeting

Robert and Ann met with Harry and presented their findings, thinking that Harry was unaware of the situation. Harry knew but did not choose to deal with it at that time. Harry said he was not sure if the EC initiative would work in this manner, as the closing ratios were lower than loans generated through traditional channels.



A large part of the meeting revolved around the EC and MIS issues. Harry's original idea of EC and MIS having weekly meetings to keep each other informed was not producing any results at all.

After this 4 hour meeting with Harry, it became apparent to both Robert and Ann that not only did Harry still "not get it", he wasn't going to do anything about the situation anytime soon. Six months after the birth of the EC department, they were no closer to completing their goals than when they had first started the effort.

Ann and Robert were also suspicious that MIS had too much "private" information about what E-commerce was doing. They decided to "plant" some e-mail bait. During the meeting, Harry repeated verbatim the confidential dialogue that served as the bait in the e-mails. Obviously, MIS was reading private e-mails between Ann and Robert. They were furious, but decided not to confront MIS, since they felt Harry would only defend them.

After the meeting Ann asked Robert to meet her in her office to discuss what had happened. As Ann entered she found Robert pacing and before she could speak, Robert, raising his voice, stated:

"See Ann! No matter what we do to help grow the business there are always roadblocks. If it isn't Terry, then it's Rudy. If not Rudy, then Harry. And I'm really surprised at Harry. Why does he put up with these people? This is ridiculous! This Company is going nowhere with e-commerce and new technology. I think it's time I reconsidered my position." Robert stormed out of Ann's office.

The teaching note may be obtained via e-mail by contacting Herbert Sherman at Southampton College – Long Island University (www.southampton.liu.edu). Requestors will have to demonstrate faculty status (full-time or adjunct) as part of the request. The teaching note includes an introduction to the case, intended instructional audience and placement in course instruction, learning objectives, teaching strategies (preparing the student prior to case analysis, traditional case method, and role playing), suggested case questions and answers, an epilogue, and an overview and discussion (with related references) of leadership theory, organization structure and design, conflict and conflict management, industry and organizational life cycles, systems theory and the concept of fit.