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# Thoughts for Investors

## Summer Newsletter

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***“An investment in knowledge pays the best interest”***

– Benjamin Franklin

### Data>Information>Knowledge>Wisdom

A recent Wall Street Journal article stated that the Allstate Insurance Company has dramatically lowered auto insurance premiums for some owners of high performance sports cars. Allstate is now the market share leader for this category of insurance and it has been very profitable. All this was counter intuitive to Allstate executives when first proposed. Everyone understands that sports cars are bought to be shown off and driven fast, a combination your mother always said would get you in trouble. A higher incidence of accidents lead to higher claims paid by the insurance company which lead to higher premiums which lead to unhappy customers.

So, how did Allstate know to lower the premiums for many (but not all) sports car owners? How did it know that it would still make money? Stay tuned.

Corporations have spent the last decade meticulously reinventing their “back office” processes. Using a methodology called Enterprise Resource Planning (ERP), these organizations have looked at all aspects of how to make and deliver their products, including the deployment of people, the running of the plants, the use of trucks; accounting systems, inventory management systems, relationships with vendors, even how to exploit existing patents. Corporations have spent an enormous amount of time and money installing gargantuan ERP software systems. The goal was to become more productive, more efficient, more

competitive. For most corporations it has been a great success. Today’s corporations are models of productivity. In fact, even though we are well over a decade into the latest economic expansion, some have argued that productivity is still advancing at the rate it did 20 years ago. Truly a tribute to this technology.

### What do we do for an encore?

Don’t start applauding just yet. All this cost cutting and productivity enhancement has resulted in record earnings for many corporations and has indeed made them competitive. It’s kept many from going out of business, pushed out by more efficient operators. Certainly Allstate has gotten more efficient, yet efficiency did not make them a market share leader.

Companies are just beginning to realize that going forward, the most successful ones will be those that grow their revenues, or more accurately, those that show strong unit volume growth. This is a topic I’ve touched on in previous letters. By way of review, unit volume growth means selling more “stuff”. You can sell more because it’s bigger (if customers want that), it’s faster (if customers want that) or it’s tastier (if customers want that). The key is the customer and that it is better to be effective, i.e. have more customers, than to be efficient, i.e. have the lowest costs. More customers mean selling more “stuff.” Selling more “stuff” means higher unit volumes and that ultimately leads to higher earnings, which is what drives up stock prices. Focus on the customer has become the new mantra for corporations.

### Technology to the Rescue (again)

Most everyone is aware that the Internet allows consumers to quickly locate (and sometimes even purchase) the goods and services they need. From search engines to electronic catalogs to shopping “bots,” these technologies have returned some of the buying power to the customer. Companies have begun to realize that taking care of customers is priority #1 and as a result a whole new area of software has been invented. Called by a few different names, Customer Relationship Management (CRM) stems from recognition that customer loyalty shrinks quickly when one sells a commodity product such as tee shirts, pool supplies, or airline tickets. To use one advertiser’s jargon, “the competition is only a click away”. If you are a fiction reader and have purchased books on-line in the past, on-line booksellers will e-mail you about the arrival of the latest Tom Clancy novel (at 35% off the list price). Or if you’ve purchased shade loving plants from an on-line plant catalog they will e-mail you their special shade tolerant plant catalog. All this in an effort to keep you a happy customer. The new emphasis is to increase the effectiveness of the “front office” (i.e. the customer service representatives and the salespeople) as opposed to increasing the efficiency of the “back office” (i.e. the accounting, inventory management and logistic systems).

Carnegie Mellon University has started a program to interpret all the data collected by bar code scanners and turn that into information. Corporations can then examine that information within their organization and turn it into operating knowledge about their customers. Finally senior management can use that knowledge to create the wisdom to lead the company into the future.

Which leads us back to Allstate. As I said previously, everyone knows that sports car owners carry a higher risk. However, what Allstate found by analyzing the data on their sports car policy holders is that some are, in fact, very low risk. These are the ones that own another car and have families. What they found was that these policy holders use the other car to pick up

the kids and the quart of milk in the snow or rain, thereby reducing claims paid and increasing profits for the company.

In conclusion, it was this chain of Data, Information, Knowledge & Wisdom that enabled Allstate to capture the major market share of what has been a very profitable component of the auto insurance business—thanks of course, to technology.

***“If we had similar progress in automotive technology, today you could buy a Lexus for about \$2.00. It would travel at the speed of sound and go about 600 miles on a thimble of gas.”***

– John Naisbitt on the advancement of computers

## AUDI PARTEM ALTERAM

*Hear the Other Side*

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If you would like to discuss the topic of this newsletter, or our team's approach to investing, please feel free to contact us by email at [al.boris@alexbrown.com](mailto:al.boris@alexbrown.com).

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