Confronting Insurance Distribution Challenges and Opportunities

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There are few topics more top of mind for insurance executives these days than distribution, and with good reason. Insurance distribution is not simply about pushing product. An outsized share of the value across the entire insurance industry value chain is added in distribution. For customers, it is in distribution that needs are understood and assessed, options – from full risk transfer to self insurance and more exotic methods of managing risk – are identified, and counsel on which carrier(s) and other providers to select is given. For carriers, it is in distribution that relationships and trust are built with agents, brokers, and customers, opportunities identified and created, and products and services sold.

Distribution has also grown in prominence as its share of underwriting expenses has risen in the past decade. While distribution expenses may not be up in absolute terms, they are up as a share of the typical carrier's expense base, having stubbornly resisted the downward trend evident in other expense categories. Some of this is commissions, as agents are understandably resistant to having their compensation reduced. Some of it is information technology, as companies pour investment dollars into building direct channels, improving agent efficiency, and becoming the favored carrier of independent agents. There are other reasons as well, all contributing to a sense that the time has come to take a hard look at what can be done to better manage distribution expenses.

Lastly, after decades of stability, even inflexibility, insurance distribution now seems to be in constant flux. Each year, owing to retirements, mergers, and acquisitions, there are fewer agencies and agents than the previous year. According to the Independent Insurance Agents and Brokers of America (IIABA), the number of independent agencies declined from 44,000 in 1996 to 37,500 in 2008, a drop of almost 15% with no end to this trend in sight. The remaining agencies are larger, more specialized, and wield greater influence with the carriers who depend on them. In addition, there is the much reported growth in direct methods of distribution, including but not limited to Internet distribution, and the attendant costs and complexities of managing multiple distribution channels.

Conventional wisdom has it that it is only a matter of time before the traditional agent is a thing of the past. Whatever analysis exists to support this belief masks important details. The perceived trend toward agent disintermediation is far truer for simpler products like private passenger auto and term life insurance than for more complex products and customers (e.g., commercial enterprises) with more complex needs. And industry-wide trends are more relevant for large players than small ones, for whom opportunities abound even in shrinking markets. One thing that is assuredly true is that carriers will be using a variety of different methods of distribution for the foreseeable future, and what will matter as much as or more than the specific methods employed is how well they align with a carrier's own unique strategy and how good a job it does of execution.

The case studies below illustrate how two companies, facing superficially similar situations, can and should reach very different conclusions regarding what constitutes the right distribution strategy.

Case Introduction: Private Passenger Auto and Homeowners Insurance Company

Our first case example is an underwriter of private passenger automobile and homeowners insurance. Its share of the market in the region where it operated had for many years been stable at roughly 7-8 percent. The company had a great reputation with its customers for prompt, friendly claim service and rapid settlement. The vast majority of its policies were distributed through independent agents who functioned as little more than a conduit for the company's products, adding little value along the way, with the exception of agents serving non-English speaking customers who provided to both the company and its customers an essential service. The company had experimented with providing a limited set of agent and customer service transactions via the Internet but had not committed to it wholeheartedly. There was little product information provided online, and there were no sales concluded online.

The company became concerned when its market share began to drop following entry into its region by two prominent national direct writers. The new entrants were using both lower prices and an online product and price comparison service to attract customers. The company saw a need to act before the momentum its competitors were beginning to develop became unstoppable.

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Case Introduction: Commercial Lines Carrier

Our second case example is a commercial lines carrier with a long history in the industry and a reputation for finding a way of underwriting, and eventually rehabilitating, some of the very toughest commercial risks, in doing so enabling them to continue doing business. The company distributed its product exclusively through wholesale agents who functioned as MGAs. After several years of booming revenue and profits, customers had begun deserting the company in droves. At first, executives attributed the plunge in revenue to a vicious soft market that had taken hold the previous year. After noting that competitors were faring significantly better, they began to consider other possibilities. Some wondered whether wholesale agents were being disintermediated by retail agents with the willingness and ability to deal directly with carriers, though they lacked the data to know for sure.

Principles

In each of these cases, though there were other contributing factors, distribution proved central to any solution. In building an understanding of the problems faced and in formulating solutions, those companies we were guided by a few simple principles:

- Stick as close to what you know as any reasonable solution will allow. A company with a first rate information technology (IT) organization, for example, is better positioned to begin selling online than one for whom IT has been an organizational backwater. This principle is not meant as a prescription for change avoidance. It is a statement that leveraging existing strengths is a far easier and more profitable method of operating than building new ones, where the choice exists;
- Avoid overreacting to industry trends. Overreacting to trends, such as a move toward agent (retail or wholesale) disintermediation, can be as dangerous as ignoring them. Only in retrospect are the pace and significance of trends truly clear;
- Challenge each party in the value chain to deliver value commensurate with its cost. Whether we are talking about lead generation, underwriting and pricing, closing, renewal, or servicing, whichever value chain participant – carrier, broker, MGA,

wholesale agent, etc. – is capable of producing the greatest value for the cost involved should bear responsibility for it. This implies, for example, that if a company currently distributing via independent agents has good reason to believe it can attract a similar or greater number of customers online at lower cost in IT resources, it should seriously consider such a move;

Manage independent agents as you would your own employees

- Manage independent agents/agencies as you would your own employees. Companies that distribute through independent agents should treat them very much like employees. Seek to appoint the best, monitor performance rigorously, align agent incentives with those of the company, and recognize and reward top performers;
- Maintain leverage over independent agents and brokers. Maintaining good relationships is important, but maintaining leverage is even more important. Leverage can come in many forms – industry-leading products and services that are in demand with end-customers, attractive commission structures, technology and support that keeps agents highly productive, etc. Agents and brokers are a practical lot, and most will take their business to the carrier that maximizes their near-term profitability regardless of personal relationships;
- Communicate clearly the division of labor among channels. Agents, often with good reason, are very sensitive to signs that carriers may be experimenting with new channels, be they banks, call centers, or the Internet. To the extent that a division of labor exists among channels and can be demonstrated – e.g., banks will only be selling life insurance products while P&C products will be distributed only through agents – open and precise communication can alleviate both real and perceived channel conflict; and
- Monitor channel performance and maintain flexibility in case industry dynamics change. No strategy is forever. In many cases, the better a strategy seems to work, the more imitators it will attract, and the quicker the supply/demand equation will shift against its adherents. Thinking ahead means seeing to it that if one channel begins to dry up, the company has sufficient time and capability to shift its emphasis to alternative channel(s). A company long reliant on independent agents can choose to remain so in the expectation that there will always be enough customers preferring this channel, but it had better have a Plan B if this expectation proves incorrect.

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Case Outcome: Private Passenger Auto and Homeowners Insurance Company

Following evaluations of the marketplace, distribution methods, and internal competencies, the company pursued a major investment in building online distribution capability. The reasoning was as follows:

- The trend toward online sales of auto and homeowners policies was, if anything, even more rapid in this region due to its unique demographics;
- The company's independent agents, even after a significant investment in training and technology to support them, were failing, with the exception of those serving non-English speaking populations, to add value perceived not just by the carrier but by its customers;
- The average age among independent agents was 55, and few had succession plans;
- The company was noteworthy for strong IT capability, and it was a reasonable bet that Internet distribution capability could be built and maintained over the long haul for less than the cost of commissions;

- The company's reputation would prevent the trickle of desertions from turning into a stampede, even if agents did start trying to switch customers to a different carrier; and
- The company was financially strong and could weather a period of high investment during the transition from an independent agent to a (primarily) direct distribution model.

While this strategy has been in place for only a limited period of time, early signs are promising. The company's website is receiving high marks from customers. The company lowered its premiums in anticipation of lower costs, and this has helped stem the tide of defections. While the national direct writers are still growing market share, it is now at the expense of other carriers.

Case Outcome: Commercial Lines Carrier

In contrast with the distribution strategy for the private passenger auto and homeowners insurance carrier described above, the carrier chose to recommit to existing methods of distribution – the wholesale agent channel. The reasoning was as follows:

Distribution strategy is far more complicated than simply deciding which channel to use

- Analysis demonstrated that the recent drop in revenue had little to do with the distribution methods employed and everything to do with deficiencies in product design, pricing, risk selection, and how agents were being managed;
- Competitors were moving toward distribution via retail agents faster than retail agents were developing the capabilities necessary for (and large enough books of business to warrant) working directly with carriers;
- The company lacked a viable alternative for the foreseeable future, given its near total reliance on wholesale agents to perform critical tasks on its behalf; and
- Based on interviews with a number of wholesale agents, demonstrating loyalty to the wholesale agent channel seemed likely to give the company a competitive advantage over carriers who had begun working directly with retail agents.

A recommitment to the wholesale agent channel was only one element in the company's new strategy. Detailed plans were also developed for addressing the deficiencies in product design, pricing, risk selection, and agency management as well as for targeting sub-segments of the market that had until that point been largely ignored. One other key element of the strategy was to develop a set of services for wholesale agents that, should the wholesale channel ever dry up entirely, would leave the company far better positioned to explore distribution alternatives than at the time of this writing.

The new strategy has since been rolled out to the company's wholesale agents, who received it with a great deal of enthusiasm. Renewal rates began rising almost immediately, and the company is projecting a snap-back in revenue based on plans and projections from its agents.

Conclusion

Developing a distribution strategy is far more complicated than simply deciding which channels to use. This is, however, a key decision, and the cases above illustrate that there is no single correct method of distribution for all carriers in a marketplace. Applying the right set of principles is key to arriving at the distribution strategy that best meets a given carrier's needs.