Operations Management

Case 1: Manzana Insurance

Submitted to

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Situation Analysis

Founded in 1902 in California, Manzana Insurance specialized in commercial insurance, with property insurance, in 1991, making up 65% of its revenues, liability insurance 20%, and investment income and miscellaneous specialty lines constituting the remainder.

Manzana operated through a network of relatively autonomous branch offices in 3 states of the United States of America – California, Oregon, and Washington. Each branch was treated as a separate profit and loss center. Its sales force comprised about 2,000 independent agents who represented Manzana and other competing insurers. Consequently, there were no exclusive Manzana agents.

Manzana Insurance, founded in 1902, had a profitable home and commercial property insurance business for several decades. The company's performance started taking a hit in early 1970s. This was due to emergence of a nimble competitor, Goldengate, and high interest rate regime.

The case is concerned with the performance of a branch, by name Fruitvale, which has been consistently losing business to its archrival Goldengate in its territory. By mid-1991, Goldengate had performed much better than Manzana's Fruitvale branch on every count and this resulted in memo being issued by the senior vice-president at Manzana. The Fruitvale branch performed badly on various measures like total number of requests for New policies, endorsements, and renewals processed, very high turnaround time resulting in late renewals and increased renewal loss rate.

The management was of the view that the branch was adequately staffed, overstaffed in some cases, and dismissed staffing as a cause for the dismal performance. The top management wanted some urgent action on Fruitvale's part and provided them two weeks to come up with an action plan.

Problem Definition

To identify and resolve operational inefficiencies in the processing of various underwriting requests, which have adversely impacted the branch profitability.

To identify and remove/ mitigate the bottlenecks in policy processing so that the turnaround time (TAT) is reduced and customer base is retained.

To come up with an action plan to tackle late renewals and thus improve renewal rate**.** Late renewals have increased by almost 90 percent over the corresponding quarter in the last year. (Case Exhibit 6).

Analysis

1. *Increasing losses:*
   From Case Exhibit 5, it is evident that the decreased profitability can be attributed to a stagnant top-line (almost constant revenues) and an increase in commission expenses, losses (ordinarily insured and extra ordinary losses), operating expenses and other expenses.

2. *Drop in number of RERUNs:*
   The revenues have remained stagnant in spite of an increase in the number of new policies (Case Exhibit 6 and table 1). This is due to a decrease in the number of renewed policies, leading to a significant decrease in revenues. Renewals have been the greatest source of revenue, comprising around 80% of the total premium revenue.

3. *Adverse Selection:*
   It may be possible that the increased insurance payments and losses are due to the poor quality of service (in terms of the TAT –Turnaround time) offered by

Manzana *(refer exhibit 5)*. Normally, only people with a high degree of risk would willingly opt for poor quality of service, since they know that good companies would reject their underwriting proposal straightaway. This results in *adverse selection* and only those clients who believe that they have a high risk would go for Manzana Insurance.

4. *Number Game:*

   It is also be possible that the underwriting team does not carefully evaluate all underwriting requests, in order to show an increase in the number of new policies and get their "salary/plus" bonuses. It can be seen from Case Exhibit 5 that the sales in 1st quarter of each year are quite low and they increase dramatically in the last quarter of each year. This may be the result of "dumping" – showing a particular amount of sales growth in a particular year to get commission (for agents) and "salary/plus" bonuses (for employees). Essentially, what this implies is that Manzana employees may be serving high-risk customers to increase the number of policies served, leading to excessive insurance payment outlays and additional losses.

5. *Underutilisation:*

   The three underwriting teams are unevenly loaded with work. The first team (territory 1) has an extremely high level of utilization (98%), whereas teams two and three have very low utilization levels (79% and 71%) respectively *(refer Exhibit 3)*. This load disparity may frequently lead to situations where one team is overloaded with work, and the other teams are under-loaded. This suggests that the division of territories on a geographical basis may not be the correct strategy.

6. *Profitability of various underwriting requests:*

   It is seen that the renewal requests take the least amount of processing time and earn maximum dollars per minute of processing. Thus, RERUNS are the most profitable among the various types of underwriting requests *(refer Exhibit 4)*.

However, it has been seen that Manzana has been consistently losing out on the number of policy renewals *(refer exhibit 1)*, seriously eroding its profitability. The primary reason for the same is delay in RERUN processing, leading to agent and customer dissatisfaction. 425 RERUNs (renewals) were processed late and 429 renewals were lost. On a quarter-to-quarter basis, 44% of renewals were processed late and 47% of renewals were lost. The drop in the number of renewals leads to a loss in revenue (Case Exhibit 5).

7. *Priority Issues:*

RERUNs are given last priority in the order of requests taken-up based on a false assumption that RUNs and RAPs are more important and generate more revenue. From the point of view of profitability of each type of request, it can be seen that RERUNS are actually more profitable than RUNs *(refer exhibit 5)*.

Although the company policy is supposed to use FIFO processing, the underwriting team implements a priority processing system, wherein the order of processing is RUNs, RAPs, RAINs and RERUNs. This leads to relegation and almost ignorance of the RERUNs, leading to late policy renewals and agent dissatisfaction. The agents are not only the customers of the company, but also are actually the internal customers. Dissatisfied agents may recommend a competing firm to the customer, leading to customer switching. Moreover, the incentive scheme for renewals is quite ineffective as the insurance commission for new policy is 25% whereas that for renewals is just 7%. Hence agents give priority to RUNs over RERUNs.

Agents are the primary customers of Manzana. They influence the buying decision of the end customer (policyholders), and can influence the risk profile of policyholders and also Manzana's reputation.

Moreover, it is a basic principle that new customer acquisition is more difficult than customer retention.

8. *RERUN Processing Issues:*

   The RERUNs are released only a day in advance, in order to get the best information to re-evaluate risks. However, it is extremely unlikely that a significant change in customer risk leading to heavy losses would occur in a few weeks just prior to the policy lapse date. Also, since the branch computer (using the "tickler" system) automatically generates a renewal request (RERUN) 30 days before the anniversary date of the policy, it is possible to expedite their processing and deliver them on time.

9. *Poor conversion of RAPs:*

   The conversion rate of RAPs into RUNs is only 15%. RAPs are given a high priority (next only to RUNs) and take up a significant amount of time for processing. However, since most of the RAPs do not translate into business (and hence revenue), most of the effort devoted to RAPs can be considered as wasted.

10. *Invalidity of usage of Standard Completion Time (SCT):*

    According to Case Exhibit 3, while calculating the TAT (turnaround time), Manzana is counting the same job more than once by adding the request on the upstream desks (tasks) also. For example, while calculating the TAT at the rating desks, the requests outstanding at distribution clerk desks and underwriting team desks are also considered, even though they have already been accounted for. Also, SCT (Standard Completion Time) is used instead of the mean time to calculate the TAT (turnaround time). When SCT is used, it is assumed that 95% of all requests will take that much time, whereas on an average, the time taken would be much less. Hence, the turnaround time calculations are inflated (i.e overestimated).

Recommendations

1. The RERUNs should be given a high priority. They should be processed as they come. In effect, FCFS (First Come First Served) should be implemented for all requests, regardless of their origin.

2. TAT (Turnaround time) should be calculated using the mean values, rather than the SCTs (Standard Completion Time), and double counting of processing steps at each desk should be avoided. This would make the TAT estimates more realistic.

3. The commission structure of agents needs changes. Since the renewals are quite profitable for the company, the commission for renewals can be revised upwards.

4. Balance the workload of the three underwriting teams by reassigning the agents to the teams so as to equally divide the number of policies handled.

5. By observing the nature of the rating and policy writing jobs, the underutilization of distribution clerks, we found that it will be economic to train employees to handle the whole range of jobs so that in case of overloading of the staff with RAP requests, policy writers can help distribution clerks and raters.

6. A flexible system, involving multi-skilled employees, schedules can be charted out on a weekly or fortnightly basis. Multi-skilling is limited to Distribution Clerks, Raters and Policy Writers as the jobs in the latter two departments are becoming clerical in nature. As this organization moves on the learning curve, a trend should emerge which will provide an almost stable employee situation in each division; but the divisions will always be armed with flexibility as a result of multi-skilling if there are discrepancies.

Exhibits

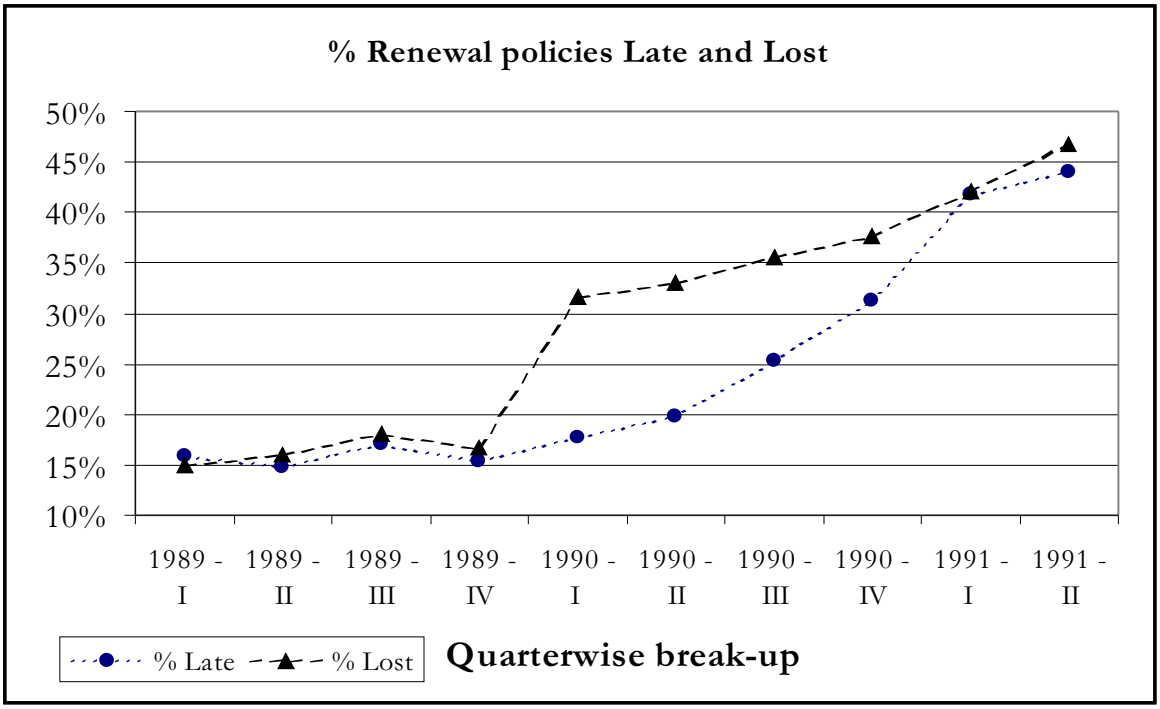

Exhibit – 1

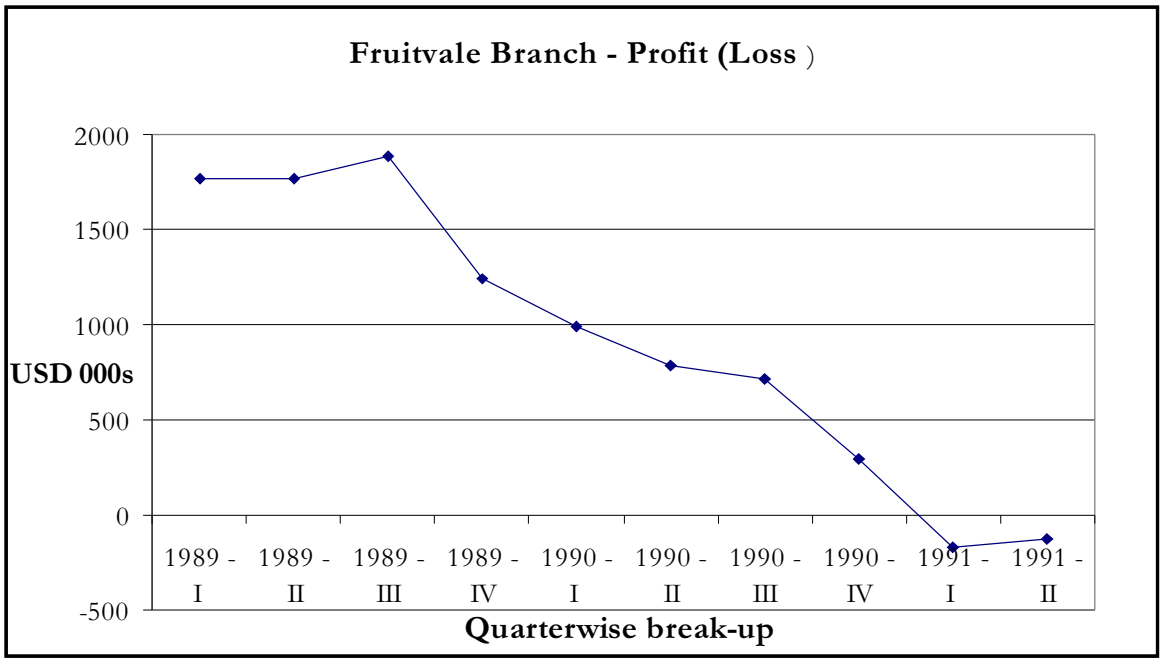

Exhibit – 2

UTILIZATIONS					
Processing Centers	**RUNs**	**RAPs**	**RAINs**	**RERUNs**	**TOTAL**
Distribution (4 persons)	11%	42%	9%	27%	90%
Underwriting Team 1 (2 person team)	13%	55%	8%	22%	98%
Underwriting Team 2 (2 person team)	8%	36%	6%	29%	79%
Underwriting Team 3 (2 person team)	7%	38%	5%	21%	71%
Underwriting Average	9%	43%	6%	24%	83%
Rating (8 persons)	6%	25%	7%	36%	74%
Policy Writing (5 persons)	15%	na	9%	39%	63%
NOTE: Utilizations for Policy Writing includes the 15% of RAPs that are turned into RUNs.					

Exhibit – 3

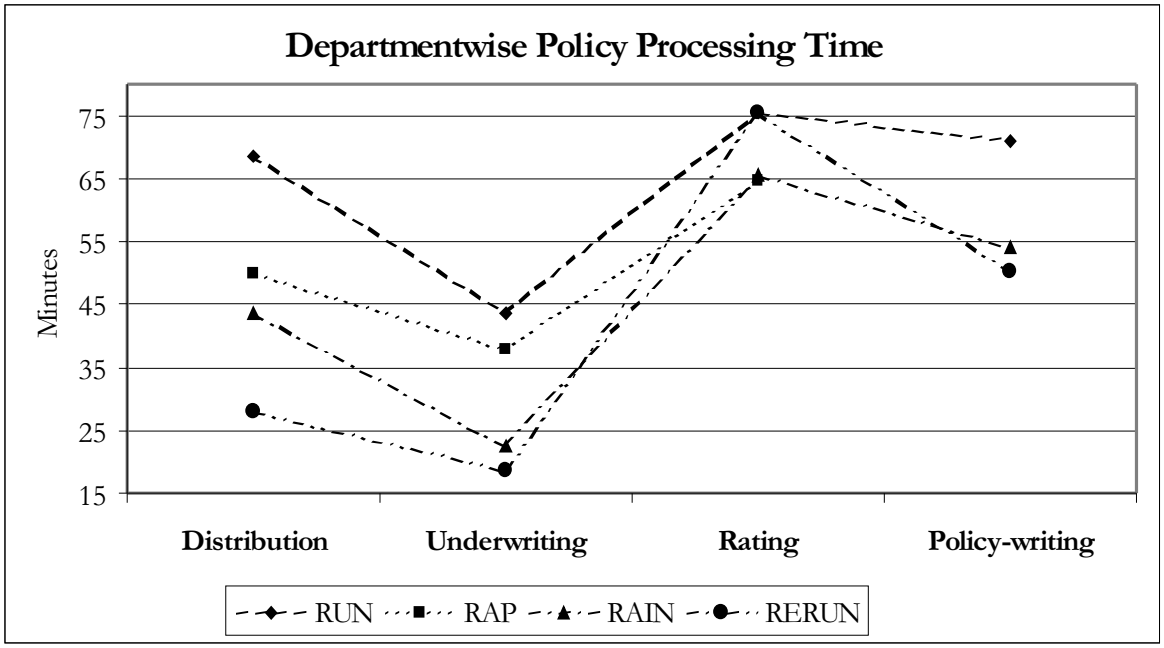

Exhibit – 4

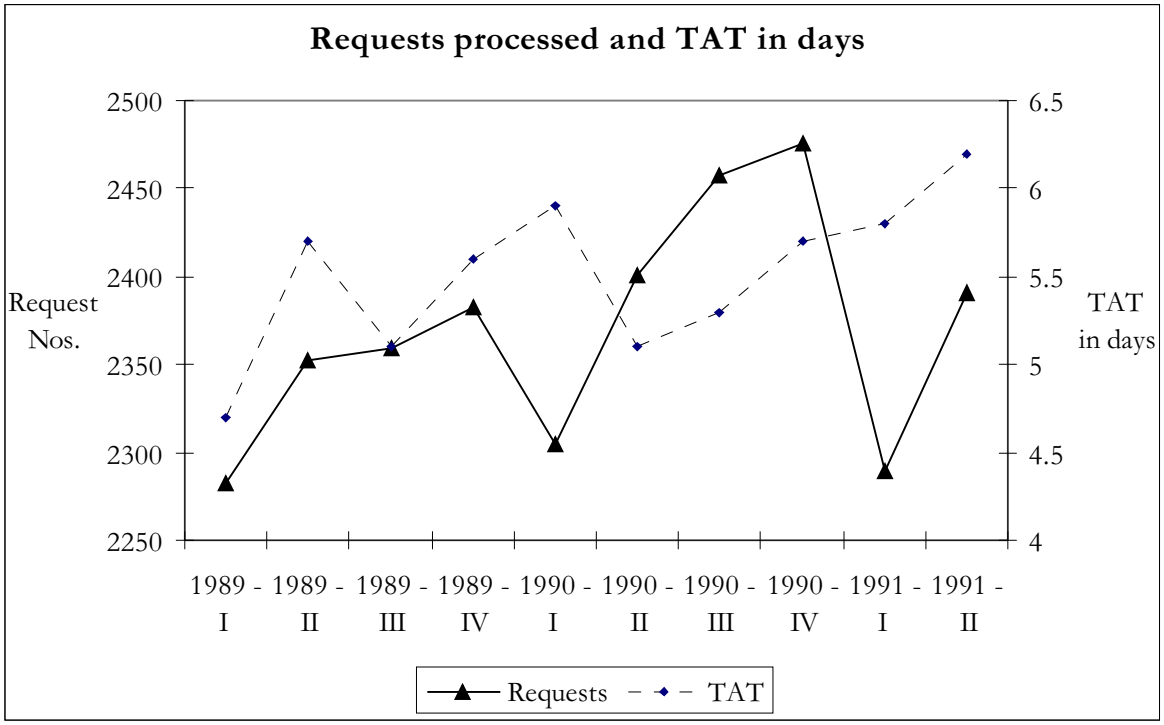

Exhibit – 5

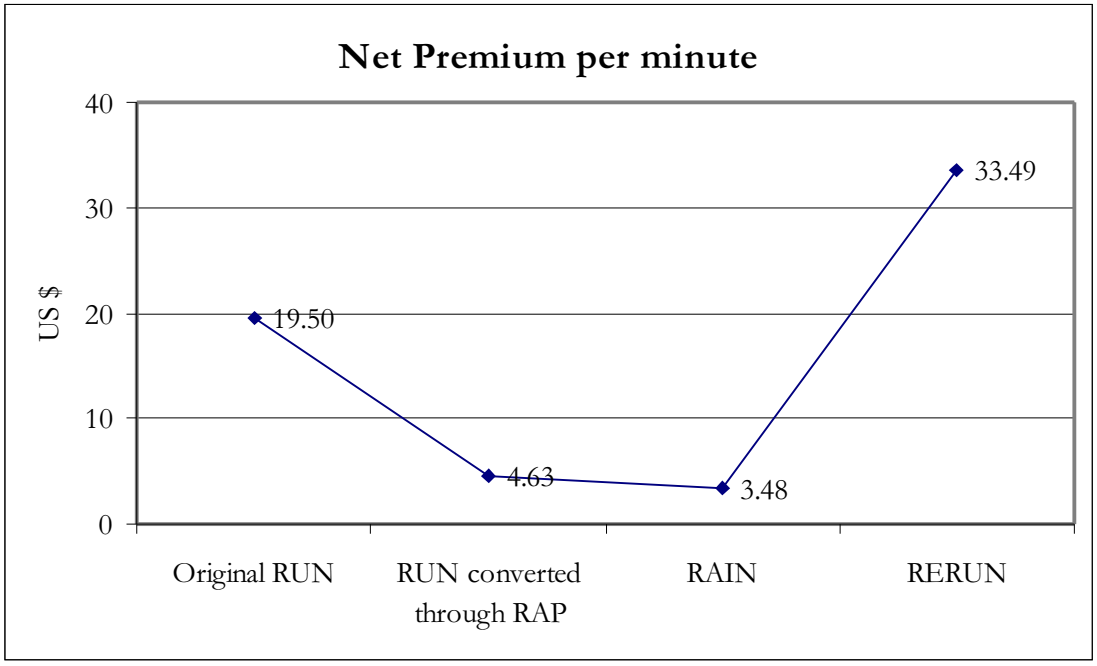

Exhibit – 6