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CORPORATE STRATEGY AND RESOURCE ALLOCATION

Moderator: E. SYDNEY JACKSON. Panelists: STEPHEN L. BROWN, GEORGE R. DINNEY, IAN M. ROLLAND.

1. How does a life insurance company formulate its long-range objectives? Mid-range? In what terms are objectives stated and performance measured?

2. How are strategies developed to achieve stated objectives? How are choices made between alternatives?

3. How are priorities determined and resources allocated? What resource category constitutes the most severe restraint?

MR. E. SYDNEY JACKSON: Corporate planning has been practised by industrial concerns for a long time but it is a relatively new management tool in the life insurance industry. The Life Office Management Association did a survey last year on the state of the art and based on a 40% reply, of those companies with premium incomes in excess of fifty million dollars, which they categorized as large companies, 15% had no formal planning process, 45% had started the planning process within the past five years and only 40% had been doing formal planning for more than five years.

There are many reasons why life companies have taken such an interest in corporate planning recently: inflation, rapidly rising expenses, increasing taxation, increasing government intervention, increasing competition from government, from other financial institutions and from other insurance companies. In a word, a period of rapid change; and in such a period it is difficult to assess your progress and your strength, while comparisons with other companies and with past history are even more difficult. Another reason is the unsettled economic conditions that we face today and tomorrow. We had thirty years of growth and reasonable stability in North America and throughout most of the world, but the future will be drastically different. Because of the uncertainty of the future we should be holding larger surpluses; but the result of recent events is that we have had our surpluses reduced.

So our companies are going to have to be very much better managed. The comfortable feeling that as long as the company keeps on doing what it has been doing,it will grow and prosper,is gone. In today's and tomorrow's environment, planning is an essential ingredient just to ensure survival.

TOPIC 1.

MR. GEORGE R. DINNEY: The motto of the Society is,"The work of science is to substitute facts for appearances and demonstrations for impressions." However, in over 25 years as a card-carrying member of our profession, I have become increasingly sure of my impressions and increasingly unsure of my facts. So my work this morning will be to substitute appearances for facts and impressions for demonstrations, probably the only intelligent actuarial posture to take as we look into the future.

My impressions are based upon the work my Company has done in the formulation of its long-term objectives. Objectives are meaningless unless they are related to the environment. So we commenced by preparing a report of some 400 pages which in the hackneyed jargon of the 1970's we called Scenario 2000. This report is our evaluation of the economic, social, cultural, demographic and, importantly, political forces that we feel will have a strong influence on our business over the next twenty-five years. Rather than attempt to uniquely identify the future environment for the life insurance business, we tried to evaluate those forces that would influence the whole financial services industry, namely, life insurance companies, general insurance companies, banks, trust companies, investment organizations, mutual funds, and so on through a list of some 43 components, each of which today are considered separate industries.

We looked at the entire financial services industry rather than the life industry to avoid the introspection which so frequently clouds our vision, to permit us to rationalize financial product and product distribution in their total configuration and, above all, to obtain a clearer idea of the long-range alternatives from which we might select our long-range objectives.

We concentrated upon the major forces which will be at work in our society over the next twenty-five years. It is axiomatic that secular change is more predictable than cyclical change. Over time the peaks and valleys become smoothed out and the direction of change is readily perceptible. Another reason for having greater confidence in long-range rather than short-range forecasts is the effect of political planning which tends to be normative and concentrates on ends rather than means. It has been said that the future has already been invented by the armies of political planners who now form the hard core of government. And, of course, as we move progressively away from democratic government to bureaucratic government, this tendency will become strongly confirmed.

The kind of environment we discerned is one that will not be surprising to anyone who has given a modicum of thought to the future. It includes:

1. Inflation at higher levels than we have experienced during the lifetime of our industry up until about 1945; not likely 6% or 7% but more than the historical threshholds of 2½% or 3%.
2. Rapid changes in technology having as yet little perceptible real value to the life insurance industry.
3. A movement toward a more planned and controlled economy - specifically bureaucratic as opposed to democratic government. Recognition, in terms of the "new economics" of the move toward a virtual service economy.
4. Continuing rapid modification in social values, tending to diminish the social utility of certain financial products such as life insurance.
5. Significant increases in average real income in North America coupled with an equally significant flattening of incomes; the acceleration of real incomes upward from the lower income levels being coupled with an acceleration of real income downward from higher income levels.
6. Increasing urbanization.
7. Acceleration of the demographic imbalance between the population not working and the population working.
8. A belated recognition of the fact that we exist in a mass market economy.

Our general corporate objectives are couched in terms of a Statement of Guiding Principles. These principles are entirely qualitative and, therefore, have little value as a set of working objectives for the Company. We accept social corporate objectives as intrinsic or inherent to corporate life and our fundamental corporate goal can be expressed simply as "profitable growth". Because of the peculiar nature of the conventional life insurance business, you cannot achieve growth in sales at a predetermined level without growth in profits at a higher level. We then take this simple measure of "profitable growth" and amplify it as will be mentioned when we discuss strategies and resource allocation.

Objectives find expression in corporate structure, and performance measurement tends to be easier under some structures than others. At present our Company is structured on the "functional" approach. Under the functional approach there is collective acceptance of goals but usually the mechanism for collective performance is not clear. The principal reason for this lack of clarity under a functional structure is that the Company manages its finances on a nonfunctional or "bottom line" approach, which is product oriented, so it is difficult to bring operational management and financial management into harmony. We have dealt effectively with this by processes of simulation and by processes of management by objective. In our Company performance is measured in a number of different ways but incentives and rewards are based upon improvement in profit.

As to the formulation of mid-range objectives, in my Company, they are determined by a simple extrapolation of the past rather than a discounting of the future. This means that there is a fundamental discontinuity in objectives which will be corrected by certain strategies to be discussed under the next topic.

MR. IAN M. ROLLAND: At the Lincoln National we approached the problem of establishing objectives by forming a corporate planning committee. Our organization is very diverse. We are in the property casualty business, the title insurance business and the mutual fund business as well as the life insurance business. We formed the committee in order to bring together people from each of these operating areas, so that they could educate each other about their businesses.

We then examined the whole company to learn what its strengths and weaknesses were. This was a very useful process because we needed to know our strengths so that we could build on those for the future. We needed to know our weaknesses so that those could be primary as for particular emphasis. In addition to looking internally, we tried to figure out what external factors would come to bear on our business.

We then moved to the development of broad principles for the operation of our business. They are very broad guiding principles which are not readily applicable to day-to-day problems. We developed six of them, dealing with areas such as financial strength, profitability, human resources, service, social responsibility, and integrity.

From the development of the six guiding principles we moved to investigate eight key result areas in each of which we developed objectives and goals over a five year planning period. We have chosen not to set specific goals on a year-to-year basis, but to look at a longer term.

We think the process has been very successful so far. It has helped the level of management that has been involved to achieve a much better understanding as to what is going on in the corporation and has benefitted us rather greatly.

MR. STEPHEN L. BROWN: Despite the fact that mutual companies do not have quite the same bottom line concept inherent to all stock companies, we have developed very similar qualitative corporate objectives, which seem to have had some meaning for our management and employees. Basically our objectives, in order of importance, are:

- financial soundness, basically making sure that we meet our obligations
- net cost, which of course means providing the lowest possible cost to our policyholders
- growth

These objectives seem rather simple and obvious, almost platitudinous. This is a good part of the reason that they have achieved such broad acceptance and recognition throughout the company. The publication and the acceptance of these objectives has resulted in a better sense of direction and understanding by a broad range of company employees as to why things are done as they are. This is a very important result.

The translation of these broad corporate objectives into more specific terms generally falls to the senior representatives of each major product area. They do this through a rather formalized corporate planning process which entails at least annual reports by each major product area to our executive committee. These reports, among other things, involve specific five year plans relating to such items as operating gains, sales, premium income, net costs, and so on.

The one exception to this area by area reporting system is with respect to company surplus objectives. Specific surplus plans must first be coordinated with a special committee of the company's top actuaries, representing each respective area before it reaches the executive committee. Unlike the Lincoln National, we do break these objectives down on a year-to-year basis.

Now given our overall corporate objectives, and a systematic process for setting specific goals related to these objectives, it really isn't too difficult to measure performance in terms of how well the specific goals were achieved.

One area of difficulty is what to do about objectives that are not achieved. Sometimes it is not easy to determine whether the failure to achieve an objective is because of a poorly chosen objective, because of external events beyond our control, or simply because of a failure to perform. In any case, it is often politically difficult to discuss this situation in the broad arena within which most of the planning process takes place.

MR. JACKSON: In some ways, we have found our efforts in corporate planning to be rather frustrating. The members of our Executive Committee, who are responsible for planning at the corporate level, are also important line officers. As such, they have become quite comfortable with planning in a one year context, since the requirements closely match their line responsibilities. However, in trying to extend our planning horizon out three to five years, it has been difficult to break away from the daily pressures in order to devote the necessary time to less immediate issues. Nevertheless, we do feel it is crucial to do so.

MR. ROLLAND: On this question of whether your planning ought to be on a year-to-year basis or oriented to a longer period of time, we have done some work on goals in the area of profitability, which is probably our most important objective at Lincoln National. In view of the fact that we are in the property casualty business, that we have a fairly good sized group health operation, and that we are also in the title insurance business, it becomes very difficult to determine what earnings are going to be from one year to the next because they are very much the result of external factors. For example, tornados in April can have a rather dramatic impact on the results of the property casualty company and, therefore, the results of the whole company. We also see that these businesses produce rather cyclical patterns in earnings that may be related to the business cycle or inflationary cycles. So, while we do adopt an objective of x percent increase in per share earnings each year, we look at that objective over a five year period of time, understanding that, on a year-to-year basis we may be either above or below our objective. The goal, though, at the end of the five year period, which we think will generally encompass at least one entire business cycle, is to be close to the objective originally set.

MR. JACKSON: A great deal of time could be spent on the question of how a mutual company measures its performance in the absence of the clear profit measure that motivates a stock company. We will have to set that aside after making the one point that the situation is different in Canada than it is in the United States.

In Canada, both the stock companies and the mutual companies sell both par and non-par insurance. For that reason the philosophies of the mutual companies and the stock companies in Canada are quite similar; both want to make a good profit on their non-par line and both want to have a low net cost on their par line.

TOPIC 2.

MR. ROLLAND: In developing strategies to achieve stated objectives, it is important to keep in mind a number of basic ingredients that must be included in all planning activities.

1. Planning must involve people at all levels in the organization and bring into the process as many different backgrounds and disciplines as possible.
2. Planning requires a good flow of complete, accurate, and timely information.
3. Any plan must be flexible and subject to change according to changes in both internal and external factors.
4. In the planning process, it is necessary to compare objectives with resources and establish priorities accordingly.
5. Planning must be an integral part of the operations of any organization. It must be a natural aspect of every manager's duties. It is, however, an aspect of a manager's job that is easy for him to overlook and, therefore, it must be carried out on some specific schedule.

These basic principles have guided the planning process at the Lincoln National in recent years. Formal planning is a relatively new activity for us and, therefore, many of our approaches are not terribly sophisticated. We are, however, pleased with the results thus far and believe that formal planning has contributed in a significant way to our progress. We have high hopes that it will play a more important part in our future progress and growth.

At the Lincoln we have enjoyed considerable success in the use of the task force approach to the development of strategies. These task forces bring together people from different levels within the Company as well as people with varying backgrounds. We believe the task force has a number of desirable aspects. The varying backgrounds and positions of task force members assure that ideas for accomplishing objectives will come from a number of different directions. Then, as ideas are suggested, the interaction of the group frequently improves the ideas and suggests many others. In addition, the fact that the task force approach increases the span of people involved in developing policy becomes very helpful in implementing that policy once it is determined. Specific examples of the successful use of the task force approach at the Lincoln involve tax planning and the development of our new corporate marketing concept. In both of these areas, we believe we have been able to develop rather unique and innovative strategies for meeting objectives through the use of the task force. Ideas and solutions to problems have come in many cases from very unlikely sources.

Between the time that alternative strategies are developed and the time that a final decision is made as to which alternative is best, there is need for considerable analysis and research. We have found that this function is not normally carried out effectively by a committee, and thus it must be assigned to one or more individuals. At the Lincoln these individuals may be task force members with particular expertise or they may be individuals who serve as staff to the task force and work under its direction. This staff work becomes very important input to the committee as it discusses the various alternatives and makes decisions as to which are the best. Committee decisions regarding alternatives constitute recommendations to the officer responsible for making the ultimate decision. We believe that important decisions must be made by a single individual who is then held accountable for results.

The process involved in analyzing alternative strategies varies according to the area covered by the strategy. At the Lincoln, we have broken our objectives down into eight key result areas. For each of these key result areas, we determine specific goals and objectives. The key result areas are as follows:

1. Profitability
2. Financial Resources
3. Market Growth
4. Human Resources
5. Productivity
6. Innovation
7. Diversification
8. Public Responsibility

After determining goals and objectives for each of these areas, we then formulate an action plan or a set of strategies for meeting the goals. Several of these areas involve goals and objectives which are subject to quantification in a numerical way. Others do not. For example, the key result area of profitability is quite susceptible to numerical evaluation. In determining strategies for this area, we utilize extensively modeling techniques which attempt to project company financial results for five years or longer into the future. We look at our expected profitability based on a variety of assumptions involving both internal and external factors. This gives us an idea as to how good things might be or how bad things might be, and it enables us to reach a decision about what appears to be the most reasonable future expectation. On the other hand, a key result area such as public responsibility is not subject to quantification, and thus decisions become quite subjective. In deciding on strategies in the public responsibility area, we evaluate the opinions of experts, the attitudes of the public, and other materials regarding the public responsibility of a corporation now and in the future. Strategies then become very much the result of developed opinions of those responsible for making the ultimate decision.

I am sure that as we progress further with our planning activities our process will become more sophisticated in all the key result areas. Interestingly, we have found that a great deal of value arises from the planning process itself. We find that the people involved develop a much stronger working relationship and that we end up with a group of people who are much more knowledgeable about total company operations. There are many who think that these results are of more value to the company than the ultimate plan itself.

MR. BROWN: We have a fairly structured planning process at our company, although we supplement it with the same sort of task force approach just described.

As to the structured process, each fall the major product areas produce strategic planning reports. These reports discuss and define strategic goals in terms of the expected external environment and in relation to our overall corporate goals. Early in the following year, the areas prepare a five year planning document in which the strategies become quantified and in which they also review the previous years results in relation to previously stated objectives.

However, many strategic questions involve more than one area and multiple disciplines in order to produce the optimum answer. It is with respect to these kinds of questions that the task force approach is most appropriate. We have used this approach with respect to questions of broad investment policy which have significant and often varying effects on the various lines of business. Setting a policy with respect to common stock investment in the general account is a good example. In fact, investment policy type questions have been raised often enough that we have made a permanent committee out of what was once a task force and that will probably give the kiss of death to the effectiveness of that operation. The task force approach also makes sense with respect to the examination of new ventures, such as entering the casualty business, and with respect to taking new major technological directions, such as tying in all our field offices with a teleprocessing system.

It must, however, be borne in mind that in the end one person must make the final judgement. I would go even further and say that task force recommendations, even if given some sort of offical stamp of approval, are absolutely meaningless unless those who actually have to carry out the actions in the operating areas are in full agreement. Sometimes planners forget that there is a practical and political aspect in the planning process which cannot be ignored.

Finally, I might mention how we have tried to deal with one external factor which has probably bothered all of us more than any other in the last few years, namely, inflation. We had our corporate planning and economic research areas prepare a study on the subject as it affected the insurance industry. The study included all the usual scenarios and their likely effects, but probably the most interesting part had to do with the actual effects of runaway inflation in other times and in other countries, such as Germany in the 1920's. To say the least the results were not reassuring for the life insurance industry. The main result of this study was to introduce a sense of heightened awareness in the operating areas of the need to build the inflation problem into their future planning to whatever extent possible. In fact, our executive committee has since required each area to deal specifically with its response to the inflation problem in their annual strategic planning papers.

MR. JACKSON: In connection with the task force approach, if the one who must make the decision is not involved in the work of the task force, is he not at a great disadvantage when it comes time to make the decision?

MR. ROLLAND: In a great many of our cases the individual responsible for making the ultimate decision was our chief executive officer. He was not directly involved in the planning process but he monitored it very closely by reading committee minutes and getting oral reports from the task force chairman so that the final recommendations were not a surprise.

We also intend that the results of the planning activities be regularly submitted to our Board of Directors, so that the Board will be fully informed as to the plans and objectives for the company over the five year period. It is then our intent to keep the Board informed as to how actual results stack up against the plan.

MR. JACKSON: Does a task force always present alternatives to the decision maker? On some occasions we have set up a task force to investigate an idea, and the people involved have become so committed to it that it builds up a momentum of its own, almost to the point of implementation, although in the final analysis it has to be turned down. Have any of the panel run into that sort of problem?

MR. ROLLAND: It is a danger. But, periodically, we review our committee set-up and the task forces that are in existence and bring to an end the ones that are not really effective and do not seem to have any particular purpose.

MR. DINNEY: On the general question of developing corporate strategy, Great-West built on the scenario that had been developed to forecast a future for the company within the context of the financial services business. The aftermath of the scenario was the development of a 157-point action program to deal with problems and opportunities that we foresaw over the next twenty-five years.

One perspective of this scenario was that we should anticipate the worst conditions and thereby develop strategies and countermeasures which, if not fail-safe, might at least be fail-resistant. We felt that, if we could develop responses to the main threats to survival, we would in the process develop positive strategies for profitable growth under conditions where the threats to survival were neither serious nor imminent.

The action plans included things like the development of flexible ordinary life insurance products for marketing and tax purposes, identification of corporate capital for acquisition and venture purposes, development of investment policies under different assumptions as to future levels of inflation and the fundamental question of corporate structure to harmonize with corporate objectives.

Our most immediate action plan is to harmonize organizational structure and organizational objectives.

Some people in our industry see the business over the long term in the form of a simple three-phase continuum. The continuum is marked first by an emphasis on marketing capabilities; then on control capabilities as business builds up and as marketing becomes less efficient and more costly; and ultimately on investment capabilities. Such a simple conception would place the emphasis of a particular company upon marketing or control or investment, depending upon the company's current stage of development and the rate at which it was proceeding through the continuum.

More specifically, a company should be organized to accomplish its specific objectives. If a company is strong and expects to remain strong in group, then group should get strong corporate identification. If the primary corporate objective is profit, then some variation of product line might be employed; or if the company is structured on a functional basis, the more oblique management-by-results technique might be used to bring the functional components into greater harmony. Similarly, if expense control or control of performance rather than profit is the most important consideration, then the control function including the actuarial, accounting, and taxation functions might be given prominence.

Usually a very wide diversity of corporate objectives can be accomplished in the design of corporate structure provided that senior management stops playing games with the corporation. For an organization to work, it must appear to work. The organizational chart is as much a diagram of how a company is supposed to run as a diagram of an automobile engine is of how the automobile is supposed to run. Some senior managers pooh-pooh the need for meaningful design in corporate structure. They say that people dictate structure and that any kind of structure can be made to work. It is my view that these senior managers are totally wrong.

Getting down to actual cases, the choice between alternatives within a company can frequently be made by vector analysis. It is possible to construct a number of different vectors or contingency plans, each responding to a different contingency that the company foresees. Taking inflation, for example, you might choose five vectors; deflation, inflation of 1% to 3%, inflation of 3% to 6%, inflation of 6% to 10%, or inflation of over 10%. Within each of these vectors, it should be possible to identify the product, investment and marketing strategies that would best respond to the given conditions. The principal strategy of the company could then be chosen in the area where the vectors or the strategies overlap. For example, a DA pension product or cost-plus health package would probably lie in all vectors and, therefore, represent a principal strategy of the company. The development of contingency plans also makes it possible to move more quickly into mid-range objectives as a particular condition, such as inflation of 3% to 6%, becomes confirmed as a mid-range trend.

MR. ROLLAND: I found the comments regarding the form of the organization interesting, since one of our prime objectives over the last three or four years has been to draw an organization chart of the company. Since we are a complex holding company, with people having responsibilities in many different corporations we have not been successful yet in getting that organization chart drawn up.

MR. BROWN: I have a little trouble with that point also. I am one of those that say the people make the organization, not the other way around.

MR. DINNEY: That is the easiest cop-out you could find. There are rigorous, logical techniques that you can apply to organizational structure. The notion that people dictate structure can lead to collapse of organization. Unless an organization establishes objectives and knows how it is going to accomplish them, it will not know whether its people are capable of reaching those objectives. That is a very important consideration. Admittedly, if you are in with a bunch of losers, you can gravitate toward people dictating structure; but that conception will never take an organization or the industry along a road that will reach the long-range objectives the industry must adopt.

MR. JACKSON: I lie somewhere between the two of you. Would you agree that, as you accomplish certain things and move toward your objectives, a reorganization to change the emphasis makes sense?

MR. DINNEY: Yes. It is fundamental that corporate plans be flexible. Essentially, there is a continuum of corporate structure going all the way from functionalism to total non-functionalism. A recent report by the Conference Board talks in much the same terms about a continuum based on the degree of decentralization in the organization. It would be interesting for a company to determine, analytically and scientifically, where it fits in that continuum at this point of time. I would say it is almost a foregone conclusion that it is not structured in that way.

Another thing that bothers me about corporate structure is the inertia that exists in our industry. The industry has been dominated by marketing from time immemorial, and it is organized in such a way that marketing has an important place in the organizational structure. It probably should have; but, because of inertia, we are perpetuating structures that may not be relevant to our industry as it moves into the twenty-first century.

TOPIC 3

MR. BROWN: It is not difficult to identify some of the key resources of a life insurance company. Of these, perhaps most would agree that people are the key resource. Very bright, dedicated people capable of exercising discerning judgment are perhaps the rarest and most important resource of all. As a convenient shorthand, we might refer to such people as actuaries. But, whatever they are called, I think a successful company must be willing to move such people around wherever they are most needed, and to provide appropriate challenges and incentives to attract and retain them.

The second "people-oriented" resource which is often cited is the agency force. Most would agree that the agency force is one of the most valuable, and perhaps the most valuable, asset of an insurance company. Many of the decisions made by companies which may appear inexplicable to outside observers can be explained most readily in terms of the care and feeding of the agency force.

Two other resources which require perhaps more in the way of allocation decisions than any others are cash and surplus.

For convenience, I would divide the cash category into two subcategories: cash available for expenses and cash available for investment. The questions of defining the amount of cash available for expenditure in total and the allocation of that total to competing demands are difficult. At the Hancock, detailed expense control is a development of relatively recent vintage outside of our Group operation. We started out a few years ago by blanketing the entire company with a single, somewhat arbitrary standard relating to percentage increase in expenses, and required that each major executive area meet that same standard. In effect, this allowed each executive area to determine its own priorities within a predetermined total expense pie.

This approach was later refined to reflect the particular needs and characteristics of each area, taking account of such things as differing rates of growth, pricing objectives, expansion of product lines, and the effects of the new pension reform act. The ultimate aim is to set unit expense goals for every activity within the company reflecting the company's surplus and pricing objectives.

Careful budgeting goes a long way toward easing the priority setting problems of at least one very important and expensive resource, our Electronic Data Processing Department. EDP in effect does not any longer have its own budget, but instead charges back all of its expenses to the user departments. This system forces those departments to live within budgets which include the actual expense of their data processing usage.

While executive areas are given a fair amount of freedom to set priorities and allocate resources within the confines of their budget and surplus goals, there are certain restrictions. For example, any major discretionary new project must travel through a "Project Planning and Reporting System" procedure, which essentially provides a detailed cost/benefit analysis in accordance with a standard format. The project report is reviewed by a broad-based reanalysis committee and their comments along with the project report itself are presented to the Executive Committee for approval. Such projects would include the development of a new product line, a new subsidiary, or the mechanization of manual procedures.

Allocating the cash available for investment is another activity involving the setting of priorities and the principles of resource allocation. There are several types of questions which arise. Clearly the basic clash of priorities is between rate of return and degree of risk. For the most part, life insurance companies, including my own, have opted for medium quality credits which can be expected to produce some small degree of losses year in and year out. Any substantial increase in quality would leave us out of the competitive new money rate picture, and would reduce the degree to which we can improve our NAIC rate. Any substantial reduction in quality could present balance sheet difficulties as well as requiring us to spend virtually all of our time chasing down problem loans.

Then there is the question as to how to allocate investable cash among bonds, mortgages, stocks, long term vs. short term, and so on. With the single exception of common stocks, the procedure for doing this is not a precisely defined one in our company. Because common stocks can have such a dramatic effect on our balance sheet we have very carefully defined the limits within which we can invest in stocks, taking account of both our surplus position and the stock positions of other similar companies. Allocation of funds among fixed income investments is a continuing process of our Investment Policy Committee, and depends primarily upon the relative attractiveness of the deals available in each area.

One other aspect of investments which well illustrates the clashing of priorities is the differing investment requirements of our various lines of business. On the one hand, the relatively high marginal tax rates of our Ordinary line implies the need for investments providing tax preferences, e.g., preferred stocks, deep discount bonds, and possibly tax-exempt bonds. On the other, the Group Pension line with its very low marginal tax rate is interested in the highest nominal rate of income obtainable. This conflict has resulted in numerous discussions and compromise solutions in the form of guidelines relating to investments with tax preferences, and other related areas.

In general, there is a great need to coordinate the activities, objectives, and procedures of the investment and insurance sides of the house, particularly in the investment-sensitive group pension business. We have done a great deal to improve this coordination within the John Hancock, and I have been personally involved in much of it myself. It is only through this close coordination that priorities can be set and resources allocated in a rational and optimal manner.

Finally, I would like to make a few comments about what I think may turn out to be another scarce resource over the next few years - surplus. The drop in surplus ratios over the last 10 years has been dramatic, particularly when the mandatory securities reserve is viewed as part of surplus. It is true that much of this drop was purposeful, reflecting a changing mix of business, tax considerations, and perhaps a feeling that surplus levels were redundant. I personally feel that this direction is a correct one and really inevitable under the circumstances.

However, at the same time that we have succeeded in bringing surplus down to historically low levels we are witnessing a burgeoning of the demands upon it. For one thing the long period of economic stability following World War II and lasting until the early 1960's may not return. I for one do not think we are going back very soon to a long period of relatively stable business and low inflation. While the current economic recovery will provide a much-needed respite, it is quite probable that financial problems will continue to affect the balance sheets and income statements of life insurance companies to a greater degree in the future than in the relatively placid 1950's and early 1960's. At the same time external pressure is growing to reflect market values and to be more diligent in reflecting problem loans in our balance sheets.

Meanwhile companies are under increasing competitive pressures to improve net costs to policyholders; and while most of this pressure has been focused on new business it is inevitable that increasing scrutiny will be given in the future to old business net costs as well.

The higher plateau of inflation rates we appear to have reached puts greater strains on life insurance companies in terms of the cost of marketing and maintaining our business. To keep up with higher levels of inflation, premium income and, therefore, sales must grow at a faster rate, again resulting in greater strains on the balance sheet.

Finally, we have the fairly recent phenomenon of life companies expanding into new areas - casualty insurance, reinsurance, real estate joint ventures, mutual funds, and so on. All of these require initial and sometimes continuing capital investments. Many add new dimensions to the long-term risk to which surplus is subjected.

If surplus is to be looked upon as a key resource of the future, then the decisions as to its allocation between dividends, new business growth, new ventures, etc., become more crucial than ever. These decisions historically have been made on a one-by-one basis; but gradually it is becoming necessary to recognize at once the many uses to which surplus can be put, and to set priorities for its use in a more rational manner. We have taken formal steps in this direction in the Hancock recently in our Ordinary area with regard to the desirable trade-offs between the rate of growth and the level of net costs of our policies, and in the pension area with respect to how much high guarantee business we will write. We also have had a surplus committee for some time now which has defined the minimum acceptable surplus levels for each major line of business. Still, I feel there is a greater need for coordinating our efforts and setting priorities in terms of surplus and related effects. It is important to realize that a decision to move into a new venture probably is also a decision to grow more slowly in some other area or to slow down the rate of net cost improvement. For many companies, the luxury of having surplus surplus is no longer available.

MR. DINNEY: Some companies employ the decision-tree approach to determine priorities and to allocate resources. It applies the thesis that you build on strength and minimize or eliminate weaknesses. So if a principal goal of a company is more effective profit management, resources should be applied to those areas where profit improvement can in fact be accomplished. The usual rule is to keep on adding resources to the profit center with the highest profit margin until the addition of these costly resources reduces the profit margin to the level of the profit center having the next highest profit margin. At that point you apply the resources in some kind of proportionate way, and so on down the line. This kind of resource allocation goes as far back as the biblical parable of the talents. It is exemplified by a chart in a recent McKinsey publication called a "Profit Economic Model of a Life Insurance Company". In actual practice, it is difficult to take a very direct and literal approach but the decision-tree approach does give a company a reasonable means of ordering its priorities.

Most of us are straight-line thinkers. We believe that conditions can be improved by simple extrapolation. One common visual image is that a company's growth is accomplished by an army of agents, supported by an army of managers or bureaucrats, writing vast amounts of insurance at low unit profit. That kind of imagery promotes massive support of the total corporation along a broad front. That kind of support defies military strategy and I think it also defies business strategy. Another image, which I think is more harmonious with military and business strategy, is to concentrate your forces. An image that I find effective is that often a company's position can be improved, not by engaging vast forces, but merely by a stroke of the pen. This kind of imagery might, for example, place the taxation function of a company into the main frame of the organization and staff the function for financial planning rather than for compliance activity.

Another familiar way to tackle the priorities problem is to use the zero budgeting rather than the marginal budgeting technique. The marginal budgeting technique will permit the continued physical expansion of the corporate buggy whip department long after buggy whips have ceased to have economic value.

Steve has remarked that people are the scarcest resource; I agree, with a qualifier. To me it seems that the scarcest resource is management that is capable of understanding and capable of performing its functions. The Pareto principle says that a small number of qualified and competent people will accomplish most of the objectives of an organization. Conversely, the principle states that a small number of unqualified and incompetent people will destroy an organization. It is my view that some people in management, even within our business, can be described in the same terms in which one of his detractors recently described the Prime Minister of Canada. He said of the Prime Minister,"He thinks you make scrambled eggs by shaking the chicken." It is because I hold this view that I expressed so strongly the case for structure dictating the needs for people rather than the other way around.

In a broader organizational sense,a very wise man once said that all managers can be classified as one of three kinds: managers of people, managers of money,and managers of ideas. The thing that is wrong with most corporate structure is that it tends to recognize and reward the first kind of manager, that is,the manager of people, notwithstanding the fact that such a manager is usually totally preoccupied with housekeeping activities and,by definition, is the strongest center for reaction in an organization. In my view capable money managers and capable idea managers should be identified and encouraged, and in a truly effective organization you will find a rare manager who combines all three qualities and who is employed by his company structurally, so as to serve the company best.

I think Steve was merely throwing us a fish when he said that actuaries are the scarcest and,by implication,the best resource of a life insurance company. It seems to me that in the future we will have fewer actuaries and more economists, fewer accountants and more statisticians, fewer personnel officers and more sociologists.

This suggests to me that the scarcest resource is the one that life insurance companies do not employ at present, because we are oblivious to the need.

MR. ROLLAND: I am also convinced that the most scarce resource is people, particularly the kind of people who are good managers. Our companies hire primarily technicians, actuaries, investment people, doctors, lawyers. These people spend most of their early working lifetimes, at the least, involved in technically oriented activities and most of our companies give them very little broad training in managerial techniques. We have finally realized that,if we are to be successful in the future, we need many more broad gauge managers that can do the right things, make the right decisions, do things other than just carry out their technical duties. For this reason we have recently devoted a great deal of time and effort to managerial training programs which are just now in their infancy but we see this as a major thrust of our company in the future as we try to develop broader gauge people.

I agree with previous comments regarding surplus. When we began our planning process at the Lincoln, we viewed as one of our strengths the fact that we were a capital-rich organization. By most standards of measurement the Lincoln Life is very strong in surplus, but when we analyzed it more carefully and tried to determine just how much of that surplus was available for developing our own businesses, we found that it was limited. We have had to make some very careful choices as to what parts of the organization were going to receive the limited amount of capital. It is important that more companies, and maybe the Society, spend some time on determining what are the appropriate minimum levels of surplus for a life insurance company, taking into account the kinds of businesses which it is operating and the kind of external environment that exists. There is rather limited material on this subject and it could very well be the subject of much additional research.

MR. JACKSON: I concur on that point. Our company is in exactly the same position. I have put the freeze on some projects we might otherwise have liked to launch until we have a better feel for the adequacy of our surplus under unsettled conditions of the future. I did not want us to branch off into new areas if it might have a very detrimental effect on our main activity. Surplus is certainly not unlimited.

QUESTION PERIOD.

MR. JOHN M. BRAGG: I think you have all done a tremendous job and we are very grateful. I think Mr. Rolland has come up with an extremely fine suggestion which Mr. Jackson concurred in and in which I also concur.

We are operating under a corporate plan at Life of Georgia for the first time in 1976. To us the marketing area seems to be the key central heart in the thing, and I am talking not just about sales objectives, but sales objectives broken down by agent, where the agents are to be located, what kind of agents you need, the growth in your agency force and, probably more important than even any of those, agents' compensation, the growth rate in agents' compensation you think you have to have, and so on. Would the panel comment specifically about the type of detailed marketing content that you have in your plans and also on the subject of how to get the essential cooperation from your marketing officers and officials in connection with all of this?

MR. BROWN: We have done some work on that at the Hancock, perhaps with some success. The way we have achieved some kind of understanding and cooperation from the marketing side is by convincing them that, if they do not meet certain productivity and expense standards overall, they are not going to get the planned net costs. So we really tied it down to very specific net cost numbers, dependent on their performance.

Backing up a little bit, years ago, we had embarked on a rapid expansion program. We have backed off that quite a bit and we have made a very distinct division between growth of a horizontal nature, which means just adding agencies and agents, and growth of a productivity nature which is what we convinced the agents we have to concentrate on if we are going to meet our expense and net cost goals.

MR. JACKSON: We too have made a major effort to get the participation of the marketing organization. We have actuaries reporting to the chief marketing officer and this team is working together very effectively. We stress the fact that we have to get good expense results if we are to maintain our dividends or improve our net costs. Our agency and actuarial officers have made our branch managers very aware of expense ratios. In this way we bring recruiting and improvement in retention rates into our plan.

MR. L. JEFFERSON STULCE: Some of us have not done a very good job in planning the development of the kind of corporate system and marketing system which we are going to have to have for 1985 and 1990 or even sooner. How do you structure to accomplish this more important aspect of long-range planning?

MR. DINNEY: That is a highly critical question. Most companies seem to be totally preoccupied with momentum projections of marketing systems developed in the LIAMA school of 1935. The life insurance industry is probably different from almost every other industry in its total unawareness of the fact that North America is now a mass marketing economy. Some people say that group is mass marketing. I do not agree. We have to develop techniques that will penetrate this market using mass marketing methodologies that already exist. After all, the commercial and industrial companies in North America have pioneered in developing distribution systems to the mass market. And yet these pioneering concepts are mostly unfamiliar to the life insurance business.

To effect that kind of change with the inertia that exists in most companies, the only thing you can do is go downstream or sideways, and create an organization that will do something ab initio. It is very difficult in a company which tends to be a democratic company, to encourage the spirit of awareness that is a prerequisite to the development of new marketing techniques. The tendency is merely to project forward what we are doing. We have to break out of that structurally and the best way to do it is downstream or sideways.

MR. JACKSON: I agree; but the reason may not be inertia so much as the reactionary factor of the agency force.

MR. RALPH H. GOEBEL: By the terms downstream or sideways, do you mean doing an end run around your regular field force creating an entirely different marketing structure or approach?

MR. DINNEY: Yes, that is exactly what I mean. An example would be the formation of a corporation that would handle mass marketing. The marketing division of most companies is too preoccupied with housekeeping, and not much innovative energy is being applied to new marketing techniques, so that is one method I would recommend to my own company.

MR. JOHN C. MAYNARD: How does the actuary fit in to all of this? One answer is that he can suggest formulas or arithmetical relationships which, if met in the development of the company's business, would produce a result which is satisfactory to the marketing and the surplus objectives. One attempt that we have been making, with some success, is to look at acquisition expenses in relation to the margins in the premiums. Establishing this relationship, setting it as an objective, and then watching the accumulation of acquisition expenses against the accumulation of the margins in the premiums and trying to achieve the planned relationship, is a way of getting the marketing officers in a state of mind such that they will accept surplus objectives.

MR. J. JACQUES DESCHÊNES: I would like to comment on the suggestion that surplus can be regarded as a source of funds for new ventures. Unfortunately, it has not been possible with the tools available to date to measure too accurately the need for surplus funds as a last resort contingency reserve related to the valuation of assets and liabilities. The need for surplus has, therefore, been determined subjectively and with wide variation between companies. I suspect that companies with a large surplus tend to believe that a large surplus is required, whereas companies with a small surplus tend to believe that little surplus is required. If this is true, then the companies who can least afford it are more likely to regard surplus as available for new ventures.

SUMMARY.

MR. JACKSON: To summarize, I will ask each panelist to reply to any or all of the following questions:

- Is corporate planning worthwhile?
- Are the biggest benefits to be derived still in the future or are you realizing them now?
- What are the biggest benefits that you have realized?
- What are the biggest disappointments?

MR. DINNEY: The benefits are mostly in the future, but in terms of our own company the greatest advantage has been in focusing the attention of management on the big issues. That resulted almost immediately in our looking at organizational structure which we feel is very important.

MR. ROLLAND: We have found the process to be extremely valuable, although the major benefits are still in the future. The principal benefits so far are that it forces a group of management people, at least for periods of time, to take their views away from the current bonfires and look a bit into the future; and it has provided a forum where our people can work more closely together and learn more about the total organization.

MR. BROWN: The process has been worthwhile in our company. While it is accompanied by a certain amount of wheelspinning, nevertheless, it comes out as a total plus. The biggest benefit has been the achievement of an understanding by one area of the problems that are inherent in another, particularly the kind of thing we talked about today about agents understanding surplus problems and net cost problems. The biggest problem for the future has also been identified today, namely, resolution of the question as to how we are going to overcome the inertia of the agency system and perhaps be willing to experiment with other types of marketing.

MR. JACKSON: We are just getting into the corporate planning process but I think it has been worthwhile. The main advantage is that it has made us aware of the problems facing us in the future.