

Simulation

The Use of Simulation in Financial Planning

Scenario Them



ScenarioNow



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Introduction

How could this happen? George couldn't believe it. He and Shirley were good savers. George had amassed over \$1M in his 401(k). They lived rather frugally except for an occasional vacation. He thought they had invested conservatively. But the evidence was clear – If they wanted to retire, they would have to scale back. “I shouldn't have kept my XYZ stock so long. What if I had diversified earlier? What if I retire at 62 rather than 60? What if...???”

George pressed the save key and then started building a new scenario. “This time I think I'll beat it,” he tells her. “Go back to the first one,” she says. “I'd rather retire two years later and help the kids with down payments on their homes.”

George and Shirley were engaged in a simulation – playing out financial scenarios with specially designed software to help explore tradeoffs for investment risk and retirement lifestyle. “There are so many issues to balance. How do most people do this?” they asked Ted, their financial planner.

When people have to buy complex products and services today, we send them to ‘an expert’. What if buying complex products and services was less like going to the doctor's office and more like theatre or a game? What might this look like?

Simulation tools can provide a very effective way to address complexity. Intuition helps us speculate what might happen. Simulation lets us play it out. In this section, we'll explore the topic of simulation, looking at the advantages and challenges it presents.

Accelerated Learning = Real Play + Virtual Play

In the movie *Groundhog Day*, Bill Murray played a news reporter named Phil Connor who got stuck reliving the same day over and over – until he got it right. Phil was a guy that couldn't be talked into changing. He was going to have to learn the hard way, even dying a few times. Fortunately, the real cost was minimal, because he got ‘do-overs’ that allowed him to step way outside the limits of his current experience and thinking – that let him learn by making mistakes. In the end, he gets the girl and finds true happiness. He's a changed man – all in the span of a single day. Just a movie you say?

David Lazenby took his 9-year-old son to the golf course. Nick loved running around in the bushes, looking for lost balls. He even took a few swings. But by the third hole he was bored, so David quit golfing and took him to the clubhouse. On the way home, they stopped at a video store and rented *Mario Golf* – an interactive Nintendo game. When David went out the following week, Nick went with him, not only playing an entire nine holes, but also showing knowledge of the game that was surprising. What happened?

During that week, Nick ‘played’ virtual golf over and over. He hooked, he sliced, he drove, he missed... and he learned. When he putted the ball into the hole, he even imitated the Mario character's expression and words.

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Accelerated Learning = Real Play + Virtual Play. Both Phil and Nick experienced accelerated learning as a result of combining real life and simulation.

Benefits of Simulation

Flight simulators have proved very useful in training pilots and improving aerodynamic design. Likewise, business and other “flight” simulators help people learn and improve processes. They do this by:

- Helping people navigate through complexity
- Visualize thinking and make assumptions explicit
- Taking risks safely

Navigating complexity. Navigating through complexity involves dealing with problems in which the results are counterintuitive. For example: Pulling a boat or other trailer behind a car may seem simple while going forward. But try backing up. The steering wheel and trailer go in opposite directions.

Many studies have shown that people’s intuition about complex problems is often flawed. Complex problems are challenging because they typically introduce too many variables for people to balance in their heads. And often the risk of mistake is too significant – like flying an airplane. Experienced pilots learn to trust their instruments. Why? Because your senses can betray you. When it appears visually that you’re flying straight, you’re actually pulling to the right. Pilots trust their instruments because when dealing with complexity trusting your senses can be deadly.

Visualize thinking and make assumptions explicit. Computer models can help us see what happens when we take our assumptions to their logical conclusion. Without them, what we think of, as thinking holistically may be nothing more than jumping to conclusions. Computer models not only help us look at problems – they are powerful tools for helping people talk about them. They allow us to visualize our assumptions and challenge/validate them publicly.

Taking risks safely. They provide new and less risky ways to test hypotheses before we act on them. They help us experiment with the consequences of our thinking.

The Impact on Selling

Why is this important to selling? Because selling is about people making and implementing decisions.

Complex decisions typically involve products and services that have:

- Longer Sales Cycles
- Higher Profit Margins

But without the appropriate tools and methods for dealing with complexity, it’s difficult for people to make confident decisions, if they can make them at all.

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The type of ‘play’ described above provides a good example of how people can navigate their way through complex decisions. They can’t think through them, and they can’t simply be talked through them – they have to play through them.

A Sales Example

Introduction: Frank was tired of the corporate game. After 30 years as an insurance executive, he was ready to go. Evie supported the move. But they had three burning questions:

1. Do they have enough to retire today?
2. Is it worth working for two more years for the extra pension and 401(k) it would provide?
3. How well will their pension provide for Evie if Frank dies?

Frank’s Story: As a senior manager, Frank’s job had its perks. His salary was good, the pension was great, and he had 8 weeks of paid vacation. Even though he felt ready for retirement, it was hard to leave. He was a good saver, but his divorce significantly reduced his nest egg. He met Evie on a cruise. And his mild heart attack last year made him think... He wanted to spend more time with her.

Frank was very concerned about Evie’s security if something happened to him. As a result, he ‘insisted’ they choose the 100% survivor benefit on his pension. But he was worried that wouldn’t provide enough income. He was resigned to working two more years to increase the benefit.

Evie’s Story: Frank was the love of her life. She worried about him hanging on at work too long. The rate of heart attack among insurance executives is almost twice the national average. She was willing to live on less to have more time with him. But would it be enough?

Scenarios. We evaluated their desired standard-of-living with different pension options. They got very excited when they saw the projections using the life-only income option, but cooled off when they realized there was no survivor benefit – the pension would stop if Frank died. An additional \$250,000 in assets would do it, but how would they fund it? Frank had only minimal life insurance outside of work and his heart attack made it impractical to consider buying enough to fill the void.

As I reviewed Frank’s employee benefits, I saw that he had the right to continue his term life until age 70. It sparked an idea. What if... we selected the life only option and continued his life insurance from work. Obviously it looked great while Frank was alive, but what if he died? The insurance helped a great deal, but it still was not enough! We played with income options and postponed touching some of their investments. Each successive scenario brought the picture closer and clearer. We found a combination that worked.

They were very excited. They were very pleased with the process and result, but they promised a ‘friend’ who was a planner that they would let him do one as well. They told me they would call me after that was completed and tell me what they decided. I thought I had lost the sale.

Two weeks later, they set an appointment to come back in. I still didn’t know the result. When we sat down, I asked how the other meeting went. They looked at each other and started laughing. The

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other advisor interviewed them and asked them to come back a few days later. When they did, they got a simple financial plan with retirement projections that told them they would be fine. And the advisor went right to promoting products. When they started asking questions, he was not prepared to respond. He offered to redo the plan. They told him they would get back to him.

The Result. Frank announced his retirement. He and Evie moved to Florida. I got a \$500,000 investment client.

What I Learned. (1) The ability to play with possibilities lead us to consider options that none of us would have looked at. (2) There is a huge competitive advantage in improving the client's sales experience. None of us had any idea what the result would look like. (That's part of the beauty of planning "live" – the element of surprise makes it entertaining.)

Summary

The world is becoming more complex. Intuition alone can get us into trouble when dealing with complexity. Combining simulation tools and a scenario planning approach helps people navigate through complexity and accelerates decision-making and learning.

In the Digital Age, understanding how to apply this to selling can be an invaluable way (and maybe the only way) for salespeople to differentiate themselves and provide value for their customers.