RECORD OF SOCIETY OF ACTUARIES
1977 VOL. 3 NO. 1

CORPORATE PLANNING: PROCEDURAL ASPECTS

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1. The organization of the planning process.

2. The corporate planning cycle.

3. The nature and use of corporate planning.

MR. ROBERT D. HOGUE: The panel this morning is devoted to the content of the corporate planning process. Distributed before the meeting was a discussion note entitled Corporate Planning - Mark III, an address by Dr. Russell L. Ackoff** given at the Life Office Management Association's (LOMA) Second Annual Conference on Corporate Planning in Kansas City last year. I would like to quote a portion of his address. "First, there is the participative principle. It is based on belief that the main benefit of planning is not obtained by consuming its products--plans--but it is obtained by engaging in the planning process. Therefore, if you will permit a pun, in planning, process is the most important product. One corporation that I consider to be doing the best planning has never produced a formal document called a plan. It hasn't had to. Everybody is engaged in the process and knows what is going on." As Dr. Ackoff discussed, the spirit, the intention and the ultimate changes in a corporation, evolved through following a corporate planning process. We'll look at four examples of how the process can be taking place.

MR. JAMES A. MITCHELL, JR.: I will describe the processes in place within the Connecticut General relative to operational planning, which we define to mean our planning for the ensuing two years. We distinguish this from strategic planning, which Lew Roth will be discussing, and which is designed to insure the long term health of our enterprise by providing strategic direction and thrust that go beyond the two year time frame of operational planning.

The second distinction I would make related to divisional operating plans versus the "Corporate Plan." Our current organizational structure consists of six relatively self-contained major lines of business. The divisions are decentralized to the extent that each has maximum control over the means of achieving its goals and is held fully accountable for its results. While describing briefly how the formulation of the Corporate Plan fits in, I will concentrate on those processes now in place for the initiation, development and integration of divisional operating plans.

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Our operational planning for 1978 and 1979 began in January of this year, with the President, his key staff people and division heads participating in an annual, 3 day direction setting meeting outside the company. The purpose of the meeting is for the senior officers to provide input to the President who is also the CEO. For this purpose, they act as staff to him in performing that part of his job involving overall guidance and direction setting. Tentative corporate level objectives, both financial and nonfinancial, for the next two years are discussed. Only major issues common to all divisions, or which have enough importance to affect the entire corporation, are on the agenda.

With the benefit of this discussion, the President formulates his annual "Corporate Direction Memo" which is released to the divisions in February. Its purpose is to express those specific directions which the divisions are to develop in their planning for 1978-79. It furnishes a framework of guidance to the divisions, and identifies the President's priorities for the corporation in the next two years.

Right now, the divisions are formulating their preliminary plans for 1978-79. In addition to the Corporate Direction Memo, they have the benefit of the work they have done relative to longer term strategic direction for their business. The process involves each manager giving "top-down" direction to his subordinates and subsequently reaching tentative agreement with each subordinate on that person's "bottom-up" preliminary plan.

The divisional effort culminates in June with submission for corporate review of preliminary plans for the next two years. These plans contain end result objectives and specific plans for their attainment. Should the consolidation of the divisional objectives produce a total result which is inconsistent with one or more of the corporate objectives, <u>both</u> the corporate and divisional objectives would be reconsidered and appropriate changes made in either or both so as to end up with a consistent overall result.

Once end result objectives have been approved, the next step in the process is to formulate a detailed action plan for the next year, with somewhat less detail for the following year, built on supportive action plans on down the line. The final divisional plan is a written report submitted in November and covering the division's principal objectives, operational plans and major development projects. It includes specific action steps and completion deadlines.

Parenthetically, in submitting both preliminary and final plans to the President for approval, each division also identifies the critical assumptions on which its plan is predicated. These assumptions are then tracked closely throughout the planning period in order to enable the division to take action as quickly as possible if and when conditions change. By attempting to understand the potential impact of any of these assumptions being wrong, we believe that we minimize the risk of foreclosing our future options.

Following review by corporate staff and approval by the President in December, each division will enter 1978 with an approved plan. Once approved, the division plan becomes a "contract" between the President and the division head and, therefore, cannot be amended by unilateral action. It is understood that the division head's effectiveness in executing his management process so that all ingredients of his plan are achieved is the single most important consideration in the President's appraisal of his performance.

Also understood, however, is the obligation on the part of the division head to request a plan change if either conditions outside his control or his internal priorities change so that a planned goal is, in his judgment, no longer desirable. Through this plan change process, our plans achieve the continuity which Dr. Ackoff describes.

Throughout 1978, a critical element of our overall management process will be to monitor progress against our 1978 plans. The divisions will generally monitor performance of their departments against plans on a monthly basis. Divisional progress review reports to the President are submitted based on results through 3, 7 and 12 months. These reviews will not only include appraisals of performance to date and reprojections of full year results; they will also represent checkpoints within the continuing process of monitoring and reevaluation of the already agreed to divisional plans, which may in turn lead to a request to the President for a change in plan. Deficiencies identified as a result of faulty execution would also be examined and corrective actions initiated. As noted earlier, the review of actual results against plan is the core of our performance appraisal process.

At its meeting during the first week of January of each year, our Board of Directors reviews the Corporate Plan for that year. Our President and CEO has described the Corporate Plan as "the heart of the 'contract' between the Board and the Chief Executive Officer." In his words, "It identifies those areas I plan to emphasize and quantifies those goals I intend to lead the management to achieve. In terms of my needs, the Corporate Plan serves a dual purpose. Its primary purpose is to help me manage /Connecticut General/ more effectively than I would without it. The second purpose is to establish a mutually agreed upon commitment between me and the Board of Directors."

Thus the Corporate Plan serves as the foundation of the results that the Board expects management to achieve in that planning period.

With that kind of commitment to planning at the top, you can see why planning has become the key to our management process and helped us achieve results that are better than would otherwise have been achieved.

MR. HOGUE: The process Jim described is an excellent example of the kind of corporate planning process that would underlie the spirit of Dr. Ackoff's address. I would like to ask you to expand on two concepts you talked about. One is the concept of the contract between the Board and the President and between the President and the top executives. The second is the related concept of the performance appraisal process. This seems to tie into those contracts. What effect do these have on the planning process?

MR. MITCHELL: As I mentioned, our planning process is the heart of the way that we manage the company. It is related therefore, to the understanding that individuals have with one another as to what is intended to be accomplished, and that is all we really mean by a contract. It is an understanding between two people. The written plan is a sort of representation of that agreement; the negotiation process that has led to it, is obviously an important part of the contract as well, because that is a key part of the understanding that the individuals have. From this process there is a plan that both of them believe in, and therefore, it is relatively a small step to say if that is what I intend to do, and that is what you expect me to do, that will be the basis on which we will appraise my performance.

MR. HOGUE: There are some company structures such as a holding company structure that often times create special situations requiring special processes.

MR. ROBERT N. POWELL: For background, I should mention that Nationwide Corporation is a non-operating holding company with investments in four life insurance companies and in one casualty insurance company which specializes in accident and health insurance and casualty reinsurance, together with investments in several companies in the financial services area. It is our belief that the management and decision making of each of the companies must be done by the company management team itself and that our role is principally one of making sure that the directional decisions made by the companies are consistent with the short range and long range goals, objectives, and plans of the company and of the parent holding company. With this background it is easy to visualize that our holding company has a deep interest and concern with the planning process that each of our companies involve themselves with. To that end, each year each of our companies has completed both an annual plan (which is sometimes called a budget) and for the past several years, a long range plan covering a five year period. While we are still somewhat in the formative stages of long range planning, we are committed to the principles of long range planning.

At the holding company level, we have prepared and had approved by our Board a strategic plan which sets forth our philosophies, a statement of our business purpose, and our goals and objectives over the long term. We have also developed an inventory of tactical (short term) goals and objectives.

After receiving Board approval of the holding company's strategic plan, we then went to the management group of each of our subsidiaries and discussed our plans and objectives with them so that everyone would be fully aware of the "big picture" at the holding company level.

We recognize, as a nonoperating holding company, that our achievements are the sum of the achievements of each of our subsidiaries and that our goals and objectives must be, in an aggregate sense, the goals and objectives of our subsidiaries.

Each company is furnished by us a set of economic and environmental assumptions. Thus, we know that everyone is operating within the same general parameters, although the interpretation of the impact of these economic and environmental considerations may be somewhat different from company to company. The planning process itself is a rather standard approach which requires that the following essential areas be developed:

I. Description of Business - All planning starts with an understanding of "where you are" and "what you have" before you can decide "where to go." This section should clarify the nature, scope, and purpose of the company and should deal with each major department. Any distinctive characteristics of the company should be set forth, and perhaps a brief history of its growth shown.

II. Environment - Competition - What are the internal and external factors that affect the Company's ability to carry out its business with satisfactory results? Some of the typical things to be considered are the state of the economy, government or regulatory relations, availability of personnel (field and home office), and major competitors.

III. Capabilities and Opportunities - Basically, this section should be an evaluation of the strengths and weaknesses of the company. Each department should be analyzed. How does the company rate in customer satisfaction, employee attitude, and profitability, for example? This must be a careful appraisal, and it points the way to corrective action.

IV. Assumptions (Predictions) - No one can predict the future with accuracy, but some basic assumptions have to be made. Certain broad assumptions about the pattern of our economy and government relations with insurance can be made, and specific assumptions about the company's progress can be made. This section can be changed as conditions change.

V. Objectives and Goals - Here is the final step in determining where the company "wants to go." A careful thinking through of the steps involved in Sections I - IV leads almost automatically into the establishment of reasonable goals and objectives. They should always be stated within a certain span of time. They represent desirable results.

VI. Policies and Procedures - This may or may not be important and may be omitted if you do not consider it to be helpful.

VII. Strategies - Programs - In this section, an effort should be made to develop specific programs to capitalize on the strengths shown in Section III. (or correct the weaknesses). This is the "how to" section. Here are listed the strategies to accomplish objectives or goals.

VIII. Priorities - Schedules - What comes first? What can wait? This is merely the operational schedule.

IX. Organization - Delegation - This is the "who is going to drive" section. It can be done before many of the other sections are completed.

X. Budgets - Resources - Naturally this is one of the most important sections. In effect, this is the control section of the entire planning effort. It is almost impossible to budget accurately without planning first. Please include both GAAP and statutory budgets.

It is my view that while the impetus for plan must come from top management, the involvement of middle management in the planning process is vital for its success. I believe this is the same as Dr. Ackoff calls participative planning.

It is also my belief that planning is a never ending kind of management activity simply because there are so many assumptions, predictions, and projections about the world in which we have to live that we cannot forecast the effect of these with any great certainty. Likewise, we cannot forecast results of our day to day management decisions with a 100% certainty and we are most likely to find that the real life situation we are living with a year or two from now will be somewhat different from the way we had planned it to be a year or two ago.

To date, our efforts at long range planning have paid off if only because of the better understanding of ourselves that has resulted from this effort. I also believe that some of our directional decisions have benefited from this exercise. By the same token, I confess that some of our efforts seem to have been in the nature of rain dancing rather than weather control.

MR. HOGUE: All of us can appreciate some of the special problems that are involved in coordinating the corporate planning procedures among related companies in a holding company structure. What are some of those problems and how can they be overcome in that kind of environment?

MR. POWELL: The first problem that occurs to me is that at the holding company level we just cannot do the financial aspects of the planning. We feel, and I think rightly so, that the company people have to do this. This creates a problem; if you recall, I indicated that we had developed a strategic plan for the holding company. We had talked about what our strengths and weaknesses were, and we had quantified some earnings goals, returns on investment goals, and other goals, which were approved by our Board. Then we went out and talked to the company management and said this is how we see the picture. This is what we think we collectively need to accomplish. We would like you to build your plan, and do it realistically, recognizing where you are and recognizing that we have an ultimate aggregate goal. I would have to confess on the first pass through, we kind of saw a mirror image of what we had said to them. We said we wanted to have 10% return on equities. We saw everybody putting together plans that were perhaps somewhat unrealistic but with a 10% return on equity which probably was not achievable. They started with a bad premise and looked at the answer and then tried to contrive a plan that would get that. Of course, we did not say each company has to have a 10% return on equity, or a 15% growth in earnings. We simply said that is our aggregate goal. We did not say that is our short term goal, but the fact that we were getting this mirror image back, in some respects, muddied the water. Hopefully, more communication about what our objectives are and what realistically can be achieved will help to sort out some of those problems.

MR. HOGUE: I can appreciate that, Bob. It is hard to get the results without the process steps being pretty much in line. Lew Roth brings us a different perspective from the previous two, since he is basically involved in the ordinary line of business planning.

MR. LEWIS P. ROTH: I would like to talk about how corporate planning is being conducted at Mutual of New York. But, before I go into that, I need to describe, very briefly, the kind of company MONY is. It is important to have some notion of the kind of company you are, or want to be, before you can begin to implement a corporate planning process.

The key fact that underlies all of our corporate objectives, goals, and policies is that The Mutual Life Insurance Company of New York is a mutual life insurance company. Our reason for existence is to serve the long term interest of our owners who are participating policyholders. While our primary business is that of providing individual life insurance at the lowest possible cost consistent with security and good service, we will participate, and have already participated, in related fields whenever we conclude that this participation will enhance our ability to perform in our primary business and that we can achieve a satisfactory return on any investment we make in such business. Thus, over the years we have entered the fields of Group Life and

Health insurance, Pensions, Individual Health insurance, Mutual Funds, Variable Annuities and Premium Financing. In addition, we have acquired in one instance and started in another instance two subsidiary life insurance companies for an investment of approximately $70 million. In addition to these supportive ventures, we have entered the risk business through an aviation pool, an accident pool and have formed a professional property liability reinsurer. Thus we are no longer a simple life insurance company responsible solely to our individual policyholders, even though they remain our principal owners and constitute our bread and butter business. That, in a nutshell is the kind of company MONY is.

In order to perform structured corporate planning one must have a fairly good fix on strategic objectives and goals, that is, the long range considerations. Only then can we deduce from them the shorter range tactical plans which are developed and implemented in order to achieve those strategic purposes. So we have spent some time and have undertaken a project which we call Strategic Planning.

Since we already know what kind of company we are, the first question we asked ourselves was what type of a company do we want to be 10 years from now. Our answer was that we want to continue to be a major insurer. This ruled out such things as complete financial services or a conglomerate operation, but it opened up the possibilities of entering other types of business. Then, in determining what activities in which we might engage, we decided we should limit ourselves only to those which involve either the management of risk or the management of investments, the two cornerstones of our business. Thirdly, we concluded that we would consider entering any business which involved the management of risk or the management of investment, but only when we are convinced that we can earn a satisfactory return on any investment of policyholder funds in that business. Also, that we would withdraw from any supporting business which we had previously entered when we are convinced that our continued participation will not produce a satisfactory return on our investment. And finally, we imposed upon ourselves some financial constraints which are designed to insure the security of our commitment to our individual policyholders and which would avoid impairing the company's ability to produce a favorable net cost for its products. The two fundamental constraints are that we will not allow our surplus to fall below a predetermined level and secondly that we will not enter any new business or invest and expand any existing business unless we are convinced that we can achieve an after tax return better than any other investment we could have made at the same time or at least as good if there are ancillary advantages of a nonfinancial nature.

We also placed upon ourselves some other restrictions: (1) the total investment should not be more than $40 million in any one venture; (2) the accumulated deficit for any venture cannot exceed $20 million; (3) turn around time must be less than 10 years; and (4) we would like to be a significant factor in any market or area in which we decide to invest.

With these fundamental objectives and constraints in mind, we looked at the environment and selected some specific strategic issues which needed to be addressed in an organized fashion. It is easy to make a long list of issues to study based on environmental considerations and a recognition of future opportunities and threats. It is not so easy, however, to cut the list down to a digestible size.

In order to insure that we were reviewing those issues which would have the most impact on our operation, we applied several tests even before any consideration was given to any specific issue: (1) will the resolution of the issue have a significant effect on our operation 10 years from now; (2) is there a significant risk if we fail to resolve the issue in the near future; (3) will the issue take advantage of our strengths or minimize our weaknesses; and (4) is the issue one which will not be resolved in the normal routines? In the process of singling out areas for special study, we identified 3 interrelated studies that must be undertaken for the whole exercise to make any sense. These are: (1) what individual and mass markets do we want to be in; (2) what lines of business do we want to be in; and (3) what distribution systems are most appropriate for delivering those lines to those markets? As a result of all this strategic thinking and planning, we came up with a list of 5 issues which we have been considering over the last year or so and they are:

(1) How can MONY substantially increase its share of the group pension market?

(2) Should MONY enter the retail side of the property/casualty business?

(3) Should MONY accelerate its sale of equity products or withdraw from this field?

(4) Should MONY have more or less of its assets invested in common stocks?

(5) What are the best places geographically to locate our different operations?

The purpose of strategic planning is to assure yourself so far as you can that you have identified and fully capitalized on the opportunities of the future to the extent that you have the capacity to do so. Only when you have done that can you be satisfied that you are doing the best job for your policyholders or shareholders.

With the strategic issues set in place, it is then time to look at the shorter term planning chronology. In our company we have a Corporate Planning Committee which consists of all the Senior Vice Presidents with the Executive Vice President as its Chairman. The purpose of this committee is to make recommendations to the President with regard to the planning process. The planning chronology, long term goals and objectives, environmental considerations, short term plans and budgets are all in the province of the Corporate Planning Committee. The planning cycle starts with a consideration of the decisions reached with regard to strategic issues and our environmental assumptions for the next several years. We have a set of 10 corporate goals which are reviewed each year and based on how well we did or did not achieve those goals, we make changes for the following year. So that you can see no department even begins departmental planning and budgeting until the Corporate Planning Committee has reviewed and changed, where necessary, the goals for the corporation for the following several years. Again, let me emphasize that those changes in goals come about by consideration of strategic issues and their resolution, goal achievement of the prior year, and environmental considerations for the next several years. Within the departments, each department head then prepares a plan which is very specific for one year, fairly specific for the next 2 years and fairly general for the period 3 to 5 years out. We use the mechanisms of expense guidelines, manpower guidelines and the process called zero base budgeting. The departmental plans of course include the budget. To us, however, the budget is nothing more than a financial determination of the cost of the plan. These plans go to the Corporate Planning Committee for review and revision. The departmental plans are analyzed at least 3 different ways before any plan is accepted. Functional cost analysis is made, an analysis by line of business is made, and, within the individual life line, a formula is applied which we call Formula 70, similar to the Canadians' Pedoe Formula, which allows us to draw some conclusions with regard to our competitive ranking with other companies. The formula gives expected expenses based on new business premiums, volumes and numbers as well as renewal premiums, volumes and numbers and the ratio of actual to expected gives us a fairly good fix on how we stack up with the peer companies with whom we normally compare. Plans and budgets are either approved or returned to the departments and, if returned, zero base budgeting allows us to eliminate or reduce those areas of least significance to our operation.

No planning cycle is complete without a good monitoring and control system. In addition to the usual monitoring devices such as financial statements, production reports, expense reports and manpower reports, we also have monthly variance reports in which a department head must not only explain his budget variance, but also his plan variance. And finally, we do what we call post-implementation audits. After each major project is completed, whether it be a new EDP system or a changed compensation formula for field underwriters, an audit by the Audit Division is performed to see if the actual plans, costs, benefits, and results were actually achieved. It is a comparison with what was projected and planned for in the original report which got management approval. If they are not the same, the project manager must explain the differences and must satisfy the corporation that the project should be continued. Although there is much Monday morning quarterbacking and hindsight implied in the process of post-implementation audit, we found it to be a highly constructive device for avoiding mistakes and other pitfalls in future projects.

In conclusion, I would like to say that a corporate plan is a waste if it is not used. The annual derivation of a plan put on a shelf to be taken out the following year and redone is worse than doing nothing since the time spent could be more efficiently used on other things. However, a plan which is used, which is monitored and controlled, allows you to keep your eye on the ball. It allows you to distinguish the important things in your operation from the unimportant and gives you the satisfaction of having influenced the outcome rather than leaving it up to luck and outside forces.

For us the plan has been extremely useful in keeping our attention on a growing premium income, which we have been doing exceedingly well within the last 2 years. On the other hand, we must be constantly aware of the fact that by keeping your eye only on those factors involved in your plan, you could be missing some other important items which need your attention. You have to be willing to change the plan when you see that there are goals and objectives not included in your plan that are getting away from you.

A good case in point here is persistency. Our corporate goal requires us to be in the top half of those companies with which we compare with regard to first year persistency. Concentrating all our attention on first year persistency, we took our eye off the fact that renewal persistency may be just as important if not more important than first year persistency. At any rate, our renewal persistency began to slip and we became concerned. One of the items up for discussion at our next Corporate Planning Committee meeting is whether or not we should change our persistency goal from first year only to a combination of both first year and renewal, and I believe we will accept a new goal which will involve total persistency. The point of this is that in order for a corporate plan to be current, it must be flexible and there should be no reluctance on your part or on the part of your management to change the goals when such is indicated by actual results or any other consideration.

MR. HOGUE: As I listened to your presentation, there were so many different perspectives in what you are doing at MONY that it was hard to really point one out as being a central feature. However, Dr. Ackoff discussed the concept of an idealized redesign and you seemed to be touching on that when you asked yourself, "What kind of company do we want to be ten years from now?" I know I have gone about the process as most companies go about it, by asking, "What do we want to do in the next ten years?" There seems to be a big difference between those two statements. Lew, would you comment on those differences?

MR. ROTH: We actually began looking at this question back in 1975 and asked ourselves, "What kind of company do we think we want to be in 1985?" You can do this two ways - retrospectively or prospectively. The retrospective approach starts right now. You take a look at your stengths, weaknesses, opportunities, environmental considerations, and plans from here into the future. The prospective approach, which we adopted, also looks at the same factors but requires you to have a specific goal. It requires you to fix a point in time to set your plans around, and then it makes you look backwards from that goal to today. The prospective plans can be very flexible and changeable in the way that you get from today to the goal, but it really allows you to fix on a goal. The retrospective approach, which most companies use, depends too heavily on projections and leaves too much to chance and outside environmental forces. The prospective approach allows more control since both the end points are fixed. The process that we went through in our company was to really narrow down several choices which were consistent with our strengths and what we saw as opportunities for the future - those two cornerstones that I talked about before - risk taking which we can do possibly better than most companies because we have a very favorable surplus position and investment management because we believe we have one of the finest investment departments in the industry.

MR. ALAN B. PETERSON: My contribution to this discussion is to describe formal planning procedures for the group insurance and pension business at Equitable. This is a significant part of Equitable's operations. In 1976, our total premium income from individual contracts was over $1 billion and group was about $3.6 billion. Life insurance in force at year end was $37.5 billion for individual and $93.0 billion for group. Of the $22.4 billion in assets, about 57% are attributable to the group lines.

A word on organization of our group operations may be helpful as context for description of our planning activities. We manage our business through six departments. Three are marketing departments with responsibility for sales and financial results for the three divisions, or lines, of group business as we have identified them: group life and health insurance on groups of fifty lives and more, group life and health insurance on groups of up to fifty lives, and group pension.

The other three departments, which report separately to Group Operations' top management, are prinicipal support operations for the marketing departments and they perform the benefit payment, administration, and EDP systems development functions.

Our formal planning - short and long range - is expressed in terms of the three lines of business just described, i.e., we work with three major plans. Although marketing department heads do not control support department activities, effective coordination between the two areas is achieved through informal interaction which in turn is based upon formal planning procedures. We do formal planning at three levels: the line of business annual plan, the operations area long range plan (combines long range plans of three lines), and the institutional long range plan which combines total company operations.

The employee benefits business gives planners real challenges. We deal in several markets against different kinds of competition; the business is massaged daily by many strong forces; it is truly dynamic; and its internal financial structures compound the complexities of managing it. All of this makes it difficult to plan long range, but the more difficult it is, the greater the need for it.

I will describe the long range planning procedures we follow at Equitable, making occasional distinctions between the short range (annual) and long range plans although the steps are essentially the same. In annual planning, the line of business manager has primary responsibility. My role in that process is to be a coordinator and a monitor of results and forecasts. For long range planning, however, as planning officer, I have first responsibility for the preparation and maintenance of those plans. This requires substantial involvement of all lines managers and part of my job is to facilitate that participation. The end result is a joint effort.

Steps in planning include:

(1) Identify key performance indicators.

(2) Review external environment.

(3) Analyze internal environment.

(4) Identify strengths and weaknesses.

(5) Make basic assumptions for operating during plan period.

(6) Set goals.

(7) Decide on strategies and make plans.

(8) Monitor results.

In January we first identify, reaffirm, or change the key performance indicators in which the goals of the plan will be expressed, e.g., new business life insurance volume, total premiums and considerations, net earnings, asset growth. Care is taken to include all significant support activities as well as marketing, and therefore goals are also considered for such things as expense budgets, productivity indexes, and benefit payment service time constraints. Key performance indicators represent what top management believes are the vital signs of the organization's health and progress. They should be as few as possible and yet provide the necessary controls for effective monitoring.

Review of the external environment is next. The very idea of getting a handle on everything that is going on is mind boggling; but when organized, the elephant can be eaten, a bit at a time. We gather environmental data throughout the year. In February it is given to line managers in condensed form with suggestions on application. We do not pretend to have summarized everything bearing upon our business, but we are confident that the most important influences have been identified.

We break the outside world down into these major components: social, economic, political, market, competitive and technological. Under social we identify major happenings and trends such as consumerism, sex discrimination, population change, and key public attitude changes. Within these, we look for direct application to our business and try to translate that into conditions to be taken into account in our planning.

There are several indicators from which to choose guides in assuming future economic conditions, but for the group business we find most concern with interest rates, common stock performance, employment, profits, and disposable personal income. Of course, we are constantly facing the fact of inflation and its varied and pervasive effects on our business.

Our political environment is more active than ever with concerns leaving no part of our business untouched--National Health Insurance, ERISA, the Section 79 follies, state vs. Federal regulation, to name a few.

In the market environment, our interest is to review the competition, check the sales resources, scan the collective bargaining calendar, consider how we are meeting customer demand and need, reconsider previously excluded markets, etc. In total effect it is a reevaluation of our marketing effectiveness.

Our study of the competitive environment digs deeper into who the competition is and what their strengths and weaknesses appear to be. There is interest in market share, concentration, distribution system, proprietary advantages and disadvantages, marketing strategy, etc.

Technological developments are of growing importance because of the need to communicate and administer records in a business which grows more complex even as it changes faster. Payment of benefits, reporting to customers, and obligations and opportunities under ERISA are examples of the need to develop and apply the best technological tools available.

The third step is analysis of the operations of the company, i.e., the internal environment. A fundamental aim of any planning effort is to "know thyself." We divide our internal environment for study into these elements: human resources, facilities, investments, customers, organization, and products and services. This self-examination is a primary topic of discussion with line managers at a series of March meetings.

Our human resource related expense is 60% to 70% of a typical total expense budget. This demands constant real improvement in "people planning." That comes in many forms, including programs for increase in productivity, training and development, and the realizing of opportunities inherent in affirmative action.

We define "facilities" as including (a) physical conditions of work environment, (b) EDP capabilities, and (c) people and organizations which are vital to the performance of one's mission but which are not under direct control. One example of this latter category is sales forces which are not employees (brokers, agents). Another is institutional investment functions which are vital aspects of group pension line operations, but are not supervised by that line manager.

In our internal environment, "investment" refers to unusually large scale, nonrecurring capital requirements, e.g., EDP systems, new product development, and unusual staff expansion.

We try to take a hard objective look at the ways in which we treat our customers. Are customers viewed too often as sources of new sales, and a never ending stream of problems, or are they regarded as the first concern of management? Is our employee compensation program designed to reward productive customer care as well as new sales? Peter Drucker has been quoted as saying that management's job in every business is to "create and re-create customers." That is not a bad guideline.

Organization of the company must be revised periodically to adapt to market and people changes. The planning process includes a step to check on how well the organization is structured to deal with its opportunities and concerns.

Products and services typically get a great deal of attention outside of the formal planning process. It is important to study them in this context, however, so that they are looked at with the same longer range perspective as the other operations elements. Product change often means heavy investments of time and money. Planning product change at longer range does not guarantee marketing success, but it certainly improves chances for it.

A second area of discussion with line managers at those March meetings is <u>the fourth step in the planning process: identifying strengths and weaknesses of of the operation</u>. This is difficult to do in a meaningful way. There is strong temptation to overestimate strengths despite a conscious effort to be realistic. Likewise, it is not easy to be candid on weaknesses. But in this analysis, I believe, lie the seeds of success in planning. Knowing with confidence where you are good and where you are not so hot is a planning fundamental. As someone has said, understanding the problem is being halfway toward the solution.

<u>The fifth step in this process of creating the formal plan is the making of basic assumptions for operating in the plan period</u>. With the benefit of our study of environments we make the assumptions which, together with what we learn from review of strengths and weaknesses, will be the bases for selecting our strategies and setting our goals. These assumptions include: economic indicators, social concerns, Social Security, regulatory and legislative issues, expense budget limits, claim rate levels, investment income, "natural growth" of premium base, capital expense, presence or absence of dramatic change in market conditions (e.g., National Health Care, and group auto as an employee benefit), etc. It is not easy to get a quick consensus on some of these. Return on common stock and incidence and form of National Health Care are just two which take some working out.

When setting assumptions we also review our long range goals (although not every year). These are the specific numerical goals which the operation has set for itself to achieve on the average over a period of years. For example, any one year's premium income may be above or below what a long range goal might stipulate, but if the goal is achieved on the average over, say, a five year period, the goal is considered to be met. Goals to be achieved on the average over the long term provide guidance for the operation and yet afford needed flexibility for the short term.

Setting goals for each key performance indicator is next. As noted, this is done within the context of (a) the company's long range goals and (b) the guidance and constraints provided by environmental analyses, strengths and weaknesses, and basic assumptions for operating. By this time, we are in April. The setting of goals and specification of strategies (seventh step noted below) are first drafted by the planning staff for review and discussion with line management.

In the seventh step, agreed upon strategies and action plans must be devised for attaining the agreed upon goals. These are the policies and projects which will get us from here to there--the track to run on. Each strategy ("prepare for the group auto market") is facilitated by a number of action plans ("set up task forces for design of product, organization, etc.").

The planning process proceeds with discussion of goals and strategies at the senior levels of the group operations area. The plan die is cast only after there are reviews by corporate management. There may be adjustments which are necessary for coordinating Group Operations' plans with our company's other operations in forming the overall institutional plan. Delivery of the completed long range plan is the first step in developing the next short range plan. The calendar for all of this might be:

January - Start long range planning process for five year period beginning next January.

July/August - Deliver long range plan as first step in short range (annual) planning for next year.

December - Complete short range plan.

Results monitoring is an integral part of the planning process. In long range planning, the previous plan edition is reviewed and serves as a guide for the succeeding process. In annual planning we have periodic review sessions during the year for each line of business at which results to date are examined and, more significantly, full year forecasts are required and compared with annual goals.

Obviously, goals and forecasts are two different things in our planning lexicon. We define the short range goal as a commitment to achievement which was set in recognition of the long range goal and the current situational analysis. The forecast required at each review session is simply a current best estimate of what the year's results will be. The essential difference between the two terms is that a forecast does not carry the commitment to achievement--it is only an appraisal of what market conditions will produce. If the forecast is below the goal, the manager will consider what he can do in altering plans to make the goal. If it is too far above the goal, and that differential persists to year end, the manager can be criticized for poor planning.

Our usage of plans produced is varied and expanding as the planning systems mature. We have been gratified to observe that both the short and long range plans are being used more often as guides for an increasing number and variety of business decisions. As this discussion has pointed out, we believe the long range planning process itself is really more useful than the plan it spawns. Obsolescence of plans is swift, but you learn much in the effort.

I suppose that it is possible to infer from this recitation of steps in our planning processes that we have achieved a high degree of planning effectiveness. Well, not as high as we would like. We do believe, however, that we have made a good start and have a productive process in place. Real value is accruing but we are only at the beginning of planning productivity.

Growth and change in the employee benefits industry are swift and uneven in incidence. We believe it is dangerous, therefore, to depend too much upon "momentum" planning, i.e., straight line projection of present circumstances. A major objective in improving our planning is to expend less effort upon projections and more upon thoughtful analysis of our resources and markets in order to provide the firm direction which a company must have in this business.

As a final thought, I offer this quote which has been attributed to Booker T. Washington, "An ounce of application is worth a ton of abstraction." This is a fitting credo for a planning officer.

MR. HOGUE: Alan, since there is very little published information on planning for the group lines of business, I would like to ask you to follow up and give a little more detail on the differences between ordinary line planning and planning for the group plans.

MR. PETERSON: The planning process for both, certainly within the same company, are or should be, identical. You should be going through the same steps. Obviously, we both operate within the same external environment and the same internal environment. And it is a fact too, that both the individual operations and the group operations of an insurance company, have the same image as far as the public is concerned. Group is subjected to and affected by many more strong market forces such as union bargaining agreements, corporate employer customer demands, government regulation (maybe it is a trade-off between individual and group on that point), and many forms of competition in the marketplace.

A second difference is the rapid rate of change in market conditions, since group insurance is a one year term product. You find yourself pretty hectically conducting your business because of that short term nature - you invite turnover and you invite examination of your performance. The pension business too, in its money management form in the larger cases, also invites a great deal more current hectic activity. A third factor is that group has relatively little control over its market conditions. Here I would emphasize that we deal with a larger power base in contrast to the individual insurance which has two customers, in most cases, the policyholder and the salesman. I would let you decide which is more influential - probably the salesman. But the customer is all powerful, all pervasive in our business. Group operations are highly visible; most of our larger customers know a great deal about our business. There are no secrets in retention and no secrets as to how much money the customer is spending on his coverage. The average individual policyholder does not have that knowledge. Group business is highly competitive in a different way than individual business - kind of a nose to nose way. Finally, there is regulation. Both are regulated, of course, but the group business moves in a more dynamic fashion and kind of gets ahead of the regulator. Regulators do not always react nor regulations change at the same pace as the business. I am sure that is good in some circumstances, but it is painful in others.

MR. WILLIAM C. CUTLIP: Within your time structured planning process, when do you do your budgeting? How do you tie it in?

MR. MITCHELL: We lay out some broad sort of guidelines that folks will use relative to what we expect our salary program to do next year, cost of benefits and other major components of expenses, but we try to encourage people not to do a detailed budget at this point, but rather to keep the planning at a fairly broad level and to be more concerned with what is the right level of dollars for them to spend. It is only later in the year in the September, October phase of the planning that we really get into specific line by line budgeting.

MR. CUTLIP: Do you run into any problem with the fact that the corporate review and approval really does not come until December, such as you have done some budgeting in September and you find out that what you budgeted before has not been approved.

MR. MITCHELL: What we intend to get in the June, July period is an agreement on such things as spending levels. I may know that I intend to run my department for X dollars next year, but I am not sure precisely how much of that is salaries and how much is rent, although I have a pretty good idea. However, I do have a commitment to run it for a certain amount of money and unless I have a good reason why not, I ought to bring it in at that level in my final plan.

MR. CUTLIP: How specific is the direction of the chief executive officer that comes along in February?

MR. MITCHELL: It is fairly broad. It does not attempt to address issues that are peculiar to any one division, but rather guidance that we believe is important to all of our businesses. It might focus on such areas as customer service and improvement in our processes for doing that. In a given year that might be one of the two or three key business items for example.

MR. CUTLIP: I am intrigued by this audit concept that you mentioned. Is money functionally or line of business organized?

MR. ROTH: Primarily we are an ordinary life insurance company, so within the ordinary individual line we are functionally divided. However, we are also organized by line of business in that the group areas, what we call mass marketing, are a line of business with their own actuarial, sales and staff organizations.

MR. CUTLIP: When the audit takes place, is the manager the person responsible for the project as being audited? If there are problems in other functional areas, does he have the responsibility for seeing that those are corrected?

MR. ROTH: He does not have the responsibility to see that they are corrected - he cannot do that. The project manager, by the way, is generally not an executive officer, but is at a lower level of management. It is his function to report, record, interpret, analyze and make sure the corporation knows why these things are happening and who is responsible for getting them fixed. It is not his job to get them fixed; he cannot do that because he does not have the authority.

MR. CUTLIP: Each of you still feel you are in formative stages of the corporate planning process. How long did it take or does it take for the staff to look at the planning concept as a regular part of their job and not something that they do when their functional needs are over which, of course, never happens?

MR. PETERSON: I think there are two things involved there. Number one, corporate planning will not be effective unless the president is committed to it, so that is where to start. Secondly, it is unlearning some habits that are deeply engrained and learning to do some of the things we talked about here this morning such as more formally organizing yourself and planning. We have been doing long range planning for four or five years and we think we are getting on track pretty well, although we recognize we still have a long way to go.

MR. POWELL: Our company's subsidiary companies have been doing an annual plan for at least seven years. When we in the holding company decided that we ought to have a more concerted effort in long range planning and a more formalized process, which was about 1973, we found no serious resistance to getting involved in long range planning. In fact there was willingness to extend the one year plan, which is the first cornerstone in a five year plan, into the five year area, so it really was not traumatic. Some of our companies had been doing it on their own.

MR. HOGUE: One of the biggest problems involved in corporate planning that I have been exposed to is the gray line differentiating conflicts, nature, and even the processes of strategic long range planning and the short term operational or tactical plans. How do you get them to correlate, and how do you get the short range plan to support and interface with the long range corporate plan?

MR. ROTH: There is really no question about it. If you have a particular strategic plan which has been well documented, and well communicated, you must have written out the tactics and the short term guidelines and guide posts to support it. We had some five different strategic issues we looked at, and in the one which involved group pensions, for example, the strategic project was the tactical plan to get to the position in which we wanted to be. The strategic questions are answered by thinking, planning, and decision making. The tactics are the basis for how you get there. Another one that we looked at is property casualty on a direct basis, but we do not have a decision there. If you do not have the resolution of a strategic issue, then short term planning ought to be ignored because it only leads to turmoil that might be nonproductive.

MR. POWELL: My answer would be how do you avoid tying the two together? The reason we are doing long range planning is to try to avoid the normal problem with one year or a tactical plan, that is, you flow with the tide and just extrapolate what you have been doing. The whole purpose of long range planning is to say maybe the tide is not going to take us where we want to go. Let us control our own destiny. If you are going to have a different end position than where the tide will take you, then you have to start making some changes in the short term to help you to obtain that different end position.

MR. PETERSON: There is great temptation in the short range plan to project the past or project the present. The significant difference between long and short range planning is that in long range planning you begin divorcing yourself from what has past.