

# A New Attitude

Three workers' compensation insurers improved their financial results through fundamental change.

by Lawrence W. Borgen

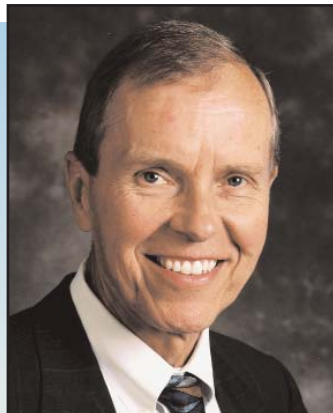
While property/casualty insurers are enjoying the significant price increases accompanying the hardening market, some company leaders have realized that inherent weaknesses within their organizations are holding back results.

*Lawrence W. Borgen is a senior management consultant with McDonald Consulting Group, Minneapolis.*

They feel compelled to act quickly and boldly to ensure long-term success by addressing such key factors as account growth, customer satisfaction and productivity.

Among the insurers who have realized improved results after they embraced fundamental change are three workers' compensation firms—two state-run funds and a for-profit company. The relatively new practices

they used depart from traditional industry practice by organizing around customers instead of such functions as underwriting, claims and loss control. In this new environment, multifunctional teams manage profit centers designed around major customer segments or premium categories. The new structures have fewer layers of management and increased spans of control. People operate under a team-based



“People feel more accountable to their peers.”

—Gary Pon,  
President and CEO

#### **Pinnacol Assurance**

**Headquarters:** Denver

**Description:** Pinnacol Assurance, Colorado's largest workers' compensation insurer according to the A.M. Best Co., is a nonprofit provider.

**Number of Active Policies:** 53,647 (as of Dec. 31, 2001)

**Total Revenue in 2001:** \$461 million



“To impact performance, you have to change behaviors.”

—Carl Swanson,  
President and CEO

#### **Montana State Fund**

**Headquarters:** Helena, Mont.

**Description:** Montana State Fund, Montana's largest workers' compensation insurer according to the A.M. Best Co., is an independent, publicly owned and self-funded corporation.

**Number of Written Policies:** 26,747 (as of Oct. 1, 2002)

**Total Revenue in Fiscal Year 2001:** \$106 million



“Continuous improvement is the only constant.”

—James C. Epolito,  
President and CEO

#### **Accident Fund Co.**

**Headquarters:** Lansing, Mich.

**Description:** Accident Fund Co., Michigan's largest workers' compensation insurer according to the A.M. Best Co., is a wholly-owned subsidiary of Blue Cross Blue Shield of Michigan.

**Total Revenue in 2001:** \$259 million

incentive program called gainsharing, and earn a percentage of the incremental profits they produce. Former rank-and-file employees adopt a business owner's mentality once they see what is possible. Customers and agents have one contact who can handle all or most of their needs.

Chief executives who are able to fundamentally change an organization start by getting their senior management team on board. Then they select the best and brightest in the company and allow them to develop the plan details and implement their recommendations. Guided by an industry-experienced outside consultant, this employee design team replaces the usual top-down planning process. Senior management interferes little in the process, but is briefed regularly. During this design phase, employees are given information about ongoing developments and have ample opportunities to ask questions. Companies take pains to overcommunicate during this critical stage to address any concerns and quell rumors.

Eventually recommendations are given to senior management for approval, followed by implementation. Follow-up audits are completed months later to ensure the organization stays on course. Carriers who have implemented this new change strategy are seeing dramatic results.

### **Initiating Change**

What would prompt seasoned chief executives to buck decades of traditional management thinking when financials are improving?

For Carl Swanson, president and chief executive officer of the Montana State Fund, a large motivator was discovering that a lack of employee trust was limiting potential in his and other organizations. After studying opinion surveys of several firms, including his own, he found that only about half of the employees trusted senior management. It was apparent people felt out of the loop and unable to impact decisions. "In traditional silo organizations, you will typically find top-down decision making," said Swanson. "When you have that, you will never have the trust

you are looking for, nor will you ever see the level of empowerment or decision making you want. It was not the kind of environment we wanted at the Montana State Fund."

The state's largest workers' comp carrier, the Montana State Fund insures more than 25,000 Montana businesses. The fund was established by the legislature to be a competitive state fund, providing market stability and a guaranteed market for all employers.

Swanson became convinced that the fund's traditional operational structure did not promote the kind of communication and cooperation required to adequately serve customer needs. "Our old organization was designed to suit us, not our customers," he said. The solution was to devise multifunctional teams and organize them around customers.

Pinnacol Assurance, Colorado's largest workers' comp insurance writer, had come to similar conclusions. "Our combined ratio was up, premiums were down and we had more employees than ever," said Gary Pon, president and chief executive officer.

Research showed that customers and brokers thought Pinnacol Assurance (then named Colorado Compensation Insurance Authority) was too bureaucratic. A common complaint was that multiple phone calls were needed to get answers. "The view was there was a lot of passing of the baton," said Pon. Since baton passes win races and not customers, something had to give, and that was Pinnacol Assurance's structure and way of doing business.

But first, Pinnacol Assurance executives needed to be convinced. They embraced the new vision after being asked to visualize what they thought was the perfect organization. There turned out to be a lot of similarities between their thoughts and the elements of fundamental change. The company then broke up its traditional functional departments and reorganized.

Having witnessed Pinnacol Assurance's experience, the Montana State Fund became convinced of the merits of fundamental change but knew there would be challenges. Swanson felt

that employee attitudes were just as important as the new structure and the new programs being introduced. To deal with the human equation, Montana took an additional step and used a prominent attitude development program to help people adjust their perspectives. "In order to achieve organizational goals and objectives, you have to impact performance, and to impact performance, you have to change behaviors," said Swanson. "Our work on attitudes reinforced the organizational changes we were making."

### **Bottom-Line Benefits**

A new culture now exists at the Montana State Fund. Senior executives agree a business owner's mentality envelops the organization. Lanny Hubbard, vice president of Montana's multifunctional teams, sees a deeper sense of caring for customers. "You give a person who used to just process applications a chance to step out of that box and they shine," Hubbard said. "People are hungry to provide the best service they can." Design group member Jill Lotter, who became vice president of operations support, elaborated, "We now have a customer-focused, employee-empowered organization that can move swiftly in a fast-changing world."

As "business owners" in fundamentally changed organizations, team members need and receive financial information to make the right decisions to achieve profitability. "If we are asking people to manage their businesses and to be entrepreneurs, you have to share information," said Jeff Tetric, chief financial officer of Pinnacol Assurance. "People want to know how to make their units more profitable, so we run Accounting 101 classes for team leaders and employees. They also meet with our external actuaries every quarter to go over reserves and how loss ratios are calculated. Then we help them analyze the information." Financial analysts are also assigned to each team, said Tetric. Employees haven't become financial experts, but they are catching on faster than you would think. "When you tie peoples' compensation to

[financials], you get their interest," Tetrick said.

This collective focus on profitability produces impressive results in most companies. Quality and customer service improve and retention is increased. Attention turns to reducing expenses and losses. Business is underwritten more carefully. Meanwhile, employees naturally cross-train each other, absenteeism drops and processing efficiencies are sought. The result? New business and renewal premium increase, expenses subside and loss ratios improve. Combined ratios begin dropping.

Pinnacol Assurance's Pon cites several bottom-line benefits. "The year following implementation, our combined ratio dropped from 115 to 105," said Pon. "During the same time, premiums increased from \$238 million to \$272 million, and net income from \$16 million to \$28 million."

"Shortly, we will have enough surplus to begin paying dividends to policyholders, something we haven't been able to do for 25 years," said Tetrick. The hard market undoubtedly helped, but much of the gains were directly related to Pinnacol Assurance's fundamental changes, said Pon. The results were achieved during a period in which Pinnacol Assurance's employee count dropped from 595 to 482.

Fundamental change was also a milestone event for the Montana State Fund, said Swanson. "We had improved dramatically in recent years, but we had stagnated," he said. "The redesign was the breakthrough we needed. We are now the insurer and employer of choice in Montana. Our premium writings have increased 47% since we implemented the fundamental change, going from \$70 million to an estimated \$104 million for 2002." Swanson reports that customers and agents are experiencing first hand the improved customer focus and services. "At the same time, our expense ratio, not including dividends expense to our customers, has decreased 10% over that same time to 30%," he said.

### Going Private

Unlike the two not-for-profit state

workers' comp funds in Montana and Colorado, Accident Fund Co., Lansing, Mich., demonstrates how a for-profit venture also has used fundamental change in its structure to improve customer service and increase profits. Accident Fund operated in a bureaucratic fashion because it was the former state workers' comp fund. When the state of Michigan privatized the company in 1995, the sale became the largest such transaction on record in America. But simply becoming a private, for-profit venture did not mean Accident Fund operated any differently.

The strategy to changing its approach to the marketplace began with defining the company's No. 1 customer: the independent insurance agent. "We realized immediately that we had to create the feeling among agents that they are our partners," said President and CEO James C. Epolito. "We took the approach that everything we did had to respond to the wants, needs and expectations of insurance agents across the state." Epolito explained that the company's top-down, civil service structure "made it difficult for agents to do business with us. Communication flow regarding customer needs and interaction was very poor."

During late 1998 and early 1999, Accident Fund's leadership team created a business development unit. This unit combined underwriting, marketing, policy processing, loss prevention and premium audit, focusing on the agent. "But even though these functions reported to a single vice president, communication didn't improve as much as we hoped," said Epolito. "We determined we needed to go a step further to create multifunctional teams that would directly serve all aspects of an agent's interaction with our company."

The teams were formed geographically because in Michigan insured businesses differ widely depending on their location. For example, Northern Michigan employers typically face risks that differ from those faced by employers in the southeastern or southwestern corners of the state.

Attention was focused on expense control and process improvement. New ways to use resources, such as loss prevention, were also considered in an attempt to return greater value to the company.

The results? "The years since our business development reorganization in 1998 have been nothing short of amazing," Epolito said. "We started this process with net premium at \$115 million in 1999 and we have more than doubled our net premium since then. We expect our net premium this year to be approximately \$350 million. We have gone from a 12% market share in Michigan to a 20% market share. And, most importantly, our agent loyalty rating has gone from 79% in 1999 to 89% in 2001." Epolito said agents were thrilled with the intense focus on them and this created greater partnerships.

"Accident Fund's success story has even more chapters," Epolito said, "but it all began with a fundamental change in our structure that recreated the way we looked at our No. 1 customer—our agents." Epolito said the company's subsequent efforts took the attitude of fundamental change and applied it to the claims department, and, most importantly, to its ongoing national expansion. "We realized through this process that changing the way we do business is the only way we're going to expand our business," said Epolito. "Continuous improvement is the only constant."

### Shared Goals

Insurers generally see broad improvements but often target one problem area for specific attention. Montana decided to focus on reducing losses. Prudent underwriting and pricing were targeted. "We had done quite a bit on the expense side already, so losses were targeted," said Mark Barry, corporate support vice president for the Montana State Fund. According to Barry, multifunctional teams have done a "very good" job of managing Montana's book of business, and have improved the firm's system infrastructure. The result? A 6% reduction in the firm's combined ratio. "Over this period, our

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teams have generated gains for the organization and themselves," he said.

The latter comment refers to the gainsharing, team-based incentive program Montana implemented. Unlike traditional profit-sharing plans, payouts are based on business unit profitability and they are earned quarterly. The multifunctional team members who manage these profit centers earn a percentage of the additional profits. The program formula includes losses, expenses, revenues and usually customer satisfaction measures.

Spurred on by gainsharing, the entire organization evolves naturally into a customer-focused, profit-oriented operation. When inefficiencies are spotted, they are immediately reme-

died. "People feel more accountable to their peers," said Pon. "There is no place to hide. Everyone shares common goals."

Indeed, the "not-my-job" attitude soon disappears in fundamentally changed organizations. People cover for each other because it is in everyone's best interest to do so. Employees who fail to pull their weight get carried, but only temporarily. Team members are patient in training their peers, and in fundamentally changed organizations, managers concentrate on coaching these individuals. But if one's attitude, effort or ability is lacking, the team does not tolerate it long. The affected employee typically leaves voluntarily, or is reassigned.

Customers and agents notice the difference almost immediately. "Brokers are raving about Pinnacol Assurance," said Pon. The Montana State Fund has also seen dramatic increases in customer service. "The results and feedback we have received from our Agents Advisory Council absolutely knocked my socks off," said an amazed Swanson. "Council members are telling us we have achieved our mission."

While CEOs Swanson and Pon are pleased with the results, they and their senior managers agree fundamental change requires tenacity. "It's so easy to quit and take 80% of the benefits," said Pinnacol Assurance CFO Tetrick, "but that last 20% is so worthwhile." **BR**