

## A Conversation with Leonard Schaeffer

*Leonard Schaeffer, former chairman and CEO of Wellpoint, Inc., was the School of Public Health's 2005–2006 Regent's Lecturer. During a recent visit to campus, Schaeffer sat down with Dean Shortell and reflected on his leadership approach and how he brought Blue Cross of California back from the brink of bankruptcy.*

*Early in his career, Schaeffer worked in the public sector both at the state and federal level. At the state level he was director of the Bureau of the Budget for the State of Illinois, chairman of the Illinois Capital Development Board, and deputy director for management for the Illinois Department of Mental Health and Developmental Disabilities. Subsequently, he served in the federal government as administrator of the Health Care Financing Administration (HCFA) and as assistant secretary for management and budget of the Department of Health and Human Services. Schaeffer also served in leadership roles as president and CEO of Group Health, Inc. of Minnesota, EVP and COO of the Student Loan Marketing Association, and as vice president of Citibank.*



Leonard Schaeffer (left) talks with Dean Stephen Shortell.

**Dean Shortell:** In 1986 you were recruited as president and CEO of Blue Cross of California. At that time the organization was near bankruptcy and ranked the worst-performing of the 77 Blue Cross plans across the country. What were some of the challenges you faced and lessons you learned from the turnaround of Blue Cross?

**Leonard Schaeffer:** Blue Cross of California was recruiting for a CEO, and I was contacted and came out here and was interviewed. They were looking for someone to do a long-range strategic plan. They'd never had one. They said the company was doing very well, and everything was fine, and I was literally told, "Put your feet up on the desk, don't worry about the operations, and spend a year thinking great thoughts." Who is going to say no to that?

I started on January 15, and at the end of the month, I said, "I'd like to see the financials." And they said, "Don't worry, we're going to make 40 million dollars this year—not a problem. The financials are not available until the end of the quarter." The financials for *January* are not available until the end of the quarter.

Financials were brought to me on one page: one cost center, one profit center. Period. Didn't break anything down. And I look at it, and the guy says, "Yeah, I guess we're not going to make 40 million; more like 10 million." So I spent a little time trying to figure out what was going on, and clearly the books and records for the company weren't accurate, the prior reports were fraudulent. I fired the CFO and started a process to figure out what was going on, and as it turned out, instead of making \$40 million, under my brilliant leadership, we lost \$157 million that year, which was an all-time record, by the way. No one else had ever lost that much money. And most of it was from prior years.

So we were losing money left and right, and we had to turn the company around. I went from thinking great thoughts to running the company in a very hands-on way. We went from 6,000 employees to 3,000 employees in 12 months. That was not fun. Most of the people that I fired were innocent victims, a lot of single mothers, one-parent families. But the obligation in my mind was very straightforward. There were two million people dependent on us to pay their health care costs. So we made a

dramatic effort to reduce costs: We cut 3,000 people in 12 months, sold a lot of buildings (actually sold buildings to pay the payroll, one for one), and as we sold the buildings, we sold the furniture, we sold the computers, we sold everything that moved. In 1986 we were the worst performing Blue plan in America; in 1989 we were the best performing Blue plan, and we never turned back.

The problem is that the comparison is a false one: it doesn't matter how you perform versus other Blue plans, it matters how you perform versus your competitors in California. We were doing very well compared to Blue Shield, and we were beginning to do well versus Kaiser. But back then it was all about for-profit HMOs. So we created an HMO ourselves, and got heavily involved in managed care—I had a lot of ideas about segmenting the population. My theory was, if you look at Americans, they don't know much about health policy, but they know a lot about the rights and privileges of consumers. What consumers do is make choices. They decide what is best for themselves and their families. HMOs are all about forcing you into a way of doing business. Our company was all about choice and options. It's administratively very complex, but consumers like it.

So we created all these products. But you need money to build systems, and money to take risks, so we created this HMO, which we took public, called Wellpoint. We sold 20 percent of it to the public, and it gave us a couple of things. One, it gave us capital to do some things; two, it gave us acquisition capital—we could use stock to buy things, which is what all the HMOs were doing at that time; and three, it gave us stock options and other things to attract people to the company. And it was extremely successful. But there was a lot of confusion at the Blue Cross level, and a lot of confusion among our customers. The basic issue was, "Look, you've got this HMO, you are making money hand over fist, why don't you cut my Blue Cross insurance premium?" The answer is because you go to jail if you do that. Blue Cross is a not-for-profit,

Wellpoint is a separate entity, and people couldn't figure that out.

So we did what's called a recapitalization, where Wellpoint bought Blue Cross, and in the process (and I'm very proud of this), we set up the sixth largest philanthropy in America. We created two foundations—the California Endowment and the California HealthCare Foundation. And we became a for-profit, then we became shareholder-owned—and therefore became subject to this rigor and oversight that the stock markets require.

We had done pretty well in California—we are a very big company, by Blue and other standards, but we had relatively small market share, so we had tremendous opportunity in California. Well, Wall Street looks beyond that, and says, "Yeah, you've got plenty of opportunity, but you are subject to only one government, only one regulator, only one economy." It made them nervous. So we began to diversify risk, so that we'd be in different economic regions of the United States, be subject to different regulators, and there would be different opportunities. We began buying other companies, and we did 17 transactions for a little over \$4 billion, and went from being a California company to being the second largest health insurance company in the United States.

**SS: So the major lesson in that is to take the bull by the horns, find out what are the problems, make the changes quickly and decisively, and get on with it.**

**LS:** You need different management techniques at different times. If you look back on the history of our company, the first stage is the turnaround. You need top-down, autocratic, "Here's what you are going to do." "Why?" "Because I told you to do it." Top-down, directed, tell people what to do. You don't have to be right, you just have to keep moving.

The problem is you can come out of a tailspin that way, but you can't really attract good people. You've got to be awfully smart to run a

company that big and tell everyone what to do. Nobody is that smart. So the second thing is participative management, where you bring people in, and they add value, and they create value. Totally different management style. The autocratic boss is the boss from hell after a couple of years. Nobody wants to work for that guy. You change or you're not successful. You can't do something for 20 years and use the same techniques. So you change from that top-down style to what we call, for lack of a better word, participative.

Now, participative is not democratic. Hierarchical organizations don't work if they are run democratically. But participative is different from autocratic. Everybody says they hate meetings. I think meetings are very good, if you've got smart people and they're willing to fight for what they believe. I go in to a meeting, I know what I want, here's what we are going to do. If you have enough smart people around the table, they'll say "No, what about this, what about that, what about the other thing?" And you end up with a much better solution, but you don't vote.

The next phase, after you get people who are pretty good and can run the railroad, you've got to begin to look outside the company, because all this internal stuff makes the company run well, but the real question isn't whether it's running well, but whether you're creating something that is valuable to customers. A leader has got to shift from internal concerns to external concerns. You've got to give up day-to-day control, which is very scary if your success is built on being in control. I can have impact and control over the company, but I can't control the external environment. Harry Truman said, "As president of the United States, I have no line of authority over anyone except the military, and anything I ask them to do, it's probably too late." He said he spent all day trying to convince people to do what he wanted them to do because it was in their own self-interest. And that's what you have to do. 