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ANOTHER PERSPECTIVE

EXPENSE MANAGEMENT

How To Cut Costs Without Cutting Your Own Throat

A self-pruning insurer will be able to reduce expenses naturally

BY LARRY BORGEN

INSURANCE COMPANIES must effectively manage expenses to thrive in today's increasingly competitive marketplace—some will need to do so to survive. The trouble is most companies struggle with the process.

Company "A" executes one chainsaw layoff massacre after another, resulting in a permanent morale malaise. Conversely, Insurer "B" avoids the chopping block like the plague, periodically trims, and gets a few short-term, painless gains.

Both achieve band-aid solutions, but neither solves its long-term competitive problems. Where do you cut, how much is enough, and will it ever make a difference?

Insurers can look to nature for answers here. Arborists know healthy trees require a sound fundamental base of good soil, nutrients, climate and proper planting. Given this, trees flourish but eventually need pruning. Otherwise overgrowth occurs, new budding is hindered, and disease and weather threaten. Sound familiar?

Given an efficient organizational structure, competitive products, market potential and talented people, an insurer should compete well. Yet even growing, profitable companies need a long-term expense management plan. However,

leaders often make the same mistake my dad made pruning in the backyard—they hack too much off. The resulting shock

sometimes causes permanent damage.

When today's employees hear cost-cutting rumors, most react as horrifically as mom did when she caught sight of old pop, sawing tree limbs.

In Company "A," office doors get closed, anxious speculation mounts, and people gulp antacids. Productivity drops like a rock. Some CEOs eventually become casualties. A merger or acquisition is another's fate. Meanwhile, benevolent Insurer "B" avoids sacred cows and cuts carefully, but like the timid backyard pruner, nothing meaningful is attained and the organization never reaches its potential.

All this angst is unnecessary. Companies can achieve long-term fixes. I learned literally at dad's feet in the backyard.

Arborists now trim and care for my trees. The upfront expense isn't pleasant, but well-pruned trees look good, and the expert is well worth the cost. Likewise, insurer CEOs can seek outside help to analyze their companies and design solutions to long-term organizational challenges.

However, whether firms go external or internal, it is important they avoid a dictatorial top-down process. Employees will



Just like trees, insurers flourish when properly pruned. Carriers need a long-term expense management plan that doesn't hack off too much, too quickly, undermining morale and productivity.

buy-in as long as they understand the need for long-term efficiency and can participate in the planning and implementation phases.

Let's assume your company's fundamentals (mentioned earlier) are sound, and you want to tackle expenses. A three-step approach to manage this is often helpful.

► **Step one**, make sure all employees understand what's expected of them. You need—if you don't already have it—a long-term expense management goal.

It all starts with an annual expense ratio target. People must understand why this objective is needed so they can do their part to contribute.

"Expense allowables" help employees grasp this concept. An expense allowable is a formula that determines how much money your team or unit can afford to spend, based on what they do and the value they bring to their stakeholders.

These numbers should tie into your company's strategic plan and product pricing assumptions. Your teams or units eventually evolve into mini-profit-centers that manage revenue and expenses to attain operational profits.

Expense allowables get people focused. They translate into manageable individual and team goals.

► **Step two** requires you to give your people the proper organizational structure, processes and tools needed to do the job.

This is critical to achieving your expense goal. Step two resolves such problems as self-serving fiefdoms, fractured work processes, poorly designed jobs, inefficient computer systems, too many managers, and dead-end career paths for technical people.

Your employees, guided properly, should create and implement the desired changes for best results.

Companies often struggle with this second step. Most are often traditionally structured companies with defined functions such as underwriting, claims and loss prevention. These areas typically evolve into fiefdoms that resist change, protect budgets

and communicate poorly with their functional peers.

The result is an internally focused silo. Frustrated customers deal with multiple insurer contacts, and often the left hand isn't sure what the right is doing.

Fractured work processes plague other insurers. A claim file passes from one employee to another, then gets buried in a manager's paper stack. These firms have more handoffs than an Olympic relay race.

Many carriers suffer from dead-end career paths. Gifted technical people get promoted to managers in these organizations. Sometimes, these technicians-turned-supervisors are successful. Usually they're not, the Peter Principle gets upheld yet again, and the employee goes elsewhere with their expertise.

The good news is these problems are solvable, and you don't even have to uproot the tree. An expert can guide you. They'll use industry experience, best practices and your brightest employees to help create and implement the desired changes.

Once you've implemented the first two steps, you've planted the seed for the next initiative in this process.

► **Step three** for effectively managing expenses is creating an ownership culture. Translated, this means employees who are motivated to mind the store and turn a profit.

How in the world does one do that? The answer is team-based incentive compensation programs that reward profitability with individual quarterly bonuses for all team members.

Once people understand how their contributions and those of their profit center impact the bottom line and their own pocketbooks, private enterprise instincts take over. They design more efficient work processes and eliminate hand-offs. Slackers disappear as peer pressure mounts to

CHECKLIST

TEAM APPROACH WORKS BEST

Insurers eager to tackle expenses and boost the bottom line should:

- ✓ Make sure **all employees understand** what's expected of them.
- ✓ Explain **why this objective is needed** so they can do their part to contribute.
- ✓ Give people the **proper organizational structure**, processes and tools needed to do the job.
- ✓ Create an **ownership culture**, so that employees are motivated to mind the store and turn a profit.
- ✓ Establish **team-based incentive compensation** programs that reward profitability with individual bonuses.

work hard.

Amazingly, interpersonal conflicts even diminish. You referee fewer squabbles as teams settle their own differences to prevent quality issues. Customers get excellent service because it makes sense to do so.

Your teams develop a bottom-line mentality and a hunger for understanding insurance company finance, so you teach them. This is not a traditional profit-sharing program where employees mysteriously receive or miss annual payments. People know where they stand, what they must do, and naturally operate as true business owners.

The old "it's not my job" mentality disappears as people cross-train, pitch-in and work together.

The result is happier customers and a healthy bottom line.

Put it all together and you have a perpetually self-pruning insurance company. Large periodic hacks become unnecessary because each branch of the organization naturally trims the fat as they grow. Now, if only my backyard tree could do that. ■

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