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STRATEGIC PLANNING

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The need for strategic planning in the insurance industry has never been greater. With the industry going through turmoil, the top management of every company and every major subunit within companies needs to reassess its position and strategy in light of major new trends. More often than not, it will not be sufficient to simply dust off and tune up old strategies. Instead dramatic new ones will be required.

While the need has existed for some time, for a variety of reasons, relatively little real strategic planning has gone on to date. First, it has taken senior managements a long time to realize that the basic ground rules of the industry have shifted dramatically. Second, few in the industry know what true strategic planning is or how it can help them. (They have it confused with long-range, operations-oriented planning.) Third, few know how to carry out strategic planning.

In my presentation today, I will start by defining what true strategic planning is. (It is much different than many assume, so it's very important to get that difference clarified.) Then I will cover why it is so critical to the insurance industry at this particular juncture. Next, I will address how you do it. Finally, I will share with you some strategic planning pitfalls and give some tips on how to avoid them.

Actuaries have many potential roles in the planning process because they follow many careers in the industry. Some participate as Chief Executive Officers (CEO) or other senior members of the management team, some as middle managers, others as corporate planners, still others as senior analysts providing input to the strategic planning process, and some as traditional actuaries laying the ongoing actuarial groundwork which provides some of the underpinnings of the strategic planning process. Depending on which of these groups you fall into, you will be listening from a different viewpoint, and I hope to have something to say to each of you.

What is true strategic planning?

Since strategic planning is the process of coming up with a strategy, let me start giving you my definition of a strategy:

> "A coherent, integrated set of objectives and actions for using an organization's resources to secure a sustainable position of advantage."

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Let's examine some of the words in the definition. First, "objectives and actions"; these are the strategy; they are sketched at a broad, macro level rather than at a tactical level. Next we have, "coherent and integrated", meaning that the pieces have to be consistent with each other and add up to more than the sum of the parts. That is to say, the financial part of the strategy supports the underwriting part, which in turn supports the marketing part, and so forth. The phrase, "resources", is there because strategic planning in the final analysis is a resource deployment process. The object is to understand the nature of these resources and their limitations, and make the best use of them. The most important words are "sustainable position of advantage." Many so-called strategies offer little or no advantage or an advantage which is temporary (as is the case with a price cut without a corresponding long-term cost advantage). The insurance industry has all too many "me too" strategies.

Actuaries make excellent long-range planners. Indeed, you are some of the oldest practitioners of the art with your underlying concern to provide a reserve structure for the life of a product. In addition to taking the long-run view, actuaries have outstanding analytical skills. But being analytical and a good long-range planner are prerequisites for, but are not the same as, being a good strategic planner.

This is so because long-range planning tends to have a more extrapolative, operational orientation, whereas strategic planning seeks new direction. Strategic planning contrasts with long-range planning on many dimensions. It focuses more on future events outside of the enterprise; it addresses a wider range of alternatives; it looks at things more in the aggregate rather than in the specific; it aims at doing the right thing vs. doing things right, at working smarter vs. working harder, at running the right ship vs. a tight ship, and at being effective as opposed to being efficient.

Another way of thinking about the difference between strategic and long-range planning is to look at the typical evolution of planning in an organization. It usually starts out with budgeting, which is a control mechanism; after some years, it evolves to long-range budgeting, which is really running the numbers out a few years further. Then you get into long-range planning (which was the "hot" technique in U.S. industry in the late 1960's and early 1970's). It relaxes many of the constraints in the budget, but it's still pretty much an extrapolative exercise tending to be financially driven. When a company gets into strategic planning, it starts asking fundamental questions about the business, such as: What business are we really in? In other words, you are trying to develop or improve the theory of your business. The ultimate stage is strategic management (which few firms have arrived at), which is having a strategy and managing to continually evolve and refine that strategy. To get this ever-increasing sophistication of evolution from budgeting to strategic management, takes decades. Most insurance companies are somewhere in the middle at the moment, at about the long-range planning stage.

Let me tell you a strategic planning success story of how Life of Virginia came to offer universal life, to make the distinction between strategic and long-range planning more concrete. In response to a lackluster ordinary life market in the last decade, most of the industry responded by price cutting, increasing productivity of the sales force, sales promotion campaigns, and by using computers to increase processing efficiency. Let me stress that these are operational responses for refining what you are doing anyway; these are not strategic responses.

Strategic planning would begin by investigating the reasons for this lackluster market. It is useful to compare the underlying premises of ordinary life with the reality of the external environment, particularly regarding the economy, technology, buyer sophistication, and the product life cycle.

Ordinary life requires an economic environment that is stable with respect to inflation and interest rates to allow level premiums. In fact, the environment is volatile. Ordinary life provides a fixed plan to allow agents to modestly tailor programs from tables in a manual. The client has fixed or limited choices on premium period, pattern of coverage, coverage period, savings period, etc. The reason for the limitations has been technological impracticality of tailoring further. However, this assumption is now obsolete with the widespread availability of hand-held calculators and of mini and micro computers. Ordinary life is designed for buyers who are unsophisticated about financial matters. However, buyers have become increasingly sophisticated, particularly about the savings component. (In fact, in 1977, we saw term pass whole life as the main source of premiums in the industry.) Finally, we've assumed growing demand with few substitute products, when in fact the market is mature with a proliferation of substitute products. In other words, the environment has changed dramatically from what are the assumed underlying success factors of ordinary life.

Continuing our success story, the senior management of Life of Virginia made these comparisons in early 1980. First of all, it saw that universal life was a product that responded to each of these four changes in the environment. However, as important as recognizing the market opportunity, it also recognized that it had organizational characteristics that put it in a particularly strong position to capitalize on it. The Company had a new president who had recently helped to develop universal life as a consultant, so he was one of only a few in the industry who were then knowledgeable about it. It had the financial backing of the Continental Group, giving it resources to invest in a new venture. The Company had recently streamlined its sales force, and made it more sales than service oriented (after formerly being primarily a debit Company). Further, Life of Virginia had made a recent thrust into the upper end of the market, and compared to the industry, it had somewhat less historical baggage of a high-commissioned sales force and a big base in whole life. This made it potentially easier for it to introduce to its sales force a lower-commission product like universal life and less vulnerable to the product stealing from its in-force base of whole life policies. Furthermore, it recognized that many of its major competitors would be less likely to rush to the market with a universal life product because they had the opposite situation.

The bottom line was that Life of Virginia's management recognized a market opportunity and that it was in an unusually good position to capitalize on it. However, a strategy was needed to assure the advantage. Management recognized that with lower commissions it needed to "pull" the potential clients to the agent rather than pay the agent to "push" the product. Accordingly, it brought out a new universal life product called the "Challenger", which had the characteristics that fit the newly identified market. It heavily promoted it through ads in financially oriented magazines such as Fortune, Money and Changing Times, trade advertising to accountants and lawyers who were financial advisors, and spot TV ads.

The results were spectacular. The Company's annualized premium in 1982 grew at 45% vs. relatively flat growth in the rest of the industry. The average size of a new policy was $11,000 greater than the industry average. Finally, Life of Virginia got a decisive jump on competition with only twelve other companies offering universal life in 1981 and only one hundred offering it in 1982.

Now, the reason for telling this war story is not to tout universal life or Life of Virginia. It is to illustrate how good strategic thinking can be used to get a position of advantage. While other companies were doing long-range budgeting or long-range planning, polishing up their old, but obsolete, strategies, Life of Virginia was thinking strategically to create a new one.

Why is strategic planning so essential in the insurance industry now?

First of all, we have to face up to our resource limitations. To most, "resource" means money, and money certainly is an important limitation in some organizations. However, often the unrecognized limiting resources are good people, management, or organizational know-how. The second reason is that it costs much more to move in new strategic directions today; the stakes are bigger. Third, the lead times to make strategic moves are increasing; as companies get larger, as the required changes get bigger, and as the internal and external approval process gets longer, you need to get started early, aim right, and build in flexibility. Fourth, there is increasing interdependence among parts of increasingly complex companies with accompanying need to coordinate many units of a large organization to recognize problems and opportunities, decide, and carry out a strategy. Otherwise, opportunities fall between the cracks.

And, finally, there is change, the most talked-about reason that strategic planning is needed. Charles Fiero and John Miller covered many of the major changes in their keynote yesterday. We are all aware of increased competition both within the industry and from new sources -- banks and brokerage houses. We've got a crazy economy with high inflation and interest rates, high unemployment, and sluggish growth. We have a technological revolution going on in computing and communications. The industry structure is changing dramatically with consolidation in your industry and new financial service companies formed by mergers between insurance companies and other institutions. We have diversification out of and into your traditional industry. You diversify into such products as health care and pure savings, while other people diversify into your territory. New products and services are being offered right and left, of which universal life is one of many. Regulation is changing both within your industry and in closely adjoining industries; deregulation in banking is a matter of great concern, as Chuck Fiero pointed out yesterday. And we have a changing role of government, with less intervention in the private sector, increased role of states, and so on. Finally, we have important social and demographic trends which influence both our actuarial calculations and also the buying habits of the public.

There are two important points about all this change. First, the basic rules of the game are changing; that's why just working harder doesn't often work as a solution. But second, and most important, this change isn't all bad. As Peter Drucker's book title implied, these are turbulent times, not bad ones. For example, all the crazy interest rates we've seen in the last decade provided the opportunity of money market funds. As Ralph Waldo

Emerson said over a century ago, "This time, like all times, is a very good one if we know what to do with it." Strategic planning is the vehicle which helps us to "know what to do with it."

So the challenges have become enormously complex. There's much less room for error; there's less fat in the economy and industry to bail you out. The enterprise must be aimed carefully and well; there aren't many second chances. Therefore, more and more victories will be founded on clever ideas, and there is a great need in the industry for shift in management skills: a strategic orientation at the top and execution skills at middle and lower levels of management.

The bottom line of all this is that good strategic planning isn't just a desirable thing anymore; it's absolutely essential. So, now the question is, how do you do it?

How do you carry out strategic planning?

The strategic planning process is a straightforward one; as you'll see, it's easy to describe, but harder to do. There are six main activities involved in strategic planning (see Figure 1). You need to scan, look outside the firm and see where the world is headed. You need to assess, look inside the firm and see how it and its strategy fits into this projection of the future. You next need to develop alternative strategies, which requires a great deal of thoughtful creativity -- that's where the working smarter comes in. You need to evaluate the alternatives and choose, a process made difficult because each strategy is so multi-faceted. You then need to implement it well; otherwise this is where many good strategies founder on the rocks. Finally, you need to monitor its progress and adjust it, both because the strategy and its implementation will need refinements in their own right and because the outside world is constantly changing.

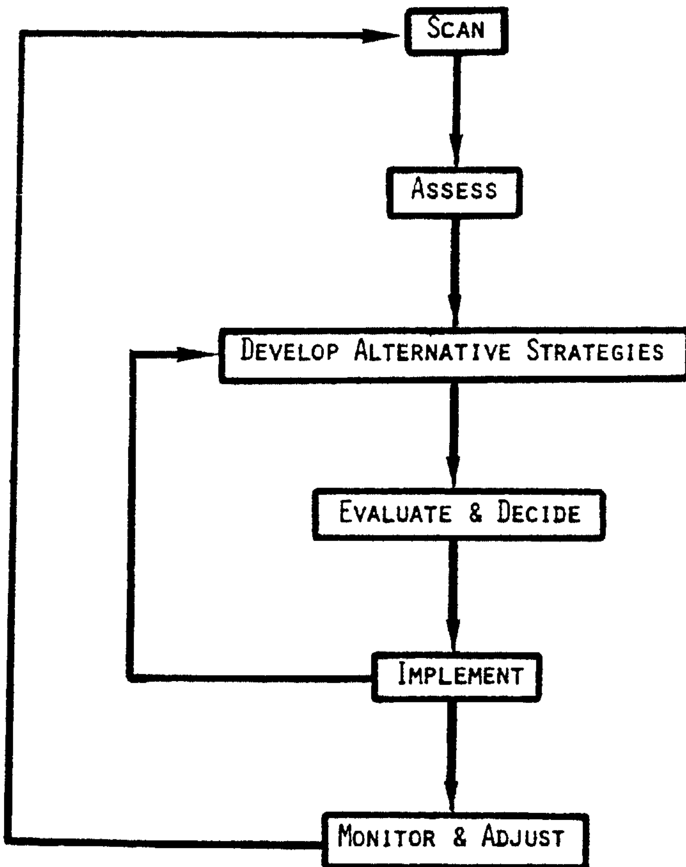
Let's look at each of these steps in turn.

Scanning asks: What's going to happen outside the organization? You need to take a look at competition, the economy, technology, industry structure (one of the hardest to predict right now), customer needs (often forgotten; we tend to push more what we can provide rather than what the customer really needs), regulation and social/demographic characteristics. The emphasis is what's going to happen; too often I see people characterize the current environment, failing to recognize that by the time they decide upon and implement a strategy, the world is going to be very much different.

Assessing asks: How well does the company and its current strategy fit the projected environment? The first problem is to identify the current strategy. Since many insurance companies don't have a clearly stated one, it has to be inferred. Then you need to take a look at the organization's strengths and weaknesses. This allows you to assess how well the current strategy and configuration fit the projected environment. Out of this comes a list of opportunities and problems.

Figure 1

THE STRATEGIC PLANNING PROCESS



Creating alternative strategies asks: What might our strategy be? Markets come first. Ask: What are the market needs? Who can we most advantageously serve, and how can we best serve them? Functional strategies follow. Marketing is one of the most important, including products (properly defined; it isn't just the policy, it includes the services going along with it), sales, pricing, advertising, public relations, and so forth. Other functional strategies must include operations (the back room), finance, human resources, and then something that doesn't often show up in the industry, R & D. Loosely defined in insurance, it is the development of new products and new ways of doing business.

The creation of new strategies requires -- as the name implies -- a great deal of creativity. You have to work hard to relax assumed constraints (such as the fixed plan) and to think in new and different ways because the world is new and different. It takes creative people, a creative process, lots of time, and lots of iterations.

In thinking about potential strategies, it is useful to keep in mind the three generic types of strategy. These are: an efficiency strategy, where you obtain an advantage by cost; an effectiveness strategy where you gain an advantage through quality; and a niche or segmentation strategy, where you gain an advantage by picking a particular market segment in which you can specialize better than others. Examples of efficiency strategies might be those of State Farm in the personal lines property and casualty business and of Northwestern Mutual in the life business. An example of an effectiveness strategy might be in health insurance offering quality through better claims handling and coverage. An example of a segmentation strategy would be at the Montgomery Ward Insurance Group, which has very effectively used a direct response strategy to market insurance through Montgomery Ward's credit files, capitalizing on its intimate knowledge of the information in that file and the distribution system that it represents.

In coming up with potential strategies, a very common mistake in the insurance industry is failure to differentiate between what Philip Kotler calls a market opportunity and a company opportunity. A market opportunity arises because of unsatisfied customer needs (of which there are plenty right now). Each market opportunity has specific success requirements, that is, what is required to take advantage of that opportunity. Each company in turn has its distinctive competences. A company will enjoy a differential advantage if its distinctive competences match the success requirements better than its potential competition. Then and only then does a market opportunity become a company opportunity.

Choosing asks: What strategy will best give a sustainable position of advantage? After having gone through the creative process to come up with some alternative strategies, one has to choose among them. There are so many facets to this choice that it depends on balancing off the answers to the following questions: Does the proposed strategy fit the projected external realities (the way universal life fit them in the success story I told you)? Does it exploit the strengths and unique characteristics of the company? Does it allow for the company's shortcomings and use its limited resources well? Is it focused (in that it uses the firm's resources to pursue a few things well rather than chasing off after many different things)? Is it consistent and mutually reinforcing? Does it meet the firm's financial goals? Does it have the appropriate risk level? If it's being selected at

a lower-level business unit, is it consistent with the corporate strategy? Does it fit the values and aspirations of the management team that is going to have to carry it out? Is it implementable? Is it clear? Does it stimulate action?

Implementing asks: How do we pull it off? The implementation phase is one of the most difficult because it involves managing change. I would like to distinguish between two aspects of the implementation process, that is, administrative change and the behavioral change required to carry it out. By administrative change, I mean organizational structure, systems, job descriptions, the placement of managers, use of technology, and other formal variables. By behavioral change, I mean the behavior of the human beings in the organization that carry out the administrative change. The reason for the distinction is that you can make an administrative change, but it won't work if the people in the organization behave in some old way or some new, unintended way. For instance, if you intend that the sales force push certain new products, but it continues to push old, less desirable ones (from the company's perspective), you are in trouble. Thus, the implementation strategy has to determine what structure will be consistent with the strategy, what behaviors are required of the players, and have a way of insuring that those behaviors occur. In one organization with which I am familiar, a good new strategy and structure was put into place but almost failed because top management's behavior at first failed to adjust to the new requirements.

From the standpoint of strategic planning, it is important to think through the implementation approach of the leading potential strategies before making a selection, because consideration of implementation may influence the choice or result in a refinement of the top contender.

Monitoring and adjusting asks: How are we doing and how can we improve? It could be you have a sound strategy but the implementation needs adjusting or you could have good implementation but the strategy needs adjusting, so you need to collect information which allows you to make that distinction. You also need to have realistic milestones against which to measure your performance. (In deciding on what's "realistic", remember that strategic changes take quite a long time.) If your strategy makes key assumptions about the future (such as about inflation or competitive reaction), you need to have contingency plans to respond if things don't work out as assumed. In addition to reacting to contingencies as they occur, from time to time you need to do a periodic review of the strategy and its implementation in order to do a mid-course correction. Hopefully, as with a space shot, your mid-course correction will be a slight redirection rather than a major change. Finally, you need to have a mechanism for responding to major unforeseen events that aren't part of your contingency.

What can go wrong?

Earlier I said that strategic planning was straightforward to describe, yet hard to do. Most companies do something called "strategic planning", but only a few really succeed. To give you an idea of what can go wrong, let me share with you some major pitfalls that I see time and time again. These occur in the process of planning, in the kinds of strategies that emerge, and in implementation.

Regarding process pitfalls, you often see an introspective process which focuses too much within the organization. Or you see a bureaucratic, mindless ritual. I sometimes call this the "rites of fall", where form overwhelms substance, where tools dominate the process, and where good, imaginative strategic thinking doesn't occur. Then there's the failure to distinguish between market and company opportunities. In addition, there's often an overemphasis on financial projections, especially early in the process, when the thought process should focus on potential strategic moves, with numbers being secondary. Finally, there's failure to consider implementation before deciding on a strategy.

The plans themselves suffer from major pitfalls. Often they are overly operational, too concerned with refining procedural details. Or they're too financial, aimed at making the short-run numbers look good. Or they're too extrapolative, blindly extending past practices into the future with modest refinement. Or they're unimaginative. Or they're too general or too specific. (For instance, they may have too general a goal like "make money" or too specific, confining a business definition such as "individual whole life business.") Or the strategies may be too defensive (for example, trying to hold onto ground that you're going to have to give up anyway) or not defensive enough (for instance, failure to defend a base core of business while you launch exciting new strategies). Or the strategy misses the firm's true uniqueness, which is like cutting off your good right arm before going into battle. Or, finally, they lack focus, frittering away resources by doing a little in many areas rather than a lot in a few areas. You can't push back the frontier by marching in twenty different directions.

The final set of pitfalls arises from poor implementation. First, there is the failure to manage according to the plan; you go through the planning process and then the strategy becomes a document which just gathers dust. Or there's lack of commitment -- the company backs down on a new strategy at the first sign of adversity. Often this is due to a failure of management to understand how long and how much it's going to take to implement a new strategy. On the other hand, commitment is not the same as rigidity; you need to flexibly push on with a well-thought-out strategy unless its underlying premises are proven later to be incorrect.

A very important execution pitfall is when the formal variables (such as organizational structure or systems) are inconsistent with the strategy. Or you might have weak or non-existent action plans to carry out the strategy. Or you might ignore the behavioral change that must accompany the administrative change to implement the strategy. Or when major new opportunities arise, they are treated opportunistically rather than checking for consistency with the strategy or consciously modifying the strategy.

<u>How can we avoid the pitfalls</u>?

The pitfalls arise because the process of strategic planning isn't an easy one. Some of them will occur even in the best managed firms. However, there are a number of actions that will reduce their likelihood.

First, line managers should plan, not planners. This may sound like a contradiction in terms, but planning is the responsibility of line management, and planners are there as staff to support the planning effort. In addition to better plans, this leads to a greater commitment to the plans.

Second, you need appropriate education. True strategic planning is not a well developed or widely practiced process in the insurance industry. Therefore, relatively few people at senior levels understand it well. Most people have risen to senior levels because of their operating skills, so good education to fill the gap is required.

Third, the process needs adequate staff support to do the analyses and gather the information necessary for sound deliberation.

Fourth, you need the right role for the planner, which depends on the organization and its senior management team. I like Peter Lorange's classification of roles as catalyst, analyst, and strategist. The catalyst facilitates planning, the analyst does supporting analysis, and the strategist devises strategies. In the ideal organizational setting, the CEO and those one level lower are the strategists, and the planner's role is more appropriately a catalyst and an analyst.

Fifth, you need broad and appropriate participation in the planning process. Instead of strategies coming exclusively out of the executive suite, you want to get many people in the organization involved in contributing ideas. This, of course, increases the likelihood of organizational commitment to the strategy when it comes time to carry it out.

Sixth, keep both the planning process and the strategy as simple as possible. By simple, I don't mean simple-minded, but to avoid undue complication. A simple planning process encourages clear and creative thinking and wise decisions. A simple strategy is usually better in addition to being easier to understand, communicate, and follow.

Seventh, it is important that planning be a vibrant, creative process each year; rather than a mindless, repetitive, bureaucratic, annual ritual. Each time you do a strategic plan or revise one you should refocus the process and do it a different way. One approach is to focus on a different set of key issues, challenges, or opportunities each time. Another approach is to hold off-site planning retreats, possible with the help of outside facilitators or external experts to provide input and a fresh view.

Eighth, you need a sufficient time (both elapsed and calendar) to carry out this creative process. To use an analogy, you don't often write a good poem by sitting down and doing it on Thursday afternoon between 3 and 5 p.m.

Ninth, you need to be sure that you manage to the plan.

Tenth, you need to consider how you are going to carry it out before you decide upon the plan.

Getting on with it

To summarize, real strategic planning is sorely needed in the insurance industry during these turbulent times. The required thought process is a big jump from long-range planning, because what is usually required is much more than simply tuning up strategies that worked well in the past. Instead, it requires coming up with clever new strategies that give you a sustainable position of advantage. Strategic planning is essential, but it isn't easy. It requires foresight to scan the business environment, objectivity to assess the organization, creativity to come up with candidate strategies, wisdom and courage to choose, vision and patience to implement, and persistence to monitor and adjust. It's a team effort to which actuaries have much to contribute.

Those companies who find a way to do it well will prosper in these times of industry upheaval, and those who don't may face a more tenuous future. It's time for each organization, in its own way, to get on with it. And it's time for you to mobilize and make your contribution.