Article from:

News Direct Newsletter

Spring 1999 – Issue No. 31

Long-Term Customer Value Not Just Policyholders

from page 7

programs will increase insurance company sales and profits over time, but they don't provide instant results. While it makes good sense to add programs that tie an insurance company's most profitable customers to a company, in the short term the installation of these programs may require radical changes to the way the company is operated, and insurers may be forced to push for changes in current insurance regulations. However, companies can't flinch even if the required changes hurt for a little while. The old expression "no pain, no gain" applies in this instance.

A couple of possible impediments that insurers may have to address when installing Long-Term Customer Value programs are accounting practices and employee bonus formulas. Often these areas are oriented to achieving short-term results and will act as disincentives for Long-Term Customer Value programs. Accounting practices need to allow for amortization of any marketing expenses that are incurred to bolster Long-Term Customer Value, even though such expenses may exceed the marketing allowance for the initial product. Employee bonus formulas that only consider one year's results are obviously not consistent with the goal of developing long-term relationships with customers.

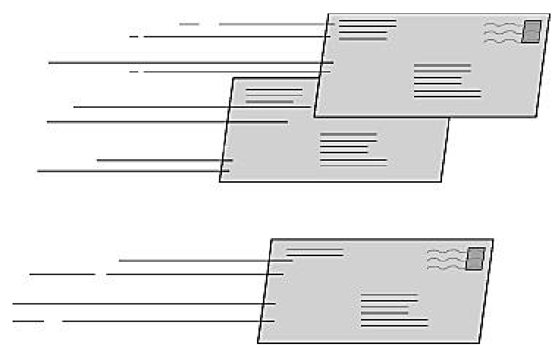
The insurance business needs to ratchet up the way it treats and serves its best customers if it intends to retain these people as clients. There are now alternative distribution channels available to customers and even alternative products that provide basically the same benefits as many traditional insurance products. If the insurance industry is not careful, it could find that "clone insurance products" issued by noninsurance companies that operate in less regulated and more flexible environments could replace products offered by traditional insurance companies.

Creating a vision of Long-Term Customer Value programs within an insurance company is not an easy task. But the insurance company that is successful in implementing Long-Term Customer Value programs will be the envy of the insurance industry.

Jay M. Jaffe, FSA, is president of Actuarial Enterprises, Ltd. in Highland Park, Ill. He can be reached via e-mail: jayjaffe@compuserve.com.

Direct Marketing: Part 1—Analysis of Solicitations

by Neil Lund



Editor's Note: This excerpt is reprinted with permission from Issue 15 in the June 1993 issue of NewsDirect.

Bob Stone, in his book, Successful *Direct Marketing Method,*[1] notes that " . . . underlying all direct marketing success is the ability to trigger a direct action, a measurable action at the right cost."

This brief article covers measurement of key actions by presenting an approach to the analysis of direct-mail insurance solicitations. The analysis also can be adapted easily to telemarketing, television, newspaper inserts, take-ones, and other forms of mass marketing.

The basic analytical approach is displayed in the table on page 9. The table sets out the data needed, the analysis performed and the formulas used in the various calculations. While the analysis and therefore the table are relatively straightforward, several items deserve some elaboration.

The key measurement in the approach is the ratio of converted premiums generated to marketing cost, commonly referred to as the TAP:MC ratio (item 21 in the table). The TAP:MC ratio approach is superior to using response rate targets only, because the TAP:MC ratio is a dynamic measure that adjusts for changes in costs, response rate, and average premium size. It also allows for a valid comparison of the cost effectiveness of various approaches. (Before we go further, a small discussion on terminology may be appropriate. Direct marketing, like much of the insurance industry, does not have a set of precisely defined standard terms; other terminology is equally accepted. For example, the term "TAP" also is known as "TARP" [total annualized renewal premium], as annualized premium, and as gross annualized premium. Similarly, some companies use the ratio of marketing cost to premiums as their measure. While the terminology may vary, the basic concepts remain the same.)

When using a two-or three-drop mailing, data should be captured and analysis performed for each drop and for the mailing in total. In such cases, mailing names such as “XYZ Drop 1,” “XYZ Drop 2,” and “XYZ Total” would be used. The budget should be prepared similarly for each separate drop and in total.

The cost of the mailing includes the costs of postage, printing (including overruns), the lettershop, and so on. Other costs that should be included as marketing costs, however, are not obvious and often subject to debate. My preference is to include the cost of any segmentation work, list fees or extraordinary expenses as part of the cost of mailing. The handling of creative costs is quite challenging. A good package can be used for many years over many mailings with great success, while some packages are used for one test and discarded. Still other packages can be customized with each use. My preference generally has been to include only any customization of creative in the cost of the mailing (partly to discourage meaningless customizing) and to carry the bulk of creative costs as part of the marketing area’s general expenses. Whatever the approach, the definition

Response Analysis

Line	Category	Budget	Actual	Formula
1	Mailing Name	Sample	Sample	Input
2	Mailing Code	50,007	505,392	Input
3	Number Mailed	507,000	505,392	Input
4	Cost of mailing	$218,000	$217,963	Input
5	Cost per 1,000	$429.98	$431.28	Line 4 / Line 3 x 1,000
6	Number of responders	2,390	2,327	Input
7	Annualized premium of responders*	$454,000	$477,043	Input
8	Average premium	$189.96	$205.00	Line 7 / Line 6
9	Gross response rate	0.3777%	0.364%	Line 6 / Line 3
10	TAP:MC gross	2.083	2.189	Line 7 / Line 4
11	Number issued	1,912	1,838	Input
12	Annualized premium issued	$363,300	$362,086	Input
13	Average premium	$191.01	$197.00	Line 12 / Line 11
14	Issued response rate	0.377%	0.364%	Line 11 / Line 3
15	TAP:MC issued	1.667	1.661	Line 12 / Line 4
16	Issued rate	80.0%	78.986%	Line 11 / Line 6
17	Number converted**	1,721	1,672	Input
18	Annualized premium converted	$327,000	$337,843	Input
19	Average premium	$190.01	$202.06	Line 18 / Line 17
20	Converted response rate	0.339%	0.331%	Line 17 / Line 3
21	TAP:MC converted	1.500	1.550	Line 18 / Line 4
22	Converted rate	90.010%	90.968%	Line 17 / Line 11
23	Marketing margin	— — — —	$7,265.67	Line 18 (Actual) / Line 21 (Budget) - Line 4 (Actual)

* *Annualized premium is used rather than modal premium.*

** *Converted means that at least one premium of any mode has been paid. Converted is net for “free looks.”*

(continued on page 10, column 1)

and capture of mailing costs must be specified and consistently applied to all mailings.

The marketing margin (item 23) is an estimate of any excess over or a shortfall from expected profits for the solicitation. It is the difference between what theoretically could have been spent in solicitation costs to generate the converted premium at the budget rate and what was actually spent. Marketing margin is a very effective means of communicating with the marketing area and can be a major part of any "source of earnings" analysis you may perform.

Finally, as noted before, the TAP:MC converted is the key measurement, but it is not the sole measure of success. If the TAP:MC converted for an actual mailing exceeds that ratio assumed in pricing the product, the potential for higher-than-normal profits exists. However, a higher TAP:MC ratio for one mailing package does not necessarily mean a better result or more successful mailing than a lower but still acceptable TAP:MC ratio for another package. For example, if a company engages in significant cross-selling, a solicitation that generates a higher response rate at an acceptable TAP:MC ratio may well be more desirable from a total lifetime profits standpoint than a solicitation package with a lower response rate but with a higher TAP:MC ratio.

This analysis is very straightforward, easily programmed as a spreadsheet or in databases, and provides an objective measurement of your marketing actions.

Neil Lund, FSA, is a vice president & chief actuary at Montgomery Ward Life Insurance Company in Schaumburg, Ill.

Bibliography

1) *Successful Direct Marketing Method*, 4th edition, 528 p. (0-8442-3180, National Textbook), NTC Publishing Group, 1984.

NewsDirect
1999 Papers Contest

The Nontraditional Marketing Section is still accepting papers for its 1999 incentive program. We are accepting original papers for publication in *NewsDirect* which would be of interest to Section members.

As an incentive, the Section is holding a contest for 1999. A cash prize of $250 will be awarded to the author of a paper the editorial board accepted for publication in 1999. *NewsDirect's* editorial board will decide which papers are acceptable for consideration. It is not required that papers be submitted by members of the Section.

Articles should be approximately 500 to 2,000 words in length. It is suggested that articles be educational in nature, include real-world examples, and cover current issues or original research. A list of suggested topics include:

Banks and Insurance	Payroll Deduction
Credit Insurance	Pre-need Life Insurance
Direct Response	Other

This is a great opportunity to share your ideas and get some recognition. If you have an idea for a paper, but are not sure if it is appropriate, please contact us. Articles should be typed in Word or WordPerfect and submitted via e-mail to **joseph.e.brennan@prudential.com**.