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**LIFE (AND CASUALTY) COMPANY ORGANIZATION
FOR THE 1980's**

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1. The Emerging Managerial Environment - What will the Life and Life-Casualty Company management environment be in the 1980's, and how will it differ from the past in terms of:
 - a. Available manpower, professional and managerial skills?
 - b. Marketing?
 - c. Distribution systems?
 - d. Products?
 - e. Lines of business and other diversification?

2. Emerging strategies - What new strategies are called for, and how will goals change with respect to:
 - a. Profit?
 - b. Surplus levels?
 - c. Growth?

3. Emerging organization - How should companies organize for the future?

MR. FRANK W. BARSALOU: It is incredible to think of what has happened in the last ten years. Events have impacted every aspect of our society from our largest institutions to each of us as individuals. Whoever thought, for example, that our mighty oil and steel industries would be staggered by foreign competition? Whoever thought that the savings and loan industry would be, for all intents and purposes, out of the first mortgage business? Whoever thought the average home in California would reach \$100,000, or that more than half our married women would be in the work force . . . that IBM and Digital Equipment corporations would be selling computers in retail stores, that a \$500 hand-held computer-calculator would have many of the capabilities of a 1960 multi-million dollar Univac which required thousands of square feet of refrigerated space? Whoever thought that Prudential would be getting into the stock brokerage business or that the Met would be marketing life insurance in retail stores? Whoever thought that the prime rate would hit 20%, and on and on it goes.

It really is a brave new world; and most challenging of all, the pace of change seems to accelerate as we go. Insofar as the life industry and the casualty industry, I think there are three primary powerful engines of change which are affecting us. The first is inflation and the attendant volatility of interest rates. The second is technology, primarily information management

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and communications. The third is changing lifestyles and consumption patterns. Examples include family demographics - not just the role of population numbers or the changing age bands, but the change in the nature and structure of households. Work and employment patterns, which involve attitudes about work, retirement, career changes, and female employment, have changed dramatically.

These factors directly relate to marketing and distribution challenges which we face not only in the life business or casualty business but in all aspects of society. Looking at the life insurance industry, let me just list a few of the problems with which we are all familiar. For example, half of the population of this country has never been called on by a life insurance agent. Most of us in the industry are seeking to sell the upper income market, above \$50,000 household income, which represents only 5% of the total number of households and only 20% of the personal income. The middle income market which consists of 40% of the households and 56% of the personal income is a secondary market. The lower income levels are effectively ignored.

Another problem is the cost of one-on-one selling. It is uneconomical for perhaps 75% of our agents to travel to a client's house and sell a \$50,000 term policy at the kitchen table. IBM and Digital Equipment discovered they could not send their standard representatives out to sell their newer, lower cost line of computer products on a one-on-one basis; so in the past year they have opened retail stores all over the country. They have responded to the challenge. We have not yet done so.

The cost of agent turnover, the cost of training and financing agents is becoming more difficult to pass on in our increasingly competitive market. The rapidly changing needs and preferences of the people buying our products present another challenge. People want more living insurance. They want more realistic cash value and tax-sheltering features, more estate protection, etc. They want a more efficient delivery system. One-stop shopping for financial services is the current trend. Product lines are expanding within given selling organizations. Time-saving sales and servicing via the electronic media and the mails lie just ahead. Finally, there will be more target-segmented products and marketing efforts by many of our companies within the industry: For working mothers, for Hispanics, for women doctors and lawyers, for 60-year-old marathoners, etc.

Another area of challenge is based on the obvious fact that most of our agents really are not making a decent living. The average agent needs a working wife, a real estate license, an inheritance or some other form of good luck to make it. Our agents have not only not kept up with inflation, but their incomes have actually dropped. What is even worse, perhaps, is that our agents have not kept up with sales people in other industries, so we have damaged our capability to attract people into our own selling organizations.

And finally, sky-high interest rates have impacted the liquidity of many of our companies, not only in terms of the cash flow out of the companies, but in terms of the impact on the investment side of the business.

These challenges, these problems are a real threat to many of our companies in the industry. For others, these problems represent great opportunities. What are some of the companies (those which will emerge as the successful companies of the future) doing to respond to these challenges?

One response involves multi-product marketing. We are not talking about merely adding casualty lines to the life line of products. We are talking about a broad range of financial services and products to offer to the clients we have been selling over the years. We are talking about mutual funds, tax shelters, personal financial planning services, etc. We can no longer seek first to satisfy our own needs and wishes as operating companies; we must become more marketing oriented.

Personal financial planning will serve as the lead in for multi-product sales more and more as time goes on. The Prudential, for example, has just introduced a \$20 simple will package. They have done this not to make money on that \$20 package, but to provide a basis for accumulating information about the purchaser for purposes of selling other products. The people who represent us in the field will become increasingly effective in this area of personal financial planning as we upgrade their quality and training.

Multi-product marketing will provide new sources of cash flow to our companies. It will provide a broader basis for income for agents and it will increase the profit base for our stockholders.

A second response is mass marketing. I am not talking about mass marketing as we know it in our established companies today. I am talking about mass marketing programs that are compatible with our field forces as they now exist. This mass marketing will involve selling via mass media and closing contracts via those media. How else can we reach the broadest segments of the market, those segments which we are not reaching today? The advent of two-way communication via satellites, via cable TV, will enhance the opportunities for conducting business on an impersonal basis in years to come.

Another area of opportunity of which many companies are taking advantage is the advent of new electronic data management and communication systems and software. This is done not only for the purpose of decreasing home office costs but also to improve productivity of agents. The typical agent spends less than 10% of his time actually prospecting or selling or closing the sale. The remaining time is spent driving to and from the prospect's residence or place of business, to or from the office preparing proposals, keeping up with tax laws, etc. As time goes on, agents will have more direct access to operating systems in the home office for proposals, underwriting and eventually policy issue. The electronic briefcase is just the beginning. Soon telephone terminal hookups will become commonplace. The productivity of the agent is directly tied to the efficiencies of this up-and-coming hardware, as the percentage of time spent on selling can increase.

A fourth approach involves personnel, both for the home office and field. I do not think the life insurance industry has competed successfully for the hard-to-get professionals that we need: the actuaries, the analysts, and the management trainees. We must think more creatively about how we contract for such talent. The lifetime arrangement between an employee and a company

will be a thing of the past a decade or two from now; contracts of two, four or five years which give flexibility and change beneficial to the individual's professional growth will become commonplace. We have to think about more creative ways to pay people, incentive pay programs, bonus programs, etc. Home employment will be more popular as congestion in the cities continues to be a problem and as the cost of transportation both in time and dollars continues to rise. Telephone hookups to home office operations and video conferencing will make home employment possible. Sabbaticals and other innovative ideas will need to be employed if we are to be able to attract the kind of talent it will take to run the increasingly complex companies that we foresee.

As far as field people are concerned, we will need fewer of them as we go into a more complex line of products. We will need more productive people with better educational backgrounds. We will need to provide better training and compensation on a salary basis more and more as time goes on. An adequate base of income for people we are trying to attract is essential. You cannot recruit good people if you cannot show them a way to make a good living.

Many of these ideas I have been discussing have been pitched toward the life insurance side of the world. But they have also been expressed by our brothers in the casualty industry. A recent survey of 44 CEOs in the casualty business came up with similar ideas: integration of insurer's life insurance and property and casualty insurance operations and marketing systems; mixed distribution systems within companies; fewer companies; substantial increase in mass marketing distribution; considerable increase in one-stop selling.

In conclusion, we all must either move with this change or be buried underneath it. Our industry has not had to change much since it began. We are still doing things in much the same way as we have always done. But times are changing and time will force us to change. The future is for realists, for those who are willing and able to accept change and to respond appropriately.

MR. GEORGE R. DINNEY: The first subject might well be subdivided into "the emerging environment" and "the emerging manager." My evaluation of the first subject falls under four topical headings - Ad astra per aspera, Omphaloskepsis, Exogenous change, Distribution not manufacture. Translating from Latin into broken English, "ad astra per aspera" might read "to the stars by way of the aspirin bottle." The legitimate translation is "to the stars through hard-ships," but both translations convey the same meaning. If, indeed, there are stars in the firmament of the insurance business, they will only emerge after turmoil, as the result of renewed commitment and effort on the part of the industry. The augury for the life insurance business in an environment of wrenching change during the time that will be spanned by the remainder of our careers.

The concern that we must share about the industry, and about the actuarial profession in specific, is epitomized by the word "omphaloskepsis." This word means "the contemplation of one's navel." Actuaries tend to be intro-

spective. We have been trained to look inwardly and to deal with problems in detail rather than to develop an outward view and deal with problems in general.

The begged question is whether the educational processes and training of the actuary really prepare us for the emerging environment. This environment promises to be one of the continuing, major and exogenous change. Exogenous changes impact us from the outside, rather than from the inside, and yet we actuaries are essentially "inside people." At the present time the principal exogenous force is inflation. It is characteristic that purely economic forces, such as inflation, tend to interact symbiotically with social, technological, cultural and political changes, so as to make them mutually reinforcing. We all know that many of these non-economic changes are extremely significant to the future of the insurance business.

One of the subtopics under this first heading refers to available manpower. There seems to be no dearth of manpower for the emerging environment, however, we should ask ourselves whether the available manpower is of the right quality to confront our future challenges. The analysis of the practice of management falls under the general heading of management science. However, life insurance management might better be analyzed under the heading of paleoanthropology, the science that deals with primitive man. The track record of life insurance management, particularly actuaries, confirms that we are engaged in anachronistic or atavistic pursuits, which are a throwback to the earliest days of life insurance. For almost 200 years the life insurance industry has existed in an environment of relative tranquillity. To gain historic perspective, we must remind ourselves that the first recorded life insurance product was one-year, nonrenewable term insurance issued in the year 1721 by two fire and marine insurance companies. In 1762, Old Equitable issued whole life policies and term insurance policies with premiums and dividends which were guaranteed and not subject to assessment. The last major change until the early 1960s was in 1839 when the first endowment policy was issued. Product defines management processes and management style. It should, therefore, not be surprising to us that after 200 years of sameness, there should have developed within the industry a management style that reflects Cro-Magnon society rather than contemporary society.

The principal attributes of life insurance management are emphasis on working faster rather than smarter; dedication to complicating rather than simplifying; inability to comprehend the abstraction that, although life insurance is an ethereal good, it is a good nonetheless and, therefore, is subject to management by the processes that relate to goods or commodities; a psychology of reaction rather than flexibility; concentration on the "doing" operations of the business rather than the thinking processes of the business, notwithstanding the fact that our business is essentially ideational. The result is that the hierarchal structure of corporate organization tends to give rewards to those people who are placed at the top of the largest pyramids of employees in an organization. The major activity of the "pyramid sitters" is housekeeping rather than the thinking processes of creation and innovation which are vital in an environment of great change.

This leads to the dilemma which is expressed in the phrase "Distribution not manufacture." There is an emerging dichotomy between the manufacturing process of insurance, represented by the insurance company, and the

distribution process of insurance, represented by the career agency system. Distribution processes are undergoing remarkable change. Despite the official endorsement by companies of their career agency systems and by agents and brokers of their companies, there is a real dichotomy. Insurance companies are diversifying horizontally, vertically or concentrically away from their distribution systems. Successful agencies and brokerage offices are diversifying vertically by acquiring insurance companies for manufacturing purposes. This in-fighting between companies and their traditional distribution systems obscures the real issues. One such issue is that insurance has no important technological component that can be protected by copyright or patent or by the private knowledge of life insurance professionals. Moreover, the risk component of insurance is diminishing. This raises doubts about the future role of the manufacturer, the life insurance company. There is nothing in a life insurance company that cannot be replicated by an entrepreneur with a life insurance charter and sufficient capital. Another real issue is that we are beginning to see a proliferation of distribution media. The life insurance industry has built its own lines of communication to the market but, in time of inflation, the lines of communication that were suitable for permanent, ordinary life insurance have become increasingly costly to maintain or extend, and therefore, are being supplemented or supplanted by other distribution systems. It is a reasonable speculation that the means of distribution will become more important than the means of manufacturing and that distribution lines will broaden to include "alien" systems, so that the balance of insurance power will swing away from traditional life insurance companies toward nontraditional distribution systems. If we were to look ahead a decade or two, we might foresee an environment in which the manufacturing process is an appendage of the distribution process rather than present circumstance where distribution processes are appendages of manufacturing processes.

Anyone who falls into the trap of proposing new solutions or new strategies should keep in mind the words of Machiavelli:

It must be remembered that there is nothing more difficult to plan, more uncertain of success, nor more dangerous to manage than the creation of a new order of things. For the initiator has the enmity of all who would profit by the preservation of the old institutions, and merely lukewarm defenders in those who would gain by the new ones.

Emerging strategies should concentrate upon simplification of problems rather than upon using new and better technology, at new and higher cost, to solve increasingly more complicated problems, that are largely of our own creation. Of relevance to this issue is a recent book by Edward Teller, titled The Pursuit of Simplicity. In Teller's words:

No endeavor that is worthwhile is simple in prospect: if it is right, it will be simple in retrospect. The pursuit of simplicity in science leads to understanding and beauty. In human affairs it may fulfill our most desperate need: The survival of a civilized human society.

The subject of "Emerging strategies" is an omnibus subject. We actuaries are involved in the production of ethereal goods. We are, therefore, very much involved in the information revolution. The information revolution could have profound strategic importance for insurance, provided we endorse the idea of simplicity in the change processes. A short but significant monograph

titled "Memo from Mercury; Information Technology is Different," written by Gordon B. Thompson, a Canadian information expert is recommended reading for those who are interested in the information revolution. Two brief excerpts will give you the flavor of Thompson's paper:

The inappropriate use of information technology (which we might quickly identify as computers) has produced some mongoloids.

Investment in information technology has a less satisfactory overall economic impact than investment in other economic sectors. This difficulty stems from our propensity to use this technology to save costs, to use it as if it were merely some new variant of industrial technology. This most certainly is not! Like wine, new technologies cannot be held in old intellectual containers.

Solutions to the emerging problems can be either tactical or strategic. Tactical solutions are frequently used in addressing distribution problems. However, tactical solutions usually have a short life or else they benefit one insurance company at the expense of another. Tactical solutions do not provide reliable answers to the distribution problems caused by inflation or caused by other major, external forces.

Strategic solutions to distribution problems usually require a fundamental change in the scale of operations. Reduction in the scale of operations is consistent with the principle of military strategy which says that the strength required for defence is only 30% of the strength required for offence. Elimination of unprofitable distribution outlets and concentration on proven markets is probably the safest solution. However, most marketing people have an optimistic outlook which leads to rationalizing and solving problems by an increase in scale. Many companies have sought to cure their distribution problems through diversification. Sometimes diversification produces economies of scale. At other times, diversification permits penetration of markets with higher profit margins. Too often, diversification produces neither of these benefits. There are several different kinds of diversification, each with its own characteristics. They are referred to as horizontal, vertical, concentric and speculative.

Horizontal diversification means that the acquiring company and the acquired company are engaged at the same product, process or market level. An example of horizontal diversification would be the acquisition of one life insurance company by another life insurance company.

Vertical diversification means the acquiring company and the acquired company are engaged in the same product, process or market but at a different level. An example of vertical diversification would be the acquisition by a brokerage office of a life insurance company.

Concentric diversification means that the acquiring company and the acquired company have some product, process or market relationship. Concentric acquisition may be less an expansion strategy than a general management philosophy. The concept is that a company must first identify its principal strength - whether management, marketing or product - and set out areas of diminishing strength around the central core. An example of concentric diversification would be the acquisition by a life insurance company of a mutual fund company. The most obvious advantage of such diversification

would be the pooling of skills, particularly in the marketing area.

Speculative diversification means there is no specific direction in the acquisition process and no other motive than the employment of redundant capital. Speculative diversification can make good business sense where both companies are involved in the life insurance business. In that case, a holding of the shares of another life insurance company can present the potential for horizontal diversification as well as the normal potential associated with any portfolio investment.

Quite another strategic approach lies in the areas of organization change. This is the final subject on the agenda.

The strategies relating to profit, surplus levels and growth are tied up in the trend by the life insurance industry away from the acceptance of risk toward more self-insurance or noninsurance. More and more, the business of life insurance is involved with the provision of "unguarantees." This suggests that profit and surplus levels, measured on a unit basis, will be lower in the emerging environment than they are today. Reduction in profit and surplus levels is consistent with reduction in risk.

Quite apart from this statistical, or mathematical, reason for changing strategic profit and surplus goals, there is quite another reason that would suggest that profit and surplus levels will reduce on a relative basis. Today we live in a consumerist market, in which product pricing figures prominently. Consumerism is not a creation of Ralph Nader. Consumerism is the ground swell social force that results from a change in our society from an industrial state to a post-industrial state. Consequently, consumerism has greater strategic implication for us than price and profit alone. The profile of post-industrial man is that he will be better educated, will have more self-respect, will want to be measured as an individual. He will expect to use his knowledge, reject authoritarianism, and want to be a participant. Although life insurance is an ethereal good, it is a good nevertheless and is, therefore, subject to the laws of the marketplace as any other good. This means that the market rationale of "marketives," or goods that the seller wishes to sell, is replaced by a rationale of "consentives" or goods that people will buy. This axiom is at the very heart of the strategic changes that are necessary in life insurance product and distribution.

Sociologists have defined the basic societies - variously classified as pre-industrial or, alternatively, as primary, secondary, tertiary, quaternary - in relation to their principal attributes. One of the principal attributes of post-industrial society is that it is "organized to play games with and against people." Our world is very much a game-playing world. I would speculate that the next major plateau of life insurance product and distribution will be the development of a life insurance game. On one occasion, addressing an MDRT group, I offered the name "duopoly" describing "a life insurance game for two or more consenting adults." A prototype life insurance game has already been developed and is currently being refined.

The Global Report to the President published by the Government Printing Office in Washington in 1980, presents a Cassandra-like perspective for the future of the world. But even its dire prophecies anticipate real growth in per capita GNP, averaging 3% from 1975 to the year 2000 for Western civilization. Consequently, the environment for growth, on average, is

excellent. The question is how life insurance will share in average growth compared to other institutions. One advantage we have is that the life insurance product, even under high growth conditions, is not normally destructive to the environment. It does not require the use of large amounts of energy or other natural resources, and it does not deprive or exploit less affluent nations. Consequently, if society should move away from "growth for growth's sake" because of the perceived evils of the growth cult, then industries like life insurance could become beneficiaries of such a trend.

There are plausible, conflicting strategies related to growth. One growth strategy might be termed "living on the frontier of change." This strategy attempts to respond to inflation or to any other change by continuously devising serviceable distribution and product systems to suit the new environment. This strategy is anti-establishment since it relies on new and better methods to meet society's changing demands. The January 5, 1981, edition of Best's Insurance Management Reports makes these comments on this first strategy:

The shift toward term . . . changes the character of the life insurance industry, which basically has depended on the long-term nature of its whole life product . . . the saviour for the life/ health industry will be new products and concepts and changes in marketing techniques, including acceptance of mass marketing.

The other strategy might be called "niche picking." Every country contains elements of pre-industrial, industrial and post-industrial societies. A life insurance company might take as its mission the provision of services to industrial society or to post-industrial society, in both cases using traditional distribution methods and traditional products. This strategy has the advantage of being able to freeze one's market, without having to make significant changes in personnel or plant or systems. If a life insurance company has found market acceptance in a particular market niche, it might be encouraged, in view of the projections contained in The Global Report to the President, to remain in that market and to ignore changes that are taking place at the frontier. This strategy will work best where a company or an industry has been given special tax or supervisory encouragement to continue present methods.

This still leaves a strategic middle ground. A life insurance company could adopt the mixed strategy of moving into frontier areas without relinquishing traditional areas. This seems to be the strategy most North American life insurance companies are now considering. There appears to be a contemporary "sauve qui peut" psychology which is evidenced by a lemming-like rush to endorse new products and new distribution systems. However, the participants in this rush are the very companies whose Maginot-line thinking has kept the life insurance industry in a straight jacket for a century. Having regard for these auspices, it seems likely that most "new systems" will merely be extensions of existing systems, and therefore, will be as vulnerable to change as existing systems.

MR. ROBERT W. REVER: On the eve of the lift-off of the spaceship Columbia, we are reminded that we are entering a whole new era in the history of man's fascination with space.

When the Columbia succeeds, America will have made an astounding advance in the history of conquering space. Its success will inaugurate the second era of the space age, the shift from space exploration to space exploitation.

The next step is likely to be "space industrialization": The use of orbiting factories and power stations to turn out a variety of goods and services better or more cheaply than on earth. And that may be followed by the most radical change in the human experience since the new world was opened up five centuries ago: The establishment of self-sufficient colonies in the "high frontier."

Once Columbia flies, not even the sky will be the limit.

But space exploitation is not the only changing factor in our environment. Other factors influence every life insurance company in this country and will, depending upon how well we read their signs and adjust our operations to them, exert significant influences on how life companies define their business and how they conduct it.

The factors are the demographic, cultural, psychological, technological, economic, political and social factors. All of these factors are forcing us to constantly change or be left behind in the race for the premium dollar. These factors, plus the factor of competition, contain the seeds of success, mediocrity or failure in the coming years.

How then, with all the environment factors in a constant state of agitation, can we prepare for the future, and what will the future be like?

The only way to predict the future is to have power to shape the future. This means that effective management must be able to manage change. The emerging organizations of the 80s are the ones which have built in the mechanisms by which to effectively and efficiently interact with the forces impacting the business from without.

Any company that wants to fit in relationship to the environment must take on some of the characteristics of the external systems, the seven factors, plus competition, with which it interacts. The external world and, therefore, the business environment, is in a state of continuous change. So the future is a moving target.

In the absence of actually knowing what the future will bring, the business organization must be in a posture to react rapidly to the changing forces that surround it.

An organization can be compared to a defensive football team. In defensive football, the down linemen play charge and key. They are primarily pressure oriented, but they look also for the options to run and pass. Linebackers and defensive backs, on the other hand, are primarily reactors. They look for situations and then they react. So, linemen "go for it," whereas linebackers and defensive backs react to the scene that is developing in front of them. All the players play as members of a team but they are each specialists who play a defined role.

Five key elements in this analogy between football and business are:

1. assigned roles and goals;
2. a common language for quickly and effectively communicating among the players;
3. well understood strategies, a common playbook;
4. coordinated effort;
5. capability of adapting the play to the action as it occurs on the scene; that is, playing the situation.

Just like a football team, the organization has to be on the balls of its feet, not on the back of its heels.

As paradoxical as it sounds, the most effective and efficient way an organization can maintain its flexibility and its ability to cope with a rapidly changing environment is to build and maintain an internal management control environment.

Management is the accomplishment of predetermined objectives through others. In this definition, the phrase "through others" sets up the familiar and classical organization which we refer to as a pyramid. It also conveys the idea that the assignment of management is to set the objectives and then define a program to achieve them. The definition of management does not say anything about how you will achieve the planned results. It includes, however, an assumption that you will accomplish the objectives in an effective and efficient manner, and this assumption sets up the need for a management control system.

Every executive should know the answer to this question, "Are you working out of your in-basket, or is the organization working out of your out-basket?" If the organization is working out of management's out-basket, it needs a management control system.

Why are control systems so important? The answer lies in the nature of the pyramidal organization. It is characterized by specialization and division of labor. Each cell of the organization develops its own way of operating and, if not checked, its own goals and objectives, regardless of the goals and objectives of the company. Different subunits and different managers invariably come to pursue and value only their own activities. They tend to overlook their relationship to the entire organization and base their decisions only on the needs of their own unit. The name for this phenomena is suboptimization.

There is nothing sinister about this natural tendency of people to want to follow their own way, rather than the way of the company.

It is like the story of two fellows who were out in a boat on a fishing trip. One took up a brace and bit and began boring a hole in the bottom of the dory. When his partner objected, the driller said, "Don't worry. It's on my side of the boat."

In the absence of rules, roles take precedence over goals; this must be prevented.

Keep in mind the contradiction of the TV commercial jingle for a major western grocery chain: "It's Joe Albertson's Supermarket, but the produce department is mine."

The day of the lone worker or the lone manager working only for self-interest in the organization is gone. Most achievement today in industry, government, the professions results from the coordinated efforts of many people seeking group ends. In the emerging organizations of the 80s, the achievement of this kind of collaboration and cooperation will be one of the major challenges to its leaders.

Abraham Lincoln said, "I am for each individual doing just as he chooses in all matters which concern nobody else."

Within the organization pyramid there is a beehive of self-interest. This "beehive" is nothing less than an invisible war in which self-interest is pursued at work. The companies that do the best job of matching personal interests with organizational interests will be the high performers of the 80s.

The key is the control environment.

What is the control environment? It could be defined as "the degree to which responsible individuals can and do evaluate the effectiveness and efficiency of the input/output relationships utilized to accomplish organizational objectives."

The theory behind the control environment is that a manager cannot do his job (which is the accomplishment of organizational goals) and cannot effectively interact with a changing world, if he does not know how the organizational resources are being utilized.

Many of us go to great lengths to avoid knowing. We keep no records, we seldom go out into the "shop" and find out what is going on in the real world of our responsibilities.

The idea of the control environment is summed up in the picture of the management job. We call this "The Management Process Cyber-Chart" (Figure 1), because it illustrates the process by which managers steer their organization toward its goals.

It is a six-block flow process, which describes the total job of a manager.

In the first block we have three principal types of information: environmental, competitive and internal.

In the second block, the information flows to the manager. The action he takes depends upon the content of the information, his interpretation of the information, and his personal management style of being proactive or reactive.

The third block shows the action that the manager takes. In the upper part of the box, the four basic kinds of action are shown. These are: planning, organizing, actuating (directing) and controlling. In the lower part of the block, we have an arrow diagram which we refer to as the Main Event Compass.



MANAGEMENT PROCESS CYBER-CHART

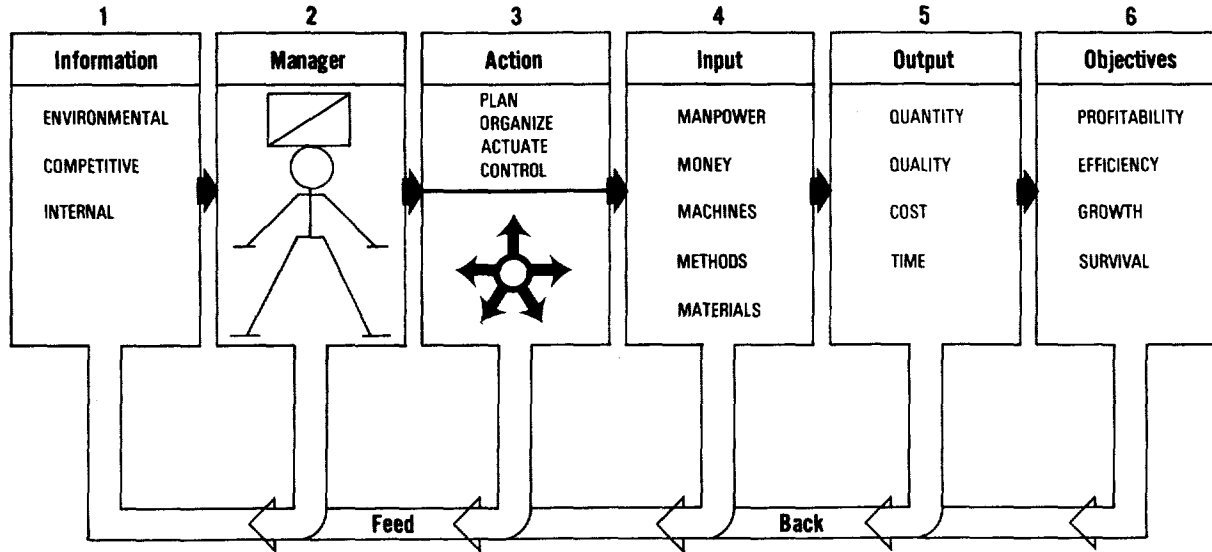


Figure 1

This represents the five kinds of decisions a manager must make when taking action: what is to be done, who is to do it. . . when, where and how.

All that is necessary to stop action is not to be able to find the answer to any one of these questions.

In the fourth block, we have the input resources: manpower, money, machines, methods and materials. The manager's job is to blend these various resources so that input/output ratios will be maximized.

In the fifth block, we have the output. This block summarizes the four ways to measure output: quantity, quality, cost and time.

In the sixth block, we have a summary of the only four objectives an organization can have: profitability, efficiency, growth and survival.

The six blocks in the diagram are connected from left to right, and each block is also connected to a feedback line which returns to Block 1, the information block. The feedback line reflects the manager's realtime environment and represents the return of information that tells the manager the results or consequences of his prior decisions. The feedback line creates the idea of interdependence and interaction among all the blocks. It also represents the idea that we do not meet with success except by reiterated efforts. There are no time outs in management as there are in athletic games.

I have defined the elements of the control environment and emphasized that the control environment must enable a company to flex with the flexing environment. I have also pointed out the propensity of people to pursue their own personal interests to the detriment of organizational objectives. The question that remains is, therefore, "How do you install a control environment, and how do you reconcile the self-interest of managers with the objectives of the organization?"

The answer to this question is in two parts:

How do you install a control environment? First, you install a group of systems designed to direct the work of management. We call these "management systems," to distinguish them from production-like systems. These are standard solutions to management-type problems and should not be confused with production-type systems such as marketing systems. What are some examples? Every organization deals with how to direct the action of the organization, how to set up controls to assure responsible individuals review important expenditures and commitments of company resources, how to make known the existence of and flow of information reports within the organization, how to administer compensation policies, how to budget expenses, how to prepare and maintain a performance plan, and how in general, to create and manage change through the discovery and correction of error and the writing of a history. These types of systems can be standardized, because they deal with standard management problems that are common to every organization.

Management systems recognize that the essential task of management is to arrange organizational conditions and methods of operations so that people can achieve their own goals best by directing their efforts toward organi-

zational objectives. These systems make known to everyone the expectations, values, rewards and objectives of the corporation.

The use of management systems is a very important part of this direction, and can account for the ability of a company to flex with a turbulent external environment. To take an example in the armed forces, a naval commander can issue a terse order that may move an entire navy across an ocean, because volumes of standing operating procedures have been issued and practiced many months and even years before. Without these customary ways of doing things, the executive issuing the instruction would have to specify in considerably more detail the quality of performance he desires; and, except in highly centralized operations, he would also have to deal with how the work was to be done. By that time, the war might be lost.

The second part of the question was "How do you reconcile the self-interest of managers with the objectives of the organization?"

Here it helps a great deal for the company to have definite ideas about the management process and to back up the ideas by definite programs. A basic element of such a program is a management development program in which the rudiments of management are taught. In the case of my own company, we have such a program. We call it Model-Netics[®] 1 - meaning management models in action. We also refer to the program as a "management language."

No system, regardless of its merit, will work if the individuals affected are not supportive of it. An operational catalyst is necessary to energize the individual's desire to make a system work. Such a catalyst is Model-Netics[®]. This management language provides the vehicle for achieving greater organizational productivity through communications and teamwork. It is the catalyst to the understanding and application of the installed management systems, which not only positively impact productivity, but also point the way to adapting to a changing world.

The Attitude Stair Steps (Figure 2) is based on the concept that action to bring about a change results from a series of attitudinal changes. The five steps in the model are:

1. Awareness - The individual must become aware of the subject for possible change action.
2. Understanding - The individual must receive or obtain enough information to gain an understanding of what is involved in the problem or the opportunity.
3. Concern - Based on the information he acquires, the individual may or may not develop concern. If he develops concern, he may move to the next step of the model, which is dissatisfaction.
4. Dissatisfaction - The individual will develop a desire for change only if sufficiently dissatisfied with the status quo.
5. Action - This is the change action taken by the individual to relieve the dissatisfaction.

1 Model-Netics[®] is a registered trademark of the Main Event Management Corporation, Sacramento, California.

ATTITUDE STAIR - STEPS

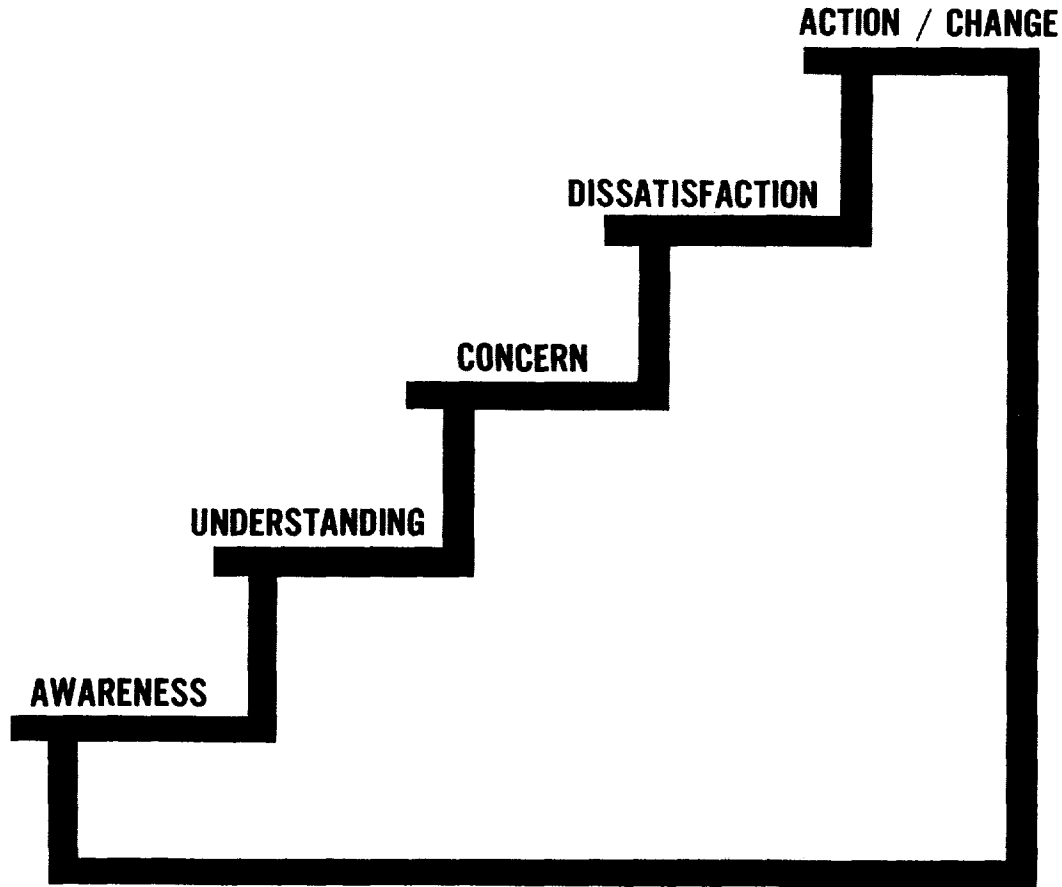


Figure 2

The essence of the Attitude Stair Steps is that ignorance often produces greater resistance than knowledge. By enlightening managers on expectations, values, rewards and objectives of the organization, we multiply our chances of reconciling their self-interest with those of the company.

Through repeated application of this model, we can lead a manager up the stairs to a level of understanding of given situations and of the management process in general. We cannot guarantee he will become dissatisfied and desire a change. But, if that does not happen, is all else lost? No. The alternative is to find another person who can continue up the stairs to the constructive action required to improve or react to the environment. The new individual now has the possibility of going up all the way. The possibility is not there, however, if the management information and management systems are not in place.

Another way of looking at the problem of reconciling the self-interest of responsible individuals with the objectives of the organization is through a model which we call the Attitude Box (Figure 3).

The Attitude Box represents the theory that the way a person responds to a given action - a stimulus - depends upon his attitude.

The Attitude Box has three components: Stimulus and response - the two upper arms; the attitude - the box in the center; and past experience and work environment, represented by the two lower arms.

The model is interpreted in the following two ways: An individual's response to a given stimulus is related to the attitude of the individual. And the individual's attitude is based upon his past experiences and the environment in which he works. In practice, we work hard to help the individual recapture his or her knowledge or experience in management and to use it in real time.

We also structure the environment through installing and operating a definite set of management systems. These two aspects of the model go a long way in helping to bring the self-interest of individuals into line with the interests of the organization.

With a solid set of management systems in place, the manager is free to move ahead in other vital areas.

The Seven Ports of Management (Figure 4) tells us the seven groups management must satisfy. These are the employees, shareholders, customers, industry, community, government regulators and vendors. The best management can do is to satisfy six of these groups and try to optimize the seventh. Which one do you think it is? The answer is the customer. Why? Because the basis for meeting the expectations of the other six depends entirely on what Peter Drucker once said, "The purpose of a business is to win a customer and thereby make a profit."

Summary

The situation today is very difficult to predict. No one knows what will happen in the social, political, economic, technological, psychological, cultural and demographic environments. But the organization that takes on the characteristics of the environment will have the best chance of

Figure 3

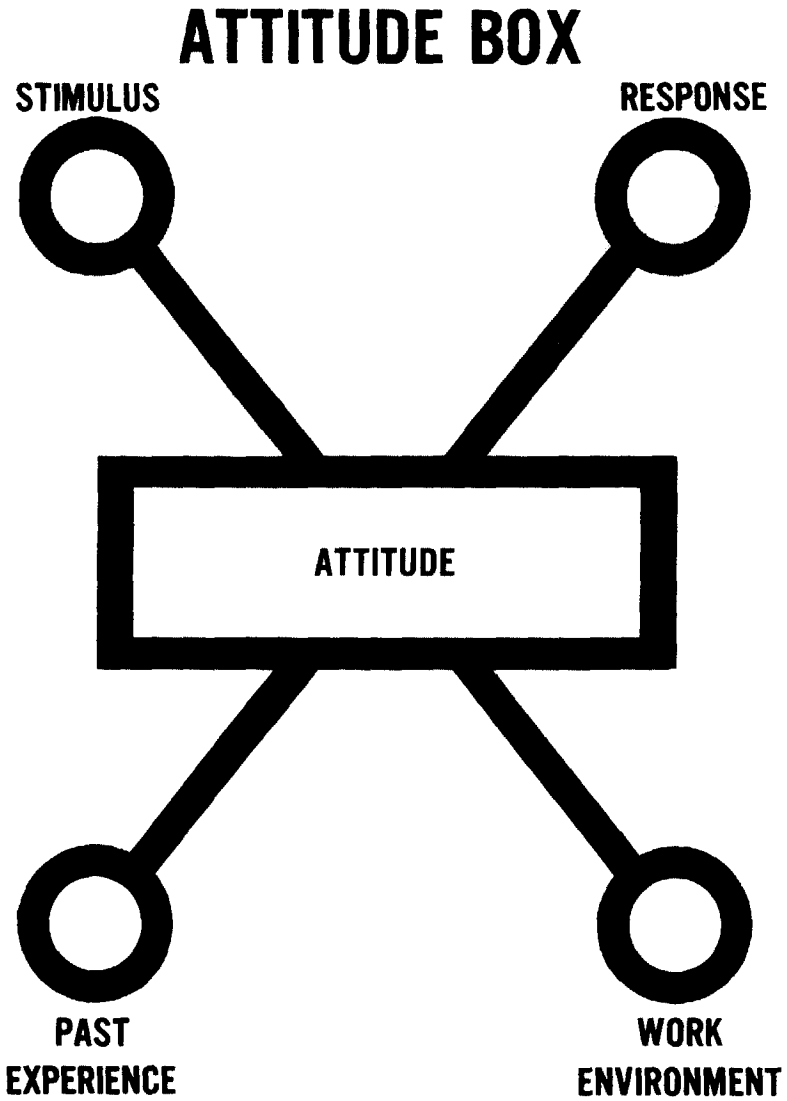
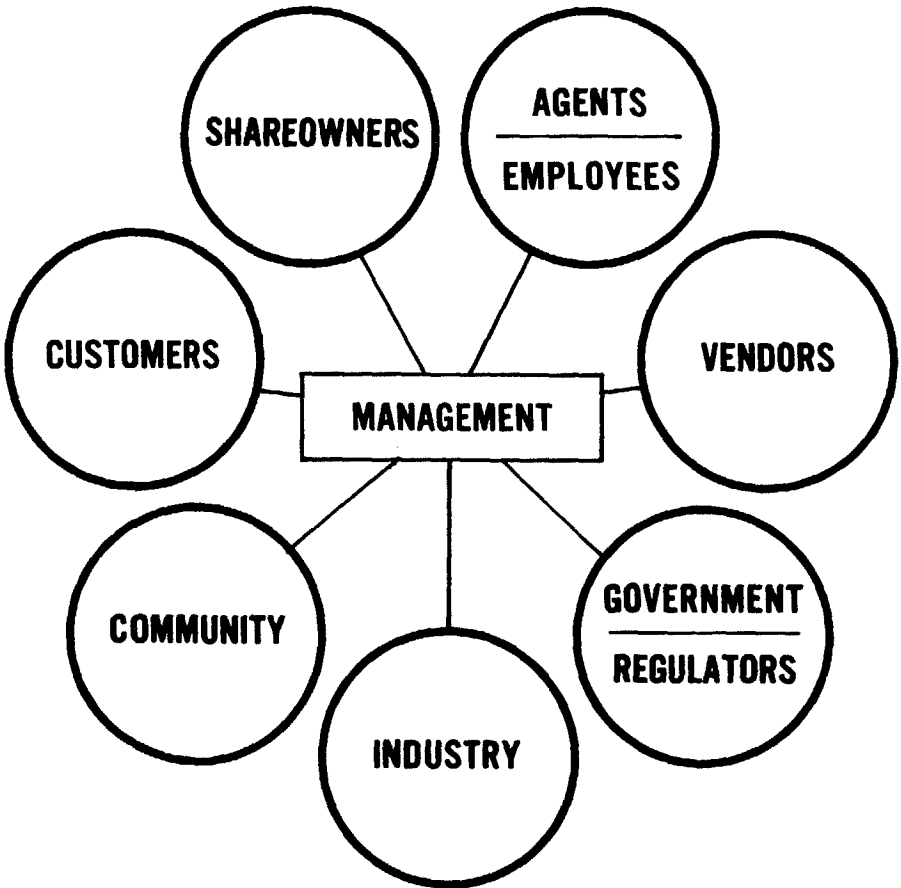


Figure 4

SEVEN PORTS OF MANAGEMENT



surviving and prospering. One of the fundamentals of adapting to a changing environment is to create a more flexible, dynamic posture. This requires a major effort to build a control environment. I have tried to put some flesh on those bones, and to show that this means more than simply subscribing to a philosophy.

In closing, I would like to quote Leonard Sayles:

The manager does not primarily seek to solve a problem once and for all or to achieve a single objective. Rather he endeavors to compensate and improvise, constantly to readjust his behavior, marginally, in response to the ever-changing environment about him. While seeking stability, holding deviations to a minimum, he can approximate the ideal only by constant change.

Thus, iterations, dynamic relationships rather than compartmentalized jobs, are basic characteristics. Continuity of flows are the objective, tying together the independent parts of the total operation that have been fractionalized by the need for specialists, departments, and organizational checks and balances. There are not the neat beginnings and ends, the sharp demarcation lines between what is inside and what is outside, between what is past, what is present, and what is future, that are associated with essentially legalistic, static models of human groups.

Only managers who can deal with uncertainty, with ambiguity, and with battles that are never won but only fought well, can hope to succeed.*

MR. ARDIAN C. GILL: Bob, you and George agree in theory, at least, with respect to management and distribution. But I do not see an agreement on the pyramids. George sees the person at the top of the pyramid as essentially a housekeeper with a frilly apron. How do you see the role of the woman at the top of the pyramid?

MR. REVER: The people at the top of the pyramid need to be involved with the organizations's goals and its future. We need to organize the routine activities in the organization so that management can spend more time dealing with the changing environment rather than those routine activities.

MR. GILL: Frank, you discussed the cost of doing business, the cost of distribution and increasing agents production. Do you, through this process, also lower agents' unit compensation and perhaps introduce "cheaper by the dozen?"

MR. BARSALOU: The question of compensation is a key one and any solution will come as a result of a systems approach. We need to create an environment attractive to talented people. First, we need to have more for our sales representatives to sell. We need more products, more opportunities for commission or some form of income. Second, we must develop distribution systems which are highly organized, and which take advantage of new

*Leonard R. Sayles, Managerial Behavior, McGraw-Hill. P259.

technology, which take advantage of the new talent we attract into the organization. Then, we can and must attract a new breed of sales representatives able to sell a more complex line of products, able to deal with the more sophisticated communications and analytical tools that will be used in the future. You cannot have increasing agent income without all three of these elements.

MR. GILL: George, do your ideas on the emerging organization coincide with Bob's, or do you differ?

MR. DINNEY: Ardian, there is an area of coincidence as well as an area of difference. My point on organization is that often times geometry dictates what people do. A person whose span of control is very large and who is identified with many people tends to become involved in interactive, pedestrian, repetitive processes. I categorize that kind of person as a housekeeper, someone wearing a frilly apron, rather than someone involved in the thinking processes of an organization. We have all talked about organization and flexibility in the face of change. However, what you can get hung up on is that every organization, at a point in time, is a static representation of a configuration of structure to deal with the missions and the direction of the organization. I am inclined to believe that organizational structure is unimportant, if not irrelevant, provided that, there are systems whereby the necessary things of an organization are done more or less automatically. There are some concepts such as the matrix structure where you get people together at decision making points, the convergency structure, and what I call finished product data processing whereby, as a natural byproduct of the system, people are brought together in decision making automatically irrespective of organization. If an organization is to meet change in the future, structure will have to be less important and more emphasis and reward will have to be given to those people who do the "thinking" rather than the "doing" operations. I have said in my own company that we should change the way of titling. Instead of having the current kinds of titling, why not have a Vice President and Chief Thinker as distinct from a Vice President and Chief Drone. Those titles would better typify the contributions that they are making.

MR. GILL: Bob, would you comment and also do you, with your view from the outside, include actuaries among the thinkers that George mentioned?

MR. REVER: I agree with George. There are routine activities in an organization that must go on regardless of the organization's structure. By having the systems in place to standardize performance of these routine tasks, you give more opportunity to managers to think. You stop managers from becoming involved in the functions which are not management's job. Yes, I consider actuaries the thinkers of our organization. I am not sure they get out of their logic boxes often enough, but I would consider them thinkers.

MR. BARSALOU: It may be heretical, but I think we have a tendency to avoid taking action by conducting another study, by overresearching. We do this especially in the larger companies where there are staffs available. Adequate research is obviously required, but enough is enough. We need to take courageous action; we need to be right only about half the time.

