

Business Performance Management Case Study - Health Insurance Company

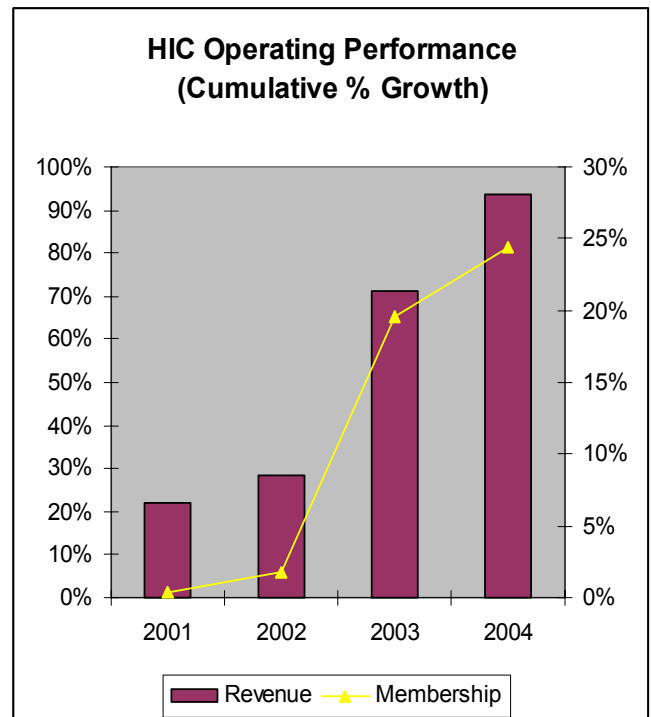
Imagine yourself as the CEO of multi-billion dollar health insurance organization. You have been promoted to that position at a time when poor operating performance and a volatile market have impacted the organization's financial stability, almost to the point where regulatory oversight could be triggered.

Your tasks are to address the acute financial situation, then to determine how to ensure future performance. You have a broad vision for the months and years ahead, but have concerns about the corporate culture and its ability to implement large projects on time and on budget. It may even be that your management bench-strength is insufficient to make your vision a reality.

Move ahead four years. Revenue has doubled, net income has hit more than \$300 million, and membership has jumped almost 30%.

This is the story of how a Health Insurance Company (HIC) successfully turned a challenging financial threat into an opportunity to create long-term, sustainable improvement.

This article reviews how a Health Insurance Company achieved success. Three phases of change – many lessons learned – and five major opportunities for future improvement are described.



STAGES OF THE TURNAROUND

Early in 2000, poor financial performance at HIC began to generate concern. Investment income had buffered three consecutive years of operating losses and the underlying financial health of the organization was not strong.

By 2001, reserves had fallen to the point where it was not clear that investments needed by the business could be made.

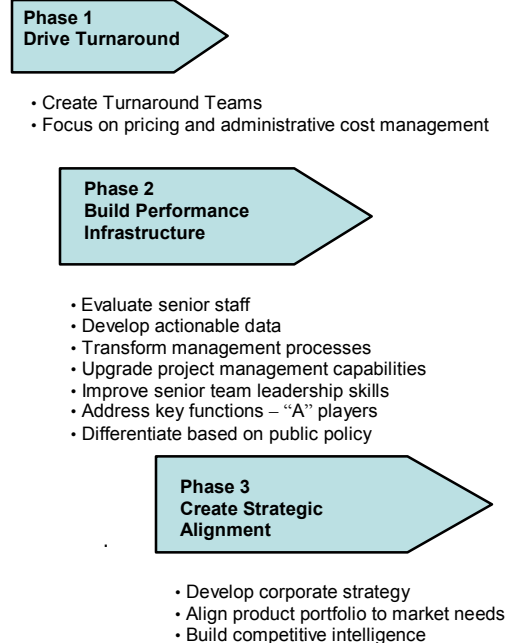
The key drivers of poor performance were uncertain. However, many unsettling facts were evident including:

- “Latency” in the actuarial model meant actual operating performance was not known for up to nine months.
- Lack of pricing discipline by competitors in the market was putting downward pressure on margins.
- The organization had not reduced administrative costs as quickly as competitors.
- HIC was slow to adjust to change due largely to IT and capital constraints, as well as a lack of management tools and processes.

The CEO and COO reviewed performance and identified opportunities for change - they came to believe their two greatest challenges were the lack of a performance-based culture and outdated management processes and tools. It was immediately apparent that extensive effort would be required to address these issues. Over time they developed a strategic phased approach to guide their work (see Figure 3).

In the first phase – **Turnaround** – leadership took immediate action in key operational areas to ensure stability. The length of this phase was approximately nine months. The goal of the second phase – **Build Performance Infrastructure** – was to create the basic building blocks that would enhance and sustain performance. This would be the foundation on which strategic change could be pursued more quickly. The length of this phase was set between three and five years, to overlap with the third phase. In 2004, HIC entered Phase 3, **Strategic Alignment**. The goal of the third phase is to better align products and the provider network with market demands and the realities of HIC’s competitive position. This phase will entail significant structural and business process changes.

Figure 3 HIC’s performance turnaround consisted of three major phases.



Phase 1: Drive Turnaround

This phase was built upon two key tactics:

Create Turnaround Teams. This tactic addressed HIC’s most pressing need, to address short-term gaps in setting rates (pricing) and administrative cost control. Teams in each critical business area were armed with broad authority to implement change. They distinguished themselves as highly motivated and able to move with a sense of urgency, getting results by:

- Remaining small and reporting directly to HIC leadership
- Using a disciplined set of metrics to track progress
- Holding each other accountable by sharing results across the teams

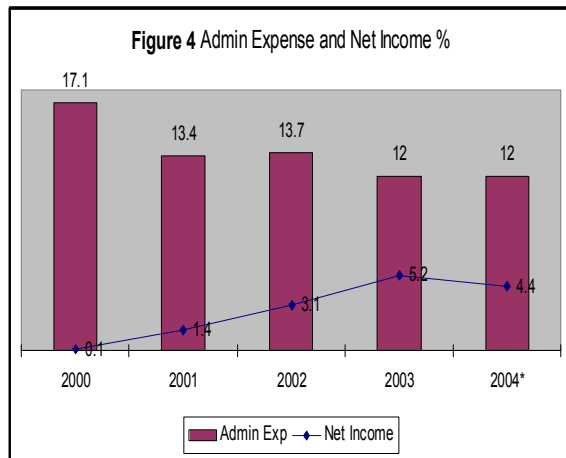
Within six months, HIC made progress toward reducing administrative costs, addressing pricing gaps in the market and stabilizing the level of reserves.

Focus on Administrative Cost Management and Pricing Rigor. Administrative costs and pricing

decisions were two major factors over which HIC held significant control. While the Turnaround Teams

generated some immediate and significant impact in these areas, continued discipline was critical to HIC's continued operating success.

By 2000, despite several years of efforts to reduce expense, administrative costs were not competitive. In the turnaround phase, administrative cost became a focus of management and of the organization as a whole. Administrative cost targets were incorporated into performance expectations and regularly reported (see Figure 4).



At the same time, a flat per member per month (PMPM) administrative cost guideline was incorporated into the budgeting process. Since the targets were first set, managers have been required to reduce costs in their area each year in order to overcome rising inflation.

Finally, leadership encouraged reductions in administrative costs by providing a disproportionate amount of strategic project funds to those cost areas.

To address pricing, HIC determined that existing methodologies were solid but could be made more sophisticated and competitive:

First, the data input process for pricing decisions was improved. HIC used more timely data and increased use of client-specific data to improve accuracy.

Second, HIC reduced the pricing cycle on several lines of business from semi-annual to quarterly to match its competitors and to more accurately price its products.

Finally, HIC redesigned its underwriting model and approach, changing from pooled risk to individual case underwriting. Methods of predicting cost trends

were revised, and tracking systems developed to ensure greater accuracy and accountability.

Phase 2: Build Performance Infrastructure

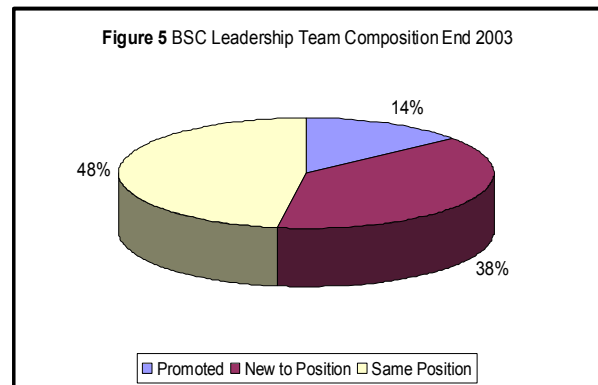
Phase 2 was designed to ensure that HIC did not have to go through another turnaround in the future. The goal was to ensure HIC did not backslide but rather continued to build a performance-based culture and management infrastructure. This has involved many activities rolling out over more than two years and has established a foundation for the Phase 3 strategies. Highlights of the second phase include:

Evaluate Senior Staff. Turnaround Team successes demonstrated the need for different types of leaders and managers. It became clear that top performers in the old culture would not necessarily excel in a new environment which required:

- Commitment to a sense of mission
- Dedication to objective, data driven problem-solving
- Focus on performance and results
- Focus on execution.

HIC started at the top. Fourteen months later, eleven of twenty-one HIC leaders would be new to their positions. While some changes came from natural attrition, most changes were initiated to introduce missing skills and capabilities (see Figure 5).

Changes in the senior management team provided many benefits to the organization - balancing experience with fresh and diverse talent. The result was an increased management capacity, a new level of energy and a willingness to challenge the status quo.



Transform Management Processes. Before 2001, HIC had 12 different planning processes and numerous review committees often covering similar topics. The result was wasted management time and overly subjective decision-making.

Business Performance Management Case Study

Health Insurance Company

HIC created an integrated planning process that reinforced accountability through rigorous and transparent performance tracking. At the helm were five high-level workgroups coordinating strategy and initiative planning across similar business units. The workgroups cut across organizational boundaries, reduced planning silos and created transparency about performance.

Operational planning was improved. Previously, each business unit submitted multiple plans for strategic planning, budgeting and resource planning. These efforts were not coordinated, consolidated, nor evaluated against HIC's strategic objectives. Most plans gathered dust while business unit leaders battled day-to-day issues and concerns.

Improvements were made, from consolidation of planning documents and deadlines, to development of a structured planning tool to consolidate and review all plans. This allowed HIC to adjust plans prior to finalization, resulting in realistic and achievable goals.

The results were striking. The number of projects and initiatives fell from more than three hundred to just sixty, with focus on twelve critical projects. Newly established monthly business reviews shifted from debates about data to problem solving of business issues. The cultural impact of candidly owning and sharing performance issues has been significant.

Upgrade Project Management Capabilities. A number of core capabilities were targeted for improvements in efficiency. Staff responsible for project management, competitive intelligence and quality management needed to be able to do more, more quickly.

By upgrading project management talent, tools and methodologies, HIC is on track to demonstrate best practice in project management, with greater capacity, successful completion of more complex projects, and decreased reliance on outside contractors. Goals for 2005 include a 3% increase in portfolio ROI, 90% "A players" in project management roles, career path and training for project managers, establishment of a project management center of excellence and an overall 25% increase in project execution capacity.

Build Leadership Skills. Strong leadership was a vital element to Phase 1 Turnaround Team successes. In Phase 2, HIC established leadership principles and behaviors to be expected at the Director level and above in the organization. Led personally by the CEO, the HIC management team defined the meaning of personal leadership within HIC and identified how outstanding leadership can help be used to meet business challenges. Designed to provide greater decision-making efficiency, improved decision effectiveness and

ultimately, better performance, the team established the seven Principles of Leadership.

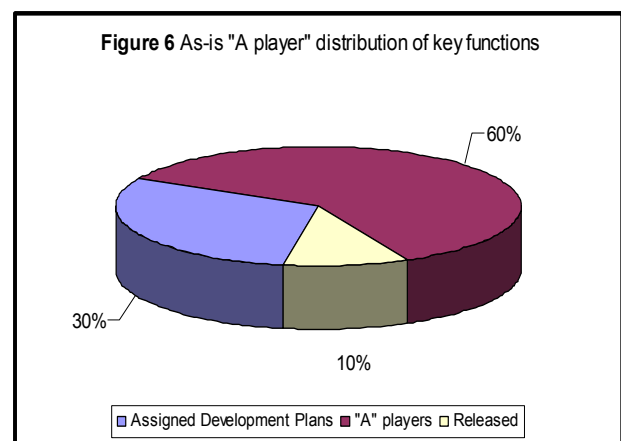
The challenge then came in incorporating these principles into the culture and daily life of HIC. The organization launched an effort focused on leadership development, consisting of four elements:

- Commitment of resources to training
- Proactive management of the leadership pipeline
- Measurement of progress toward program goals
- Links to the performance management system

The human resources organization took responsibility for evaluating all new positions and hires according to the principles, and incorporated the principles into the performance review process. Executive development programs were implemented for senior executives and director-level leaders.

Critical to the leadership pipeline was a formalized succession planning process. Potential successors for key positions were identified and their capabilities measured against expectations. The process identified critical gaps in the leadership talent pool and required senior staff to plan to address these gaps.

Improve Key Functions. Once the new senior management team was stabilized, HIC launched what was called the "Key Functions" project. Through interviews and by reviewing three-year business plans, some 50 critical, non-senior management positions were identified as key to the success of the organization.



Individuals in these key functions went through a rigorous evaluation. Those with poor evaluations were placed in development programs or were reassigned or released (see Figure 6). The project is on track to have "A" Players in all key functions by the end of 2004.

Phase 3: Create Strategic Alignment

HIC has entered the third phase of its performance turnaround, aligning the product portfolio and provider network with the demands of the market and competitive pressures. Where the changes in Phase 2 were primarily internally focused, Phase 3 changes are driven by customers, competitors and broader industry forces, prompting three immediate tasks.

Create Corporate Strategy. Phases 1 and 2 focused on raising operational standards to a level of excellence, with great success. However, as the company evolved and basic organizational and process changes were made, it became clear that to push forward would require a more comprehensive corporate strategy.

Given internal competition for resources and an array of challenges to prioritize, a significant push has been made to evolve the existing strategy of operating excellence. HIC has developed a broad corporate strategy appropriate for today's organization and market conditions.

The new corporate strategy acknowledges that the healthcare environment will get tougher as the marketplace continues to consolidate, resulting in continued strong competition and rising healthcare costs. Further, HIC must act quickly to prioritize actions that will achieve market leadership in the near term.

The refocused strategy has several immediate implications including the refocusing of 2004 and 2005 work to emphasize internal capabilities and lines of business with the greatest opportunities.

Define Product Portfolio. HIC is better aligning the product portfolio to the demands of the market. This has involved complex analysis to understand where the greatest opportunities exist to profitably increase overall market share. A number of segmentation strategies are available including designating lines of business by aggressive growth, opportunistic growth and steady state development.

Distribution channel enhancements are also important – this could involve a renewed focus on enhanced channel support, building relationships through better service capabilities (access, education and tools) plus compensation plans and incentives aimed at growing desired segments.

Build Competitive Intelligence. HIC is working on better understanding how to compete. Two key

elements are market-focused strategies and competitive intelligence. HIC is investing to improve its competitive data gathering and analysis to help decision makers manage and work ahead of trends.

Competitive intelligence is being used to test existing strategies for competitive vulnerability. It is expected that competitive intelligence will also be used to drive the development of line of business strategies.

LESSONS LEARNED

Many lessons have been learned – in retrospect it is now clear that some actions should have been done quite differently. The following is a selection of our personal learnings from the last three years.

What worked....

A. Don't Wait for Strategy

During Phase 1 and early in Phase 2 it was sufficient for HIC to focus on simple blocking and tackling: restructuring basic management processes and functions to improve efficiency. We believed we did not have time or the need to develop an overarching business strategy.

However, while the pragmatic approach avoided organizational distraction, a time was reached when strategy development not only could – but should – have been initiated.

Toward the middle of Phase 2 the list of easy wins to pursue began to diminish. Without a strategy it was not clear where to focus resources and management attention next. As a result, the business units began to ask questions about focus we were not able to answer. In retrospect, HIC would have achieved greater traction at an earlier date if the formal business strategy development had started during the earlier stages of Phase 2, rather than waiting for events to make the need for such strategy more obvious.

B. Take Actionable, Incremental Steps

HIC resisted the temptation to swing for home runs and instead focused on taking actionable, incremental steps. Looking back, actions with the greatest immediate impact simplified execution and effectively increased implementation capacity.

For example, HIC eliminated information system components from the scope of several reengineering efforts, maintaining the focus on process and people

before implementing enabling technology. While this reduced some of the projects' expected benefits, it

ensured positive steps toward the desired outcome. Ultimately, this approach created confidence, momentum and quick returns.

C. Go Ahead, Take Risks

HIC proceeded with several high risk initiatives – with few adverse consequences. For example, HIC replaced a significant number of its senior leaders over a very short period of time. By making dramatic change quickly, organizational disruption associated with the moves was minimized.

HIC's old perceptions of risk were based on past experiences under different leaders. However, as new leaders from other industries were introduced, the appetite for taking calculated business risks increased.

D. Solve People Problems First

HIC took time to ensure the right people were on the leadership team and in other key positions to tackle the challenges ahead. The rationale was simple – the right individuals with the right know-how and experience make subsequent problem-solving easier.

At HIC, senior leadership was willing to make an honest evaluation of its team members. HIC made significant leadership changes starting at the top of the organization. While difficult, these changes made it easier to address future problems.

In some situations, decisions were delayed or avoided. However, in time, it became clear that it would have been far better to make change earlier and more aggressively in almost all of these cases.

E. Delay IT Investments

HIC consciously delayed or scaled-down many IT projects during Phase 1 and 2. Why? IT projects were typically high-dollar, high-risk and had narrowly defined benefit streams. By delaying the investments, HIC's employees focused on better understanding the root cause of the issues. Eventually, several projects were modified to focus on improving people skills and business processes rather than improving IT capabilities. HIC developed both quick, tactical solutions for the interim and a better understanding of appropriate IT solutions.

This approach did have limits. First, all IT work could not be expected to cease. HIC worked to determine which projects were a foundation for future IT improvements, and which were potential distractions. The establishment of a centralized Project Management Office (PMO) reporting to the COO

helped streamline decisions and focus the project portfolio.

Second, it was agreed up front that limiting the IT portfolio was only an interim solution. At some point operational and competitive pressures would require HIC to increase spending on infrastructure and applications, but the key was in the timing.

F. Let Internal Resources Drive the Improvements

HIC avoided the temptation to bring in teams of outside consultants to accelerate organizational improvement. Internal resources were given the authority and accountability to lead the turnaround. HIC explicitly accepted the trade-off between the greater potential speed of a consultancy and the need to allow the organization to create solutions that would benefit from buy-in and ownership.

This approach was especially appropriate due to a cultural bias against outside consultants caused by the failure of a large project. Consultants were not completely avoided, either, but utilized for specific projects and unique content issues. In essence, the experiences, perspective and horsepower of consultants were seen as a **supplement** to the organization's turnaround needs, not driving factors in making it possible.

G. Leverage Strategic Investments by Redeploying Operating Budgets

Unable to invest in the business at the desired rate, HIC used operating budgets to fund more strategic investments. Analysis to identify the highest and best use of resources lead to a) identification of low-value activities which could be eliminated, and b) effective redeployment of baseline (operating) funds. This controversial approach reduced capital requirements and increased capacity to improve the business.

In one case, rather than provide new funding to sales and marketing projects, HIC redeployed over several millions of dollars of existing department resources toward more favorable geographies and product types. This approach helped to produce the results the business units sought without increasing capital budgets.

H. Look for Points of Leverage

As projects were implemented, it was clear there were capacity constraints; PMO data confirmed that HIC was unable to invest in its business at the speed and depth it would have liked. The challenge became to identify points of leverage to address these constraints.

Of three constraints identified – people, capital and technology – it was initially thought that capital was

the biggest constraint. However, as operating performance improved and project resources increased, it became clear that it was people who were the real constraint to investing in the business.

We learned that managers did not have enough time, and often were missing critical skills, to lead new work. HIC launched initiatives to increase implementation capacity by upgrading project management talent, teaching analytical skills, leveraging insights from the PMO and introducing

quality management techniques – all skills that “keep giving back” as the management team moves into the future.

What we could have done better...

I. Identify a Change Catalyst and Change Driver

HIC created a group to be accountable for driving the change effort. Once the Turnaround Teams had completed their tasks, a Vice President for Business Performance Management (BPM) was appointed, reporting directly to the COO and working closely with the CEO to continue the performance turnaround work. The role integrates several important functions:

- Business planning, competitive intelligence and strategy development
- Portfolio analysis, PMO and project management center of excellence
- Measurement, dashboards and performance reporting
- Capital allocation process
- Management venues design and facilitation
- Internal consulting

HIC could have seen earlier and stronger gains from this function by better clarifying and communicating its purpose to management across the organization at the time it was established. Confusion about roles and accountability for performance improvement created challenges that needed to be overcome before progress could begin. Those issues were eventually addressed, however, and BPM has proven critical in supporting the organization through Phases 2 and 3.

J. Understand the Organization's “Terminal Velocity of Change”

At times, HIC reached its ‘terminal velocity of change’ – a point where the organization was not able to absorb the pace of change – without realizing it. These periods of friction could be identified easily in hindsight, characterized by a high level of noise, agitation by staff, and even some pushback from executives. These periods were generally counterproductive to the transformation effort.

HIC would have benefited from an upfront acknowledgement that the organization did have

limits on the rate at which it could change. A mechanism was needed to identify this “terminal velocity” more quickly.

At points where the terminal velocity was reached, it would have been helpful to have more dialogue about how to moderate the pace of change until the organization had regained its footing and was ready to push for the next milestone.

K. Automate Management Processes

Rapid improvement of HIC's management processes (such as business planning and measurement systems) created many manually-intensive processes. While the organization was careful in its IT investments, there were opportunities missed when it came to supporting the automation of essential processes, especially those that supported decision-making.

For example, even as HIC improved and expanded its data collection and analysis functions, executives were expected to support these new processes with existing tools and staff. Executive time was spent manually compiling and drilling through data – activities that could have been automated, saving time and building capacity to address more complex aspects of the change effort.

GREATNESS IS A JOURNEY NOT A STATE – MANY CHALLENGES REMAIN FOR HIC

HIC has enjoyed tremendous progress. It has upgraded management practices and talent to a new standard – a standard that recognizes the need for more than competitive parity. It has become more rigorous about its business methodology and has been willing to concentrate on a handful of actions that will truly deliver benefits. In three years, HIC has gone from needing Turnaround Teams to delivering the best operating profit performance in its history.

However, HIC still must overcome challenges to remain a viable competitor in the marketplace.

Address rising health care costs

Health care costs are expected to continue to rise at alarming rates. Over the last several years, average annual premium increases for employers have ranged from 10% to 15%. Since 2000, national health expenditures have increased from 13% of the GDP to approximately 15% and this rate of increase is expected to continue through 2012 (see Figure 8).

Successful health plans must find innovative means to control rising costs and provide purchasers with affordable health care. The challenge to HIC is to stay current in its understanding of the complexities of these pressures and to introduce innovative products to address purchasers' concerns.

Lower administrative cost structure

Over the past several years, HIC has been able to lower administrative costs and achieve parity with its competitors. However, **maintaining** competitive parity will be more difficult for HIC than **achieving** it in the first place. Cost reduction options today are less obvious and have more significant trade-offs than in the past three years. HIC must adopt rigorous business improvement methodologies, such as Quality Management, to enable the organization to properly identify and evaluate alternatives.

Maintain pricing discipline

Maintaining pricing discipline is a significant driver of profitability and is critical to successful operating performance. HIC must continue to improve its ability to develop accurate projections of industry and competitor trends. Focus and resources will be needed to build greater expertise in understanding unit cost behavior, actuarial modeling and competitive behavior.

Continue to build leadership capabilities

HIC is just beginning to institutionalize leadership development initiatives. It will take several cycles and much persistence to ensure these principles are incorporated into the daily life of all employees.

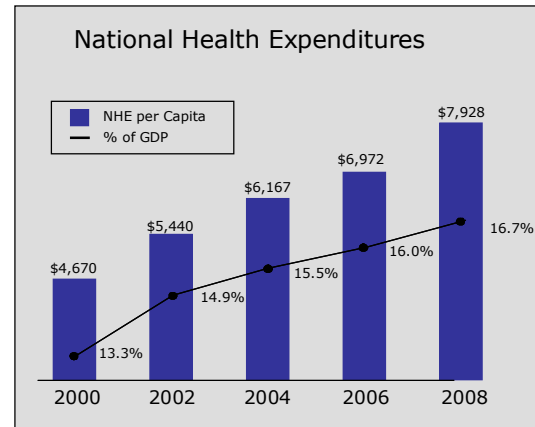


Figure 8 . The cost of health care is expected to continue increasing at an almost unsustainable rate. This and other industry trends creates many challenges for HIC and the health care industry.

Source: Centers for Medicare & Medicaid Services, Office of Actuary

Improve core capabilities

The health care industry is facing a tumultuous future as it addresses rising health care costs and shifts in purchaser demands. This is a tougher environment than any HIC has encountered and it demands a clear response.

First, HIC must continue to identify, prioritize and implement upgrades of a targeted list of core capabilities.

Second, HIC must be sure to finish the initiatives it has started before moving on. Successfully implementing current projects such as moving to “A” players in key functions, upgrading project management and actuarial analysis is important to establishing credibility and a track record of project execution.

Third, HIC must be prepared to keep making the tough decisions about what should be included in an optimal portfolio of products as well as how to address underperforming talent.

This process has no ending.

About the Author

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McQueen Consulting is a partner to business leaders seeking significant improvement in business performance.

At HIC, Mr. McQueen worked with the CEO and COO to design and drive the change process. In 2002, HIC asked Mr. McQueen to build and lead its Business Performance Management organization.

Mr. McQueen has held operating positions and provided advisory services – strategy, operations and change management - to Fortune 100, startup and mid-stage companies. These firms represent leaders in the healthcare, energy and technology industries.

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