

Nolan Insights

People, Process, and Technology

MANAGEMENT INSIGHTS

FOR

MID-SIZE INSURERS





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IT'S TIME TO LEAD!



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The way I see it, as insurance industry leaders we have two options: 1) sit and wring our hands while soft market conditions, stiff competition, unprecedented CATs, and regulatory uncertainty put some carriers into a catatonic state; or 2) get active about leading our industry and our companies into the emerging positive cycle. The choice comes down to leadership with a bias toward action, or accepting the status quo.

As I look out five years, that glass is more than half full. When I say “get active,” I’m talking about:

- Streamlining operations to be lean and mean;
- Replacing outdated, expensive, and innovation-hampering technologies with a combination of new technology, outsourcing, and hosted (a.k.a. “cloud”) solutions;
- Being creative with new product development to meet the needs of current and soon-to-be new consumers;
- Finding new ways of attracting and serving policyholders through enhanced service and support models, social media, simplified self-service, affinity groups, and other creative models;
- Solving the integrated channel conundrum such that agents are engaged and reinvigorated, and customers are served on their terms; and
- Ensuring the right people are in the right jobs and that they have the proper training and the appropriate authority to fulfill their responsibilities.

The insurance industry, like many others (e.g., automotive, housing) has been through a very tough time, but we are emerging in very good shape all things considered. Now it’s time for leadership, tough choices, and unwavering determination from within the industry. It’s time to step up and fundamentally improve those key elements of our operations that will make the difference between surviving and thriving.

In this special publication, *Nolan Insights*, you will find timely content that will help you prepare for and execute essential improvements. And just as we have been for the past 38 years, the Nolan team is here to assist you.

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 50 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.

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
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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

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.

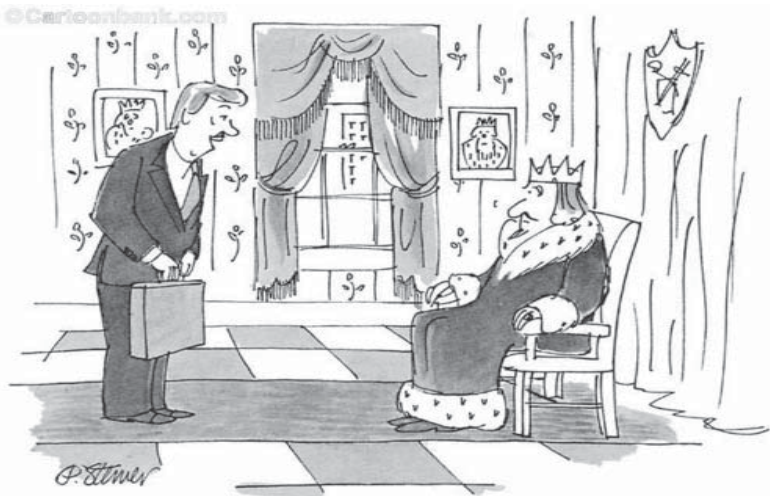
Next is a deep-rooted dedication to ongoing learning and continuous improvement. An example of this is strong representation at many of the industry conferences. Mid-size carriers are hungry for ideas and lessons learned. Rather than following textbook fads, they look for what works and what will fit 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 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 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. ■

LESSONS TO REMEMBER AS MERGER AND ACQUISITION ACTIVITY INCREASES



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There have been countless acquisitions in the insurance and financial services industry already this year. Slow organic growth, unpredictable investment earnings, failed institutions, and attractive acquisition targets are escalating M&A priorities on the executive agenda. Given the slow and extended economic recovery, M&A is likely to remain a hot topic for many for the foreseeable future.

Most carriers deal with M&A activities only occasionally. 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 mergers and acquisitions. These include:

- When evaluating potential opportunities, stick with your core business. Many institutions have excess liquidity even now and may consider adding “portfolio plays” to their book of business. That’s fine for businesses that are already successfully operating a portfolio of companies; however, those that aren’t should be wary of venturing into uncharted territories, whether they are lines of business that require a dramatically different understanding of risk, underwriting, claims, or distribution. Experimenting with diversification can be a good thing, but be measured in how much is pursued and decide how much you are willing to put at risk.
- Be prepared to move quickly. Many of your peers and competitors are reviewing the same opportunities, and those who can act quickly, accurately, and decisively will win. Those who overanalyze M&A options may find themselves watching opportunities pass them by—especially now given the heightened interest and need to grow.
- Don’t be afraid to give serious consideration to businesses with seemingly unattractive operations. Often, operations that are not run to your standard offer the greatest opportunities for improved performance and profits.
- Be diligent in your due diligence. The need to act quickly can also lead to overlooking key reviews. This is not limited to deal evaluation, but includes final terms and conditions and operational and cultural attributes.

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- Leverage your strong cash position. Especially today, going to the capital markets for funding may slow you down and have you looking for returns that 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 issues can also slow potential business integration efforts and 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. Periodically review your pre-integration decisions and their rationale to ensure that the team hasn't drifted from your original intent. Re-validate your assumptions.
 - Finally, don't underestimate the challenges of cultural integration. Substantial evidence indicates that the main reason mergers and acquisitions flounder is a 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 will likely be challenged in the long term. Consider your own management style and what you expect to see.

These are just a few of the lessons the Nolan Company has learned. For more, visit us at www.renolan.com. We are pleased to be helping so many fine clients today in their pursuit and implementation of merger and acquisition opportunities. Let us know if a conversation about the need for speed might be valuable to your organization. ▀

BUYING WHILE BLINDFOLDED



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A phenomenon is unfolding across corporate America, especially in financial services: the rise of procurement and vendor management functions. Once found only in larger organizations and government entities, these departments are now part of companies of every size. What concerns me is how many companies are getting this important function absolutely wrong.

Nolan experiences this as both a supplier of services and from the inside. One of our services, in fact, is to help companies build procurement functions—and fix broken ones. Companies implement such programs with the best of intentions: manage spend, reduce cost, improve negotiation, strengthen contracting, eliminate fraud, and guarantee outcomes. Unfortunately, many programs quickly deteriorate into a robotic process that effectively isolates buyers from sellers and focuses on a checklist instead of the ideal solution. Sound familiar?

One common problem is that business-side buyers of specialized solutions (for example, an analytics tool or related service) cannot freely communicate with suppliers. Likewise, suppliers must operate in a cone of silence and avoid contact with buyers, or face disqualification. Sellers must therefore prepare a specialized proposal based on an RFP and perhaps a brief Q&A session. Making matters worse, procurement staff find themselves in an untenable situation when they are unfamiliar with the specialized solutions and services they are asked to procure.

Unfortunately, many programs quickly deteriorate into a robotic process that effectively isolates buyers from sellers...

An example of a procurement tool stifling common sense is Ariba, a procurement management system that many suppliers are required to participate in by their buyers. Once a day, the system sends buoyant “opportunity notifications” to suppliers, letting them know that eager buyers are looking for a product or service. Unfortunately, these notifications have no details about the buyer or what they are looking for.

Important specifics—such as industry, size of buyer, and required skills/capabilities—are nowhere to be found. The unintended consequence is that suppliers don't respond because they quickly learn that their efforts seldom yield business. Buyers likewise end up getting half-hearted responses, often from less-qualified suppliers who are taking a shot in the dark.

A successful procurement program should do these things:

- Focus on finding the most suitable solution, not on simply following a checklist or finding the lowest cost. Every solution and procurement situation is different;
- Foster business relationships and trust between business-side buyers and solution providers, whether or not a purchase ultimately takes place;
- Bring best practices to the negotiation and contracting steps;
- Help manage risk; ultimately, the business-side buyers should own the risk, not the procurement function;
- Avoid abdicating responsibility to tools and technology. Buying and selling are based on relationships and personal trust;
- Measure and report the value delivered; and
- Keep it simple for buyers and sellers.

If your organization has a procurement or vendor management program, don't allow the program itself to become the focus. Find the best solutions, taking into account a range of business-decision factors. And don't allow your procurement program to isolate your business people from the solutions they are seeking. In other words, don't buy while blindfolded! ▪

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. Insurance companies are 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 sustain as they emerge 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, as 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. ■

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