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Improving Insurance Distribution Profit Margins with Modern Technology

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In 2004, TowerGroup estimates that insurers will spend approximately 25% of their development budget to improve and streamline the distribution process. Distribution costs affect insurers' profits, and it is difficult for insurers to find economic value from them. For insurers to realize the highest value from distribution, they must improve operations and agent-based support for key distribution segments. This includes enhanced operations to support a multiproduct, multichannel distribution model that compliments an insurer's revenue objectives and profit margins. Insurers can realize the highest value from their agent distribution channels by developing an integrated suite of services oriented to driving sales and reducing servicing costs.

Distribution costs continue to escalate, and it can spread an insurer's organization thin to support a burgeoning network of distributors such as captive, career, and independent agents; wirehouses; banks; broker/dealers; and alternative channels. Agent-based sales will certainly continue to dominate the distribution of insurance. However, this distribution model is often the largest expense for insurers to manage cost-effectively in terms of resources, capital, and operational capabilities.

Distributors want to do business with the best insurance companies. Agents define those types of insurers as ones that are easy to do business with and that can facilitate improved services to their shared customers. Insurers can take advantage of the present opportunities by managing distribution as a core part of the business and not just a cost of doing business. They can achieve this goal via the strategic use of technology and offer ample support to distributors in information reporting, improved operations, sales and marketing, as well as performance tracking to a large network of agents and brokers.

Focus on Profitable Segments

Insurers enter into distribution agreements for various reasons, and certain distribution partners deliver advantages over others. Partnerships with distributors can expand an insurer's reach to customers of all levels of affluence. They can decrease customer acquisition costs, improve retention, and increase opportunities for cross-selling. It is imperative today, however, to maintain strategic partnerships with a *select* group of distributors and build loyalty with profitable partners. Insurers that identify "partnering" as a core skill can manifest long-term competitive advantage.

Developing and maintaining strategic partnerships pose challenges for both insurers and distributors to achieve mutual success. Successful manufacturer/distribution partnerships typically entail the following characteristics:

- Commitment from both entities to build a profitable business model with fair and equitable revenue sharing arrangements in soft and hard markets
- Shared goals and objectives with mutual support, respect, and cultural compatibility
- Alignment of products and services to brand and customer demographic
- Performance monitoring to include sales and marketing and customer service-level agreements
- Timely and accurate dissemination of business information to manage financial and business risks

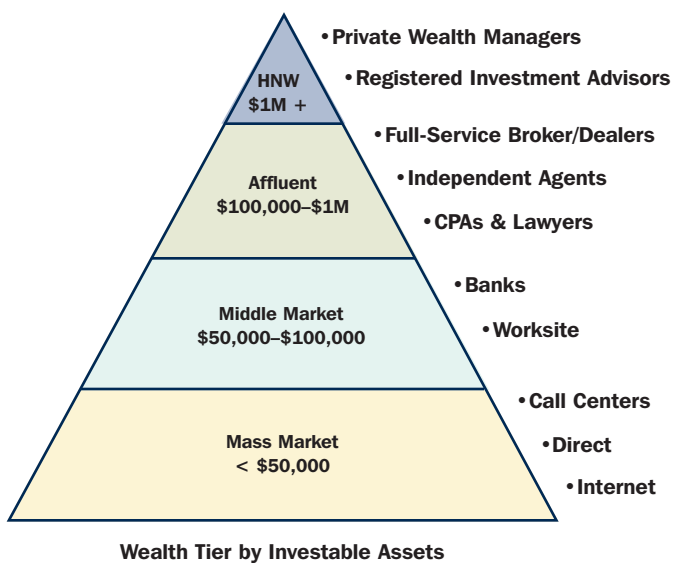
Insurers that administer their distribution partnerships with these guiding principles often find it easier to manage conflicting objectives that may arise.

In addition to these principles, insurers must employ strict financial discipline to current and future distribution partnerships to maintain profitable operations. Blanketing the market to fully extend the insurance distribution network poses many problems, because not all distribution partnerships deliver the same economic value. Some insurers may find that, over time, they have acquired unprofitable partners with unprofitable customers. Insurers may also support high-value partners that drive revenue and demonstrate a propensity for future growth with little overhead expense. Profitability pressures for these partners may include hard dollar costs, such as revenue sharing arrangements and marketing allowances, or soft dollar costs, such as wholesaling coverage and customer service.

For insurers to derive economic value from all of their distributors, they must segment profitable distributors from unprofitable ones and direct resources to profitable areas of the operation. Exhibit 1 illustrates the relationship of distribution channels to segments of select customers and demonstrates distribution targets based on the distributor's predisposition to attract and retain individual customers in those wealth tiers.

However, a recent study conducted by Tillinghast/Towers Perrin on finding economic value in distribution demonstrates that even when insurers employ strict financial discipline and metrics, distribution costs continue to

Exhibit 1: Align Distribution Channels to Target Customer Segments

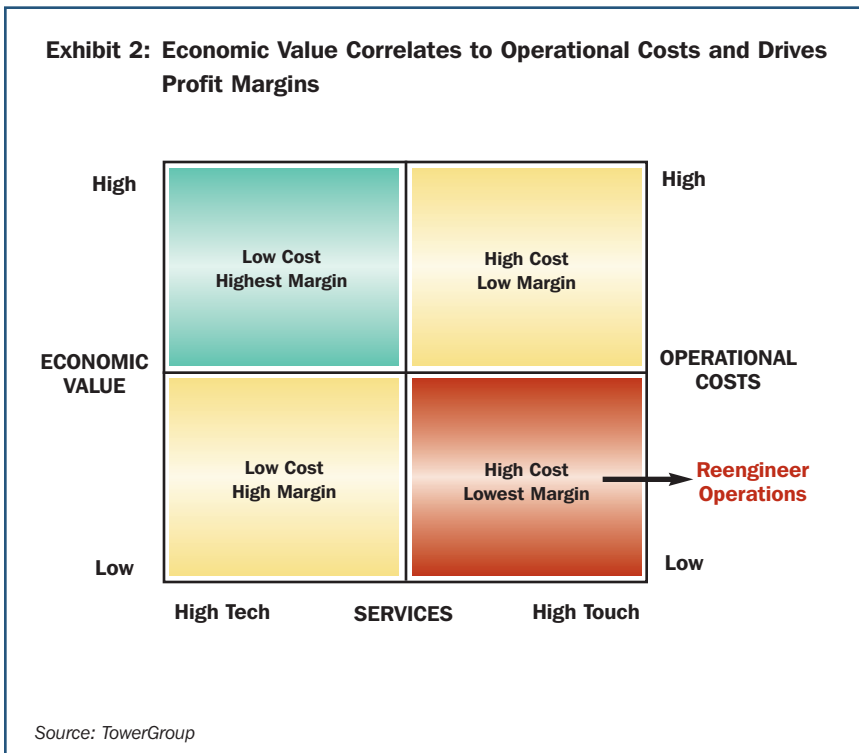


Source: TowerGroup

escalate. For example, according to this study of companies with a profit and loss (P&L) statement for distribution, retail distribution incurred an average loss equal to 17% of distribution revenue in 2001. Projected results did not demonstrate major improvements in the coming years for those firms that closely managed costs to budget and allocated resources to high value distribution opportunities.

TowerGroup contends that for insurers to increase the value and profitability of their interactions with distributors and their customers, they must approach distribution with a technology solution that is flexible and cost-effective. Insurance companies support complicated distribution processes and must continuously plan, manage, evaluate, and adjust support and services to accommodate demands from their partners. Support for distribution from a flexible and cost-effective technology environment allows insurers the leeway to readily adopt new distribution channels and adjust services without creating a profit margin imbalance.

Exhibit 2 illustrates how profit margins closely correlate to economic value and the operational costs associated with high-tech and high-touch support services. The best economic value for insurers is in partnership with distributors that demonstrate a high propensity to drive sales and manage their business with high-tech services and self-service outlets such as the Internet. The least profitable opportunities are with distributors that do not demonstrate the potential to grow their business and that require a high level of personalized services. Partnerships with distributors in this quadrant, as captured in Exhibit 1, are in need of remedial action. Insurers must consider alternatives for restructuring operations oriented to high-touch services for low-value customers. Otherwise, they risk high losses in the distribution of their products and services.



Insurers can create competitive differentiators with a business-processes approach to increase the value of customer interactions. A keen focus on profitable distribution segments, combined with technology solutions to drive business objectives, provides a solid foundation to reengineer the agent-based insurance distribution process.

Targeting Profitable Opportunities with Technology Solutions

A number of viable technology options are available today for insurers to develop a flexible and cost-effective multichannel distribution network. These solutions manifest in self-service portals and customer relationship management (CRM) systems for sales, marketing, and service, among other functions. However, a major impediment to realizing the full benefit of these solutions is the lack of availability of data from core operating systems.

Insurers with open access to these data stores can achieve the following goals:

- Establish a comprehensive view of the joint customers of the producer and the insurer
- Gain economies of scale from a common set of data and business rules
- Lower operational costs in distribution by the use of lower-cost channels
- Lessen agent-based administrative tasks to maximize sales activity
- Provide analytical support to manage the producer and customer life cycle
- Track distribution partner activity and establish key performance metrics

Microsoft .NET, Java 2 Enterprise Edition (J2EE), and Java 2 are among a few modern languages available to integrate back-end processes from transactional systems to front-end applications such as portals and CRM. Reengineering core systems and establishing connectivity and integration between them can be a three to five year project. There is little chance for insurers to achieve this state with a high degree of reliability from the rapid implementation of an enterprise-packed solution. Therefore, TowerGroup recommends selective investments in key applications, with the long-term goal of reengineering core systems and designing flexible enterprise architecture. The long-term benefits to this approach will outweigh the short-term costs.

Another means to reduce distribution costs would be the use of Web technologies to help insurers realize hard dollar savings and hard dollar revenue. Progressive Insurance reports hard dollar savings of 20% of revenue for operating expenses, as compared to the industry average of 23% to 25%. Because the firm uses a Web site to allow their 30,000 agents to obtain quotes and complete new policy applications online, agents can work faster and more efficiently. Sales and marketing productivity is another area that delivers hard dollar revenue growth. Distributors and their customers want insurers to provide them with their total financial profile, so that services are comprehensive but targeted according to their particular needs. The results are improvements to cross-selling techniques and retention rates of existing customers.

In 2004, insurers working toward a reengineered architecture will find that the newer technologies can facilitate faster systems development. They provide flexibility such as reusable components and process prototypes that can reduce time-to-production and deliver applications within budget. Standards such as ACORD XML (Extensible Markup Language) provide support to development so that insurers can enable sharing between systems, languages, communication methods, and infrastructure. However, the same tried and true benefits that come from strategic planning and design philosophy will dictate the quality of the finished architecture.

Conclusion

It is imperative that insurers address their architecture issues so that they can improve distribution capabilities and drive down distribution costs. Insurers can mitigate distribution expenses by employing technology to cost-effectively align them with their distributors and their shared customers in areas such as sales, new business, claims processing, underwriting, and service. Expanding distribution capabilities, so that it is easier to manage a multiproduct, multichannel distribution environment, will give rise to competitive differentiation with high-value distributors.

Deriving economic value from distribution requires a three-pronged approach:

- 1) Development of well-defined business objectives and requirements
- 2) A flexible architecture to integrate back-office data stores with front-end applications
- 3) Guidelines to manage strategic partnerships with financial discipline

Factors such as collaborative capabilities in information, operations, sales and marketing, and performance tracking can establish distinct distribution advantages over competitors. Successful insurers will realize the highest value from their distribution channels by focusing on distribution as an asset and as a core part of the business.

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