RECORD OF SOCIETY OF ACTUARIES
1985 VOL. 11 NO. 4B

INDIVIDUAL LIFE INSURANCE AND ANNUITY PRODUCT DEVELOPMENT

Moderator: DONALD R. SONDERGELD
Speaker: IAN M. ROLLAND

MR. IAN M. ROLLAND: I cannot stand here and tell all of you, as product development actuaries, how to develop products. It's been a long time since I've done any theoretical actuarial work. We do spend a lot of time on product development at the Lincoln, and about the only admonition I give to the product development actuaries is to build into products at least a 15 percent return on investment so I can satisfy my responsibility to the shareholders. But, I thought I might be able to talk to you from the perspective of a chief executive officer of a major life insurance company about some of my views on what will separate the winners from the losers in our business in the future. Then I will talk briefly about how I think that might affect you as product development actuaries.

It's no secret to any of you that the environment we operate in is becoming more and more complex all the time. It's more competitive, it requires us to do everything we do better than we did in the past, and some of the methods of operation that got us through in the past are not going to be adequate in the future. We are going to have to pay a lot more attention to the basics of our business.

At the Lincoln, we have identified what we think are a few key factors for success. We hold them up to our employees and say we think these are factors we've got to concentrate on if we're going to be one of the best insurance companies in the business, and if we're going to return an adequate profit to our shareholders. We identified only a few items and kept them relatively simple because we think every employee in the organization should adhere to these and participate in our success. So let me tell you what these three key factors for success are.

First of all, we think the winners in our business will be the low-cost producers. Secondly, we think the winners will be market-driven organizations. Thirdly, we think the winners will demonstrate a willingness and an ability to adapt to change.

Which companies today, in our business, have some kind of sustainable market advantage? That is what we all try to achieve; we try to have something that somebody else can't copy or emulate, at least not easily. You think about who you believe has that kind of advantage in the individual life market, in the group insurance markets, and in personal lines property/casualty insurance. You have an idea of who those companies are, I have my own. The ones I have in mind are all companies that give a great deal of attention to putting out a product at the lowest possible cost.

Now, why is this a critical factor? A major reason is that low-cost producers have a lot of choices that simply aren't available to others. They can make decisions to reduce prices and expand market shares and still earn reasonable profits. Or, they can make decisions to maintain prices, maintain market share, and take high profits. The high-cost operations don't have those choices. The low-cost operations have a variety of choices, and they can vary those choices to meet market conditions.

Another reason we think that being a low-cost producer is particularly important in our business is that insurance is something that's very close to a commodity. I think all of you probably know as well as I do that producing a product, or a service, that somebody else can't copy in our business is pretty difficult to do. It's not all that hard to change the name on a policy form and file it with an insurance department. In fact, I recall a time at the Lincoln National when another company took one of our policy forms, put their name on it and filed it, and forgot to change the reference to Fort Wayne, Indiana, in the text of the policy. So our products and services can be copied rather easily--but not always correctly.

Those of us who got into the universal life market early had a market advantage for a short period of time, but it didn't last very long. So getting a sustainable market advantage because of the design of our products and services is very difficult. In that kind of an environment the winners are always the low-cost producers. So we think this is a key factor for success.

Now, how do we try to achieve that at the Lincoln National? I think there are a lot of approaches to it that depend on the company's management style. At the Lincoln, we think that we need to approach this on both top-down and bottom-up perspectives.

The top management of the company has to make it clear to everybody in the organization that productivity improvement is an important corporate objective. Then ways must be found to involve all the employees in the effort to reduce cost. Cost reduction has got to be a way of life for every employee in the organization. Management needs to find ways to give them incentives to take an interest. At Lincoln National, we try to do it through a program we call Quality Commitment, which makes extensive use of quality circles where all employees are involved in finding better ways to run the business. We believe that it's the people who do the work who can best identify how to get it done better, or more efficiently. If one can simply bring them together and give them incentives to participate, they will come up with ideas on how to do things much better than ever thought of in the past. The knowledge that exists among the grassroots employee population must be unlocked.

Additionally, top management has to have a commitment to do something about cumbersome and bureaucratic management structures. In our business, and I think this pertains to U.S. business across-the-board, we are over-managed. We have too many layers of management. The issue here is range of control.

To the extent that the range of control each manager has can be expanded, the layers of management in an organization can be cut. I hear too often that a particular individual can supervise only one or two people because this person is an individual producer; I don't dare overload him, or her, with management responsibility. A lot of management theory indicates that five or six reporting subordinates are about all an individual can handle. I don't buy that. I personally have between 12 and 14 people reporting to me, and I don't think it's a burden for others to try the same thing. To the extent one can do that, one eliminates management overhead and, believe me, it's excess management overhead that increases costs the most severely.

Arbitrary cutbacks and one-shot cost-reduction programs are not very effective. A lot of companies have tried these. They bring in consultants to tear up the organizations to produce staff reductions. Then the consultants leave and the organizations are left in turmoil and disruption. Furthermore, employees don't think they've been a real part of the process--and they often think they've been wronged in the process. Over a period of time, the same inefficiency will creep back in. The key to being a low-cost producer is to make every employee understand the need for him or her to be part of the effort, to get them to pay attention to it every day of the week. It's difficult, it takes communication, but it can be done.

I also think that success in being a low-cost producer involves taking a very hard look at the way products are distributed. That particularly relates to the agency system. It's my view that the agency system in this industry will be under severe attack in the future, and we are going to have to find ways to make it more efficient. We need to find more ways to help our agents sell more business and become more productive individually. As product development actuaries, you have been faced with the need to reduce commissions in order to be competitive in the marketplace. You deal with pressure from agents who feel they are not properly compensated, and you deal with pressure from the marketplace to cut distribution costs. You've got to figure out the right balance between the two. I think that struggle is going to become even more important in the future. So, the agency system will become an increasing focus for productivity improvements.

Next I think a company must make technology work for it. We need to find more innovative uses of technology to help us market products and increase volumes.

Now let me talk about being market-driven. Market-driven, in my view, first involves knowing what your market is, then knowing what markets you really want to serve--up-scale markets with incomes over a certain level; lower, middle-income markets; large businesses, small businesses. You've got to know what kind of markets you are tying to serve. And you in the audience, as product development actuaries, realize that we must know what our customers in those markets want. It's no longer good enough for us as actuaries to design products and hope they'll sell. We need to know up front what our customer's needs are and put out products that meet those needs.

So, I think each phase of operation needs to be undertaken with the customer in mind. The customer is our reason for being in existence. Too often we have felt that we were doing our customers a favor by selling them products. But we must understand that everything flows from our ability to meet customer needs. So, we must go to extra lengths to satisfy the customer.

Success in this area depends upon everybody in the organization being market-driven. For example, your telephone operator deals with customers directly, and that customer's view of your company may depend on the operator's attitude. Also, we've got to get the idea across that everyone of our employees has some client relationship. We sometimes think that staff departments are not in contact with the customers. Maybe we think the agents and people who work in sales are the only ones who are in contact with customers. But even employees who work in staff departments have client relationships. Our lawyers have client relationships. Our data processing people have client relationships. How they serve their customers has a significant influence on how we interface with our final customer.

Sometimes I hear it claimed that being market-driven is at odds with being a low-cost producer. Some say that one can't produce products or services at a low cost if worried about being market-driven. Some people say that there is a trade-off between low cost and quality. I don't believe any of that. I think a market-driven strategy is supportive of being a low-cost producer because it results in a highly focused, and therefore very efficient, strategy. I think we also have to keep in mind that lower unit costs can be achieved by higher volumes, sometimes more easily than by lower expenses. Lower unit costs are achieved not only by keeping expenses in line, but by building volumes to produce those low unit costs.

Toward the goal of adapting to change, I think one of the hardest things I've had to do is create an environment in which people feel comfortable with change. But ability to change is an absolute key factor in being a low-cost producer, and in being market-driven. Selling those two concepts absolutely depends on a willingness to change the way we do things. It is easy to observe examples of companies in the U.S. that have relied on their past successes for far too long. They figured that what was going on was pretty good, and they would stick with it. Look at how the steel companies are still floundering because they didn't update plants. They didn't change operations. The Japanese and Koreans did. The automobile industry is changing now, but it was in trouble for a period of time because it simply wasn't willing to change to meet the market.

In our business, a lot of us stuck with nonpar permanent whole life insurance policies that had marvelous built-in profit margins; the only problem was that nobody would buy them. We stuck with that too long. Look at our sales organizations. We may think sales volumes look pretty healthy, but we may later encounter a problem with replacements.

So we've got to be willing to examine everything we do. We must be prepared to make changes even when things are going well. Sometimes those changes are high-risk changes, but often that's where the biggest payoffs are. So, it's necessary to focus on things that are going well and not simply on the problems.

It's natural for people to resist change. Change substitutes the unknown for the known and none of us likes that. Change also reduces the value of experience, and that's a problem for a lot of us, particularly those of us who have been around for a long time. People don't know whether or not they will be able to succeed in the changing environment, and some don't, and that's got to be dealt with.

Since we need to create an environment where change can take place, it's absolutely essential to communicate with all employees to make sure they understand the reasons for the changes and the direction of the company. Finally, the process of change must be backed up with a planning system that can do a reasonably good job of anticipating the changes coming down the road. That planning system has got to be handled by operating people, people on the line who are responsible for running the businesses, and not people at the corporate staff level. Planning has got to be an integral part of running our business; our managers must constantly look at the environment and respond early to those changes that might become crises.

So, low-cost producer, market-driven, change-oriented, are what we at the Lincoln National think are the three key factors for success in almost all the businesses we're in. This has implications for product development actuaries because product development is not the exclusive domain of actuaries. It must be a participative process, a process in which the actuary, marketing and market-research people all participate. It has to be a joint effort to produce products that are truly market-driven. The products will have to be developed strategically; that is, based upon a real knowledge of the markets you are tying to serve, who your customers are, and what those customers want. That's being market-driven. I can't think of any group in our companies that need to be more sensitive to the marketplace and to our customers than those who design our products. The market-driven concept must be a key factor in everything you do.

Also, it is clear that in this environment of rapid change, products you design have to be flexible. You've got to meet a variety of customer needs and must take into account the fact that those needs will probably change over time. Products have to be flexible to meet those needs. One of the strong selling points of the universal life product is the fact that it is flexible. I think flexibility is a more important factor in that product than the interest-rate credits. Flexibility in a product is what will sell it in the long run.

As you design your products, the changing needs of customers must dictate products that can be changed or modified easily. Products will have a short life span. Just a few weeks ago, I experienced a fair amount of frustration in my own organization when I was told that we could not respond to needs for changes in our products that the marketplace was demanding because we didn't have the computer systems to support the changes. We just can't put up with that kind of environment any longer. We cannot be driven by inadequate, or inflexible, computer systems, nor inflexible procedures, when putting out products and services that our customers want. The companies that can't respond will lose out. They will lose sales, they will lose the commitment of their agency forces, and they will lose the commitment of their customers. So being change-oriented and market-driven certainly is a key part of everything that a product development actuary has got to do.

It's going to be up to you, who operate in a more complex environment, to interface with many more people in the organization than you've probably been used to so that you come up with products and services that truly meet the strategic needs of your organization. If you put all that together, then success is going to be yours, and you will have a lot of fun doing it.