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FINANCIAL SERVICES COMPANIES

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Exploration of the strategic thrust of some companies to offer a wide range of financial services and products, including insurance, mutual funds, investment and financial advice, loans, leasing, stock brokerage, savings and checking accounts, real estate services.

- o Identification of financial services companies
- o Products and services
- o Distribution systems
- o Competitive advantages and disadvantages

MR. HOWARD T. COHN: I think our keynote speakers this morning set the stage for us perfectly. We could not have done better if we had written their speeches ourselves. Consequently, I am going to move directly into our program. We have three distinguished speakers who are going to discuss this subject.

Our first speaker is a guest of the Society. Joe Plumeri is an Executive Vice President of Shearson/American Express. He is Shearson's Director of Marketing and he is going to tell us something about Shearson and American Express' long-term strategy in the development and expansion of their financial services.

MR. JOSEPH J. PLUMERI: What I'm going to talk about is the whole subject of change. As I talked to various panels across the country such as this one about financial services and about changes, it was interesting to me how many people I have talked to actually do not understand the changes that are going on in the financial services business. In many cases, they resist those changes. So I will begin my remarks by sharing with you one of my favorite letters, one that was written a long time ago but one that probably epitomizes what is going on in this country as it relates to financial services and to the kinds of things that are happening that make drastic changes in financial institutions and the way business is done.

> "Dear President Andrew Jackson:
>
> The canal system of this country is being threatened by the spread of a new form of transportation known as railroads. The federal government must preserve the canals for the following reasons:
>
> 1) If canal boats are supplanted by railroads, serious unemployment will result. Captains, cooks, drivers, repairmen and

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lock tenders will be left without means of livelihood, not to mention the numerous farmers now employed in growing hay for horses.

2) Boat builders would suffer and tow line, whip and harness makers would be left destitute.

3) Canal boats are absolutely essential to the defense of the United States. The Erie Canal is the only means by which we can move the supplies so vital to waging modern war. As you may well know, Mr. President, railroad carriages are pulled at the enormous speed of 15 miles per hour by engines, which in addition to endangering life and limb of passengers, roar and snort their way through the countryside setting fire to crops, scaring the livestock and frightening women and children. The Almighty certainly never intended that people should move at such breakneck speed.

Signed,

Martin Van Buren
Governor of New York
April 1829

Despite Mr. Van Buren's fears and concerns, the world did go on. People did, in fact, prosper, and canal boats became museum pieces. But, we all adjusted and were able to go forward and lead our lives quite healthfully. Basically, there is no difference between this letter and the resistance a lot of people are having to the notion of financial services and the breakdown of traditional institutions in our business.

First, I will define what financial services are about. Financial services, in essence, is the taking of a financial asset. It is the management of that asset. It is the transfer of that asset. It is the access to that asset. It is the protection of that asset - insurance, accessability through automatic telemachines, checking accounts, and credit cards. And enveloping that entire definition of a financial asset is credit and credit information that is associated with that definition.

The three reasons why financial services have come about are as follows:

1) During the course of the seventies, the consumer went through an incredibile stress test. Because of inflation, interest rates, and all of the kinds of things that went on during that decade, financial services emerged at the end of the decade. The consumer had to become more sophisticated simply from the point of view of survival. And, as a result of that, emerged value and discounting. They have emerged as a mood in this country that suggests "I am not going to buy it unless I am absolutely convinced that I get what I pay for. And there are too many alternatives now that I understand I can go to to be able to get that value." A sophisticated consumer means that the designers of products are going to have a heyday in the decade of the eighties.

2) Bank deregulation. In the absence of deregulation, brokerage firms would not be able to sell the kinds of banking-related products that we sell. Banks (and savings and loans) would not be able to get involved in the discount business as they have in the course of the last three or four months.

3) High technology. Irrespective of how big your company might be in the financial services business, you need two things to be able to compete in that business. First, you need to have a great deal of capital to be able to create the products that are necessary within the definition to be able to deliver them. More importantly, to be able to deliver those products, you must be able to integrate them. This takes a great deal of refinement in your technology, so you need the money to create the products and you also need the money to create the technology that integrates all of those services together. Therefore, technology plays a big part. However, if a company does not understand that in agreement with that technology must be a great deal of high touch in terms of the distribution that it has, then the high technology is not worth it.

To be able to share with you a strategy that American Express and Shearson/American Express is going to employ, I must be able to share with you the axioms that we are guided by. I come from a business, the brokerage business, that has always been perceived by most people as being the business of the purchase and sale of stocks and bonds. When I began in the business sixteen years ago, I had five products: stocks, bonds, commodities, tax shelters and mutual funds. Three out of those five products, depending upon the stage of the game of development, were not saleable. In 1966-67, commodities, for the most part, were for weirdos and freaks. That is to say you had to have a high emotional level to participate; it was very risk-oriented. Mutual funds, later in the sixties, were waning, not waxing, and tax shelters were scandal-ridden. The only reason people bought tax shelters was because they could get a five or six to one write-off , while forgetting about the investment value completely. You begin to understand, as you look at those things, how people felt about investments and viewed brokerage firms. We are in a business today where we have over 265 products. Our biggest problem is being able to educate the consumer as to what we do. Invariably, as I meet people and they ask me what I do, I tell them I am with Shearson/American Express and immediately I'm asked: "How is the market? I used to play the market." It is an interesting perception change. Not only do we suffer with the challenge of being able to define what we do, but so do the other people who choose to participate in what we call financial services.

The current environment has placed new pressures on the individual. There is a crisis/loss of confidence in security of traditional safety nets, i.e. the things that people thought were secure and safe, the products that were offered by traditional institutions, simply do not work any more because I took my pencil and I put it to the paper and that makes no sense to me. That addresses the sophistication part. The new products/options have led to conflict-opportunity contrasted with anxiety and confusion, i.e. on the one hand I understand that with all of the competition that is being developed out there, I am going to be offered so much more than I had before. The anxiety and the confusion comes in being able to separate from

the crowd what is best for me from what is available to me. I have a great deal of confusion, so to take advantage of everything that is afforded to me now as a consumer, I must be able to understand where to go, what to do, and what is available. The consumer recognizes a need for information and expert advice.

If I am confused and I am anxious and I have the inability to understand or clarify what is going on in the marketplace, I need to get information to be able to help me. The whole computer age that is going on now is nothing more than an amplification of that need so that a company must be able to recognize information. We use the word "information" in a different term. We like to think of that in terms of education, because as you go through your formulation of your strategy, you must be able to educate people as to what is going on.

There is now a new connection between practical and emotional needs. Financial well-being is a process rather than an event. There used to be a time in our culture, prior to the eighties, where people would make an investment or borrow money or buy an insurance policy, and it would be an insulated piece of investment purchase. It was done unassociated with anything else. People constantly say I bought something from this guy a few years ago, but I don't know what I bought. Sophistication has made for people with the ability to understand that they want to be part of this process now which is ongoing. They are beginning to understand that their life insurance policy may, in fact, be related to their mortgage, and their mortgage might be related to their bond portfolio, and their bond portfolio might be related to their stock portfolio, and on and on. That was not the way people felt before. These were isolated little events that took place in their financial life.

People used to talk in terms of money as net worth. Today, they talk in terms of money, financial security and comfort as self worth, and there's a big difference. That tends to support the ongoing process of "I want to be involved on a daily basis with my money and what it's all about."

There are strong desires for personal involvement, control and attention. People want advice that is right for them, not what's selling this week. When they buy something, they want to understand why they bought it. They want to understand what it is related to in their other investments. They want to make sure that they bought it because they need it. This had not been the case in our society. Marketing, at least in the brokerage business, has always been a misnomer. We never sold anything to anybody because they needed it. When I was a broker, I called people on the phone and said: "I have this terrific stock. Dividends are terrific. The earnings are terrific. The price is at its low. I think you ought to buy it. Take 1,000 shares." That was the nature of the brokerage business. It's a much different environment now, which I suspect relates to the fact that in those days, with an inflation rate of 2% and a prime rate of 2 1/2%, nobody concerned themselves with need. The legislation in terms of taxes was not as confiscatory or as confusing as it is today, so who cares about need? All people were concerned about then was greed - the American Way. Now, they want someone to say to them: "I care about you because I cannot care about you and sell you something you do not need at the same time." They want someone to want to make them smarter at controlling their investments.

They do not want to give you money where you control it and do what you think is best for them. They want to be involved. There is an ongoing process here which tends, in a lot of degrees, to upset the notion of financial planning.

They want an advisor or a consultant, not a money manager. They are willing to pay for good service and advice. As you are developing a strategy in financial services, this tends to suggest the following: "If you make me feel that I am buying what I need, that you are concerned about me, and that you give me value, which comes by information, education and my ability to understand what I am doing, then I will pay for that. But, if you do not give me what I pay for, I will leave. There are too many other alternatives I have at my disposal." Therefore, in any financial services organization, as you begin to understand your own strategy, you must be able to formulate in your mind that you must give value. Then, the notion of selling things through the mail by direct response seems to be abolished when there are other alternatives that people can have by virtue of better and cheaper products, where at the same time they are able to talk to a human being.

There are three classes of individuals in terms of the market segment. First, there is the elite, which is approximately 3% of the population, with incomes in excess of $65,000. There is the affluent, which represents about 5% of the population, with incomes of $35,000-$65,000. And there is that segment which we characterize as the mass class, with incomes between $25,000-$35,000, which represents about 15% of the population. Each one of those selected, targeted audiences requires different things. If you try to address all three of those market places with the same distribution system, you are suggesting to yourself that you can be all things to all people. By virtue of the chronology of those segments and the income disparity of those segments, it is insane to suggest that one could apply one distribution system, a plethora of products that that distribution sells to all three of those segments, and make people feel that you are concerned about them. The idea of one-stop financial shopping is a myth. It cannot work. We have never seen a company that has tried to be all things to all people being able to prosper. But, it can be done by uses of new distribution systems that are different than what we had traditionally been used to.

The conventional wisdom in terms of that research suggests there is not one company good at everything. From that, the strategy that evolves is that at Shearson/American Express, we have 4,300 financial consultants - we do not call them account executives; we do not call them investment executives; we do not call them stock brokers. We call our people financial consultants because that is, in reality, what they do. At Shearson/American Express, we want to approach the classes that represent the 8% of the population that is affluent and elite. The reason for this is that because of the plethora of financial products available, this category needs and is desirous of financial services. They need and want the help at that level on a very personalized basis and should get it. We feel that the clarification and confusion in the marketplace is only going to come from the relationship that two individuals have: the one who represents the financial institution and the one who represents the client. To be able to do that professionally, you have to recognize who your segment is.

You do not go up to people and say that I am concerned about you. That is like going up to somebody and saying that we should be friends. Or trust me. Assume that you take Shearson/American Express, Merrill Lynch and a bank. You asked fifteen questions to people. Assume that questions 3-15 are tangible, volume-oriented questions like: "Who has more products?" When you see the lines, the bank line comes out to here. You will see the Shearson line come out to here and Merrill Lynch will go through the wall. Now, when you are trying to create a strategy, it makes no sense to fight the battle on that line or any one of those tangible, volume-oriented lines. If you ask questions one or two, things become very interesting. Question one is: "When you buy it, do you really feel that you need what you bought?" And the lines go like this: very close; they almost touch. The second question is: "Do you feel whoever sells you these things is really concerned about you?" The lines are close again. So if you are going to fight the battle, are you going to fight it down here? That is crazy. There are 11,000 guerillas at Merrill Lynch every day with 300 products. (My best friend is also the Director of Marketing at Merrill Lynch.) I am not going to fight the guerillas!

If you are going to develop a strategy, where is the high ground? The high ground that the research suggests is not down here where we play the game that my product is better than your product. The high ground is what no one has taken yet and it is to make people feel that they buy it and they need it and you are truly concerned about them. If you want to emerge successfully in the financial services business, that is where you have to fight it. Did you see the paper this morning? Did you see how many IRA ads were in there? You talk about bore and confusion! How do you fight along those lines? You must understand that people want to be informed and educated. People who have taken the time to educate me have told me they are concerned. They took time to explain things to me. Hopefully, if the educational process goes well, it will graduate into advice, because I will always go back to the font of widsom when I need the advice. We did it with professors in college and we have done it all of our lives. If backstage takes place correctly, it will graduate into a relationship between a client and a financial consultant. That is the strategy which Shearson American Express has in terms of its financial consultant force.

How do you handle the mass class? These people are not desirous of financial services. You must be able to provide products to that group with the same basic characteristics of concerns and needs. Being lower scale does not necessarily mean that group does not have the same concerns and needs as everyone else. To address those needs, you must develop a different kind of a delivery system that still includes human beings who are able to deliver financial products that make sense for those people at that stage of the game. The products could be mortgages, because they are the first important financial purchase for an individual in the 20-30 age bracket. You need to have a distribution system different than your financial consultant force to be able to do that. Then, you are really not trying to be all things to all people by the same person. You are creating strategy for delivery systems that enable you to do that.

MR. COHN: Thank you, Joe, that was great. What a relief to know that we still have 92% of the population to work with.

Our next speaker is Peter Walker. Pete is a Director of McKinsey and Company. What is interesting that I have learned about McKinsey is that while a few years ago, they had separate consulting groups for the banking industry and for the insurance business, those two groups today have been combined into a single financial service consulting group. That gives you some indication of how impressed McKinsey is by the changes that are taking place in our business.

MR. PETER B. WALKER: The subject I will cover is strategic thrust in financial services today. First, I will make an assertion, which is that of all of the activity going on in the marketplace today, I contend that a very small proportion of it is really strategic. There is an awful lot of activity which is just individual companies following what I would call a herd instinct in response to some basic pressures. So what I would like to do is first differentiate between those "me too" kinds of activities that are not creating any sustainable competitive advantages from a much smaller list of things that companies are working on (although few have delivered) that might differentiate them in the future. In order to do that, I would like to cover four subjects. One is to look at the forces at work that created all of this turmoil about financial services. Second, I will look at the kind of activities under which we could group the things that are going on today. Third, I will step back from those and look at some of the lessons learned, and then fourth, I will talk about some of the strategic thrusts, that if companies are successful, really would differentiate them.

In terms of forces, I put them into two categories. The first would be basically responding to operating pressures. The life insurance industry clearly feels under enormous operating pressure because of the changes in interest rates, the increases in lapse rates and, in general, an erosion of the fundamental economics of its core business over time. It is much more pronounced in the products that are being marketed today than is actually reflected in the reported earnings, where you still have a nice cushion of that old book of business that is still in force.

The banks are going through exactly the same thing. The banks, for years, had a free ride with interest-free deposits where the customers they had to worry about were those who were aggressive enough to go to passbook savings. Now, they are paying close to money market rates for those same funds. Banks also have learned over the course of the last five or six years - not learned but gotten used to - growing their operating costs at 15-20% per year. There is an enormous amount of momentum to that cost base in the banking industry, because it's driving their earnings down. It will drive them down in 1983 and it will put them under the same kinds of earnings pressure as an industry that the life industry is facing. Property/casualty industry had in terms of its basic macroeconomic factor, its capital and surplus, $5 billion in 1950, $12 billion in 1974, and over $50 billion today. That excess capacity is putting enormous pressure on pricing in the marketplace. Property/casualty companies that were used to return on equity figures in the low to mid twenties in the late 1970's are looking at a decline in four years from 23% to 15%; last year 10%; this year close to 5%.

Every one of these industries is looking out at the others thinking they are disadvantaged from an operating point of view when, in fact, the entire

industry group is going through enormous pressure. The one notable exception, especially driven over the last four to five months, is the stock brokerage business, which has taken off with the volumes and the increase in stock prices.

You have the concerns that everybody has widely held over very different forms of operating pressure and over perceived external threats. Looking at the Pru/Bache combination, American Express/Shearson, Sears/Dean Witter, and at the size of the customer bases and the capital bases they bring to the market, you have to be concerned. We know that deregulation is underway and assume that because we have had operating problems, the others probably have greater strengths than we do. You cannot pick up the paper without reading about another new product being introduced, another consolidation in the marketplace, another acquisition.

Therefore, there are two fundamental forces that are very powerful: operating pressures that are internal and perceived external threats. If you look at the activities that companies have been going through in response to these, you can put them in a couple of different categories. Joe mentioned one, which was proliferation of product. By any measure, the number of products in the marketplace and combinations of products has increased many times over just in the last five years.

The second is a search for more efficient channels. How many career agency companies have not gone through the exercise of looking at the investment required to grow one career agent? They have compared that with the present value of future profits at today's margins and basically said we can grunt and groan all day long, but we cannot make those numbers work. So everybody is discovering the brokerage business. Everybody is discovering direct marketing approaches. Everybody is looking for joint ventures with other financial institutions - anything to find a way to get the product out cheaper. You have to shift and search for lower cost channels. The same thing is true in property/casualty, where you find independent agency companies increasingly looking for ways to go direct or to get ownership pieces of agents. Also, you find banks that are saddled with a terrible distribution system in the form of branches. They are saddled with high cost brick and mortar and unresponsive tellers. What they basically need is electronic banking and they are moving to it quickly with ATMs, but they are saddled with their own form of albatross.

Also, there is technology, where everybody is trying to get in front of the other guy by being at or close to the state-of-the-art and capitalizing in a way that is unique.

The last area is acquisitions. How many life companies have acquired brokerage firms or taken pieces of brokerage firms from a well-conceived strategy as opposed to "we better get one while there is still one out there and we will figure out later what we are going to do with it?" What did they pay for it? If you compare the present value of future profits they can expect to get from those account executives with what they paid in terms of multiple of book, it is a pretty tough equation.

These two forces, internal operating pressure and the external threats, generate activity in channels, products, technology, and in acquisitions.

Over the last five years, what are some of the lessons learned from this activity? Products are not today and never will be a source of sustainable competitive advantage. When no one had discovered the brokerage game, there were companies who really were product leaders and could count on a six month, nine month, or even twelve month head start on competition. Now that everybody has been committed to careers discovering brokerage, the product lead time is probably measured more in weeks than it is in months. How many CMAs are there in the marketplace today? It is just too easy to copy. Nobody has a patent on product.

In technology, the same thing is happening. Basically, what we are finding are companies investing enormously to be state-of-the-art and paying a multiple of what it costs to go with the industry solution that trails closer and closer on the heels. Sometimes, those companies that have gone state-of-the-art have locked themselves into hardware and software that gets quickly outmoded and very expensive to fix. Therefore, technology is hard for me to see as a source for competitive advantage.

How about just capital? Again, it used to be, especially in the property/casualty business in the mid-seventies, that anybody who had the capital had a clear competitive advantage because they could do things that others could not afford to do. Today, all three of these major industry sectors are absolutely awash with excess capital. If you look at the life companies today and the real value of the capital that they are sitting on and put it to the test of "let's not invest any of that capital unless we are going to get a good return", you have far more capital than you really have attractive investment outlets for from an operating point of view. Property/casualty, as I mentioned, has $50 billion capital and surplus. They could probably be handling the risk that is out there today with half of that. The commercial banks are sitting on $120 billion of capital. *Capital has become a commodity.*

What I feel will be <u>the</u> principal battleground is distribution. What will differentiate one company from another over time is going to be explained by distribution. A very simple analogy is a property/casualty business, a commodity product as these others are becoming - automobiles and homeowners. That business sold through independent agents has a commission rate of 17%. Through Allstate, State Farm, closer to 10%. Through USAA, 4%. Group auto, 1-2%. And if you just look at those shares over time, you see they are moving all in the direction of low cost distribution. The more commodity-like the product, the faster that move. In terms of convenience to the buyer, this is again totally explained by distribution. The personal trust and relationship Joe was talking about. That is not institutionalized. That is the person on the front line who is doing it. This is what I see as the principal battleground and one where the life industry, if you pit your distribution muscle against the banks or against the property/casualty business', you look pretty strong. You have an awful lot of people who have been selling a product that people do not understand, do not think they want, do not think they need in large numbers for many years. Banks cannot come close to saying that. The property/casualty industry cannot say that. But, it does require a capacity for change that is probably unprecedented in your history. So, again, going back to the outline, there is an awful lot of flurry of activity in different areas. But, the one area where companies ultimately will be able to differentiate themselves will be distribution.

What are some of these strategic alternatives that are likely to be that win? I will break the market broadly into corporate and personal.

In the personal market, the most attractive market is that broad other 92% of the marketplace. I think you can take that top 8% and put it aside. It is overcrowded. There are so many people being pushed into that small battleground. It just does not make economic sense for the rest to go after it as well while ignoring the other 92%. Let's go back to that 92% and think about the different kind of channels that are out there. One that has enormous long term promise and is basically up for grabs is the distribution of individual products through the employer. I am not talking about group underwritten products, but simply employers offering the convenience of payroll deduction. The support of the employer is given, which represents the individual employee's interest with the carrier or the financial institution, while making those commodity-like products available to the employee on a low cost basis. Look at what is happening in terms of the trends on flexible benefits, the introduction of IRAs, the growing momentum in group auto, which, for years, people have put down as they will never solve the tax problem. It is not a tax problem. The fact is there are property/casualty companies today growing very rapidly in group auto by just going to the employer and saying: "You can offer your employees automobile insurance 10% cheaper than they can get it in the marketplace by doing it through you with these minimal commissions." And employers are able to offer that "benefit" to their employees at no cost.

That is a battleground that I see that will be very important and one ultimately the banks will clearly set their eyes on much more so than individual distribution. Anyone who has stood in line at a bank for a half of an hour and been told they are in the wrong line does not have to worry about that group of people being effective one on one sales people. They are absolutely at ground zero. But, on the other end of the spectrum, with their relations with corporations, banking products have led the route towards unbundling that we are now seeing in group insurance, the introduction of TPAs, cost containment specialists and property/casualty. As a consequence, they know how to sell and market unbundled products. They have better relationships with the Chief Financial Officer. Also, they have formal relationship management marketing programs that are far better wired up than what the insurance industry has. (In Japan, over 50% of the life insurance is sold on the employer's premises by individual agents.)

The second area in the personal market that is a major area of opportunity up for grabs is what I would call "value-added wholesaling." This is not simply making the product available to someone who controls a customer, but meeting the needs of the person you are wholesaling through in a unique way that will enable you to build a tight relationship and compete on the basis of simply product and cost. Now you can look at areas like credit insurance, where that has been happening for years. American Bankers and others are very effective at working the S&L and bank market on a relationship management approach. Those same kinds of opportunities are available in other markets.

Another area under personal insurance is direct marketing. We have all been tired to death by getting buried in paper when we come home at night from the stuffers. The only institution whose stuffer I will read is

American Express, because they have, over the years, set a quality standard in what they do through that vehicle that is very high. That is an area where the insurance industry is relatively at the neophyte stage and where for years has just been throwing out tons of paper while accepting 1/2 of 1% to 1% response rates. The economics just does not work.

In the corporate market, we basically see a business owner market that is absolutely wide open. We see the GECCs of the world. We see the banks when they go national. We are looking at independent agents who have relations with those business owners and the upscale life companies - all coming from a different point of view while business owners are confused, harried and do not understand. They would love to find a way to consolidate those relationships for somebody who can deliver it on the front line. If you look at the number of small businesses out there, it is an enormous market opportunity.

Once you get to the middle and corporate market, you are back to unbundled products and services, relationship management and professional selling skills at the employer level. Again, that is one where I see the banks as having a pretty big head start on the insurance industry. In closing, in looking at all of these opportunities, less than 1% of what's been done in the marketplace over the last five years is really strategic in terms of building sustainable competitive advantages along the dimensions that I have been talking about. The rest is everybody thinking that because they are moving much faster than they used to move, that they are thinking strategically and making strategic moves. In fact, the market is just moving that fast and everybody is essentially playing a "me too" game.

MR. COHN: Thank you, Peter.

Our next speaker is Paul Finkel. Paul is a Vice President and Corporate Actuary for the Reliance Holding Group. He is going to give us still a third perspective on this issue.

MR. PAUL A. FINKEL: We tend to look at the financial services industries along strictly legalistic lines such as life insurance, property/casualty insurance, banks, thrifts, stock brokers, real estate brokers, title insurance, mortgage insurance, mortgage brokers, etc. However, almost all of these legal entities offer a broad spectrum of services which are designed to reach identical markets. Consider the range of the life insurance products.

On one extreme, working towards the center, I would place SPDAs, variable annuities, universal life, and variable life. These are the "invest the difference" portion of "buy term and..." Looking at the other end of the spectrum, I would put group life, group health, and group dental.

One end of the range of the products is primarily designed to meet individual investment needs. The center is primarily for insurance needs; the other end is for group or corporate needs. Life and property/casualty companies have long been thought of as sister industries and multiple line companies have been around for a long time. Yet the spectrum of P/C products hardly overlaps the life spectrum. Personal lines such as homeowners and auto are not inconsistent with individual life, and both types of

insurers can write A&H business. Yes, workers compensation has life contingencies. But, consider general liability and commercial fire, for instance. There are few, if any, examples of products competing directly with each other. The property/casualty range of coverages has less in common with life products than the range of services offered by thrifts, retail bankers, retail stock brokers and realtors.

The most similar products are the money market mutual funds, money market funds offered by banks and thrifts, time deposits and SPDAs, which are competing directly for the same savings dollar. The similarities of these products far outweigh the differences. The selling features which differentiate the products are those that are uniquely provided to that separate legal entity such as tax deferral, FDIC coverage or the ability to offer guaranteed returns.

Many other products from these diverse legal entities compete with or complement each other on the retail or individual sale level on the wholesale or corporate level.

In addition, the distribution systems compete with each other. The goal is either to reach the customer first - for instance through real estate brokers - or to have the best control over the customer through credibility of service. Perhaps banks lead in this regard.

It has become necessary, when doing competitive analyses, for the various sectors of the financial services industry to look closely at each other. It is logical that for product design or marketing purposes, companies have considered acquisitions or joint ventures. This is in part for offensive reasons.

However, most of the movement toward creating a financial services supermarket is for defensive reasons - in particular, to provide increased sales to help cover overheads or to increase the salesman's income. How much do you as actuaries price for maintenance of a life policy? $15? $20? $25 or more? We spend this sum annually in order to collect premiums by preauthorized check on a fixed day of each month with relatively few exceptions.

Consider a bank where the customer makes deposits or withdrawals, writes checks and transfers funds from one account to another at the time and place of his own choosing. How much must this cost per annum? Now place the activity in Citicorp's New York City branches with high rent and overhead. It's no wonder that banks are considering two alternatives, both defensive in nature:

1) Either withdraw from retail banking, as Bankers Trust has done; or

2) cover the overhead of the branches by offering more services and sales to that customer waiting in line.

Unfortunately for our industry, the banks have chosen the wrong additional products to sell. They think that customers, after waiting in line for a teller, will then line up at a kiosk for discount brokerage services, or life and homeowners insurance. What the banks should do instead is to use

the pushcarts similar to those on every corner of Philadelphia or New York selling hot dogs and pretzels to those queuing for their banking services. That would quickly generate sales.

Regardless of whether the reasons are for offensive purposes or, as I believe, defensive purposes, other financial industries are after our customer base and are willing to sell life insurance to them.

The full financial services supermarket will not corner the entire market, but it will garner a share of it. Kroger has just announced that they consider their experiment sufficiently successful so that they plan to have financial services centers in more than half of their 1,200 grocery stores.

We need not join the full financial service race. But this decision should be reached only after assessing the threat to our own natural markets. If we choose not to compete with a full range of products, we should be certain that our companies are positioned to continue to grow in spite of the changing marketplaces.

Reliance Group Holdings, my employer, has adopted both strategies:

a. We have a fleet of companies which at present offer several different financial services products; and

b. We are trying to both protect and expand upon our distribution systems.

Reliance is now a private company owned by Saul Steinberg and his family. The group of companies grew out of acquisitions based on stock in a computer leasing company, Leasco, which is now dormant. Our group includes several financial services companies, although by far our largest company is Reliance Insurance, which with its property/casualty subsidiaries ranks as approximately the 25th largest in the U.S. It is a national agency company selling through independent insurance agents. We are also in life insurance, title insurance and mortgage insurance.

Unfortuantely, Reliance was fifteen years ahead of the times. In 1968, Leasco unsuccessfully attempted to acquire the Chemical Bank in addition to its holdings in Reliance Insurance. Shortly after that, Citibank tried to acquire Chubb but was thwarted by a change in the one bank holding company laws. It is this law that is part of the Maginot line of defense preventing bank and insurance company mergers.

In addition, Reliance owns 25% of two large savings and loans, 40% of a large insurance broker and 7% of a stock broker. These large equity holdings are designed to position us so that we can expand into other financial services fields if it is felt that it is needed.

Although we own four different types of insurers and have a large investment in two S&Ls, Reliance has experienced little additional business which we can directly attribute to our being able to offer a comprehensive range of insurance products.

The second strategy of protecting and expanding the distribution systems is one that all of us should do. A major key to success in our business and most others is an effective, efficient distribution system or systems.

Reliance is a firm believer in the independent agency system of selling property/casualty insurance. We recognize that the direct writers in particular have made large inroads. However, we think that there is a natural marketplace for independent agents.

Our large position as a national broker is not incompatible with support of the independent agents. In addition, it could give us the ability to control a distribution network should the national brokers accelerate their acquisition of independent agents.

Thus, we feel that Reliance is well situated to maintain our position in the retail business. Our ability to reach the individual purchases of insurance could remain regardless of the success of the full financial services companies. If not, we are part way along the full services path and could complete the task, if need be.

For those of you not wedded to a single method of distribution, the strategies for protecting your market share without having to have all products for all people could be more creative.

Joint ventures with similarly sized companies in other financial services fields could be put in place. Banks, thrifts, stock brokers and mutual funds are faced with the same problem, especially as fewer of them remain independent. Product specialization is another alternative.

Expertise in an area should be more of a marketing benefit than company affiliation. Merrill Lynch has owned Family Life since 1974. However, most of Merrill Lynch's insurance sales are placed with other carriers.

Similarly, marketing specialization would be of value.

There are disadvantages and risks associated with restructuring a company in order to provide a broad range of financial services. The cost of being able to provide this broad range of products may outweigh any advantages. The financial services industries have cyclical earnings patterns that are very similar. 1981 and 1982 were bad years for all of these businesses. Acquisitions are rarely self-financing and the cost of buying companies could put a strain on the balance sheet and, in particular, on cash flow, if subsidiaries have low earnings or regulatory dividend restrictions. Baldwin United is one of the most diversified of the financial services companies with ownerships of S&Ls, banks, life insurers, property/casualty insurers, insurance brokers, and a trading stamp company. Its financial piano is badly out of tune at least temporarily and in great part due to the cost of an acquisition, in this case, of MGIC.

Furthermore, are the advantages of having a full range of services ethereal? Does a sufficient volume of additional sales occur to warrant the extra cost? We at Reliance have not been able to measure that and most of your companies out here offer and sell a wide range of insurance products. If you look at the distributor - many in our case is the individual agent-you will find that in spite of having a wide range of products, his sales are at a very narrow range of products. Almost invariably, no matter how professional he is, his pet product will fit the needs of all of his clients. The ability to sell a broader range of products may not increase an individual salesman's productivity.

The financial services companies probably have very little influence on the retail customer. Do New England Mutual's life agents have sufficient credibility to sell their customers common stocks? Can an S&L sell automobile insurance to its depositors? In my opinion, the answer to these questions is "a little." This gives me comfort that monoliths, single line companies, can survive in the retail business. Department stores appear to be the dinosaurs. Their market share has been badly eroded by the specialty boutiques on one end and the discounters on the other. Articles seem to imply that the only survivor in the department store business may be the big firm such as Macy's.

However, the potential entrance of banks into the insurance field has me concerned in the corporate market. Bankers often have the credibility and almost invariably the financial muscle to have their corporate clients listen to an explanation of other services which the bank could provide. The banker can open the door for the insurance expert but cannot make the sale. Usually this entree is sufficient if the product is competitive enough.

The real threat may be in this corporate market and could affect the group writers and property/casualty companies far more than the incursion of other financial services industries which, to date, has been almost entirely in our individual markets.

MR. COHN: Thank you, Paul. Who would like to have the opportunity to ask the first question for this group?

MR. GARY CORBETT: Mr. Walker, I believe you suggested that the lead time in technology was shrinking. This may happen in the future, but we are a long way from it for the forseeable future. I suggest that technology can still be a considerable advantage.

My second comment is related to the question of how effective banks can be in the personal market. Some people have very good experience with banks and some people have very poor experience. If the banks keep their branches alive, they might be very effective at marketing commodity type insurance products.

MR. WALKER: Responding to the first comment, I would draw a distinction in technology between: 1) those companies that have over time had a culture that is very much driven towards operating efficiency and have been superb in how effectively they are able to operate them; and 2) companies in property/casualty like Safeco and USAA, that have clearly gathered a competitive advantage that is very much rooted in the people and the disciplined approach to management. I was responding instead to companies that have always been in the middle of the pack administratively and never particularly strong in terms of their expense management skills. They are reaching out for a competitive advantage by trying to be the first on board with the next new transaction processing system or data base management capability. If they are looking for the advantage in the pure technology itself, my supposition is that they are kidding themselves and they are going to pay a lot more for it. That is very different from replicating the kinds of discipline that Safeco has had over the years.

On the banking side, I would agree that there are banks that have a good personal touch. They tend to be smaller local banks that do not have a "look down on the retail market" attitude as the larger banks do. They tend to keep people in place simply because they are in a community. But, it is hard for me to imagine that the great economic pressure the small banks are under is going to leave them a very viable threat. If you look at the retail capabilities of the big banks, they are far from a personal touch.

MR. WILFRED A. KRAEGEL: Perhaps each speaker might respond to a question on one stop services. What are the major forces (and there relative importance in the future) that lead individuals toward one stop services and those that lead them away from one stop services?

MR. PLUMERI: I do not think that there is anything that can lead people to a well that distributes everything. Within a market segment, you can possibly be most things to some people within that segment. If there is anything that will draw them to your well, it is probably value. I think that you must demonstrate to that segment that you are offering value. You cannot fight a battle by saying that your products are better than their products. But the individual distributor of the products can be the one that exudes value by virtue of the concern that I spoke of. There must be value added that will tempt individuals to possibly do more of their shopping in one place.

What will lead people away from that well is just the opposite effect. If you do not give me value, then I have no reason to pay through the nose for what you are charging. For example, in the stock brokerage business, we have traditionally peddled stocks. This has made up for most of the revenues in our industry. With the advent of discounting and other alternatives, it is pretty easy to suggest that the affiliation that I have with the individual that represents a stock brokerage firm is only one that gives me the ability to buy or sell stocks. We understand that we are not going to be right all of the time so it does not make a great deal of sense to confine our relationship to simply the purchase or the sale of stock. Because, if I do that, at one point in time, the consumer is going to say "I will go to my bank" or "I will go to my savings and loan" or "I will go to my discounter. I will pay 70% less and will buy $200 worth of research every year." "Why should I continue to do that business and pay through the nose because I get no value?" So I think that the ingredient is value.

MR. FINKEL: I think we all have to recognize that no one marketing system is going to capture 100% of the business. We would be foolish to think that a supermarket approach would not make in-roads. It would have some success. The forces towards people going to a supermarket are convenience and public awareness - a supermarket can advertise. Look at the shopping mall. You need an anchor store - maybe a department store that draws you there. The boutiques could not survive without the drawing power of the supermarket.

The forces against them are what we have been talking about. People want more personal services; they think they are getting some expertise by going to a store that specializes in one item. There is a market of people that just prefers to arrange for that. Certain stores obtain business simply by

advertising or letting it be known that they are the most expensive and the most exclusive. That, too, has a natural marketplace. I think we try to come up with an overall cure for how to get the 100% - but on the 8% or the 92% of the market, we are going to find ourselves arguing with each other. I think the answer for each of us is to choose what way we want to market and what section of the market will remain there. Then, either consider the supermarket approach or the specialization approach. It is pretty obvious to me that as the laws change, you can have in the very near future one source offering virtually every financial services product. We are going to have to recognize that and combat it as we see fit.

MR. WALKER: From the customer's point of view, the two major factors would be convenience and, on the negative side, concern about objectivity. It is really an issue that is much more driven by the distributor than it is by the customer. Customers, really met with someone who is able to deliver the full range competently and who has a strong enough relationship to make it credible, could probably be very effective in that environment. But, the obstacles on the distribution side are almost insurmountable because there is a question of both the competence and capacity of the individual sales person and a question of their own motivation. With all of these forms of distribution, the effective ones are driven by the desire to make money. People become good at selling certain products to certain markets.

MR. ARDIAN GILL: I would like to ask Mr. Plumeri and Mr. Walker a broad question about a narrow subject. The subject is direct response. The comments that I noted were Mr. Walker's admiration of the American Express quality image. It is the one envelope that he opens. It shows people the neophytes and it shows that a 1/2 of 1% response does not work. I used to open the American Express envelopes because I could not distinguish them from the bill, but I have now learned to distinguish them by the heft of the envelope. Now that I have a complete set of inaugeral letters and commemorative plates, I no longer open them. The questions are:

1) Does the American Express quality image still work? It seems to me to violate one of the tenets mentioned that the price is a little high.

2) If 1/2 of 1% does not work, what does? What does American Express get in the way of a response and are there any examples in the insurance industry of companies that are non-neophytes and have discovered a way to make it work?

MR. WALKER: With respect to American Express, all I can say is that just two months ago, I bought a set of binoculars for the opera and that my sample size is literally that small. What I am saying is that I do not even look at the other stuff. Maybe it is because when I open the bill, it catches my eye. I actually read down and have bought things, but I do not have any feel for what their statistics are in terms of response rates or what their overall economics are. However, I am familiar with some other companies' economics of merchandise through the mail and it is a pretty attractive business. In part, the margins are better. Also, the nature of the products being sold is much more tangible than that of an insurance product. On the insurance side, we have spent some time looking at direct response. I have been overwhelmed by the number of players and the lack of success, except in situations where there is very strong sponsorship. We

also had occasion to look at some of the direct response heavyweights in the merchandising side. Some have a data base management capability that will enable them to store all of the demographics on the customers. They will know the buying patterns by age of people and will be able to produce and send catalogues out to families with kids in the age range of 8 to 10, a month before their birthday, of the kinds of the things those people buy. I just compare that with the relatively indiscriminate blanketing of the marketplace with product offerings and see a pretty big gap. This does not mean that within that huge population of people in insurance who have played at direct response, there are not a couple who probably do it far better than the others. They are those who have probably specialized in it. But again, as a comparison with some of the other kinds of merchandisers, they seem as a group to be fairly weak.

MR. PLUMERI: Thank you for your purchases. We appreciate it a great deal.

The direct response business or the direct marketing business which American Express is in is different. American Express has always been in direct marketing of things on a monthly basis through its monthly statements. There are approximately 144 million monthly statements sent out to individuals in the course of one year. The response on the course of a given year is about 1/2 of 1%. On 144 million pieces, it becomes a very big business. I think that the quality aspect has a great deal to do with the way people perceive you as a company. That is the reason why American Express does a great deal of business in direct response on a monthly basis. When I was referring to direct response, I was referring to the financial services business distinguished from selling things over the mail. I do not believe that you can sell financial services through the mail. I think you can do direct marketing of financial services. You can educate through the mail. You can tell them what business you are in through the mail. But, making a point of sale through direct response by a piece of paper without any human connection is going to become a very difficult thing to do. That is what I was alluding to. I will give you an example. We have been notorious in the brokerage business to stuff our statements at the end of each month with a sales piece. This month it might be IRAs, the next month it might be corporate bonds, etc. It was sales-oriented. Our response rate on a monthly basis was less than 1/4 of 1%. What we have done recently is to put a newsletter into those statement stuffers, which is nothing more than an educational piece. It sells nothing. It simply tries to inform and educate people as to what is going on. At one point in time as that educational process increases, what we will hopefully find is a point of sale on a product that picques the interest of the need. Before we started doing that, the response rate was less than 1/4 of 1% that on a monthly basis. On our newsletter, we get in excess of a 3 1/2% response. One series of cassettes talks about real estate - generically. Another talks about municipal bonds - generically. Another one talks about capital markets - generically.

MR. GILL: I want to pick up on one of the points Mr. Plumeri just made that you can educate by mail. There is one company that I think is successful in direct response in the insurance business by following exactly that principle. With Academy Life, the first response is really to an invitation to become educated. The mailing is the education. Only if they respond to that is there any transaction.

MR. PLUMERI: That is what I define as direct marketing rather than direct response.

MR. ROSS J. HANSON: I think that Mr. Plumeri has just discussed what my question was going to be, but I am going to ask it anyway. It seems to me that the product part and the technology part are manageable things. There are things we can get our arms around. However, the distribution thing is really difficult, and you mention, Mr. Plumeri, the fact that there must be an awareness on the part of the financial counselor as to what the real need the individual has. We must have a perception that the real need that he has is being taken care of, and I agree with that 100%. The thing that I find difficult is where do we find the people who can do that? There are 8 to 20 million households in the United States that come within your affluent class. My knowledge is that of the people in the distribution systems, very few of them can really do what you just said very well in large numbers. It seems to me that what you just spoke about is a good rule, i.e. maybe the distribution of financial services is through large scale education. Then the buyer goes to suppliers and makes his own choice regardless of what the supplier has to say to him. I think those 8 million households we are talking about are a lot more sophisticated than the salesman in the vast majority of cases. In other words, I can make a better choice and lots of my friends can make a better choice than can the person offering that service to me, providing we know what is available.

MR. PLUMERI: I agree with everything you said. What I agree with most profoundly is the fact that once you recognize that you need to have different distribution systems, there is a financial consultant who addresses the needs on a much more upscale basis and then there is another individual who can also distribute products for individuals who do not need the kinds of sophisticated products because they are at that stage chronologically or financially in their life. I will make another distinction, also. Most people have not come to the realization yet that you need to have new non-traditional distribution systems. That is argued constantly, especially in the brokerage business, because people constantly talk about the fact that if you try to create a whole new approach to distribution with individuals who are possibly salaried vis a vis commissions, there is no way in the world that you can maintain the sales force that you have and pay them a commission when you are going to get another thousand people that you create and pay them salary. That is one argument that you have to overcome. The second one is the real problem. Where do you find these people? Like all of us, as representatives of companies, we recruit constantly in colleges and universities. I have never seen so many graduates coming out of business schools or graduate schools wanting to become involved in the financial services area simply because it is much more expanding than it was before. Secondly, you can take a lot of people who have traditionally been trained in the insurance business, for example, who could do very well in each one of those distribution segments. It is the way you train them. Thirdly, there is a difference between the distribution, which we consider to be people, and tools to help the distribution process. The education through direct marketing, measured media, and CMA types of accounts is nothing more or less than a tool to help a relationship. You have to provide tools so that individuals conceptually know where to go with the money. The distribution is people. The distributor is not an expert in the financial services business. You cannot sell 290 products and be an expert at every one of them.

MR. COHN: Thank you, Joe. I want to thank all of you. You have been a patient audience and we appreciate your participation.