The Nolan Newsletter

People, Process, Technology

NOLAN

ROBERT E. NOLAN COMPANY
MANAGEMENT CONSULTANTS

Second Quarter 2005 *Volume 32, Number 2*

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Nolan is an operations and technology consulting firm specializing in the insurance, health care, and banking industries. Since 1973, we have helped companies redesign processes and apply technology to improve service, quality, productivity, and costs. Our consultants are senior industry experts, each with over 15 years of specialized experience. We act as trusted advisors to our clients, ultimately expediting and magnifying improvement initiatives and we are committed to delivering measurable and sustainable results. Visit www.renolan.com to download articles, client success stories, and industry studies.

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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EMERGING TREND HARDER TO SPOT

Recently, we have been invited to speak at conferences on trends we see emerging in the financial services industry. We have been reviewing data generated by our insurance surveys, and scanning industry literature even more than usual. While the observation points are many, it is too early to draw final conclusions just yet. However, experience shows there are often major and strong opposing forces taking form just as new trends are starting to emerge.

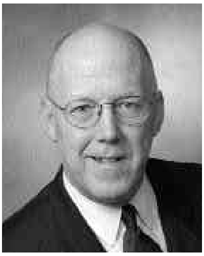
For example, while recent surveys of industry executives say outsourcing is low on their list of priorities, more and more domestic and offshore vendors are developing Business Process Outsourcing (BPO) service offerings. Another example is the dawning recognition that customer value is driven more by relationships cultivated by one-to-one marketing, which encourages customers to remain loyal to a company. Yet customers view many products as commodities, and therefore ignore the relationships and go for the lowest price. Customer focus is being trumpeted as important to deliver excellent service, but functional or shared services functions continue to be put into place.

When these opposing trends exist within the same company, there is a lack of alignment. Perhaps the lack of speedy adoption of a new trend across the board is an indictment of the usefulness of the trend. Or, maybe it is just a reflection of the typical incremental approach to big change that the financial services industry has a reputation for.

If nothing else, perhaps just recognizing that these opposing forces even exist, and that in a specific company a conscious, versus an accidental or unintended, direction is what is most useful. Usually, an outside view by a trusted advisor who truly understands your organization can identify that this is occurring and enable management to either take corrective action or verify that it is acceptable. Enormous resource time and expense can be saved either way. ■

Ben DiSylvester
Chairman

Ed Fenwick Promoted to Vice President



The board of directors of the Robert E. Nolan Company is pleased to announce that Ed Fenwick has been named vice president in Nolan's insurance practice. His responsibilities include the development, design and supervision of insurance assignments. His duties also involve being a member of the insurance practice management team that determines the overall direction of the insurance practice, including product design and strategic direction.

Ed joined the Nolan Company in 1984. He brings more than 23 years of experience in designing and implementing change that improves organizational performance. In his tenure at Nolan, Ed has conducted and managed projects in the insurance, mortgage, reinsurance, technology and marketing areas.

Ed's management background and his extensive operations experience in systems development, performance management, productivity measurement, quality improvement, process design and organizational design have established him as one of Nolan's most accomplished senior professionals. Ed's achievements prior to joining Nolan include, as chief operating officer, overseeing a national marketing field force of 15,000 employees, and the start-up, growth and sale of two successful service businesses.

Ed has a Bachelor of Science degree from the University of Massachusetts, and a Master's degree in Organizational Development from the Austin Barney School of Business at the University of Hartford.

Ed will continue to be based out of Nolan's Connecticut office in Simsbury.■

CHANGE AGAIN? WHAT A PAIN!

Dennis Sullivan
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Just when you have your routine down, it seems some minor business need (like profitability or market share) comes along and disrupts everything. You are either required to cope with a new system, understand a new set of processes or actually learn some additional skills. What a pain! Why can't management just leave things alone? I've got my routine down! Now, at least in the business world, we have some actual data and defined requirements to help direct the change. However, in the public policy arena minor issues like education, healthcare and retirement are debated by the uninformed, the politically motivated and the unaffected. As Don King often says, "What a great country."

Let's get back to our change issue. Why is change so hard? In the last few years many of our clients have been facing more challenging budgets, limited technology support, an ever-changing set of competitors and more demanding clients. It is a tough environment. Where we have seen success and maybe a blueprint for progress is with those companies who are using experience-based market analysis, best practice operations management techniques and real data, versus anecdotal analysis and little or no data. It is not a ready-fire-aim approach, but it is also not a six-month process of building a case study, projecting ROI, doing detailed risk assessment, and then getting input from 10 different executives on what decision to make.

It is a rapid change process that requires nimble managers to "read signals and react quickly". It takes confident front-line managers, given the responsibility to make changes and reinforced by strong leaders who have developed them to do so. Our experience is that successful change managers capture data, constantly evaluate performance, and make regular adjustments to changing market needs and customer demands. If turnaround time needs to be tweaked or unit cost needs improving, they have the data and the information to help pinpoint opportunities and limit risks to quality and customer satisfaction.

Execution is the key component to effective change. Being able to execute—with confidence—is a learned skill. When you can recognize the problem, have the insight into how your processes work, and know the cost of those processes, you are prepared to react, and to make changes quickly and with confidence. It will be the norm for you and your front-line supervisors and not a fire drill. Change is the norm today. Be ready for it. Expect it! And make it happen.

Be your own internal operations consultant. Know how things work; involve your managers in understanding the processes and the data needed to measure their effectiveness. Help them execute change. It will make life easier and make you a better leader. ■

"Let's change 'brink of chaos' to 'Everything is wonderful.'"

The ABCs of a Lean Manufacturing Approach in Financial Services

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"Lean manufacturing," as a concept, has been around for some time. Its roots go way back to Henry Ford and the assembly line. The concept became most fully developed at Toyota between 1949 and 1975.

But it wasn't until 1990, when James Womack wrote the book, "The Machine that Changed the World," that the approach caught the imagination of manufacturing people. The number of implementations started to grow, the knowledge and experience bases expanded, and success stories became more frequent.

The core disciplines and tools are similar to most other improvement concepts. They include team development, Six Sigma/TQM, process mapping, etc.

What's unique about lean manufacturing is that it has an almost singular focus on inventory. In manufacturing, inventory hides waste. Almost every imperfection or problem creates a need for inventory. Hence, inventory is a result, and it measures the imperfection of the system. At Toyota, they identified all points of inventory. They then asked, "What are the reasons for the inventory?" The final step was to use the core disciplines and tools to systematically eliminate those reasons.

What are the implications for using the lean manufacturing approach in the financial services industry? We think they are the following:

1. Develop a "mental model" to assist the thinking process and guide the strategy and planning of a lean initiative. This is critical to ensure that it is a successful strategic initiative and not another failed management fad. Copying techniques and approaches in slavish and unthinking ways will yield poor results.

2. Find the measure of imperfection that fits your organization's needs. In most cases, it won't be inventory. We

think it will be time. Time to get a new product to market. Time to process an application. Time to resolve a claim. Time to correct errors. Time to close the books.

3. Develop an approach that is right for getting your organization lean, based on your needs. Don't seek a standard toolkit and attempt to apply it. No two settings will be the same, so no single approach will work for all. You probably already have most of the disciplines and tools you will ever need in your organization from previous improvement efforts.

We have several financial services clients currently implementing a lean manufacturing approach, and their efforts are showing significant value. We are being asked more each week about it by clients. We think sticking to the ABCs of lean manufacturing will help you succeed in your efforts with it.■

If you enjoyed reading this article, visit

www.renolan.com to read Ed Fenwick's article titled

"The ABCs of CRM in the Insurance Industry."

A Team Approach to Creating Solutions

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"Change alone is unchanging." The words ring as true today as when uttered almost 2,500 years ago by the Greek philosopher Herakleitos. In an era marked by unrelenting change and global competition, organizations face a new set of problems, and the solutions can sometimes seem elusive. The ability to anticipate and adapt to change is an increasingly valued skill among growing and successful organizations.

Many individuals and workgroups lack the skills needed to separate causes from effects and apply critical thinking to devise solutions. All too often, they rely on old solutions to tackle new problems. Fortunately, defining and solving problems doesn't require the wisdom of an ancient philosopher. It lends itself to a structured approach that can be applied to develop innovative solutions. Not surprisingly, it starts with people.

Involve the Right People. Establish a cross-functional team comprised of technical and process experts from across the organization. Most of the processes and problems that impede quality, productivity or customer satisfaction cut across department or *functional* lines. Gaining a detailed understanding of the problem(s) and developing solutions require a diverse set of individuals, each of whom brings unique knowledge and perspective to the table. By involving the right people, organizations can piece together the "big picture" and begin to develop solutions that work for the total organization, not just for one area. It's necessary to get all perceptions out in the open so that the group can separate opinions from facts and paint an accurate picture. Different backgrounds, cultures and experiences don't necessarily make for a smooth or easy process. But those differences enrich the team and help them move the problem-solving process forward.

Define the Current State. Most of the problems we deal with are fundamentally *process* problems. Understanding the current state is essential; a solid fact base is the foundation for future change. Mapping the process will help the team clearly see where it falls short of achieving expectations. At this point, it is critical to achieve clarity around the *root causes* of the problem(s) versus *contributing causes*. In complex processes, it can be tricky to isolate the root cause. Here's a simple test to separate the "wheat from the chaff." If we eliminate the issue in question, will it eliminate the problem? If the answer is yes, then we've found a root cause. If the answer is no, then the odds are we're looking at a symptom of the problem.

Define the Future State. Once the team understands the current state, the next step is to explore ways to change it and make it better. Designing *"how we want things to be"* challenges the creativity of the team. We may have many options; which one is the best? The key is to get all the ideas on the table to assess feasibility, cost, potential barriers to success and, most importantly, whether the ideas fulfill the goal of the organization. Consider whether the new design corrects the root causes identified. Think about capability gaps that would hinder implementation of the solution. Is the solution consistent with the organization's core values? What do employees need in order to buy in and help make the change succeed?

Recommend the Solution. At this stage, the team should be able to apply their best collective judgment to form a consensus around the best solution—the one that best eliminates root causes and helps the organization achieve its goals. In most cases, there will be one solution that clearly satisfies the initial imperative, appears most feasible to implement and can produce sustainable improvement. The team forms a consensus and proposes their recommendation to the approving individual or group. A solid, well-formed recommendation will incorporate the necessary performance measures that define success and help ensure that the new process produces the desired results.

Test. The more complex the issues and the greater the magnitude of the proposed change, the more prudent it is to pilot test the redesigned process. You want the change to work! If the proposed change is substantial and the potential resistance within the organization is likely to be high, all the more reason to validate that the intended benefits are achievable while, at the same time, working out any remaining kinks in the process.

Implement the Change. Most people need and want to feel accountable, to have a direct stake in their company's success and the rewards (and risks) that can result. Having the cross-functional team highly involved in implementation applies their deep knowledge of the process, reinforces their accountability and allows them to make corrections, as necessary, during rollout. The result? A team of experts implements a new and more effective process. And you've built a group of loyal believers who will continually seek to improve processes by applying a combination of analytical and creative thinking.

"The difference between change that succeeds and change that fails is often not the caliber of thinking or level of effort put forth. Even the most successful teams need guidance to keep them on track."

The difference between change that succeeds and change that fails is often not the caliber of thinking or level of effort put forth. Even the most successful teams need guidance to keep them on track. If you would like to talk about the problem-solving process or tips on how to keep your team on track, send me an email at linda_bambacus@renolan.com. ■

“BLINK”—SEEING BEYOND THE OBVIOUS

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When experienced consultants visit a prospective client site, what exactly do they see that helps them to understand what and where opportunities for improvement lie?

Malcolm Gladwell may provide some insight in his latest societal explorative entitled, “Blink: The Power of Thinking without Thinking.” In this follow-up to his bestseller, “The Tipping Point,” Gladwell discusses how people from all walks of life with extensive experience in their chosen field have developed a “cultivated ability” to sort through massive data and get key answers in the blink of an eye.

He explores how some people develop an “adaptive unconscious” that sorts through the information presented, eliminates the extraneous and homes in on the few necessary facts to arrive at accurate decisions. Many times this happens without the “expert” realizing what helped him or her to arrive at the answer.

Gladwell’s essential premise is that the more experience we have, the more accurate our snap—and considered—judgment will be. He suggests that this “rapid cognition” is not easily passed along like an algorithm, but rather gained through experience, study and effort.

Over the years, I have engaged in many dinner conversations with highly experienced consultants. Often they express curiosity about client-company managers who may not see an opportunity to improve their area significantly, but the opportunity seems obvious to the consultant. Usually, the manager is very effective in day-to-day business, but may have limited experience in organizing and running a set of processes.

On the other hand, consultants have extensive experience in analyzing how to improve operations and ensure effectiveness and efficiency. The consultant has focused on the critical elements that make the difference between operating conservatively (the way many organizations design their processes) and operating effectively.

Recently, banks have reacted to bank examiners, and specifically to Sarbanes-Oxley, to the point where their controls exceed the value to the stockholders and customers. This seemingly innate knowledge makes consultants valuable to their clients, but at the same time, processes that help the client share in the learning result in valuable operational improvements, knowledge and skill transfer. This is the challenge of every good consulting firm, and it is what differentiates the great firms from the good ones.

Excellent firms always ask to visit prospective clients to view what is going on before preparing and presenting a proposal. Every bank is different, and data alone can only provide a piece of the whole organizational picture. The bank's processes, organization, culture, technology and people will help provide a confident, comprehensive picture of the potential opportunity.

The work of consultants may appear to come together in the blink of an eye, but for us, it has taken over 30 years and dozens of improvement projects to produce this cultivated ability. Gladwell shed some light on why consultants are of value to their clients, but it is our job to deliver more than the answer. Maybe that is the subject of another book.■

Also by this author...

Email us at info@renolan.com to receive a reprint of the article, "Measuring Operational Efficiency: A Guide for Commercial Bankers" by Bob Grasing.

An Expensive Cushion

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When bankers or insurance executives create a cushion for "just-in-case" staffing, they are engaging in a very expensive way of doing business.

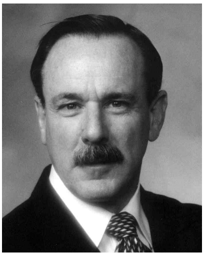
Let's say Bank M employs an average of three full-time tellers and two part-time tellers that each work 20 hours per week. If you multiply a typical annual salary with benefits of $20,000 by 50 branches, a 10-percent cushion in staffing can cost Bank M an extra $400,000 per year! This "just-in-case" cushion, while soft and comfortable, is expensive and not in anyone's best interest. Additionally, Bank M's customers will likely not perceive a single difference in the level or speed of service.

An effective way to remove this cushion is to use a flexible staffing solution that matches customer arrival patterns with available staff. Using a flexible staffing model is not easy work! And who wants to do something hard? Well, think of this cushion in another way. It is essentially the same as if Bank M's branches were out-of-balance by a collective total of *$7,700 per week*. Seen in this light, what type of effort might management be willing to undertake to regain this money? Fortunately, both software and outside expertise are available to help do the heavy lifting required to get started.

The next hurdle is cultural. Many companies that employ a high percentage of part-time staff believe they already have a flexible staffing system. However, those employees often work the same schedule each week. Cultural change is needed to get buy-in that we are all in business to serve customers. And this means employees will need to be available when the customers want them to be.

As with any initiative worth undertaking, the hard work will pay off. And in the case of a company like Bank M, the money saved can be funneled back into salaries and stock dividends. And the customers will receive great service. ■

Do You Have Petri Dishes in Your Refrigerator?



Merit Smith
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When you visit the Smith household, expect to be welcomed and made to feel comfortable, but you'll need to take care of yourself. Recently a visiting friend came back from the kitchen with a sandwich and beer and said, "You have Petri dishes in your refrigerator!"

He sounded surprised to find Petri dishes on the top shelf of our refrigerator. I explained, "Those are Lauren's. They're part of some science she's doing." I let the subject drop, but I knew he found Petri dishes in the refrigerator to be odd.

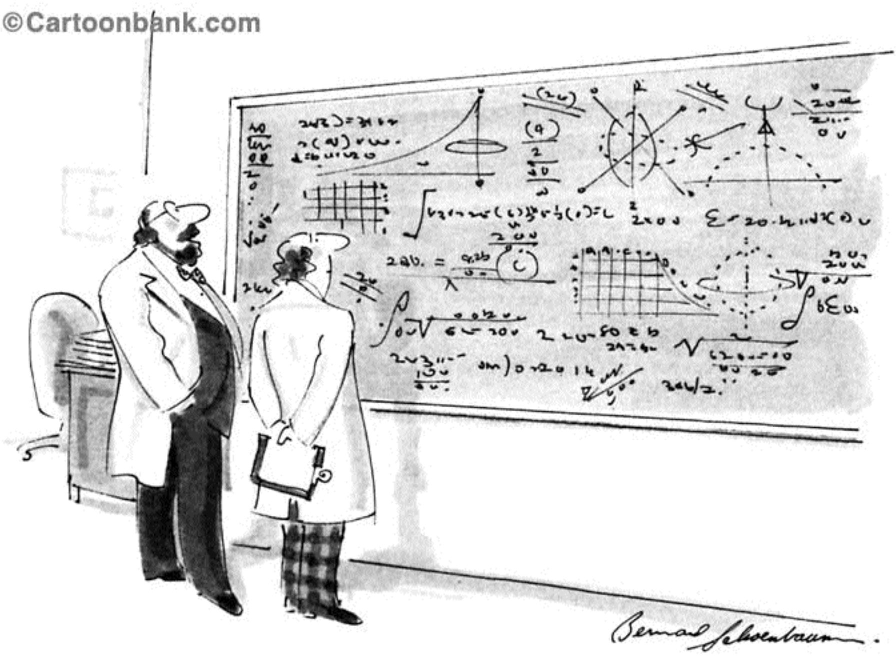
My daughter, Lauren, does a lot of science projects, and she has staked out the top shelf of our refrigerator as hers. We've learned not to disturb them, and those little covered dishes, neatly labeled, are a normal part of our home.

The following week I visited two different clients, both regional health plans. In the course of the visits I asked them, "What projects are you working on that will expand your markets?" The answers surprised me. Both of them said that they were working on small scale tests of new products. And both were testing products designed to serve the "down-scale" health care market. The rationale was quite similar between the two executives. Both of their regional markets had sizeable uninsured or underinsured markets, and these populations presented both a growing political problem and an untapped source of revenue for them.

Over the next month, I found five more plans that were attacking the underserved segment of the market. Some were approaching it via bare-bones offerings to small employer groups. Others were trying individual products as their vehicle. I found a client who is testing a prepaid health services card, exactly like a prepaid phone card. And we found a health system that offers a gift card that can be used anywhere in the system, such as in the hospital gift shop or the cafeteria or for an HMO co-pay. Many of these experiments are small scale, just a test without great expectations. I found two health plans that are basing their geographic expansion on low-end products.

The health care press frequently features articles about new birthing suites, concierge-level service and other efforts designed to appeal to high-end niche markets. Meanwhile, there is a vast under-served market that represents a huge pool of revenue.

I view all of these little experiments like Petri dishes: a place where learning happens and new things are created. Got a Petri dish in your refrigerator? I'd love to hear about it. Email me at merit_smith@renolan.com.■



"Oh, if only it were so simple."

SET SAIL FOR SUCCESS

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Several years ago I got hooked on sailing. While on vacation, my wife suggested we take a champagne sunset sail. Ten minutes into it, I was hooked! I couldn't tell you at the time what fascinated me about sailing. But five years and a lot of mistakes later, I think I now understand.

Sailing is an exercise in managing constant change. Even before you leave the slip, you must understand the condition of your boat and the environment you are about to encounter, and plan accordingly. As you proceed, you are faced with management issues that range from effective communications to crisis management.

Understanding the conditions is crucial to a good sail. Sailors know the boat, the crew's capability and the environment. They check rigging, sails, the engine (because the wind doesn't always blow), the weather, the tides and their navigation equipment. They ensure they are prepared and explain the crew's roles. They provide leadership and set direction. In business, most managers believe they understand the condition of their unit and what they are about to face. But do they?

Sailors must plan their sail based on the objective and the variables they expect to face. Change is constant and makes modifying the plan necessary to meet objectives. Similarly, managers must take the time to create a plan and then work it to accomplish their goals. How many managers sail their unit in circles and never reach their objective?

Sailing requires constant monitoring for changes in the wind, water, clouds, crew and the boat. Monitoring internal and external forces and staying aware gives the sailor a necessary edge for success. Likewise, managers face constant internal and external changes. Do they see the change coming and are they prepared?

Sailors find out rather quickly that if communications break down, mistakes often happen. Recovery is not a fun exercise in heavy wind and seas. Effective communication is essential for a safe, enjoyable on-track sail. Most managers will tell you that they strive to keep the lines of communication open with their employees. However, that does not mean the communication is effective.

A sailor must take action, rather than react. In sailing, reactions usually mean you are going aground, the boat is about to broach, a crewmember is overboard or you're about to hit an object in the water. Taking action requires anticipation, whether you're sailing or managing.

Good sailors constantly evaluate. Is the course correct? Has the wind changed? Are the sails trimmed? Is the crew performing properly? Evaluation creates an understanding of what is happening and gives time for appropriate adjustments. Failure to evaluate brings the sail—or a process—to an undesirable state. Managers should constantly evaluate to ensure they are on course for success.

The need for recovery happens to even the most prepared and experienced sailor. Even with all the preparation, unique circumstances occur that cause the need for a quick and effective recovery. By recognizing the possible scenarios for recovery, plans can be developed and practiced. Managers have a similar responsibility when things go wrong. Identifying such situations before they occur and developing a recovery plan is a critical part of management.

I have been managing and consulting for quite some time now, and more recently, sailing. I find that the challenges faced in both environments are very similar. The elements of good management apply to sailing, and vice versa. Think about sailing as you depart on your next course for management success. And may you encounter fair winds and calm seas.■

WHAT'S YOUR SERVICE GOAL?

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How do you measure service in your call center? Which metrics do you use and how do you set your performance goals?

These are common questions that our clients frequently ask. So, let's talk about three of the most common service measures: average speed of answer (ASA), abandon rate and service level (x percent of calls answered within y seconds).

ASA is one of the oldest and most problematic service measures. First, it completely ignores abandoned calls and, second, it can be extremely misleading over longer time periods (day, week or month). Your ASA may be 30 seconds, but very few callers experience a 30-second delay. The vast majority of calls are answered with little or no delay and only a small percent experience extended delays. Worst of all, measuring ASA can lead managers to do the wrong things to meet ASA goals (see my Second Quarter 2004 Nolan Newsletter article, "Chasing the ASA"). We would strongly discourage using ASA as a service metric, but if you insist, 30 seconds would be a reasonable goal for most of our clients.

Nearly all call centers track the abandon rate. It's a common and somewhat useful metric. Our biggest issue with abandon rate is that it tells you nothing about the vast majority of calls that are being answered. It's also a metric that is nearly impossible to control because callers abandon for any number of reasons, many of which have nothing to do with the call center.

Many companies measure ASA and abandon rate and believe that the combination of the two gives them an accurate assessment. We disagree. If you want to track the abandon rate, that's fine. We would suggest a goal of 2 – 3 percent. Also, you might consider eliminating "short abandons" from the calculation (within 10 seconds or so) since there's not much you can do about callers who abandon that quickly.

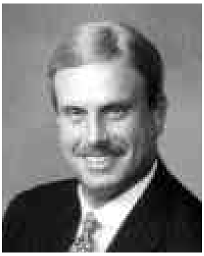
Service level is easily the best service metric because it gives you the best view of what callers experience when they contact you. Keep in mind that it's still an average, and like ASA, it can be misleading over longer time periods. It's OK to report service level performance over the entire week or month, but to really give an accurate assessment of service, you should report the percent of 30-minute intervals in which you meet your goals. This gives you a measure of service consistency.

Let's say your service goal is to answer 80 percent of calls within 30 seconds—a reasonable goal for most of our clients. What you want to do is maintain service within +/- 10 percent of your goal for every 30-minute interval. In other words, you want to avoid periods below 70 percent and above 90 percent when either callers are waiting too long or you have too many agents waiting for calls. You want to give your callers a consistent service experience, but you also don't want to waste valuable resources doing it.

There are two other cautions we would add about using the service-level metric. First, you must ensure that the service-level calculation includes abandoned calls (you may exclude the short abandons if you wish). And second, since service level only measures the calls getting into the queue, you must have a measure of blocked calls or busy signals.

There are other supplemental service measures: repeat calls, calls resolved on contact, and timeliness of research and follow-up work, just to name a few. However, when it comes to measuring the caller's ability to access your call center, the service-level metric is the best way to do it.■

MICROMANAGING AND TWO CANS OF BEER



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I recently read this story and thought it fit with a number of issues we face with our jobs each day.

A philosophy professor stood before his class with some articles before him. When the class began, wordlessly, he picked up a very large empty glass jar and proceeded to fill it with golf balls. He then asked the students if the jar was full. They agreed that it was.

The professor then picked up a box of pebbles and poured them into the jar. He shook the jar lightly. The pebbles rolled into the open areas between the golf balls. He then asked the students again if the jar was full. They agreed it was.

The professor then picked up a box of sand and poured it into the jar. Of course, the sand filled up everything else. He asked once more if the jar was full. The students responded with a unanimous yes.

The professor then produced two cans of beer from under the table and poured the entire contents into the jar, effectively filling the empty space between the sand. The students laughed. Then, as the laughter subsided, the professor said:

> "Now, I want you to recognize that this jar represents your life. The golf balls are the important things—your family, your children, your health, your friends, your favorite passions—things that would make your life full, even if everything else was lost. The pebbles are the other things that matter, like your job, your house, your car. The sand is everything else, the small stuff."

> "If you put the sand into the jar first, there is no room for the pebbles or the golf balls. The same goes for life. If you spend all your time and energy on the small stuff, you will never have room for the things that are important to you. Pay attention to the things that are critical to your

happiness. Play with your children. Take time to get medical checkups. Take your partner out to dinner. Play another round of golf. There will always be time to clean the house, and fix the disposal. Take care of the golf balls first. Those are the things that really matter. Set your priorities. The rest is just sand."

There was a pause, and then a truculent student voice from the back muttered, "What about the beer?" The professor smiled. "I'm glad you asked! It just goes to show that no matter how full your life may seem, there's always room for a couple of beers!"

While you are busy chuckling over this anecdote, just remember that this is also good advice for a project manager: Stop micromanaging and get the big things in the project done first. If you don't, you'll never get everything done within the time available. ■

"If we're going to prioritize, we're going to need some priorities."

EVOLVING TO A RISK-BASED PRICING MODEL

Steve Discher
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Property and casualty carriers are increasingly considering moving from a traditional risk-selection model to a risk-based pricing model. While many insurers are in the early stages, others, like Progressive, have already shifted to this new business model.

Insurers continue to look for high quality and sustainable earnings growth while maintaining a strong customer and surplus base. An insurer's ability to retain customers while driving to a lower combined ratio (some well below 95 percent) is becoming increasingly challenged. This is particularly true now that the hardening cycle appears to be turning towards softening rates.

Property and casualty insurers face intense competitive pressures as other personal lines insurers, particularly those driven by Wall Street expectations, seek expansion in a slow growth market by taking away competitors' business. The competitive thrust is often based on price, and insurers continue to explore expanding existing pricing in a way that's consistent with a risk-based pricing model.

Using detailed risk pricing with certainty and precision based on data and experience is nothing new. The notion that "there is no such thing as a bad risk, just a poor price" has been a long-standing anecdote for insurers. However, this anecdote is too simplistic. It has resulted in poor outcomes for companies that do not approach the issue by properly integrating pricing, underwriting, agency management and marketing. A key challenge for any insurer is having the data and experience needed to generate an underwriting profit at a competitive price. This is also why we do not have full migration toward risk-based pricing models today.

Companies considering a move toward risk-based pricing should consider four key issues:

1. **Data Accuracy, Reliability and Usability.** Large incumbent insurers often have a competitive advantage, namely a database of statistics on their current drivers and householders. An insurer's ability to price accurately is driven by data accuracy. Equally, an actuary's ability to correlate, project and price is hindered by unreliable data. The challenge is capturing and managing just enough of the required data to make accurate pricing decisions. Other issues to consider in moving toward a risk-based pricing model include disparate and inaccurate data sources, the inability to collect and integrate reliable data, and the sheer volume of information.
2. **Company Culture (from front line to back office).** Moving from a risk-selection culture to a risk-based pricing culture creates the need for new behaviors and new ways of working that involve increased integration of pricing, underwriting and channel management. New approaches are required for greater cross-organization cooperation. A new mindset is often needed to change the organization's belief that profitability can be driven by pricing vs. risk avoidance.
3. **Implementation.** Implementation of this model is very complicated, particularly in an exclusive agency environment. The implementation process requires planning and analysis. For example:
   - Should rating variable changes be applied to both new and renewal business? For instance, a merit-rating plan that charges for the first violation may be actuarially justified, but may cause disruption in the renewal book.
   - Should implementation be done in stages to avoid renewal-to-renewal increases even at the cost of delaying the desirable competitive advantages for new business?
   - Will there be regulatory restrictions on what can be done at implementation with respect to variables or tier management?

- What assistance will be provided to agents in surfacing those insureds whose book of business has substantial renewal-to-renewal changes?
- What will be the new role of underwriters, pricers and managers of the agency distributions?

4. **Managing customer and agency expectations against the competition.** Consideration should be given to the following:
   - How fast do quotes have to be?
   - What renewal-to-renewal change is acceptable?
   - How should delicate rating variables such as credit score/insurance score be handled?
   - What disruption is caused by a movement of a policyholder from one company to another in regard to supporting tiering objectives?

These issues also need to be addressed in a way that does not erode company-combined ratio and retention-rate targets. If there is not integration of functions and strong discipline, the benefits of risk-based pricing only flow in one direction: from the company to the insured, in terms of lower rates. This, of course, is only half of the equation and needs to be balanced with "pricing up" the book for those risks that are appropriate (while closely monitoring the market and managing retention). While company retention targets may stay the same overall, retention by sub-segment will likely need to be reviewed as a result of more refined pricing.

In progressing toward these new models, consider experimenting before moving full-force into the new model. Before implementing, consider a prototype approach when moving toward risk-based pricing business models. While the benefits can be worth the move, insurers need to be careful to keep a strong hold on their existing success. ■

Torturing Customers

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Sometimes, companies can be remarkably effective at torturing customers. Here I offer a case in point. As you may know, two major cellular carriers recently merged. Overnight, customers of the smaller carrier became forgotten stepchildren and were summarily sentenced to receive unimaginably poor service.

I experienced this firsthand when I became entangled in a phone replacement fiasco. I visited the cell phone company store to secure a replacement for my broken cell phone. This was the same store I had been patronizing for years. Three days later, I still had no replacement. I learned quite painfully that customers of the "old" cell carrier were being channeled into the "new" carrier's service processes. But those service processes had not been modified to accommodate the unique service scenarios created by customers of the old carrier. So the upshot was that I, a longstanding customer, could not get a replacement phone. And believe me, I tried.

If that weren't enough, I was supremely frustrated to watch new customers wander in off the street and get new phones with unlimited free minutes and free trips to Aruba. But I, an existing customer, couldn't get so much as a "sorry for the inconvenience." In fact, the store clerk and the customer service help desk both told me that my best bet was to switch to a competing carrier. Believe it or not, this problem has yet to be resolved satisfactorily, but in the short term I did engineer a workaround that got me a replacement phone and kept my account intact.

Unfortunately this "good service gone bad" scenario is not unique to the cell phone business. In fact, we often help our clients redesign service processes to accommodate business and marketplace changes, such as mergers, technology innovations, business policy changes, regulatory & compliance issues, and product changes to name a few. Well-run companies routinely fine-tune their operations to reduce costs and improve competitiveness and customer satisfaction. But even good companies can make a misstep once in a while, as evidenced by my cell phone experience.

Every so often I stumble across service shortcomings in my own organization. I always wish someone—even a customer—would have told me sooner. And in the case of the cell phone company, I kept thinking that their head of customer service couldn't possibly be aware they were systematically infuriating customers. I imagined him sitting in an office marveling at the efficiency with which the merger was proceeding, completely oblivious that thousands of customers were being run off by his own operation. Why hadn't someone told the emperor he had no clothes on?

Here are some thoughts about maintaining good customer service:

- Let your best customers determine how they want to be served. Don't make customers conform to your idea of service—let them choose.
- Audit your own service by calling your own call centers, interacting with agents, using your own web site. Do this during peak demand periods to get the same experience as your customers.
- Set up a "red alert" process whereby process breakdowns can be diagnosed and corrected with urgency. On several occasions throughout my cell phone fiasco, service agents and even supervisors told me "we're aware of this, but we don't have any way of correcting it."
- Make sure your acquisition process doesn't trump your service process. Acquiring new customers is essential but expensive. It's even more expensive when you lose good customers in the rush to attract new ones.
- Don't make customers solve your service problems.
- Obvious but too often overlooked: debug your processes in a model office.

And finally, don't even think of replacing your cell phone during a phone company merger.■

UPCOMING NOLAN EVENTS

April 4: Insurance Data Management Association
Rod Travers, Nolan senior vice president of technology, will speak to this group of professional insurance data managers and statisticians on the topic of Business Process Management (BPM) in the insurance industry. www.idma.org

May 22 – 24: ACORD LOMA Insurance Systems Forum
Nolan is a gold sponsor of this premier insurance business and technology event, to be held in Orlando, FL. Nolan practice director, Steve Discher, and Nationwide Insurance vice president, Jeff Stein, will speak on operations excellence. www.loma.org

May 22 – 25: AMIfs/BAI Profitability and Performance Measurement Forum
Nolan is a premier sponsor of this event, providing lanyards to all attendees. Nolan president Bob Grasing will present a case history clinic to the audience of banking professionals. www.bai.org

June 5 – 8: IASA Annual Conference
Rod Travers, Nolan senior vice president of technology, will speak to attendees about BPM in insurance. Steve Discher, Nolan practice director, along with Horace Mann vice president John Meyer, will lead a session on business-driven IT. Nolan is an associate sponsor of the event. www.iasa.org

June 6 – 8: BAI National Loan Operations
Nolan president Bob Grasing and a client will discuss designing an integrated loan process at this annual event to be held in Washington, DC. www.bai.org

June 13 – 17: ITFMA IT Performance Management and Benchmarking Conference
Nolan chairman Ben DiSylvester will discuss benchmarking and best practices data within the financial services industry. The event will be held in San Diego, CA. www.itfma.com

June 20 – 22: LIMRA Executive Marketing Forum
Nolan chairman Ben DiSylvester will address insurance chief marketing executives about the current challenges and risks facing the insurance industry. www.limra.com