From the reprint department of:

Business Insurance®

a publication of Crain Communications Inc.

Reporting weekly for corporate risk, employee benefit and financial executives.

As seen the week of:

AUGUST 5, 1996

Perspective

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Benchmarks keep companies moving

External reference points key to significantly improving risk management results

By Paul Steinman

A GROWING NUMBER OF ORGANIZATIONS now use benchmarking to improve how they manage and control their total cost of risk.

By comparing operations against a standard, it's possible to identify good and poor performers relative to the benchmark, as well as the factors contributing to the performance differences.

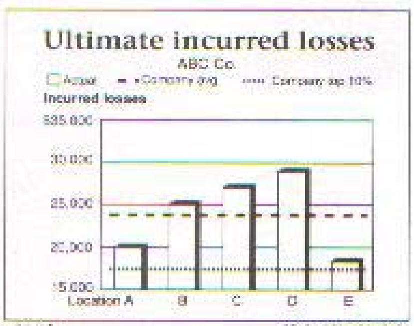

Figure A GRAPHIC BY LISA KRUSS

Alternative practices then can be applied to improve results.

Until recently, internal benchmarking—such as comparing loss experience of one location against that of another—was the most popular benchmarking technique used in risk management.

In figure A, five locations of the hypothetical ABC Co. are compared with each other with regard to ultimate losses per some unit of exposure.

In addition, each location is compared against two standards—the company average at ABC Co. and the average for the top 10% of locations within the company.

Without the benchmarks, individual locations can compare themselves against one another. However, the significance of their performance becomes more apparent when compared against the benchmarks, which provide a point of reference and furnish each location with a new yardstick. In this way, each location can determine if its performance is above or below the company average, as well as the average of the top 10%.

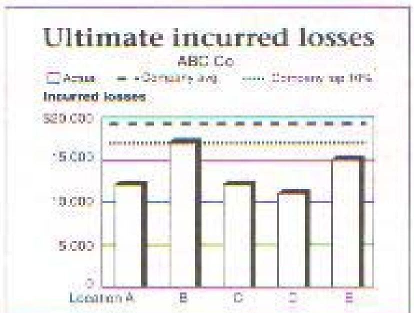

Figure B GRAPHIC BY LISA KRUSS

Such comparisons help identify ideal performance standards, and companies can use them to set attainable incremental goals.

In this case, although Location E is the best in the group, it still has a long way to go to become a top performer. Benchmarks can help Location E adjust its goals accordingly.

Similarly, Location D may set a more realistic goal of reaching the company average.

These comparisons are the first step to gaining insights about the underlying processes that contribute to superior results.

Identifying the practices and procedures that achieve the best results provides the operations in the comparison group with blueprints that can lead to improved results.

Even though internal benchmarking can be very useful, it doesn't always produce optimal reference points.

In figure B, five locations of the ABC Co. again are compared with one another, the company average, and the average for the top 10% of locations within the company.

However, this time all locations are performing better than the company average based on the benchmarks established earlier, and all but one rank among the top 10% of performers in the company.

Although Location D has achieved the best results in the comparison group, its performance hasn't created a new standard for the company.

Missing from this comparison are external points of reference. Without them, the ABC Co. can determine only how well it is performing against itself. Gauging whether its performance is in fact superior or inferior can only be accomplished by adding an external reference point.

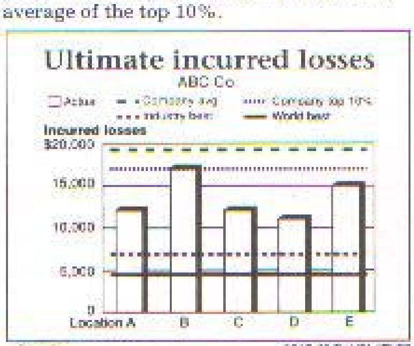

Figure C GRAPHIC BY LISA KRUSS

In figure C, two external performance standards have been added—best in the industry and best in the world. With these references, it's clear that the ABC Co. has a long way to go before it can consider its results the best in its industry, and even longer before it makes it into the upper echelon of World Class.

Further, although Location D, ABC Co.'s top performer, can be classified among the best in the industry, the external benchmark implies that it still might identify practices that can improve its results further.

One reason internal benchmarking is more widely used over external benchmarking is the availability of information.

Typically, external benchmarks are either unavailable—because competitors rarely share this information—or unreliable. Nonetheless, external benchmarks yield a wider array of methods to improve results.

For external benchmarks, use a top-down approach. Start with broad comparisons before examining information with a greater level of detail.

For example, a benchmark based on a national average could be the first point of reference.

The next point of reference could be refined to a particular industry based on an industry average.

Subsequently, a more detailed view could be created for each state.

This approach is particularly important for workers compensation, where each jurisdiction is governed by a different set of rules.

Finally, information would be analyzed by various factors and processes, including length of disability for return-to-work programs.

In evaluating claims and exposure statistics, several items can be compared, including:

- Coverage, such as workers compensation, general liability.
- Financial information, including medical, indemnity, expenses.
- Medical costs and medical-only claims.
- Indemnity costs and claims.
- Expense costs and expense-only claims.
- Average incurred.
- Industry type.
- Cause of loss.
- Contributing hazards.
- State, province, or country.
- Time to report claims.
- Time to close claims.
- Body part (for workers compensation).
- Injury (for workers compensation).

These items can be used in any combination.

The benefits of external benchmarking can be illustrated by a group formed in 1993, the Johnson & Higgins Workers' Compensation Quality Council.

That group was comprised of seven large firms—GTE Corp., Xerox Corp., PPG Industries Inc., Whirlpool Corp., Abbott Laboratories, Colgate-Palmolive Co., and Johnson & Johnson. Each participant had ample statistical information for internal benchmarking, but was unable to make meaningful external comparisons.

The group pooled its workers compensation loss and exposure information to measure and identify best practices for reducing total cost of risk.

With the group's combined information assembled, external benchmarks were developed using the top-down approach discussed above.

Some of the participants were surprised that their results were not as impressive as they thought; others now had the means to validate their success. The group prepared process maps of practices of members with the best results and compared them with their own.

By understanding practices that led to improved results and how the culture of the corporation affects the process, several members of the group were able to apply these practices to their own operations and achieve improved results.

Benchmarking is becoming an increasingly popular method for organizstions to reduce their total cost of risk. While internal benchmarking is often the best place to begin, more sophisticated techniques now exist for external benchmarking.

Through proper comparison, an organization can identify target areas that may have a positive effect on its bottom line. BI

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