

The Banality of Greatness

State Farm is there

The flat, level Central Illinois prairie stretches in all directions, broken only by a small network of roads and the occasional town. Aging barns and farmhouses dot the landscape and the coal-black Corn Belt soil—thick and fertile—yields an abundant harvest. On a winter's day a certain bleakness blankets the terrain; in the summer, under the hot August sun, cornstalks form an endless pale yellow cover.

Situated in the heart of this region, forty miles east of Peoria and almost equidistant between Chicago and St. Louis, at the intersection of the Amtrak rail lines and Interstates 55 and 74, is Bloomington, a bland Midwestern town of 52,000. A mile or so from the decaying downtown area, along what was once Route 66 but is now a multilane highway that rings the city, stands a low rectangular office complex almost as large as the Empire State Building. This is the corporate headquarters of the State Farm Insurance Companies.

Although one imagines that people in this part of the country leave their front doors unlocked, security at the building's entrance is tight. Six uniformed officers are on guard in a command center with at least forty closed-circuit TV monitors, and the glass front doors are electrically controlled. It's not clear why security is such a concern, but some years back an irate group of consumer advocates stormed the president's office in search of, one imagines, lower insurance rates. But then, State Farm is a magnet for this sort of thing. During the week we visited, union officials representing striking workers at Archer Daniels Midland, a giant agricultural processing company of which State Farm owns 7.4%, called for a boycott of the Good Neighbor company.

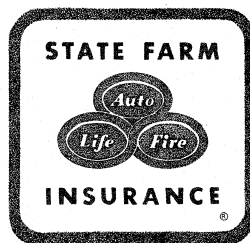
Almost everything about State Farm is on a grand scale. It is far and away the largest insurance company in America, with about 22% of the auto and homeowners markets. It has 65,000,000 policies in force, 67,000 employees (including 400 in-house attorneys), and 18,000 agents. Its \$22 billion in surplus and \$20

billion in property/casualty claim-benefits paid last year dwarf that of any other insurance group.

State Farm has twenty-eight regional offices, each with about 1,200 employees. There are 900 claims offices across the country. In all, the company occupies 22,599,431 square feet of space—enough to fill 753 football fields. Not far from its Bloomington headquarters, a new 2,000,000 square-foot office complex on 217 acres is under construction. This \$180-million project, which includes two power plants and one grounds-maintenance facility, will house 5,200 people, the majority of them in computer operations.

State Farm is one the largest users of first-class postage in the country, sending out 298,000,000 pieces of mail last year at a cost of \$113 million. Its agents mailed 12,000,000 credit-card-sized State Farm calendars, 1,279,000 Norman Rockwell wall calendars, and a similar number of State Farm road atlases.

State Farm shipped 188,000,000 pounds of freight last year, or 2.89 pounds for each policy. It recycled 8,398 tons of material (51% of its total waste). Its 14,000 passenger-car fleet is the largest in the country.



Size, of course, doesn't explain the company's success—it merely measures it. State Farm's achievements are the result of its unique corporate culture: it is a "mutual" insurance company in the very best sense. Everything revolves around its single-minded dedication to its customers—the "owners" of the business.

"Our goal is to serve our customers—period," says Bill Sirola, the company spokesman. "Not growth or price, just service. We write homeowners, auto, and life. We don't do credit cards, mutual funds, or financial services. We concentrate on what we know, and that's the American market. People want service. We're an efficient company with a well-priced product."

State Farm is efficient. Its expense ratio, although not the lowest in the industry, is five to six points below the average, a significant competitive advantage. Although State Farm is commonly referred to as a "direct writer," the term is a misnomer. State Farm writes business through its 18,000 *exclusive agents*. These agents, independent contractors who run their own businesses, sell only insurance—not real estate or "financial services." Commissions are reasonable: 10% for auto insurance and 15% for property. State Farm agents make a good living.

Despite its stature as a national financial powerhouse, State Farm's roots are, not surprisingly, on the farm. The company embodies the rugged individualism of the American spirit, and its story is very much that of its founder, George Mecherle. In fact, his biography, *The Farmer From Merna* by Karl Schrifftgiesser (Random House, 1955), is

State Farm: A good idea catches on

	Earned Premium	Policyholders' Surplus	No. of auto policies
1922	\$12,768	\$7,758	1,339
1927	685,922	223,153	
1932	5,795,110	1,233,385	335,952
1937	10,448,251	3,377,955	
1942	24,033,121	8,994,982	840,149
1947	69,951,025	15,978,049	
1952	128,477,169	70,342,659	2,447,380
1957	314,493,729	117,636,494	
1962	544,080,101	274,418,045	7,517,769
1967	1,054,339,745	383,634,938	
1972	2,007,403,168	1,100,847,940	13,548,047
1977	3,825,941,534	2,652,819,153	
1982	6,648,542,012	6,820,838,365	23,456,475
1987	13,053,522,194	13,985,982,488	
1993	21,924,001,917	21,269,733,369	36,252,796

subtitled "A History of the State Farm Insurance Companies."

Mecherle was born in 1877 in Merna, a tiny crossroads community nine miles east of Bloomington. The Mecherle family was thrifty, conservative, and hard working. "By neighborhood standards they were even rich," writes Schrifgiesser. "Neither poverty nor insecurity ever threatened them. The banks owned no part of their land. Frugal but never mean, they had an abiding love for their land and no fear of the hard work that its care required."

George Mecherle never completed high school (the local school was shut down during his first year there). Instead, he went to work on his uncle's farm, eventually saving enough money to acquire it outright. He was more than just a good farmer: he was a good businessman and a believer in efficiency.

"He understood how to restore tired, worn-out soil through the use of phosphates and limestone," says Schrifgiesser. An early believer in the theory of crop rotation, he was, in the words of one neighbor, "a scientific farmer without a scientific education."

Despite his success (his farm was worth a quarter of a million dollars by 1917), Mecherle was a provincial man whose travels had rarely taken him beyond the immediate area. Observes Schrifgiesser, "Up to the age of forty he was just another McLean County farmer—prosperous, progressive, and seemingly with no ambition to move far from his home, his family, or his rustic way of life." Unfortunately, his wife suffered from severe arthritis, so he sold his equipment, rented his farmland, and moved his family to Florida. But the warm climate didn't help her, so the

Mecherles returned to Bloomington and George began looking for some new endeavor to keep him busy. He ended up selling insurance policies for the Union Automobile Indemnity Association of Bloomington, a small reciprocal insurance exchange.

A short while later, in 1922, he formed State Farm with the radical premise of selling auto insurance at reduced rates to farmers under the theory that rural areas were less hazardous than cities, and that farmers were better-than-average risks. The policies were sold by part-timers—mostly farmers who belonged to farm bureaus and farm mutuals. (The company switched over to the career-agency system in the early 1950s.) State Farm billed and collected the premiums directly (a novel idea) and issued six-month rather than one-year policies, thereby keeping the initial premium payment even lower. A non-refundable initial membership fee was also charged.

By 1931, State Farm had 366 employees, 70,045 policies in force, and offices in every state west of the Mississippi. "Its growth has been phenomenal," reported the Alfred M. Best Company.

Insuring the preferred risk had always been one of the important tenets of State Farm's operations. Ironically, the preferred risk just happened to be, in the words of the company's assistant secretary T.F. Campbell, "the average citizen of normal habits."

By 1942, twenty years after it had been founded, State Farm was the largest automobile insurance company in America.

In many respects State Farm is something of a conundrum. It is a fierce advocate of free markets, but, as a result of its mutual ownership, it is actually a collective. Although there are no large shareholders to demand profitability, it has been recording excellent results, delivering a good product, and providing exceptional financial stability for generations. All this while "in the clutches of nepotists," as *Fortune's* Carol Loomis noted with irony. Since its inception, the company has been dominated by two families. George Mecherle, the founder, was succeeded by his son Ramond, who was followed by Adlai Rust (George Mecherle's right-hand

Jardine Insurance Brokers, Inc.

San Francisco, California

has sold certain assets of

Jardine Insurance Brokers of Upstate New York, Inc.

Schenectady and Syracuse, New York

to

Marshall & Sterling, Inc.

Poughkeepsie, New York

*The undersigned initiated this transaction and acted as
financial advisor to Jardine Insurance Brokers, Inc.*

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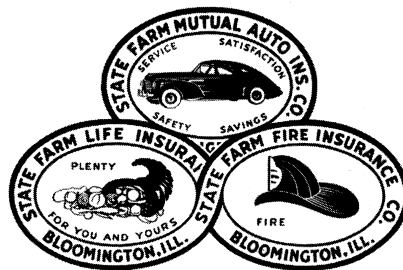
man) and then his son Edward, who ran the company until his sudden death in 1985. This unexpected occurrence caught State Farm off guard, and the board of directors, chaired by Roland Marston, searched for a successor, ultimately settling on Edward Rust Jr., who also happened to be Marston's nephew. By all accounts, the company has been run well run under Ed Jr., as he is often called.

True to its roots, State Farm is a conservative skinflint that never forgets that each dollar belongs to its policyholders. When we asked for a copy of the company's Schedule D (the list of investments filed with state insurance departments), for example, John Killian, the controller, told us that he could only *lend* us one since the company hadn't spent the money to get extras printed.

When it comes to its investments, State Farm is also refreshingly out of synch. It is a buy-and-hold investor with a conservative portfolio managed for the long haul rather than for the next quarter. Because of the strength of its balance sheet, it can afford to invest a significant portion of its capital in equities. (This strategy is also employed by other well-capitalized insurers such as Berkshire Hathaway and Cincinnati Financial.) In fact, a complaint leveled against State Farm by consumer advocates has been that it has too much capital—that it doesn't really need \$20 billion in surplus.

Longtime readers of Emerson, Reid's Insurance Observer will know that we scoff at such mindless notions. State Farm's capital, top financial ratings, and debt-free balance sheet are significant competitive advantages that provide great comfort to the company's policyholders, agents, and employees. Furthermore, it's conceivable that State Farm could face \$10 billion to \$15 billion in losses if a Class 5 hurricane hit a heavily populated area along the east coast. (When we asked State Farm why it doesn't reduce its exposure in this area, we were met with a surprised look and a straightforward answer: "We do not like abandoning customers. It's not our tradition.")

In fact, it's difficult to find any rational, informed person who has anything but praise for State Farm. We checked in with our pal Brian Sullivan, the savvy and erudite editor of *Auto Insurance Report* (and now *Property Insurance Report*) to hear his thoughts.



An early logo

"All I can do is gush about those guys," he sighed, a trace of regret in his voice for not providing us with some juicy exposé. "I speak with everyone in the industry, and State Farm's competitors say that they don't really compete with State Farm—they let them do their thing and fight for the rest.

"It's generally accepted that if State Farm wants market share it can take it. The irony is that they've gotten to this point of power by not really wanting to be at this point of power. It sounds so hokey to say that it has grown out of their dedication to service, but it's true, and no one can tell me otherwise.

"Allstate agents, for example, will freely criticize their company, but State Farm agents, even in states where they're cutting back, remain pleasant and upbeat about the company. The agents even echo the company when they say that want to grow in life insurance. Its unusual for agents to toe the company line so consistently, but they do, and it's because they mean it. The agents are singing out of the same hymnbook as the company, and that's unusual."

To get a better handle on just what it is that makes State Farm so special, we sat down with John Killian, the vice president and controller. Like everyone else, he attributes State Farm's success to its customer orientation. "Business is conducted with absolute integrity. The numbers are a *result*, but what causes them is customer satisfaction.

"Historically, we've viewed our role as fiduciaries. Our advantage comes because State Farm is *not always* the cheapest. The combination of price and service equals value. And the most important aspect of value is the personal insurance agent in the neighborhood, who has a personal relationship with the customer.

"We don't have any sophisticated strategy. We're not bumpkins, but we're really not all that sophisticated. I don't want to be simplistic, but it's not all that complicated. We're unwavering in our dedication to personal lines."

We then spent some time with Vincent Trosino, the fifty-three-year-old chief operating officer. Trosino grew up in Philadelphia and got a degree in psychology from Villanova. Upon graduating, he was advised by an employment agency to apply to State Farm. He'd

never heard of the company and thought the employment agency was recommending a job at the state prison.

Trosino went through State Farm's training program, worked in regional offices, then served as director of personnel at the headquarters. He got a masters in human resources management and worked in line management in the southern California auto division before returning to Bloomington.

"We serve our customers first," he started off. "Outsiders don't always believe that's really our goal, but it is. We want to stay with what we do well. Selling more life insurance, for example, is one of our major goals. State Farm Life has excellent twenty-year records, but we only sell 16% to 18% of the life insurance bought by our customers. If we want to retain the long-term policyholder it's better to have the life insurance."

Although he is on top of the changes that the industry is undergoing, especially competition from financial-services companies and banks, Trosino, unlike many others in the industry, isn't looking for government protection. "As long as there's a level playing field I

State Farm

(\$ millions) December 31, 1993

Assets	
Cash and short term investments	\$772
Bonds	22,865
Common & Preferred stock	11,637
Equity in insurance subsidiaries	6,373
Other	5,890
Total Assets	<u>47,537</u>
Liabilities	
Claims and claims expenses	15,158
Unearned premiums	6,536
Other	4,573
Total Liabilities	<u>26,267</u>
Policyholders' Surplus	\$21,270

think its healthy to have competition. If we want to keep the government out of our hair, competition is good. Our strategy is to compete vigorously for the customers we want. I still think that when people look at their car and their home insurance they want personal attention."

He has no plans for State Farm to enter the financial services business. "Our business is not the investment business," he says emphatically. "We're in the insurance business, and—oh, by the way—we produce capital that must be invested."

"How do you spend your days?" we asked.

"What do I do? Expense management. Strategy. We ask the question, 'Where is this thing going?' A lot of my time is taken up by politics, regulation, and legislation. We're in a proactive mode. As Wayne Gretzky said, 'Skate to where the puck *will be*, not where it is.'

"How do we keep our culture with 67,000 employees? That's crucial. Our rank and file get competitive wages based on the region, and our executive-level salaries are benchmarked to the industry. We pay reasonably, although far from excessive. We don't try to compete with the top salary-payers. No one's enormously wealthy around here. People need to save. They respect State Farm when they retire. We have very low employee turnover. It's a cultural thing."

That holds true for the company's agents, as well. More than 86% of new State Farm appointees are still with the company after four years, versus 20% to 40% for the rest of the industry. Perhaps that's partly because it's not easy to become a State Farm agent. New agents must go through a two-year training

period and then come up with the money to start their businesses.

Given State Farm's size, complexity, and financial wherewithal, the company's top executives aren't well paid compared to their competitors at stock companies. Always curious to understand what makes people tick, we asked Trosino whether he was interested in money.

"I'm not here to judge," he said plainly. "That's for others. Once you meet your needs, compensation means different things. How many cars, suits, and shirts can I own? There's that subjective other-person comparison, but from my point of view, if I'm competitively paid with the other employees here, that's okay with me. I have accepted the State Farm Mutual nature. If I ever regret that, then I'm out of here. I've been headhunted and offered much more, but it's not about that. I guess you have to be here and be part of the culture to understand that. It's almost a religious thing."

As we were getting ready to leave, the conversation veered to politics and social issues. "I believe I have an obligation to support my fellow man," Trosino said, "but I'm against socialism and government intervention."

His sentiments echo those of George Mecherle, who, despite being a product of the late nineteenth-century prairie, wasn't influenced in the least by any of the progressive political movements of his generation. According to *The Farmer From Merna*, Mecherle was, "by instinct and upbringing, by environment and experience, a dyed-in-the-wool Republican who honestly believed that his and his fellow citizens' interests were best served by the Republican Party, which had come into being in the very region where he was raised. He was, in so many ways, a rugged individualist—and his rise from an inexperienced farmer to the chairmanship of a multi-million-dollar business had been so rapid, and accomplished so consistently along the lines of an old-fashioned success story, that he could countenance no political philosophy which seemed to place any barrier in the way of private initiative. He looked with dismay upon what he felt was the 'trend toward socialism' in the New Deal."

The spirit of George Mecherle lives on in Bloomington, Illinois. ■



Far out, man! An ad from the Sixties.