



Ready or Not

Although the post-Sept. 11 market appears to give weaker insurers a respite, they need to make action plans to fight for their survival.

by Bill Schrepf

Illustrations by William Waggoner

In the midst of an over-capitalized property/casualty industry that for several years made many U.S. property/casualty insurers vulnerable to failure or acquisition, all insurers waited and prayed for signs that a “turn” in the market had arrived—

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that very competitive pricing was a thing of the past and that industry profitability and revenues were rising. That has all changed.

The terrorist attacks of Sept. 11, 2001, seem to have taken care of the industry’s excess capacity. Interestingly, however, the larger and stronger companies appear to have been impacted the most, an unexpected outcome.

The “turn” had probably already arrived by Sept. 11. Rates were rising

strongly before then and have risen even more dramatically since. While many property/casualty executives are now looking forward to improved profitability, they have almost immediately begun worrying about the future. Conversations these days seem to question:

- if higher rates will be short-lived;
- if future terrorist acts or catastrophes will more than offset any rate gains in the marketplace; and
- if the future is bright or if this is

but a brief upturn before the market returns to the highly competitive state that existed prior to Sept. 11.

Pre-Sept. 11 Performance

The key to understanding what is likely to happen next, and what it might mean for a company's strategy and tactics, is understanding the competitive economics that were driving the market prior to Sept. 11. How have they changed, if at all, and how will they impact the competitive playing field over the next several years?

A critical element that is often overlooked is the widely differing performance of property/casualty competitors prior to Sept. 11. Superficially, everyone was hurting and all insurers were complaining about inadequate rates; there was a near-unanimous consensus that the market was extremely competitive. Everyone claimed to be in pain.

At the same time, however, a significant group of companies were consistently earning returns on surplus of 15% or more. Even the second quartile of companies averaged returns on surplus of about the cost of capital. Unlike the poorer performers, and despite their protestations to the contrary, these high-performing companies did not need rate increases to achieve adequate returns. In fact, the high-performing companies had been widening their advantage over the past several years—the gap between the strong and the weak grew significantly during that period. The best performers could have reduced rates even farther and still earned more than adequate returns.

Advantages Shape Performance

How has Sept. 11 changed this scenario? For one thing, it looks as if most or all of the excess capital is gone. A number of the strongest performers have lost large amounts of surplus. They will have to take some time to rebuild surplus before they become expansive again. Today's rising insurance rates, however, and the already much lower costs of the strong performers suggest that they will be able to replenish their surplus

more quickly than most companies. Some have not even suffered substantial losses and remain very profitable despite Sept. 11, and those companies will have more surplus and higher margins than ever.

The reality, then, is that the most likely scenario is one in which there is a competitive respite of indeterminate length during which everyone strives to rebuild surplus. This respite, however, is likely to be followed by market-share expansion initiated by successful companies already earning high returns prior to Sept. 11. At worst, the rate increases that followed Sept. 11 could be a brief, emotion-driven blip in a continuing highly competitive marketplace.

Either way, the imperative inherent in these facts is that property/casualty companies need to be prepared to fight for survival. They need strategies and tactics that will assure survival at a minimum. Optimally, they need to adopt action plans that will place them among the top performers rather than among the lower-quartile performers—those most likely to disappear over the next few years.

Strategy for Success

What might a success strategy for today's marketplace look like?

Best practice performance in insurance basics will be essential. One clear minimum condition for survival is outstanding performance in the critical areas that drive property/casualty performance. Top-performing companies typically have better pricing and underwriting processes, stronger reserves, lower claims frequencies, faster claims closing rates, more efficient processes, better management of human capital and more responsive customer service. They also use less reinsurance, achieve higher investment returns and use capital more efficiently than other companies.

The bottom line: A company that doesn't deliver best practice performance in insurance basics is likely to be in deep competitive trouble in the next few years. Unfortunately, achieving best practice performance is

probably only one of the outcomes that will be essential for survival in the next few years. Without it, there is no way a company can match the costs and the prices of strong competitors. In addition, best practice performance means better outcomes for customers. They benefit from lower rates, higher dividends, fewer claims to deal with, and lower claims costs and expenses. Taken together, these translate into a far better overall customer experience. The lower costs and superior customer experiences that result are likely to produce compelling advantages in the on-going fight to attract and retain a superior book of business.

Excellence in several other areas also will probably be required. Analysis of the tactics of best performing companies suggests that they are going beyond best practice performance in insurance basics. They also are aggressively pursuing other critical outcomes that will make them even more competitive and successful in the future. The most effective companies exhibit the following traits:

- more strategically focused;
- adapting and innovating more rapidly;
- making more effective use of technology; and
- selecting, evaluating and rewarding people more effectively.

Greater Strategic Focus

The best performers continue to focus their business on areas where they can know more about the risks they select than their competitors. Rather than trying to price and write whatever business comes through the door, they use a number of tactics to enable them to focus their resources on superior risks. These can include developing niche businesses in which their teams gain expertise and experience not available to underwriters and claims staff who must deal with a broad, general, multiline book of business. They can also include using brokers or agents who focus on a certain kind of business, thus leveraging the producers' specialty knowledge to the insurer's advantage. In addition, tactics

may be linked to differential service and pricing levels that play to the special needs or desires of a particular group of insureds.

Rapid Adaptation and Innovation

Evolution seems to be a watchword in the insurance industry. Change comes slowly to most insurers, if at all. This may be a result of the caution and risk aversion that are drilled into most insurance managers over and over again during the course of their careers. Many of the top-performing companies, however, are changing faster and more effectively than their peers. They understand that evolution is no longer enough to survive and thrive in today's rapidly changing marketplace. Projects are designed to produce outcomes in a few months rather than years. Sweeping changes are sought rather than small, incremental ones. Most importantly, effective project management and accountability, coupled with change management processes focused on the people affected by the changes, lead to more rapid and more successful implementation.

Creatively Leveraging Technology

Nowhere is this rapid adaptation and innovation more important than in the area of technology. Creative use of technology is likely to become an ever-greater differentiator among successful competitors. This is not about marketing or selling insurance over the Internet. Rather, successful competitors are using technology to shape products and services in ways that have not been seen before. Customers are adopting e-commerce at very rapid rates. They like the convenience of self-service as long as the electronic tools and services are easy to use and responsive to their needs.

Top performers understand that these kinds of tools create a very sweet combination: improved service that is both cheaper and more customer friendly. While most companies are still living in an environment where even the smallest technological changes take years and cost millions of dollars, the best performers are imple-

menting and managing change in months—and they are doing it at far lower costs and with much greater impact than their weaker and slower-moving competitors.

Building a High Performance Team

Developing and delivering best practice performance, superior strategies and creative new technology are not possible without superior people performance. The best performing companies—although there are great differences in their cultures and methods—also seem to do a better job of managing their human inventory. They are better at selecting people, perhaps because they are clearer about the outcomes they need and the skills and attitudes that are necessary to achieve them. They evaluate performance effectively and challenge their high-potential people with the problems and opportunities that are identified—making sure that really strong performance is recognized and rewarded. They rapidly deal with non-performance issues rather than allowing their organizations to drift with little or no focus on those who are not contributing to or are detracting from the organization's critical outcomes.

Prior to Sept. 11, there were many insurers—whether or not they recognized the danger—whose future was very much in doubt. Though the need for strong companies to rebuild surplus may buy the vulnerable ones a brief respite, the significant competitive advantage enjoyed by the top performers in today's property/casualty marketplace almost certainly means that any respite will be short-lived. It could even widen the gap as the best performers accumulate capital much faster than poor performers do.

Any company that does not recognize the threat and the need to adopt much more aggressive approaches to improve its insurance operations remains at risk. In fact, even today's top performers may well be at risk if they do not continue to rapidly change and innovate in order to maintain and strengthen their competitive advantages. **BR**

