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# Meeting the Challenges of the 1990s

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Article abstract

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# Meeting the Challenges of the 1990s*

by

John Reeve**

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## Introduction and Overview

Insurance, as an industry, has traditionally been insular. It has developed its own special characteristics, separate even from other activities within financial services and certainly very separate from broader commercial and industrial sectors.

This insularity has been particularly evident in the development of executive management. Typically, this has been sourced from within the company; occasionally, where it has been necessary to bring someone in from outside, executives have been sought from elsewhere, but almost invariably from within the industry.

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As a result of this process, the industry has tended to be run by specialists, usually with a technical/actuarial or a sales/marketing background. Cross fertilization of ideas from other industrial and commercial activities has been limited, as has a clear strategic focus for the business and a broad range of management skills within the top management team.

While the insurance industry has been developing along traditional lines with limited change of a fundamental nature, arguably this insularity has not mattered too much. But where the environment becomes fast changing and less predictable, management skills become far more important. In fact, they become perhaps the key element that distinguishes winning and surviving companies from the losers.



It is too difficult to argue that such a change is now occurring in the insurance industry in general and in the life industry in particular, to which the rest of this paper is addressed. It most certainly is happening in the UK. Progressively, it will be occurring in Europe as internal barriers fall; and it would be surprising if it were otherwise in the US, sooner or later.

The factors bringing about accelerating change in the life industry are numerous. To touch on just a few:

- Over-capacity is evident, i.e., too many "me too" suppliers chasing the available business.
- New competition has emerged, particularly in Europe, where banks and savings institutions are entering the market for life and pension products, using their brand image to sell to a "warm" customer base.
- Distributors in general are exercising more and more power. With an excess of competing life companies, they can increasingly act as does a supermarket chain towards competing suppliers, demanding the keenest prices and their own branded products.
- An increasing number of regulations are being promulgated which are frequently selective and often discriminatory

against the life industry in comparison with competing savings media. These regulations can reshape the industry itself, for example, by radically affecting both distribution and products.

- There is a progressive loss of tax privileges which used to be the prerogative of the life industry, and a corresponding propensity to grant fiscal privileges to competing savings and investment products favored by the Government of the day for ideological or other reasons.

- Rapid technological advancement is changing the potential for efficiency improvement and enhanced service delivery, as well as impacting how a salesman sells the product and, indeed, the very marketplace itself.



These are just some of the factors influencing the pace of development of the life industry. Their relative importance changes from market to market, but they have a common effect. They are putting increasing pressure on revenues, cost and margins.

In such a changing environment, quality of management is likely to be a key determinant of success. The winning companies will have top management teams that recognize these drivers of change, have developed clear strategic responses and have the energy and determination to implement these strategies within their own organizations.

It is unlikely that an entirely inbred management team will posses the full range of skills and experience needed to meet all these challenges successfully. With greater frequency, we will see insurance companies' management teams supplemented with high caliber management from outside the insurance industry. This will change the very character of the industry itself.

### Specific Issues for Insurance Company Survival in the 1990s

Insurance company management must face many issues in the 1990s. In the space available in this paper, just a few will be touched upon in no particular order of priority. However, in the real world, priorities must exist. A clear focus on those issues that most critically affect survival and performance will be a universal feature of winning companies in the tougher competitive environment that lies ahead.

Let me give, then, my own view on some of the more important issues that will need to be addressed to "meet the challenges of the 1990s."

### Organization and culture

640 I doubt this issue has been given much prominence on insurance company agendas in the past. I suspect it will in the future.

Apart from any other consideration, it will become increasingly harder to attract good quality staff to fill routine administrative functions; and even harder to motivate them to give the improved service delivery to customers that will be so important in the future.

Without being too specific, insurance company organization are likely to move away from hierarchical structures based on functional specializations, towards structures that reflect at least some of the following features:

- empowerment of front line staff (customer service and sales);
- restructuring of remainder of organization to provide maximum support to the front line staff as the main reason for its existence;
- fewer management layers;
- democratic approach toward such issues as status and decision making; and
- different skills for middle managers; not issuers of commands but leaders, coaches and facilitators.

To this will be added a particular emphasis on customer service and quality for the whole organization.

Quite a few management buzz words are included here. But, nevertheless, there are clear reasons for these trends which will be difficult to ignore.

The implications of new structures are considerable at the very least:

- greater emphasis on training and acquisition of skills;
- new criteria for selection of middle and senior management;
- revised incentive structures for all staff;
- removal of status issues; and
- redesigned office environments.



Thus, these new organizational structures will require not simply modest tampering with the existing organization but, rather, a radically different approach to all employee related issues.

A parallel trend is likely to be the progressive disaggregation of the company as a whole into separate profit centers or Strategic Business Units (SBUs). Even internal service departments may be operated on this basis. The objectives will be to provide clarity of focus within the organization, clearer allocation of responsibilities and a greater ability to incentivise based on measurable performance.

Finally, such new organizations will require clear goals and values that are clearly understood by everyone working for the company. In other words, a Vision. Although this is another fashionable buzz word, if this succeeds in motivating staff towards desirable objectives, can any organization afford to be without one?

## Service

Service will be a key differentiator between companies in the 1990s. Many companies are saying this and quite a few, in a broad range of industries including insurance, are actually doing something about it.

That is precisely the point. In this environment, if an organization has no clear focus on improving customer service, how well is it likely to do?

The best companies will be undertaking a major and continuing effort to improve customer service which, in the insurance industry, historically has been mediocre at best.



These improvements will be of many kinds and they will be measurable.

Hard measures of customer service will track performance of such factors as:

- customer to customer turnaround times; speed of service is a growing requirement -- many insurance companies measure how long a transaction spends in a given department but fewer know how long it takes to get a piece of work from the customer back to the customer.
- error rates; as well as "do it fast," do it right -- and right the first time.

Equally, systems will be put in hand to track "soft" measures such as:

- overall customer satisfaction and attitude towards the supplying company; and
- willingness to repeat purchase.

These are less easy to measure regularly than hard measures, but techniques are improving. However, there are signs of "survey fatigue" emerging amongst customer groups. As more and more companies seek such measures, customer resistance to co-operation may grow.

Overall, it will be critical to get customer orientated culture and attitudes to pervade the whole organization. "Putting the customer first" must become more than just a slogan; and this is where good management and good leadership can make a vital difference.

In Sun Life Corporation, we have distilled our focus on customer service to the 3Fs -- Fast, Friendly and Fault Free (Don't tell me there are actually **4** Fs here - my accountants and actuaries have told me this already.) This is easy to remember -- for **every** member of staff.

Thus, setting and measuring service standards and customer satisfaction objectives, together with instilling a customer service orientated culture, are key. But in order to embrace all staff, customers should be defined as being internal as well as external. Work done for another function or department is just as important as that done directly for the customer. All staff are involved in "putting the customer first".



However, as always in life, conscious trade-off decisions must be made, e.g., quality of service versus its cost. That is why service and costs should usually be treated as a single subject.

## Costs

With margins under pressure, control of costs will be critical to financial performance. Furthermore, with increasing regulatory requirements to disclose cost structures, cost control will become an important element to successful marketing as well.

However, arbitrary cost cutting is unlikely to be a successful strategy in the increasingly competitive market of the 1990s. Not least, cutting costs will do nothing for overall financial performance if, as a result, customer service is damaged.

Increasingly, a more scientific approach to cost management will be required. Costs must be designed out of the organization.

For overhead activities, this will involve identifying and eliminating work of low value, i.e., work that is "nice to have" but which does not directly add to shareholder or customer value.

To make this process of identification most effective, it will be preferable to involve all relevant staff. That way, they will personally contribute, which is an increasing demand; and they will be more committed to the results, however painful.

For customer service and administration functions a fundamental redesign and re-engineering of process flows right

across the company will be required. The key objectives will be to eliminate unnecessary steps in the process, reduce customer to customer turnaround times, reduce errors and cut processing costs. This is a classic example of where costs and service are so closely related; in this case the program should successfully enhance both.

In Sun Life Corporation, and as a result of such a process, we are moving rapidly towards a Case Manager approach whereby, instead of a piece of work passing from department to department on a production line, one member of staff will undertake an entire customer transaction -- from customer to customer.

This has already been successfully pioneered by a number of US insurance companies. The benefits shown by their results and our own pilot tests are an improvement in processing speed, reduced errors, lower costs, enhanced job satisfaction and personal ownership of the work and of the quality of service given to the customer.

The key to effective cost control in the future will be to seek a process of continuous improvement from staff at all levels. However good one becomes, and as the Japanese have taught us, it is always possible to find new ways to do it better and to do it cheaper. Successful companies will integrate this into their philosophy and practice of operation.

### Quality

Quality is another fashionable subject, with many different emphases and interpretations. Many, if not most, companies are running a quality program of some kind.

This extremely wide and complex subject will not be discussed here, even in summary. I would merely make the following brief comments:

• If you do not have programs to improve quality, then you should; your competitors will if they have not already; 

• Such programs can become very broad and diffuse; it is arguably better to focus on a few key issues and to make practical and measurable progress on these before moving on;

• The program will not work without top management's visible commitment to it, specialized training for those involved and continuous efforts to refresh the initiative.

Overall, quality is an inherent part of delivering service and value for money to the customer. It cannot be ignored.

### Distribution [and Strategic Focus]

Most insurance distribution systems are too costly; they take too much out of both the proceeds to policyholders and the profit to shareholders. In an increasingly competitive environment, the economics of distribution will claim increasing attention.

This emphasis on economics raises crucial issues for insurance companies. Marketing hype is likely to be "out;" good sales management disciplines will be "in."

This process will place natural focus on salesforce productivity, requiring enhanced emphasis on selection, training, motivation and, particularly, day to day management.

But it will also require more fundamental questions to be asked. For example, which distribution systems are likely to be the most successful and cost effective? Increasingly, insurance companies will become more focused on individual market segments, each of which will have individually tailored distribution systems.

As an example of this latter process, Sun Life Corporation has split its main distribution channel for Independent Financial Advisers (Independent Agents) into two halves. One concentrates on national brokerage chains and networks; the other on smaller "high street" brokers and pension specialists. The service requirements, degree of technical support and overall

selling approach are fundamentally different for bigger brokers from those for smaller brokers. An overall blanket approach is no longer sufficient; segmentation, focus and specialization will become increasingly critical.

In turn this increasing specialization will require insurance companies to decide in which market segments they are well positioned to compete and in which they are not. For multi-distribution channel companies it will require them to accommodate differing sales cultures within a single organization, leading inevitably to greater decentralization.

The pressure on margins will also encourage innovation; distribution routes that are fundamentally cheaper (for example -- under certain circumstances Direct Marketing) will gain priority over those that are more costly and inefficient.

Distribution skills will become more specialized. For example, banks selling life insurance products to their own customers will acquire special skills appropriate to branding and marketing to a warm customer base, including the attainment of very high standards of salesforce productivity.

Overall, the growing pressures on life companies will bring about very fundamental changes to the patterns of distribution in the years ahead. Selection, focus and exploitation of particular distribution systems will be critical for future viability and success, not least because generating strong new business is a fundamental requirement for the achievement of a declining trend in unit costs.

### Products

Just as distribution systems are likely to become more focused on individual market segments, so too are products.

Twin benefits will be sought from:

- product innovation, to add value and differentiate from competitors; and
- rationalization, to keep the product range focused and cost effective.



Above all, the approach to product design will change. Because of some of the trends mentioned above, product design increasingly will become a multi-disciplinary activity.

Products will not be designed just by marketing staff or actuaries; products have servicing cost and quality implications, systems development and information technology (IT) implications, asset management and risk management implications.

Thus, product design teams will include representatives from all these activities. In particular, products will be designed not just to sell, but also to be serviced and administered efficiently and cost effectively over the longer term. This will require interesting trade-off decisions. Discussions are likely to be lively.

Innovation, where achieved, will give a new edge. A reputation for innovation can give a lasting competitive advantage. However, the progressive weight of regulatory restrictions eventually may suppress this important and creative activity, to the detriment of the life industry itself.

Above all, any company seeking to provide shareholder value should avoid competing only with commodity products and selling exclusively on price and risk acceptance. This is competing unintelligently and, sooner or later, will bring inevitable difficulties in its wake.

### Investment Performance

As markets become more sophisticated, acceptable investment performance will become more critical for sales performance. In the UK, when selling through Independent Financial Advisers, an organization must exhibit good investment performance in order to win any business from the broker.



In addition, however, investment performance and innovation can be used as yet another way to add value in a competitive market. The difficulty lies in determining which organizations truly can demonstrate superior investment performance over the longer term. Cynics say all investment managers trend to the average over the really long term and, through technical factors, few will succeed in actually beating the indices.

True though this may be, first, not every potential customer has reached this state of heightened cynicism; second, there is always room for specialization and innovation. In fact, as an example of the latter, products are now emerging that, through sophisticated use of derivatives, guarantee to outperform the indices.

Whatever investment philosophy is adopted, the Investment Managers are custodians of huge amounts of policyholder moneys. As such, they must project the image and reality of financial prudence, integrity, expert knowledge and good judgment.

The need for specialization continues to grow as customers demand access to an ever wider range of geographic funds, growth funds, income funds and every other kind of fund. This creates opportunities for the investment department of the company, provided it has a clear focus and strategy founded on a body of sound technical skills and experience.

It is not necessary to have an investment department in house to be a successful insurance company, as some who sub-contract this service have proved. But if one does have such a department, it must, as a minimum, be extremely competent. Anything less will store up trouble. In addition, to seek competitive advantage in ever more competitive markets, an investment department should be designed to add value in creative ways, enabling the insurer to compete in both the protection and the savings markets. A useful skill may increasingly become a necessary one.

### Financial Strength [and Risk Management]

It goes without saying, or it should, that an insurance company should have undoubted financial strength, both in perception and in reality. That so many do not is an indictment of management, over time. 

Given the increasing volatility of financial markets generally and the well publicized failures within the industry, perceived financial strength is critical from a marketing perspective. The "flight to quality" in the US markets has been very real.

This is particularly true when the consumer has choice -- for example when buying through an independent broker, agent or financial planner who is able to exercise judgment on this issue.

The need is obvious -- a strong balance sheet with adequate capital resources, as well as developed and proven risk management skills. It is the latter, in particular, that have proved to be the downfall of so many US insurers.

The matching of assets and liabilities and the selection of assets themselves are part of the core skills of any insurer. If companies are not strong in these areas, then in competitive markets and with increasingly volatile assets, they will, at best, be at a competitive disadvantage and, at worst, will put the very survival of the organization at risk.

Accepting excessive risk is frequently a lazy reaction to management responsibilities. Management should be striving continually to add value and to differentiate their business. If they do not do this, they will find themselves equipped with "me too" products and distribution and forced to compete on price and risk acceptance. This will always, sooner or later, lead to trouble.

In competitive markets, well-developed risk management skills are increasingly essential for long term success. Financial strength, whilst not in itself any guarantee of success, will become a pre-requisite for it.



Finally, it should be noted that financial strength gives the flexibility to seize new opportunities in a way that is denied weaker brethren. Hence, assuming they stay alert and well managed, the strong will get stronger and the weak...

### Technology

Technological advance is confronting management with more and more opportunities and choices -- and costs.

Technology based costs are becoming an ever greater proportion of the total cost base of the company. This reason alone requires a high degree of IT competence, particularly since insurance company systems have become so complex.

But technology is not just changing the way that the business is administered; it is also changing the very marketplace itself. The use of technology at the point of sale has become a regular feature of the way we do business, in its own way changing the role of the salesman. (Are they all now financial planners?) But technology is also creating new markets entirely -- the electronic market place. In the UK well developed screen-based quotation systems now exist for the simpler life insurance products. These systems rank different companies for different products and customer profiles/needs. This requires new skills to ensure that quotations appear competitive within this environment.

Increasing technological sophistication is producing bewildering choices for insurance company managements. A clear basis for exercising this choice and for prioritisation is essential.

It is all too easy to embark on mega projects, which so often lead to mega disappointments and mega write-offs.

For a customer driven organization, prioritisation is at least possible. Culture and organizational design will also affect choice.

The following statements are obvious:

- Seek technical solutions to meet identified needs; don't follow exciting technologies and look for problems to solve with them. 
- Critically cost justify all projects.
- Adopt an overkill approach to project monitoring and control.
- Spend money on IT that will achieve:
  - improved customer service in a way visible to the customer;
  - reduced operating costs; and
  - enhanced sales performance.

IT management should be as high quality as any other part of the management team. But its focus must be integrated with the strategy and objectives of the organization as a whole.

If the organization is committed to enhancing aspects of customer service, such as customer to customer turnaround times, look for IT to play its part in providing solutions. But do not let technologists spend money for its own sake, eroding already narrowing margins.

Overall, good management seeking value for money will make a positive impact in this area as in any other. It is just another challenge to insurance company management that the best will rise to and the less adequate will get wrong.

### Conclusion

In the space available only the surface of some of the issues that will constitute the challenges of the 1990s for insurance companies have been touched upon.

But it is clear that these challenges will be considerable and certainly sufficient to differentiate clear winners and losers as the 1990s unfold.

Undoubtedly new challenges will emerge, additional to those that have been mentioned.



The key point, however, is not that these are correct prescriptions to each of these challenges. It is that insurance markets are becoming much more competitive, and as such the quality of management will be a critical determinant as to whether a particular insurance company ends up in the winning or losing category.

The vision, culture, strategy and focus of a company will determine its competitive positioning. The skills and experience necessary for a management team to make more right decisions than wrong ones are probably broader than will be possessed by any in-bred management.

Increasingly, top executive management will be drawn into the industry from other industrial and commercial sectors. And increasingly, most of the problems of the insurance industry will be seen to be nothing special. They will say -- "so what's special about insurance?"

Ninety percent of the management task will be non-specific to the insurance industry. The tasks of delivering customer satisfaction at an ever lower real cost, of seeking continuous improvement throughout the organization and of delivering shareholder value will mostly use disciplines developed in other industries.

This will change the character of the insurance industry itself and the skills and experience required for those aspiring to future leadership roles within it.