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ROLE OF THE ACTUARY IN CORPORATE PLANNING

1. The technique of corporate planning—what is its purpose and value?
2. What is the role of the actuary in the setting of objectives?
3. In what ways can the actuary assist in the translation of these objectives into meaningful plans of action?
4. What is the actuary's role in the necessary financial testing of these plans to meet objectives?
5. What controls and reporting mechanisms are required to check that the objectives set are, in fact, being met?
   a) Does the actuary have a role to play here?
6. What is the nature of the projections required for corporate planning in an insurance company?
   a) What has been the practical value of these projections?
   b) Do they assist the actuary in other areas of his work?
7. What manpower and organizational structure are needed for effective corporate planning?

MR. THEODORE S. ROSKY: Planning is one of the basic functions of managing.

Stanford Research Institute defines planning as "the process of thinking ahead and making a predetermination about a course of action. It is this action-ability of results that distinguishes it from other kinds of thinking about the future, such as daydreaming or forecasting."

Planning can be divided into two types—strategic and operational. Strategic planning must be customer-oriented. It charts the future course of the corporate enterprise, providing a broad frame of reference within which operational planning is done. The broad objectives are quantified where possible to arrive at more specific long-range goals. This cannot always be done. Profits and growth rates are more easily quantified. For example, strategic objectives on profits could be expressed in terms of a minimum annual rate of growth of annual statement gains or minimum rate of return on the investment in new business. Growth rates could be expressed in terms of annual rates of growth in payments by customers or of insurance in force. Additional measures could be obtained by comparing performance with that of competitors of similar size and markets. Share of the market can be a valuable yardstick.

Strategic planning communicates strategic priorities. In a larger organization this helps keep divisions from working at cross-purposes. Almost by definition, strategic planning must take place at the top management level.

Operational planning is the process of determining specific plans to attain the goals derived from the strategic planning. This takes place at the divisional, departmental, and sectional levels and is a two-way process. The broad goals and outlines of the strategic plans are communicated downward, where they are translated into more specific operational plans, which are communicated upward to form the total corporate plan. At this stage the entire organization should be "on the same wave length," with line managers in tune with the goals of top management.

The actuary, to the extent that he is a member of senior management, is an active participant in the strategic planning process. His role most certainly would include determining whether or not the corporate objectives are readily obtainable or are not consistent with each other (such as goals calling for substantial business growth coupled with a greatly increased growth rate in annual statement gains).

Senior management should be provided with certain basic data which form a frame of reference within which they can determine the specific goals to be obtained as a result of the strategic plan. These should be customer-oriented wherever possible. Key elements to be considered would be such things as the gross national product, disposable personal income, and the amount of available savings dollars. From these, the probable size and shape of the insurance market can be determined.

In turn, this enables management to set goals for themselves in terms of their share of the market. This quantifying process can be carried out by any number of different types of people—econometricians or market researchers, to name but two. The actuary can be very helpful in this process but is not necessarily the prime party to perform this function.

All of management should be involved in operational planning. The translation of operational plans into quantitative terms is done by each of these planners. The actuary's role is obvious in the translation of the total plans into earnings and surplus growth. He can be very helpful in ensuring that the plans are internally consistent, both within each department and among departments. There is an obvious interrelationship between the planned results and the parameters which the actuary uses in his pricing and dividend work. This is another facet of his tests for consistency.

The actuary can be a partner in making policy decisions in areas such as marketing, investment, and underwriting by quantifying the impact of proposed courses of action. In these areas he can play a vital role.

There is no "right" way to plan. The process must be individualized to fit the needs of the particular enterprise for which the planning is being done. It might be helpful to give you a brief history of our planning endeavors at Connecticut General. We have more unsolved problems than we do pat answers. Perhaps the main lesson we have learned is that the best way to start planning is simply to *begin* and then to refine the process each year as more is learned about the benefits that can be derived.

A form of planning, via the budget and budget standards, has been used by us for many years. We began our current company-wide planning processes in 1964. Detailed plans on courses of action for the forthcoming year were developed, along with a more general description of planned actions for the following four years. We felt that a period of five years was long enough to give us a good indication of the direction that each of the departments was taking, while still keeping the time span manageable.

The question arises of whether one should plan for some longer period of time, such as ten years. We have found that the human factor probably does not permit effective operational planning that far ahead. The senior management's strategic planning is on a longer-range basis, but the operational plans, so long as they fit within the strategic framework, probably need not be for that extensive a period of time.

Originally, our planning process was directed along budgetary lines to a large degree, being numerically oriented. The process has evolved from year to year. We continue to place more emphasis on the first year of the five-year plan. This makes the process as much one of control as one of planning.

One of the problems has been that of getting department managers to emphasize what *they* were going to *make* happen instead of making forecasts. Too much emphasis on the numeric side of planning can result in making the process a "bottom up" one, where the total plan is determined by adding up the individual pieces. We currently are placing more emphasis on setting standards for the level of over-all corporate performance.

We have added a further dimension. Each departmental manager sets forth in his plans what it is that he will accomplish in the forthcoming year. His plan (which is an action plan) becomes the performance standard against which his performance is assessed. This step has had a measurable impact on our planning, making it a much more effective communication and control device.

Our planning process begins with a strategy meeting at the senior management level in June. It is at this time that the broad outlines of strategic plans are examined. The primary focus is on strategies to capitalize on opportunities, with emphasis on what it is that we want to make happen and how we are going to make it happen. Each of the line areas discusses major present and future environmental factors and their planned actions to capitalize on them. Through this meeting we attempt to develop the broad strategic framework and to set guidelines for the objectives to be implemented in the subsequent operational planning. In areas where further work needs to be done, specific timetables are laid out so that the strategic plans can be developed prior to the actual preparation of the operational plan.

Operational plans are developed in the fall and discussed at meetings in November and early December. Each of the officers reporting directly to the president prepares a plan which covers his operations. These plans are reviewed collectively by this group. Plans for the year immediately ahead are in considerable detail, including specific operating plans and target dates and corresponding spending plans. Emphasis is placed on action plans—steps being taken or to be taken. Plans, once they are agreed upon, are reported in summary chart form to the board of directors.

A review process takes place three times during the year: at the end of three, eight, and eleven months. The focus is on the first year of the plan. The three months' review takes into account any planned new actions arising from an analysis of the actual results for the preceding year. Three months' data are carried, but emphasis is on the currently planned twelve-month results. Written reports are distributed late in April and are discussed at a one-day meeting early in May. Progress against plans, again in chart form, is reported to the board of directors later in May.

The second review takes place after eight months. At this stage the departmental managers have a fairly accurate picture of how they stand with respect to their planned actions for the full year. Projected deviations from plan are noted, as are any shifts in emphasis or planned new actions. Significant changes in external factors which might influence current or future plans are brought out. Reports are distributed in late September, discussed in early October, and presented to the board of directors later in October.

A last-minute review of planned results takes place in December, based on the results of eleven months. No written reports are required. This brief review helps ensure that there will be no significant surprises in the operating results for the year.

In our corporation, the planning and control systems are the responsibility of the vice-president and actuary. The planning co-ordination is performed under his direction by a small staff. Each line area has a small group who support its planning work. These people, in addition to performing review and control functions, also produce the annual financial data for their operations. The basic planning responsibility, of course, is vested in each of the operating managers.

There is another type of planning, falling somewhat between strategic and operational, which deserves some consideration. This involves planning what to do in the case of a sudden, unexpected happening which, while not likely, has some slight probability of occurring. Examples of this type of event are such things as a stock market crash, a currency devaluation, a sudden take-over bid which materializes from out of the blue, riots in the city, or a phone threat that there is a bomb somewhere in the home-office building. In any of these cases a prompt course of action on the part of management is necessary, and unwise decisions are likely to be made in the heat of battle. Effective planning in these cases would consider what steps should be taken, making the basic decisions in a thoughtful atmosphere. Certainly one should not plan for every contingency, no matter how remote. Good judgment should be used to decide for which, if any, of these types of events we should have plans.

In summary, I would offer the following definition of long-range planning, which was made by Dr. Seymour Tilles, vice-president of the Boston Consulting Group: "At its best, a long range plan is a statement of strategy, sequenced over time, expressed in terms of resource requirements and funds flows, and representing a consensus of the top management team."

Much time, money, and effort have been invested in our planning work at Connecticut General. The return on this investment, however, makes it well worth the price. It is only through planning that we can be masters of our own destinies.

MR. W. JAMES MACGINNITIE: These remarks should be prefaced by the observation that they are based on the experience of a large casualty company. What follows is an attempt to abstract those aspects of our experience that should be useful to life actuaries and executives.

We started our corporate planning operation at Continental National American in August, 1966. Initially, we concentrated on special projects. It soon became apparent that for every problem we resolved several more appeared; we despaired of ever getting our arms around the total set of problems. So we, like many others, retained a consultant. The first thing that he helped us to do was to analyze our industry and our particular company, so that we could design our own individualized planning system.

The design of the planning system is one of the most crucial steps in getting planning started. Some companies may have informal systems already, and they may well suffice, perhaps with minor modifications. Others will require major modifications, as ours did. But it is important that the planning system, formal or informal, be designed for your individual company. Standardized, textbook systems will probably do more harm than good.

To do this in our own case, we analyzed the various facets of our business and our company and the effects of these facets on the several aspects of our planning system. We looked at such things as the nature of our competition, the nature of our management system, and the knowledge and inclinations of our management. Then we looked at the effect that each of these items had on the various aspects of the planning system. We asked how, for example, the knowledge and inclinations of our management affected the time span of our plans. How did they affect the frequency of their review, revision, and extension? How did they affect the information required for planning? After this analysis was completed, we were in a position to make some decisions about the planning system best suited to our needs. We then prepared a formal document covering the major aspects of the system.

The first aspect to be settled was the objectives—what we were trying to accomplish in planning. These are distinct from the objectives of the company, which are usually expressed in terms of growth and profitability. These objectives of planning will vary from company to company, and it is important that those differences be recognized. In our own case, we decided that improvement of communication, co-ordination, and control was the primary objective. Improvement of the decision-making process and environmental surveillance were secondary objectives.

While objectives were the first part of our document, we did not decide on them first and then move on. Rather, this was a cut-and-fit process, as are most things in planning. There is nothing more misleading than a writer who suggests that this is a nice, orderly process. It involves a great deal of recycling, particularly during the start-up phases. We have come to believe that short cycles with tight deadlines are the best way to get formal planning started. This means that some jobs will be done in an unsatisfactory manner or not at all, but this has forced us to put our resources into the critical areas and leave the others until later. In the process, we have gained a much better understanding of what is needed, and we will be much further ahead after two short planning cycles than if we had permitted ourselves the leisure of one long initial cycle.

After objectives, we set out the hierarchy of plans. This made very clear the distinctions between profit planning and strategic planning. Profit planning is usually just an extension of budgeting. Instead of the usual budget period of one year, it goes two or even five. Strategic planning starts with an indefinite time span and works back; a good strategy should last until the environment has changed enough to force a revision. It deals with such basic questions as the businesses we want to be in and in what manner as well as the long-term objectives and goals and the major actions necessary to achieve them. Both kinds of planning are required; one without the other is not likely to be successful.

In our own case, we specified a corporate strategic plan and, below that, a corporate operations plan and a corporate development plan. The operations plan deals with short-term operations; it is profit planning. Below it are the operating plans and budgets of our marketing and service areas. The development plan covers those things that we will be doing which involve significant change; an example would be the entry into hitherto unpenetrated markets. Below the development plan are the detailed plans on each project. Given the hierarchy of plans, we also had to specify which functions would be covered and the depth and detail of that coverage. We found that there are many things which do not require extensive planning; they are much better left to operating management.

Next, our attention turned to the time span of the various plans and the frequency with which we would review them, revise them, and extend them. These time spans vary. Our strategic plan is indefinite in length, but it is reviewed annually. It will be revised whenever the environment requires it to be. Operations plans, on the other hand, are three years in length, are reviewed semiannually, and are revised and extended each year.

The fourth item in our system was the content and issues of the various plans. We had to make sure that we were getting at the key issues in our company, not just a lot of interesting, but not critical, problems. One of the ways in which we did this was to analyze those things which had to be done if we were to be a successful business venture. Our tentative list said that our critical success factors were market position, price adequacy, supporting services, and investment income.

Another way we got at the key issues was to sit down with each of our officers and key executives and ask them to tell us what they thought the company's strengths and weaknesses were and what the threats and opportunities facing us were. It became apparent from the poll that we do not have a clear understanding of the financial aspects of the insurance business. This is something that actuaries are going to have to solve, since it will be much harder for financial people to learn insurance than for actuaries to learn finance.

The next section of our systems dealt with information requirements. This covered both the information required about our environment and the information about our internal results and capabilities. As you can imagine, the actuaries were very much involved in the analysis of the results of our competitors and in recasting a lot of our own operating data. Among other projects, we had to perform a discounted cash-flow analysis of our various lines of business, so that we could determine how much investment income should be credited to each line. While this may seem to be fundamental to a life actuary, it is not a common practice in the casualty field.

Our planning document dealt extensively with the procedures to be followed during the planning cycle. Planning reports were prepared on a wide variety of subjects, including most of the issue families mentioned before. This involved something which is fundamental to the planning process: the enumeration of alternatives along with the analysis of their ramifications. One of the ways we looked at alternatives was to examine their financial impact. A computerized financial model of the company was constructed by the actuaries for this purpose. It was used to identify the size of the planning gap, which was the difference between where we were going if we continued as we were, which we called momentum, and where we could go if we attained certain goals, which we called potential. This gap proved to be very useful in motivating some of our managers.

Next we considered manpower and costs. Planning for a big company is not cheap. It requires the commitment of some of its most expensive manpower. Large amounts of their time must be committed; it cannot be done on an "in addition to everything else you're doing" basis. Most of the planning work has to be done by the operating people; the planner merely provides the system and some help. We went looking for people with the following characteristics: good knowledge of the business, good communications skills, persuasiveness, good analytic ability, and good perception of strategic issues.

Our document also laid out the schedules we would follow, and we then forced ourselves to do what we would be asking others to do: specify the results we expected to obtain and the controls that would be used to make sure that they were obtained.

CHAIRMAN C. NORMAN PEACOR: Any discussion of long-range planning should certainly begin with a definition. Let me offer one by Dr. E. Kirby Warren from his book entitled *Long-Range Planning: The Executive Viewpoint.* Long-range planning is "a process directed toward making today's decisions with tomorrow in mind and a means of preparing for future decisions so that they may be made rapidly, economically, and with as little disruption to the business as possible." He goes on to describe what long-range planning is not, and I am sure that many would find his analysis interesting and informative.

Dr. Warren also made some interesting observations on the why of long-range planning. The comparison I would use is his description that the United States as a young and promising nation was isolated, or at least insulated, from the competition of more mature nations. It could afford to waste its resources and was probably wise not to allocate its energy to detailed long-range planning. He goes on to point out that, as this country approaches maturity, it is no longer isolated or insulated nor does American business any longer reign supreme and unchallenged in efficiency and know-how. These same observations pertained to the life insurance industry, which has grown up virtually unchallenged in its sphere of operations since the middle of the last century. Today, the inroads of social insurance, savings bank life insurance, competition for the savings dollar for mutual funds, and so forth, make the analogy with the national scene and, in a frustrating fashion, show that we can no longer as an industry disregard outside influences. Today's decision-making processes require planning for survival.

Long-range planning at the Massachusetts Mutual got its embryonic start just two years ago. At that time, our incoming president, Charles Schaaff, listed establishment of the process as one of the goals of his program. In January, 1967, a group headed by the senior vice-president began meeting to determine how, when, who, and under what conditions the company should embark on a long-range planning program. After exploring a great many possibilities, one particular avenue of approach seemed to fit our requirements. We considered and rejected proselyting a staff or attempting to develop one from scratch by means of our resources within the company. We chose, instead, to retain the services of a management consulting firm in order to give this program rapid impetus and specific direction.

On August 1, 1967, the program got under way. By February 1, 1968, we had in being a corporate long-range plan, largely operational in nature, with specific short-range objectives and programs. Adequate control points were established in the form of quarterly reviews, and the first of these has been held. We are now engaged in the process of improving on what has gone before, and we are also proceeding at a more deliberate pace.

As a start, we spent the first two months merely trying to come to grips with a definition of the purpose or mission of our company as well as a consideration of the environment in which it would operate. Getting agreement on a broad statement of company mission proved to be an interesting yet difficult assignment as various executive officers, for the first time, tried to express their own points of view about the role of the company. It was here that the actuary contributed substantially to the statement of the company mission in the strength of his insistence on financial soundness in the company's operation and in the protection of the policyholders' interests.

For my own part, I feel it is difficult, if not impossible, to make effective long-range plans while lacking a full understanding of the framework within which plans are to be made. Projects which implement ideas requiring several years to complete do not represent long-range plans. Similarly and parenthetically, forecasts of results some years in the future also are not long-range plans.

At the same time that the company mission was being defined, measures of performance were also developed. These were broad measures as they applied to the company's operations. They are fairly obvious and related to such things as volume, premiums, surplus, assets, and the like. We attempted to select one overriding measure as "the most important" but finally had to settle for five, with the volume and premium ones being broken down between total business and new business.

We did have a particular problem as a mutual company. Stock companies can always relate to some function of earnings as a major measure of performance, and this becomes an excellent guide and standard. As an idea, we considered taking our annual statements of the last several years and arbitrarily and artificially creating a stock image. We would then have been in a position to evaluate our progress by means of this type of yardstick which is available to so many companies. We did not pursue this idea to the point of doing it, because it did seem so artificial. Had we done so, however, there is no doubt but that the services of the actuary would have been called upon to provide the necessary financial transition and analysis for meaningful results.

As part of the preliminary staff work, analysis of "environment" was made. We were concerned with national economics, the role of government, and the place of insurance in a national economy. We proceeded from that to an analysis of our own markets and areas of involvement. Manpower analysis was of particular interest and importance. Finally, we analyzed our position with respect to that of our competitors from the standpoint of growth, net costs, and so on. This staff analysis provided a beginning for analyzing where we had been, what we had done, and where we wanted to go.

From this base, we proceeded to the divisional plans. Each division had to define objectives, "reasons for being," which would support and complement the corporate structure. "Improvement opportunities" were sought out and, in some instances, created. Once over-all objectives had been defined, further refinements took place on a departmental level in terms of the means of achieving those objectives. As a final step, action programs were developed for 1968 which specifically defined what was to be done, what resources were to be committed, who was responsible for carrying out the program, and what results were to be achieved. These action programs provide the check points for reporting to the chief executive officer to see that the programs are, in fact, being accomplished.

In effect, our long-range planning process moved from broad, general definitions through a hierarchy of steps to the specific. This planning process is literally from the top down.

In our development, the role of the actuary was to a large extent no different from that of any other division officer. More to the point is that the actuaries' own objectives and programs called for greater management information and better communication of it. They are concerned, among other things, with extensions of model-office techniques for a variety of purposes. The subject of operations research will receive further development, and there is a heavy emphasis on more extensive use of our computer facilities and the data available.

One area in which more can be done involves what I would call "the evaluation of differences." Very often, the actuary has been called upon to forecast or to predict what will happen. Just as often, by the time the forecast gets hedged about and the uncertainties apologized for, much of the forecast credibility has been weakened. In my opinion, there should be a greater emphasis upon the preparation of analyses using controlled and varying conditions whereby top management can evaluate the possible results of alternative, probable courses of action. Here, again, I would draw a careful distinction between forecasts and evaluations of possibilities. The attitudes and approaches of operations research techniques can provide new insights into the role of the actuary in long-range planning.

Let me give a specific example of an area in which we are working. Pages 5 and 6 of the Annual Statement are simply susceptible to model building. In a projection sense, the results of future experience can be prepared, evaluated, and varied, in particular varied, using statistical and probabilistic methods to create alternative results. Management decisions could then be made either to influence or to take advantage of the best possible conditions, and plans prepared accordingly. The Joint Economic Committee in its pamphlet *U.S. Economic Growth to 1975:*

Potentials and Problems stated succinctly, "One might almost say that the very purpose of making such projections is to bring about changes that will produce a better situation in the future than would result from a mere extrapolation of the past."

All these remarks are, in general, directed toward operational long-range planning. At the Massachusetts Mutual, concurrent with this, we also became involved in questions of strategic planning. These questions in particular relate to the development of new marketing opportunities and new product developments for the company which lie within the purview of the corporate mission. Our entry into the variable annuity field would have represented the result of strategic planning had we had planning at the time we decided to enter the field. Once a decision is made to do something under strategic planning, the rest of the long-range planning process takes over and translates ideas into action.

In summary, I would suggest three major parts of the long-range planning process: (1) there must be a clear-cut, well-understood, and generally agreed-upon corporate purpose; (2) measures of performance—corporate, divisional, and departmental—must be defined and quantified so that periodic and regular evaluations can be enforced; and (3) all levels of management must be involved, but direction must emanate from the chief executive officer, and he must be vitally and particularly involved.

MR. WILFRED A. KRAEGEL: Would the panel address itself briefly to the question of organization of planning and how the planning group relates organizationally to the other areas of the company?

CHAIRMAN PEACOR: At Massachusetts Mutual the planning group happens to funnel through me, and I have a direct pipeline to the chief executive officer. We have a small staff with the capability of obtaining assistance from any operation within the company. It is independent of all other reporting structures.

MR. ROSKY: Our group reports to the vice-president and actuary. There also are small staffs in each line department supporting the planning function. In our company the departmental managers play the key role in the planning process.

MR. MACGINNITIE: Administratively, we report to a senior vice-president, but functionally we report directly to the planning committee, which is made up of the president, executive vice-president, senior vice-president, and assistant to the president. I think it is imperative that there be a direct pipeline to top management and their time as well.

We also have felt strongly that we need planning functions in each of the major operating areas, whether this is one man or a group, and we work very hard to establish good collateral relations with those people.

MR. ROBERT H. DREYER: The panelists have spoken of the several facets of the actuary's work as an integral member of the planning team. As a consultant, I would like to add another, the role of the actuary as an educator. This role is often shared with reinsurance representatives who do similar work with companies that are in the embryonic stage, particularly where the staff does not encompass a broad background of experience in the internal operations of a life company. It is crucial that the personnel of a new company be properly educated—for the sake of the policyholders who seek coverage, for the sake of the stockholders who have invested their money, and for the sake of top management who must make the decisions and see that they are carried out. A sound start also requires that management be properly educated so that they can develop a workable plan and carry it through to completion. In this capacity, we, the consultants, do not make decisions. Instead, if we perform our educational duties properly, we will act as a funnel which channels the ideas of management into a smooth-flowing stream. Our objective is to educate management to make their own decisions.

MR. BRUCE E. NICKERSON: It is rather clear from the discussion we have had that long-range planning is not at all the same thing as operations research, even though both are concerned with trying to control the future.

I would like the panel to comment on the extent to which a company's effectiveness in choosing plans is dependent upon the company's operations research capability.

MR. ROSKY: If planning helps in the allocation of scarce resources, both financial and manpower resources, then, I believe, you need some common frame of reference for that allocation. To the extent that operations research gives you an additional tool to measure the value of going in a particular direction, it plays a valuable role in the process.