Arthur D Little

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Six Habits of Highly Efficient Insurers

Achieving Cost-efficiency

Efficiency in Europe's insurance industry has improved significantly in recent years. At first glance, these improvements might seem to be the result of high-profile programs to reduce costs and increase operating profits. However, closer inspection shows that the most efficient companies are, in fact, likely to adopt a far broader range of strategies to achieve their efficiency targets. A study by Arthur D. Little has identified six key areas that the most efficient companies focus on in order to drive down the cost of generating income from premiums.

In the last few years, most European insurance companies have implemented programs to improve efficiency and, as a result, the insurance industry is more efficient than ever before. Nevertheless, there remains a significant variation in efficiency levels. A survey of 50 of the largest European insurers conducted by Arthur D. Little has found that the average net expense ratio is 25.18% and the most efficient insurers achieve a net expense ratio almost two and half times lower than the least efficient (see figure 1). Ranking the countries by cost-efficiency of their insurance companies demonstrates that Europe's most efficient insurance companies are concentrated in the Nordic countries: Denmark (average NER: 17.50%), Sweden (17.76%) and Norway (20.01%). It is clear then that, for many insurance companies, there is still enormous scope to efficiency improvements. The least cost-efficient insurance companies are in Austria and The Netherlands, both of which countries have an average NER of over 30% (see figure 2 overleaf).

Analysis of the top performers in the survey yields ideas as to where insurers seeking to improve efficiency might focus their efforts. There are six characteristics that are found repeatedly among the top performers:

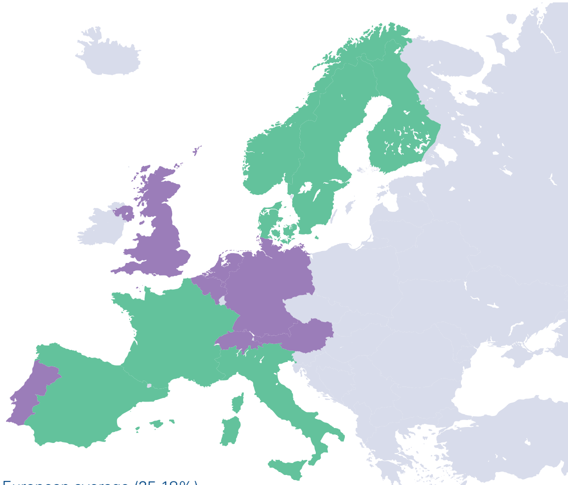
- customized distribution channels
- efficient distribution
- performance-based compensation
- centralized support functions
- IT and internet proficiency
- decentralized organization

Figure 1. Insurances ranked by average cost ratios 2005-2007

	Rank	Insurance company	Country	NER %
Above[1]	1	Macif Assurances	France	14.23
	2	Topdanmark	Denmark	14.44
	3	Trygg-Hansa	Sweden	15.72
	4	TrygVesta	Denmark	17.06
	5	RBS Insurance	UK	17.55
	6	Folksam Sak	Sweden	17.69
	7	If Skadeförsäkring	Sweden	17.85
	8	Ethias	Belgium	18.56
	9	GMF Assurances	France	18.81
	10	Gjensidige	Norway	19.41
	11	Länsförsäkringar Sak	Sweden	19.78
	12	Sparebank1	Norway	20.61
	13	Fondiaria SAI	Italy	20.70
	14	NFU Mutual	UK	20.79
	15	Codan Forsikring	Denmark	21.00
	16	Talanx Group	Germany	21.24
	17	Caser Seguros	Spain	21.28
	18	Pohjola	Finland	21.36
	19	Cattolica Assicurazioni	Italy	21.95
	20	Taipola General	Finland	22.33
	21	Mapfre Seguros	Spain	22.48
	22	Unipol Insurance	Italy	22.62
	23	Allianz S.p.A.	Italy	23.63
	24	Toro Assicurazioni	Italy	24.40
	25	Die Mobiliar	Switzerland	24.93
Below[1]	46	Ergo Insurance Group	Germany	33.23
	47	Aviva	UK	34.43
	48	UNIQA Versicherungen AG	Austria	35.60
	49	Helvetia	Switzerland	35.67
	50	Fortis Insurance	Belgium	35.79

Source: Annual Reports, Arthur. D Little analysis Note: [1]Versus average (25.18%)

Figure 2. Countries ranked according to the efficiency of their insurers



	Rank	Country	Average NER %
Above[1]	1	Denmark	17.50
	2	Sweden	17.76
	3	Norway	20.01
	4	Finland	21.84
	5	Spain	21.88
	6	Italy	23.39
	7	France	24.52
Below[1]	8	UK	25.45
	9	Germany	28.10
	10	Belgium	28.39
	11	Portugal	29.32
	12	Switzerland	29.74
	13	Austria	30.20
	14	The Netherlands	30.23

Source: Arthur. D Little analysis Note: [1]Versus European average (25.18%)

Customized distribution channels

The top-performing insurance companies distribute their products via a wide variety of distribution channels. By selecting an appropriate mix of channels, they can maximize convenience for customers and optimize their own distribution costs. Options for distribution channels include:

- **Own sales force**: Sales to private customers are handled either by a company's own sales representatives and through call centers. Using its own sales force gives a company full control over distribution, however it can be costly and requires considerable strategic effort. Therefore, a sales force is best used for customers with large accounts, such as corporate clients. Personal service and individual negotiation can help in building trust with these clients and increase the size of each account.
- **Brokers and agents**: In market segments where local presence is key (e.g. rural areas) many companies rely on local brokers or agents to distribute their products and handle customer contact. Selling through an agent means giving up some control over the product but provides more flexibility and lower fixed costs, since many agents are only paid commission on the policies they sell.
- **Bancassurance**: Distribution through banks is becoming increasingly popular: it provides access to a large distribution network with low fixed costs. The bank controls the distribution of the product and may even sell it under its own brand name.
- **Telesales**: Telesales is one of the most important distribution channels in the insurance industry. Insurers achieve efficiency by using skilled personnel able to handle customers' questions and requests quickly without having to transfer each call.
- **Internet**: A well-functioning online sales channel allows insurers to sell products and services around the clock at low cost by avoiding costly manual administration. Furthermore, encouraging customers to manage their insurance online can lead to efficiency improvements in, for example, claims handling.
- **Partnerships**: A partnership with another organization, such as a sports club, gives insurers access to a distribution network without incurring large fixed costs. In partnerships, the partner organization usually controls distribution. These partnerships help the insurer to reach a large number of potential customers, often with a standard tailored policy.

Efficient distribution

Minimizing the number of staff involved in each customer contact helps to improve efficiency. Ideally, a single employee should be able to handle as many issues related to a customer's request as possible. To achieve this goal, the most efficient insurers follow appropriate strategies in three key areas:

- **Empowerment**: All customer-facing staff are trusted to make as many decisions as possible without having to consult management.
- **Training**: Customer-facing staff receive comprehensive training in all aspects of the insurance business in order to be able to handle a wide range of customer-related issues,.
- **Support systems**: The most efficient companies use advanced IT support systems to give customer-facing staff the information they need to service customers.

Performance based compensation

Performance-based compensation is used to encourage staff to be cost conscious and work towards profitability. It also supports the retention of qualified and experienced staff. Performance-based compensation can take a number of different forms:

- **Variable salary**: A commission-based salary makes the closest connection between performance and compensation. For this model to function, the work done by the employee has to be easy to measure.
- **Bonuses**: By attaching a bonus to the fulfillment of a target, a company can give employees an extra incentive to work towards efficiency goals. For the bonus system to be effective, employees must have a real opportunity to affect the outcome and, as a result, different goals for different positions are necessary.
- **Stocks:** Allowing employees to buy company shares at a favorable price can make them feel more involved in the company. As owners, the staff are rewarded when the company does well, and this gives them the incentive to work towards profitability and efficiency.

Traditionally, companies have used performance-based compensation to motivate sales staff. However, many of the top performers now recognize the need for better reward systems even for support and back office functions and are developing methods to link compensation to performance in these areas.

Centralized support functions

Centralized support functions are a common feature of top performers, enabling these companies to achieve economies of scale, improve knowledge-sharing and allocate resources more efficiently:

- **Economies of scale**: Concentrating functions such as IT, marketing and HR in single, central departments can deliver significant cost savings. For example, fixed costs can be divided among larger volumes of output leading to a lower per unit cost. In addition, larger volumes also give companies stronger purchasing power with suppliers.
- **Knowledge-sharing**: Concentrating expertise and specialist know-how in one place enables knowledge and ideas to spread fast and efficiently. The stimulating and sometimes competitive climate that results from having many talented people working together is also the perfect seed-bed for creativity and innovation.
- **Efficient allocation of resources**: Consolidating resources enables top-performing enterprises to smooth out interdepartmental workload peaks and troughs, thus reducing backlogs whilst increasing staff motivation.

With all resources located within a centralized function, management can allocate resources where they are most needed at any time.

IT and the internet

The most efficient insurers use IT and the internet to improve efficiency in all parts of their business, from internal processes and customer service to distribution and sales:

- **Internal processes**: The way IT is used for internal processes probably has the greatest impact on cost-efficiency. IT allows information to be distributed efficiently through a company, making it possible for staff and management to take well-informed decisions. Some companies are moving towards a system where claims handling is fully automated from beginning to end.
- **Self service**: Internet-based customer service, where existing customers can get an overview of their policies and get their questions answered on-line, reduces the need for expensive human customer support. Using the internet, companies effectively delegate some elements of administrative customer data handling to the customer. In the case of corporate clients this can yield particularly impressive improvements in efficiency. Internet-based customer service can also help to improve customer satisfaction.
- **Sales and distribution**: Distributing insurance over the internet makes it possible to reduce the use of expensive sales staff and middlemen, although it is not possible to distribute. This channel is best suited to simple products that demand limited special knowledge. Most insurance companies use the internet as an additional sales channel, while some companies launch special brands that are distributed only via the internet.

Decentralized organization

Decentralized organizations tend to have fast and efficient decision-making and are able to spread cost-consciousness more easily through the firm:

- **Shorter decision-making processes**: In a decentralized business, decisions are taken closer to the market, which speeds up the process. A decentralized structure gives top management more time to concentrate on strategically important issues instead of everyday operational matters.
- **Responsibility spread through the organization**: Having a decentralized organization divided into different business units with profit/loss responsibility helps insurers to encourage cost-consciousness throughout the organization. Linking remuneration with each manager's performance helps to align the manager's priorities with the organization's profitability target. Furthermore, delegating responsibility and awarding managers a high degree of freedom often has a positive impact on motivation.

- **Creation of a benchmarking culture**: A decentralized organization offers top management the opportunity to benchmark different business units against each other. Benchmarking helps identify and spread best practices throughout an organization. It also encourages managers to become more efficient in order to prove their abilities.

Conclusion

Clearly the precise degree of efficiency any individual insurance company can expect to achieve depends on external factors as well as the specific strategies it adopts. For example, an insurer holding a substantial market share in a highly consolidated market could expect to realize greater cost savings through economies of scale than a smaller insurer operating in a fragmented market. Similarly, scope for realizing the efficiency savings offered by internet distribution is far greater for companies operating in regions where internet penetration is high.

Nevertheless, despite the impact of external factors, each insurer's performance is in its own hands. The Arthur D. Little survey shows that, in fact, many of Europe's largest insurers have failed to leverage economies of scale fully and that there is, as yet, only a weak correlation between a country's internet penetration and cost-efficiency of its insurers. We believe, therefore, that there are still enormous opportunities for many European insurers to improve their efficiency. The strategies adopted by the current top performers provide important clues as to how this can be achieved.

Insurance efficiency study – December 2008

The Arthur D. Little study consolidates data from 50 major insurance companies in Europe with the aim of identifying the most efficient. The survey covers the largest insurance companies based on net premiums written in each of 14 selected countries: Austria, Belgium, Denmark, Finland, France, Germany, Italy, The Netherlands, Norway, Portugal, Spain, Sweden, Switzerland and the UK. The study focuses solely on non-life business; in those cases where a company has both life and non-life segments, the life business has been excluded.

The ranking is based on the net expense ratio, calculated by dividing the net operational cost (acquisition cost + administration cost) by the net premium earned (after reinsurance and unearned premiums). The ratio obtained shows how much the company spends for every euro received in premium income – in other words, how efficient it is.

Contact

Gerrit Seidel
Managing Director Germany
Global Head Financial Services
seidel.gerrit@adlittle.com

Erik Almqvist
Director Financial Services Nordic
almqvist.erik@adlittle.com

Author: Daphné Schalbetter,
Manager, Financial Services

Arthur D. Little

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