The Nolan Newsletter

People, Process, Technology

ROBERT E. NOLAN COMPANY
MANAGEMENT CONSULTANTS

First Quarter 2009 *Volume 36, Number 1*

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New Financial Service Landscape Brings New Challenges

If 2008 is any example, 2009 promises to be a year of considerable change. Political change and economic change are perhaps obvious, but we can also expect change in the business community, education, and the environment. *The Nolan Newsletter* is also undergoing a change this year. Since 1988, Ben DiSylvester has provided industry insights, an objective perspective, and a unique outlook on the issues facing financial services organizations. Ben continues to offer his valuable insights in *The Nolan Newsletter* and beginning this quarter, his contributions will be the closing article in each edition. With this quarter, I begin authoring the opening article of *The Nolan Newsletter*. Much like Ben, I will bring my own unique perspectives and thoughts to each issue. I look forward to sharing my insights, and I welcome your feedback as well.

Saying that 2008 was an eventful year for the financial services industry would be an understatement. During the fourth quarter, we saw insurance giants suffer stock price drops of magnitudes never before seen. One-time market leaders teetered on the brink of bankruptcy, and banks and investment firms—long thought to be the backbone of our financial system—looked for government bailouts. We saw a stable and once stodgy industry hit by investment income turmoil, reserving challenges, and operating decisions foreign to many senior officers who had previously experienced only the relatively good times of the last thirty-plus years.

Someone once said that where there is chaos, there are opportunities. I think that is true.

Our financial services industries need a fresh look at their operating model, their financial model, and their pricing model. We got lazy! We settled for mediocrity in operations because our investment income was robust and our fees for services were going unchallenged by consumers. That has all changed now, and as an industry we have a chance to make a fresh start.

I understand that many of the fiscal challenges have little to do with running the day-to-day; however, it is now running the day-to-day effectively and efficiently that will help us out of this financial mess. The winning companies, those with strong fundamentals in place, will survive and prosper at the expense of those who can't adapt to a more intensely competitive landscape, which is approaching. Market share will be at risk. Retaining current clients will require nimble operating models and new thinking on how to get the most from technology investments past and future. Meeting the needs of customers just became harder because they expect value for their dollar even more so than in the past.

As we enter 2009, be innovative in your thinking as you tune up your service model. Understand the risk-reward principle when evaluating new products and new marketing campaigns. Make sure the numbers work when you are investing in new technology. And clean house in your fundamental, day-to-day processes so that you have an impact on the bottom line with operating profit. Yes, 2009 will be trying, but the opportunities are there for success for those who have the drive and creative energy to build that best-in-class operation. ▪

Dennis B. Sullivan

Dennis Sullivan
Chief Executive Officer

Finding Opportunity in Crisis

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First, the bad news. It is an old myth that the Chinese word weiji (危機 translated as "crisis") is made up of two characters—one meaning danger, the other opportunity. JFK employed this myth routinely in his speeches, and it was then appropriated by Richard M. Nixon and others. The usage has been adopted by business consultants and motivational speakers and has gained great popularity in universities and in the popular press. For example, in 2007, Condoleezza Rice repeated the misunderstanding during Middle East peace talks; Al Gore did so in testimony before the U.S. House of Representatives Energy and Commerce Committee, and in his Nobel Peace Prize acceptance speech. I am a little befuddled why speech writers don't check Snopes.com before adding such quotes—Kennedy and Nixon excused.

The good news: there is a reason this myth is so pervasive and persistent. It goes beyond the drama of the two symbols and a western bias for inspirational oriental wisdom. It is appealing for a very simple reason—most people believe it to be fundamentally true that there is opportunity in a crisis. There is sufficient statistical and anecdotal evidence that this is true. Emerging markets generate more millionaires per year as a percent of their population than established markets. Industrial market segment leadership change is its greatest during periods of turmoil. My kids will most likely get approval to have a sleep over on a school night when my wife and I are in a heated debate about a home renovation project. But more relevant to this current economic crisis, consider the following:

- One of our long-term clients is experiencing massive growth in their annuity business. A large part of the growth is from annuity owners fleeing uncertainty and moving to the safety of a large, old mutual company. The other part of the growth is people leaving CDs and fleeing to the safety of a large, old mutual company. This same large, old, and successful mutual company was also quick on its feet to see the opportunity in the crisis and quickly deployed an advertising campaign which was not about some sexy new guarantee feature, but rather about the stability and durability of their business model.
- My 16-year-old son just got his drivers license so I had the pleasure of getting auto insurance quotes. My agent started the conversation by

saying, "If you want to get this done quickly we will be eliminating some of the top-end insurers." He said, "Companies like XYZ and ABC are swamped right now and it can take 8 to 10 weeks to get a quote." I did some quick research at home on the named companies and guess what I found? XYZ and ABC had also, in their own unique ways, gone to the market with a solid message that allayed fears and attracted those that wanted to move to the safety of an organization they knew would be there.

- The President and CEO of one of our clients is spending a large part of every day encouraging each and every segment of the business to stay focused, find the opportunities, and exploit them. He said to me, "Some part of our competition is losing focus and seeing the fear. There are obstacles but probably no greater opportunity to capture profitable market share than in this crisis."

> *"There are obstacles but probably no greater opportunity to capture profitable market share than in this crisis."*

A crisis, and we are in one, is painful and full of difficult choices. An organization can become overwhelmed easily with the negative news and managing difficult budget decisions. However, as we have seen time and again over our 35 years serving the insurance industry, the opportunity window is there and it will never be bigger than it is at the start of a crisis. The Nolan Company stands ready to help your organization find that window and make the most of it. I'd be glad to personally share some of our relevant experiences and advice. ▪

Everyone Has a Plan Until They Get Punched in the Mouth

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This was the most enlightened comment ever spoken by ex-heavyweight boxing champion Mike Tyson during his reign in the ring. What does it have to do with our current banking crisis? The economic impact of the subprime lending crisis, the credit default swaps, the side bets wagered by financial service industry leaders, the CDOs (collateralized debt obligations), and the relatively recent adoption of mark-to-market accounting rules have resulted in the subsequent deleveraging of the banking industry. And, of course, the collapse of credit on a world scale has led to the inevitable global markets' decline. I think we can safely call this a "punch in the mouth" to the banking industry without overstatement. The question is, how many banks will get up and what do they need to do to survive?

Every bank has its own set of conditions and while we have nearly 8,000 in the banking system, the top nine hold nearly 60 percent of the assets. This is why they were addressed first in the Treasury Department's bank recapitalization plan. The other 40 percent is just as important to the financial life of the economy. We need to concentrate on what those banks have to do today to reposition them (or react to the punch).

There is a wide array of scenarios, but for this discussion let's separate banks into two basic categories: 1) those banks that are viewing our economic crisis as the opportunity of their business lifetime (to add to their footprint and profitability); and 2) those banks that are seeing the crisis as "a fight for survival."

Operating efficiency can improve the odds of survival for relatively clean banks.

The banks that have no subprime loans and have been based on good credit quality are not immune to the crisis since instability will likely bleed into the consumer side in the near future. Credit card delinquencies are up and banks with a sizable home equity portfolio or auto loan portfolio should have major concerns right now.

This is also a time to examine every element of revenue and expense that is required to run the bank effectively. Operating efficiency can improve the odds of survival for relatively clean banks, as well. A thoughtfully designed operations improvement initiative should be positioned to properly align the bank's cost structure and should also examine the value of all services from the stockholders' and the customers' points of view.

The Treasury has indicated that the second wave of the recapitalization process will target banks that would use the capital for acquisition. Therefore, banks need to have a plan for consolidation that would eliminate cost and leverage their management and administrative assets. The annual Nolan Efficiency Ratio Benchmarking Study indicates that the average range of administrative cost for many banks is in excess of 22 percent of operating costs. High performing banks are between 12 percent and 14 percent, so the gap becomes the eventual purchase price for banks positioned to step up.

The boxer who survives the blow certainly needs to quickly reassess his strategy and tactics to get back into the fight. And like the boxer, there will be many survivors in banking. However, these questions remain: Which banks will become stronger as a result of this crisis? Which institutions will actually win the fight by seizing the opportunity to aggressively take advantage of their financial competitors' weaknesses? ▪

It's Still About the Customer

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Today, the popular topic is how to navigate these rough waters by cutting costs, reducing staff, closing operations, and other actions aimed at managing the crisis. No doubt these times are both difficult and unique, especially in terms of the breadth, depth, and degree of governmental actions. But, if you plan to keep your doors open, I suggest it is now even more about the customer than ever.

There is comfort in consistency, and two measures that have been consistent over my career are that 1) satisfaction and customer retention are linked, and 2) claim-handling experience and retention are powerfully linked.

The J.D. Power and Associates' 2008 Claim Satisfaction Survey once again proved these two points. Customers who rated their service experience high on specific claim practices also indicated a very high level of "will definitely" renew. What are the keys to moving an insured's claims experience to the high satisfaction levels while not inappropriately paying claims?

In our experience, there are two very different but powerful forces that management must harness and shape in order to consistently deliver such results—the forces of culture and process. Just as the forces themselves are different, the skills that a leader must possess to affect them are very different. But these two enablers are also very independent from the outcome you are seeking to build: this is because your customer service goal is tied to your staff's desire, willingness, and ability to deliver that service. Without a supporting process, your attempt to build a culture that reinforces customer service will soon wither under your staff's frustration at not having true support from management to do what they are being asked to do. Similarly, having the process without the culture to support how to use the process will not be effective in the long term, with the tools unused as a result.

Where to start? I suggest these questions:

- Does your process address the reality of the emotional impact of the loss event?
- Does the process set expectations in the initiation phase of the claim?

- Are those customer expectations then embedded into the control tasks of the claim?
- What do your staff members think are their personal roles in customer satisfaction?

The additional drivers identified in the J.D. Power survey will be familiar. They include returning phone calls, answering customers' questions, providing flexible appraisal appointments, sharing information between claim representatives, and providing proactive updates.

The next steps are yours. Now that you have that information, you can look at your process, hand-offs, file documentation, use of diary tools, use of prompts, and how file reviews are used to support a customer service focus. And, most importantly, listen to the culture to learn what behaviors are valued. ▪

"Please stay on the line. All of our customer service representatives are kidding around and throwing paper airplanes at each other."

Choosing a Solution Provider: It's Not Just About Checklists

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At Nolan, our projects often involve helping clients find the right solution provider. This entails evaluating outsourcers, system vendors, or other specialized resources. We all love our feature/function checklists, and Nolan feels that checklists level the playing field. To a certain extent, they do. However, when a client is trying to evaluate a solution provider who will be responsible for delivering critical services and providing strategic insight to the organization, there is more to consider. A strategic vendor is one that helps to shape its industry, thereby providing a level of relationship that makes the client stronger. They provide insight to their clients to help them determine how to advance their business.

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Will the vendor you choose be an industry leader, become stagnant, or (worse) be obsolete in five years? Those of us who are old enough to have picked Beta over VHS back in the '80s know all too well the importance of factors beyond pure feature/function.

A number of factors can determine a vendor's success or failure; these include client satisfaction, functional and technology strength, financial management, and regulatory compliance. While these are certainly important, other variables influence whether a company achieves industry recognition, which can be one predictor of success. These other variables include the following:

1. **Product strategy**. I don't mean just putting a bunch of disjointed wish-list items from a few key clients on a piece of paper and calling it a product plan. What I do mean is taking a look at the market issues, trends, and drivers that are not only influencing clients today, but are able to interpret the market dynamics in an attempt to predict (and perhaps even shape) industry direction. How does the vendor gather this information? Do they sit on industry boards, work with consultants, and hold focus groups? Are they active with trade associations in agenda-setting activities?

And then, can they translate the information into capabilities that are included in a multi-year product roadmap? Whether or not your organization needs all of the new functionality, you need a product that keeps ahead of the market.

2. **Marketing**. Getting their message out to the industry is what ensures that vendors are top-of-mind with prospective clients and the consultants doing the reviews. If they are not visible in the market, they probably aren't being invited to many dances. I know that, in theory, it shouldn't be this way. However, by selecting someone with no market presence, you run the risk of the vendor becoming insular and getting feedback only from the clients they currently serve. This is not about expecting vendors to spend a lot of money on advertising and trade shows. There are other ways to get publicity—independent analyst reviews, industry councils, and articles in peer-reviewed journals, to name a few.
3. **New clients**. When you look at their client base, what is the sales trend? A client may have 100 clients, but if none has been signed in the last three years, it could indicate a problem with the vendor's ability to keep current. It could also mean that you will end up paying more over time because the money that is needed to run the company is coming only from existing clients.
4. **Strong leadership**. Is the vendor's leadership team truly focused on making this company a success? Are they in it for the long haul? How do they see their company and leadership transitioning in the future? Do you see strong leaders at multiple levels of the organization? When you are talking to the vendor's senior leadership, are they people with whom you can picture sitting on a task force to solve an industry problem? A "no" to any of these questions might be a red flag.
5. **Client focus**. It is important to understand the dynamics of the vendor's relationship with their clients. Do the clients see them as industry leaders? Ask questions, not just about the nuts and bolts of the product, but about how the vendor has worked with clients to solve challenging business issues. Has the vendor brought industry insight into their clients' organizations, or are the clients always leading the vendor? When a client is in the position of *always* leading and the vendor is no more than an order taker, it is a sign of a limited relationship.

This list represents one of the many areas we look at when reviewing solution providers for our clients. In the health care IT industry, health plans have been subjected to a lot of pain, especially over the past 10 years. Having been in this sector of the industry for more years than I care to admit, I have always advised our clients not to build everything in house—they should acquire services from companies that help them improve the way they do business, both today and tomorrow. Is the company that you are considering one of them?

I welcome your questions and comments about partnering with solutions providers and would be happy to share some of our experiences helping others with this. ▪

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 overpay 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.

- **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. ▪

Cutting Costs Across the Board: A Necessary Crisis Strategy?

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In times of financial crisis, many companies are forced to initiate cost-cutting measures. For most financial services firms, this means headcount reductions. If you Google "cost cutting strategies" you will find approximately 1.8 million hits. Yet, many executives will take the "easy way out" and demand 10 to 20 percent cuts across the board. This is not a strategy. The expectation is that the "fat" will be trimmed while the result may be just the opposite.

Consider this: An across-the-board headcount reduction will impact the cost conscious manager the most and impact the high-cost manager the least–just the opposite desired outcome. Cutting costs in an area where the manager has always been conscious of the number of employees required to do the assigned work will, in effect, be cutting into the muscle, not the fat. Conversely, a manager who has operated with excess staff will be able to cut and feel less (or no) pain. Unfortunately, this manager will probably also be praised for their ability to weather the storm.

One of the quickest and most equitable methods of determining headcount requirements is development of staff models. These models determine the required time to complete the current workloads and then determine the required number of employees necessary. The models also take into account vacations, sick time, overall staff experience, volume fluctuations, and supervisory personnel. Staff models also yield the invaluable benefit of being able to forecast future staffing needs based on workload volume increases or decreases.

The result of implementing staff models will be the true identification of "fat" and the ability to trim costs with the least negative impact on productivity and service. Companies that have implemented staff models rarely, if ever, resort to across-the-board cuts because they have the ability to focus on areas where cost reduction is deemed appropriate. In fact, many companies that have long utilized staff models do not look at headcount reduction as a first solution when crisis times arise.

The Robert E. Nolan Company has a 35-year history of helping companies develop simple, yet effective, staff models. If your company is looking for ways to reduce expenses in an equitable way, we can help you pinpoint where they exist. Remember, across-the-board headcount reduction is not a strategy; it is, most times, a knee-jerk reaction. ▪

CLIENT SPOTLIGHT

Project: Operational redesign of telephone sales, underwriting, and customer service

Client: Direct General, an automobile insurance carrier

Industry: Property and casualty insurance and financial services

Product Lines: Automobile insurance in 13 states, premium financing, financial services

Objective

The objectives of our engagement:

- Provide a basis for staffing telephone sales, underwriting, and customer service operations;
- Redesign jobs, where needed, to make the operation run more efficiently;
- Generate increased revenue through reallocation of resources;
- Improve customer service by operating the call center for longer hours and more days per week; and
- Provide the company with a road map of improvement activities for the next year.

Current Environment

Once a public company, Direct General was recently acquired by a private investment firm. This fast-growing company was actively acquiring new businesses and required fast, high-impact changes to operations so new business could be absorbed. The new management team believed productivity improvements could be implemented and opportunities realized that would decrease expenses and increase revenue. Nolan provided assistance in identifying and prioritizing these opportunities and implementing responses to them. A highly-skilled, fully-engaged management team began putting the changes in place soon after they were validated.

Project Scope

Nolan consultants worked primarily in the client's operations centers and information technology division. Direct General's management provided unrestricted access to all other divisions and personnel as needed. C-level personnel were actively engaged in the project and provided effective communication when required.

Project Results

Nolan conducted on-site analysis of work performed in various underwriting and call center operational areas. Through this process, Nolan identified client resources that, although working hard, were not providing appropriate value. Many activities were a carry-over from old operating methods and systems and were no longer needed. Nolan recommended that the client retrain and re-task these individuals to value-adding positions.

Shortly after arriving at the client site, Nolan consultants determined the best opportunity to maximize revenue. Many incoming phone calls generated requests for quotes; however, too many quality leads were being dropped. Using data mining, client operations center leadership worked with Nolan to provide the best potential leads to outbound telephone personnel. Simultaneously, the outbound sales team was restructured and retrained. Outbound sales increased by 50 percent within three months with no addition of personnel.

Telephone service operations functioned in three primary locations using virtual call center technology. Nolan consultants worked with Direct General and its network provider to right-size the telephone network, generating savings for the client. Using historical data and data mining techniques, Nolan assisted the client with network capacity and staff modeling for its busy season. This enabled management to prepare in advance to have lines available, thereby increasing sales. Nolan provided the client with models for telephone trunk capacity for future use. To help floor management, Nolan installed its own workforce management system and linked it to the client's telephone network for real-time reporting. The system bases staffing requirements on sophisticated calculations so the client can determine staffing needs using current, accurate call-volume data rather than infrequently updated metrics.This new system enabled Direct General to schedule multiple shifts for a six-day workweek with maximum flexibility for workers to change schedules. It proved to be a key improvement, cutting the time that management spends on scheduling by 80 percent.

Working with Direct General, Nolan developed metrics and management reporting to measure and manage performance. These tools enabled the client to improve performance and reduce hiring. Client management teams worked with Nolan to communicate all of the changes and new tools to the telephone center staff; the entire staff was trained on the meaning and use of the new measurement tools. This encouraged buy-in by the employees, who now actively monitor their own results. Although not quantifiable, this implementation led to improved employee morale and an interested, engaged call center staff who consistently provide better service to clients and who have increased sales for the organization.

Support from Direct General's executive leadership and sponsorship from the top level down played an important role in the success of this project. The teamwork between Nolan consultants and key personnel drove the redesign initiative toward success in maximizing revenue, improving service, and controlling staffing costs.

LEADING THROUGH THE CRISIS

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The challenge of turbulent times brings with it an intense pressure on an organization's leadership—pressure for performance and solutions that can seem almost overwhelming at times. The impact of the subprime lending crisis, credit default swaps, complex hedging strategies, and the collapse of credit on a world scale have combined to create a global recession estimated to last at least fourteen months. Each day industry leaders wake up facing these challenges. Some are filled with self doubt and many are stressed by the need for quick decisions and action, knowing that the success–or even survival–of their company depends upon making the right choices.

Other articles in this newsletter offer strategies for managing during these trying times: value-based expense savings versus broad cuts that could permanently impair; step-by-step considerations for dealing with the acceleration in mergers and acquisitions; and examples of the opportunities created by the crisis that some companies are working to their advantage. Achieving the benefits of these and other management strategies will depend upon effective leadership, challenging even the best to rise to the occasion.

George S. Patton, a man known for dealing with crisis situations, once said; "It is nearly impossible to remain both aloof and effective." Patton was a staunch advocate of avoiding the inevitable temptation of being driven behind closed doors by a crisis, analyzing mind-numbing data, searching for solutions, and losing that crucial connection with those being led. Winston Churchill showed similar leadership in his refusal to leave London during the blitzkrieg of 1940, as did Rudy Giuliani 61 years later when faced with the aftermath of September 11th. In all three cases, the tenets for strong leadership during times of crisis are effectively illustrated as:

1. Staying visible, leading from the front, engaging with, reassuring, and learning from those dealing with the issues directly. Businesses are not turned around by reports or statistics; they are turned around by people and actions. An effective leader knows this and puts himself or herself among those who can make the difference.

2. Acknowledging the realities while communicating an unwavering and clear vision of what is required to navigate through the crisis. People need to see the big picture towards which they are working, akin to looking at the cover of a puzzle when trying to put together the 1,500 small pieces—it provides focus, a common goal, and the glue that holds the organization together.
3. Relying upon open debate with a diverse leadership team of complementary skills, one willing to challenge one another, bring a magnifying glass of honesty to each decision, and unite together once the decisions are made. Colin Powell said it best:

   > "When we are debating an issue, being loyal to me means giving me your opinion whether you think I'll like it or not. At this point, disagreement stimulates me. But after the decision has been made, the debate ends. At this point being loyal means getting behind and executing the decision as if it were your own."

...tough times rarely create leaders; they merely show you what kind of leaders you have.

Ideally, a strong team has been built and prepared for this challenge, as it has been shown that tough times rarely create leaders; they merely show you what kind of leaders you have. And as John Maxwell described in the Law of the Inner Circle from his book, *The 21 Irrefutable Laws of Leadership*, the leader's team will determine the leader's success.

A second critical leadership element (particularly important in the management transparency described above) is the decision-making process used by the team. Evidence-based management, a derivative of successfully developed evidence-based medicine, is a process by which all of the facts involved in a given situation are collected and then unemotionally validated as accurate and contextually applicable. Strategically rational decisions arise from these facts. The process requires being willing to face the hard facts about what may or may not work, which in turn requires the painful process of weeding out the anecdotal lore that often passes for conventional wisdom. The results are decisions built upon the foundation of fact having the permanence of strategy versus the transience of perceptions, beliefs, and prior practice.

What does this process typically involve at a practical level?

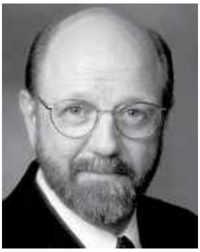
1. Old ideas get treated for what they are—old ideas, not necessarily the best ideas;
2. Everything is subject to critique and hard review, including "breakthrough" studies;
3. Collaboration and collective effort are used in lieu of conclusions dictated unilaterally;
4. Openness, directness, honesty,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

Fact-based decisions... will improve performance and competitive positioning.

Fact-based decisions made with a diverse and transparent management team that is engaged and leading from the front will drive realization of opportunities that will improve performance and competitive positioning. There is no doubt these turbulent times will challenge the best in all of us. Yet within these challenges the opportunity to excel (while the economy gradually returns to normalcy) does exist. A real chance to establish a sustainable competitive advantage is attainable for those willing to listen, willing to have the tried and true folklore of their organization challenged, and interested in finding the leverage points amid the noise of the turmoil.

I welcome your observations and comments about leadership during a crisis. The Nolan Company has assisted many clients through times like these. We stand ready to share our experience and insights with you. ▪

Success Is Customer Perception



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By now, many of you know that I enjoy sailing. I also enjoy taking guests (let's assume they are my customers) sailing. But what I enjoy about sailing might not meet the expectations of my guests. I may be having a great time while the boat heels to 35º and water rolls over the gunnels, or when the boat sloshes up and down (and up and down) through the waves, or when we listen to Jimmy Buffett CDs while sitting in 98º heat with no wind to be found. I may think it's a great sail while my guests turn a color somewhere between yellow and green and begin begging to go home.

You may think things are great, but your customers may be turning yellowish green because things are not great for them. My point is that you must measure success not by your standards, but by your customers' standards.

A few years ago, I was working with a training department. They were extremely proud of the number of classes they held, the number of trainees they "got through" the claims training program, and their graduation rate. As I recall, they graduated 97 percent of the people who took the classes. They were sailing without regard to their customers' expectations. They looked at the training activity and the graduation rate as measures of success. However, of the 97 percent who "got through" the training, 30 to 40 percent were unable to perform the job for which they had been trained.

> *...you must measure success not by your standards, but by your customers' standards.*

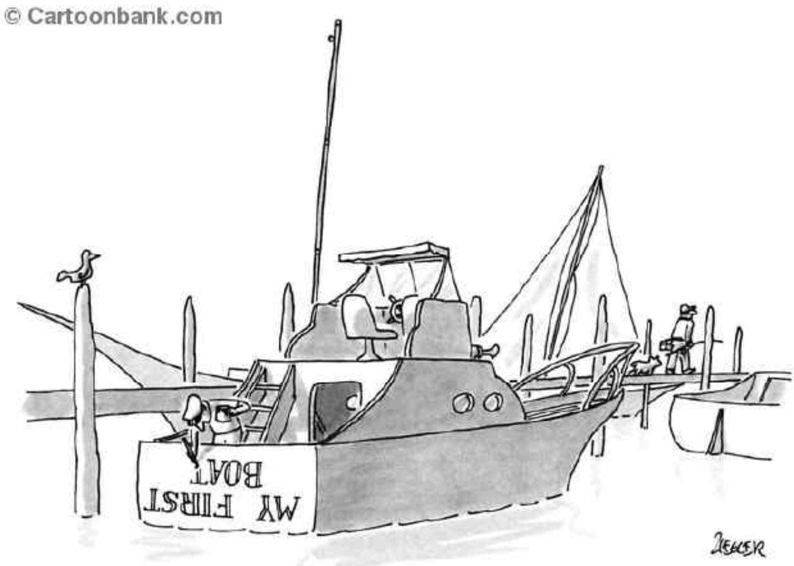
The managers of the claims department (the yellowish-green customers) who were receiving these newly trained employees were frustrated by the high number of the new employees who couldn't perform their jobs at an acceptable level. Many had to be retrained by the claims department. Those who could not be trained the second time were let go after a lengthy termination process.

In this situation, the training department felt it was doing an excellent job, whereas the claims department felt the training department was a failure. It's the classic example of judging success by an incorrect standard.

Instead of looking at the number of classes conducted or the graduation rate, the training department should have studied the impact or results of their training effort. An outcome where 30 to 40 percent of the graduates are ineffective and require retraining does not reflect success. In such a case, it is critical to get the two departments to work through the problem to:

- Revise the curriculum and testing to meet the claims department's needs; and
- Revise the training department's measurement of success by using statistics from retraining and forced turnover (for inability to learn the job) in the claims department.

When I sail with guests, we discuss their expectations and I try to measure the success of the sail not by my standards but by those of the people who will truly judge my performance. After all, it's their perceptions of the sail that really count. ▪



Designing for Technology's "Sweet Spot"

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Over the last several years, the approach to process design and improvement for insurance companies has evolved to one that follows this sequence:

- Identify customer requirements.
- Design processes that best support those customer requirements.
- Break up the processes into the job roles required by the processes.
- Align the job roles into an organizational structure that makes sense.
- Apply technology to best support the processes—from a speed, efficiency, and effectiveness point of view.

The theory behind this methodology is that design follows customer requirements. This technique supports a clean-slate approach to process design, without the burden and constraints of the current environment. The reality is that this approach is most effective when there are time and/or budget constraints, a lack of readily available technology, and, in many situations, when most or all process design benefits can be achieved without major technology upgrades.

Recently, some of the assumptions of this approach have been challenged. Technology is now readily available from vendors to support the core functions of policy administration, billing, and claims. And many of these solutions are comprehensive, flexible, and affordable when compared to the cost of developing these capabilities in house from scratch. When new technologies are proposed, vendors tend to state that the new system will accomplish all the requirements of the RFP, either as base functionality, configuration, or customization.

While it is true that there is now a broad array of affordable solutions available to insurance companies, all technologies are designed for a core set of requirements that the technology best accommodates and supports. Understanding this "sweet spot" is a critical part of the evaluation and selection process. Accomplishing this calls for a revised approach to process design. In situations where it is initially understood that new technology will play a part in the redesign, the processes themselves should be developed and evolved with the technology in mind. The following sequence will help companies to select the technology that best supports effective processes:

- Conduct vendor research to pre-qualify those appearing to have the products, technology environment, and the history of successful implementations required.
- Develop high-level process designs and business requirements—that is, understand and separate the must-have requirements and functionalities from those less critical to the final implementation.
- Prepare and conduct a comprehensive request-for-proposal (RFP) selection and proof-of-concept (POC) effort. In the RFP, include questions to understand the process approach that the technology was initially designed to support. Also, contact other customers of the vendor(s) to help identify (from a process perspective) the typical level of customization required and strengths and weaknesses of the product out of the box.
- Most importantly, during the course of implementation, constantly review and adjust processes as the new system is being configured. This refining is necessary in order to best align the processes to the sweet spots of the technology. Often, processes can be modified to better coexist with technology without hurting overall performance or effectiveness.

...understand and separate the must-have requirements and functionalities from those less critical to the final implementation.

The benefits of this approach include the implementation of processes that are most efficient and effective and the selection and use of technology that best supports the processes. Implementation time and cost will also be reduced as a result of lighter requirements for configuration and customization of software packages. ▪

Oprah and Me

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One night last week, I dreamt I was on "Oprah." No lie; I'm not making this up. Apparently, I was some kind of management consultant guru because Oprah wanted my opinion on a wide range of business topics. However, since it was a dream, I can remember only one: Oprah wanted to talk about mass layoffs. I told her they are the result of massive management failures that are seldom acknowledged or publicized.

When you read about a company reducing its workforce by 10 to 20 percent or more, it is usually the result of a series of management miscalculations. Occasionally, a company is cutting its losses—eliminating expenses related to business that is bringing in little or no commensurate revenue. But, many times, an organization is just trying to do more with less. It is recognizing that its expense structure is not allowing it to generate sufficient profit. In that case, the reduction is an admission that management 1) did a poor job of managing expenses, or 2) cannot price or market the product properly.

If a company has allowed its salary expense structure to get out of line in relation to its profit model, it is either generally overstaffed or top-heavy in management. Let's be clear: If a company is properly staffed, large reductions in staff will negatively impact service and/or quality. Ultimately, that negative impact will show itself on the bottom line.

Across-the-board staff cuts can lead to the loss of the employees that a company can least afford to lose. Even targeted cuts can fail to retain the high performers, unless they are clearly identified by effective measures. Accurate performance measures that drive staffing models can determine the impact of staffing changes. It is one thing to reduce staff when the volume of work is falling; it is something else to reduce staff in the face of constant or growing volumes if the real work remains. In the latter instance, backlogs, poor quality, and unsatisfied customers are almost guaranteed.

In my dream, I wowed the "Oprah" audience. I charmed them. I knocked them out with my vast knowledge, superior intellect, and smooth delivery. Next week, I'm going to dream that I have my own show... "Dr. Eugene." ▪

LEADERSHIP: THE POWER OF ASKING THE *RIGHT* QUESTIONS

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During a recent conversation with a client, she complained about how things were bad at her company. Projects were behind schedule, recommendations that had been enthusiastically approved 12 months earlier were now the "dumbest decisions" ever made, and the original project team members were under constant attack from the CEO, who was on a rampage to find people to blame for the failure of the project. The sky was falling and nothing seemed to help.

As my client was talking, I was reminded of a time early in my career when I worked for a manager who always wanted to blame somebody for every failure, real or imagined. The results were similar to my client's poor morale and lack of execution. This led to project failure and an operating environment that was in a constant state of crisis.

This manager's usual mode of operation was to ask questions like:

- Whose fault is it?
- Why are we behind?
- Why can't we get this right?
- What is taking so long?
- Why can't you get this?
- What are you going to do to fix this?

These questions are devastating and disempowering, and there's an implication that the questioner has no responsibility whatsoever for the outcome. At the time, I did not realize that the negativity of the questions contributed to the problem.

I was asked to take over a project that was failing. I began by asking the team, "What will it take to bring this project in on schedule?" We left the meeting with an action plan that enabled us to finish on time and within budget. I noticed that the attitude of each participant changed. As the project progressed, I continued to focus on successfully completing the project, rather than the little things that were going wrong. We finished ahead of schedule and well under budget! I wish I could tell you that I was an enlightened leader who fully understood the power of asking the right questions. The reality is that I was a young, scared MBA without a clue as to what to do. It wasn't until I became a full-time manager that I was able to fully appreciate and understand what happened during that project.

Consider how the questions listed above make **you** feel. In an environment where these questions are the norm, folks are typically resistant to change, lack creativity, and are afraid to make decisions. Unfortunately, when organizations find themselves in a crisis, these are often the questions that are asked. The negativity of these questions stifles success at the very time new ideas, energy, and commitments are needed most.

Now, look at a different set of questions—ones that have a positive, forward-looking focus:

- What aspects of this project are working well?
- What are we trying to accomplish?
- What do we need in order to reach our goal?
- What ideas do you have that will help us move forward?
- What needs to happen to get this project completed?
- How can I help?
- What accomplishments can we celebrate?

These types of questions are powerful tools for bringing out the best in people. Notice how you feel when you read these questions—they are positive and energizing. When forward-looking questions are used, people let down their barriers, communicate openly, and take personal responsibility for the outcome. We tend to move toward whatever we focus on. If we focus on the obstacles, we spend more time addressing the obstacles than moving toward the goal. When we focus on the end goal, we tend to do whatever it takes to get there in the most efficient manner.

I saw this in practice when my children were younger. If I told them not to spill their milk, more often than not, they would spill it. I had focused them on spilling milk. However, when I told them to hold the cup with both hands, they didn't spill the milk. Their focus was on the outcome I really wanted, not the outcome I was trying to avoid.

I suggested to my client that she go back to her team and turn the CEO's questions around. There was nothing she could do in the short term to change the CEO's approach, but she could immediately change the way she interacts with her team. Several days later, she called back to tell me that the transformation was miraculous. Her project was back on track, and the team was reinvigorated and excited. My client was embarrassed that she hadn't seen the simple solution, but it is easy to get distracted by the negative and get caught up in the "crisis." ▪

Do Your Workers Know What to Do?

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After facilitating a workshop, I was rehashing the results with one of the supervisors who had attended. She was a fairly new supervisor who had been promoted less than six months earlier, and this was her first opportunity to lead people. She confided that she was having problems with a person who had transferred into her area a few weeks ago. She said the person had received good reviews in the old area but that she just wasn't doing well now. As it happened, I had met the employee in question in an earlier workshop. The supervisor and I discussed the situation a little more, and I agreed to talk to the employee to see if I could discover anything that would help.

Over an informal lunch meeting, I asked the employee about the new area and how things were going. "Not well!" was her response. She went on to say that a lot of the time, the work she did just didn't seem to please her supervisor. I asked how much training she'd received, and she said she'd gotten enough; she knew how to do the job. In fact, she didn't know what the problem was; she had been trying different things and none of them were making her supervisor happy.

When I went back to the supervisor and related this conversation, she confirmed the same things that the employee had said. "She does things, but they aren't the right things." I asked her what the right things were, and she recited them as if she was reading from a list. I asked if the employee knew what those things were. The supervisor's answer was revealing: "I shouldn't have to tell her. She should know!"

Knowing what to do is different from knowing how to do it.

You can see how this situation evolved—a good worker who doesn't quite know what to do and a supervisor who thinks "she should know." How often are workers not sure what exactly they should be doing? Knowing what to do is different from knowing how to do it. We know how to process transactions, for example, but knowing *which* transactions to process is another matter.

Fortunately, the solution is simple. But it takes a little work on the supervisor's part—the supervisor must figure out the details of the job description and explain them to the worker. If the supervisor is having trouble figuring it out, he or she might find clarity by thinking about why they do the work they do. It's not just to finish processing a transaction. We don't update the amount we bill someone just for the sake of updating. We do it so that we bill our customer the correct amount.

That's not all, though. The supervisor must also figure out how to measure or judge whether the task was accomplished with success. When the supervisor has taken the time to communicate what to do and how performance will be measured, it makes the worker's job easier. And, it makes the supervisor's job a lot easier, too. ▪

NEWS BYTES...

A recent study found that it takes 64 seconds to regain your train of thought after an e-mail interruption. People who check their e-mail every 5 minutes spend 8.5 hours each workweek trying to recall what they were doing.

A Strategy for Surviving Past Today

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With bad economic news—bankruptcies, bailouts, and shrinking economic output—coming at us every day, it is hard for management to see beyond the next overnight investment placement. Even if an organization has more than enough cash in reserve and no exposure to the toxic investment vehicles that are bringing down hallowed financial institutions, most companies will feel the effects of a potentially deep and long recession. It is infinitely easier to lead and manage in good times than in challenging times like these. However, declining sales and eroded investment income will expose and magnify previously hidden issues. These include: low productivity, average quality, questionable organizational structures, non-value-adding products and services, incorrect pricing, and unnecessarily high costs. In a recessionary environment, previously ignored problems could have an exponentially worse impact on your bottom line.

Most management teams have experience with difficult times. Some tried-and-true approaches, including across-the-board budget cuts and the dreaded staff layoffs, are usually what companies turn to when the going gets tough. These approaches cut expenses, but staff morale, service, and expertise all take a serious hit, as well. And once the pressures ease and the economy improves, the company emerges perhaps a little worse off and less prepared to handle the increased activity.

There is an alternative to this type of decision making. It enables an organization to not only survive the daunting challenges of today but also position itself to thrive when the economic cycle turns and revenue and growth trend upward again. It involves four important action steps, but with just a bit more strategic thinking added:

1. **Reduce expenses wisely**. We recently saw this quote: "Invest in success, eliminate failure." This is a useful framework when reducing expenses. Arbitrarily chopping expenses in functions that work in equal percentage as functions that aren't working well does not make sense today. Rather than reducing expenses across the board, work with your people to quickly identify non-value-adding activities in your operations. Think effectiveness in delivering what your customers need and want. What better way to cut expenses than to eliminate what your customers don't want

or need from you anyway?

2. **Improve service now**. In deep downturns and economic uncertainty, fear grips even the most rational of people. There is a good chance that many of your customers are worried about your company, whether they should be or not. The worst thing that your company could do is to give poor customer service to someone with this mindset. A bad customer service interaction could be the very thing that motivates them to seek another carrier. Nothing will help retain customers (think "revenue") better than consistently knowledgeable and efficient service experiences with your company.
3. **Rationalize the organizational structure**. Rare is the executive who hasn't questioned why there are several service centers, or wondered why there are so many people doing what seems to be a simple task in some part of the organization. Now is the time to address and resolve those lingering questions. Rationalizing organization structures streamlines decision making, improves service, and reduces significant unnecessary expenses. Better yet, it positions your organization to respond even faster when the cycle turns upward again.
4. **Communicate frequently**. In periods of uncertainty, people look to their leaders for reassurance. Explaining how the company is being affected by these events and what is being done to address them is critically important. The message of "cutting expenses" is one that employees certainly expect to hear, but that message alone is hardly reassuring for the long term. Rather, share with them the vision that by taking the right actions now, the company will be positioned to be even stronger in the future. And don't forget that nothing contributes to good communication (and success) better than actually enlisting your people to participate in all the elements above, with clearly stated goals and guidelines.

You know what needs to be done. It is how you do it that will determine if it just gets you through this difficult time or contributes to the long-term strength of your organization. ▪

Nolan Events

PCI Executive Roundtable Seminar
January 25-27, 2009: Carlsbad, CA
Nolan is pleased to be a morning break sponsor at this Property Casualty Insurers Association of America event - *www.pciaa.net.*

LOMA Emerging Technology Conference
February 18-20, 2009: San Diego, CA
Nolan will be a Bronze-Level Sponsor at this conference - *www.loma.org.*

NAMIC Commercial Lines Seminar
February 24-25, 2009: Chicago, IL
Steve Discher (Nolan Senior Vice President) will speak on "Product Innovation: Increasing Speed to Market" on Feb. 24. Nolan is also an afternoon break sponsor at this event - *www.namic.org.*

Women Business Leaders Summit
March 11-13, 2009: Scottsdale, AZ
Nolan Vice President Teri Mullaney is a board-elected member of the Women Business Leaders of the U.S. Health Care Industry Foundation. Nolan is a Bronze Sponsor at this private event - *www.womenleadinghealthcare.org.*

LOMA Customer Service Conference
March 11-13, 2009: San Antonio, TX
Dennis Sullivan (Nolan CEO) will present "Reducing Expenses Without Sacrificing Service." Nolan will sponsor a breakfast at this conference - *www.loma.org.*

California Association of Health Plans Fundraiser
March 17, 2009: Napa, CA
Nolan is a sponsor at this annual invitation-only event in Napa Valley - *www.calhealthplans.org.*

The Life Insurance Conference
March 30-April 1, 2009: Orlando, FL
Ben DiSylvester (Nolan Chairman) will serve as a panelist at two sessions, "Trends in Life Insurance Products" and "Ask the Expert." Nolan is pleased to be a refreshment break sponsor at this conference - *www.loma.org*

2009 IASA Annual Conference
June 7-10, 2009: Orlando, FL
Nolan is honored to sponsor the conference's keynote address to be given by Michael Eisner, former CEO of The Walt Disney Company. Eisner's speech, "The Creative Economy," will discuss the importance of generating fresh ideas while enhancing and protecting your brand. Nolan executives will also co-present and moderate various sessions - *www.iasa.org.*