The Nolan Newsletter

People, Process, and Technology

NOLAN

ROBERT E. NOLAN COMPANY
MANAGEMENT CONSULTANTS

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Through *The Nolan Newsletter*, we share with our readers:

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

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Troubled by the "New Normal"?

Are you as tired of hearing the phrase "new normal” as I am? The “new normal” is just another catchphrase that makes for good headlines and negative articles lamenting the glass as being half empty. It focuses on what we no longer have—how things are worse today than yesterday. It basically says, live with it; business is bad and so is your life.

You have two choices in business: accept mediocrity or find a solution to a better way. Look for the white space in your line of business and make the adjustments to be a leader. It is all about adapting, a willingness to change, and the ability to get your team to create a positive new normal. Your specific market may be smaller today, but that challenges you to innovate and find a better way of delivering your service to your customers and be at the top of your market.

Are you up to the challenge? Now is the time to step up your focus and energy in all facets of the business—sales, operations, service delivery, and product design. Winners adjust! Be a winner, and you will love this new normal of being at the top. ▪

Dennis B. Sullivan
Chairman and CEO

2000-2010: The Decade of Legacy Upgrades

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As we look to the future, I wanted to pause and give the financial services industry its due credit for making substantial progress in upgrading core information and processing systems over the past several years. Just before the last decade began, the industry was focused on Y2K (and then recovering from Y2K fatigue). Since then, many of you have been busy upgrading core policy administration, workflow, financial, and customer information systems and processes. Over the past decade, the foundational technologies supporting the financial services industry have matured to a point where executives have agreed that it's worth the cost and risk of replacement. For those of you who have completed this monumental task, congratulations! You have positioned yourself to be a more efficient, nimble competitor and a better service provider to your customers.

Over the past decade, the foundational technologies supporting the financial services industry have matured...

More recently, many of you also took advantage of the economic lull of the past few years to invest in the proverbial house-cleaning, especially around core technologies and processes. We've had the good fortune of working with many of you on these efforts to upgrade core technologies, redesign processes, and harvest the benefits of more flexible and efficient business systems. Several others are in the process of doing the same, anticipating an economic rebound that we are starting to see.

While a good majority of companies have replaced these expensive, inflexible legacy systems, there are still a few who have not, largely due to the immense expense and a challenging business case. The fact of the matter is this: it's unavoidable. If you haven't reached a tipping point, you most likely will in the next decade. Support costs, sparse legacy technology skills, limited vendor support, and the time needed to implement even basic changes make it too risky and costly to hold off much longer.

Few carriers today have not addressed these core issues. If you haven't planned to sunset or replace your core systems, think twice about your expense levels, market share, and long-term competitiveness as you look to 2011 and beyond. ▪

Praise the Fundamentals

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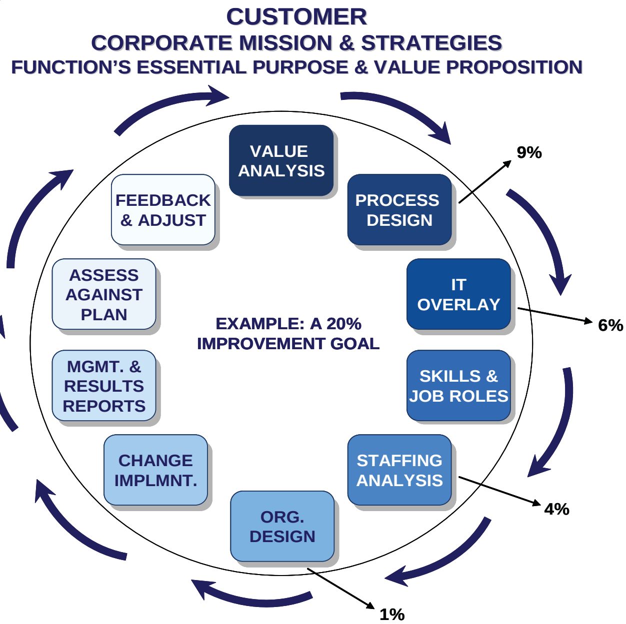
Based on our ongoing conversations, by and large, Nolan Company clients are an optimistic group; despite 2010 proving to be a test of that important characteristic. As optimists ourselves, we believe 2011 will justify that outlook and present us all with opportunities based on a more certain business-operating environment.

What this should mean to senior executives, and operations leadership in particular, is a need to expand our focus from market-share retention and maintenance of static or incrementally lower expense ratios to include a more aggressive, comprehensive approach to achieving operational excellence. That value proposition has elements formally or informally embraced by nearly all companies, but its comprehensive adoption has become more urgent for all companies. This is because of the painstakingly slow pace of the economic recovery for all companies and for health care firms in particular, which are now operating under dictated medical expense ratios and strict definitions of the composition of medical spend.

But, as you prepare to again make optimal use of your managerial muscles, exploring the development or purchase of market-differentiating capabilities, we think it's worthwhile to pause briefly and consider the state of your operations' fundamentals. Sustained excellence in nearly every field—sports, construction, the arts, and the military, to name a few—mandates sound fundamentals before higher-order expertise and capabilities can be developed. Business operations, whether in property/casualty, health care, or banking, are no different. There are three questions to ask:

1. Do we have a clear, universally-understood, and consistently-utilized operations-improvement process?
2. Do we know what relative benefits to generally expect from the economic elements of the improvement process?
3. Have we subjected our key functional operations to this process to ensure that any new capabilities are built upon a solid, efficient, and effective foundation and that contemplated new capabilities cannot be developed internally on a more cost-effective basis?

If those are good questions to ask, I recommend immediately taking steps to swiftly and thoroughly answer them. The following chart illustrates one approach to answering those questions in the affirmative: a 10-step, continuous-loop operations-improvement process. The process begins with a vigorous value analysis, exercised under the over-arching guidance of clear customer identification, strategies to satisfy customer needs and exceed their service expectations, and an unqualified statement of each function's essential purpose and value proposition (a distilled declaration of why the function exists and a statement of the function's approach to executing its essential purpose, respectively).



The process appears straightforward; but, as we all know from our management experiences, "straightforward" does not always mean simple. To assist those charged with managing this process, we've found four rules that, if knowledgeably applied, will provide some discipline to the effort and, usually, help optimize results.

1. Settle upon the correct essential purpose for the function under discussion. If this brief declaration of the reason for the existence of the function (a noun-verb phrase or short, single-sentence statement) is not accurate, results from the succeeding improvement process steps will be sub-optimal.
2. Thoroughly execute each step of the process; even the difficult ones. Consistent, thorough execution of the entire process helps to institutionalize it as "standard operating procedure" within the organization and provides a common process-improvement vocabulary.

3. Execute improvement process steps in the order illustrated, resisting the temptation to jump to what may appear to be obvious technical or structural solutions to business problems.
4. Recognize that most business challenges require multi-faceted solutions and that all elements of the solution are not created equal with regard to their impact on quality, timeliness, and expense.

It's easy to grasp the likelihood of multi-faceted solutions for complex business problems; however, quantifying the sources of benefits and managing benefit level/source expectations are thornier challenges. An approach I've found useful in managing expectations for a generic, multi-issue operations improvement effort is displayed on the chart, highlighting four typical improvement sources and their relative value, assuming an improvement target of 20%.

- **Process Redesign:** Provides the lion's share of the total typical benefit because this source addresses the high-cost elements of any operations division—its human resources. This source also forms the foundation for benefit flow from the remaining three sources.
- **IT Overlay:** Bringing automation to bear on redesigned processes offers important benefit opportunities; limiting or removing the need for manual intervention for comparatively less complex tasks and service transactions. While the volume of these tasks/transactions may be high, the aggregate economic gain from their automation is disproportionately lower because the time required to complete them in a manual environment is short.
- **Staffing Analysis:** Once the process-redesign step is complete, the organization will have a well-quantified understanding of how existing gross-resource expenditures are allocated across those tasks/transactions to be performed in the redesigned environment. Staffing analysis brings increased precision to our understanding of the skill sets and number of people required in the new environment.
- **Organization Redesign:** This is a two-dimensional view. The first (horizontal view) is to ensure effective spans of control for supervisors, managers, directors, and executives. The second (vertical view) optimizes the number of organizational layers from the front-line associate to the executive.

Although there is little doubt that uncertainty will continue to be our companion in 2011, there are good reasons supporting a cautiously bright outlook. If you would like to learn more about the improvement model outlined here, please let us know. As you develop your 2011 improvement plans, we would be happy to help you target high-opportunity areas and achievement approaches. Have a productive and successful year! ▪

Envision the Future

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I went through the Philadelphia airport every Thursday evening for two and a half years. More than a hundred times, I went through the security line. I am convinced that the security operation was never structured the same way twice during that whole time—different levels of staffing, different numbers of screening stations, and different approaches to expedited boarding. Just about every little thing that could be different was changed every week. The results: on occasion, there was absolutely no wait; at other times, there would be hundreds of people in line—all for no apparent reason.

Why should this be? No doubt the management and staff wanted everything to go smoothly with minimal disruptions, but they just could not seem to put it all together successfully. I believe this was because they didn't have a vision of what success would look like. They couldn't look at their successes and see what would be required to replicate them.

A strong vision is critical to a successful operation. Everyone needs to know what is expected, and this can be achieved only when everyone has a clear picture of success. Senior management must see the picture and clearly communicate it so that everyone is taking actions to move toward that goal. Arguably, the most famous vision statement was developed in the early days of Microsoft: "A PC on every desktop." What a clear, simply-stated picture of the ultimate goal. Every clerk, programmer, or marketer could see their activities as movements toward that end.

A strong vision is critical to a successful operation. Everyone needs to know what is expected, and this can be achieved only when everyone has a clear picture of success.

As part of every strategic planning exercise, senior management drafts a vision statement. We have all seen them posted around the office. Most of the time, they are bland and generic; applicable to any company or industry. The most successful statements, though, communicate a true vision. They paint a picture of what the future will look like when the company works together to achieve its potential. ▪

Managed Medicaid Rated a "Strong Buy"

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If we were rating managed Medicaid as a stock, it would be a "strong buy." Why? Read on.

There will be sustained enrollment growth in managed Medicaid. It is estimated that the number of people eligible for Medicaid will grow by 16 million over the next 10 years.

Today, approximately 71% of the total Medicaid population is in a managed Medicaid plan. It is clear that states are going to struggle financially as they try to fund their share of Medicaid costs in the face of increasing enrollment. We expect that one tactic states will employ to reduce costs is to shift enrollment from traditional to managed Medicaid. At the same time, states will begin eliminating cost-plus contracting in managed Medicaid, thereby shifting risk (and presumably costs) to the private sector via managed care organizations (MCOs). These two factors—increasing enrollment and states shedding risk—will drive significant opportunities for MCOs in managed Medicaid.

Managed Medicaid can be good business; but, to be successful, MCOs must actively manage their relationships with states.

Managed Medicaid can be good business; but, to be successful, MCOs must actively manage their relationships with states. Three key areas of focus are:

1. **Being a rate shaper vs. a rate taker in the rate-setting process.** MCOs must actively negotiate rates with states. MCOs should prepare for rate negotiations by developing actuarially sound rate models so that they can defend their margin requirements. Further, MCOs need to ensure that they are diligent in submitting priced encounters for all services covered under contract. States should be given all relevant data (e.g., encounter data) needed for rate setting, and MCOs should check the math (that is, develop their own actuarial model) that the state used in rate setting. Most would agree that state agencies are well-intentioned, but they do make mistakes; MCOs should trust but verify.

2. **Actively managing revenue across the organization.** MCOs need to implement and maintain mature processes to ensure that they are reconciling membership and revenue with the state on a weekly or other regular basis. This process should include member-level revenue forecasting, reconciliation, and research. In addition to ensuring that they are receiving revenue for members who are eligible for coverage, it is at least as important to verify that they aren't incurring medical expenses for ineligible members. Other key aspects of revenue management include state incentives and bonuses, sanctions and penalties, third-party liability, entitlement risk management, and onboarding new members. Successful MCOs will have robust, well-managed processes to support all of the key revenue management functions on an integrated basis across the various silos in the organization.

Any MCO participating in the managed Medicaid market will have to demonstrate value to the state.

3. **Treating the state as a customer.** States will be under increasing pressure to meet the financial and regulatory requirements introduced under the Affordable Care Act. Many states control the enrollment into plans, and they certainly determine who they will contract with. MCOs that take the time to understand all of the touch points with the state and invest in the appropriate level of resources to guarantee good customer service will increase their chances of success in the marketplace.

Any MCO participating in the managed Medicaid market will have to demonstrate value to the state via good health management programs, satisfactory member and provider services, solid transactional capabilities, and a sufficient provider network; these are the costs of admittance. MCOs that want to excel in the market will be sure to actively manage their relationship with the state. For the MCOs that are willing to make the investment, we rate managed Medicaid a "strong buy." ▪

Survive and Thrive (Part I)

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As we learned in graduate school, the primary goal of any organization—above profitability and customer satisfaction—is survival. Over the past three years, 304 banks have failed. This number is especially stunning when compared to the previous eight years, when only 27 banks failed. In proportional numbers, these last three years resulted in more than 100 failures per year versus fewer than four per year in the previous eight years—a 25-fold increase in the failure rate. These numbers exclude the large banks that were bailed out by TARP. Clearly, this recent trend is a threatening storm cloud for many of the remaining banks. Breaking the recent failures down by asset size, we see the following:

- 245 banks with less than $1 billion in assets (a 3.3% failure rate)
- 50 banks between $1 and $10 billion in assets (an 8.2% failure rate)
- 8 banks between $10 and $50 billion (a 10.4% failure rate)
- 1 bank over $50 billion (a 2.7% failure rate)

I'll leave it up to others to dissect the exact causes, but the most common underlying root causes for the failures have been bad loans and significant missteps by bank management.

Some questions that begin to arise from this stark reality are: "How many more banks are on the failure bubble, and what actions can bank management take to survive?" To answer the first question, one can analyze the $1 to $10 billion asset segment. Currently, there are 558 active banks and savings associations in this category; whereas three years ago, there were approximately 608. Two telling statistics of the failed banks in this asset category are the changes to their net charge-offs (NCO) and efficiency ratio (ER) over the few years preceding their demise. These changes are especially revealing when the banks are compared to their peer group. Looking at year-end data two years prior to a bank failing, the NCO and ER numbers tend to resemble those of healthy banks. However, the year-end data one year back begins to show a large gap between the ailing banks and their healthy peers. What this tells us is that a bank can look healthy one year but slide downhill quickly the next. Loans are charged off in growing numbers, and the ratio between income and expenses deteriorates rapidly.

Recent history also shows that the vast majority of banks in this $1 to $10 billion asset category that have continued to survive have maintained an ER at or below 62% (note that the ER of the top quartile of banks is 51%). Obviously, the lower the ER, the better shape a bank will be in, but any bank with an ER over 70% is beginning to slip into an unhealthy situation.

Using June 2010 data, more than 180 organizations—35% of banks, thrifts, and savings associations in the $1 to $10 billion asset class—have an ER ratio of 70% and are in the survival danger zone. This provides some insight into our first question about how many banks are on the failure bubble. Having this many banks in the survival danger zone is a risky situation for both the banks and the financial industry.

So, what are some survival strategies for these banks? Clearly, an aggressive work-out plan to minimize the effect of bad loans is a top priority. Fortifying the collection department and being flexible with repayment terms is one strategy. Improving the ER is a companion strategy that also should be addressed. For an $8 to $9 billion bank to drop its ER from 70% to 60% requires some combination of increasing income and reducing expenses. Because increasing income traditionally requires a longer timeline than reducing expenses, expense reduction is the most reasonable option if organizational survival is at stake when time is of the essence.

When organizations get into the survival mode and choose the expense reduction route, they usually focus on across-the-board actions, such as cutting everything by 15%. In the short run, that action is harmful to everyone—employees, customers, and taxpayers (through the loss of jobs). It punishes those managers and employees who have tried to keep expenses in line with work needs and rewards almost no one.

Surgical cost cutting, on the other hand, requires strategic information about where the best opportunities lie for reducing expenses without placing undue hardship on employee workload. With high-quality information, some parts of an organization can be cut by 20%, while other parts can keep their current cost structure. This strategic information can be obtained by using comparative peer data, such as that in the Bank Performance Study that Nolan does each year. (Find out more at www.bankbenchmarks.com.)

Survival is the primary goal of every organization, and surviving means having a chance to be profitable again. Surviving also provides management with the opportunity to resolve to never again get in the same financial bind and to take actions to do a much better job running the company.

Look for Part II - "Thriving" in next quarter's Nolan newsletter. ▪

Designing Processes to Address Changing Customer Behaviors

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Customer preferences and behaviors are changing at an increasing rate, and it will impact banks' service delivery significantly over the next two years. New research from Nielson (third quarter of 2010) finds that 53.4 million U.S. consumers own smartphones—up from 26 million in 2009 and 15 million in 2008. The projection is that half of American adults will own one by the same period in 2011.

According to a September 2010 Google Finance Customer Experience Benchmarking study, when it comes to financial products, 88% of customers today start their journey online. It is noteworthy that 68% of those surveyed prefer to apply online, compared to 29% who prefer the traditional branch experience. However, 89% of people said that they are open to applying online in the future if banks can get their approval processes up to scratch.

It is clear that delivery channel preferences are shifting along with customer capabilities, and we need to be designing the right customer experience in the delivery of those services along with technical capabilities. This design requirement presents an opportunity to reduce the cost of delivery while improving the customer experience.

The aggregators are starting to provide customers with content that they are looking for in an easy-to-use format.

Banks are responding in a variety of ways, using their own systems and partnering with some aggregators. Citibank has partnered with Bundle and Microsoft to provide a personal finance site that will attract and hold their customer base. The 2011 bank startup, BankSimple, is partnering with Mint. Variations of Yodlee's program all operate essentially the same, whether it is with Fidelity's FullView, Bank of America's My Portfolio, Wachovia's OneStop, or HSBC's EasyView. The aggregators are starting to provide customers with content that they are looking for in an easy-to-use format. Other aggregators include Blippy, Swipely, and Money Dashboard.

The evidence is clear with regard to customer behaviors and mobile opportunities. The question is, how will community banks respond? Will they design service offerings and applications on the mobile web, or will they safely develop device-specific sites?

There are many strategic questions to be answered. The pace of behavioral change should not be ignored. It is time to design this alternative delivery channel and engage the customer in the process. Currently, only 40% of the top 100 banks offer services over the mobile web. It is a good bet that a year from now this percentage will be significantly higher. But what will be the startup cost and, more importantly, what will be the ongoing delivery costs? You can design it or adopt what the systems designers designate. ▪

It is time to design this alternative delivery channel and engage the customer in the process.

"We're letting you go...your smartphone can do your job without you."

CLIENT SPOTLIGHT

Project: Review and Design of Enrollment and Billing

Client: A Regional Health Care Payer and Management Company

Industry: Health Care

Our client had recently undergone a significant systems implementation that had major service and financial impacts. Their concern was with the rate of resolution of the operational issues as well as the high projected running rate costs of the new environment. After an operational assessment, Nolan confirmed that material service, quality, and revenue problems were persisting despite ongoing internal efforts, which negatively impacted profitability and growth rates.

Project Objective

The client's primary objectives were to:

- Implement immediate corrective actions to recover service and data quality after the conversion and enrollment season.
- Redesign processes for enrollment and billing to dramatically improve service reliability, data accuracy, and member experience. Reliability improvement is more important than productivity improvement, but both would be targeted.

Project Approach

Nolan's approach was to:

- Use the team-based redesign process as an environment where trust and deferential respect can be understood, modeled, and nurtured.
- Include the client values as part of the project's design guidance, directing the project team to specific types and levels of improvement, such as cycle time or cost.
- Drive improvement in members' initial experience, so the member sees the experience as an expression of the hospitality and value of the plan.
- Redesign the process to increase service reliability, which is related to increasing levels of trust between the member and the plan and between associates who manage the complex, interrelated processes.

Key Issues

Some of the client's key issues were:

- Staffing levels were confirmed as being at the high end of the norm for similarly situated plans, with significant skill variability that was directly contributing to error rates.
- Existing processes were fragmented, with an excessive volume of poorly coordinated handoffs, resulting in long delays and errors.
- No clear end-to-end measures of performance existed, including quantifying the downstream impacts of service delays and errors. The result exacerbated team distrust.
- Uncollected and aged receivables were growing, as was unapplied cash. This, in turn, cascaded to inaccurate or incomplete payment of agent commissions.
- Due to enrollment and revenue processing errors, claims payments on members were either not being made when applicable or paid in error on terminated/unpaid plans.
- Working relationships between key departments were identified as tending to be ineffective to counter-productive.

Project Scope

Nolan conducted interviews of enrollment management and, later, the management of the billing function. In both areas, we found a high level of interest in accelerating improvement and a joint redesign effort.

An immediate triage of existing enrollment and revenue collection issues was undertaken concurrently with a redesign of these areas that focused on optimizing critical processes. Specifically:

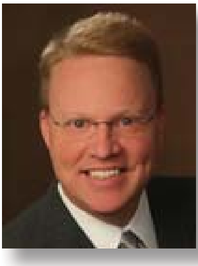
- Quick-hit interviews were held with key staff to develop process and structure changes with immediate impact.
- Enrollment and revenue organizations were redesigned, new integrated teams created, and handoffs eliminated.
- Performance and quality metrics were established and communicated to all affected parties.
- Receivable issues were identified, files cleaned up and brought current, and a collections plan implemented.
- Agency processes were redesigned to address lags and errors, field communications and transparency improved, and a commissions reconciliation process implemented.
- Training, quality control, and productivity plans were put in place for long-term improvement of effectiveness.

The units can benefit from a more detailed analysis of the existing data to find process or skill "hot spots." Identifying hot spots enables targeted interventions that can prevent current and future errors and define a population of historic transactions that should be subject to special review.

Project Results

Uncollected receivables of more than $2M were identified and written off. Unpaid and overpaid commissions were corrected with the field force, allowing them to return to growth plans. Process redesign across sales, underwriting, enrollment, and billing were put in place to minimize errors, improve timeliness, and enable scalability. Quality improvements and error reductions resulted in savings opportunities of $1,060–1,640k. Operational expense savings opportunities were identified, reducing costs by $758–858k. The total financial impact was $1,818–2,298k upon conclusion of this 18-week project.

CIOs: Beware Attack of the Bosch Dishwasher



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OK, I used that headline to get your attention. Now read on—I'll make it worth your while. Whirlpool, the largest appliance manufacturer in the world, has been a household name for generations. Any guesses who the second- and third-largest manufacturers are? Bosch is number two, and Electrolux is number three. Many people are surprised to hear those names. Nevertheless, Bosch has in fact been sneaking up in market share for years.

All kinds of things are sneaking up on CIOs, and many don't realize it. For example, think about the everyday terms we once used in IT: *software development life cycle, mainframe, MIPS, terminal, COBOL, chargeback, table-driven, batch, dialup, and even client/server*. That's just a random sampling of terms that are nearly obsolete or have become very specialized. Yet some CIOs and IT shops still operate as if those terms are in vogue.

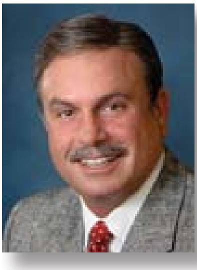
Now here's a random sampling of the terms CIOs *should* have in their lexicon today: *business strategy, operations improvement, transformation, process automation, analytics, outsourcing, integration, consolidation, agile development, CMMI, cloud computing, mergers, mobile, differentiation, risk-sharing, cost savings*.

Today's CIO is less a technologist, and much more a business person who creates advantages and differentiators using technology. Some ideas for thriving in this role:

- Team with your business-side counterparts to understand their objectives and challenges; jointly map out solutions that can be accomplished in 90 days or less.
- Initiate new business projects that materially improve business performance, even if technology is secondary to achieving the improvement—for example, increasing speed to market or reducing costs.
- Ignore hype and buzzwords; do what matters for your company.
- Seek outside perspectives from peers, advisors, solution providers, and job applicants.
- Compare your operations and management practices to those of successful competitors.

If these ideas and the aforementioned terms are foreign to your IT function, believe me, your competitors (and potential acquirers) are sneaking up on you. And some of them are companies you may never have heard of. ▪

The Art of Communication



C. Kim Wilkes
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I recently accompanied my father on a visit with his doctor. As the doctor was discussing next steps, he told us a story about the most important thing he'd learned in all of his medical training. He said it didn't come from medical manuals, classes, labs, or residency. On his graduation day a mentor sat him down and said, "The most important thing in your career will be communication —listening to your patients, understanding what they tell you, and making sure they understand what you are telling them."

Think about how true this is in every facet of our lives. Whether it's a superior, co-worker, spouse, child, relative, or the repairman; most mistakes, arguments, failures, and disappointments come from miscommunication or simply the lack of communication. Too often, we think we have communicated effectively and then become upset when the results are not what we expected. Many times, we are really thinking about what we are going to say next while the other person is talking, or we interrupt or get defensive before their comments are finished.

...miscommunication in the business world is caused by people not listening effectively.

Communication has four pieces to it: 1) the words we choose; 2) how we say them; 3) body language; and 4) how we interpret and understand the other person's message.

Consider how the simple statement, "I need to speak with you," can be construed many different ways depending on how you say it and the body language used. Based on the delivery, the person hearing the statement can become inquisitive, concerned, anxious, or immediately defensive. The simple interpretation of six words can lead to unexpected outcomes or miscommunication, depending on their delivery and receipt.

I feel that much miscommunication in the business world is caused by people not listening effectively. We jump to conclusions, don't ask enough questions, or misinterpret what the person is saying. Remember the old adage: "God gave us two ears and one mouth, so we can hear twice as much as we say." ▪

Bank Performance Study 2011: Measuring Excellence

The Robert E. Nolan Company is once again offering the opportunity for all banks and credit unions with more than $900 million in assets to participate in our proprietary industry study, which is unlike any other. The analysis results in comparative line-of-business measures that help participating organizations identify gaps in income, expenses, staffing, and productivity. It is organized by 80 distinct lines-of-business and provides comparisons to the mean average, the benchmark (top-quartile) banks, and the median bank for each of 1,200 performance ratios calculated. And the great news is that there is no fee for participation.

What Participants Can Expect

The analysis will identify gaps in performance that quantify specific areas where the greatest opportunities for improvement exist. The unique approach ensures that each bank accounts for its income, expenses, staff (full- and part-time), outsourced activities, operational transactions, balance sheet items, and activities unique to each line-of-business. In this way, a directional view can be developed to determine the underlying reasons for identified performance gaps. The comparisons are organized in pools, an approach that maintains participant confidentiality while providing granular performance gaps.

Performance Gaps Identified

Each participating organization will receive:

- A management summary identifying the areas with the greatest opportunity for bottom-line improvement;
- A detailed report that prioritizes the opportunities by total organization and within each line-of-business;
- Each of the 1,200 detailed measures with comparison to median, benchmark, and mean averages;
- Year-over-year comparisons for multi-year participating organizations; and
- A review of systems employed by line-of-business for each participating bank.

You will not want to miss out on this unique performance study when planning for operational changes within your bank or credit union. To view a sample of the output that participants will receive and to register for Nolan's 2010 Bank Performance Study, go to www.bankbenchmarks.com.

Registration Deadline: March 26, 2011

Input Deadline: April 30, 2011

Results Distribution: June 11, 2011

Follow the Money for Successful Programs

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In program management, following the money—if pursued with authority and diligence—allows businesses to keep control of activity and aid in predicting project trends and any obstacles that may lie ahead. Program management is a very different animal from project management. Program management centers on the delivery of outcomes and benefits through coordinating *multiple* interrelated projects across several business units, whereas project management usually focuses on completing limited and specific operational deliverables for a single business unit.

Another distinction is that programs usually manage major *transformational* deliverables of the organization, not just incremental improvements as do projects. Since program management is concerned with coordination, a good analogy might be that the program manager performs as an air traffic controller rather than a pilot—and both are needed to fly efficiently and safely.

Programs are usually most effective when multiple business units, vendors, management teams, and technologies are necessary to deliver a new future-state vision. In terms of scope, programs generally last for years, involve dozens of staff and contractors in implementation, and require investment of tens of millions of dollars. Due to their nature, programs can take years just to achieve full budget approval while moving from early conception to corporate-level consensus. Program proposals are extremely visible within the organization, typically initiated by senior management and approved at the executive or even board level.

Despite this, a surprising number of programs end up fizzling out or have very murky beginnings and endings. On the flip side, programs can also take on a life of their own, with all projects in the firm seemingly becoming part of the program. This ends up as unwieldy as an overburdened, top-heavy ship in rough waters that sinks under its own weight and lack of maneuverability. We have seen two tactics that ensure neither of these fates fall upon a newly-established program.

First, clearly define criteria for when projects should not be added to or should be removed from the program. This step controls scope creep and allows projects to end predictably and gracefully. The end goal of program managers is to put themselves out of a job by completing all the projects of the program and moving them to the normal operational management, thereby successfully finishing the program.

Second, staying focused on the accounting and financing of the program throughout the program timeline gives the program manager exceptional navigational control towards success. Unfortunately, effective and thorough methods for ongoing program accounting are often overlooked when a program is proposed and are unusually hard to initiate after the initial board approval of the program. To ensure that the program's sponsor's financial expectations are always aligned with the delivery team's, the accounting method must be consistent with the methodology in which the original budget was put together—which is why it is critical to develop these plans (and authority) as part of the proposal process and not after the program's inception.

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Another potential source of trouble is that when a program is approved, it usually has a multi-year scoping budget attached to it. But as individual projects are approved, their budgets are often delegated to and managed by the individual business units, thus making it difficult to integrate projects into the holistic view of the overall program costs. The difficulty arises in distributed program accounting because many business units have unique project reporting and budgeting methodologies that are totally incompatible in terms of timing, detail, and units of measure with other business units. Typically, many business units do not want to spend the time and effort to change their recording method for a 'home office' program (and do not have the staff time or budget allocated to do it). Inability to effectively integrate critical accounting information leaves the program manager (and sponsors) nearly blind to the true financial status of the overall program compared to the original forecasts.

Another challenge of distributed program budgeting is that the program's individual project budgets become embroiled in competitive cost justification within the business unit's other tactical budgets. Because many program projects include major infrastructure improvements (that cannot be justified at the business-unit level), these projects are subject to interruptions, staff reduction, and even cancellation by the business unit, delaying the program's goals. In this scenario, by relegating budgetary control to the business units, the program manager has also forfeited control of the resources necessary for successful completion of the program.

To avoid these scenarios, our recommendation is that new programs have a separate budget that is approved and controlled throughout the life of the program directly by the executive committee or board level that originally approved it. Also, the program manager needs to have appropriate staff, tools and methodologies, and budget for an entire program accounting function that will allow for continuous and consistent tracking of all related staff costs, capital expenditures, and operational expenses for all projects within the program for its duration.

The goal is to allow the program manager to effectively report and be accountable to the sponsoring management for how much has been spent of the forecasted multi-year budget, how much is projected to be spent to complete the original outcomes, and any delta between that and the original budget. Another goal is to equip the program manager ahead of time with a capability that effectively forecasts where critical budgeting problems may be arising in order to implement mitigation plans.

In effect, by providing the program manager with the tools and authority to follow the money, executive management insures the program is executed throughout the years of implementation as originally envisioned and does not fizzle out or sink from scope creep. ▪

"I've spent fifteen years thinking about planning this project, and now you tell me it isn't needed?"

Achieving Success in the "New Normal"

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Surviving the economic turmoil of the last two years has required, in many instances, draconian measures as companies have faced investment losses, revenue declines, and increased competition. The industry as a whole has reacted strongly, imposing increased governance practices, clarified product portfolios, enhanced investment management disciplines, and strong expense management. Expense management has been one of the greatest areas of focus, with the industry experiencing a drop of approximately 20% in total operating expenses two years in a row. These reductions have come at a human resource cost because fewer employees have been asked to complete more work faster in an environment where quality is critical.

At the same time, as the industry emerges from the downturn and enters a slow recovery, nothing has become more apparent than the importance of service delivery as a competitive advantage. With products fast approaching parity in terms of pricing and guarantees, achieving differentiation in a highly-competitive market turns more and more to the ability to deliver service in an exemplary manner; one that binds consumers to the company and earns their loyalty.

Baseline expectations are for transactions to be completed on a once-and-done basis, without handoffs and callbacks, correctly the first time, and on the consumer's schedule. "Customer-centricity" has become a necessity for achieving competitive advantage. The foundation of a true service advantage is the front-line human resources who represent the thousands of points of contact with customers on a daily basis. These same resources are the ones that have been optimized, streamlined, and redesigned to achieve the necessary expense savings.

The "new normal" is the result of economic and regulatory changes and demographic shifts, and achieving profitability in the new environment will require intensely-focused strategy in managing a company's talent resources. The differentiation will come from the skills, attitudes, and abilities of the front-line and transactional staff who represent the source of service delivery.

Recall any simple transaction that left a lasting, positive impression on you versus the same type of transaction that left no—or, worse, a negative—impression. Even done right, the human contact involved in delivering service defines the impression made upon the customer, and that contact depends upon the attitude of the individual service staff. Developing a culture that breeds the right kind of service-oriented attitude will be a key requirement to achieving the level of differentiation necessary to overcome competition.

Granted, relatively high unemployment would appear to make it a buyer's market in terms of resources. However, acquiring and retaining both the quality and the necessary service orientation will require more than simple competitive wages and an efficient work environment. Companies will need to develop programs that institutionalize an awareness of the importance of not only doing things right, but in how these things are done. Impressions and treatment will be the defining characteristics, with thoroughness and correctness being baseline expectations. The challenge comes in shifting from an expense reduction focus, where efficiency and austerity were necessities, to one where strategic investment in service development programs and supporting technologies becomes the norm.

This challenge arises at a time when both the consumer and workforce demographics are shifting to a more global and diverse constituency. Leading and serving in this environment require greater sensitivity to differences in values and cultures. Addressing these complex demands requires a two-pronged strategy.

First, from a consumer perspective, greater analytics supporting a deeper understanding of each unique market segment are required to feed information into the sales and service process. True customer relationship management systems that collate and organize a company's interactions to inform each contact provide a basis for personalizing service in a manner that leaves the customer with a sense of being treated as a unique and important individual.

Second, from an employee perspective, companies will need to look at employee programs that provide flexibility, convenience, a sense of balance, transparency, and a supportive environment. Job enrichment opportunities to keep talented staff challenged will be as important as providing the tools and empowerment necessary to deliver on customer expectations. Employee engagement will be the measure of success in terms of workplace effectiveness.

Leadership in the coming years will be greatly challenged by the complexity of the marketplace and underlying demographics. Business has truly become a globalized endeavor requiring broader and deeper understanding of individuals as unique entities, each bringing different values and expectations, whether employee or consumer. Success will depend upon strategies that integrate an analytical strength, cultural awareness, employee engagement, flexibility, nimbleness, and adaptability. Fulfilling these strategic imperatives will require targeted investments in leaders, employees, and technology in order to build the necessary capabilities. Tomorrow's market leaders will consist of the companies that recognize and implement these capabilities the quickest. ▪

Predicting the Unpredictable

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If you are interested in a very good (but not necessarily easy) read, try Nassim Taleb's *The Black Swan*. The book takes you on a journey crossing history, perceptions, and logic. The idea behind *The Black Swan* is that events that have low or no predictability do regularly occur and can have very large, game-changing impacts. One of his examples is 9/11: few of us would ever have thought such an attack possible. But after-the-fact, connect-the-dot analysis shows that it was visible in hindsight; couple the notion of events with low probability and outsized outcomes with the idea that we are wired so that dealing with the unlikely is just something people don't do well. We like order; we like predictability. "Like" may not be strong enough: we almost require predictability. We want the world to fit our view.

You may have seen or heard of the "Invisible Gorilla." (You can find it on YouTube.) With only a mild expectation set, people can miss what is right in front of them—in this case, a guy in a gorilla suit whom you would think impossible to miss. Because it is not in their realm of possibility of the situation, most folks do not see it.

You and your team face this head-on nearly every day. Your ability to see what is going on and be open to identifying black swans has a direct effect on your success. Looking for the unknowns and what project management calls "the unknown unknowns" is a basic part of managing risk. But to do it, you have to identify those threats and opportunities that would be high-impact and not filter them out because they don't fit your expectation of what should be happening.

"New Coke" was launched in 1985. Market research supported the popularity of the new formula, the competitive force of Pepsi called for action, and internal politics made such a flagship product change possible. A few days after the launch, a forceful backlash developed. It was a movement, a reaction management never considered possible. For Coke, it was a Black Swan event.

For me, improving my "vision" starts with identifying the assumptions and beliefs that underlie my perception of the situation. If you can get a hold of those, you can improve your ability to manage the risks and opportunities you face. ▪

Nolan is Goin' Green

The Nolan Company is proud to make a donation to EarthShare® on behalf of our subscribers to *The Nolan Newsletter.* By updating your contact information and making the decision to receive our quarterly newsletter in electronic format, our subscribers have reduced the amount of misdirected and undeliverable mail. As we receive updates, Nolan will continue to contribute to this wonderful cause.

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The Customer Is in Charge

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Nolan's recent industry survey revealed that most companies are only dabbling in social media. However, although companies are not quite ready to engage their customers in one-on-one communications, they are in social media anyway because their customers have put them there.

An article published by *BBC Business News* in October 2010 describes how consumers use social networks like Facebook and Twitter to wield tremendous power by posting comments about their experience with products and service. When an airline failed to compensate a passenger for damage to a $3,500 instrument, he made a music video of his experience. Within three days, the video was watched half a million times, and more than five million times within six weeks. This prompted thousands of other customers to come forward to vent their own frustrations with that airline.

In another example, a major retailer was caught off guard when newspaper reporters called for comment about an internal crisis. Company executives had no knowledge of the fact that half their stores were experiencing a major technical problem, despite the fact it was all over the Internet.

On the positive side, some companies know that social media can be used *for* them as well as *against* them. One travel company ran a contest through both its traditional e-mail newsletter and Twitter; both channels generated the same number of responses. The interesting thing is that their newsletter goes to 2.2 million people and their Twitter accounts number just 12,000. Savvy companies are hiring organizations that provide customer intelligence by scanning the "chatter" to identify potential problems for companies before they get out of hand.

There is no question that the power of the relationship is now with the customer. This makes it even more important to find and fix the weaknesses in your customer-service functions and customer-facing technology. With word-of-mouth the primary factor behind as many as 50% of purchases, it is good for sales as well. One thing is for sure: even if you don't know your weaknesses, your customers do, and they are more than willing to share what they know with thousands of others. ▪

Nolan Events

PCI Executive Roundtable Seminar
January 23-25, 2011 - Naples, FL
Nolan is pleased to be sponsoring the Opening Reception on Sunday, January 23, at the Property Casualty Insurers Association of America's roundtable seminar to be held at The Ritz-Carlton Golf Resort in Naples, Florida - *www.pciaa.net*

Prepaid Expo USA 2011
March 6-9, 2011 - Orlando, FL
Join Nolan Vice President, Jim Dean, at this event to be held at Orlando World Center Marriott Resort in Orlando, Florida - *www.iirusa.com/prepaid*

BAI Payments Connect 2011
March 7-9, 2011 - Phoenix, AZ
Join Nolan President, Bob Grasing, at the Bank Administration Institute's conference to be held at the Phoenix Convention Center - *www.bai.org*

CAHP 8th Annual Fundraiser
March 8, 2011 - Napa Valley, CA
Nolan Senior Vice President, Scot McConkey, and Nolan Vice President, Merit Smith, will be attending California Association of Health Plan's annual fundraiser in Napa Valley, California - *www.calhealthplans.org*

CLM Annual Conference 2011
March 23-25, 2011 - New Orleans, LA
Nolan is pleased to be a breakfast sponsor at the annual Council on Litigation Management conference. Join Nolan Executive Vice President, Steve Discher, at this event held at the New Orleans Marriott - *www.litmgmt.org*

LOMA Customer Service Conference
March 28-30, 2011 - Baltimore, MD
Nolan Senior Consultant, Steve Murphy, will be presenting "Peak Contact Center Performance: Management Matters" at this conference held at the Hyatt Regency Baltimore on the Inner Harbor - *www.loma.org*

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