

**RECORD OF SOCIETY OF ACTUARIES
1975 VOL. 1 NO. 4**

**FINANCIAL ANALYSIS AND CORPORATE STRATEGY
IN AN INSURANCE COMPANY**

**Moderator: FRANK S. IRISH. Panelists: W. JAMES MacGINNITIE,
WALTER N. MILLER, WILLIAM A. SPARE**

1. Evaluation of external factors that affect the long-run outlook for the company. Analysis of the impact of inflation and other economic factors, demographic changes, competitive forces, governmental action, and societal changes.
2. Assessment of strategic opportunities, organizational strengths and weaknesses, market potential and profitability.
3. Development of a long-range plan of action; investigating alternatives; identifying measurements of achievement or goals; and monitoring progress.

MR. FRANK S. IRISH: Strategic planning is a conceptual subject, broad in nature, and aimed at defining the ideas that underlie the allocation of organizational resources. Since it deals with a poorly-defined future and since it works with broad concepts, strategic planning is often thought to be a world apart from such a down-to-earth subject as financial analysis. This should not be the case.

We must not only try to foresee the forces that will impinge upon us in the future, we must also analyze the past to find out how best to deal with those forces. As the inscription on the Archives Building says: "The past is prologue." If we have a faulty understanding of how things happened in the past, then we are poorly equipped to deal with the future.

We hope to make the point that strategic planning is not simply a system of brainstorming, and that analysis is the necessary concomitant of the process.

MR. WILLIAM A. SPARE: External factors have, and will continue to have, a major impact on long-range plans for life insurance companies.

During the past 25 years it appears that many companies were lulled into complacency. Mortality was improving. Interest rates were climbing steadily from their post-World War II lows. Increases in expense rates were more than offset by improvements in mortality and interest. Dividend scales were steadily improved and all seemed right with the world. There seemed to be little need for serious long-range planning under such conditions.

Plan portfolios were relatively uncomplicated 25 years ago. The federal income tax law presented no particular problems. There was relatively little change in marketing thrust. Agents' commissions were usually the standard 55 and 9-5's. Policy loans were no particular problem. External factors seemed to be of no great concern to the industry.

Financial analysis was often limited to that which was required for annual statement purposes. A good deal of time and effort was devoted to refining figures for page 6 of the annual statement (the analysis of increase in reserves). Short-range forecasts were made but usually for purposes of determining the amount by which next year's dividend scale could be increased.

Suddenly a wave of change came over the industry. There was an explosion of new products and concepts - jumping juveniles, family policies, high cash value specials, discount for policy size, female rates, guaranteed purchase option, new term coverages, HRLO products, the investment generation method of allocating investment income, and GAAP accounting.

The new federal income tax law which became effective in 1958 set actuaries and lawyers to work analyzing its complexities. The need for careful tax planning became evident.

Changes in the economy resulted in a demand for lower-priced products bolstered by the advice from sources to "buy term and invest the difference." Companies started to give serious attention to their markets to determine the effect that such trends would have on sales.

Government regulations intensified. Whereas in past years states promulgated regulations on a relatively uniform basis (through the efforts of the NAIC), now states were beginning to act quite independently, resulting in a myriad of minor differences in policy provision requirements, policy form language, applications, and reporting requirements. Keeping track of these differences became increasingly more expensive and time-consuming.

The introduction of computers revolutionized the record-keeping function, substantially reducing the time required for actuarial calculations, as well as making it possible to perform a great number of complex calculations which were impractical with desk calculators. Massive expenditures were made for hardware and software.

The consumer movement reached the insurance industry with an impact that is not yet fully realized. We are aware of complications brought about by the introduction of new methods of cost comparison, desirable as these may be. But do we realize that proposed legislation could result in a drastic change in our distribution system if agents are not permitted to represent just one company? Many companies have introduced elaborate non-vested contracts in order to pay higher amounts to their agents who remain with them, at the same time paying substantially lower amounts to those who terminate in their early contract years. A proposed requirement that all contracts be fully vested would have a major impact on current marketing methods.

Then, of course, inflation entered the picture. In addition to incurring more expenses because of the many new avenues of activity which were being followed, the problem was intensified by the rapid increase in the price tag for all activities. The effect on operations was compounded by the levelling off of the mortality improvement. Interest rates, though still increasing, could not be expected to continue to increase at the same rapid rate. It was realized that we could no longer count on increased loading losses being offset by increased mortality and interest gains. Expense control and expense budgeting became of prime importance.

With the increasing impact of external factors on our business, more companies are beginning to realize that planning is an essential management process. No longer can we continue to operate merely on a year-to-year basis. We must consider the major changes in direction which the company may have to take in the future because of the influence of factors which are outside of our control.

It is imperative that companies study trends in these external factors and attempt to evaluate their effect on future company operations. Large companies

can afford to set up special departments whose sole purpose is to analyze such factors and forecast future trends. Small companies must depend on outside sources for their information.

An important source of such data in the life insurance industry is the Institute of Life Insurance. Included among its publications are the Fact Book, the MAP survey (Monitoring Attitudes of the Public), the Trend Analysis Program reports, and various special studies.

The Life Insurance Marketing and Research Association (LIMRA) also publishes extensive data with respect to the marketing function which is invaluable in planning future marketing efforts, including product needs, field organization, new agent training, and compensation arrangements.

Last year the Life Office Management Association conducted a survey among its 424 member companies on the state of the art of corporate planning in the life insurance industry. Answers were received from 141 companies. Of these, only 31% have been engaged in formal corporate planning for 5 or more years. Another 49% have introduced formal planning within the past 5 years. 20% have no formal planning in effect. The 113 companies engaged in formal planning account for approximately 42% of total premium income of all United States and Canadian companies.

As between stock and mutual companies, it is interesting to note that 90% of the mutuals are involved in formal planning compared with only 76% of the stock companies. Also, 45% of the mutuals have had formal planning for 5 years or more versus only 25% for the stock companies.

One of the questions on the survey concerned the extent to which external factors were taken into consideration. Of the 113 companies engaged in formal planning, only 76 included the effect of external factors in their plans. The major factors included, and the percentage of these companies including them, were as follows:

| | |
|-------------------------|-----|
| Inflation | 81% |
| Federal social programs | 79 |
| Legislation | 78 |
| Consumerism | 74 |
| Competition | 73 |
| Disposable income | 55 |
| Demographic changes | 49 |
| Availability of labor | 37 |

It is also interesting to note that, although 76 of the companies included external factors in their formal planning, only 32 attempted to quantify them.

MR. W. JAMES MacGINNITIE: Corporate strategy formulated without thorough evaluation of the external environment in which the Company will be operating is a meaningless exercise. Bill Spare mentioned the LOMA survey of 113 companies, of which 37 did not consider external factors. I certainly hope that they misunderstood the question.

The list of environmental factors that should be considered will vary from company to company, depending on its particular market position and mode of operation. There are several places to look in developing such a list, including the textbooks and articles on planning and future research. I would like to mention just a few factors that seem particularly noteworthy in the projected future environment:

a. Inflation. Some effects of continued inflation seem worthy of mention. There certainly may be a continued lessening of interest, on the part of insureds, in deferring consumption, that is, in saving. This means that sales of life insurance products with a significant savings element will suffer further. Life insurance has been capturing a decreasing share of the available savings, and if total savings decrease, at least on a relative basis, then life insurance will be getting a smaller share of a smaller pie.

Another impact of continued inflation that may result is in the area of expenses, where salary and other cost increases may overwhelm economies of scale and computerization, leading to increased expense levels. In the area of interest rates, we may see no further increase or certainly not the kinds of increase that we have had in the past decade or two. Even then, the mix of business has been shifting toward coverages with little investment content and toward variable products where the excess interest is credited to the policyholder. In both cases, excess interest is not available to offset increased expenses. If mortality continues to hold relatively stable, then the life insurance industry could be faced with a need to increase prices and/or cut dividends. Past experience would indicate that it is much easier to make money in a line where prices are moving down rather than up; witness medical expense coverages or, more dramatically, medical malpractice.

One immediate consequence of this effect is the need for actuaries to test the adequacy of their rates and GAAP reserves under inflationary conditions. Depending on the final interpretation of the new requirements for an actuarial signature in the statutory statement, it may be necessary to test statutory reserves as well.

b. Societal. The trend toward two wage earners in the family is well documented and, although many agents see that as an opportunity to sell protection for two incomes, I submit that many buyers will see it as two group policies (often with overlapping benefits), two Social Security coverages, and, most important, less dependence on a sole breadwinner, hence less need for individual life insurance.

The "live it up, let the kids make it on their own" syndrome, if more than a temporary phenomenon of the widened generation gap of the 60's, will adversely impact the sales of insurance where the aim is estate protection and transfer of wealth to the next generation.

Residual market mechanisms, common in the casualty industry, were tried in the early 60's by health insurers as they formed special pools for the aged on a state-by-state basis in a futile attempt to prevent the birth of Medicare. There is discussion of such mechanisms under some proposals for National Health Insurance, where uninsurable groups would have access to insurance at reasonable prices. An alternative is government insurance, where Social Security already provides a sizeable package of life, disability income, and retirement benefits.

Residual market mechanisms become a tax on insurers; often small but not always, and they are an environmental factor that should be evaluated.

A final societal factor that bears watching is forced investments. Long common in many smaller foreign countries, there is now active consideration of forced investments in New York bonds. Once New York can do it, everyone else can, and the end result may be like what I experienced some years ago while working in Colombia where, under certain conditions, our forced investment requirements would have exceeded our total portfolio.

MR. WALTER N. MILLER: There is much interesting material around which indicates that the structure of our markets, from the standpoint of age distribution and family composition, may be changing rather drastically over the next 20 years or so. The extent to which we are really moving towards zero population growth is another important factor which deserves serious consideration. As far as societal changes are concerned, it seems to me that we are heading into an era where there will be relatively fewer large families and relatively more single people composing our markets. This suggests that fairly significant proportions of our total potential customers may be becoming less and less interested in life insurance coverage and more and more interested in other aspects - e.g., disability income coverage and, in particular, more investment-oriented products. If this is true, it leads directly to consideration of competitive forces.

We should be paying a lot more attention to competitive forces stemming from outside the industry, particularly with relation to investment-oriented products. In this area, I foresee increasing difficulties in competing with other financial institutions for a reasonable share of the "savings dollar." The one big thing we have had going for us in the life insurance industry is the ability to provide guarantees as well as some types of important collateral benefits (for example, waiver of premium) which can't generally be offered by other financial institutions. However, I think that our edge here has been eroding. Marketing methods and strategy are items which have to be seriously examined. Many of the investment-oriented products we offer today (particularly those sold as individual policies) are priced to reflect traditional patterns of agents' compensation. Since other financial institutions seem to be offering products which are more and more comparable to ours, but under different marketing approaches not requiring typical individual policy compensation levels, might it not be important for us to examine our own situation in terms of whether some rather fundamental changes may not be necessary in order to improve, or even hold, our competitive position versus these other institutions?

For example, in Canada other financial institutions, particularly trust companies, have become very aggressive in the Canadian Registered Retirement Savings Plans (RRSP) market. RRSP can be broadly characterized as an analogue to our new Individual Retirement Account (IRA) market although RRSP limits in Canada are considerably higher than the \$1500 limit that we currently have under IRA. The result of this competition for life insurance companies in Canada has been interest rate guarantees carrying a good deal more risk for these companies than was common not long ago and fundamental changes in agents' compensation packages.

With respect to governmental actions, the "make projections and studies under various scenarios" approach obviously has some validity but, to my mind, less validity than in the economic area, because it seems to me that future governmental actions may be the most difficult to predict. While it might be difficult to translate into results, I believe that we should be doing much more to try to influence governmental actions than we are now. Evaluation means "How are we going to react?" What we really need to do is to intensify our efforts to shape our own destiny.

MR. IRISH: The problems of inflation have assumed increasing importance in

strategic planning. As an example of an analytic approach to the problem, one can look for correlations between inflation and other variables. In this country, it turns out, there has been some positive correlation between inflation and personal savings and premium income, but if we turn to the historical experience of other countries we find that severe and prolonged inflation is highly detrimental to savings institutions. The explanation seems to be that in mild inflation, or in the initial stages of a severe inflation, people respond to increased incomes by saving more, by updating their insurance programs, and so forth.

But there comes a time when the initial euphoria subsides, and people feel that they no longer can provide for their own financial security by saving. The effect on different lines of the insurance business will be different, and the prospect of continued inflation may well cause a company to reevaluate its product line emphasis. In life insurance, a likely trend is a tendency toward term insurance (both group and individual). Term insurance is hardly the whole answer however, for until we find a way to keep settlement options from declining in real value, we are not serving the basic purpose of providing income to survivors.

Investing the policyholders' money in assets that are responsive to inflation might be a way out, but unfortunately most types of assets have not proved very satisfactory in this regard. The return on short-term investments is perhaps the most highly correlated with inflation, but historical experience does not indicate that it has actually been a very good inflation hedge. Our analysis may well bring us to the conclusion that price-indexed mortgages and bonds are a necessity in prolonged inflation and that, perhaps, a wholly-indexed economy in our country, repellent as that may seem at first glance, may be the only way to continued prosperity in some of our business.

Inflation has some other implications for strategy. What we planners call societal trends have been studied in detail, and we are told that the new generation has different attitudes toward work, the family, and security. It looks upon personal financial security as something the government should provide as a guaranteed right. There is at least some truth in this, and it is unfortunate that inflation, by its disruptive effect on the individual's ability to provide for his own financial future, accentuates these trends.

I cannot leave the subject of inflation without mentioning the excellent Trend Analysis Report on the subject, particularly its analysis of the "ratchet scenario." This grim view of the future envisions repeated recessions and a governmental response of economic stimulus which only serves to fuel the economy for another cycle and a yet higher rate of inflation. We may be seeing it happen now.

MR. MILLER: You cannot just look at possible inflation scenarios in a vacuum. Many other items are linked with the future progress of inflation, and the big problem is that the linkages may not be what we thought they were. For example, most "classical" economic theory tells us that interest rates should rise in an inflationary period, and vice versa. However, this is not necessarily true, and I think it is very much worthwhile examining the extent to which your company might be damaged if inflation continues at high levels and interest rates stay level or decline. I am sure none of us will like what we see in projections under this sort of scenario, but to ignore such possibilities might be sweeping some rather important considerations under the rug.

MR. SPARE: In today's world of spiraling inflation, social changes, and governmental regulation, management must aggressively pursue strategies which will

result in long-term advantages to the company. Strategies may be defined as major courses of action to be taken to achieve stated objectives.

The aforementioned LOMA questionnaire also considered the types of strategies which were being used by companies. Of the 113 companies engaged in formal long-range planning, 98 included strategies in their plans. However, only 60 of the companies attempted to quantify them. Strategies being used, and the percentage of the 98 companies using them, were as follows:

| | |
|--|-----|
| Expansion of current lines | 92% |
| Diversification of insurance products | 84 |
| Market intensification | 77 |
| Expansion of domestic markets | 66 |
| Divestiture of products or businesses | 44 |
| Acquisition or merger within the insurance field | 27 |
| Diversification of non-insurance products | 27 |
| Expansion of markets overseas | 18 |
| Acquisition or merger outside of the insurance field | 12 |

One major strategy from which all companies can benefit is an effective expense control system. At our company we initiated a special expense study earlier this year which has already resulted in significant savings in many areas, especially in travel and entertainment.

Some years ago we had conducted an extensive study of our operations which resulted in a significant reduction in clerical personnel. We have managed to retain that saving through follow-up by our Systems Department and by requiring a strong demonstration of need before additions to complement are allowed. Therefore, in setting up the new committee, we felt that any additional expense savings had to come in areas other than personnel reduction.

The new expense study is being carried out by a top level six-man expense control committee chaired by the Controller and reporting directly to the President. That committee is investigating every aspect of company operations, questioning operating policies of long standing, no matter how sacred they have become over the years. Operations which seem to be of questionable value are being reviewed and studied in depth by the departments concerned. Suggestions were solicited from all Home Office officers and field managers. All of these are being considered and we expect permanent savings to result.

MR. MacGINNITIE: One technique that we have found to be particularly useful in getting a strategic planning cycle underway is to take a SWOT's inventory: Strengths, Weaknesses, Opportunities and Threats. All that is required are some skilled interviewers and an hour or so of time from each interviewee. Usually all the senior executives and a cross-section of lower level people will be sufficient. Simply ask them for their ideas on what the company's SWOT's are, and then sort them into families of issues. Several key strategic issues will emerge quickly, and the staff will be primed into doing something about them. Task forces, drawn from a cross-section of the company, are the next step. Do not be afraid to use people in areas outside their own expertise

(a computer man on a marketing issue, or vice versa); often their ideas and input will have great value, and in any event the appreciation of each other's problems will increase dramatically.

A strategic opportunity that many life companies have been evaluating in recent years is the casualty insurance business. Forbes Magazine characterized one company's interest as a "death wish," and it is clear that the well-known casualty underwriting cycle is setting downside records this year with the underwriting loss for the first six months exceeding that for all of 1974. Some commentators observe that the industry seems to be losing its "double or nothing" bet.

There are some favorable indications, however, including the continued lessening of inflation from 1973-4 levels. Our analysis of the casualty industry's experience since World War II indicates that 60% of the year-to-year variance in underwriting results can be explained by change in the inflation rate. When inflation is accelerating, underwriting profits are hurt, and when inflation is slowing, underwriting profits are helped. Unfortunately, this time around the underwriting losses have become quite large, and there is a long way to go to pull them back to the break-even point.

Another favorable indication is the sizable rate increases most companies are obtaining, with a few notable and rather noisy situations in states where regulatory officials are seeking to moderate or even avoid the increases.

That the casualty business is a volatile one is clear: underwriting profits went from nearly 5% of premiums in 1972 to a loss of nearly 5% last year. Investment income before capital gains has always exceeded the underwriting loss, except for 1957, however, so there has been some profit. But if volatile profits are a measure of risk, then casualty is indeed a risky business and represents a strategic opportunity that must be thoroughly evaluated before making the move. Analysis of the moves that have been announced to date would indicate that life insurers who see casualty as a new product that can be distributed through existing distribution systems to market segments they currently serve have decided to take the plunge; those who do not see a fit with their current distribution capabilities have decided not to enter. The most notable cases have been large companies with agency forces that have evolved from industrial debit forces. There the casualty products are being sold through the same agents to the same policyholders; only the product is new. The inherent risk of volatile underwriting results remains, but the other risks of establishing a new market position are minimized. A key benefit is the increased income and viability of the agency force.

Other life insurers have seen group casualty, particularly group auto, as a product whose time will come, and feel that it will be a natural addition to their group portfolio; even a necessary one to protect the life and health business. The timing of group auto will be affected by many factors in the external environment, including national health insurance, removal of laws and regulations against group casualty, and changes in the tax laws to afford group casualty the same favored treatment as group life and health. The list of key factors - we refer to them as critical success factors - that should be covered in evaluating casualty as a strategic opportunity includes the market position, the price adequacy, and the supporting service requirements. By market position, we mean the ability to sell the product in sufficient volume to a desirable market segment so as to avoid unacceptable costs of distribution and anti-selection. By price adequacy, we refer to the ability to obtain a price, in the market place, that will cover costs and leave a reasonable profit. By supporting service requirements, we mean the ability to handle the business, including quota-

tion, underwriting, issue, billing, collection, endorsements, claim investigation and settlement, record keeping, and statement preparation. Before deciding to enter the business, you must be satisfied that you can be successful in all these factors. The list - market position, price adequacy, supporting services - seems to fit life and health insurance as well, and is a useful checklist in evaluating strategic opportunities.

MR. MILLER: You can do all the assessment and evaluation you want, you can prepare brilliant actuarial studies of market potential and profitability, but you may wind up by discovering that you have thrown a lot of time, effort and money down the drain if your company is not prepared to move in response to the conclusions indicated by the studies. Before any company embarks on efforts along these lines, it should first make sure that its management is willing to consider what might be some far-reaching changes in the company's method of operation, and that the company is organized so that, when a decision is made to make a certain move, it can be implemented in reasonable time before the train has disappeared down the track.

Having said this, I will now offer a thought that might seem to be completely contrary. It is possible for a company to hurt itself seriously by overreacting. Innovation, creativity and the ability to implement change rather rapidly once a course of action has been decided upon are things that all of us should strive for in our corporate environment. However, there is also the question of priorities. It has often been said that, within reason, a company can do anything but it cannot do everything. Thus, a proposition that is worth considering is that even large companies, with their tremendous resources, can sometimes be better off letting others test the waters in a particular area.

One of the items in this part of the agenda which is quite important is the one of assessment of market potential. Frankly I have not yet perceived a good way to do it.

Bad assessments of market potential can hurt you two ways. The one obvious way they can hurt is to cause you to miss legitimate opportunities. Another way they can hurt you is that bad assessments of market potential can make you spend a lot of time and money for virtually nothing.

In this connection we hear a lot about test marketing of new products as a good way to assess market potential. I wonder whether it can be done without spending almost as much as if you were going the full-scale introduction route, and I would be interested to hear the thoughts of others on this question.

MR. ALEXANDER MARSHALL: Metropolitan has not used test marketing on new products for the reason already cited, i.e., nearly the full range of development costs are incurred on a new product whether you test market or go full scale. We have, however, used a test-marketing approach in servicing guaranteed issue options which have begun to mature in recent years in order to determine the most economical procedures. These guaranteed issue and other similar options give the policyholder the right to acquire additional coverage, up to stated maximums, without providing current evidence of insurability.

Metropolitan felt it was proper to remind such policyholders of their option privileges as the option dates approached. It was initially proposed to do this by letter notification, with appropriate notice to the sales representative. If the insured wanted to secure the additional coverage to which he was entitled without evidence, he had only to complete a brief application form submitted via the sales representative, and the policy would be issued. Our

Marketing Department suggested that a substantially higher placing rate could be secured if the new policy was issued in advance and given to the sales representative for delivery when he first made contact with the insured to advise him of his option privileges.

Substantial additional expense would have been involved if we were to issue a policy in advance under all such maturing options. As a result, it was decided to issue such policies automatically in advance only in selected areas to see if higher placing rates could in fact be achieved when that was done.

At the end of six months we found that, while the placing rate was around 90% for cases on which the insured received letter notice and completed an application requesting the coverage, the result was nowhere near that high for cases on which policies had been issued and sent out in advance. Further, and perhaps more important, of those eligible for additional coverage under these options, we found there was virtually no difference at all in the placing rate between the group to whom the policy was automatically issued in advance vs. the group who received only letter notice and who had to complete the application.

This had two important implications for Metropolitan. First, we were able to test the effect of issuing the policy in advance at about only 1/10 the cost we would have incurred had we issued policies in advance on all maturing options. Second, we were able to delay introduction of a different program involving automatic advance issue without underwriting on blocks of in-force business until we find a way to ensure a placing rate high enough to at least cover the expense of such automatic issue. Thus, this experience suggests that there are situations in which test-marketing techniques can be adapted with advantage even though they may not always be appropriate for testing new products.

MR. SPARE: Our company is one of those companies which does not have a "formal" long-range plan in effect. However this does not mean that we do not do planning.

In 1970 our total company production was approximately \$550,000,000 which included both individual and group life, health and annuity coverages as well as mutual fund sales, all translated to an equivalent amount of life insurance. It was decided at that time to embark on a program of planned growth in order to provide a sense of direction for the company, keep better control of our expenses, and generate enthusiasm in both the home office and field.

To achieve this growth we would concentrate on agency building by attempting to improve the productivity of our present agents, by recruiting and training more agents, and by attempting to improve our agents' retention rate. We would concentrate in building our present agencies rather than establishing new ones.

It was decided to tentatively set a production goal of \$1,000,000,000 for 1976, the Bicentennial year. This meant that in 5 years time we would have to almost double our production.

We then set about to determine whether this goal was feasible. To do so we had to consider such questions as the following:

1. How much production can we expect in 1976 from those of our present agency force who will still be with us in 1976?
2. How many agents must we recruit, train and finance each year between now and 1976 in order to make up the balance needed to obtain the goal of \$1,000,000,000 in 1976?

3. What will be the cost involved in hiring and training these agents?
4. What will be the additional statutory surplus strain which will result from this increased production?

Our first step was to determine the amount of production which would result if we continued to grow at the same rate as in recent years. We made separate projections for individual life, individual health, group, and mutual funds. Within the individual life line we broke down the production between existing full-time agents, part-time agents, brokers, managers and supervisors, and financed agents. In this calculation we assumed that financed agents would be hired and retained at the same rates as in recent years. The resulting production estimated for 1976 was considerably less than the \$1,000,000,000 goal we had set for ourselves.

We next determined how much additional production would be obtained from our existing agents if we could increase their productivity by about 2½% over what it would be if no special effort were being made. We then assumed that the balance of the required \$1,000,000,000 production would have to come from additional financed agents appointed between 1971 and 1976 and from better retention rates of all of our financed agents.

Taking into account estimated amounts of production for new agents (separately for successful and failing agents) and improved retention rates of new agents, we determined how many additional agents would have to be hired each year to produce the required volume of sales. We found that the required number of agents was substantially higher than we could reasonably expect to hire and train.

At the same time we attempted to estimate the additional statutory surplus strain which would result from the additional production. To do this we constructed a simplified model office consisting of only four plans of insurance at several issue ages. The plans, issue ages, and percentage distribution of the plans in the model office were roughly representative of the characteristics of our then current paid for business. (For many years we have had a model office which breaks down our in-force into plan, age and duration cells and which we have used quite successfully to estimate dividends, reserves and other items for the following year, but we have not yet adapted it for use in longer-range projections.)

We then calculated premiums, reserves, cash values and dividends for these plans for each of the first 5 years, assuming that the then current dividend scale would remain in effect through 1976. We made the usual assumptions as to mortality rates, lapse rates, expense rates, investment earnings, and agent termination rates. The expense rates were split between policies written by financed agents and policies written by established agents. We also assumed an inflationary factor in our expense rates.

Using asset share methods, we calculated first year losses per \$1,000 and renewal gains per \$1,000 for business produced by both financed agents and established agents. We then applied these gains and losses per \$1,000 to the amount of additional production which was required in order to estimate the additional surplus strain which would result each year from 1972 to 1976. Because of the broad assumptions, we expressed our results in terms of ranges rather than as single dollar figures.

In considering the results, it seemed apparent that not only would it be impractical to recruit and retain the number of agents which it was indicated

would be needed, but also that the resulting surplus strain would be higher than we were willing to accept. Therefore we came to the conclusion that the goal of \$1,000,000,000 in 1976 was too high.

We then decided to calculate the estimated total production which would result under a more reasonable set of assumptions. This principally involved reducing the number of new financed agents which could be hired, although other minor changes were made in other assumptions.

Working through the calculations it was found that a 1976 estimated production figure of about \$840,000,000 would result. The additional surplus strain was estimated and found to be acceptable.

It was therefore decided to set a goal of \$800,000,000 for 1976. We then set goals for intermediate years for the number of agents to be recruited and retained, and for the amount of production from new agents and existing agents.

The program was closely monitored each year and it was found that the assumptions with respect to the hiring and retaining of new agents were closely realized.

Production from other sources was higher than we had assumed and we now find that our goal of \$800,000,000 for 1976 will very likely be reached in 1975. Our current estimates indicate that reaching this point a year sooner than originally planned will have no major effect on our surplus position.

MR. MacGINNITIE: Evaluation of alternatives is one of the more important parts of strategic planning. There are usually more alternatives than there are human and financial resources to devote to them, so it becomes important to evaluate them carefully and decide which ones deserve the most consideration. This process may involve several iterations, starting with a quick and dirty evaluation of a large number of ideas (opportunities from the SWOT's), selection of several promising ones which are then further evaluated, etc., etc.

At each stage, there should be some evaluation of the resource requirements, the financial consequences, and the cost to exit. Resource requirements mean not only money but things like space, computer programs and time, and people, including management time. New ventures require substantial amounts of managerial time, and it is imperative that management roll up its shirtsleeves and learn the new business at the beginning, rather than having to do it later when things go wrong. Financial projections would seem to be an obvious necessity, but you would be amazed at how often they are left until after the fact. And cost to exit is something that should be considered explicitly: how much will it cost, in both money and manpower, to get out if it does not work out. Considering the mortality rate on new products and new ventures (estimated by some to be well above half, depending on closeness of fit to existing operations), this cost to exit would seem to be of self-evident importance.

Turning to the monitoring of progress, the most successful approach we have seen required the establishment of targets or goals in each of the critical success factors. Where possible, these goals were quantitative, but not always, since qualitative measurements can be particularly important in the early days of a new venture, when quantitative data is sparse and not terribly credible. Where the achievement of these goals is going to be influenced by external factors, then quantification of the variation expected with changes in the external factors is in order. A good example is a goal that assumes some inflation rate, say, 7%. How much will the goal change if inflation is 8%, 6%?

Monitoring of progress toward the goals is important, in order that corrective action can be undertaken as quickly as possible when an adverse variation develops. Alternatively, aggressive exploitation of an opportunity may be indicated when the variation is favorable. One key item to remember in establishing a monitoring system is the independence and objectivity of the evaluators.

MR. MILLER: To me, the key word to keep in mind in considering this topic is "dynamic." This means that monitoring progress (or perhaps lack of progress) is critically important. For example, cash flow analysis should be continuous. At New York Life, we analyze and update our cash flow estimates monthly to see if changes should be made in the full year estimate.

Policy loans can be a critical problem because they are most difficult to predict. We have found a very strong correlation between policy loan election rates and average 90-day bill rates - but are the bill rates any easier to predict?

Long-range projections should be revised at least annually since a short-term shift in an item may have a severe impact if it is deemed to continue, e.g., a small decrease in average persistency may have little effect in the short-run but could mean millions or billions of dollars by the end of 20 years.

The purpose of a good deal of long-range planning, projecting, and forecasting is not so much to say where you are going to be, but to identify the relative differences in where you might be depending on whether or not something happens or whether the company does or does not adopt a certain course of action that is currently proposed. The purpose of these activities is not necessarily to solve all your problems, but to try and find out which of the problems that currently face you are worth trying to solve. Remember the company can do anything but it cannot do everything.

