

## Chief Balancing Officers

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*“Checking the results of a decision against expectations shows executives what their strengths are, where they need to improve, and where they lack knowledge or information.”*

Peter Drucker

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Executive Management bears the ultimate responsibility for the success or failure of the insurance company. Yet this senior team must work largely by indirect means: setting goals and communicating strategy; strengthening the organizational culture; recruiting senior talent and building teams; and determining how to allocate capital, especially for long-term priorities.

The team faces complexity, uncertainty, time pressures, and constraints in its efforts to lead the organization and set and deliver on performance expectations. Today, these traditional challenges occur in the context of unprecedented levels of investor and regulatory scrutiny. Executive Management must find the proper equilibrium among these pressures, striking the right balance at the top and causing this influence to pervade the organization.

In the wake of the Sarbanes-Oxley Act (SOX) and worldwide solvency initiatives, enterprise risk management, corporate governance, and compliance are major focal points for Executive Management. Governance starts with performance. It reflects the highest level balancing act for management: *Are we performing to policyholder and shareholder expectations?* Risk starts with the flip side of performance: *Are we successfully assuming and managing the right risks to sustain this performance?* Compliance sets the rules by which we must play: *Are we complying with regulatory requirements?* Executive Management must understand and balance these business forces to ensure long-term success with customers, investors, employees, and the law.

Driving your organization’s performance is an exercise in balancing:

- Strategic goals and operational objectives
- Financial performance and operational drivers
- Short-term and long-term pressures
- Top-down and bottom-up perspectives.

There are many business approaches that help unlock the right formula: Total Quality Management, Balanced Scorecard, Six Sigma, home-grown variations of these, and more. Such business approaches provide focus, context, and alignment for decisions. They all require the development of a performance management system. This system turns your organizing philosophy into executable actions for decision-makers at the top and throughout the business. Among the many methodologies and frameworks for defining a performance management system, three basic concepts are universal:

1. How does this action tie back to the financials? (the *so what?* question)
2. How does this action tie back to organizational functions and roles? (the *who is accountable?* question)
3. How does this fit with the business process? (the *where?*, *when?*, and *how?* questions)

While many companies embrace a business philosophy, most lack the performance management system necessary to make it truly successful. Four common barriers prevent Executive Management from striking the right balance in achieving performance, managing risk, and ensuring compliance.

#### **Barrier 1: *Poor vertical visibility of performance drivers***

Executive Management requires a simple vertical hierarchy to connect goals and objectives to underlying functions, processes, and decision areas—including a clear tie back to the financials. This hierarchy is central to a performance management system. With it, Executive Management can understand what has happened, guide today's actions, and plan future performance. However, despite extensive help in this area (Six Sigma, Balanced Scorecard, Total Quality Management, etc.), companies still struggle with successfully implementing a performance management system. Why? It is difficult to translate the top-to-bottom conceptual logic—goals and objectives, leading and lagging indicators, financial and operational considerations, cause and effect—into practical, measurable areas for which people can feel accountable. The many interrelated factors become too complex to implement or manage.



As this illustration shows, a pyramidal hierarchy ensures a clear, logical path to follow from strategic goals at the enterprise level to operational objectives at the functional level, and then down to specific decision areas within those functions. This reduces the number of goals at the top while building detail at appropriate levels of the organization. This creates a basis for delegating accountability.

The pyramid structure requires a consistency and logic that governs cause-and-effect assumptions. Metadata underpin this consistency, which requires defining appropriate business rules and controlling changes through them.

**Barrier 2: *Unclear ownership of performance goals and accountability for them at the front line***

Executive Management is accountable for everything, but directly controls nothing. Executives rely on many individuals to strike the right balance and make the right decisions. Micromanaging is maligned for good reason: it is not feasible for an executive to be everywhere, doing everything; it weakens everyone under the executive, and it distracts the executive from strategy into tactical execution.

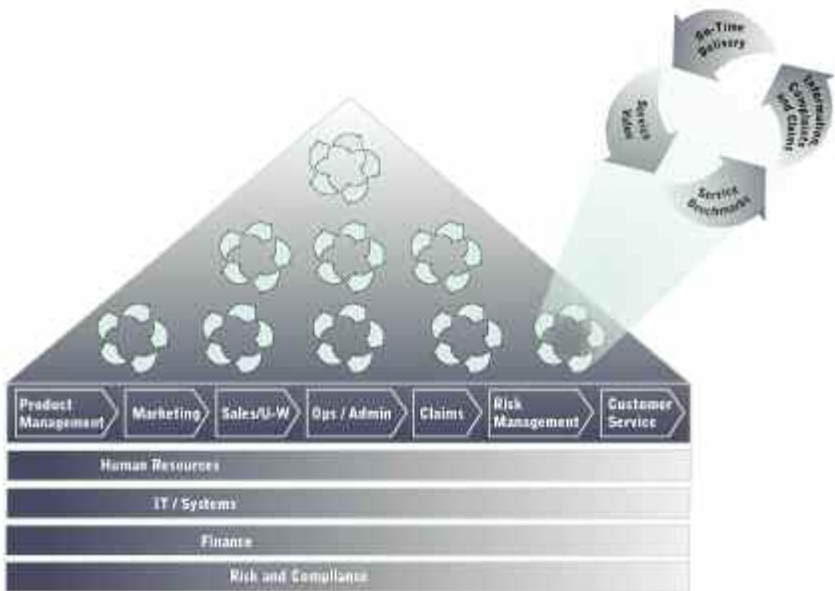
Successful leadership thrives in an environment where there is clear ownership of and accountability for results up and down the organization, rather than merely expected tasks and duties. Ownership requires clearly assigned roles in making decisions that drive performance goals and objectives. Accountability requires measuring the value of actions and outcomes. Using the pyramid structure, you can overlay the goal hierarchy with primary and contributory roles in decision-making according to function and decision area.

FUNCTION	DECISION ROLES	PRIMARY WORK	CONTRIBUTORY	STATUS
IT/Systems	Executives	*		
	Managers	*		
	Analysts	*		
	Professionals	*		
Compliance	Executives	*		
	Managers	*		
	Analysts	*		
	Professionals	*		
Audit	Executives			*
	Managers	*		
	Professionals	*		
Finance	Executives		*	*
	Analysts		*	
	Professionals		*	

You can assign accountability for these decision areas through the planning process. When you ask people to contribute a target number or set an acceptable threshold for a goal or measure, you have shared ownership of the outcome and helped link the person back to the financial results.

**Barrier 3: Poor horizontal visibility of cross-functional alignment and coordination**

A true performance management system spans more than one function or department. It sits above the business process flow in a related but non-linear fashion. Many performance decisions draw upon different elements across process flows in an iterative way.

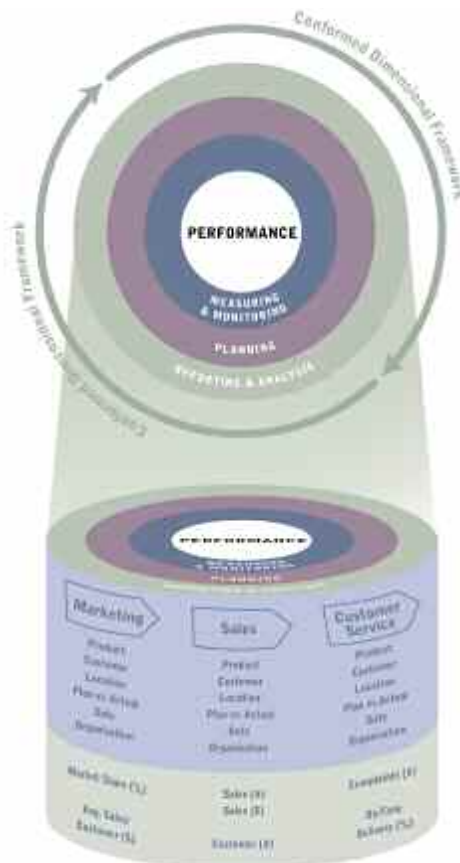


*Decision areas overlay the familiar view of core processes and underlying support processes. Each functional set of decision areas provides an iterative feedback loop. Cross-functional sets combine to address additional performance goals and objectives.*

Even if your performance management system adequately captures vertical cause-and-effect relationships, it may still lack visibility across different functions that share common goals or objectives. This visibility is necessary for striking the right balance throughout the organization. Cross-functional or “horizontal” visibility lets decision-makers across business processes collaborate and execute strategy. It also lets Executive Management weigh in on the difficult choices that cannot be resolved at lower functional levels. Delays in cross-functional handoffs and misalignments among departments negatively affect your overall performance.

The performance management system must include two capabilities. First, it must show how everything fits together in terms of business process. Second, it must include a consistent definition of and context for performance drivers across functions that share common goals or objectives. In metadata terms, horizontal consistency means defining common dimensions shared across functional decision-making processes. (For example, it is critical to define and track products, customers, and locations—the anchors of the business—consistently across processes.)

### Horizontal Coordination: Conformed Dimensionality Across the Value Chain

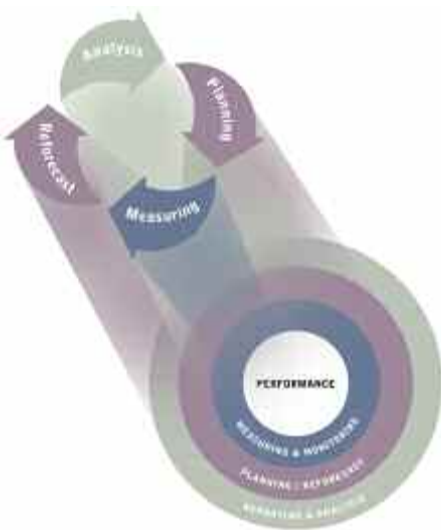


**Barrier 4: *Current executive information capabilities do not support the nonlinear and iterative nature of decision-making/management processes***

For most employees, decision-making work has increased relative to transaction work, but this situation is not reflected in the information we receive to do our jobs. This problem is most acute in the management process itself. Decision-making should flow top-down and bottom-up in an iterative closed loop. Various decisions in different functions need to be grouped and understood together when they affect the same goals. There are also different decision-making cycles and requirements for long-term strategic goals than for short-term monthly and quarterly operations.

These metrics constantly evolve because 1) they often need tweaking (typically realized by using them), and 2) people's behavior eventually adapts to what is being measured. There is a natural tendency for people to learn over time how to "work the system," which obscures its original intent. This requires agile, adaptive, and controlled metadata functionality of business rules, definitions, and audit trails.

A multi-year strategic management planning process starts by reassessing assumptions and conventional wisdom based on rigorous analysis. You must validate or readjust what is important, and should therefore be measured and translated into operational plans that can be delegated down through the organization. Decision flow then switches to monthly or quarterly monitoring of performance with fast, drill-down analysis and reporting on the underlying causes of results. When these causes have been understood by each of the contributing decision-makers, you can **reforecast** adjustments to operational and financial plans. The bottom line: *You need performance management information at each of these steps to support your decision-makers effectively.*



Strategic management cycle:

- **Analysis** → Where do we want to be? (vision and goals)
- **Measures** → What's important? (priorities)
- **Planning** → How do we get there? (objectives and targets)

Operational management cycle:

- **Monitoring** → How are we doing?
- **Analysis and reporting** → Why?
- **Planning** → What should we be doing?

## Decision Areas

The six decision areas listed below support the core governance, risk, and compliance balancing act of Executive Management. They include four performance management decision areas and one decision area each for risk and compliance management.

- **Performance** →

**Financial management** → Are we performing to shareholder expectations?

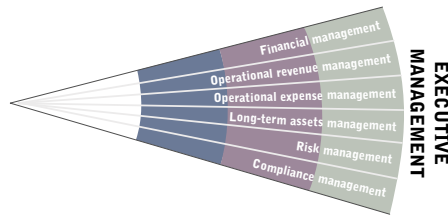
**Operational revenue management** → Are we driving revenue growth effectively?

**Operational expense management** → Are we managing operational expenses effectively?

**Long-term assets management** → Are we managing long-term assets effectively to increase future revenue and expense management capabilities?

- **Risk management** → Are we managing the risks of sustaining this performance?

- **Compliance management** → Are we complying with regulatory requirements?




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*“We encounter so many ‘aha, I see!’ moments when users see reports and numbers for the first time—numbers that include all data presented in a way that they can understand and act on.”*

Patrik Schnizel, Chief Contoller, Folksam

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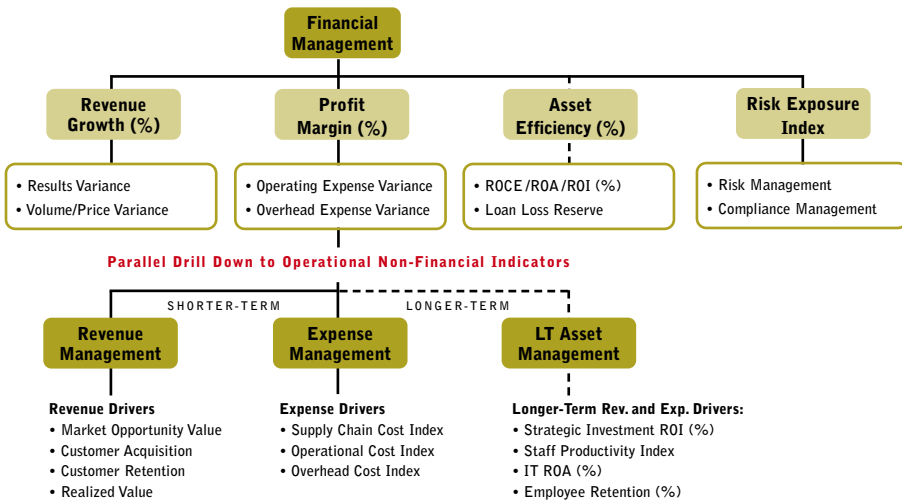
The four decision areas for performance management are further designed to support several interrelated balancing acts: between leading and lagging indicators, between income and expense trade-offs, between short-term and long-term resource allocations, and between top-down and bottom-up management processes. Specifically, each of these decision areas has two integrated levels: an overview “dashboard” level and a more detailed operational level.

The latter is an intermediate level that points to other underlying decision areas that contain even more detail, as in the pyramid structure outlined on page 117. It allows Executive Management to gain a comprehensive view of business performance and to zero in on additional detail for greater insight when necessary, then reset targets and plans accordingly. In each case, the set of goals in the overview level dashboard is purposely limited to one illustrative goal per theme, with additional

goals and metrics made available at the next drill-down level. Each insurance company will have its own variations on these goals and may determine that more than one indicator should be added at the dashboard level.

Inspired by the Balanced Scorecard framework, the four performance management decision areas provide clear, parallel paths to drill down from goals into their underlying operational drivers. The customer-focused perspective is adapted to include information and metrics from decision areas that drive income. The internal process perspective is adapted to focus on operational expense drivers.

The learning and growth perspective also reflects investment and leverage from long-term assets such as human capital and IT assets. The financial management perspective is where we analyze and monitor directly quantifiable financial indicators, but the three other performance management decision areas provide parallel non-financial paths to drill down to operational drivers.



The functions and decision areas described in the rest of this book form a bottom-up framework for designing effective and interconnected information sweet spots of scorecards and dashboards, analytical and business reports, and budgets and plans. Each decision area in this chapter shows a path or starting point for linking the other decision areas together in a top-down logic and, by doing so, establishing cross-functional teams to drive shared goals and objectives. This chapter also highlights the balancing act and trade-offs that Executive Management must make.



## Financial Management

The financial scorecard is a well-developed information sweet spot for most companies. Its bottom-line results are tied to executive financial rewards and additional incentives such as share options, as well as overall risk factors, to align shareholder expectations with executive team motivation.

The three basic performance measures illustrated here are critical to any business. Revenue growth and operating margin are linked to the statement of income, and asset efficiency is linked to the balance sheet. The fourth is a high-level risk measure. Revenue growth is a key component of shareholder value creation. If costs stay flat, revenue increases will directly affect earnings growth, leading to a positive change in the price to earnings ratio (P/E). Executives and investors watch the operating margin and the associated percentage of operating margin to sales ratio. More sophisticated performance measures include return on capital employed (ROCE), return on assets (ROA), and economic profit. Risk exposure is the flip side of this coin, tracking various categories of risks and mitigating factors that could affect the company's ability to meet its performance goals.

These measures more closely align with the investor's perspective, since they give an indication of the risks/rewards generated by a given capital or asset base. Since the capital tied up in the business has a certain opportunity cost for investors, unless these rewards are sufficiently high shareholders will take their cash elsewhere.

### *Premium Revenue Growth (%)*

*Is revenue growing? How fast? How does this compare with projections?* Executive Management reviews the income statement and the sales plan variance to find out how the insurance company performs against plan, and drills down to find the drivers of any revenue variances. Product and service variances tell Executive Management what other decision areas should be examined. For example, if premium is increasing, then Executive Management should review the underwriting profile to confirm there is no adverse selection. If premium is decreasing, then commissions, claims and administrative service standards need to be reviewed.

### *Profit Margin (%) / Combined Ratio*

The profit margin is a vital internal performance benchmark. When compared to that of a competitor, it provides a performance comparison for investors. If profit margins are weakening, Executive Management will examine the income statement to determine why. Other margin indicators such as net interest income or non-interest income help identify what type of earnings or expenses are changing. Operational plan variance may suggest that operating expenses are significantly higher than plan, and the drill-down variance can help determine the cause.

### *Asset Efficiency (%)—ROE, ROA, ROI, Economic Profit*

Assessing the insurance company's performance through ROE or similar measures gives Executive Management the same benchmarks that shareholders use to evaluate the business. If the asset efficiency index is not aligned with market expectations, Executive Management can look at causes in the balance sheet or income statement. The CapEx and strategic investments decision areas may highlight when a major strategic decision or investment program has impacted the asset base.

Alternatively, by looking more closely at the management of assets and liabilities, Executive Management may decide that more effort should be placed on investment management activities to improve overall asset efficiency and economic returns. The treasury decision area can give Executive Management confidence that cash, liquidity requirements and cost of capital are effectively managed for surplus targets.

### *Risk Exposure Index*

Executive Management needs a clear understanding of exposure changes in the insurance company's major categories of risk. Its ability to communicate these risks while instilling confidence in investors and regulators that it is managing them appropriately is critical. While underwriting risk appetite is what generates returns, regulators, customers, and investors expect the controls for these risks to be solidly managed. Risk exposure is a derived metric that shows residual risk after inherent risk has been mitigated.

Executive Management can review changes in exposure and evaluate the potential impact on capital allocation across the operation. Drilling down into the risk management decision area gives Executive Management additional insight into inherent risk (such as loss events, loss amounts, or risk assessments), and into the methods of responding to risk (such as avoidance, acceptance, and reinsurance).

Likewise, review of compliance management shows the effectiveness of internal controls and the status of current compliance programs and audit activity. Managing compliance is clearly driven by the company's reputation and litigation risks, hence the need for Executive Management to be informed and involved. SOX performance is first reported to the Board's audit committee, whose directors, together with company officers, are now more personally liable for financial misstatements and inaccuracies. Directors' and officers' liability insurance rose tremendously after SOX was enacted, precisely for this reason. Internal controls documentation extends to third-party relationship coordination as well. The Board must be assured that reinsurance claims procedures are defined and tested to assure timely claims payments for all treaties and facultative agreements.

**Financial Management**

**Revenue Growth (%)**

**Income Statement**  
Goals

- 1st Yr Gross Written Premium Actual vs. Plan Variance (\$/%)
- Gross Written Premium Actual vs. Plan Variance (\$/%)
- Net Written Premium Actual vs. Plan Variance (\$/%)
- Statutory Income (SAP) (\$/%)
- Net U/W Income (GAAP) (\$)
- Net U/W Income (GAAP) / Operating Profit (\$/%)

**Drill-Down Variance**  
Goals

- Net Written Premium (GAAP) / Operating Profit Change (\$/%)
- Gross Written Premium Change (\$/%)
- Net Written Premium Change (\$/%)
- Insurance Services Revenue Change (\$)
- NWP Premium /Services Revenue Variance (\$/%)

**Results Plan Variance**  
Goals

- Results Variance (\$/%)
- Results Plan (\$/%)

**Profit Margin (%)**

**Income Statement**  
Goals

- Assumed Premium (\$/%)
- Ceded Premium (\$/%)
- Net Earned Premium Actual vs. Plan Variance (\$/%)
- Net Incurred Losses (\$/%)
- Loss Adjustment Expense (\$/%)
- Acquisition Expense (\$/%)
- Management (Gen&Admin) Expense (\$/%)
- Statutory Profit (\$/%)
- Net Income (GAAP) / Operating Profit (\$/%)

**Drill-Down Variance**  
Goals

- Incurred Losses / Profit Change (\$/%)
- Loss Adjustment Expense / Profit Change (\$/%)
- Expense/Profit Change (\$/%)
- Product/Service Expense Variance (\$/%)

**Operational Plan Variance**  
Goals

- Combined Ratio
- Net Commission Ratio
- Gross Loss Ratio
- Net Loss Ratio
- Expense Ratio
- Operating Expense Variance (\$/%)
- Operating Efficiency (% of assets)

**Asset Efficiency (%) ROE / ROA**

**Income Statement**  
Goals

- Actual vs. Plan Variance (\$/%)
- GAAP Income (\$)
- Net income (GAAP) / Net Profit (\$/%)

**Balance Sheet**  
Goals

- Insurance Industry Credit Rating
- Premium: Surplus
- Loss Reserves: Surplus
- Solvency Ratio
- Return on Assets
- Return on Surplus
- Risk Adjusted Return on Capital (RAROC)
- A/R Reserve
- Earning Assets/Total Assets

**CapEx and Strategic Investments**  
Goals

- Investment (\$)
- NPV (\$)
- ROI (%)

**Cash Balances**  
Goals

- Liquidity Ratio
- Volatile Liability Dependency
- Cash & Securities/Assets
- GL \$ Reconciliation (%)

**Treasury**  
Goals

- Interest Sensitivity Ratio (%) (Assets/Liabilities)
- Dollar Gap Ratio (%) (Interest Sensitivity)

**Risk Exposure Index**

**Risk Management (internal)**  
Goals

- Loss Incidents (#)
- Loss Value (\$)
- Risk Level Index
- Risk Mgt. Audit Score

**Compliance Management**  
Goals

- Compliance Completion (%)
- Compliance Costs (\$)
- Material Deficiencies (#)
- Materiality Rating
- Regulatory Compliance (%)
- Risk Level Index

**Underwriting**  
Goals

- Credit Rating Index
- Combined Ratio
- Loss Ratio
- Avg. Deductible (\$)
- Avg. Excess (\$)
- Net Written Premium
- Retention 1st Year
- Retention Renewal

**Claims**  
Goals

- Claims Pending (#/\$)
- Avg. Settlement Time
- Case Reserve (\$/%)
- IBNR (\$/%)

**Loss Control**  
Goals

- Risk Exposure Count (\$)
- Maximum Potential Loss (\$/%)
- Loss Controls (#)
- Loss Controls Assessment Score
- Loss Adjustment Expense (\$/%)
- Expected Net Loss (\$/%)

**IT Compliance Mgmt.**  
Goals

- Compliance Completion (%)
- Compliance Costs (\$)
- Material Deficiencies (#)
- Regulatory Compliance (%)
- Risk Level Index

### **Operational Revenue Management**

Premium growth is a key driver of profitability and shareholder value—attracting the right customer with the right risk profile at the right price, and then retaining that customer. Executive Management must focus on managing revenue or income goals and directing the business and its resources to the most profitable market and channel opportunities that meet underwriting selection criteria. This requires cross-functional cooperation. Growth requires looking beyond current income performance to new opportunities. The strategic plan for growth involves Marketing, Underwriting, Sales, and Product and Portfolio Management. Executive Management looks at the insurance company's ability to acquire new customers in order to generate new income, and compares this to existing customer retention/persistence performance.

#### *Market Opportunity Value (\$)*

While you may structure your organization along functional lines, revenue opportunities cut across Marketing, Sales, and Product and Portfolio Management. By clustering the decision areas associated with market opportunities, you allow more complete and aligned decision-making. This important business driver allows you to develop an overarching index or series of indicators to describe performance. If needed, Executive Management can drill down further into specific decision areas and the related goals and metrics.

If market opportunity value tracks below an acceptable level, Executive Management may look for new market opportunities. For example, a new customer or product segment growing at 20 percent annually is clearly attractive, but the insurance company may have a poor market share. The competitor position assessment indicates a low level of competitor consolidation, suggesting it would be easy to gain share by working with knowledgeable agents. Product and Portfolio Management has evaluated the costs necessary to enter this segment. Available market producer and customer feedback gives some confidence that these new product concepts could hit the mark. Executive Management can now assimilate this information and decide the best way forward through the relevant insurance channels.

#### *Customer Acquisition (%)*

Revenue management is also concerned with the underwriting effectiveness of customer acquisition strategies. This means becoming well versed in revenue results and the expectations for future revenue pipeline and demand-generation activities. If you have weak agent/customer relationships, increasing customer calls may be a solution. The customer acquisition percentage lets Executive Management monitor this key performance area. Executive Management must closely scrutinize product innovation to see if new products deliver their projected revenue results. Most organizations launch new products or services with high optimism.

Executive Management must be particularly attentive to early performance indicators. If projected premiums and revenues are not delivered, you must find out why and communicate this to all levels of the organization. Results plan variance becomes an essential information sweet spot for determining the why and where of problems, allowing for a decision regarding the what. You must explain these findings well enough that the Board has confidence in the proposed measures, and also be detailed enough to allow lower levels of the organization to execute effectively.

*“With our performance management solution, we have a simple and quick environment which can handle all our needs and gives us insight into operating costs per cost center and product, sales in relation to the budget, internal purchasing support, premiums paid and disbursed insurance sums. We’ve increased our reliability and reduced the time spent on certain operations from 66 hours to three. In the long term, this means we’ll save masses of time and money thanks to this solution. We are now able to focus 85 percent of our attention on strategic initiatives that help drive our business.”*

Patrik Schnizel, Chief Controller, Folksam

### **Customer Persistency/Retention (%)**

Growing revenue is not enough if income leaks away due to poor customer retention. If the customer retention index is low, Executive Management must focus on the underwriting, operational and service performance issues that directly affect customers. Early indicators of potential problems are likely to come from inadequate policy administration delivery performance and from complaints and claims. Monitoring these early indicators informs the team and helps ensure accountability from those responsible. Service benchmarks also offer insights into customer service problems that need to be managed.

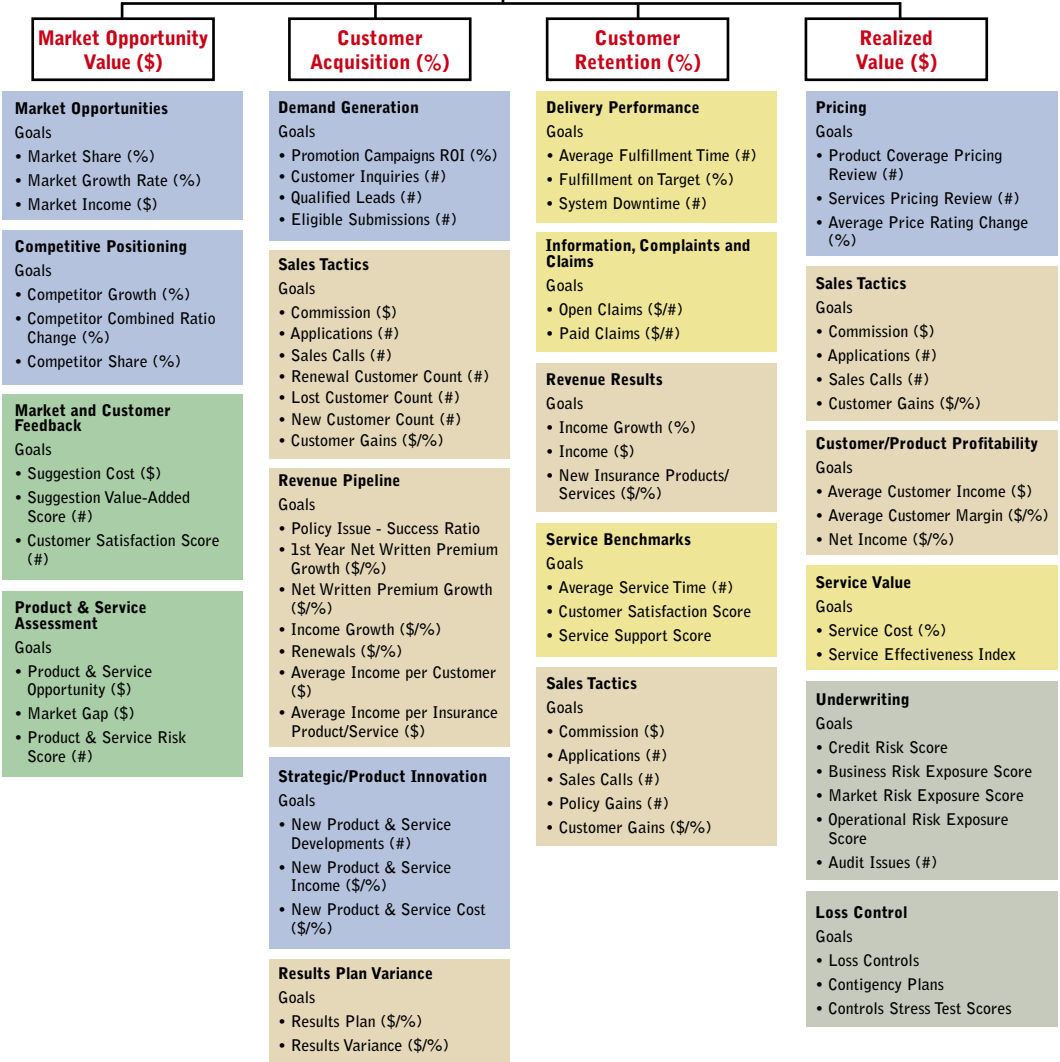
These benchmarks may also indicate the relative service performance differences between the insurance company and its competitors, highlighting disadvantages that could lead to customers’ switching despite consistently good service performance.

Despite positive numbers in these early-warning measures, the premium revenue results decision area may indicate poor results, with decreasing income to existing customers. The solution may be rebalancing sales tactics. Perhaps you need a greater emphasis on improving customer information to better clarify product or service terms when making a policy application.

### **Realized Value (\$)**

Realized value provides an overview of the effort going into driving premium revenue growth and its effect on profit or margin. The customer/product profitability decision area is an important sweet spot for Executive Management. You must review unprofitable customers and pursue different strategies if they are important to the business. A pricing review may indicate that increasing prices or reducing services for a large but unprofitable customer segment would be a bad decision, since this would accelerate the competition’s penetration of that market segment. Reviewing the service cost of the service value metric could highlight too much spending on service support. In that case, you might increase or introduce a service charge to maintain existing service levels.

Executive Management may also examine product profitability to determine realized value performance. You may look at options to correct the underperformance of certain product and service offerings. These could include discontinuing a service, increasing the price, or changing sales tactics. Increasing prices for certain niche segments may offer a “milking” option in the short term to counteract losses somewhere else. Compensating for losses by increasing profits elsewhere is a common decision area in the Executive Management balancing act.



MARKETING

SALES

DEVELOPMENT

CUSTOMER SERVICE

EXEC. MANAGEMENT

### **Operational Expense Management**

Once customers have committed their business, there is little scope for operating and delivery errors not affecting profit margins. The insurance underwriting contract promises delivery of services when a loss occurs. Information that helps Executive Management identify operating anomalies and act quickly can make the difference between success and failure.

By grouping relevant functional decision areas together, the information sweet spots can be aligned with typical business concerns. These business challenges need to be approached cross-functionally and cannot be solved in isolated silos.

Business is a process that starts with inputs and ends with outputs. In between, you must manage value-added activities for efficiencies and costs. On the input side, this starts with the internal operating processes needed to deliver a product or service. You manage these internal operating processes by monitoring operating costs, reflecting the key driver in achieving sustainable margins. Organizations carry a number of support functions broadly classified as overhead. You must manage these overhead costs to ensure that, for example, departmental headcounts do not grow out of control, and that your various support activities deliver real value. When you have a finished product, you must distribute and deliver output, bringing the cycle back to supply chain efficiency across the total insurance distribution network.

### ***Supplier and Distribution Chain Cost Index***

This index highlights the balancing act for management between external resources input and output. The unpredictable is the norm. Transaction volume spikes, customer complaints, operational failures and third-party support failures mean that this month's service and resource requirements are not the same as last month's. The premium revenue plan variance metric reflects future income expectations; if it indicates an unexpected increase in new customer accounts, claims, and customer support, Network and Logistics must respond to assure adequate capacity. If insurance distribution chain resources are not allocated and aligned with customer expectations, the expected level of service may be disappointing and become a problem that Executive Management must address, for example, through possible incentives to minimize negative long-term impact on customers. This applies most acutely to insurance claims and rehabilitation support services that affect customer service timelines.

The ability to see across supplier and distribution chain indicators helps Executive Management understand the overall situation. Planning must take into account handling catastrophic events as well as standard operational cycles. Poor delivery can highlight a problem that may also be reflected in poor process performance. The surge in transactions may create an increase in operating failures that Executive Management must decide either is temporary or requires an increase in capacity. Information, complaints, and claims may indicate risk and exposure with certain customers.

Temporary process bottlenecks can be solved by looking at delivery performance. Increasing back-office capacity with additional short-term resources may delay investment, but will probably require a reassessment whether the existing infrastructure is sufficient. This ability to see insurance supply



**Supply Chain Cost Index**

**Procurement**  
Goals

- Supplier Testing Score
- Supplier Timeliness (%)
- Purchase Price/Unit (\$)
- Supplier Performance Rating

**Network and Logistics**  
Goals

- Transaction Timeliness (%)
- Efficiency Ratio (#)
- Customer Growth (%)
- Infrastructure Score (#)

**Delivery Performance**  
Goals

- Average Fulfillment Time (#)
- Fulfillment on Target (%)
- System Downtime (#)

**Information, Complaints and Claims**  
Goals

- Open inquiries (\$/#)
- Resolved inquiries (\$/#)
- Lost Customer / Agent Count (#)

**Results Plan Variance**  
Goals

- Results Variance (\$/%)
- Results Plan (\$/%)

**Process Efficiency**  
Goals

- Operational Failures (#)
- Process Cost (\$)
- Process Value-Add (\$)

**Operational Cost Index**

**Production and Capacity**  
Goals

- Capacity Utilization (%)
- Systems Up-Time (%)
- Transaction Volume (#)

**Cost and Quality Management**  
Goals

- Transaction Reconciliation (\$/%)
- Cost per Transaction (\$)

**Product Development Milestones**  
Goals

- Product & Service Development Cost (\$)
- Product & Service Development Lead Time (#)
- Project Completion by Milestone (#/%)

**Operational Plan Variance**  
Goals

- Operating Expense Variance (\$/%)
- Overhead Efficiency (% of Assets)
- Cost/Income Ratio (%)

**Information, Complaints and Claims**  
Goals

- Open Inquiries (\$/#)
- Resolved Inquiries (\$/#)

**Project / SDLC Management**  
Goals

- IT Project Completion (%)
- IT Project Lead Time (#)
- IT Project ROI (%)

**IT Vendor Management**  
Goals

- IT Contract Cost (\$)
- IT Project Completion (%)
- IT Project Lead Time (#)
- IT Vendor On-Time (%)
- SLA Performance (%)

**Operational Risk**  
Goals

- Operational Risk Rating (#)
- Controls Performance Rating (#)
- Contingency Testing Score (#)

**Overhead Cost Index**

**Income Statement**  
Goals

- Actual vs. Plan Variance (\$/%)
- Income (\$)
- Net Income/Profit (\$/%)

**Organization and Staffing**  
Goals

- Average Tenure (#)
- Employee Turnover (%)
- Headcount (#) / Plan (%)

**Cost and Quality Management**  
Goals

- Transaction Reconciliation (\$/%)
- Cost per Transaction (\$)

**Operational Plan Variance**  
Goals

- Operating Expense Variance (\$/%)
- Overhead Efficiency (% of Assets)
- Cost/Income Ratio (%)

**Benefits**  
Goals

- Benefit Cost Increase (%)
- Benefit Costs (\$)
- Benefit Costs/Payroll (%)

OPERATIONS	CUSTOMER SERVICE	IT	PRODUCT MANAGEMENT
HUMAN RESOURCES	SALES	FINANCE	EXEC. MANAGEMENT



and distribution chains from end-to-end and derive information from different decision areas is essential to good leadership. When Executive Management understands the various tolerances and risks, it can confidently make an informed decision. Information gaps are not acceptable reasons for failure.

### *Operational Cost Index*

Executive Management uses operational cost to monitor the operation's backbone and the related cost implications of inefficiencies and bottlenecks. For example, if you approve a new transaction system, how can you manage and monitor its implementation effectively? In the project management software/system development life cycle (SDLC) decision area, a clear plan will outline the scope of work and time needed to implement the new system. Executive Management must watch cost and time overruns, and perceived risks. You can use the service vendor management decision area and its indicators of past vendor performance to mitigate risks and make better forecasts.

If the policy application process is difficult—causing system rejections, delivery delays, and an increase in complaints and claims—Executive Management can look at capacity management. With the information from this sweet spot, it can assess the implications of using overtime to push applications through. You can gauge cost implications from the operational efficiency and quality management decision areas. The increase in operating costs will affect the operational plan variance. Executive Management will use this information to communicate the discrepancy from plan and focus on solving this problem. The above example illustrates the importance of managing the unforeseen by using fact-based indicators. Every business has to be ready for the unexpected. Companies that manage these situations as they occur gain a significant advantage.

### *Overhead Cost Index*

Monitoring support functions with the overhead cost index ensures the balance between cost and value makes sense. If this area underperforms, you can analyze the organization and staffing decision areas to look at headcount, or the income statement to review more detailed functional costs. Management analyzes ratios to understand the cost changes and the relative importance of various support functions or departments. For example, percentage of back-office costs to assets and percentage of branch headcount to total headcount will tell you whether these resources are changing in proportion to the business. Increasing revenue unaccompanied by an increase in Customer Service headcount could affect future customer relationships and account loyalty.

The results plan variance gives Executive Management a key indicator to determine future resource requirements and support costs. If you expect strong income growth, then this insight can be used to look at the operational plan variance. Senior management can take a more active role in deciding if future income growth requires broad resource upgrades in the support functions. You can integrate the associated increase or decrease in costs into the planning process. Fast, proactive decision-making increases competitive capabilities across the organization.

### **Long-Term Asset Management**

Long-term investment and asset decisions represent Executive Management's opportunity to influence the future direction and success of the business. This is where the right investment choice can fundamentally redefine both the revenue opportunities and cost efficiencies of an organization. Unfortunately these important decisions are both costly and risky. Senior management has to decide carefully which investment options have priority. The uncertainties involved in these long-term investment decisions are difficult to balance against a backdrop of short-term performance pressures. Failure is not a palatable option, resulting in a lower share price, restructuring and, at the extreme, corporate failure.

What are long-term assets? From a balance sheet perspective, what asset/liability mix is required, for what risk exposure and at what expected returns? From an executive perspective, they also must include intangible assets such as human capital and IT capability and infrastructure. Designing key measures that offer a holistic perspective on these investments (tangible and intangible) allows Executive Management to monitor the long-term health of the corporation.

#### ***Strategic Investment ROI (%)***

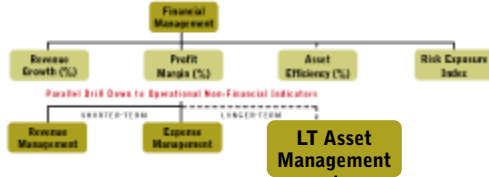
The strategic investment ROI percentage tracks strategic projects. This sweet spot lets Executive Management learn from the past and adapt those experiences to future decision-making.

Strategic investment decisions, for example, an acquisition, require input from a number of decision areas. The market opportunity decision area may have identified an attractive adjacent market segment. You may build a case for the acquisition if existing options for the organization are limited and strategic/product innovations show poor performance of new product and service propositions. The case for acquisition strengthens if your existing product offering is underperforming and there is little prospect of generating satisfactory growth or market share. If the competitor assessment decision area has identified a potential acquisition target that satisfies corporate due diligence, you then require financial evaluations. Through the CapEx and strategic investments decision areas, Executive Management can review scenarios with associated ROI assumptions. If these conform to the corporate investment structures, then Executive Management must consider whether the balance sheet is strong enough to finance the acquisition. *Should you increase debt or is it necessary to raise additional capital from new shares?*

The above example reflects the type of information sweet spots that Executive Management requires in order to make strategic investment decisions. By making strategic investments a dedicated sweet spot, it can monitor investment performance and rationale for a decision. Acquisitions fail in financial terms due to overpaying for the target or poor execution when consolidating the business. With Executive Management well informed by past acquisitions of the key factors that influence success or failure, you reduce the risks for the future.

#### ***Staff Productivity Index***

Human capital is a key asset of any business, and Executive Management must track this asset's productivity. A basic assessment reveals headcount and assets per employee by department, but there



Strategic Investment ROI (%)	Staff Productivity Index	IT ROA (%)	Employee Retention (%)
<b>CapEx and Strategic Investments</b> Goals • Investment (\$) • NPV (\$) • ROI (%)	<b>Organization and Staffing</b> Goals • Average Tenure (#) • Employee Turnover (%) • Headcount (#) / Plan (%)	<b>Business Value Map</b> Goals • Business Priority Score • Business Value (\$) • Information Quality Index • IT Capability Index • IT Costs (\$)	<b>Talent and Succession</b> Goals • Employee Satisfaction Index (#) • Succession Gaps (#) • Talent Gaps (#)
<b>Balance Sheet</b> Goals • Return on Assets • Return on Equity • Earning Assets/Total Assets • A/R Reserve	<b>Results Plan Variance</b> Goals • Results Variance (\$/%) • Results Plan (\$/%)	<b>IT Portfolio Management</b> Goals • IT Capability Index • IT Costs (\$) • IT Efficiency Index	<b>Organization and Staffing</b> Goals • Average Tenure (#) • Employee Turnover (%) • Headcount (#) / Plan (%)
<b>Market Opportunities</b> Goals • Market Share (%) • Market Growth Rate (%) • Market Income (\$)	<b>Business Value Map</b> Goals • Business Priority Score • Business Value (\$) • Information Quality Index • IT Capability Index • IT Costs (\$)	<b>Project / SDLC Management</b> Goals • IT Project Completion (%) • IT Project Lead Time (#) • IT Project ROI (%)	<b>Benefits</b> Goals • Benefit Cost Increase (%) • Benefit Costs (\$) • Benefit Costs/Payroll (%)
<b>Competitive Positioning</b> Goals • Competitor Growth (%) • Competitor Price Change (%) • Competitor Share (%)	<b>Compensation</b> Goals • Average Compensation Increase (\$) • Average Compensation Increase (%) • Compensation Cost (\$)	<b>IT Vendor Management</b> Goals • IT Contract Cost (\$) • IT Project Completion (%) • IT Project Lead Time (#) • IT Vendor On-Time (%) • SLA Performance (%)	<b>Compensation</b> Goals • Averages Compensation Increase (\$) • Average Compensation Increase (%) • Compensation Cost (\$)
<b>Product &amp; Service Assessment</b> Goals • Product & Service Opportunity (\$) • Market Gap (\$) • Product & Service Risk Score (#)	<b>Operational Plan Variance</b> Goals • Operating Expense variance (\$/%) • Operating Efficiency (% of Assets) • Cost / Income Ratio (%)	<b>Results Plan Variance</b> Goals • Results Variance (\$/%) • Results Plan (\$/%)	<b>Training and Development</b> Goals • Skills Rating Gap (%) • Training and Development Cost (\$) • Training and Development Activity
<b>Strategic/Product Innovation</b> Goals • New Product & Service Developments (#) • New Product & Service Income (\$ /%) • New Product & Service Cost (\$/%)	<b>Training and Development</b> Goals • Skills Rating Gap (%) • Training and Development Cost (\$) • Training and Development Activity		<b>Income Statement</b> Goals • Actual vs. Plan Variance (\$/%) • Income (\$) • Net Income/Profit (\$/%)

MARKETING

IT

HUMAN RESOURCES

SALES

FINANCE

can be many added levels of sophistication in this tracking. Understanding the context for changes in staff productivity requires Executive Management to seek information from a number of decision areas.

If this indicator increases, implying improved staff productivity, Executive Management should look at how to sustain it. The results plan variance decision area may show an increase in income or assets versus expectations, and organization and staffing information will help Executive Management see if and where additional staff were employed. If overall headcount has not increased and an assessment of the compensation decision area indicates stable staff expenses, you know your staff is more productive. The business value road map may confirm that a recent project implementation has had a direct and positive impact on staff productivity. You may have seen an associated increase in training and development expenditures due to the new project, but the result directly improves the staff productivity index. With these figures, Executive Management can push for a review of plans and have other functions record the impact in operational plan variance.

#### *IT ROA (%)*

Sudden technology shifts can upend the business model, so Executive Management must know where and how IT assets are driving value across different business units, lines of business, and functions. Comparing the upward or downward trend in IT ROA with current financial and operational results lets you see potential weaknesses in IT strategy. Likewise, comparisons with staff productivity and strategic investment percentages highlight the level of alignment with long-term business goals. If IT ROA is declining in a high-performing area of the business, a drill-down on the business value road map may indicate what specific drivers of performance are at risk, such as revenue growth or profit margins. Understanding who is affected leads to a more productive and proactive approach.

#### *Employee Retention (%)*

Retaining employees saves money on recruitment and start-up costs; keeping the right employees builds one of your most important assets. The talent and succession review decision area provides additional information for Executive Management, making it aware that new people and talent are necessary to improve the capability of the business. Designing a blend of internal career advancement and strategic recruiting of new talent is an Executive Management priority.

If the employee retention percentage is a concern, you may examine compensation and benefits information, looking at market comparisons. Overall staff cost-to-income ratios provide high-level benchmarks for senior management to compare against competitors. Do you increase staff costs, with the associated effect on the income statement, to reverse a weak employee retention index? Perhaps low employee morale is the cause. If so, improving compensation may not actually change employee retention. In this case, it may be more productive to invest in employee team-building or other employee development programs. Training and development information may help to set an appropriate strategy.

## Risk Management<sup>1</sup>

Recent regulatory trends such as Solvency Acts for insurance capital adequacy and SOX for publicly traded organizations have heightened the importance of better risk management. So have trends like globalization, integrated financial markets, the knowledge economy, and political uncertainty. The resulting competitive environment and constant rapid change have created countless potential threats to business performance. Today, more than ever, how well you take and manage risks affects your cost of capital through:

- Investors and major exchanges such as NYSE and NASDAQ
- Lenders and related rating agencies such as A.M. Best, Moody's and S&P.

This decision area provides a consolidated view of several categories and hierarchies of risk, such as operational, credit, and market risk. In addition to these, organizations must monitor environmental and natural risks that impact disaster recovery and business continuity. Having a single integrated universe of identified risks that cuts across common organizational units, functions, and business processes enables more coordinated and cost-effective risk responses.

The trend toward an integrated view of risk has gained ground as the costs of compliance have increased, in particular due to SOX. Many enterprise and operational risk frameworks are available, including the so-called COSO II, the Enterprise Risk Management—Integrated Framework published in 2004 by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). This framework identifies four objectives and eight risk management components, as shown in this exhibit. The cube visual reinforces the multidimensional nature of risk management and compliance.

- The four objectives—strategic, operations, reporting, and compliance—are represented by the vertical columns.
- The eight components are represented by horizontal rows.
- The entity and its organizational units are depicted by the third dimension of the matrix.



Ideally, this decision area combines both qualitative and quantitative information. Qualitative risk ratings and assessments are more reliable and verifiable when they are underpinned by numbers that measure risk incidents, events, and loss amounts. Setting accepted risk thresholds, modeling expected outcomes, and monitoring actual results ensure finer insights and tweaking for managing risk.

For many risks, such as those related to SOX, specific internal controls are in place to mitigate risks. This decision area helps to flag the controls that are most effective and reduce inherent risk to a more acceptable exposure of residual risk.

<sup>1</sup> As a subject, risk management warrants a book of its own. Accordingly, this decision area is only meant to provide an overview of what could easily be several more detailed information sweet spots. Also, although it is represented here as a drill down within Executive Management, many companies have a separate risk management function.

**Risk Management<sup>2</sup>**

Risk management is more than tracking obscure or unlikely threats. When risks are tracked against a common map of the business, it is easier to establish the relationship between business performance and risk, like flip sides of the same coin. Insuring common operational risks, notably in Human Resources and Finance, is another area of overlap. For example, the escalating costs of employee benefits and uncertainty in workers' compensation claims are forcing companies to negotiate more self-insurance offerings from their insurance carriers, requiring close analysis and monitoring of reserves-to-losses trends. Likewise, determining the right price for insured cash flow programs requires similar analysis of bad debt reserves.

GOALS	METRICS	DIMENSIONS	
Loss Incidents (#)	Claim Payments (\$)	Control Objective	Risk
Loss Value (\$)	Claim Payments (\$)	Control Objective	Risk Category
Risk Level Index	Claims Aging (\$)	Credit Limit Range	Risk Type
Risk Management Audit Score	Control Effectiveness Rating	Range	Risk
	Country Risk Rating	End Customer Location	Strategy Focus
	Credit Balance (\$)	Region	Strategic Area
	Default Rate (%)	State/Province	Strategy
	Environmental Risk Rating	County	Transaction/Process
	Estimated Loss Incidents (#)	Postal Code/Zip Code	Process
	Estimated Loss Value (\$)	Reporting Period	Sub-Process
	Intrinsic Risk Rating	Year	Activity
	Operational Risk Rating	Quarter	Organization
	Operational Risk Rating	Month	Division
	Residual Risk Rating	Information Supply Chain	Department
	Risk Impact Rating	Information Source	Organization Code
	Risk Likelihood Rating	Product Line	
	Write-off Amount (\$)	Product Line	
		Risk Review	
		Response Type	
		Response	

FUNCTION	DECISION ROLES	PRIMARY WORK	CONTRIBUTORY	STATUS
Risk Management	Executives	*		
	Managers	*		
	Analysts	*		
	Professionals	*		
Audit	Executives	*		
	Managers	*		
	Professionals	*		
Finance	Executives		*	
	Managers		*	
	Analysts	*		
Regulatory/Legal, Human Resources, Marketing, Sales, Purchasing, Claims and IT/Systems				
	Executives		*	*
	Analysts		*	
Customer Service	Executive			*
Operations/Production	Executives			*
Actuarial	Executives			*
Underwriting	Executives			*
Loss Control	Executives			*
General Management	Executives			*

### Compliance Management<sup>2</sup>

Managing compliance is the key operational execution area of risk management. Even when addressing purely regulatory requirements, the frameworks that guide compliance are often based on a risk perspective. For example, SOX program management uses the COSO framework for defining internal controls requirements based on identifying risks of financial misstatement. Likewise, non-SOX internal audit programs are also anchored in initial risk assessments that suggest which areas of the business require audits.

Ideally, compliance management provides an integrated view of the entire regulatory universe. Most companies face numerous overlapping regulatory requirements. In insurance, certain business processes are scrutinized by a designated Compliance Officer. Knowing where and how to leverage the same controls for multiple regulatory reporting can save you considerable effort in compliance.

As in IT compliance management, this decision area can draw on more than one data source. The first is compliance program management solutions, such as for SOX, that manage a company's projects and programs to ensure compliance. The second source is a new category of tools, often referred to as continuous controls monitoring software, which generates real-time or near real-time information about

GOALS	METRICS	DIMENSIONS	
Compliance Completion (%)	Controls (#)	Application Software	Reporting Period
Compliance Costs (\$)	Exceptions (#)	Application Type	Year
Material Deficiencies (V)	External Audit Fees (\$)	Software	Quarter
Materiality Rating	Internal Audit Costs (\$)	Alerts/Incs	Month
Regulatory Compliance (%)	Issues (E)	Control Frequency	In Scope
Risk Level Index	Items Overdue (R)	Control Method	Key Control
	Outsourced Internal Audit	Control Objective	Regulators
	Costs (\$)	Control Objective	Regulator Type
	Qualitative Materiality Rating	Control Owners	Reg. Standard
	Quantitative Materiality (%)	Function	Remediation Status
Regulatory Audits	Risk Impact Rating	Position	Risks
	Risk Likelihood Rating	Control Owner	Risk Category
	Sample Size (#)	Control Type	Risk Type
	Significant Deficiencies (#)	Documentation Status	Risk
	Tests (W)	Entity	Test Status
		Financial Account	Transaction Process
		Financial Statement Type	Process
		Financial Statement Line	Sub-Process
		Financial Account	Activity

FUNCTION	DECISION ROLES	PRIMARY WORK	CONTRIBUTORY	STATUS
Compliance	Executives	*		
	Managers	*		
	Analysts	*		
	Professionals	*		
Audit	Executives	*		
	Managers	*		
	Professionals	*		
Finance	Executives		*	
	Managers		*	
	Analysts		*	
	Professionals		*	
Regulatory/Legal	Executives			*
	Managers		*	
	Analysts		*	
	Professionals		*	
Human Resources, IT/Systems, Customer Service, Marketing, Sales, Purchasing, Operations/Production, Actuarial, Underwriting, Claims, Loss Control, and General Management				
	Executive			*

<sup>2</sup> As compliance can span several regulatory areas, this decision area is only meant to provide an overview of what could easily be several more detailed information sweet spots. Also, although it is represented here as a drill down within Executive Management, many companies have a separate internal audit function reporting directly to the Board's audit committee.

transactions and flag any exceptions to expected outcomes, as defined by internal controls. For example, inconsistent accounts payable patterns in terms of purchase order numbers or amounts that are just below authorized levels might indicate fraud.

Finally, compliance management can also draw information from solutions that automate manual spreadsheet-based processes, including reports that are used to perform detective or monitoring control activity. The most common and costly, from a compliance perspective, are manual financial reporting and close processes, in particular for consolidation and adjustments.