Additional Remarks and Comments on Global Expansion and the Impact on the Insurance Value Chain: the Reassessment of Business Models and the Revisiting of the Value Proposition by Brian M. O'Hara*

Introduction

The property & casualty (re)insurance industry is clearly in transition. Three-quarters of the U.S., Latin American and European non-life P&C companies surveyed in a recent study by the Economist Intelligence Unit and PricewaterhouseCoopers considered themselves to be in the business of providing insurance services *at the present time*. But when asked what business they thought they would be in by 2005, only 41 per cent said insurance. The remainder said that by 2005, they will have executed a shift in strategic direction and established themselves in financial services. They said they would achieve this by adapting their business models to embrace one of three approaches: pursuing new strategic alliances, combining new alliances with the ownership of banking assets, or becoming fully-fledged financial services conglomerates. This is largely a reaction to a lack of profitability and the general volatility of P&C business. However, what is needed in the P&C industry is reinvention as well as diversification.

Companies that radically alter their business models, effectively reinvent themselves. Indeed, some companies are constantly reinventing themselves, adjusting to changing circumstances and marketplace forces that demand flatter, more agile and more global corporate structures. In some situations, global business structures are not optional. For example, in the large corporate risk transfer sector, global capabilities are a prerequisite in

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order to service the worldwide needs of multi-national customers. But to be a global property and casualty player requires scale, strong credit ratings, a critical mass of customers worldwide and large net line capacity, as well as access to reinsurance capacity, a global network of policy issuance, accounting and claims capabilities, the ability to provide ancillary specialty coverages and a global brand. Additionally, such insurance companies often require an organizational structure arranged along global product lines, matrixed for easy access by brokers and customers.

Underwriting ignored

Today's organizational structures scarcely resemble those of 20 years ago. There is no driver more compelling for this change process than necessity itself, the mother of most reinvention. Property and casualty companies such as XL Capital that were formed during the hard market of the mid-1980s, were inclined to favour a one-size-fits-all approach to what was then a predominantly acquiescent marketplace. Shaped by the then prevailing shortages of liability insurance capacity, XL Insurance's mission and philosophy in 1986/87 was simple: to provide stability and to maintain a very significant underwriting capacity for third-party liability insurance and directors and officers liability insurance as well as to develop a strong corporate identity as a facility which meets the needs of large risks with heavy liability exposures. There was no mention of relationships and professional solutions tailored to client needs. Soft markets and increased competition in the mid-1990s soon demonstrated the shortcomings of the one-size-fits-all model as companies adopted a relationship-driven, customer-centric approach to their business. Encouraged by the leading consultancy firms, (re)insurers focused almost entirely on pleasing their customers and ignored deteriorating underwriting and exposure.

For many (re)insurance companies, control of functional, product line and geographic divisions has required the development of matrix management models, the success of which can vary widely from company to company, dependent largely on levels of expertise in implementation. After the decentralization trend of the 1980s, many companies are also suffering from considerable duplication of effort and are increasingly turning to shared-service organizational models to combine the economics of centralization with the superior service and customization associated with decentralization. A shared service centre, essentially a separate organization within a corporation that provides internal support services for all business units, typically provides human resources, finance and IT services to internal customers.

Of course, there is not a single ideal, prescriptive business model and it is rare to find an organization applying any one business model approach in its purest form. Most organizations are hybrids. Because each model has specific strategic advantages, companies often try different models at different times. Some may even use a combination of business models at the same time: one for a particular marketing campaign, one for sales distribution, another for research. Strategy is not the problem. Most companies strategize without much difficulty, developing a clear vision of where they want to play in the value chain: full service retailer, manufacturer, distributor or processor. The tough part is not deciding what to do but knowing how to make it happen. Knowing, for example, when to re-underwrite and give up near-term growth in underpriced markets in return for long-term sustainable results.

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The challenge of the mega-corporations

However, in the cyclical and volatile insurance space, one of the biggest challenges facing property and casualty insurance companies, even those that are accustomed to reinventing themselves periodically, is the challenge to develop a robust business model that will allow them to respond meaningfully to the catastrophic risk transfer needs of today's mega-corporations. Consecutive waves of consolidation activity have meant that risk is increasingly being concentrated and premiums diluted. As a result, for many mega-corporation accounts, the (re)insurer's spread of risk has become inadequate and invariably the mega-corporation's self-insured retention is too low.

Consolidation in the customer base of the (re)insurance industry associated with these changing risk dynamics have altered the risk transfer value proposition. In the past eight years, value has been delivered not by design but by providing service below cost out of an overriding desire for customer retention and market share.

Risk transfer products, attachment levels and capacities available to these huge corporations are based largely on pre-consolidation calculations which use underwriting considerations developed to enable risk transfer to take place in primary layers. But most mega-corporations, for example, in the fields of energy, chemicals, automobiles, consumer products and financial services where consolidation has been particularly acute, need to transfer their catastrophic exposures not their expected losses. These companies have a vastly-expanded capability to retain risk in these expected loss ranges.

Yet the property and casualty (re)insurance market is still working from a pre-consolidation model. Just as ACE and XL were invented as a result of a combined effort by insurers, insureds and brokers to address the changing value proposition of the mid-1980s, so a new paradigm is now needed to address the emerging risk transfer challenge posed by the mega-corporations.

New proposition needed

The business model that might best respond to this situation may be one that allows or encourages the formation of consortia between policyholders, brokers and the risk transfer professionals. Only in this way can a new paradigm be spawned that enables the ultimate risk-takers to accept greater ultimate exposure to risk. Thus the old customer win/(re)insurer lose proposition, which inevitably leads to further reductions in the availability of risk transfer capacity, could be replaced by win/win.

Part of the mega-corporation challenge will lie in finding a way to change the practice, inherent in our marketplace, of developing short-term business relationships between customers and (re)insurers. Any new value proposition for meaningful coverage and capacity for a mega-corporation will almost certainly require the development of a new relationship dynamic, one which is built on a long-term partnership rather than the currently accepted market practice in which risk transfer pricing is pre-determined for the life of a 12-month policy. Instead of the perceived exposure to loss for the next 12 months, risk transfer solutions could be calculated based on the reality of experience gained during a five- to ten-year horizon.

An organization's success hinges on it having a corporate culture that is built for transformation, that is opportunistic, smart and agile, that is innovative, continually learning and able to reconfigure and refine itself as challenges confront and in turn confound conventional practices.

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Business model competition

In his book *Leading the Revolution*, Professor Gary Hamel argues that the unit of analysis for innovation is not a product or a technology, it is a business concept. He says that the building blocks of a business concept and a business model are the same. A business model is simply a business concept that has been put into practice. Competition in financial services, communications, entertainment, education or any other field takes place not between products or companies but between business models.

Business concept innovation starts from the premise that the only way to escape the squeeze of competition is to build a business model totally unlike what has gone before. The formation of ACE and XL Capital in the mid-1980s and their creative approach to underwriting and to policy language was the result of just such a business model.

At its most effective, business concept innovation leaves competitors in a quandry: if they abandon their tried and tested business model, they risk sacrificing their core business for a second-place finish in a game they did not invent, with rules they do not understand. Yet, if they do not embrace the new model, they run the risk of missing out on a new wave and, potentially, a new competitive advantage.

Thus, the ability to first identify, then deconstruct and finally reconstruct business models is key to developing an innovative corporate culture. Successful business models must also be able to answer the question: Will the core competencies that have served so well in the past be regarded in the same light in the future? Key too is the ability to question the status quo in the knowledge that some of the decisions and choices underpinning a particular business model may have been shaped by a logic that no longer prevails. In this post-September 11 environment, that will apply to a great many business models.

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Additional Remarks and Comments on Global Expansion and the Impact on the Insurance Value Chain: The Reassessment of Business Models and the Revisiting of the Value Proposition by Jean-Philippe Thierry*

For many insurers, the preferred path of value creation is still the optimization of various links in the chain of business around the key functions of management and distribution. Today, global expansion is opening a new path of value creation, the objectives of which are to gain and retain more customers with a better response that is more extensive and of higher quality. But this path is a demanding one because it requires serious reconsideration of the value offer.

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1. Taking another look at the value proposition

To retain customers, who are better informed and have the entire range of market offers before them, the value offer of the insurer must:

- be able to cover the range of customer insurance needs at all times, turning if necessary to the products and services of specialized insurers for specific needs;
- add on services that are closely linked to insurance products, including access to healthcare networks, financial advice, prevention, loans, management of demand deposit bank accounts, etc.;
- even open up to non-insurance players (automobile, property, etc.) that include insurance products/services with their base offers.

In some cases, among them savings, the insurer could enrich his value offer with comparable products supplied by competitors providing the customer with choices at least at the same level as those offered by independent advisors and thereby remaining transparent.

The limits of the review of the offer for the insurer are then set by:

- His legitimacy in presenting the offer: co-branding may facilitate the review of the offer but raise the issue of choosing among "partner" brands compared with the image conveyed by his own brand name.
- The capacity of his network to sell the enriched offer: training and implementation of the right tools using new technologies may also enable the review of the offer, but it does not exclude the need to segment the network based on the level of skill attained by each network in respect of the new offer.
- The possibility of including the new offer in sales and management information systems: the use of the Internet, while facilitating information exchange, may also enable the review of the offer, but the review is limited by the constraints imposed by the information systems architecture of the insurer. Here, emphasis must be placed on the importance of an "open" sales system that can be connected with any business line server and also allows any rapid, inexpensive change in the offer of the insurer.

To win new customers, informed, with benchmarks, and aware of their freedom of action and choice, the insurer must present them a value offer that anticipates their expectations:

- Through his distribution network, an offer at the same level as that of independent advisors, possibly with a choice between proprietary and "external" products enriching the offer: the limit of the review will then be the capacity of the insurer's network to adopt external products; this limit may be pushed back using new information technologies that enable the insurer's network to benefit directly from tools supporting external supplier sales or by "virtualizing" the value offer.
- Through new distribution channels, an offer that can enrich the usual offer and is naturally adapted to their usual relational system with their customers. In this case, the insurer will be constrained by limitations set by various links in his value chain:
  - adaptive research and development: the ability to revamp existing products;
  - high-performing, customer-oriented administrative and claims management: "factory" or service network at low management cost and with a high level of quality;
  - management of partnerships;
  - commercial: careful selection of new networks and implementation of "win-win" policies.

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2. The revaluation of the business model

New value offers related to global expansion therefore imply offer enrichment, perhaps using the offers of other suppliers, integrating the offer into those of other distributors.

The integrated business model cannot respond to this need and therefore must be re-examined in light of three observations:

- acquiring a new business is a lengthy process, buying one is difficult and often risky; in both cases, the investment is significant;
- there is no secondary business for a company that is not the core business of another company;
- some insurance sub-markets are so narrow or specific that only a few specialist insurers can be present and create value.

Therefore, the insurer has even to select a few main businesses where it could appear more efficient to turn to a specialist insurer than to act alone and for which he becomes the distributor.

Moreover, the insurer has to choose among complementary businesses in the context of a global expansion:

- Those that offer a competitive advantage, which will have to be integrated into the core business: for example, managing banking demand deposits to support savings product sales.
- Those where it would be more advantageous to turn to an external supplier selected for the quality and competitiveness of his offer.

The insurer will then have to move from *a traditional integrated business model* toward new *"distributor" or "assembler" models*, having to prepare for and move with change in his value chain, in particular at the customer relationship management (CRM) level, after-sales management (co-ordination of actors) and leading operations (consideration of partnerships, clear separation of tools, namely in respect of management systems).

Even in his own businesses, the insurer will have to pay special attention to changes implied by the necessary enrichment of his offer so as not to make processes overly complex and retain high performing "factories". In particular, the insurer will have to favour the development of specific information tools for new business lines when they cannot be integrated naturally and simply into existing information systems. Therefore, he will opt for a group of management chains functioning side by side rather than a single, more complex system that is more fragile and cumbersome to maintain.

By paying attention to the performance of his "factories", and to innovation and adaptation capacity in research and development, this insurer will be able to participate in the packaged offers of other players on other markets and therefore use other distribution channels for finding new customers; the insurer will move away from a traditional business model toward a "manufacturer" business model.

3. Conclusion

Tomorrow the insurer will have to build *not one but several models at the same time*: "distributor", "assembler", "manufacturer", and expected value creation in the context of

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global expansion will be found in balancing and articulating correctly these different models. But success will mainly depend on three key elements:

- distribution;
- information systems architecture;
- the ability to manage different partnerships simultaneously.

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