

# Nolan Insights

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*People, Process, Technology*

## STRATEGIES FOR MID-SIZE INSURERS



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- Updates on industry, business, and technology trends
- Client case studies
- Information on speaking engagements, conferences, and web seminars

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## IT'S TIME TO LEAD!

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The way I see it, we have two options: 1) sit and wring our hands while the stock market's daily fluctuations hold the financial service industry hostage; or 2) get active about helping to lead our financial service sector into its next significant positive cycle. You make the choice. As I look out five years, that glass is more than half full. And when I say "get active," I'm talking about streamlining our own operations to be lean and mean and be creative with new product development that meet the needs of current and soon-to-be new consumers. It also means being vocal in the coming onslaught of governmental involvement and new "programs." The industry has brought this challenge on themselves, in many ways. Straying from proven and sound lending principles; believing the Pollyanna myth that everyone deserves the same, regardless of their contribution; and good old-fashioned greed have all contributed to today's situation. The point is our industries—insurance, banking, and health care—have all been hit hard. Although a half a million new jobs have come into the health care industry, investment portfolios have been hit hard and new planned governmental controls are lurking. It is time for leadership from within the industry.

The insurance, health care, and banking industries face an uncertain future, and we can give up or we can get involved by addressing the real issues: operational inefficiency; an inability or unwillingness to truly leverage technology; the need to rebuild consumer trust; and an ability to bring product and operational creativity and innovation to the marketplace. We know creativity and innovation are foreign words in government programs, but unless we take a hard look at the financial services industries and create value for today's customers and future generations of customers, we may all be paying higher taxes merely to pay ourselves an "average" salary as we all start working for one big new company—The U.S. Government.

It is your choice! To me, there is no choice, it is time to lead! ▪

## CHARACTERISTICS OF SUCCESSFUL MID-SIZE INSURERS

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The Nolan Company has the good fortune of working with all sizes of insurers and financial services companies, from the largest multibillion-dollar entities to those whose revenue and premium bases are less than \$100M. It is common to hear about the accomplishments of very large companies. Less is heralded about smaller companies and what makes many of them so successful. To that end, I am dedicating this article to the characteristics of great mid-size insurers.

There has been substantial consolidation within the P&C, life, health, and banking industries over the past decade. Some sectors have consolidated by as much as fifty percent within the past 10 to 15 years. Still, small to mid-size financial services firms continue to thrive and grow, and there are countless examples of companies that continue to endure in the land of much larger competitors.

The first noteworthy attribute is an ability to **identify and exploit niche markets**. The smaller players who've been successful have scanned, screened, and realized niche market opportunities faster than their competitors. Niches can include specialization of product, channel, customer type, or a combination of the three. For example, one client saw an opportunity with a number of its largest agency partners to exploit a new product placement. While the product was only placed with a handful of agencies, the size and profitability of the niche placement made good business sense for the client. Niches can also include business that might be considered non-core to many, such as third-party processing or service fee businesses. Companies that successfully realize niche opportunities maintain a markedly different culture and mindset—they are focused on business development and are highly entrepreneurial. They look at how to make an opportunity work, not find reasons that it will never work. While opportunistic, they are highly disciplined, subjecting every niche market being explored to the fundamental question, “How much would this business add to the bottom line?” In terms of cost-benefit analysis, niche markets are often too small for large competitors to consider, but they can often be very attractive to the mid-size firms who have access and the ability to capture them.

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Exploiting niche markets cannot be achieved without the ability to find and source the opportunities. Those who exploit niches well **maintain a close pulse on the market through intimate relationships with channel partners, customers, and the local marketplace**. Mid-size financial services companies often cannot afford big research departments and large investments in traditional market intelligence; instead, they leverage their customers, channel partners, and the relationships of their senior management to keep them in the flow of ideas and opportunities. Yes, necessity is the mother of invention; that is why successful companies have very close, sometimes family-like relationships with their customers, who are most often agencies and other channel partners. Being close with their partners and customers allows companies to identify possibilities before they become known by others.

Because niche prospects often spoil quickly, the best mid-size companies **listen carefully to the market and act swiftly**. These companies are truly nimble and are able to act on market opportunities in days or weeks versus months or years. They are able to move forward on market niches with measured experimentation and minimal bureaucracy. Their behaviors, people, and culture are focused on problem solving, and they value content and good ideas over tenure, hierarchy, structure, and empire-building. They have an adaptable human resource model that allows them to add businesses to the operation while minimizing the traditional human resource and organization structures. And their internal metrics and rewards systems keep management's attention and actions fixed squarely on top-line growth.

*Companies that  
successfully realize  
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and mindset...*

Changes in the political environment, along with the economic crisis, have consumed much of the headlines and have introduced new dynamics into the market. Earlier, I noted three core themes for successful mid-size companies:

1. Their ability to identify and exploit niche markets;
2. Their ability to maintain a close pulse on the market through intimate relationships with channel partners, customers, and the local marketplace; and

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3. Their ability to listen carefully to the market and act swiftly.

Not surprisingly, leadership is at the top of the list. The carriers we see have leaders who create a culture and environment of high-performance standards and constructive behaviors. They ask tough and probing questions of their teams, their employees, and yes... their outside advisors. Executive managers are not command-and-control characters, but rather those who excel at delegation, holding their people accountable, and staying close to the issues at hand.

*The most  
successful  
executive teams  
stay close to  
the issues...*

These companies have very strong and loyal cultures where it takes years to develop people and their management teams. Many hire and promote almost exclusively from within. The most successful executive teams stay close to the issues not only to ‘trust and verify,’ but also to coach and help their teams work through the issues. Modest-size organizations can’t afford to immediately terminate or move someone aside who has the capacity to get the job done, but simply lacks the training or exposure. It is also true that these carriers are often in smaller communities, which constrains the talent pool, requiring more focus on internal development versus outside hiring.

The next theme is around focused use and leverage of technology. With scarce resources and often niche market positioning, it is critical for the mid-size carrier to be laser-focused with investments in technology, especially where technology is key to supporting the business strategy. These carriers have strong internal agreement on the role of technology (e.g., Support vs. Enabling vs. Driving), as well as investment and delivery plans.

Next is a deep-rooted dedication to ongoing learning and continuous improvement. An example of this is strong representation at many of the industry conferences. Mid-size carriers are hungry for ideas and lessons learned. Rather than following textbook fads, they look for what works and what will fit their situation. They have a culture that asks “Why?” or, “How can we do this better?” at every level of the organization. And, they are willing to share their ideas and successes with others.

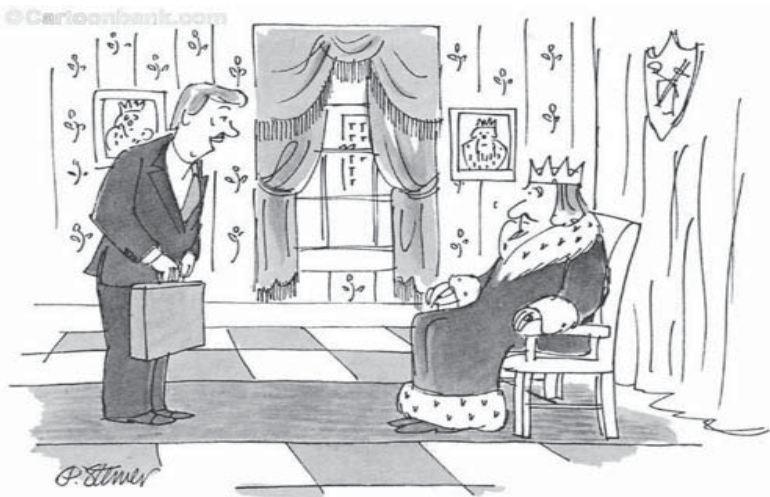
The last theme is mid-size companies’ long-term versus short-term commitment to their customers, market, partners, and business plans. This is especially true for mid-size private versus public companies. For

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example, mid-size mutuals take a hard look at the long-term viability of their business. Modest-size public companies tend to be much more bottom-line focused and reactive to fickle market attention, which can result in greater efficiency, but fewer products and services, which leads to longer-term growth and viability challenges. Taking a short-term view can lead to decisions that limit long-term prospects, which leads to further consolidation... and, you know the rest of the story; i.e., a self-fulfilling prophecy of following the leader and being gobbled up by the larger competitor.

In a world filled with jargon attributing successful business strategies with words like scale-driven, consolidation, outsourcing, off-shoring, commoditization, and meeting short-term earnings commitments, there is a contrasting and successful business model, which can be described as local, personal, niche, entrepreneurial, relationship-based, and committed to the long-term. Mid-size carriers have the distinct advantage of being able to pursue these values on their own terms. We salute the many successful mid-size carriers who are proving it during these exceptionally challenging times.

These are just a few of the core characteristics of mid-size companies that are flourishing in today's world of larger scale, consolidation, outsourcing, off-shoring, and commoditization. ▀



*“Your Highness, even a small kingdom can make effective use of modern management techniques.”*

# A CASE FOR EVIDENCE-BASED MANAGEMENT

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Society has benefited tremendously over the last 200 years from evidence-based medicine, where physicians' actions are guided by solid research. Starting with Pierre Louis' elimination of bloodletting as a standard treatment in 1836 (George Washington died after five pints of his blood were drained to treat a sore throat), evidence-based medicine has carried forward, with doctors like David Sackett of Canada's McMaster University its contemporary exemplars. The rigors and discipline placed on medical research have ensured a constantly improving quality of life.

Despite the portability of the relatively straightforward concepts involved, the discipline involved in evidence-based methodologies has not made its way from medicine, science, and engineering to the business world. Instead, the business world relies more upon individual expertise, prior practices, and strong belief systems—in part due to the demands for expediency and the apparent lack of complete information. Some of these misleading approaches and their inherent risks and pitfalls are:

1. Casual benchmarking. Benchmarking is an excellent practice. But unfortunately, the need for quick results often drives superficial analysis that results in imitating practices that might not be the real source of advantage. Is the practice really the cause of the result? Why? What are the potential disadvantages and costs of change?
2. Doing what seems to have always worked. Like evidence-based medicine, the treatment needs to fit the specific disease, but treatments evolve. Proficiency and efficiency are admirable goals, but they are bound by the specific situation. Change a variable or a condition, which happens all the time in today's dynamic environment, and the underlying, once-reliable practices need to be revisited, too.
3. Succumbing to entrenched but unchallenged beliefs. Among the hardest things to change are management practices based on deeply rooted beliefs about what creates success or advantages. One example is stock options as an incentive: they were responsible for a decade of bogus results and bankruptcies, yet many people still believe in their effectiveness. Another controversial belief that studies have been unable to support is that being a first mover creates a market advantage. (Most first movers are replaced by fast followers.) Be sure practices are not based on preferences, intuitive

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fits, or untested beliefs.

Evidence-based management involves collecting the facts, validating the evidence, and then using the results to drive decisions. It represents a new way to think about management: learning to face the hard facts about what does and doesn't work while weeding out the anecdotal lore that often passes for conventional wisdom. Contrast this studied approach with the parochial process in which personal experience, anecdotal information, historical practices, business advice books, and intuitive solutions are combined like a managerial stew. Clearly, decisions based on reality are more strategic and less risky than those guided by perceptions, beliefs, and prior practice.

To be effective, an organization must be willing to accept the discipline that comes with converting from interpretations into evidence-based decisions. What does evidence-based management look like in practice? Here are some indications:

- Old ideas are treated for what they are: old ideas, not necessarily the best ideas;
- Everything is subject to critique and hard review, including “breakthrough” studies;
- Collaboration is used in lieu of conclusions dictated unilaterally;
- Openness, directness, honesty, and non-personalized critiques are integral to the process;
- Failures are viewed as learning opportunities—starting points for the next effort; and
- A neutral and objective view is maintained throughout the process.

For companies willing to venture into this more disciplined decision-making process, choosing to exchange unsubstantiated beliefs for an unrelenting commitment to facts and evidence, the benefits can be significant. Fact-based decisions underpin opportunities to improve performance and competitive positioning as strategies become more apparent, viable, and reliable. Leveraging the knowledge gained in a manner not easily imitated by competitors leads to advantages such as higher-product margins, better pricing, and powerful service differentiations. Through evidence-based management and the knowledge base that results, a sustainable, profitable competitive advantage is built.

Take a pulse check today. Are your strategic decisions based on validated and well-developed data, or is your organization subject to some of the distractions of anecdotal evidence? The difference can be the basis for substantial future growth. Contact us to learn more. ■

## ACCELERATING UNDERWRITING PROFITABILITY

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In challenging financial times, insurance carriers cannot rely as much on investment income to boost profits. They must look for improvement opportunities across the enterprise, including core business operations. One area of close examination is improving loss ratio through improved risk selection and premium pricing. But such changes take precious time. *The real trick is to accelerate implementation of improved underwriting standards to achieve benefits sooner.*

Research shows a typical underwriting period—that is, the time between implementing one set of underwriting changes and the next—ranges from 32 to 36 months. By reducing this cycle time to 18 months, a carrier can, over a three-year period, effectively *double the effective loss ratio improvement.*

By utilizing stand-alone technologies such as new data analytics tools, advanced rules engines, automated workflow, and predictive modeling techniques, underwriting improvements can be accelerated without the need of expensive and costly changes to existing underwriting, claims, and back-office systems. Other benefits can also be achieved with these tools. For example, expenses can be reduced by improving productivity and reducing labor costs associated with developing and rolling out new rates and rules. The tools also enable actuaries and underwriters to analyze more pricing scenarios with a greater number of rating variables than previously possible, which in turn reduces risk and improves effectiveness.

How does a carrier begin to implement these improvements and accelerate capturing the benefits? Fortunately, such changes can yield significant benefits when applied incrementally, as opposed to a massive redesign/replacement of the existing environment. In fact, the infrastructure needed is complementary to an existing environment. The first step is to develop a clear vision of the desired environment based on five key areas: data research, rate and rule development, predictive analysis, automated exception monitoring and notification, and a framework for how they will all work together. In my next article, I'll elaborate on subsequent steps which include process and solution design, implementation, and benefits capture. ■

# M&A BACK ON THE AGENDA: NOT JUST GROWTH – SURVIVAL

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With a few exceptions, there has been a relatively modest level of mergers and acquisitions (M&A) in the U.S. insurance market over the past several years—certainly not the flurry of activity seen in the 1980s and ‘90s. This has been driven by three key factors. First, insurer profitability has been very strong for most. For example, the P&C industry has enjoyed record profits the last several years in spite of large catastrophes and a softening market. Second, strong carrier balance sheets have played a role. P&C and Life businesses experienced increases in surplus and solid investment returns. This, combined with strong management of the bottom line, has resulted in continually strong capital for the industry. Finally, with a few exceptions, there has been no compelling reason for carriers to either sell or buy over the past several years. When earnings are growing (or at least not shrinking) in a soft market, there are few compelling reasons to over-pay for a potential acquisition or consider merging if solid earnings and surplus are being sustained.

Now, major drops in the Dow have changed the game. Investments are worth far less right now and carriers are going to struggle much more than they have in the recent past. For that reason, mergers and acquisitions are quickly moving up on the executive agenda—not just as a way to grow, but as a way to survive.

For those carriers who are quickly being thrown into the deep end of the M&A pool, we have a few suggestions and lessons learned from our long history of advising clients in evaluating, selecting, and implementing merger and acquisition opportunities. These include:

- When evaluating potential opportunities, **stick with your core business**. Many carriers have excess liquidity even now and are likely to consider “portfolio plays.” That’s fine for businesses that are already successfully operating a portfolio of companies. For those who do not, be wary of venturing into uncharted territories. Those may include lines of business which require dramatically different understanding of risk, underwriting, claims, or distribution. Experimenting with diversification can be a good thing, but take a carefully measured approach in deciding how much you are willing to put at risk.

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- **Prepare to move quickly.** Many of your peers and competitors are reviewing the same opportunities. Those who can act quickly, accurately, and decisively will win. Those who over-analyze M&A options may find themselves watching opportunities pass them by—especially now that liquidity is so important to survival.
  - Don't be afraid to **give serious consideration to businesses with seemingly unattractive operations.** Operations which are not up to your standards are often the greatest opportunities for performance and profit improvement.
  - **Be thorough in your due diligence.** The need to act quickly can also lead to overlooking key reviews. This is not limited to just deal evaluation but also final terms and conditions.
  - **Leverage your strong cash position** if you can. Especially with today's market conditions, going to the capital markets for funding will slow you down and you may end up ceding returns which would otherwise be better passed on to current shareholders.
  - **Consider IT integration issues carefully** before, during, and after the deal. Before a deal can be struck, accurate and timely financial, HR, and operational data is needed. IT compatibility and dependency issues can slow business integration efforts and possibly reduce longer-term integration benefits.
  - **Line up the right team to execute** with speed and precision. Integration is hard work and requires experienced resources to realize the benefits expected from a merger or acquisition.
  - **Don't underestimate the challenges of cultural integration.** There is substantial evidence which points to why mergers and acquisitions fail. The #1 reason most noted is the failure to integrate company cultures. Analytically speaking, you can pick the best target but if you don't have the right end-state culture you won't integrate and the projected benefits will not materialize as expected.

These are a few of the key issues you should consider as today's market dynamics put M&A back in play. And these aren't just hypothetical. These are the very issues we are helping our clients work through right now as they pursue merger and acquisition opportunities. The need for speed blended with diligence is critical right now. I welcome the opportunity to discuss these key issues with you as you confront them. ▀

## OPERATING IN THE “CONE OF UNCERTAINTY”

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Southern coastal residents know as much about the weather halfway across the globe as they do about the weather in their backyards. That’s because weather systems off the coast of Africa could eventually arrive on our shores in the form of a hurricane. Once the system evolves into a tropical storm, its most-likely storm track is predicted, with the extra feature known as the “cone of uncertainty.” And as the whole nation saw with Hurricane Gustav, everyone in the “cone” is advised to take measures to protect their property.

Due to economic conditions, most companies are now operating in a cone of uncertainty. Revenue growth and profitability are all in question. Further, inflationary forces of rising prices and declining productivity widen the cone of uncertainty even more. The credit crisis is putting some banks on the brink of survival. Insurance companies are also feeling effects of the credit crunch and other economic forces. Pressure on property and casualty premiums are forcing companies to look at how they price risks. The declining returns on investments have squeezed the life insurance industry profitability just as products “guaranteeing” certain benefits are being introduced.

The decisions that organizations make when in the cone of uncertainty will determine how much “damage” they will absorb from the economic storm. Rather than merely slashing costs across the board, we believe there are three elements that enable organizations to deal with the cone of uncertainty more effectively: 1) Stay focused on top-line revenues by working with the distribution system to leverage all sales opportunities; 2) Stay focused on the customer by improving service, quality, and productivity; and 3) Identify and eliminate all non-value added work, versus across-the-board cuts. This three-step approach involves all parts of the organization in a positive way, versus in a reactive and negative way.

And, when the storm passes and you are no longer in the cone of uncertainty, your organization is stronger and able to seize the opportunity to begin growing again. ■

## NOLAN'S NEW LIFE & ANNUITY INDUSTRY SURVEY

We invite you to participate in Robert E. Nolan Company's new **Life & Annuity Industry Survey: Strategies for an Evolving Industry**. The market is in an era of unprecedented change, so we have designed this survey in order to explore and provide analysis on the emerging strategies being undertaken to profitably address those changes.

If you have participated in past Nolan surveys, you know the value they provide in the form of insights and perspectives into key strategies being undertaken across critical functional areas. The findings and analysis help bring perspective to the dynamics that will shape the industry in the coming years.

There is no cost to participate, and the survey can be completed online or submitted via fax or mail. Once the survey results are tabulated and analyzed, Nolan will release a comprehensive findings report in early 2010.

For more information or to participate in this survey,  
go to: **[www.renolan.com/lifesurvey](http://www.renolan.com/lifesurvey)**.

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