

Gibson insurance company

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Overview Gibson Insurance Company has tasked Rebecca Hampton, the controller, with reviewing the company's allocation of corporate support costs in order to better assign the cost attributed to product lines and business units. This is important because it would help to provide better information for pricing decisions, sales compensation, and focus on areas in cost improvement. Gibson sells two categories of financial products: annuities and life insurance. They are both sold by in-house sales agents.

Gibson decided to start purchasing other corporations in order to quickly grow the company's customer base and its assets under management (AUM). GIC acquired Compton Insurance Services and Midwest Mutual Insurance Company, and although they all sold the same services, the prices and features were different. Gibson had a decision to make: keep the new acquisitions as separate legal entities, or completely absorb them into its corporate system. GIC chose to keep them as separate legal entities, and treat them as wholly owned subsidiaries for legal and financial reporting purposes.

Rebecca decided to re-evaluate the cost allocation structure. She chose to list them under 4 categories: Policy Acquisition, Customer Service, Sales and Marketing, and Corporate Overhead. All Relevant Issues Gibson Insurance main issue is its cost allocation system that allocates support costs to its various product lines based on total number of policies. This provided for an inadequate application of resources for each business unit and product line. For example, selling a new policy takes more resources and effort than maintaining an in-force policy.

Another concern is a decline in profitability although the sales volumes are increasing. This is possibly due to hidden cost problems or incorrectly set prices. After a breakdown of support cost, Gibson also had a issue with possible inefficiency of processes. Hampton felt as though they used to many resources with selling new policies. Relationships Among Important Issues GIC's current cost allocation system provides for a inadequate allocation of cost. With the true costs for each division and product line mis represented Gibson is unable to accurate set prices to match expenses of products.

This also does not allow them to identify problem areas, or inefficient processes, in need of attention. With those two issues secretly effecting the books, GIC profitability has suffered. Relationships of Case Issues to Aim of the Company Gibson's poor cost allocation and lost in profits has it wanting to develop a new allocation method. With this new method they will be able to more accurately apply resource cost and pricing to specific business units and products. After implementing the new drivers they will be able to streamline processes to lower costs.

Making these changes will allow Gibson to get to gain control of costs and by affect its profitability. New Problem Statement Resulting from Case Analysis Gibson is concerned about its current allocation of corporate support costs. Currently it feels the resources of various business units are not properly assigned. Rebecca Hampton, the controller, must come up with a new allocation method to obtain a better handle on profitability, product pricing and agent compensation, and current costs. Objectives - verifying the old or developing new based on analysis Gibson Insurance main objective is to improve profitability.

Its second objective is to better control pricing and resource allocation. To control pricing and resources, Gibson third objective is to develop a new cost allocation method based on different cost drivers. Finally Gibson aims to streamline its processes in the future to further lower cost to increase profit.

Statement of Alternatives After analyzing the case we have come up with five possible alternatives for Gibson Insurance company. First, Gibson can choose to use the newcost drivers, developed by Hampton, to reallocate costs to provide a more accurate picture of indirect costs.

Second, Gibson can choose to reanalyze cost to come up with different cost drivers also to provide a more accurate picture of indirect costs. Third, they can redivide the support services to individual business units. This will help eliminate the simple allocation issue. Only the cost incurred in each department of the business entity will be attributed to the operations of the business entity. Fourth, Gibson can separate the individual product lines support. They can have have four separate departments for new and in-force insurance and annuities.

This will dial in the cost not only to individual product cost but what status these products use the most resources. It can turn much of the indirect cost into direct costs. Lastly, Gibson can choose to do nothing. It can continue to use current method of allocation and make educated guess on what costs are incorrect and what prices are set correct. This option is not an ideal one because Gibson is currently losingmoney. After choosing and implementing one of the above options, Gibson can begin to work on underlying issues.

They can use the new cost allocation analysis to see if any area of business is in need of adjustment. It can then decide if price meets the cost demands

of division and product line. Action Plan We agree with Gibson's controller that the new way of allocating costs is the best plan of action for Gibson. Under the old system, costs were broken up by separate legal entities and product lines. Using the old method, Midwest has \$5, 087, 166 in total support costs, while Gibson has \$5, 080, 997 and Compton has \$3, 751, 837 totaling \$13, 920, 000.

The new method calls for the allocation of costs based on cost drivers, which Hampton divided into four categories: policy acquisition, customer service, sales and marketing and other corporate support. Each cost account is driven by a cost driver. Policy acquisition is driven by the number of steps required to move a new policy application to an in-force status. Customer service costs are driven by the number of incoming calls. Sales and marketing costs are driven by the number of solicitation needed to sell a product. Lastly, other corporate costs are determined by the dollar value of AUM.

The total support costs of \$13, 920, 000 is broken up into \$4, 375, 000 in policy acquisition costs, \$2, 426, 000 in customer service costs, \$4, 552, 000 in sales and marketing costs and lastly \$2, 567, 000 in other corporate support costs. The new cost allocation system allows Gibson to identify where the costs are emanating from. It helps them identify where they can cut costs and where to focus their resources to meet their aim. By employing the new system, the per units costs for each cost-driver is as follows: \$42. 20 per step, \$44. 06 per customer service call, \$10. 2 per sales solicitation call and \$14. 92 per policy for the overhead costs. Under the new system it was found that Compton has the support highest costs, as opposed to the old

system where Midwest had the highest cost. The costs for new life insurance policies makes up 40% of the total costs, which is \$5, 609, 243. However, the new life insurance policies bring in \$19, 200, 000 in AUM for Gibson. Yes, it is costing Gibson more to bring in new policies, but new customers are expensive because they take away from the profit. Therefore, we do not see any problem with this plan.

Moreover, the new plan allows them to see that the in-force policies are not costing them anything, which tells them to focus their resources on the new-policies for both the product lines. By analyzing we decided that it is definitely costing Gibson more to bring in life-insurance policies than annuities. For example, it takes five steps to complete a policy acquisition for life insurance compared to only two steps for annuities. Also, it takes them 10 extra sales solicitations per policy for life-insurance compared to annuities. We also feel that 20 solicitation calls for one life-insurance is expensive.

It costs \$881. 22 to make 20 calls and the AUM for a new life-insurance policy is only \$1500, so the profit margin is less than 60%. Perhaps they can train their sales employees to better perform each call and sell a policy with less number of calls. By doing this they will be able to cut their sales and marketing costs by 50% and increase their profits. Their total sales and marketing costs will go from \$4, 552, 000 to \$2, 276, 000 and it brings down the new life-policy costs from \$5, 609, 243 to \$4, 326, 989, which will make their product line more profitable and bring in more profits for Gibsons Inc.

Knowing Constraints - Potential Problems Gibson Insurance Company also has to deal with potential problems. If they break up the costs into individual

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processes, they could possibly spend a lot more money and time than they need to. By gathering the data and breaking it up into many costs accounts will eventually cost them more in terms of management compensation, rather than helping them save. Also by implementing a new training program we may have resistance from current employees because they may feel that they are doing their job correctly without needing more training.

Analysis' Presentation Leads to Definition of Problem By analyzing the cost structure and re-allocation the costs with the new cost drivers, we have determined that the problem is the cost of sales solicitation and, possibly, the price that Gibson is charging for its insurance policies. Develops, Justifies, and Rank Objectives Gibson has five objectives. Their primary objective is to improve their profits, which requires that they prioritize other objectives, which will help them reach their goal of maximizing profit.

By developing a new cost allocation method based on different cost drivers helps them to find places where they need control costs and resources, which helps them maximize profit. Develops and Weighs Alternatives We have listed five different options for Gibson to choose from. First option is to go with Hampton new cost drivers and reallocate cost on that basis. By choosing to go with the controller's numbers we will save time and money on research vs Option 2. After we do that we will have a more accurate picture of cost and resource allocation. This will allow Gibson to work on specific areas of cost that may be hindering the company such as the number of sales solicitations. By implementing the new training program we can reduce sales and marketing by 50% by cutting the contacts needed in half. Second, Gibson can choose to reanalyze cost to come up with different cost drivers

also to provide a more accurate picture of indirect costs. By going back and re-evaluating the drivers it would take more management resources. We would need to pull department heads off jobs and waste time possibly to return to the with same drivers that are already presented.

So by choosing the first alternative we can get the new cost implemented faster and begin work on fixing problems sooner. Third, they can redivide the support services to individual business units. This will help eliminate the simplify allocation issue. Only the cost incurred in each department of the business entity will be attributed to the operations of the business entity. This will not be ideal because it would require additional spending on recruiting new personnel including management. Fourth, Gibson can separate the individual product lines support.

They can have have four separate departments for new and in-force insurance and annuities. This will dial in the cost not only to individual product cost but what status these products use the most resources. It can turn much of the indirect cost into direct costs. This will prove to be an inefficient method of allocating cost. Gibson would need to assign more resources to hiring personnel and restructuring processes. Gibson would possibly have to redesign it entire operating process to separate its departments and consolidating its different products line from different companies under one business entity.

It would also have to deal with the backlash of current customers who may run into problems during the shift. Lastly, Gibson can choose to do nothing. It can continue to use current method of allocation and make educated guess on what costs are incorrect and what prices are set correct. This option is not

an ideal one because Gibson is currently losing money. Selects Appropriate Alternative After analyzing the alternatives, we decided pick the first alternative that calls for to use the cost drivers developed Hampton.

The costs are divided into four different costs namely, policy acquisition, customer service, sales and marketing and other corporate support. Each cost has cost driver, which decides the total cost for that cost account. Policy acquisition costs are driven by the number of steps required to move a new application to in-force status, which is two steps for annuities and five steps for life insurance. Number of incoming customer calls drive the cost for customer service while the number of sales solicitation drives the cost for sales and marketing costs.

And finally, corporate overhead costs are driven by the dollar value of AUM. This plan will facilitate the decision process for the management because it helps them see where the costs are emanating and where they better turn their resources. For example, by allocating the costs differently they were able to see that Compton has the highest support costs at \$5, 100, 202. 17 as oppose to the last plan where Midwest had the highest cost. It also allowed them to see that the in-force policies are not costing them anything in terms of policy acquisition and sales and marketing costs.

This tells them which product line is more profitable and which is not, so they focus their resources accordingly. By finding where the costs are stemming from, they will be able to better control the costs thereby increasing their profits, which is their primary objective and that is that the first alternative is appropriate alternative for Gibson. Probability of Success This action plan will be successful for Gibson because it will help the managers realize where the

majority of their costs stem from. It will also help them determine where they should be focusing their attention to.