

How Much Change Do You Need?

This is our second letter on what insurance companies can do to become more competitive and take advantage of today's economic environment.

Last month I wrote about today's difficult economic environment and the challenges this presents to our industry. This is a time when everyone is intensely focused on the price they pay for everything, including insurance and financial services. Our industry has recognized and even encouraged this. We have auto and other insurance companies who advertise solely on having the lowest price. On-line brokers advertise they offer the cheapest term insurance. And a few insurance companies flush with cash from the recent hard market have decided to artificially lower prices and buy market share.

This has created marketplaces where price (which was always important) is now even more important. Companies who relied on "value" or "relationships" and allowed their price-competitiveness to slip are finding this strategy isn't working any more. Price, value and relationships in today's market go hand-in-hand. If you do not have a reasonable price, i.e., a price that is comparable to your competition, your customers and agents will assume the value isn't there either and the relationship crumbles.

But some of these insurance companies offering competitive prices are doing it the right way. They have realigned their cost structures so they can compete in today's marketplace and still attain the other financial goals necessary to ensure long term success. We know they are there because many of them are our clients.

This is why I strongly urge you to see the current difficult market as an opportunity and to take advantage of this adversity by joining the companies who have redesigned themselves, reduced their cost structure and made other fundamental improvements in the way they operate. They have done this to ensure their success not only in today's environment but also into the future. With a little courage and hard work, you can turn our current difficult economic situation into a catalyst for change and the best thing that ever happened to you and your company.

Let's assume you want to do something truly significant or are willing to at least consider it. What do you do? And, most importantly, what is the next step? The first thing you need to do is to identify the amount of change you need. Everything else you do or might do hinges on this. You need to know if you only need to make small incremental changes to attain the competitiveness you need or if you need large fundamental changes to get there. If you only need small, incremental changes, you can probably make them on your own. Larger, fundamental changes will require outside expert help.

We usually recommend that clients who want 10% or less improvement in expenses do the work without outside assistance. This assumes you have strong management support and a good management team. You can always get "spot" assistance from a firm like ours on an as needed basis. If you want more than 10% you should consider outside help. If you need more than 20%, outside help is definitely needed, especially if you want to make changes that will provide permanent and long term benefits and not have to redo them in the next year or two. Working on this level of change requires an experienced guide to ensure you get a sound, practical blueprint that will produce the results your company needs.

Here are the steps you should follow to determine the amount of change you need:

1. Determine where you want your competitive position to be in your marketplace.

This is usually expressed as a part of your marketing strategy. At a minimum you need to identify your market, who your competition is and where you want your price to be within this market. Be as specific as possible. Do you want to have and maintain the best price in your market or do you just want to be better than specific competitors? Focus just on the price. Do not do anything to decrease profitability or other goals that might negatively impact the long term success of the company.

This research may identify product and other changes you should consider. These are important, but don't let these new ideas hinder your work on becoming competitive. Assign them as parallel projects and integrate them at a later date. It is also important that you establish ways to keep the competitive data you accumulated up-to-date. Once you attain the pricing success you need, you will want to maintain this advantage. It is a moving target and you will need new data continually to keep up.

The result of this exercise will be a specific marketing strategy that defines what you need to attain to be successful in today's environment within your market.

2. Identify what you need to attain at a corporate level to get to this new competitive position.

There are only a few areas you can change that will help. You may be able to get some help from increasing investment returns. Some companies can improve loss ratios by managing their claims better. (We'll talk about this next month.) The biggest area for improvement is almost always in reducing operating expenses but you have to do this without damaging customer satisfaction. This is usually the best answer because every dollar you get from reducing costs goes directly to the company's bottom line. It has an immediate and direct impact on your ability to be competitive.

Once you determine how much you need to reduce operating costs, change your corporate core success measures.

3. Translate these corporate goals into department goals where they can be implemented.

This is the step where your corporate goals become "up close and personal" for your employees. This is where you determine new expense goals for each department. Not every area in the company will be able to reduce costs in the same manner or to the same degree but every area must participate. Establishing new departmental goals lets everyone know you are serious about this transition and that they will all be an important part of it. It also tells you where the major changes must occur and where the rest of the project will focus.

Since growing is one of the main reasons for making these changes, you need to understand which departments have costs that are directly impacted by sales growth and which do not. This can be most effectively reflected by establishing *expense allowables* for each department. These are formula driven expense goals that increase or decrease during the year depending on the specific factors that drive costs within each department. They ensure that departments make the best decisions throughout the year as sales and other results occur. To read more about this concept, please see our letter from August, 2002 entitled [Is It Time to Move to Expense Allowables](#) on our website or call me and I'll send it to you.

4. Create an environment where every employee wants to continually beat their goals.

This is where you connect incentive compensation to your new business strategy so each employee has a personal reason for wanting this new effort to be successful. This step is not necessary to accomplish this redesign but the benefits are so significant it must be mentioned. The best approach is to install a gainsharing type incentive plan that ties each employee to his or her team or departmental results.

If you would like assistance in doing the things described in this letter, please call me. Also, please visit our website at McDonaldConsultingGroup.com, where you'll find further explanations of these ideas (and other exciting ideas) in our Concepts and Ideas section.

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