

Ensuring Culture Change at Arbella

A Case Study in the Effectiveness of Rewards

**WorldatWork Annual Conference
May 13, 2002**

Welcome!

What's different about this culture change case study?

- Real clarity about what culture change looks like
- An emphasis on base pay Vs. variable compensation
- An honest look back...current status...and future plans

Arbella Insurance Group

- Regional property and casualty insurer MA, CT, RI
- 2nd largest personal lines company in MA
- \$660 million revenue—600,000 policies
- 1100 employees
- 8 locations

Business Challenges 2000–2003

- **Strategic Planning Exercise (November 1999):**
 - ❖ **Projected revenue decreases**
 - ❖ **Expense pressures - decreasing dollars for salary budget**
 - ❖ **Desire to change compensation programs to recognize performance differentiation**
 - ❖ **Desire to use compensation programs as a culture change driver**

Leadership Challenges

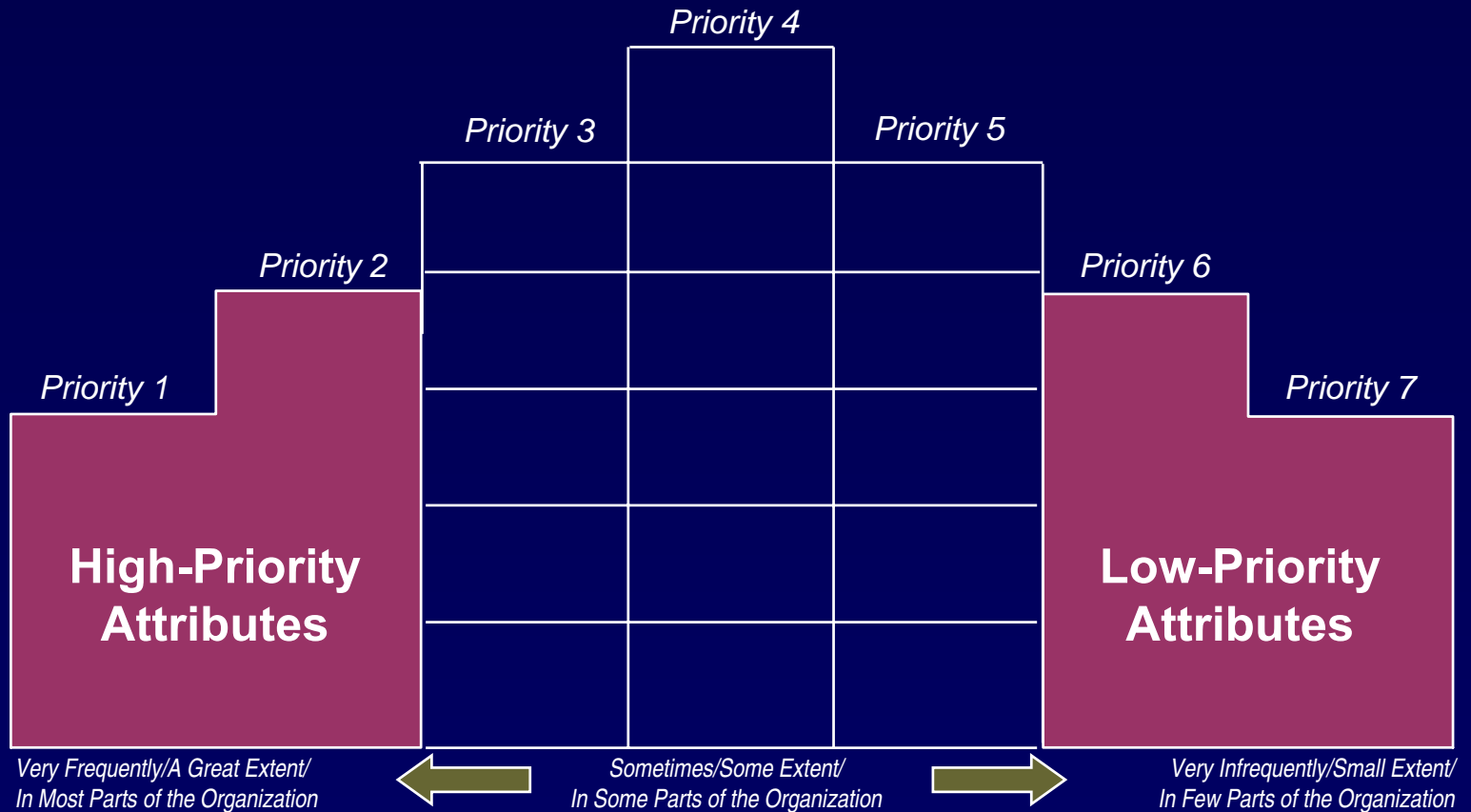
- **Executive team changing—widely variant expectations and behavior**
- **Differing views re: need to work on culture change**
- **Need to agree on vision of desired culture and establish perception of current state status (November 2000)**

Organizational Cultural Assessment

- **Leadership team independently completed Hay's C-Sort diagnostic tool**
- **C-Sort methodology uses 56 attributes to describe organizational cultures**
- **Sample Attributes**
 - ❖ **Encouraging teamwork**
 - ❖ **Supporting the decision's of one's boss**
 - ❖ **Rewarding superior performance**
 - ❖ **Pushing decision making to the lowest levels**
 - ❖ **Maximizing customer satisfaction**

Data Collection

- Leadership team asked to sort 56 attributes from high to low priority
 - ❖ First, based on current culture
 - ❖ Second, based on desired culture



C-Sort Findings

- Modest agreement about current culture
- Strong agreement regarding desired culture
- Significant gap between current and desired culture

	<i>Compared to Hay's Normative Database</i>	
	<i>General Industry</i>	<i>Insurance Industry</i>
Consensus Regarding Current Culture	Average: 43rd percentile	Low: 25th percentile
Consensus Regarding Target Culture	Very High: 78th percentile	High: 66th percentile
Gap Between Current & Target Cultures	High: 68th percentile	High: 63rd percentile

Culture Change Priorities: Three Elements

- 1 Greater emphasis on performance and less on job security, loyalty, and consistency***
- 2 More value for flexible work environment and less reliance on compliance and adherence to rigid structures and functional hierarchies***
- 3 A shift in orientation from internal to external while maintaining focus on customers***

1

Performance

■ **Emphasize**

- ❖ **Being flexible and adaptive in thinking and approach**
- ❖ **Attracting top talent**
- ❖ **Rewarding superior performance**
- ❖ **Capitalizing on creativity and talent**

■ **Deemphasize**

- ❖ **Providing secure employment**
- ❖ **Being loyal and committed to the company**
- ❖ **Establishing clear job descriptions and requirements**

Note: Attribute ranking changed by at least 2 categories. Emphasize attributes appear in top 3 priority categories, deemphasize in lower 3 categories.

2

Flexible Work Environment

■ **Emphasize**

- ❖ Continuously improving operations
- ❖ Being flexible and adaptive in thinking and approach
- ❖ Using limited resources effectively

■ **Deemphasize**

- ❖ Quality checking subordinate's work
- ❖ Being precise; minimizing human error
- ❖ Minimizing unpredictability of business results
- ❖ Using proven methods to serve existing markets
- ❖ Respecting the chain of command
- ❖ Supporting decisions of top management and of one's boss
- ❖ Maintaining clear lines of authority and accountability
- ❖ Establishing clear job descriptions and requirements

■ **Maintain Emphasis**

- ❖ Encouraging teamwork

3

Orientation

■ **Emphasize**

- ❖ **Providing employees with resources to satisfy customers**
- ❖ **Delivering reliably on commitments to customers**

■ **Deemphasize**

- ❖ **Using proven methods to serve existing markets**

■ **Maintain Emphasis**

- ❖ **Maximizing customer satisfaction**
- ❖ **Demonstrating understanding of customer point of view**
- ❖ **Maintaining existing customer accounts**
- ❖ **Responding to customer feedback**

Culture Change & Rewards: Background

Prior to project, compensation system characterized by:

- Competitive salaries
- Traditional grade structure
- Grades based on job evaluations
- Very little differentiation in merit pay
 - ❖ Merit matrix guidelines
- Modest (\$200) bonus opportunity below management, based on company performance

- Entitlement
- Internally-focused
- Control oriented
- Rigid structures

Culture Change & Rewards: Background

- **No opportunity to enhance competitiveness due to budget constraints**
- **Needed to better leverage existing investment**
- **Base and merit pay was logical choice**
- **Decided to stop treating merit like a tax**
 - ❖ **Paying it is inevitable**
 - ❖ **You don't see anything in return**

Culture Change & Rewards: Background

Salary increases are one of Arbella's largest annual expenditures

Arbella Merit 1040 Form

Line 1: Total Payroll.....	\$52,000,000
Line 2: Total Merit Budget.....	4.5%
Line 3: Promotion Budget.....	0.5%
Line 4: Other Out-of-Cycle.....	0.0%
Line 5: Total Expense.....	\$2,600,000
Line 6: Total Return.....	???



Culture Change & Rewards: The Opportunity

- **What was Arbella getting in merit ROI?**
 - ❖ “I get to keep my people”
- **What should management expect to get in merit ROI?**
 - ❖ “I get to recognize my best performers”
 - ❖ “I retain my top contributors”
 - ❖ “It puts the ‘teeth’ in our performance-based culture”
 - ❖ “It facilitates management discussion of talent”
 - ❖ “It builds teamwork”
 - ❖ “It improves returns on other reward programs”

Reward Objectives

■ Culture Findings

- ❖ Performance
- ❖ Flexible work environment
- ❖ Orientation



■ Competitive Findings

- ❖ Within competitive norms
- ❖ Lower on variable pay



■ Reward Objectives

- Maximize return on compensation investment
- Place more value on individual performance
- Support cross-functional teamwork and performance
- Invest in manager development

Reward Changes

■ Reward Objectives

- ❖ Maximize return on compensation investment
- ❖ Place more value on individual performance
- ❖ Support cross-functional teamwork and team performance
- ❖ Invest in manager development



■ Proposed Reward Changes

- ❖ New salary structure
- ❖ New merit pay program
- ❖ Change incentive plans
- ❖ Management training

Reward Changes

- **Place more value on individual performance**
 - ❖ **Change merit increase to better reward top performers**
 - e.g., Goal: upper quartile merit increases average 7% (assuming 4% budget)
 - ❖ **Simplify job classification system**
 - Method: Reduce numbers of levels and titles
 - Objective: Reinforce importance of broader role Vs. finite jobs and individual contribution Vs. job value

Reward Changes: New Merit Pay Program

Unbundled the Merit Program

- Merit pay (equivalent to cost of labor changes)
- Merit plus pay (true merit)

	% Population	2001 Merit Pay		2001 Merit Plus Pay		Total Average Increase
Objective		<ul style="list-style-type: none"> • Recognize steady performers • Ensure pay remains competitive 		<ul style="list-style-type: none"> • Reward top contributors • Align pay with performance 		
Steady Performers	• 75%	3.5%	+	0%	=	3.5%
Top Contributors	• 25%	3.5%	+	Average: 4%*	=	7.5%
Total Cost		3.5%	+	1%	=	4.5%
						2001 salary increase budget

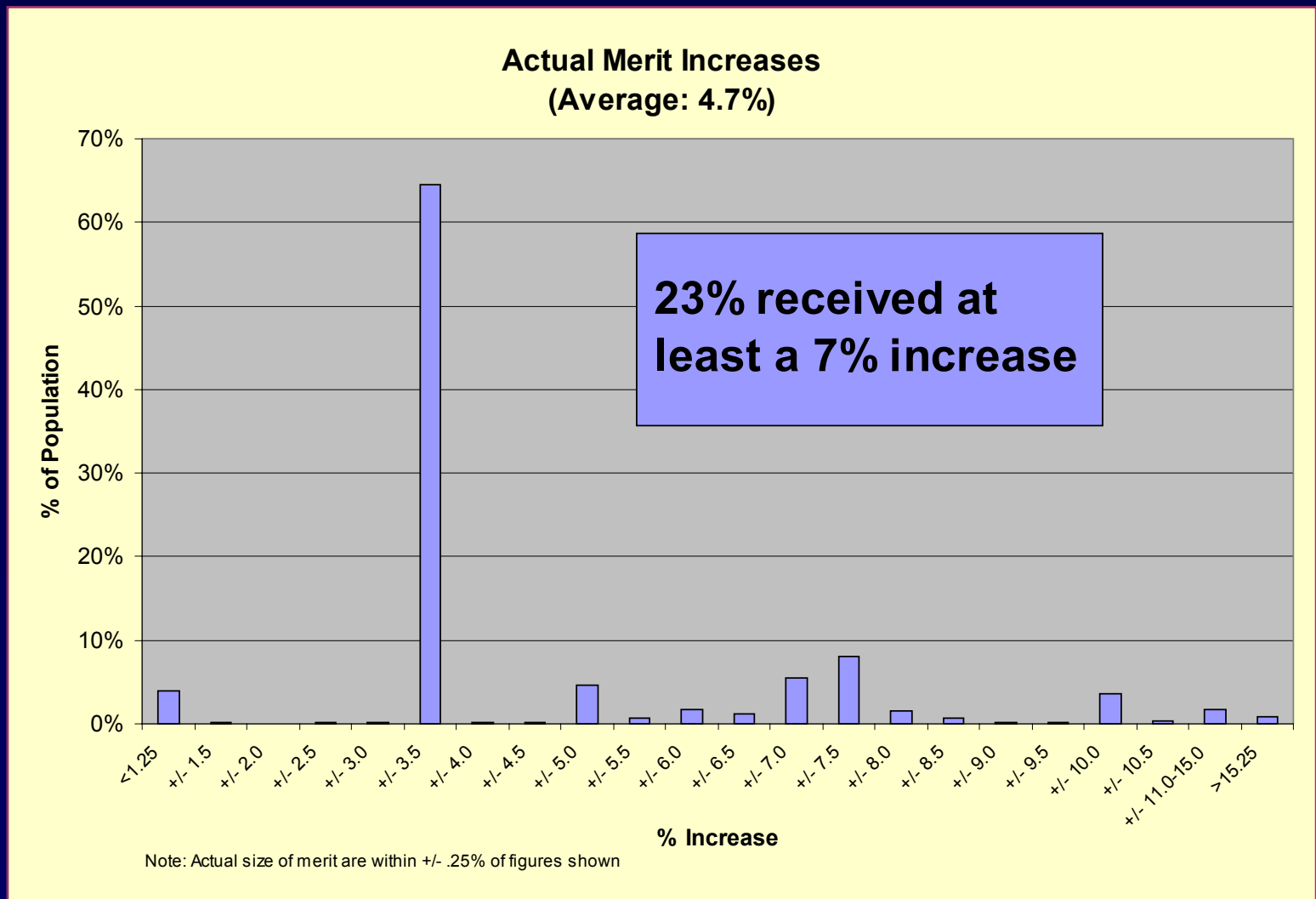
* Individual increase in excess of 15% treated as an exception

Culture & Reward Changes: Implementation

Preceded reward changes with management communication and training

- All managers' meeting sharing cultural findings and reward changes
- Training on new reward and merit pay program
 - ❖ Identifying merit plus candidates
 - ❖ Communicating new reward philosophy to employees

2001 Merit Increase Distribution: Actual



Culture Change: Two Years Into The Change

- **What's working well (November 2001):**
 - ❖ **Customer service focus has not diminished**
 - ❖ **Line management sees progress toward desirable cultural attributes**
 - ❖ **Executives perceive culture has shifted significantly toward performance/process orientation**
 - ❖ **Management has little trouble making distinctions between levels of performance**
 - ❖ **Management generally supportive of changes**

Culture Change: What Needs More Work (May 2002)

- **Keeping executive management engaged**
- **Cultural change is a leadership process, not an HR or compensation program**
- **Empirical data around cultural attributes**
- **Assisting line management in using performance discussions to make differentiation - not tenths of merit %**

Culture Change: Results So Far

- **Line management sees progress on desirable cultural attributes**
- **30% of staff were designated “significant” performers**
- **Compensation spending was directly on budget for '01**

Group View of Target Work Culture

“Our Desired or Ideal Culture Would Reward, Encourage and Support the Following Behaviors and Activities . . .”

		Adapting quickly to changes in business environment
		Gaining the confidence of customers
		Capitalizing on windows of opportunity
	Attracting top talent	Anticipating changes in the business environment
	Responding to customer/agent feedback	Taking initiative
Maximizing customer/agent satisfaction	Maintaining existing customer accounts/agent accounts	Applying innovative technology to new situations
Demonstrating understanding of the customer's point of view	Providing employees with resources to satisfy customers/agents	Treating employees fairly and consistently
Delivering reliably on commitments to customer/agent	Rewarding superior performance	Capitalizing on creativity and innovation
Encouraging teamwork	Using limited resources effectively	Pushing decision-making to the lowest levels
Being flexible and adaptive in thinking and approach	Continuously improving operations	Encouraging innovation

Very Frequently/To a Great Extent/
In Most Parts of the Organization

Sometimes/To Some Extent/
In Some Parts of the Organization

Target Culture Behaviors That Characterize Arbella

Responding to Customer Feedback	Treating Employees Fairly & Consistently	Maintaining Existing Customer/Agent Accounts
Maximizing Customer Satisfaction	Demonstrating Understanding of the Customers/Agents Point of View	Encouraging Teamwork
Delivering Reliably on Commitments to Customers/Agents	Continuously Improving Operations	Gaining the Confidence of Customers/Agents

Target Culture Behaviors That Sporadically Characterize Arbella

Using Limited Resources Effectively

Rewarding Superior Performance

Taking Initiative

Adapting Quickly to Changes in Business Environment

Anticipating Changes in Business Environment

Encouraging Innovation

Target Culture Behaviors That Are Not Yet Characterized By Arbella

Attracting Top Talent

**Providing Employees
w/ Resources to Satisfy
Customers/Agents**

**Being Flexible &
Adaptive in Thinking
& Approach**

**Capitalizing on
Windows of Opportunity**

**Applying Innovative
Technology to New
Situations**

**Capitalizing on
Creativity &
Innovation**

**Pushing Decision-
Making to the
Lowest Levels**

In Summary

- **Significant progress has been made**
- **More progress is needed**
- **Rewards can help, but can't do it alone**
- **Building a business case for change is crucial**
- **Invest in managers to sustain change**

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