Distribution: the Key to Success in the 90s (Part 2 of Insurance in the 90s)

Distribution is the key to success in tomorrow's market. But today's distribution conditions are not the same as tomorrow's. Anyone who wants to be a winner in the 90s must therefore start the process of change now.

BY STAFFAN CANBÄCK

To survive in the future, Swedish insurance companies must adapt to a changing market, with changing customer requirements and an acceleration of shifts within the industry. The businesses run by insurance companies and banks are becoming increasingly similar.

In this round of changes, the spotlight will be on distribution. It is the key to understanding and influencing the customer's purchasing decision. And as the customer 's requirements changes distribution must also develop.

At present insurance companies and banks have totally different distribution systems and products. It is a question of who is in the strongest position to face the future – insurance companies or banks. In reality , both probably have a good starting position – albeit within different customer segments and markets.

The problem in fact is that both banks and insurance companies have insufficient knowledge of distribution. The challenge facing most players is to continue to develop this knowledge taking the customer's perspective as a starting point.

Companies must review and change their view of the successful elements in distribution. They must also ask themselves what the role of personal relations will be in the future. What is meant by comfort for the customer from a localisation and administrative perspective? What prices are acceptable at a given service level? Which products can logically be distributed together?

We need to think through our customer segmentation and our channel strategies. In ten years we might see a completely different market, with:

- greater choice for the customer in terms of both product and distribution;

- new dominant methods of distribution above all for simple, standardised products;

- significantly higher productivity within traditional channels, with better customer segmentation and more cross-selling;

- insurance and banking products provided by the same company.

These changes represent not only a threat, but also major opportunities for our insurance companies.

The Market is Changing

Changes in the market have their origins in changes in customers' purchasing patterns.

As people become richer, they demand more of their insurance companies and banks. Consumers will increasingly want to benefit from their financial assets. They demand products that offer a high rate of return, financial security or future pension income. This is true throughout Europe, and as Nordic consumers are among the most prosperous in Europe, there are major consequences for Nordic insurance companies.

It is equally important to acknowledge that consumers will become more selective in their choice of insurance cover. They will be increasingly aware of differences in prices and services between companies.

The definition of good customer contact will also change. Sales success used to depend on personal contact between the customer and the insurance company's sales representative. Nowadays, especially in urban areas, customers demand fast, efficient and polite telephone contact.

There is another change in the market which also forms part of this discussion – the much-discussed shifts between insurance and banking services. This might well be a slow development. But even so, every day we read in the newspapers how our banks and insurance companies are moving into each other's business areas: at the moment Skaraborgsbanken is offering life insurance from the American company CIGNA; Skandia is providing services such as mortgages through its sales force; PK-banken is collaborating with Livia in the field of life insurance.

Redefinition

The outcome is increasingly intensive competition within the financial sector. In this changing environment a redefinition of roles is unavoidable. Products will no longer be supplied exclusively by insurance companies, banks or other players.

The traditional product families will be replaced by product groups designed to satisfy specific customer requirements. These requirements cover five areas (see diagram): 1) capital investment; 2) transaction and cash services; 3) financing and consumer protection; 4) financing and property protection; and 5) income protection.

New Customer Requirements are Changing the Structure of the Financial Market

		PRODUCT GROUPS BASED ON CUSTOMER NEEDS				
		Capital investment	**Transaction & cash services**	**Financing & consumer protection**	**Financing & property protection**	**Income protec-tion**
TRADI-TIONAL PRODUCT FAMILIES	**Payment**		–Cheque/ wages account –Credit/ charge card –Currency –Post Office/Bank giro –ATM card –Telephone banking –Balance account			
	Capital growth	–Long-term certificate of deposit/deposits –Securities-based funds –Bonds –Shares –Property funds	–State bonds –Short-term certificate of deposit –Short-term special borrowing			
	Consumer credit		–Cheque account credit –Credit card credit	–Blank credit –Car leasing –Repayment		
	Property				–Mortgages –Home savings –Estate agency	
	Protection	–Life insurance / Pensions insurance		-Car insurance -Travel insurance -Credit insurance -Contents insurance	-Home / House–Life insurance	–Health insurance –Liability insurance –Accident insurance –Loss of profits insurance

These product groups do not correspond at all to what is normally offered by a bank or an insurance company. Life insurance, for example, can no longer be considered a protection product, but is simply one of many capital investment options. This means that insurance companies are now competing not only with each other but also with banks that offer similar services.

These changes are leading to more distribution channels and more products. Just like banks, insurance companies will experiment in order to find new solutions. The best option for an insurance company will be defined by the market segment that it wants to open up, the nature of the product, the financial aspect, the risks and not least the company's organisational skills.

As customers' needs change and the shifts in the industry gather pace, we ask ourselves whether the banks or the insurance companies will come out on top. At present there is no straightforward answer.

The banks might steal customers from the insurance companies because: 1) many insurance products are simple protection-based or savings-based services that require limited sales skills; 2) banks enjoys a level of respect and customer loyalty that is often greater than that enjoyed by insurance companies; 3) banks have better customer databases; and 4) distributing insurance, especially through banks with national coverage, costs significantly less than the often high-service and high-cost sales channels of the insurance companies.

Despite these advantages on the side of the banks, insurance companies can achieve a stronger position in the financial market of the future. Why? There are three significant reasons for this.

The Most Important Reason

The most important reason is that insurance companies are built up around sales staff, not around cash desks. What does this mean? Well, the shift towards life insurance and investment products means that most financial services will require more knowledge and a greater sales effort.

The second reason is that insurance companies today are better at handling parallel distribution channels. Insurance companies have experience of telephone sales, direct marketing, office sales, specialist and general representatives, field sales and brokers. All insurance companies know how difficult it is to deal with apparently competing channels. This is something that the banks will have to learn.

The third reason is that the banks' management groups are supposed to be fully occupied with the difficult task of developing and rationalising their networks of branches.

The shifts within the industry will generate major changes in the competitive positions of the various companies. Insurance companies seem to be as well positioned as the banks are. Insurance companies that actively take on board and exploit the changes in the market have every chance of succeeding.

Finally, banks and insurance companies do not always need to be competitors. In some cases they might find that they can collaborate in a mutually beneficial way. When all is said and done they still have the same customers, complementary products and sales channels. Collaboration can prevent their being competing distribution systems providing basically the same products. In countries such as Holland, France, Spain and Denmark such collaborations have had extremely positive results.

Whatever the structure of the industry looks like in the future – led by banks, insurance companies, or characterised by collaboration – the companies which come through these changes in good shape will be those that have benefited from and adapted themselves to the new requirements. This adaptation requires a company to take three fundamental steps, with the customer as the starting point:

- *Understand the customers´ needs.* Almost without exception, insurance companies and banks know far too little about their customers, particularly private customers. Few financial institutions can describe their customers' needs in anything more than vague terms. Knowledge of which market segments there are and what they require is indispensable if a sales drive is to succeed. Insurance companies must carefully analyse the wishes and needs of various customer groups. The products must then be adapted to meet customer needs and the distribution channels selected must be those that best introduce the customer to the product.

- *Select a clearly-defined role.* Almost all Swedish insurance companies generally compete on the domestic market using similar, traditional strategies. As the market for financial services matures, new roles will be developed.

  One or two companies will broaden their skills base, seize new opportunities and become international. Acquisitions of, or mergers with, banks will probably be an important ingredient for companies that adopt this strategy.

  Some will choose to act aggressively within profitable niches. They will choose not to compete for the broader market. Their competitive advantage is specialist knowledge of a particular product, customer group or geographical area.

  Others will maybe become more straightforward insurance providers. They will take care of the production, claims processing and underwriting, but will leave the distribution to others, such as brokers, banks or other organisations. International experience tells us that this can be an attractive option.

Some players – mainly newcomers – will aim to achieve a low-price image within price-sensitive market segments. This will require rigorous cost control. Very few traditional insurance companies have either the ability or the culture required to play this role.

What will happen to the traditional, broad-based company that only sells insurance? In time it will probably disappear. It will be difficult to compete with more focused players who offer either better service or lower prices.

- *Overhaul distribution systems and products.* Major gains can be made in having a range of distribution channels with different service levels. For example, there is little point in selling complex life insurance products and simple liability products through the same channel. It can be significantly more profitable to sell complex products through a high-service channel, and hive off simple products to channels offering simple service, such as direct marketing and telephone sales. This development has already started, but many companies still have a long way to go.

  Productivity can also be improved by improving sales skills within each channel. As we illustrated in our first article in this series (Försäkringstidningen 12/89), we estimate that the difference in the combined ratio between the best and the average company is two percentage points for the sale of material products.

  How can insurance companies prepare new channels and products to take advantage of new sales opportunities? Success in building new channels and products requires both finesse and resolve. Even small initiatives within a distribution strategy can be perceived as disruptive by an insurance company's sales force. Many insurance companies have therefore opted not to experiment with new channels. Sooner or later they too will need these new channels. Insurance companies must therefore find ways of expanding their existing distribution channels in a way that does not make their sales force leave to join competing companies.

Thorough Knowledge

Tomorrow's requirements place a high priority on a thorough knowledge of customers and competitors, as well as the ability to adapt. Experimentation will gain increasing importance as a tool for working towards change.

The winners will be starting the process of change right now. But others will wait. Why? The changes are taking place across today’s industry borders, so it is not enough simply to look at trends in life insurance, liability insurance or banking. And these changes take place step by step rather than in leaps and bounds. So, some companies will respond too late and be too cautious. But for those that seize the initiative, the opportunities will be greater than ever.

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