

## **Chapter X**

### **An Epiphany ..... Don't Pick Winners to Win**

*“Once I realized my goal was not to try and pick more winners but to out gamble my competitors, I started winning!”*

I was once like everybody else. I equated good risk taking to picking winners. This was both true in my professional insurance underwriting career as well as my gaming hobbies. I spent all of my time trying to pick a higher percentage of winners, and while that activity sounds completely consistent with improving risk-taking to most people, it was my greatest barrier to development.

I had spent years studying certain topics I had interest in. Some of those topics included health, life, mortality, disease, disability and dental risks. These topics related directly to my professional life in healthcare insurance. Others topics such as horse racing, card playing, the stock market and sports betting were side hobbies that held as much interest to me as those I was being paid to professionally understand. Nevertheless, the underlying concepts of risk-taking were exactly the same regardless of topic.

As I tried to expand my knowledge and capabilities in the risk-taking arena I was fortunate enough to become acquainted with true geniuses. They educated me in statistical theory, understanding the hidden world of variation, organizational design and situational leadership. Though these geniuses are now long gone from this world, their knowledge stimulated me in ways they could never imagine. You see, by taking their teachings and assembling apparently isolated bodies of knowledge into a comprehensive risk-taking approach, I could “out-gamble” competitors.

Advanced organizational design theories involved a core understanding. Separate parts of a system are sometimes much less important than the interactivity of those parts. This concept can be easily understood by considering the assembly of an automobile wherein the best individual parts of any car (think Mercedes engine,

Ferrari carburetor, Cadillac exhaust system, etc.) can be installed in a car. Unfortunately, the car with all these great parts will not run because the parts do not interact properly with each other. This concept is much more profound than many people think. Remember, Michael Jordan (a great part) was never an NBA champion until Phil Jackson came into the picture to focus on interaction of the parts.

Another element of organizational design theory was to utilize a process of idealized design. To develop true ideals you must assume existing systems or structures do not exist. For example, if you had no company, no existing building, no system, etc., wouldn't you design your company, building or system much differently? This concept advances thinking into an idealized world rather than limiting your planning to existing barriers.

By deploying both of these concepts to my risk-taking process, I dropped my existing paradigms. I also discovered how apparently disparate bodies of knowledge can interactively come to bear on an "ideal" risk-taking system.

The knowledge related to statistical understanding and variation allowed me to stop thinking about how the upper or lower end of any bell curve is not indicative of the performance of any system. Predictive models that over value recent data points or anomalies are much less accurate than those that minimize those values.

The understanding of situational leadership played directly into my new risk-taking system. Rather than developing algorithms or approaches to fit all conditions I found that situations varied. You see, leaders have to be versatile regardless of their personal styles or tendencies. To get results, there are times when leaders may need to be highly directive and demanding. In another situation they may need to be much more understanding and facilitative. This situational understanding, which doesn't exist in far too many poor leaders, applies in spades to risk-taking. For example, the values associated with pedigrees and workouts, in predicting future thoroughbred racing results, have little importance when

handicapping a race if all participants have raced for 3 or 4 years. If, you are trying to predict the results of a race where participants have barely seen a racetrack, and the horses have next to no past performance results, pedigrees and workouts can be highly predictive.

With all of this said, the most important risk-taking revelation I ever had occurred one morning at 3 AM. After staying up until midnight preparing a healthcare renewal analysis, I woke up. I could suddenly see how my risk-taking development efforts were wrong. I was taking aggregate past health claim data to project future claims, the same way every other underwriter in the country was. Since the company I was working on was going out to the marketplace for bids, my chance of beating my competitors was simply mediocre.

The next morning, I went to the office and had an entirely new analysis run. By looking at every individual's healthcare condition (not that anyone cares but these were called ICD-9 codes) I could predict future costs by person and condition. It took me 3 more days to complete the analysis. I knew that over 50% of future aggregate claims would be based upon future cost estimates, not past claim costs. We not only saved the case for my company by lowering the premium, but made a considerable profit on this group, and every other one my unit underwrote over the next few years.

Picking winners didn't matter if everybody else was picking the same winners, and I had always inherently known this. Nevertheless, based upon competition in the healthcare world, or other bettors at the racetrack who helped define the ever-changing odds, I had unfortunately spent all of my time trying to pick more winners. Instead what I should have been doing was trying to bet on "good risks" others were not betting on.

If I was picking 35% winners at a race track or 60% winners as a healthcare underwriter, and I improved those percentages by say 5%, there was no assurance that I would increase my bankroll or corporate profitability. Why? Because if my competitors are picking the same winners at the racetrack, the payback odds will be lower.

If I pick winners in healthcare that my competitors pick, the profit percentages will be lower. On the other hand, if my win percentages stay the same but I am betting on risks which others are not betting on, the profit payback percentages will go up dramatically.

So, what did I do differently to develop my risk-taking systems? I went to the data and started to look for things others were not betting on. Could I discover a different criterion for risk taking? In horse racing, instead of studying what factors produced a winner in a race, I started studying what factors produced longshots, or large economic paybacks. For example, wasn't it more valuable to know what factors would have helped me predict just one 20 to 1 winner in a race than five 2 to 1 winners?

This concept took me right back to the drawing board. From horse racing, to sports betting, to isolating ICD-9 codes in healthcare or raising accidental death and dismemberment rates in Montana, I could see where the risk-taking profitability paybacks (odds) were much higher when my competitors were not playing.

This secret was hidden to me much of my life, and will always remain a secret to many of my competitors in the risk-taking arena. They are simply busy trying to pick more winners and therefore studying the wrong things. It doesn't matter if you bought Netflix at \$50 a share before competitors jumped in at \$250, or played American Pharoah at 9 to 10 odds in the Preakness when he had an over 80% probability of winning the race, or bet the 2001 Patriots to win the Super Bowl at 60 to 1 pre-season odds, out-betting your competition is always going to be the key to profitability because your competitors define the paybacks.

My goal of increasing bankroll, whether it was for personal or corporate reasons, was much more valuable than my original "deluded" goal of picking more winners. Though this concept will remain hidden to many people, it eventually shifted my predictive models in a very good way, and my life.