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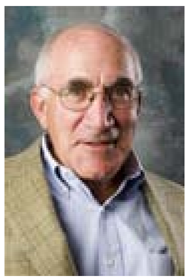
AN ACTUARY'S INSIGHT INTO STRATEGIC OPPORTUNITIES

By Jay M. Jaffe



We live in a world of fast paced change. Therefore, a business needs to accept that change is an inherent part of its culture and that the amount of change that will be needed in the future is probably much larger than a business predicts.

The challenge is to identify the steps that will be necessary to continue to be a relevant business in the future and then to be one of the organizations that successfully and profitably implements the changes that you've identified.

This article has one main goal: to help you to better see some of the changes that will be needed by your organizations during the coming decade. The specific types of changes the article discusses are strategic opportunities rather than operational or administrative changes. Unfortunately, a hand-held GPS programmed to tell you exactly when and in which direction to turn doesn't exist for these travels.

Business history books are full of stories of companies that had great ideas and failed to implement their strategies. In some cases the inventors of new concepts have even had to watch as other organizations found ways to take their ideas and create very successful businesses. However, the best organizations seem to have the knack for both identifying how the future will look and then making it a reality. GE's memorable slogan "we bring good things to life" reflects exactly how the company operates and why it has been a success.

SUTTON'S LAW

Willie Sutton was a bank robber and supposedly replied to a reporter who asked him why he robbed banks by saying, "because that's where the money is." By the way, Sutton denied that he ever uttered these words.

Regardless of whether the quote is from Will Sutton, it forms the basis of Sutton's Law which is taught to medical students. Sutton's law states that when diagnosing, one should first consider the obvious; put another way, a physician should first conduct those tests that could confirm (or rule out) the most likely diagnosis. Sutton's Law is taught to medical students so that they will order tests in a sequence that is most likely to result in an accurate diagnosis, hence treatment, while minimizing unnecessary costs.

But Sutton's Law is universal. It is applicable to any process of diagnosis, such as debugging a computer program. As I will explain, it is even applicable to identifying and implementing strategic opportunities for insurance marketing.

If you want another way to remember the principle of Sutton's Law, remember the physician's adage, "When you hear hoof beats behind you, think horses, not zebras."

APPLYING SUTTON'S LAW TO INSURANCE

The basics of insurance haven't changed over the years. The aim of insurance is to provide collective protection against risks rather than individuals assuming the burden of such risks. Insurance is intended to cover events which are unpleasant and occur randomly in an exposed population. Insurance is based on the Law of Large numbers which means that while we can't predict whether a particular individual risk will suffer a loss, we can actuarially predict the total losses for a large group of covered risks.

Most people understand that they can't afford to cover certain risks by themselves. While home fires don't occur infrequently, if one were to occur and cause serious damage, most of us either couldn't afford to repair our residence or it would put a large dent in our savings. Thus, we turn to insurance.

The connection between Sutton's Law and insurance is that there are usually several obvious reasons people buy insurance and these reasons haven't changed over time. The reasons include:

- Insurance is required–such as by a mortgagor to cover property being secured by a loan;
- Insurance covers an event that we recognize is more a matter of when it will occur rather than whether it will occur–such as death, medical costs, etc.;
- Insurance provides peace of mind against a very unpleasant event–such as cancer insurance provides because we've all seen the dreadful impact of cancer on a friend or loved one; and
- Insurance seems like a good bet–such as accidental death insurance

where only a very small premiums is paid relative to the amount of benefit provided.

What Sutton's Law really means in relation to insurance strategic opportunities is that you need to look for new ways to apply the old rules. For example, 20 years ago there wasn't coverage for lost or damaged cell phones. But as cell phones, PDAs, iPads and other personal electronic devices have proliferated our way of life, the motivations just described drive people to buy coverage in the event they lose their electronic communication capacity. Fact: nearly 30 percent of households today don't have landlines–this means they communicate entirely with PDAs, Skype or other devices not wired to telephone poles and explains why insurance for cells phones has become a popular product.

It is very unlikely that any of us will ever create a real new insurance product during our careers. But we can find profitable new strategic opportunities that work off of the basic principles of insurance and apply these to new markets or in new environments. The following section describes a specific instance of how I applied the principles to identify a new strategic opportunity.

SELF-SERVICE LIFE INSURANCE

Nearly three decades ago I was a speaker at the Montreux, Switzerland Direct Marketing Symposium. Insurance direct marketing was one of perhaps 20 tracks at the meeting.

On the long flight home it hit me that there was a strategic opportunity to change the way life insurance was sold. Specifically, the onrushing advances in computer technology would make it possible to offer meaningful amounts of life insurance directly to consumers.

Historically, life insurance is a product which people say is sold rather than bought mainly because for most of us it is unpleasant to accept our own mortality and life insurance may not be a simple product to understand. Moreover, purchasing a life insurance policy is usually a complicated process.

So why did I see that things could be different. Here are the factors I identified as being game changers:

- The ability for computers to cost-effectively store and retrieve information rapidly;
- The integration of computers into the daily lives of the public;
- The increasing availability of "user friendly" software so that computer users would not have to become computer geeks; and
- The ability of home computers to communicate with other computers.

OK, I missed predicting the Internet and its impact on the world but in all other respects, I was able to understand the importance of fundamental factors that would be game changers and why there was a new strategic opportunity staring us in the face.

I imagined that if people were able to buy life insurance directly they could be charged less for the policies because commissions to sales people would be eliminated. I even predicted that there would be aggregators that would provide detailed information about the products offered by many companies and that underwriting would become automated through the use of medical data bases.

As I learned later, I forgot that it would still be necessary to drive people to specific sites and that this would be expensive. I also didn't foresee the proliferation of data which, by itself, would help reduce costs because there would be more accurate and comparative information about premiums available to the public. Even though I didn't exactly predict how this new distribution opportunity would develop, my few omissions don't in any way diminish that I was able to see an entirely new and emerging distribution system for life as well as non-life insurance.

When I identified a strategic opportunity for life insurance, I didn't use a crystal ball or a time machine. What I did, many of you can and should be doing. Look at what is happening around you and then put all this information into perspective. Those of you with insight look at changes as information; those of you who ask why someone else thought of the idea tend to look at changes as noise.

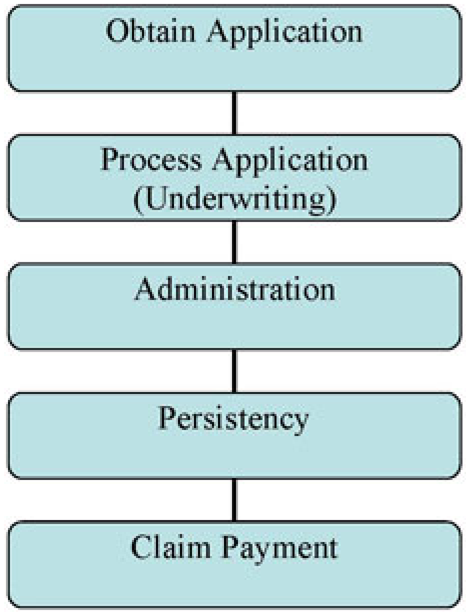
If you don't innately have the skills to look ahead with confidence, it can be learned. All it takes is a bit of effort in order to train your brain to look at the whole picture. And if you want to read my prediction about "Self Service Life Insurance," see Best's Review, October, 1983.

As Sutton's Law stresses, look for the obvious or, at least, the obvious direction in which the insurance business must travel in order to keep pace with emerging environments so that you can identify new strategic opportunities.

IDENTIFYING STRATEGIC OPPORTUNITIES

Assuming that you're on board with needing to find strategic opportunities, how can you and your companies make this happen? For insurance marketing you need to visualize the components of insurance products and then go after opportunities that improve operational or marketing efficiency in one of these areas. I also am defining new strategic opportunities to be more or less the same as game changing steps. So while tangential or marginal new efforts are always important, I am not considering such activities as new strategic opportunities.

Here's a simplistic but helpful picture of what I mean when I talk about visualizing the components of insurance products such as is the situation for directed marketed programs:



The first task is to get somebody to respond. This can involve such factors as:

- Media,
- Offer,
- Product, and
- Price.

Here are a couple of break through events, or game changing activities, I have seen during my career that have changed the insurance direct marketing business:

- Guaranteed Issue Life (graded death benefits),
- Telemarketing, and
- Internet.

GI or graded death benefit life made it possible for older people to obtain small amounts of life insurance for final expenses without having to undergo a physical exam. It was both an appealing offer and because it used graded or modified death benefits, it made underwriting unnecessary.

Several years later another breakthrough change occurred when a group of companies discovered that they could market their products by the telephone. The use of telemarketing became feasible as less expensive and easier to use telephone equipment and competing phone providers became available, but it also was in reaction to the overloading of direct mail that was clogging everyone's mail boxes and was becoming a less effective media. However, while telemarketing was also a very productive media, it was extremely capital intensive and many smaller companies were precluded from using this approach.

The introduction of the Internet is a now event and we still don't know its impact, but it has already altered the way insurance is marketed.

Application processing is the next phase of our business. I've already mentioned guaranteed issue life insurance as an example of a new strategic opportunity. GI essentially avoids any meaningful underwriting and allows for all applicants to be accepted.

But what about opportunities to make underwriting a less painful process for all the other forms of insurance where applicants must still undergo some form of approval? Yes, there are always going to be strategic opportunities emerging that can help.

In both P&C and life/A&H markets, major game changing processing opportunities have become available to insurers in recent years. For auto insurance the use of credit scoring has become common place because this data enables underwriters to efficiently and appropriately place applicants in one of several risk classes. For life/A&H, prescription drug records are increasingly used because they offer a fast and effective insight into the health of applicants. Both of these strategic operational activities are the result of improved data bases and the ability, almost in real time, to retrieve and analyze the information they provide.

The administration of insurance products offers many opportunities for new strategic opportunities. Improving administration not only reduces costs, but should lead to improved policyholder satisfaction and persistency.

A simple example of an administrative strategic change that occurred during the early years of my career was the acceptance by both the public and insurance companies of automatic premium payments from checking accounts and credit cards. With these changes it became possible to insure many people who simply would not have the discipline to pay monthly premiums or would not have had the available cash to pay using quarterly or other less frequent premium payment modes.

The ultimate test of an insurance policy is when a claim is submitted and paid. While claim payment is a very important step, it is not a particularly sexy part of our business. For those types of insurance where claim payment is more frequent, it is necessary to find ways to make the process more user-friendly. However, I can't think of any game changing claim payment strategies that have emerged, although there are many changes that have been implemented to make the claim payment process more efficient and transparent.

The message from what we've just covered is that you don't have to completely change the entire insurance experience to be able to find new strategic opportunities. Some companies may be better at one part or the other of the overall process and in these areas they may be innovators. For whatever reasons, in other areas they may be and should be more comfortable being buyers or borrowers of new concepts from others.

Clearly, many strategic opportunities emerge as a result of new and improved technologies. Other strategic opportunities develop as solutions to business practices that otherwise prevent or deter sales. Then there are also strategic opportunities that emerge as a way to solve heretofore unsolvable problems. Crises are another source for new strategic opportunities because these events blatantly identify flaws that cry out for solutions.

If I were asked to start looking for new strategic opportunities, I would become very knowledgeable and sensitive to the following:

- Media changes,
- Governmental/Public policy changes,
- Technology developments,
- Economic trends and changes,
- Consumerism developments, and
- New social trends.

These areas are starting points for finding the strategic paths and opportunities that are going to define the insurance markets and products of the future. Think of finding new strategic opportunities as a treasure hunt. The clues you receive in a treasure hunt often have multiple interpretations and meanings. The winners of the treasure hunt are usually the people who can read the minds of the staff that created the treasure hunt. In our world the development staff is the public.

MAKING YOUR STRATEGIC OPPORTUNITIES SUCCESSFUL

My first suggestion for helping to improve the chances for success for strategic ventures would be to understand the numbers. Don't think that you can make these activities successful without a detailed grasp of what makes each new strategic venture tick. Fortunately, actuaries already understand this aspect of insurance.

Secondly, the management of new strategic opportunities needs to be put in a separate business unit. I've made this point countless times: most insurance companies stress current activities and results rather than investing in longer term programs. There is too much pressure to produce results today and asking people to work both on meeting current targets and investing in new strategic opportunities is almost never going to work.

The term used to describe an organizational structure that helps improve the odds of a new strategic marketing opportunity being successful is skunk works:

Skunk works describes a group within an organization given a high degree of autonomy and unhampered by bureaucracy and is tasked with working on advanced or secret projects.

One of the requirements for a skunk works is a separate budget and another is a dedicated project staff. If you decide to create a skunk works but not use a separate budget or dedicated staff, you are very likely to be unsuccessful.

Another factor to help bring success is a committed management along with a requirement that there are measurable performance requirements.

Let's assume that you've gone along with my keys to success. Then there's one last element that you need to buy into and it is the most difficult of all the steps: "know when to fold 'em." It is always painful to kill a project but sometimes euthanasia is the only reasonable course of action. The odds of any individual new strategic opportunity being a success are low–actually very low. Therefore, as a friend once explained, one can't dabble in new strategic opportunities; it has to be at least a 110 percent commitment.

CARLSON'S LAW

I first learned of Carlson's Law in an editorial written by Tom Friedman in the June 5, 2011 Sunday *New York Times*. Curtis Carlson is CEO of SRI International. Here's Friedman's description of Carlson's Law and its importance to anyone thinking about strategic opportunities:

"In a world where so many people now have access to education and cheap tools of innovation, innovation that happens from the bottom up tends to be chaotic but smart. Innovation that happens from the top down tends to be orderly but dumb." As a result, says Carlson, the sweet spot for innovation today is "moving down," closer to the people, not up, because all the people together are smarter than anyone alone and all the people now have the tools to invent and collaborate.

Friedman's discussion of Carlson's Law was written in the context of the political world, but it applies directly to every other part of our environment including the business of insurance. The ramifications of Carlson's Law are enormous particularly to a business such as insurance that tends to be relatively slow moving, is usually reluctant to be on the bleeding edge of innovation, generally fails to grasp strategic opportunities, and usually develops new products from within rather than asking its markets what products they want to buy.

SUMMARY

Here's what I've learned and observed about how insurance companies have dealt with finding and implementing new strategic opportunities:

- Most insurance companies historically have performed rather poorly in terms of recognizing and successfully implementing new strategic opportunities;
- New strategic opportunities often are right in front of our eyes, but we need to keep our eyes open to see them;;
- If we don't commit to the need for and importance of new strategic opportunities, your chances for success will be minimal; and;
- In the event that insurance companies see the need to pursue new strategic opportunities, but comprehend that the strategic opportunity business is not their cup of tea, it is strongly recommended that they make friends with their local sharks (aka, venture capitalists or VCs) because they are in the business of identifying and implementing new strategic concepts.;

In the very beginning of this article I talked about change. Change and crises are our friends. Somewhere within insurance companies there should be a Change and Crisis Observation Department that monitors the environment and then recommends possible strategic options. A key function of this new department is to both learn to accept and minimize the impact of failures.

I love to fish. When you go fishing sometimes you land many fish and some days you have no luck. As a fishing-friend once reminded me, if it were so simple it would be called catching rather than fishing. The same can be said about finding and implementing profitable new strategic opportunities.

Jay M. Jaffe, FSA, MAAA, is president of Actuarial Enterprises, Ltd. He can be contacted at jay@actentltd.com