The Nolan Newsletter

People, Process, and TechnologyF

ROBERT E. NOLAN COMPANY
MANAGEMENT CONSULTANTS

Fourth Quarter 2010 *Volume 37, Number 4*

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Nolan is an operations and technology consulting firm specializing in the insurance, health care, and banking industries. We help 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. Visit our Website at **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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People, Process, and Technology

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It's That Time of Year Again...

Fall foliage, the start of the NFL season, kids back in school, and—oh yes—next year's budget! The dreaded budgeting process is well underway (hopefully), and predicting the future is at hand. With all the challenges facing today's economists about job growth, new sales, and the ever-volatile stock market, we executives are struggling with some of the same issues—growth, expense management, sales projections, and staffing needs. While there is little risk to economists in a bad prediction, today's business executives have a lot on the line in managing expenses. Preparing next year's budget requires skill whether you are a mutual organization, a stock company, or a not-for-profit health care organization.

Without some scenario-planning tools to help with the projections, the task can be difficult. And without some level of precision, you could spend the next 12 months answering to your CFO during monthly variance-reporting sessions. This time of year offers a great opportunity to look at total company performance for 2010 and evaluate what will change, what remained the same, and where you expect to have a different look in 2011. It is also an opportunity to review performance to last year's budget, evaluating not only sales projections, but staffing levels, outside spending (vendor management) on services (i.e., contract programmers), and temporary help against what was planned.

Establishing a well-thought-out staffing plan based on factually engineered metrics provides you with a model to plan for 2011, and you'll use it throughout the year to monitor the effects of changes in sales and operating performance. This cost model will account for 60% of your total budget. The other critical analysis that needs to be performed is a more comprehensive vendor management model to track and evaluate your external spends. Tightening the reins on outside spend will afford most companies an opportunity to conservatively realize up to a 5-15% reduction in overall spend.

Taking this broader analytic approach to the budgeting process allows those financially proactive companies to save money and turn their budgeting process into a model for ongoing analysis. Give us a call and let us help you during these challenging times. The Nolan Company has spent the last 30+ years helping companies conduct this kind of analysis. ▪

Dennis B. Sullivan

Dennis B. Sullivan
Chairman and CEO

Scot McConkey Joins the Nolan Company

We are pleased to announce that Scot McConkey has joined the Robert E. Nolan Company as Senior Vice President. Scot will have leadership responsibilities for Nolan's health care practice.

Scot has spent nearly 25 years in professional services and has focused on health care for the last 20 years. He has previously led national health care practices that provided consulting, systems integration, and outsourcing services to the health care market. Scot will be leveraging Robert E. Nolan's 37 years in the industry to expand its presence in the market through expansion of current services and offerings.

Prior to joining the Robert E. Nolan Company, Scot spent time with CSC, First Consulting Group, and Accenture.

Scot holds an MS in Industrial and Operations Engineering from the University of Michigan and a BS in General Studies, with concentration in Computer Science, from the University of Michigan. ▪

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JOIN NOLAN AT UPCOMING

Health Care Industry Events

California Association of Health Plans' 25th Annual Conference
October 18-20, 2010 - Indian Wells, CA

Texas Rural Health Forum
November 10-11, 2010 - Austin, TX

Lessons to Remember as Merger and Acquisition Activity Increases

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

Most carriers deal with M&A activities only occasionally. For those carriers who are quickly being thrown into the deep end of the M&A pool, we have a few suggestions and lessons learned from our long history of advising clients in evaluating, selecting, and implementing mergers and acquisitions. These include:

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

evaluation, but includes final terms and conditions and operational and cultural attributes.

- **Leverage your strong cash position.** Especially today, going to the capital markets for funding may slow you down and have you looking for returns that would otherwise be better passed on to current shareholders.
- **Consider IT integration issues carefully** before, during, and after the deal. Before a deal can be struck, accurate and timely financial, HR, and operational data is needed. IT compatibility issues can also slow potential business integration efforts and reduce longer-term integration benefits.
- **Line up the right team to execute** with speed and precision. Integration is hard work and requires experienced resources to realize the benefits expected from a merger or acquisition. Periodically review your pre-integration decisions and their rationale to ensure that the team hasn't drifted from your original intent. Re-validate your assumptions.
- Finally, **don't underestimate the challenges of cultural integration**. Substantial evidence indicates that the main reason mergers and acquisitions flounder is a failure to integrate company cultures. Analytically speaking, you can pick the best target, but if you don't have the right end-state culture, you won't integrate and will likely be challenged in the long term. Consider your own management style and what you expect to see.

Substantial evidence indicates that the main reason mergers and acquisitions flounder is a failure to integrate company cultures.

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

The Basis of Competition is Changing–Are You Ready?

Merit Smith
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Understanding the impact of reform is a bit like watching mountains emerge from the rain and fog: you don't see the mountain all at once. Perhaps you sense the form of the mountain from a larger patch of gray, then catch a glimpse of it through the fog, then gradually see the shape and, later, details emerge.

We have the reform law, a few regulations, and some public pronouncements. But we don't have key regulations or details for the critical changes that will shape the future of health carriers and the industry. By "critical changes," I mean the provisions and regulations that change the economic model of health insurance—the detailed definition of the medical loss ratio and the mechanics of rebating premium.

Even without this critical information, we can see the shape of the mountain through the fog. We can tell that the basis of competition is changing. Let's think about the future competitive environment in terms of what we know today.

Here are some things we can anticipate about the future:

- Product features and benefit design will be less important. Why? The government will move us toward standardized benefits.
- Medical costs will be less important as a component of market price. Why? The HHS will largely dictate the range of medical prices, and mandated minimal medical loss ratio targets combined with rebates will go a long way in reducing carrier incentives to innovate and tightly manage this element of cost.
- With standardized benefits and medical prices, what's likely to be the basis for competition? Service experience and administrative costs. Of these two, which will be more important? Administrative expense. Why? New buyers don't have an objective basis for evaluating service, and they don't trust carriers' promises about service. But they can evaluate cost, and they are increasingly price-sensitive.

Will you be ready to compete when your product is distributed via an exchange with a limited number—perhaps five—of health plans? Where will you compete on administrative cost? Aiming to be close to the average of the peer group is old-style thinking that will ensure that you become a non-competitor. Can you compete in an environment where the marketplace sets your price point for your administrative services?

What do you need to do to be ready?

- Understand today's administrative cost structure in detail, with more focus than you ever have.
- Understand the sensitivity of your cost structure to differences in revenue, units, and fixed and variable costs. Perhaps you have done this but not with the detail, focus, and urgency you will need.
- Be prepared to simulate differences in your cost structure based on differences in the ultimate definition of "medical loss ratio."
- Begin to manage costs today. Of course, you have been doing this as part of your response to the recession and slow-motion recovery. But taking even more steps today to reshape costs will be easier than doing it in the future.
- Renegotiate any long-term contract (for space, systems, law firms) you have.
- Be prepared to simulate a number of market scenarios and expense structures.
- Understand that expenses are the shadows of management decisions. You and your managers determine your expense structure. How you do that will determine your future under reform.

Nolan has developed a set of tools to help you with this analysis and simulation. If you would like to learn more about how we can help you reset your cost structure for a new environment, call me at 719-339-9803. ▪

PODCAST:

The Data Dilemma in Predictive Analytics

Nolan Vice President and Health Care Director, Merit Smith, talks with Bob Hyle, Editor-In-Chief of *Tech Decisions* magazine, on "The Data Dilemma in Predictive Analytics." Merit discusses the problems insurers face in dealing with their data as they employ predictive analytics.

To listen to the full podcast, go to http://bit.ly/cdF7h4.

Beyond Data: From Analytics to Action (Part II)

Mike Meyer
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In Part I of this article, I defined "business analytics" and provided an example of how one organization successfully applied the concepts to achieve a significant impact on profitability. In this article, I offer some suggestions and tactics that will help you make the best use of analytics in your improvement programs. (To read Part I of this article, *Getting the Most From Business Analytics*, go to www.renolan.com/insurance/articles.htm.)

An essential component of any successful implementation of business analytics, and one central to the Nolan approach, is a deep understanding of the industry, products, marketplace dynamics, processes, business drivers, and competitive factors, among other things. In our case, that encompasses health care, insurance, banking, and financial services. Many companies have made significant investments and great strides in implementing business analytics software, but most still struggle with effective use of the resulting management information. A successful analytics program should provide a positive ROI, which in turn requires taking it beyond software and reporting and into the realm of management practices and operations improvement. Nolan's typical approach to supporting business analytics efforts includes the following steps:

- Work with the finance or analytics area to establish a baseline of data and reporting that tells a story in terms of potential opportunities.
- Work with functional areas and/or lines of business to help them understand and fine-tune the data and identify and validate opportunities.
- Develop improvement initiatives that are structured and scoped to fully address each opportunity area.
- Lead or facilitate the improvement initiative in a manner that maximizes data visibility, participation, buy-in, and overall positive impact.
- Reinforce continuous improvement principles throughout the process so that the overall analytics process is further streamlined and fine-tuned with each initiative.

The following are some techniques we use when assisting clients with analytics effectiveness. You may find some of these helpful in your environment.

Benchmarking

Benchmarks are an element of business analytics, and they should be viewed as a means to an end. The end purpose should be to improve or validate performance, not to simply take measurements or make comparisons. If you embark on benchmarking, establish a solid link between the resulting analytics and a comprehensive activity-based management program. In other words, formally incorporate the benchmarks into your ongoing improvement initiatives. Benchmarks are often thought of as an external comparison (e.g., relative to peers, competitors, or "the industry"), but benchmarks are just as valuable when used internally to analyze different geographic locations (such as service centers or sales offices) to determine performance strengths, weaknesses, and best practices.

IT Assessment

IT costs and allocations are often not clearly understood. For example, a recent Nolan bank performance study found that the IT costs at a participant bank (IT expense as a percent of total bank income) were significantly higher than those of its peer group—but it wasn't clear why. An IT resource allocation analysis was then conducted to isolate whether the primary issue was on the operations side or the system development side. The data indicated that on the development side, over 40% of the activities being performed were not critical and could be streamlined, consolidated, or eliminated. This provided a business case to proceed with an initiative to develop and implement a new project/portfolio management process that would result in a capacity increase of 10–15%. Ultimately, this lowered overall IT costs and recast IT cost allocations more equitably.

Cross-Functional Expense Views

Many financial service organizations view expenses from a functional or business unit perspective. Functional managers are responsible for managing these expenses within the scope of their organizational structure. Business analytics tools can provide new and different views of expenses that can in turn provide new insights into opportunity areas. Expenses that seem insignificant within a given unit can be significant when viewed more broadly. For example, expense line items such as travel can be selected and views created at various levels, such as enterprise, function, line of business, region, and office. Typically, potential opportunity areas are identified quickly. With further investigation and management action, those findings lead to more effective policies, improved consistency, and reduced overall expense.

Unit Costing

Marrying expense and volume data from different perspectives can create some interesting insights into unit costs. Unit costs are an ideal metric for measuring efficiency within an operation by simply looking at how many pieces of work the organization is getting and how much it is costing to get each piece done. The key here is to focus on the core work volume and understand its definition. If a global view is desired on the expense side of the equation, all expense line items can be included, as opposed to limiting expense scope to personnel-related costs. However, both views can be valuable, depending on the audience. Limiting expenses to personnel costs provides a more precise view of productivity management effectiveness. The global view is a bit more complex in that it requires allocations of overhead, but it can provide a true view of what a function or process costs an organization.

Product Costing

Product costs are useful for evaluating product pricing and profitability. Accurate views of product costs require a fairly sophisticated business analytics capability, but the value can be significant. Understanding costs at this level can help to ensure that products are priced effectively and profitably in the marketplace and to determine when it makes sense to underprice a product in order to gain market share. Identifying unprofitable products can lead to their redesign or elimination in order to improve overall profitability.

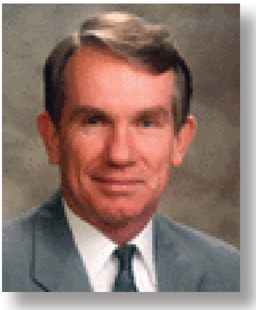
Incentive Plan Financial Soundness

The key here is to determine if there is a direct relationship between business results and what is being paid to employees in variable compensation. Ideally, business result trend lines and incentive payout trend lines should match one another to a degree, with the business result line climbing at a faster rate. Business analytics data can be developed for key business metrics and corresponding incentive payouts. These become the basis of incentive plan fine-tuning or redesign to ensure ongoing financial soundness and ROI.

In Summary

The examples I've provided here are just a few of many possibilities. With techniques and tools evolving at a remarkable pace, we have really only scratched the surface of business analytics. But the basics remain the same: organize data so it "tells a story," and then use it to drive performance and profitability improvement. The speed, scale, and accuracy with which you do this can create major cost and competitive differentiators for your organization. ▪

Remembering Pat Townsend



We at Nolan were saddened to learn that Pat Townsend passed away this past month. We feel that it is important to mention him both as a friend and for his contributions to quality improvement for the financial service industry. His breakthrough book, *Commit to Quality*, published in 1986 by John Wiley & Sons, chronicled the "Quality Has Value" process at our client Paul Revere Insurance. The book was the first business book to detail the steps a financial services organization took to implement a highly-successful quality improvement initiative. Our senior consultant working with Pat on site remembers how, when faced with any hurdle, he would use intelligence, humor, and honesty to solve the problem. For example, the Quality Department distributed a calendar for Paul Revere's internal use with reminders of things to do to deliver quality service. Everyone in the department was horrified when it was discovered that there was not one but two September 22 posted on the “Quality Calendar.” Not Pat. He quickly went into high gear and pronounced that it was a day so important we had to have it twice and then developed themed programs for service delivery on those days. It was a clear demonstration that recovery is a critical element in any quality culture.

Paul Revere’s CEO at that time, Chuck Soule, noted that Pat’s innovative ideas fueled the growth and success of the process with both home office and field personnel. One of his unique strengths was the creative ways that he designed recognition and reward for employee performance in meeting the company’s quality goals. Pat could frequently be found throughout the company passing out "quality coins" to employees who had acted on behalf of the quality tenants. He felt that public recognition fostered continued acts of quality. Later in his career, we had the good fortune of working with Pat again at UICI and found that his exuberance for quality improvement was even greater through his experiences and research on the subject.

Pat used his experience at Paul Revere to become a member of the committee that defined and established the Malcolm Baldrige United States National Quality Award, and he was an Examiner for that award for two years. In addition, Pat co-authored five books with his wife, Joan Gebhardt, on the subject including: *Quality in Action*, *Five-Star Leadership*, *How Organizations Learn*, and *Recognition, Gratitude, and Celebration*. Pat’s greatest gift may have been as a communicator—a nationally-recognized speaker and author of over 200 published articles on quality.

He will be missed by his friends and the financial services community he served. We encourage you to visit, www.patrickltownsend.com, a website dedicated to the remembrance of Pat Townsend. ▪

The Impact of Dodd-Frank on Community Banks

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Community bankers are dealing with the immediate issues presented by the new financial reform act and are anticipating what the impact will be as other provisions are ironed out over the next two years. Simply put, the new regulations will reduce fee income, increase the cost of funds for banks, and result in significant internal regulatory compliance and reporting costs.

There are reports that many small banks are concluding that the amount of change will require them to sell out to larger banks. There have been more than 120 bank failures so far this year. And, while the signs of economic recovery are registering faint positives, the year-over-year statistics are unsettling. Banks started amending their fee structures in anticipation of the regulation changes earlier this year; consequently, fees from deposit accounts are down more than 7% from the same period in 2009. Assets are down by 1%, and credit card balances are down 2.5%, reflecting a cautious public.

The changes in NSF fees and the lower interchange rate represent the most obvious reductions in fee income. While the interchange rate change is targeted at banks with more than $10 billion in assets, smaller community banks are expecting they will have to follow suit. This will put bottom-line pressure on every community bank, and bankers are discussing various steps to recapture that revenue. A comment on the changes by JPMorgan Chase's chairman and CEO, Jamie Dimon, was succinctly put: "If you're a restaurant and you can't charge for the soda, you're going to charge more for the burger." Community banks are planning a variety of pricing moves to recover lost income, including eliminating free checking and instituting a monthly fee that is waived only if a significant monthly average balance is maintained. Other banks are opting to direct customers to ATMs rather than tellers. They are structuring lower fees on deposit accounts with a maximum of two teller visits per month.

The cost of funds is growing as well with a regulation change that will allow interest on business deposit accounts, and this will likely impact the community banks more than the money center or super-regional banks where larger or more sophisticated commercial customers already have sweep accounts.

The hidden but real variable cost that will play out for all banks is the cost of compliance, which relates to additional reporting and procedures that will be necessary to comply with regulation changes. These changes will include:

- Adding staff in compliance
- Adding work for new business and credit staff
- Adding procedures (time) to open accounts

This additional time to open new accounts will logically limit cross-sale opportunities and either lengthen the customer's wait time or increase the number of banking staff. Martin Zorn, Chief Administrative Officer for Tennessee Commerce Bank, was recently quoted in *Bank Systems and Technology*: "There is going to be more regulation, so in preparation we need to go to IT and all other departments to find efficiencies to do what we are doing more cost-effectively."

From our discussions with CFOs and CEOs, we know that this is exactly what the efforts of the next two years will focus on. Activities will be directed to significantly reducing operating expenses. The necessary reductions will not simply come from incremental changes in targeted areas. The changes will require a dramatic reduction in labor costs and process time, but improving the customer experience will need to be kept a primary objective. Bankers need to work actively and systematically to offset the additional costs and loss of revenue so that when the economic recovery is finally complete, bank performance improves as well. ▪

We need to communicate our financial collapse in the most positive and upbeat way possible.

CLIENT SPOTLIGHT

Project: Strategy to Enter the Insurance Market

Client: Large Credit Card Processor

Industry: Insurance and Banking/Card Processing

Project Objective

The client is a large processor of credit cards for automotive and commercial fleets. The client has extensive experience providing electronic payment capabilities for automobile warranty repairs and was interested in expanding services to the insurance industry—specifically, automobile property damage claims payments. The company engaged Nolan for assistance in developing an entry strategy for the insurance market for their payment service capabilities.

Starting Environment

From experiences in other industries, the client was well aware of the benefits of payment electronification versus checks. Some of the benefits are improved vendor-client relations, dramatic reduction in check processing costs, reduced fraud and lost-check processing costs, better financial controls, and even opportunities to generate revenue from the payment process.

Even with the typical benefits understood, the client needed to better understand how their service could work effectively in the insurance industry and how to market and sell the services in this unique environment. They also wanted a better understanding of how a typical claim payment process could improve with implementation of their service.

Project Scope and Steps

The scope of the project covered the domestic P&C and life insurance industries. Nolan started by conducting a complete review of the client's existing services and their marketing and sales approaches for the insurance industry to date. This was followed by a comprehensive industry introduction, including:

- Industry fundamentals
- Case studies of other software and services firms' experiences (successful and failed) in entering the insurance industry
- Typical market entry processes and timelines

Nolan then created an inventory of all insurance lines of business and identified for each the types of claims paid, the demographics of the claim payments (to claimant or vendor, centralized or fragmented, typical size of claim, number of payments, etc.), industry size, and appropriate payment media (ACH, check, prepaid card, instant credit, etc.).

Nolan then performed an analysis to map the client's services to claim payment types to determine which payments could benefit from their solution. Thereafter, industry sizing profiles and a market entry roadmap were developed, and the sales and marketing team was trained in the new approaches.

Project Results

New sales and marketing plans and product presentations that are specifically designed around the insurance industry are in place. The client's product development group now has a purpose-specific enhancement plan to adapt their services to the unique needs of the insurance industry. Two new insurance industry sales have been made since the beginning of the engagement, and the client is using a new implementation approach for insurance customers. On the strategic level, the client has a three-year product roadmap outlining the most effective means of rolling out their services to several different insurance lines of business.

Nolan helped this client develop and adopt an effective product and market entry strategy tailored to the insurance industry. They are moving along a specialized roadmap, and they have accelerated sales and improved client satisfaction.

The Humble Checklist

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Is there anything more mundane than the humble checklist? My mother used them for grocery shopping, and she'd give me one when she sent me to the store so I wouldn't forget anything.

As I got older, I used them when the consequences of forgetting something were more than I wanted to bear…such as the mosquito repellent, warm clothes, or toilet paper on a camping trip (guilty on all counts). The specter of complexity also reared up, and the checklist helped manage it. After ruining a few model cars and airplanes, I learned to follow directions, which are really a checklist for assembly ("Now set aside the fuselage to dry before attaching the wings").

But then I went to college, became an engineer, and started designing and building things. At first, my mantra was "Real men don't plan." Plus, I was a highly-qualified, well-trained guy—maybe even an expert in some circles. Of course, experience proved the best teacher, so I learned about project planning and even adopted some of its tools and techniques, like Microsoft Project, the critical path, resource scheduling, and leveling…you know the drill.

"But what about the checklist?" you ask.

Let's review. What do you do when you have a complex project with a plethora of deliverables and the risk/consequences of failure are more than you can bear? Add to the equation a lot of well-qualified people from different departments and cities working on the project who bristle at suggestions on how to do their jobs. You crank up the ol' project plan, which was exactly where I started. When I wasn't getting what I wanted or needed, the checklist entered the scene.

One of the things that became clear during the project plan exercise was that the ratio of tasks to deliverables was very low; there were very few tasks required to produce most deliverables. Also, many of these deliverables were components of the final assembly (a "fuselage")—in this case, a new product launch supported by enhanced systems that included websites, IVR, an EDI clearinghouse, and new business processes with some outsourced operations.

So the project plan was set aside and the components listed in a spreadsheet. These became separate deliverables in a checklist form that could be assigned to one or, at most, two people. Deliverable components were sorted by functional area; working with each functional area, dates were added, sorted chronologically, and edited. This produced a solid checklist for each functional area.

The eight team leaders then met as a group to review and critique each checklist. The result was an integrated view of the project but with specific deliverables, dates, and the responsible party identified who could work with little coordination required to deliver the component.

The team leaders met with management for 30 minutes every week to review *exceptions* to the lists. Meetings have lasted as little as eight minutes (when was the last time you held a project review to eight minutes?). The project manager visited with each of the eight team leaders before the meeting to update the checklists in a PowerPoint deck. The deck consisted of four pages of checklists with issues and risks on each one. During user acceptance testing, one more page was added—acceptance criteria. You guessed it: a checklist with 50 items for "go live"—well thought-out, granular, and binary. It passes or doesn't.

"But what about the checklist?" you ask.

Before "go live," the component structure was given an operational readiness review in a conference room pilot forum. These consist of checklists of operational scenarios going in and corrections or enhancements coming out.

Success! "Check the box" became the informal team motto.

I would be remiss if I didn't acknowledge my colleague Merit Smith for some of the inspiration for the use of checklists. Merit suggested books by Atul Gawande, a surgeon and writer. Dr. Gawande cited the use of checklists in ER applications by doctors and other health care professionals and in aviation by pilots and others in flight operations. It's not that these folks aren't highly trained and competent; they are, but even the pros forget things or miss steps, and in medicine and aviation, the result can be catastrophic. Plus, checklists build effective teamwork in the cockpit and the ER from the get-go. Patient survival rates have risen and airline safety is excellent!

Complexity, timeliness, effective teamwork early on, risk mitigation, cost management, and delivery—all aided by the humble checklist. It works for grocery shopping and camping trips, too. ▪

Are You Ready for Your Next Acquisition?

James Dean
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The acquisition cycle is finally heating up. Companies are sitting on unprecedented cash reserves, organic growth is nearly flat for most industries, and P-E ratios are at their lowest in many years. Add to this brew the fact that management is under pressure to use the cash to benefit shareholders by paying dividends, reinvesting in the company, or making an acquisition. Among these choices, it is clear that an acquisition (by fueling immediate growth) will be a serious contender among the choices available.

Unfortunately, acquisitions do not have a great record overall for increasing shareholder value. Some studies have shown that over half of all acquisitions do not provide favorable returns for the acquiring companies. The reasons most commonly cited for these failures include underestimation of the cost and effort of operational integration and poorly-executed integration efforts.

When brought into the confidence of the deal team for a pending acquisition, operational managers are often challenged with how to develop reasonable benefit forecasts and integration plans when very little supporting information is available. Typically, interviews of the target's operational managers are off limits, and little detailed planning has been conducted.

Despite these limitations, the integration effort is expected to start quickly after "Legal Day One," and there is typically little time for operational due diligence before then. One aspect of Nolan's engagements on acquisitions involves helping clients prepare for and be in a strong position to quickly validate assumptions (and make necessary adjustments) between the time an acquisition announcement is made and the target company is legally acquired. Three critical activities are:

1. ***Create an Acquisition Integration Team (AIT)*** – Due to confidentiality concerns, an initial deal team is usually composed only of the most senior management plus financial and legal advisors. Usually, operational managers are not brought in until a financial deal is close to being struck, but that doesn't mean that operational managers must sit idle. If a company's strategic plan includes acquisitions, it is only practical to assign a team to develop operational due diligence and integration frameworks. There may

be many members on this team, as just about any acquisition will touch a wide cross-section of the acquiring company's organization. When building the team, it is highly valuable to include staff members who have been through an acquisition—from either the acquiring or acquired perspective. Lessons learned and previous planning experience will translate to valuable insights for team members without that experience.

2. ***Create an "Acquisition Playbook"*** – When the AIT is brought into a deal, there are four major activities driven by two key dates. The dates are "Announcement Day" and "Legal Day One." Two critical efforts must be executed swiftly between these two dates:

    a. **Conduct on-site operational due diligence** of the target company to validate and/or adjust assumptions and forecasts regarding the integrated organization.

    b. **Finalize the details** of what will take place on Legal Day One, when the acquiring company formally takes over the target company's operations.

    And, there are two major streams of work that must be executed starting on Legal Day One:

    c. **Continue regular day-to-day operations.** This can be much more complex than expected. Many of the target company's management staff will, out of necessity, refocus on integration activities as opposed to their normal operating duties. New priorities, reporting relationships, and approval processes will also be needed, adding to the workload as well.

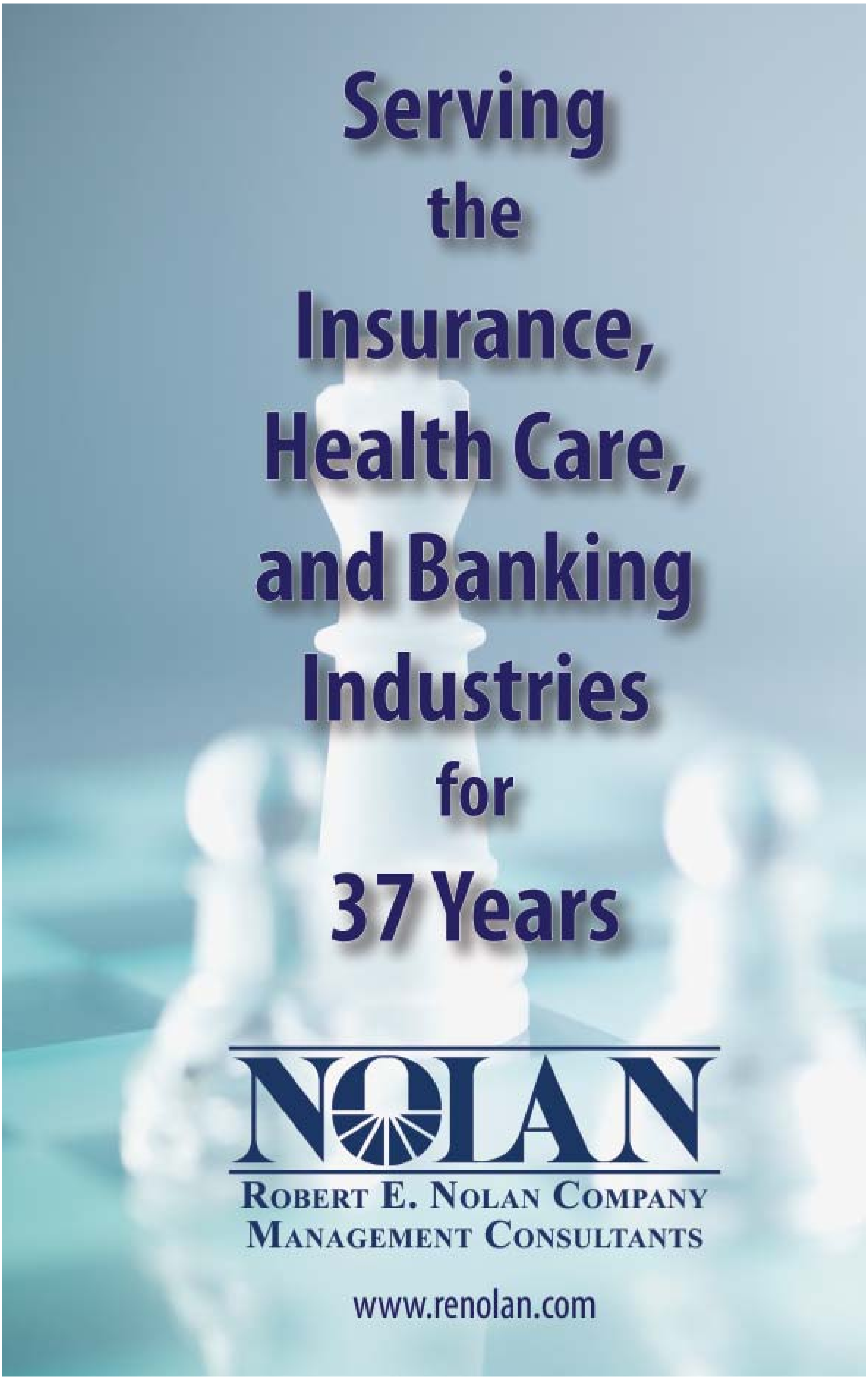
    Being prepared with the right execution framework, tools, and organization structure is the key to a successful integration.

    d. **Execute integration activities.** Hundreds of new activities will be launched simultaneously on Legal Day One by both the target company and the acquiring company, most of which have to be finely coordinated—a detailed action plan, establish appropriate and definitive authorities, develop a proactive and multifaceted communication plan, and define escalation procedures to address integration problems and unforeseen issues that will definitely arise.

    When all these activities are taken together, the plans may encompass thousands of tasks. However, an integration team may be given a window of only 4–8 weeks to develop them! Most acquisitions have similar core activities—as they say, the devil is in the details. By proactively establishing an AIT prior to an acquisition and developing an “acquisition playbook” with templates for the activities previously noted, the AIT will be ready to act quickly and eliminate the costly mistake of making it up as they go.

3. ***Define “Done”*** – With integrations there is a tendency to place certain activities into the integration plan when in fact they actually belong in the scope of daily operations. This creates a never-ending integration effort. The goal of the AIT is to phase out the integration efforts as quickly as possible. Significant management discipline is needed to ensure that only integration-related projects and activities remain on the integration plan and to reclassify tasks back to the day-to-day management environment as quickly as possible and without mercy.

Acquisition integration, much like consolidation, is among the most complex and difficult activities that most managers will face in their careers. Being prepared with the right execution framework, tools, and organization structure is the key to a successful integration. ▪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The Speed and Cost of Complexity

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It’s a warm, sunny Sunday at the end of summer, with hardly a cloud in the sky and only a slight breeze to disturb the tranquility. Thus all the harder to believe that the earth is spinning on its axis at 1,000 miles per hour and orbiting the sun at an incomprehensible 67,000 miles per hour. There isn’t the slightest indication that anything is moving except for the butterfly that just darted by.

With all this spinning and hurling, why don’t we get dizzy or at least have some sense of motion? Isn’t it reasonable to think we’d feel something?

But frequent fliers will agree that after takeoff, once the plane’s speed becomes constant, there is little sensation of movement. The constant rush of movement produces the sensation of no movement at all. When something becomes constant or omnipresent, we stop noticing it.

Perhaps that’s why the complexity that afflicts most businesses is so insidious. It spreads at such an astounding pace and seeps into so much of the day-to-day routine that we don’t notice it. But it’s there and it’s costing your business more than you think.

Complexity is like an iceberg with only a fraction of its mass visible above the water and most of its bulk hidden below the surface. What’s hidden below the surface is what drives disproportionate cost in your organization. Costs related to complex products and services that were devised by some of your best and brightest employees. This makes it even harder for executives to recognize the unintended but nonetheless negative impact of complexity; they simply cannot believe that the work of their smartest employees is hurting, not helping, the economic health of their organization.

Like the movement of our planet or the hidden mass of an iceberg below the surface of the sea, complexity is not easy to see, and it didn’t get there in one giant leap. It got there one decision, one idea, one “enhancement” at a time—all piled up, layer upon layer.

Need to energize your sales force and give your revenue line a jolt? Just add one or two new, innovative features to an existing product line; give it a new name; introduce some updated marketing collateral; and you’re on your way to reaping new profits. Not so fast...

Even small extensions in a product or service have hidden dimensions. Supporting processes and technology and administrative and marketing overhead are just some of the hidden costs that come along with even a tweak to a product or service. And if your staff is really innovative in terms of what they can dream up, the associated process and infrastructure costs go up exponentially.

Complexity that comes from meeting real customer needs or demands, however, is a necessary cost of doing business. Complexity that feeds the ego of star performers without adding real value for the customer and the bottom line is pernicious and needs to be rooted out. Being able to distinguish between customer demand and complexity for complexity's sake isn't always easy. One way to do this is to insist on rigorous profitability analysis, not mere "business case" justification, for new product and service initiatives.

Of course, this assumes that your organization has the ability to measure product or service profitability in the first place. This is often one of the most important and least understood weapons in the war against complexity.

How often are the business cases used to justify a new product or service put to the analytical test to determine the resulting impact on profitability? And even if this analysis is performed, does it address the hidden costs of complexity, or does it address only the 20% of costs that are visible above the water line? In most cases, the answer is that the analysis sees only the easily seen.

Undertaking rigorous profitability analysis entails more than a cursory look at sales, revenue, and standard operating costs. The costs associated with complexity got there bit-by-bit over time, and it can take detective work to uncover the layers that have built up. Doing this can be hard work, but it's worth the effort to understand how complexity is impacting your organization's performance, the rate at which it is using up your capital, how it is degrading staff productivity, and whether it is contributing to or detracting from your bottom line.

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Because finding the costs of complexity can be hard, it's no wonder that traditional cost reduction efforts often fall short of the mark in terms of producing significant and sustainable changes in cost structure. One-time, ad hoc attempts to ratchet down costs usually miss the expenses that, if found and eradicated, would transform your company's cost structure. And even if you find those costs, it's for naught unless you commit to eliminating the non-value-added activity that produced them in the first place.

Understanding the rate at which complexity drives up costs—and the corresponding extent to which gratuitous variety does nothing for customer value—is the key. The costs of complexity can be found dispersed throughout your organization:

- More administrative staff to handle new, more complicated work processes
- More IT investment as applications have to be updated to support more complex processes
- Whole new functional areas that sprout up to support product extensions and "coordinate" new activities across organizational lines

Cost-cutting measures that are not focused on finding and rooting out complexity are doomed to fail and be repeated at predictable intervals. That's because the problems they end up fixing never ferret out the costs that remain hidden from view, draining profits.

Defining the metrics that quantify the cost of complexity can help you understand which intricacies really matter to your customers and drive profit versus those that merely add cost without adding to the bottom line. Only by measuring the right things can you distinguish good from bad complexity.

Defining the metrics that quantify the cost of complexity can help you understand which intricacies really matter to your customers and drive profit.

Products and services are changing at a frenetic pace—almost as fast as the earth's relentless motion through space. Making sure your organization takes note of the impact this speed is having on your costs can set you apart and help you win the battle against complexity.

Effective innovation demands an understanding of the total cost of delivery. Of course, you must respond to customer demand for variety. But ignore the hidden costs of complexity at your own peril. ▪

Revenue Down, Claims Up, Expenses Flat—Oh, My!

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The long view forward is worse than Dorothy's when she looked down the yellow brick road and imagined lions, tigers, and bears ("Oh, my!").

Lacking a pair of magical ruby slippers, we see companies pursuing two distinctively different approaches to this long-term challenge of aligning operating expenses with the new normal of lower expenses and higher claims. Some are pursuing transformational strategies to achieve a significant shift in cost structures. Others are taking the traditional approach of increasingly tighter annual expense control.

Both approaches have risks. The risks are primarily related to time. The transformational strategy faces the risk that the organization will not be able to pull off the change in the timeframe needed to significantly impact expenses. The current economic environment may continue so long that the traditional, incremental approach ends up in a dead end where service starts taking a serious hit—further hurting both revenues and claims.

Our thinking is that the transformational strategy will produce more long-term winners than the incremental approach. Why? Two reasons:

- The risks are internal and can be managed. You can build or buy the capabilities needed to implement the changes. By contrast, the economic environment is external and can't be managed, at least not by one company or industry.
- When the economic environment improves, the organizations pursuing a transformational strategy will be in a strong position to compete against companies that have had to cut their way to near death.

The challenge that many organizations face in considering the transformational strategy path is leadership. Leaders are needed that can see an opportunity that is beyond reach and create the organizational energy and focus around it which makes it seem possible. Some examples we are seeing:

- Moving to one common administrative platform and sunsetting all the costly legacy systems currently supported.
- Creating a real and meaningful self-service environment.

- Bringing predictive analytics into a process that yields faster, better, and cheaper delivery.
- Developing electronic communication capabilities that kill print costs and drive greater success in the acquisition process.
- Dealing creatively with closed blocks of business to kill the resource drain and risks.

These are all hard initiatives to think about in challenging times like these. The two key questions are:

- Where do you want to be when this environment turns?
- Do you have the leadership on your team to drive transformational change?

We hope this article creates some interesting conversations in your planning sessions this year. If you would like help in preparing for or facilitating these conversations, please give us a call. ▪

New Technologies for Sales & Services

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While most insurance company websites are useful, they are a bit passive both in presentation and interaction. However, the opportunity to employ technology to attract sales and build stronger customer relationships has never been better.

Here are three key technology concepts you can use to guide the design of your sales and service processes:

1. **Process Autonomy.** Design a highly interactive website that pulls the prospect through an iterative process that presents information specific to that individual based on a combination of their expressed interest, goals, and answers to well-formulated questions. This enables prospects to build a solution best for them, either during or prior to a consultation and tweaking session with a professional agent or broker.
2. **Transaction Transparency.** The typical customer has little or no understanding of what happens after he or she answers all the questions. Not knowing what is happening can be frustrating and can even reverse the purchasing decision. Enabling applicants and agents to look in on the company on a real-time basis and see the progress their case is making through the process takes away the mystery and keeps them engaged.
3. **Social Networking.** Customer and agent surveys are very useful, but even more effective are individual dialogues to better understand what they are looking for from you. This information becomes invaluable for product design, customer service, and future technology improvements.

These technologies are already in general use in other industries, from courier service tracking to pizza delivery. Banks to car companies are making use of social networks for web-based customer panels. Some auto repair shops enable their customers to log in and see their cars being worked on. These emerging "cool" features will, like many emerging technologies, become the standard expected from every company. Couple all of this with Internet-enabled mobile devices, and agents and customers are totally engaged in the process, including prospecting, sales, application, service, and benefits. ▪

Nolan Events

IASA Executive EDGE
September 26-28, 2010 - Oakbrook, IL
Join Nolan at this event to be held at Oakbrook Hills Marriott Resort in Oakbrook, Illinois. Nolan Executive Vice President Rod Travers will be moderating the State of the Industry on Monday, Sept. 27 at 9:00 a.m. Nolan is pleased to be a break sponsor at this event - *www.iasa.org*

101st International Claim Association Annual Education Conference
October 3-6, 2010 - Austin, TX
Join Nolan Executive Vice President Kim Wilkes at this event to be held at The Renaissance Hotel in Austin, Texas - *www.claim.org*

California Association of Health Plans' 25th Annual Conference
October 18-20, 2010 - Indian Wells, CA
Join Nolan Vice President Merit Smith at the Annual CAHP Conference to be held at The Renaissance Esmeralda Resort in Indian Wells, California - *www.calhealthplans.org*

Texas Rural Health Forum
November 10-11, 2010 - Austin, TX
Join Nolan Vice President Merit Smith at the Texas Rural Health Forum to be held at The Renaissance Hotel in Austin, Texas - *www.tha.org*

2010 Property Insurance Report National Conference
November 14-16, 2010 - Dana Point, CA
Join Nolan Executive Vice President Steve Discher at the annual PIR National Conference to be held at The Ritz-Carlton in Dana Point, California - *www.riskinformation.com*

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