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SOME OBSERVATIONS ABOUT CONGLOMERATE MANAGEMENT

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Editor's Note: Mr. Neuschel, a senior partner in McKinsey & Co., originally presented these remarks at a recent insurance management symposium. The editors welcome him as a contributor to these columns.)

Reduced to its simplest terms, success in the new game of conglomeration, acquisition, merger, diversification, or whatever other name you wish to call it depends, of course, on how well a company *selects*, and then *manages*, one or more acquisitions. Probably more than 90% of all life insurance companies have yet to make a major move in this game. The special difficulty of the game is that, with each succeeding acquisition, it becomes less and less feasible for top management to understand, let alone get deeply involved in, the operation of each company.

Yet the acquisitions have to be assimilated, they have to be monitored, and they have to be made profitable. And for this reason, those who are playing the acquisition game—and playing it successfully—have had to learn new techniques and systems and approaches to managing in order to compensate for the limits of their experience to date, as well as for the natural limits of human stamina, memory, and ability to supervise a large number of activities at one time. Most of what my colleagues and I have learned about the reasons for outstanding performance versus disappointing or lack-luster performance in this whole field can be summarized in the form of some four, or five ground rules or guidelines.

Need for Planning

First, develop a well-thought-out, clearly expressed *strategy* for growth through acquisition. Or stated another way, the companies that have been most successful in this area *buy to predetermined specifications.* That is, they acquire according to some rational plan and set of objectives, not just expediently or as a reaction to opportunities to buy.

Development of this sort of strategy means reaching agreement in advance on two elements. First, what are the company's *quantitative growth objectives* and the *alternative means of achieving them?* Answering this key question requires, in turn, the answering of underlying questions like these:

(a) What's a demanding but realistic *growth-rate target* for both return on investment and earnings per share? And, what should your company seek in terms of "*investors' gains*"—that is, the combination of an improved price-earnings ratio as well as increased earnings per share?

(b) Next, what contribution toward these targets can be expected from the company's present businesses and from any related businesses that may be in the planning and development stages?

(c) What then is the "growth gap" —so to speak—that must be filled by the acquisition program?

Second, after defining these sorts of quantitative growth objectives, the other element in the overall strategy takes the form of an *acquisition theme*—i.e., the industries in which acquisitions will be sought, the rationale behind that industry grouping, and the criteria that will be applied in the selection of specific acquisition candidates.

But, whatever the approach, the great advantage of having this sort of well-articulated growth strategy is that it forces management, in advance of any acquisition, to think through quite specifically what it plans to do with the acquisition, how that move will contribute to the company's growth objectives, and what—realistically—*it can pay* for the contemplated acquisitions. Without this sort of planning, most companies are, by default, forced into dealing with their diversification moves largely as investments. This is seldom, if ever, a means of acquiring a good company, or of making a sound acquisition.

Nevertheless, neither the industry, the background of the individual company, its motives, the type of synergistic potential, nor any other of its outward characteristics seems to make the critical difference in determining success or failure. What then is left? Only one thing —*the quality of management.* This is where the real secrets of success lie. Here's where the men are clearly separated from the boys. And here's where some very definite similarities among successful acquirers set them off sharply from the unsuccessful.

Before we consider what some of these similarities in management technique are, I'd like to observe that this critical ingredient of management excellence poses a particularly sobering problem for the life insurance industry in its move toward conglomeration. The reason for this observation lies in the hard but unavoidable fact that a number of forces in life insurance company operations tend to inhibit the development of management skill instead of promoting or stimulating it.

This doesn't mean for a moment, of course, that there aren't lots of outstanding executives in the industry, because there certainly are. But what it does mean is that these inhibiting forces in the industry must be recognized realistically and fought against continuously if you're going to generate the supply of well-rounded, fully effective executives needed to carry out the complex and demanding management job that's so critical to successful growth through acquisition.

Let me mention just four of these inhibiting forces — four conditions that we might label "barriers to management vitality" in the life insurance industry.

(1) As the first of these factors, *the long lag between cause and effect* in the industry is certainly a fact of life. This acts as a barrier to management excellence in that it tends to conceal mistakes and also makes the need for change less evident.

(2) A second barrier to management vitality is the *difficulty of measuring a life insurance company's performance* in a tangible, meaningful way. The mutual companies, of course, lack the harsh measure of profit and loss that's continuously applied to most other types of business. But even the stock companies suffer a somewhat similar lack. Here again I'm thinking of the long lag between cause and effect that I just mentioned. That is, even in the stock companies, the measurement of performance is difficult because of the long interval between the making of a decision and the determination of its outcome—for example, the profitability of a new type of contract.

(3) Another significant internal force is the tendency toward *rigid compartmentalization of function* that exists in many insurance companies. This may—

(Continued on page 5)

Conglomerate Management

(Continued from page 4)

in part, at least—grow out of the fact that the organization of an insurance company is largely composed of a number of important professional specialties—actuarial, medical, legal, investment, etc. Without necessarily intending to do so, the personnel of such groups become concerned chiefly with their own professional pursuits and often fail to give adequate attention to the influence of their activities on the operating costs or effectiveness of other departments. As a result, the development of people tends almost automatically to take the form of growth in technical knowledge and experience rather than growth in business judgment and broad-guaged managerial skill.

(4) The final fact of life that tends to inhibit management vitality is the *lack of executive mobility* in your industry. This is not true of most other types of business. In our consulting work, we see a continuous movement of key executives from one industry to another—from an extractive business to a manufacturing business, from banking to manufacturing from manufacturing to transportation, from durable goods to consumer goods, and so forth. One of the great advantages of this sort of mobility, of course, is that it helps to prevent inbreeding. It ensures that fresh points of view and experience are continuously being brought to bear on management methods. Conversely, without this sort of cross-breeding, it's much more difficult to bring about a continuous, healthy challenging of traditional practices.

In the face of these and other similar forces that might be cited, there's little question that management excellence is more difficult to achieve in the insurance industry than it is in many other types of business. And so, in face of this difficulty, those who embark on any sort of acquisition program are just going to have to work that much harder to make sure that they *do* "bring to the party"—so to speak— the management skill and vigor and imagination that, by all odds, are the most critical prerequisite to success.

Effective Acquisitions Management

Management excellence isn't achieved simply by recognizing the need for it, nor just by "taking the vow" to do better. It's achieved only by the thoroughness and consistency with which key executives carry out the major elements of the management process. From my experience and that of my colleagues, let me enumerate briefly some of the key steps the most successful acquiring companies take in their assimilation and management of acquisitions. All these steps can be grouped into four categories which represent the basic management elements that any well-run enterprise applies routinely to all its operations—i.e., *organizing*, providing *leadership*, setting *objectives*, and exercising *control.*

Let me give you a few examples of how these basic elements are applied to the management of acquisitions. In the area of organization, virtually all the conglomerates that have travelled farthest down the growth-through-acquisition road have reorganized their top-management echelon to cope with the problems of managing an acquisition program. Several of these reorganizations have come out of bitter experience. In the 1950s, some companies embarking on this path attempted to have their presidents and operating vice presidents double as acquisition program managers. The result was to overburden these men and to neglect the management of operations in the original business, while at the same time giving insufficient time and effort to the management of the acquisition program.

More forward-looking companies have realized that the function of managing the existing business should be separate from that of managing the acquisition program. And this objective has typically been achieved in either one of two ways.

One way is by splitting the top job into two jobs such as Chairman and President, or President and Executive Vice President, or Chief Executive Officer and Chief Administrative Officer—with the former member of each pairing concentrating most of his time on overall direction of acquisition strategy and allocation of resources among the company's businesses; while the latter concerns himself principally with the operation of the original company.

The second way in which this organization need has been filled is to set up some other top-level executive to handle the job. Typically, he might be called something like Vice President for Corporate Development, but, whatever his title, he and his staff concentrate full time on planning and executing the acquisition program.

The second element of the management process to which the most successful acquirers have given attention involves the caliber of leadership and motivation that is supplied to the acquired company. Let me give you some examples to illustrate the great range of diversity this ingredient can take. A long-standing part of the approach of one conglomerate is that it devotes a good deal of top-management time to each acquisition right after the purchase. Typically the chief executive of this company spends up to two weeks divided between the headquarters of the acquired company and traveling with the acquired company's president to meet its customers.

Another Method

Another successful acquirer seeks to increase the motivation of the acquired company's management team by "frequent exposure to the parent company's management philosophy," (John Kitching, "Why Mergers Miscarry," *Harvard Business Review*, Nov.-Dec., 1967; Vol. 45, No. 6). An executive of this company, in describing one such effort, said this: "We just kept on meeting with them and communicating our ideas on growth. And finally they stopped thinking about plateaus, and started thinking about mountains."

Looking at the reverse side of the coin we find that unsuccessful acquirers tend to focus their initial communications efforts on assuaging hurt feelings and allaying fears. By contrast, the successful acquirer acts decisively to create a vigorous and constructive atmosphere for change in the acquisition. In effect he says clearly: "This is what our program consists of, and here are the reasons why it makes sense for you to get on board."

And as one final illustration of the motivational element in this whole process, many successful acquiring compa-

(Continued on page 6)

Conglomerate Management

(*Continued from page* 5)

nies have set up executive incentive compensation plans tied to profits or return on investment—often by explicit formula. However many different forms this part of the acquisition-management process might take, they all add up to providing an intelligent, vigorous, know-where-you're-going brand of leadership that creates a strong atmosphere for change throughout the entire company as well as a feeling of confidence and enthusiasm among the key executives in the acquired organization.

The third element to which management of successful conglomerates gives attention is that of getting the newly-acquired company to adopt quickly the parent company's approach of planning and control so that the acquisition can establish sound operating objectives and other performance criteria, and so that it can also furnish to the parent company the kind of management information that will enable the later to exercise meaningful control.

This requirement, as I suspect some of you have already found out, poses a particularly knotty problem for most life insurance companies that are about to embark on the acquisition trail. The reason lies in the present condition of the planning and control processes and management information systems in most life insurance companies.

The extremely detailed schedules of the convention statements give life insurance executives the illusion that they possess a fairly extensive system of financial controls. But, the liquidation-accounting approach required by state insurance departments places minimum emphasis on information needed to manage the business. In addition, few if any life insurance companies have identical accounting systems. And so even two life insurance companies in merging find it difficult to consolidate their systems. In light of this fact, it's almost inconceivable that a life insurance company's budgeting and management information systems would be useful for controlling any other form of business.

So it seems clear that one of the most compelling requirements that any insurance company faces in moving into the conglomeration field is that you have to develop a whole new set of planning and control tools, in many instances far more advanced than those you now use, if you're to maximize the potential from your acquisitions.

Let me—by way of a wrap-up—acknowledge that there's nothing new in the management techniques or approaches that I've outlined. As a matter of fact very little in the area of basic management principles is really new. A top executive of Procter & Gamble expressed this point well when he was asked to explain the reasons behind his company's outstanding and long-sustained leadership in its industry. His reply was this: "In the main, our competitors are acquainted with the same fundamental concepts and techniques and approaches that we follow—and they are as free to pursue them as we are. More often than not, the difference between the level of their success and ours lies in the thoroughness and self-discipline with which we and they develop and execute our plans."

Realistically, we must recognize that there's no secret weapon, no magic formula that will ensure the success of any acquisition program. The ingredient that makes the difference is probably the scarcest of all resources—good management—management which never underestimates the size and complexity of any acquisition and, therefore, never fails to invest the time, imagination and leadership that are the price of success.

In the final analysis, this is the synergistic catalyst that makes two plus two equal five—and not just three or even less, as has been the case with a number of unprofitable acquisition programs. □

Philippines

(*Continued from page* 1)

ship. Persons with an interest in actuarial work could enroll as non-voting Affiliates, and attend meetings of the Society. Commencing in 1969, the Society plans to have its own educational and examination program leading to Associateship (a new designation) and then to Fellowship.

A period of rapid formation of new life insurance companies in the last 10 years has created a sudden demand for additional actuaries. The financial difficulties of some of the new companies have impelled the Insurance Commissioner to propose a ruling that each company have its own full-time resident actuary, a condition impossible to atta[illegible] at present. Of the present 41 Fellow[illegible], 22 are with life insurance companies, 10 are with the several government insurance programs, one is in the Insurance Commissioner's office, and the others are in various private capacities. Fellows are automatically accredited by the Insurance Commissioner for certifying reserves and other actuarial data in the financial statements.

The actuaries meet quarterly for discussion of current topics, and have an annual convention at which formal papers are presented. The program committee shows a refreshing originality; the 1967 convention was held on an inter-island excursion steamer (attendance at the sessions was 100%!) and the 1968 convention took place in Taiwan (at which, alas, a quorum was not present!) Copies of the *Proceedings* of the Society are sent to the Library of the Society of Actuaries.

A continuous inter-company mortality investigation has been in progress since 1956. In 1966 there was published a graduation of the first eight years' da[illegible] covering exposures of 650,257 life-ye[illegible] (P 2,650,000,000) and 2,245 deaths (P 11,300,000). It is interesting to note that at ages below 40, the ultimate death rates are about 15% higher than for Table X-18 (the 1958 CSO Basic Table), but thereafter show a much slower rise, and run about 5 or 6 per thousand below Table X-18 at ages 55 - 65.

Other committees of the Society are gathering data on persistency, expenses, and build, and studying taxation or operations research. These present remarks are submitted on behalf of the new Committee on Foreign Relations, which hopes for an enlargement of our contacts with American actuaries, and extends to you a cordial invitation to visit us, as 10 of you have already done! □

BIBLIOGRAPHIES

The Committee on Research has in preparation Bibliographies on —

Numerical Analysis
Decision Theory
Game Theory and Gaming

These will be prepared in the Fa[illegible] and there will be a later announcement of their availability. □