

The Distribution Dilemma

White Paper

Dave Greenwell



THE REVERE
GROUP
an NTT Data Company

The Distribution Dilemma

What's an Insurer to do? On the one hand there appears to be an ever creeping erosion of the market share of insurance products sold through agents. On the other hand, most companies have huge investments in their agent force and still receive the great majority of their premium income from agent cultivated business. For most companies the path forward lies somewhere in the middle. The key is a deep understanding of market dynamics especially as it impacts your specific target markets.

Recent history has shown that there is a significant and growing minority of the market that prefers to buy insurance products without the help of an intermediary. A deeper analysis of this trend reveals that it is skewed toward predictable market segments and products. For example, the market has and continues to discount the value of an intermediary in regards to the commodity end of the product spectrum, e.g., personal auto insurance and term life insurance. This propensity to buy through direct channels also seems to predominate in specific identifiable demographic groups, e.g., people that do not have easy access to an agent or those that are more comfortable with surfing the web.

It is important to note that there are really two distinct direct sales channels that appeal to very different segments of the market. The first is the old tried and true inbound/outbound call center and the other is the relatively newer internet channel. The dynamics of these two channels are very different. The call center channel appeals to those customers that feel a need for human intervention in the sales process but are not adequately served by the agent channel. The internet channel appeals to those customers that do not see much value at all for human intervention in the sales process.

So, once again, "What's an Insurer to do"? The simple answer that should bring a sigh of relief to many companies is to stay the course. By this I mean that if you are an established company with an established agent-led sales process then you should continue to look to your agent force for the majority of your insurance sales. That is not to say you should ignore the direct marketing channels. These channels are important and growing and should be a part of the sales channel portfolio of most insurers. More importantly, it is not to say that you should expect to rely on the agent distribution channel as it is orchestrated today. There are fundamental changes at play in the marketplace that require fundamental changes in the approach to managing an agency force.

Conventional wisdom holds that the direct channels can deliver insurance products 5% to 12% cheaper than agent channels. This savings basically reflects the compensation structure of the agents less the cost of any additional company staff required to support the direct channel. So long as the consumer believes he/she is receiving incremental value equivalent to this differential the two channels should perform equally in the marketplace. At this point in time, many consumers do value the comfort of having an agent they know and trust and therefore are willing to continue to place their business through the agent. An interesting dynamic that has begun to occur though is the desire to have the value of the agent at the pricing of the direct channels. This dynamic will continue to place pressure on pricing and, in lieu of our ability to reduce agent compensation, will force companies to continue to reduce their back office expenses.

One possibility that might allow companies to reduce the per-unit compensation paid to their agents would be to increase the productive capability of each agent. If, for example, we could double the production of each agent without increasing their workload, we could possibly reduce their per-unit compensation in half while holding overall agent compensation flat. Before you scoff at this as a purely hypothetical wish, field research would indicate that there is plenty of room for improvement in an agent's workload. Less than half a producer's day is actually spent on selling activities. The remainder of a producer's time is spent on administrative tasks, office management, personal education and a myriad

of other non-selling activities. Much of this workload is necessary to comply with Home Office directives and much of it is driven by the way we have chosen to set up our agency forces.

This leads us with two potential avenues to explore. The first would be to increase the customer-perceived value of working through an agent to a point where the consumer would be willing to pay the incremental cost of the intermediary. Most of our better producers have already accomplished this task. These agents have made the transition in their customers' minds from sales person to personal risk advisor. These agents understand their customers well enough to add value in the sales process. For example, they might offer risk engineering advice that lowers the overall cost of insurance for a customer and, yes, risk engineering can be effective even in the personal lines. For example, self insuring through higher deductibles for a customer with a low propensity for claims is a great example. Or writing the teenage son's auto coverage through an indemnity company to reduce the overall auto premium might work in some cases. In addition to these activities, these more customer-intimate agents have inserted themselves into the claims and policy administration workflow by being the first point of contact for any post sales transactions that a customer might have. All these activities work to increase the perceived value that an agent brings to a customer and, therefore, justifies the perceived higher cost of buying through this channel. Following this avenue will necessitate all of one's agents into customer-intimate agents, a task many of you have struggled with for years.

The second avenue to explore takes the opposite approach, i.e. if we can't improve the perceived value add of the agent channel we need to reduce the added cost of this channel. One possibility is to change the role of the agent to where their job was a mirror image of the job of a customer service rep in a call center. In this model, the agent's role would be to contact and bind a customer very quickly and then pass all the current and future administrative activities over to the home office. Geographically relevant and qualified leads would be fed to the agents by the home office so the agent would not have a need for a pre-sales team on his payroll. Under this approach, the component of agent compensation that exists to pay for the agent's office staff could go away since the agent would no longer incur these costs. This approach should greatly increase the proportion of time agents could dedicate to selling activities which should translate into higher sales volume. The key design consideration with this approach is to balance the reduced cost at the agent's location with the increased cost at the home office such that the net effect is lower costs based on economies of scale at the home office.

Both of these approaches require fundamental changes to the role of the agent and, because of that, are not without risk. With that said, the risk is prudent given the need to evolve the agent model to maintain its currency in today's environment.