

CE News "Risky Business" No. 16

Terra Insurance Company (www.terrarrg.com) just may be the world's most successful professional liability (PL) insurer. In 2002, a truly disastrous year for many PL carriers, Terra celebrated its highest-ever stock valuation and its fewest-ever claims per insured. Terra CEO David L. J. Coduto has a simple explanation for the company's atypical performance: "We only insure firms that are passionate about quality, in what they provide and how they provide it." The insureds wouldn't have it any other way: Because Terra is a risk retention group, the insureds own the company. Ergo, the better Terra does, the better the insureds do. And while Terra, as other insurance companies, has an investment portfolio, that's not what the company looks to for profits. "We invest very conservatively," Mr. Coduto said. "We look to make our money through underwriting." In other words, Terra plans to profit from what it sells, a straightforward concept that also is atypical: Most of Terra's competitors take that approach only when they have to. When the economy is booming, they generally sell their products below cost to almost anyone willing to buy them, in order to boost cash flow which they then invest. In 2002, most PL insurers' investments took a beating, as did their underwriting decisions, thanks to the predictable problems generated by firms that think QA/QC is what a duck says.

Almost seven of every ten Terra insureds have never reported a serious claim, an amazing statistic given that Terra insureds specialize in geotechnical and environmental engineering, activities many PL insurers consider the "mother of all risks." Terra surveyed those firms to identify factors that contributed to their success. What was one of the most important factors of all? Client selection. Which only makes sense, given that high quality is useless if it's not what the client wants or is willing to pay for.

I've mentioned Terra's findings to a number of engineering firm principals, and I often hear, "That's easy to do when your firm is small. But when you have a firm our size, with so many mouths to feed, you can't be quite so choosy." Wrong! While a few Terra insureds are small, billing around \$300,000 per year, the average insured bills about \$8

million per year, and some bill almost 20 times that. Talk with them about client selection, as I have, and you'll get an earful. It breaks down something like this...

Good clients understand that quality pays for itself, by generating life-cycle cost-effectiveness and short-term risk reduction. They know that cutting corners creates shortcuts to disputes; that disputes benefit no one except lawyers and others engaged in dispute resolution. Good clients also understand that, while professional liability insurance is necessary, it's a safety net, not a trampoline: The time, effort, and expense required to extract money from an insurer often makes the effort counterproductive. Good clients know that retaining a quality-oriented firm is the best insurance of all, and that mutual development of a comprehensive scope of service is the best way to begin each project. Given the benefits they derive from high quality, good clients are willing to pay higher rates to achieve it.

So, how do you go about upgrading clientele? In a word, *marketing*. If right now your marketing program consists of answering the telephone, you cannot help but have too many high-risk clients; the kind of organizations that flit from consultant to consultant, in part because of the bridges they burn. The cost of dealing with such clients – the cost of an ineffective marketing program – can be huge, in terms of bills that go unpaid and festering liabilities to any number of third-parties.

“But, if it wasn't for clients like that, we'd lose 30% to 40% of our business,” some say. If you are genuinely committed to quality, however, your gross shrinkage will be short-term (accompanied by a much higher profit margin). During that period, you will be able to restructure, by winnowing staff, to upgrade average performance; by expanding your service mix, so you can offer your good clients more services to select from; and by actively engaging your best clients to help you find more clients just like them. True: It takes courage to reject clients and decline engagements. However, by taking such action while pursuing a high-level marketing effort designed to attract better clientele, you should be able to return to the growth track in relatively short order and, thanks to higher quality and lower risks, stay on it indefinitely. Besides, as Terra insureds emphasize time

and again, really good clients frequently dispense a hearty pat on the back for a job well done, something which, when all is said and done, may be the best reward of all.