

**Edited transcript of Q&A with Mr. Flaherty  
at the All Officers' Meeting  
September 27, 1995**

**Q: How do you see the Chairman of the Board and the President's role unfolding?**

I think that comes under the broader heading of organization planning, succession planning, etc. In the last 10 months, I've done a great deal of reading, trying to understand how to best position the company from a structure standpoint to most effectively win in the market.

When you report on something like reengineering, even if you give a lot of detail, you're really just scratching the surface. The same thing could be said about managed care, public policy, and so on. So we have a very complicated strategy that we're trying to implement, and it requires the talents of this group. As one individual, I am glad that you are here and that you are making the heavy contributions you're making.

About two years ago, I was concerned about people understanding our corporate direction and being concerned about possible changes in that direction. I did a lot of listening, and I interviewed folks in this room and others. Questions surfaced like: Why do we still have market segment teams? Why don't we go to strategic business units? And other questions generally asking about structure as it tied to strategy.

While the temptation was certainly there to just make decisions, we said, "no," let's put some discipline into this. We hired Delta Consulting to pull together your collective thinking. Not that your collective thinking will control — in the sense of we are an Athenian democracy and we're going to make decisions based on a 29 to 21 vote —

but rather we have to address the issues that are important to you. We need to know what they are, and we need to know their scope and intensity.

We have almost finished interviewing the people around this room. The resulting information will provide a database, in addition to the strategy material — the premise being that strategy drives structure — that we will be looking at going forward.

The questions that will emerge from that will be: What should your senior leadership structure look like? And, what should your organization's structure or themes be?

We have a four-member steering committee — Mike Cascone, Bob Lufano, George Cassidy and myself — working directly with the consultants. We will take the data they gather — I understand it's going to be hundreds of pages — and work it down to a reasonable degree. Then, we will engage the organization, starting with executive staff. Next, we will create design teams made up of people in this room and people that report to you. We'll ask you to work with us to flesh out what our choices are around structure and that sort of thing.

For my role, we are leaning toward more of a CEO role and less of a COO role. However, it isn't necessarily clear that our best interests are served by simply saying COO. We may need to go to an office of the chairman or an office of the president. Or we may need some other strategy. I didn't want to close that out until I heard from you. So that's the way the two connect.

Let me mention a few other things. First, board development is an important responsibility as is leadership of the board. It's also one we've been working on for 17 years; it's not something new. While we work with an active nominating committee, board recruitment was done by management employing a search firm. We have specified the qualities we're looking for and combined that with individual suggestions from people both on and off the board. For the most part, new board members in the last five to eight years have been people I've identified as contributors through my other work activities.

It's important for the board to be cohesive. It's a little larger and it's more diverse than it was before. We have some strong personalities on the board. I purposely sought strong personalities because when we know we're going to be challenged, we get higher quality decision-making from all of us. And that's needed to win.

As typified by this meeting and many others, Mike [Cascone] has assumed both a formal and informal leadership role in our organization. We expect that to continue and to expand. In terms of precisely what the form and structure should be, I don't know. Every organizational form has its weaknesses. There isn't one that gets rid of all your problems without creating new ones.

Let me reinforce a couple of notions I believe are central to the organization's strategy and structure. We're going to have to compete on the dimensions discussed this morning. And we are going to have a very difficult government and regulatory climate in which to do business. The net effect is that we're going to have to do essentially what we've laid out in our plans. The crunch is going to come in funding it.

*[Note: conference referenced is a two-day Health Care Executive Summit hosted by IBM. About 50 companies were represented, ranging from Aetna, Prudential, Columbia, etc.]*

Tom Frist, vice chairman of the board of Columbia/HCA, reported [during the conference] that they now process claims directly for WalMart. They have a proposal to General Motors to do Florida retirees over and under 65. According to Frist, these customers are very interested in eliminating the 15 to 17 percent managed care companies take.

Similarly, major employers in Minneapolis are saying, "We don't really understand why this middle man is in here." I think that middle man has got to be extremely user-friendly and incredibly efficient. The only way I know to do that is to work at a level of effectiveness that clearly exceeds the rest of the players in the business.

The other thing is that quality will be the dimension of competition. We've made marvelous progress in terms of NCQA, but I don't think we have a corporate culture across all units that focuses on TQM or techniques of that type. Intellectually we've said once we reengineer we'll take other improvement efforts and roll them into a TQM or CQI approach — I'm using those two terms interchangeably. If we're going to perform effectively and get our costs down, we're going to have to do that.

I think we're essentially right on in our strategy. We're also right on in using reengineering as a tool to implement that strategy.

Coming out of reengineering, our strategy and our ten years of experience, it is inevitable that questions about structure are arising. Should you have market segment teams? Should

they be the current form? Should they be an amalgam of the current form? Should we refine our segmentation? Should there be 10 or 12 market segment teams? There are other questions such as: Should you match off the functional areas of the segments rather than create teams to match off to the segments?

Those questions have been raised. They will, in turn, determine what units need to be aggregated and what makes sense to cluster together.

What I'm trying to do is avoid drawing any predetermined conclusions. I want the people who are going to manage those areas to be involved in those decisions.

**Q: You mentioned there was recognition of the difficult government/regulatory climate in the conference you attended. Did you hear how other carriers are dealing with it?**

No. The only company that seemed to have its future tied to the regulatory climate in Florida was Columbia. They indicated that while they view Florida as their primary market, they're clearly going to cross the entire country. And, they're focusing not just on the less valuable community hospitals but also on acquiring teaching hospitals.

They talked about active negotiations in Denver for a major teaching institution, and about acquiring one in Tulsa. And, they're getting into the Boston market. They said in some of that discussion that, yes, they had had to wrestle through the climate because some of those climates are hostile to investor-owned institutions.

If you listen to an Aetna talk, it appears they're looking at it from an

opportunistic standpoint. If a market goes sour because of regulation — if Florida goes sour — then they'll focus more resources on Georgia.

**Q: Listening to the strategies shared at the conference, what observations did you make about our strategies in terms of positioning us to be market leader in Florida or other markets?**

We found people in almost every element of the business who are ahead of us — but no one who is ahead of us in an operational sense. However, there are people out there who give us concern. It doesn't threaten the wisdom of our strategy, but it does say, we better execute it.

We learned that Cincinnati Blue Cross — which has become part of Anthem — has a major identity campaign underway in the midwest (Kentucky, Ohio and Indiana). They are now Anthem Blue Cross/Blue Shield. They have many of what we would call virtual office capabilities operational today. They have beta sites in 50 to 75 physicians' offices with the capability to interact with them in terms of referrals, appointments, etc.

Separately, I learned that they have decided to be aggressive about expansion. They concluded that they could not support their infrastructure unless they had a \$10 billion base of business. It's predictable that they intend to extrapolate from Cincinnati into the midwest. If they stay in the Florida market — thanks to you folks, we haven't been their most wonderful market to enter — and I presume they will, then they are going to be using those capabilities to compete with us.

They've also set up CHINS (Community Health Information Systems). I know how hard it is to get 50 or 60 Blue Cross plans to collaborate and make decisions together. The thought of getting, community by community, their health care delivery power structure together and making decisions on systems and computers, is daunting.

I learned that the Ohio plan has an initiative in Dayton and another, separate initiative in Cincinnati. This capability is central to being highly efficient going forward — even though there are still unanswered questions.

There are dozens of independent, unrelated initiatives going on. Some are going to survive and some aren't. Can we afford to be on the sidelines and have that happen to us? I don't think so. Can we finance it by ourselves? I don't think so. So as another element of strategy, I came away feeling that we've got some work to do in this area.

One other gap in our strategy I'll mention is the fact that I don't believe we have a formal strategy for dealing with academic medical centers. I don't consider them to be managed in the traditional sense of that term for private industry. I consider them to exist and historically to have been beyond corporate-wide management.

Someone who ran a major teaching center once said that the number one principle for managing a complex medical institution is compromise. You take all the competing physicians and find a compromise, in the middle, because that's what you can implement.

A presentation from Emory showed that the same techniques as those used in large complex businesses are being used in one academic medical center — reconciling some 28 separate [medical]

departments and vested interests with different users and different requirements.

There are a couple of things we need to say about ourselves. There is great danger in being so distracted by the wisdom of our strategies that we cease to be — or to become — adequately customer-focused. We've always said there is a difference between being “market-oriented” and being “marketing-oriented,” meaning do whatever you're told to do by the salesmen. We must be market-oriented. And we must be customer-focused. We can have elegant solutions; however, if they are a day early or a day late, and if they don't relate to where the customer is at that point in time, you're “dead meat.”

IBM is an example of that. For a generation, they recruited marvelously talented people. They did good work, but they didn't do the right good work, and they didn't stay customer-focused. They are much improved, but they still have trouble being customer-focused. They are so conscious of their own capabilities that they forget the customer may not wish to do things that way.

That relates to another issue. We say we're going to compete on the basis of quality, cost, service and access. But we define service in an historical 20-, 30-year-old basis. Service needs to be much more rigorously defined and agreed to by everyone in this room. For example, forcing a customer to integrate data because we run it on two systems and therefore it comes out in two formats is not good service. That doesn't mean that PBO can change it. But we can change it; and I think we have to.

In this new environment, service has to be thought of in terms of meeting customer expectations — expectations that are many and diverse. From the

feedback I get, we're not organizationally geared up to match off as well as we could. Every other company is struggling with this same issue. I didn't hear from anyone [at the conference] who felt they were on top of this challenge. It's an area that we need to strengthen.

**Q: Relating your comments to an earlier slide showing our overarching strategy, the enabling strategies and the supporting strategies, no where in there was a customer service strategy. Is that inconsistent with your last comment?**

Let me restate because that's a very helpful comment. I was saying that I identified three examples of gaps in our strategy — CHINS, academic medical centers and the rate at which we intend to introduce virtual office. Those three things made me feel that there is a missing set of paragraphs in our plan.

Then, what I was trying to do was go beyond that and say I see a couple of other areas where I think we don't have adequate plans. Under that heading, I put quality and customer focus. This drops you down into service — service in the broader definition, not the cycle time or the inquiry rate. That was the way I was organizing my thinking.

My concern is not that someone in this room is performing inadequately. My concern is that we don't have a consensus around what constitutes superior customer focus and what constitutes superior service. We may take satisfaction in a three-day cycle time or a five-day turn around time when the customer is sitting there cranking away at numbers from one of our reports that are unintelligible to them.

**Q: Could you talk about the timing of new introductions relative to development caused by the external environment and the amount of work we've put into that development?**

For reasons that aren't altogether clear to me — it may have to do with the nature of how the product is sold and distributed in the industry, not the company — it's my view that we place very little value in capturing and analyzing our market experience.

There's an old saying that in the absence of factual knowledge, you might as well use the most powerful opinion. And in product development, the use of pocket vetoes means everyone's powerful. Everyone meaning many functional managers are powerful.

It's my impression that we have a tortuously slow and difficult product development and rollout process. We must accelerate that. We need to process our experience with Care Manager to understand why we were stalemated for several years in resolving our understanding and needs for that product — not in a personality sense but in terms of what it takes to make well-informed decisions on a timely basis. Making well-informed decisions is a mixture of processing our experience with other types of information. And, it begins by having that information.

The Case for Change says we need to cut our product development cycle to one to six -months. I think it depends on how you define product. If it is defined as it was with Care Manager — saying we need a new network of primary care physicians — I'm not sure we're ever going to get to the point where we have new networks in one to

six months. So, to me there are contributing factors.

There is the general need for much more rapid decision-making and product development. We have to look at how other companies do that. Test marketing is an example. Within systems development, prototyping has taken the place of previous development initiatives. We have to use those techniques, but we have to be well informed, and we have to process our experience.

We have trouble with that one. When I say that, I'm not talking about the marketing division, I'm talking about the 50 people in this room having a common factual basis from which to make all their decisions. We're getting better at it, but we still have work to do.

So, yes, we need more rapid decision-making. We need more and better information. We're going to do a lot of work on the pocket veto issue, and I'm hoping that it will become something everyone can talk about. I have heard some constructive discussion, and I really encourage all of us to work on it.

**Q: The point pushing the back of my mind is the fact that the external environment is putting significantly more pressure on us to move quickly.**

Society and industry have changed. In terms of our industry, the luxury of long time periods for decision-making is disappearing. But, I would also say this ...and let me use a presentation by Columbia as a specific example to make the point.

Columbia is pursuing a completely integrated system, one component being a physician management company. In the course of their presentation, they said: "You know, we don't know what to

do. We lost \$50 million last year on that part of our business. We're going to have to buy somebody or we're going to have to figure it out." Then, they went right on talking because they had made \$300 to \$500 million on their core hospital business. Spilling \$50 million a year until they get it right is an okay balancing out of the needs of that company for its broad strategy.

In my view, the speed of decision-making and the amount of facts and information to support that decision should be directly related to the number of zeros that are involved!

Coming out of the Delta work, I'm sure one of the findings will be that people use the formal decision-making processes as a barrier. They don't do analysis for the sake of rapid decision-making. They do it to keep you off their back. They may, at the time they're doing it, think it's in the company's best interest; I presume they do feel that way. But if they feel your approach is "half-baked," it's a convenient barrier. It would be much more constructive to confront the fact that they think your idea is "half-baked."

We need to talk about it and work it. Instead, we intellectualize our conflicts and put them into what computer programmers call loops — it never stops, it just keeps going around. I don't think that's accidental behavior; I think it's learned behavior. We need to confront and reduce it, if not totally eliminate it, from our business.

#### **Other Comments:**

Our new chief financial officer, Chris Doerr, will start the first of November. Chris was interviewed by a number of us and, speaking for myself, I don't ever recall a series of feedback reports that

were so consistently positive, particularly about his interest in working with people and having an interest in people. Chris was a clear first choice.

While we have many talented people in Finance, it's an area that has been subject to a tremendous number of complex, unanswered questions: What is your cost structure? What is your pricing policy? They are separate, but they need to integrate. How do you keep score? What is your corporate financial management framework? How do you handle resource allocation decisions?

A lot of very tough policy and strategy questions. Many of you in this room are going to have to work with Chris and the rest of us in trying to work our way through them in the coming months.

We think there is a need for a small staff, for what would be called Corporate Development. Other people might call it Mergers and Acquisitions.

Something else I'd like to mention is that the Georgia Plan received legislative permission this past year to convert to a for-profit organization.

There are drumbeats that start in California and come east, headed by Consumers Union and others, that say when you convert to for-profit, you should give whatever you're worth to the general public. California has set up a foundation and is giving it \$3 billion of stock. We understand there's a demand that's been placed on the St. Louis Plan for several hundred million dollars.

Within the next four weeks, the Georgia Plan is going to do a private placement offering (stock offering) for the purpose of actualizing their conversion to a for-profit company.

The surrounding, physically contiguous plans have been invited to take small stock positions in the Atlanta

Plan. While it's a very, very small step as far as Florida is concerned, I view it as a positive step. Whether or not it will stand the test of measurement as an investment we'll have to see.

Looking at mergers between and among plans in an all or nothing sense is an ultimate crap shoot. Whereas if we could do more things together and have more shared interest in order to pick-off opportunities, there is, over time, a chance to accumulate relationships and know-how and then make a series of wise decisions.

I wouldn't want to think about what would happen to our reengineering effort if we said: "We want you to simultaneously work with Alabama and Georgia so that whatever you come up with is acceptable and meets their needs, and so on." We're stretched to our human limits right now. Down the road, those questions are still going to be on the table, but let's get through our own work first. So I see that as positive and would continue.

The last thing I'll mention is that I spend about a third of my time with the Association on committees, travel and other related activities. At least for the next year, I'm going to continue that. I think it's critical as we get Trigon, as we get Anthem, as we get California Blue Cross (who has bought HSI) that we be at the table, even though obviously no one plan can control the voting. So that will be an important part of our work going forward.

Thank you very much.