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Model of Business Success:

George J. Mecherle: Founder of the State Farm Insurance Company

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Introduction

This article is the second article that I have written about business people who have achieved outstanding accomplishments in their respective business fields. The first article discussed the story of Mrs. Rose Bumpkin and can be found at www.focusinvestor.com/articles.htm. In this three-part article, I will cover the story behind Mr. George Mecherle, the man responsible for creating and growing State Farm, in three parts in this article. The first section will provide the reader with a biography of Mr. Mecherle's early life in order to understand his foundation and the second section will discuss the creation of State Farm. The last section will discuss the key personal traits that helped make Mr. Mecherle's life, and State Farm, a success story.

Biography

George J. Mecherle's parents immigrated to the United States in 1852 from Germany. They were farmers in their country of origin and they searched for an appropriate place to do the same in the United States. They finally picked a spot to farm in Merna, Illinois, not far from Bloomington, IL. They ran a successful farm in their new hometown and, by all accounts, they had an excellent reputation for fair play in their community.

Their fifth child, George, was born in 1877. He was born and raised on his parent's farm. He must have learned his strong set of values (which he followed faithfully for the rest of his life) from his boyhood days on the farm.

His mother, Mae Edith, believed strongly in education and she tried to instill this in George. He was a decent student but only stayed in High School for approximately a year, after which he decided to go back to work on his parent's farm.

His uncle, Fred Mecherle, offered George a tract of farmable land so he would be able to start farming on his own. He was to pay rent to his Uncle, at first, with an option to buy the land at a later date. After he had proved successful at farming he married Mae Edith Perry, who had lived down the way from the family farm, in 1900.

It was said that George was a good storyteller with a particular knack of making people see things his way. He was also consulted on occasion about business decisions that had to be made at the family farm and earned a solid reputation for integrity in his business dealings.

During the next eighteen years, his love of politics and farming showed in several ways. He served as the road commissioner for several years (an important position in a farming community especially considering the rise in popularity of the automobile at the time) and he was also a member of the Old Town Farm Mutual Fire Insurance Company. At the insurance company he was occasionally consulted on his opinion concerning matters of business policy.

His wife, Mae, developed arthritis so George decided to rent out his farm and move the family to Florida. He was hoping the warm weather would help alleviate her pain from the arthritis. When her pain did not subside George moved the family back to Illinois where they lived for the remainder of their lives.

When George arrived back in Normal Illinois he tried several jobs before the idea of State Farm was fully developed. He worked as an automobile insurance salesman for a period of time and was quite successful. His natural powers of persuasion served him well in this field not to mention that he could relate well to his largest group of customers, farmers. He left the firm,

because he disagreed with the operation of the firm, and became a tractor salesman for a brief period of time.

In 1921, he became interested in the Tazwell County Farm Bureau (Farm Bureaus were groups of farmers who grouped their funds together to pay any losses someone in the group sustained). Each member of the farm bureau, at six month intervals, was assessed a pro rata share of the group's overall losses and expenses. After this exposure, Mr. Mecherle told all his acquaintances he would be forming an "honest insurance company" based on the farm bureau model.

State Farm: An Idea Developed

Mr. Mecherle then commenced working on a plan to create his own insurance company, one that would incorporate several innovative ideas he had worked on. He had discovered a pricing error on the part of the insurance companies of the time. This discovery would provide him with a key competitive advantage. At the time, insurance companies were charging every automobile owner the same rate without taking into consideration where the policyholder resided. These companies were called capital stock insurance companies and they, at the time, were not under the jurisdiction of the antitrust laws. Since the antitrust laws didn't influence them, they colluded to keep auto insurance policies pricing artificially high (much like OPEC does today).

George Mecherle thought that his company could charge the farmers a lower rate and still make a profit. This reminds me of the business model that Mrs. Rose Bumpkin used at the Nebraska Furniture Mart. She charged a lower price than the competition and thus was able to generate a large volume of business. The high volume of business made up for the lower pricing policy. She was also extremely concerned with the integrity of her business operation, just like Mr. Mecherle.

Mr. Mecherle was also able to spot another area where he could gain a competitive advantage. He decided to charge customers their insurance premiums in six months increments. This allowed the farmers to put up less money initially as compared to the common practice of the time, which was to make the policyholder pay a full year's premium when initiating (or upon renewal of) their insurance policies. This pricing policy was also a stroke of genius for another reason. Since State Farm had decided to collect premiums on a six-month basis, it could also correct bad policy pricing quicker. This was yet another competitive advantage for the new firm.

He also made key early decisions that had a significant impact on the efficiency of the agency system used by State Farm while, at the same time, lowering the cost of operations. The agency system had several advantages in its design when compared to other insurance agency systems in operation at the time. State Farm used its home and branch offices to relieve the agents from as much clerical work as possible by issuing policies, pricing, and collecting renewal policies. This allowed the agent to concentrate their time and efforts into selling insurance policies. This operational system had yet another advantage, the policyholder benefited from the costs saving attained by having lower premiums on their policies.

From the beginning, State Farm also was being very innovative by charging all new policyholders a one-time membership fee. This fee had several benefits to State Farm as they were able to use this fee to cover the cost of acquiring new customers, and they also didn't have to set up reserves on this fee. This setup allowed State Farm to have yet another cost advantage over other insurers at the time. Since other insurers were spreading out the customer acquisition cost over the life of the policy, this required them to charge a higher ongoing rate than what was being charged at State Farm.

Another factor in State Farm's success was that it initiated a completely new plan that no other auto insurance company was doing at the time. State Farm wanted to have the policyholder share some risk and so brought the 80-20% plan into effect. That is, State Farm, would pay 80% of the damages, while the policyholder would be responsible for paying the remaining 20% of any damages the policy would pay out on. This system forced the policyholders to have an interest in keeping their losses to a minimum. State Farm was also very focused on being selective about the business they were accepting.

Once Mr. Mecherle had determined which overall agency structure and pricing policies would give him the biggest competitive advantages, he focused all his energy on accomplishing his goal of creating a statewide farmer's mutual automobile insurance company that would sell good insurance at the lowest cost possible. Within the first year of its operation, George and his team of salesman had sold policies in 46 counties in rural Illinois. Within 5 years the company had grown to include 183 employees and its income had grown from \$22,000 to \$773,000.

Mr. Mecherle's reputation for integrity in his business dealings, as well as his ability to convince people that his ideas were correct and reasonable, enabled State Farm to expand nationwide with minimal problems. It was aided immensely by existing policyholders spreading the word about State Farm's impressive operation to their friends and relatives all over the United States.

Within its first 15 years of operation, State Farm had over a million policyholders and was the largest auto insurer in the United States. State Farm has been so successful that it was able to build up a large surplus fund which it can use as a competitive advantage today by allowing them to endure short term losses in order to keep (or gain) market share.

Key Traits

Traits that made him successful:

1. Honesty & Respect
2. Focus
3. Great judge of character
4. No quit attitude (Being determined)
5. Good communication skills

His initial plan was constructed to replace what he seemed to think was a dishonest method of making rural customers pay the same rate as urban customers. He also wanted to create a fair claim settlement process. He thought he could provide an honest rate and still make money. He also understood how important his employees were and took a personal interest in understanding their personal situations. He often could recite many details of employees' lives even when the company had grown to many thousand of employees.

Once he had determined that his pricing policy would allow him to make a reasonable profit, he would not be deterred in his decision to form his own insurance company. George was not deterred even when Herman Ekern, an experienced lawyer, tried to persuade him that the chances of his forming a successful insurance company were extremely slim. He simply modified the parts of his plan where he agreed with their criticisms and continued pressing on, eventually persuading even the skeptical lawyers that his plan had merit.

Once the insurance company was operating successfully, he decided that what worked in his state could work anywhere in the country. He kept pushing toward that goal even in the face of initial opposition in his own company and roadblocks put forth by the other insurance companies of the day.

He seemed to have a knack for finding the right man for the job. Once he had chosen someone, he wanted that person to run that job independently. He reminds me of Mr. Buffett, as they are both quite adept at judging the character of a person, and they both liked to let successful managers continue to do what made them successful without inserting outside influence unless absolutely necessary.

George also had good communication abilities and was easily able to communicate his desires to his sales force, insurance regulators, and policyholders. When State Farm became so large it became difficult for him to communicate with all its employees, he formed a company newspaper to keep the lines of communication open between himself and his employees.

Conclusion

Mr. Mecherle found models that worked and stayed with them. His initial pricing and agency model had the advantage of creating a lollapalooza effect by the dual creation of an entirely new pricing policy and a refined agency system. This lollapalooza effect created a pricing system nearly 40% lower than any other insurance company in operation. It was almost predetermined to be a great success.

Mr. Mecherle also took advantage of other business models not specifically related to auto insurance and incorporated them into his mental models, which proved useful when he created his new insurance company model. All of us should follow his example and not be trapped by narrow mindedness and the desire to follow pathways that have already been well traveled.

If you are interested in learning more about the life and career of Mr. Mecherle, I would strongly recommend reading, Title: The Farmer From Merna: A Biography of George J. Mecherle And A History Of the State Farm Insurance Companies of Bloomington, Illinois written by Karl Schriftgiesser in 1955.