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Insurance is no commodity business

John Kenneth Galbraith was right, says ROSEANNE BACHMAN – 'conventional wisdom' may be popular but is often wrong

IN AN ideal world – and in line with notable marketing concepts – you would not want your products or services relegated to the commodity segment of any market.

However, conventional wisdom running through some areas of the property/casualty (p/c) market seems to pinpoint that trading in the commodity graveyard is inevitable. In fact, "insurance is a commodity business and the customer only cares about price" is a common cry from some insurers and brokers alike. I have even heard a senior executive espouse in the hallowed hall of Lloyd's that the insurance industry is nothing but a commodity business despite the breadth and global reach of that executive's company.

'Conventional wisdom'

It was economist and writer John Kenneth Galbraith who coined the phrase "conventional wisdom". He also observed the commonly held beliefs that became conventional wisdom were frequently wrong. In the case of insurance being a commodity business, he could not have been more accurate.

Contrary to popular belief, the insurance industry does not meet usual definitions of a commodity product or service. Commoditisation is usually evident where customers view products as homogeneous, where there is little or no differentiation between competitors, where consumer knowledge about a product is so complete that no additional information is needed and where the product only trades on price. Furthermore, while the industry does succumb to trading on price from time to time – and while there are segments of the market that could be viewed as a commodity – the majority of the industry is not homogeneous and is not fully understood by customers.

The insurance industry is part of the "knowledge" industry, after all. With this in mind, how can it be possible that an industry that sells its understanding and management of risk and is experiencing a war for talent is viewed as identical in most aspects? Surely as part of the knowledge economy, the industry is dependent on its employees' ideas, wisdom, and ability to execute strategies?

It would be difficult to imagine these being exactly the same across companies in the market, whether that be internally or how they are presented externally. Even if the wording of policies and strategies were the same or similar, key differentiators would be the companies' risk assessments and the way in which they provide their individual services.

Insurers' products consist of considerably more than just the policy document; the key elements include the promise to pay up should a loss occur and the service delivered before, during and after a claim. A company's track record of upholding that promise and the anticipated potential to fulfil that promise are key – and often undervalued – differentiators.

An unintended outcome

Alas, the commoditisation of products can be an unintended – and unavoidable – outcome, even without spreading the word that yours is a commodity business. Trading on price encourages customers to think products should all be viewed as the same, even when they are quite different. If you were to encourage this further still by claiming that the business itself is a commodity, then that would only further enforce the belief that it is. As the saying goes, you are what you believe.

The industry can ill afford to accept this, however, particularly at this time. And while Mother Nature has taken a bit of a breather after back-to-back record-breaking loss years for the industry, the factors that brought those losses remain.

The amplification of volatility will not fade away and the record number of cats to date this year in the US is a possible indicator of the type of loss year it might be.

The recent earthquake in China is a grim reminder of Mother Nature's power, as were last year's back-to-back category five hurricanes only a week apart. Category five hurricanes are supposedly rare events. If you add hurricane Mitch to last year's two, that makes three category fives in nine years for central America. Throw emerging risks and some potential liability issues into the equation and it becomes clear that there is more to this than price alone.

In my opinion, two key aspects need to change. First, the industry must believe that it brings value to clients and second, it needs to effectively communicate that value to the clients. Insureds are not always the experts on weighing up the costs of loss prevention and/or insurance versus the true cost of a loss.

The value comes not only from the eventual payout when a loss occurs but also from helping clients to understand and mitigate their risks before and after a loss. Insurers must bear in mind that many insureds would place business continuity after a loss as more important than anything else, including receiving a substantial payout. If the industry does not effectively communicate how it can help assess risk, the knowledge of past losses, the vision of future losses and other services provided, then it is hard for clients to fully grasp the value that insurers add.

Insureds might say that price is all that matters but that is usually before they have had a chance to weigh up potential differences. Half the battle is to make sure that price does not dominate discussions. A local direct carrier is currently running a TV advert that, unlike many competitors, does not emphasis price in the message. Instead, it draws attention to small differences in the firm's coverage.

Changing people's reactions

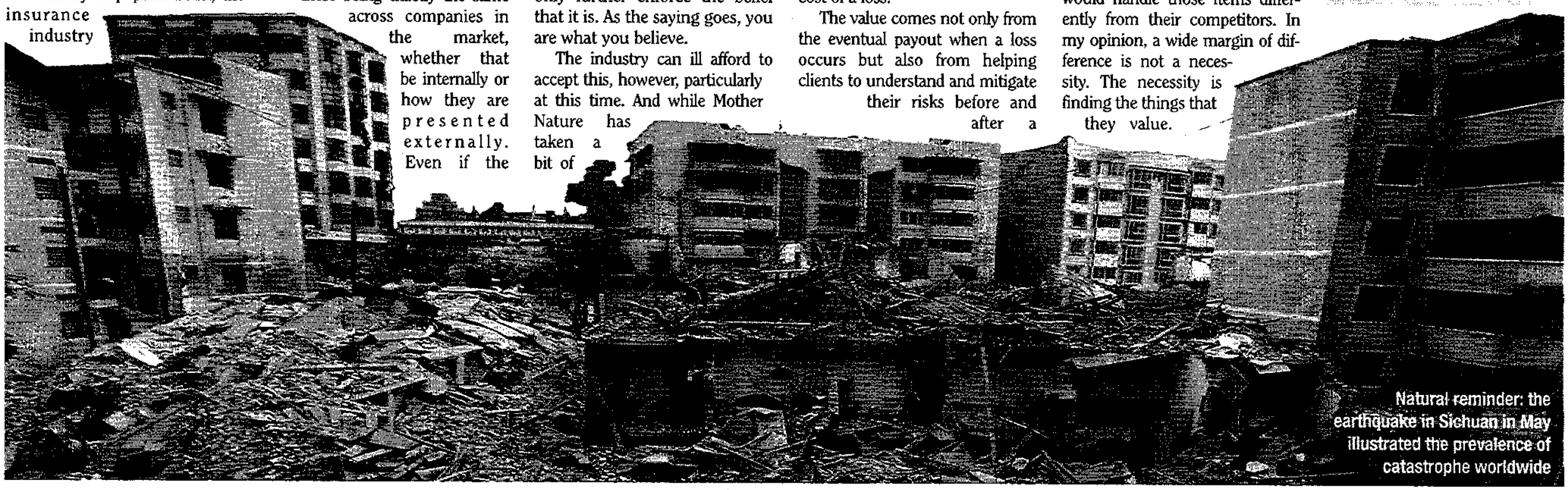
By doing so, peoples' reactions are swayed from irritation — when certain items are not covered – to a generally more optimistic outlook on hearing how the carrier would handle those items differently from their competitors. In my opinion, a wide margin of difference is not a necessity. The necessity is finding the things that they value.

Naturally, clients who never look beyond price do exist but the question then becomes: do you want to operate in this part of the market?

Bucking "conventional wisdom" is undoubtedly not an easy task; however, I still believe that it can be done. In fact, some of the most successful companies across many industries have achieved their success by defying conventional wisdom.

I am encouraged by an interview I read in *Fortune* magazine with the marketing manager of Procter & Gamble, the producer of many products on our grocers' shelves. When asked how many of his products were commodity products, he replied: "None." So, if he does not consider the coverage and protection provided by his firm's nappies as a commodity product, then given the importance of the coverage and protection provided by insurance, it is hard to believe that that would be considered a commodity.

Roseanne Bachman is an independent insurance consultant



Natural reminder: the earthquake in Sichuan in May illustrated the prevalence of catastrophe worldwide