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BRIDGING THE DISTRIBUTION GAP: A DYNAMIC NEW ROLE FOR ACTUARIES

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Abstract

Actuaries can profitably assist in bridging the financial services distribution gap by delivering a unique solution to each customer. Bridging is accomplished by including each customer in the sales and solution design process. The technology, methods and processes are available to accomplish such bridging!

What is this distribution gap? The gap between customers' expectations in this information era, and what is actually delivered; this includes the efficiency with which customers' expectations and deliverables are met. From the providers' perspective, the distribution gap may also be defined as the gap between optimal distribution efficiency and actual distribution efficiency.

The distribution gap has three components: the customers' gap, the distributors' gap and the designers' gap.

We begin by bridging the customers' gap. In fact it will vanish, because customers will participate in the design of the solution and drive the sales process. As a result the customer will no longer face a harsh, often irrational, accept-reject choice and live with what is delivered. Neither would they have to shop for both the right company and product. They will quickly assure themselves that they have found the right company and then focus on assisting in creation of the right solution.

Next, bridging the distributors' gap eliminates distribution inefficiencies and lack of overall satisfaction. Distributors will not face the formidable task of finding the best-fit customers and placing standard one size fits all solutions into the customers' lives as the best they offer. Distributors will now focus on a partnership with the customer throughout the process.

Finally, the designers' gap is bridged because they will have an active role in the day-to-day distribution and delivery process. They will no longer confine themselves to the traditional role of defining standardized products and then disconnecting from the distribution process to assuming the role of the enforcer.

The result will increase distribution efficiencies, customer satisfaction and loyalty. Actuaries are well placed to play a pivotal role toward bridging the distribution gap.

Introduction

The benefits of a comprehensive solution that bridges the financial services distribution gap are profound for all three groups: customers, distributors and providers.

We begin by defining the customers' gap, the distributors' gap and the designers' gap.

Next, we present a case study of the Acting Agent distribution platform and how it enables the realization of this new efficient distribution process. Acting Agent (a co-winner of the Product and Process Innovation Marketing Award cosponsored by Professional Insurance Marketing Association (PIMA) and Society of Actuaries) provides a solution to quantify and bridge these gaps. Financial services providers can attain efficiencies while retaining their current distribution philosophy. This enables the providers to retain their brand value and minimize wholesale business changes.

Finally, we show practical road maps, using a few popular distribution philosophies as starting points, for providers to follow towards a more efficient and effective distribution mechanism.

The Distribution gap

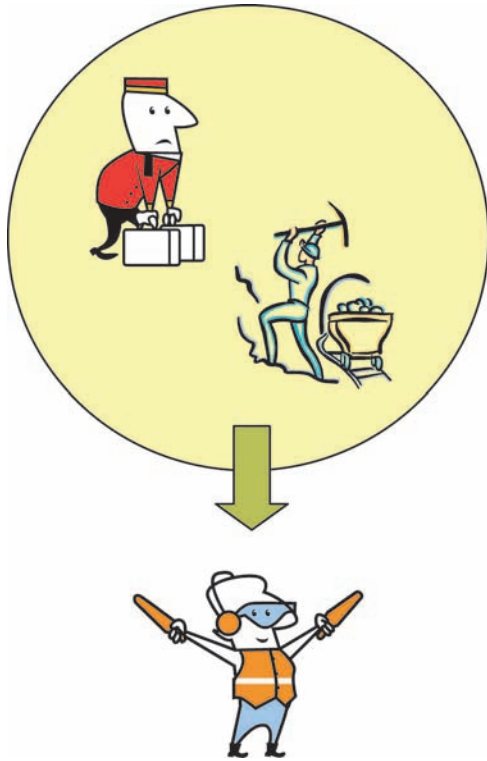
The distribution gap in broad terms is an efficiency gap and an expectations gap combined. From the providers' perspective, the distribution gap is defined as the gap between the actual efficiency of distribution process and the optimal efficiency. From the customers' perspective, the distribution gap primarily represents unmet expectations.



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Customer's Gap

Each customer faces two main gaps that prevent him or her from fulfilling their needs. First, they spend time and energy trying to find the best combination of provider and product. Irrespective of the competence of the vendor/producer of the provider, this burden is placed on the customer. The process would become far more efficient for both the providers and customers if they did not have to shop for product. Second, customers are left with a harsh choice of either accepting what is delivered or rejecting it. Every reject decision, from a customer's perspective, represents the inability of the deliverable to meet their expectations. Currently it is estimated that 20 to 60 percent of the decisions can result in a rejection. By participating in the design of the solution customers get a product that is unique to them, and the provider can attempt to eliminate rejects and increase satisfaction and loyalty.

In summary, by simply eliminating the reject choices the provider can expect to increase distribution by three-fold. Increase in profitability due to the increase in customer loyalty is an added bonus.

Does a distribution gap really exist?

Of course it does.

1. Predictability of sales is illusive at best. Can any provider claim enough control over distribution? How well do management expectations translate into sales actions?
2. A disproportionate gap exists between effort required to gain sales and actually delivered sales. The 10 calls to one sale industry average is only 10 percent efficient.
3. The inability to traverse all segments of the marketplace, such as the middle market, is yet another piece of evidence.
4. The overall lack of penetration of the market - place is perhaps the most telling signal of all.

These few observations are a testimony to the existence of a distribution gap.

Three main categories of subordinate gaps, each representing one key contributor, form some of the underlying reasons for the existence of the distribution gap. We believe that to bridge the distribution gap, all three must be addressed simultaneously.

Currently it is estimated that 20 to 60 percent of the decisions can result in a rejection.

In the past, one of the mitigating factors to enable bridging this customers' gap has been the expense incurred to provide such a highly customized service. Technology is now available to deliver a highly customized solution to each customer on a cost-effective basis.

Distributor's Gap

The distribution gap consists of several components: an effort-to-benefit ratio component, a product-fit component, a skill component and a lack-of-institutional-memory component.

The effort-to-benefit ratio component arises because distributors are required to find the prospect who is willing to become a customer of

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the provider. If the distributor gets to meet four out of 10 prospects that is a 60-percent-wasted effort, a major contributor to the distributors' gap.

The product-fit component is related to the customers' gap in terms of the reject choices made by the customer. The root cause of a reject choice after a contact is the fact that the distributor has to offer an existing product as the customer's only solution. Producers are often faced with the task of selling a round peg to fit the customer's square hole. This creates a gap between customers' expectations and what can be delivered, another reason for rejection and cause of an increase in the gap between the achievable revenue and actual revenue, compromising distribution efficiency.

Skill sets of individual distributors vary greatly. The burden they carry in terms of understanding product, creating solutions and practicing the art of selling are enormous. This gives an example of the application of the 80/20 rule, where 20 percent of producers, the highly skilled ones, account for 80 percent of the production. This, in turn, contributes toward the distributors' gap from a provider's perspective.

Providers often lack, or have little memory of, the actual sales dynamics that occurred to build each customer relationship. They are unable to pick-up the relationship effectively when there is change in distribution personnel. The result is a choppy experience for the customer. Providers' inability to synchronize management expectations with individual distributors' actions only adds to the gap.

In summary, the distributors' gap is multifaceted. The designers' gap, the customers' gap and the process followed by the distributors all contribute to the breadth of the distribution gap.

Designers' Gap

Designers' inability to profitably deliver a unique solution to each customer affects both the distributors' gap and the customers' gap. Today, generally speaking, they create a one-size-fits-all product then move into an enforcer role. The enforcer role often prevents them from helping in

the distribution process. Inability to make profitability trade-offs at an individual case level prevents them from entering this space and hence creates the gap.

The designers' gap is also a gap in roles performed within the current system. It is completely within their control to bridge the gap by undertaking a nontraditional role.

A Nontraditional Role for Designers

Designers can trigger a domino effect by taking on a nontraditional role in support of customers and producers. In order to master and successfully accomplish this new dynamic role they need a new set of tools and a distribution platform modification that enables them to participate in a profitable fashion.

It is impossible to cost-effectively get an actuary to sit down with each customer to design and deliver a solution. Acting Agent provides an innovative way by which an artificial intelligence-based proxy of the actuary does the interaction on their behalf in such a way that it enables them to perform their enforcer role simultaneously. Their nontraditional role would be to manage the artificial intelligence entity.

A New Distribution Platform is Essential

A new distribution protocol is essential to attain a new operating state, which bridges the distribution gap and places the providers and their distributors or producers in a continuous improvement loop.

Acting Agent as a comprehensive distribution platform

Acting Agent provides a solution to bridge the distribution gap and implement the new distribution protocols required to attain a more efficient operating state.

In a nutshell, here is how Acting Agent delivers its promise.

It helps bridge the customers' gap by:

1. Enabling the designer to provide a unique solution to each customer that he or she cannot get anywhere else.
2. Helping producers master sales dynamics, which raises baseline producer competence.
3. Providing a highly flexible action management structure that ensures that each customer's experience is unique, consistent and meets his or her expectations.
4. Establishing institutional memory of the actual relationship-building sales dynamics that occurred between the producer and customer to the provider. This enables the provider to ensure customer loyalty and satisfaction.

Acting Agent helps bridge the distributors' gap by:

1. Eliminating the producers' need to find the right customer because Acting Agent finds the most suitable customers and prospects for them. Customers' or prospects' suitability is based on the imminence of their need, their motivations, likely matching of producer's skills and personality and attraction to the provider.
2. Creating a unique solution and associated sales process for each customer.
Each unique sales process tries to maximize producers' effectiveness and ensures that the provider's uniqueness is amplified vis-a-vis the customer. Each sales process is based on two factors: first, the strengths, weaknesses and past performance patterns of the producer, second, the reasons that drive each customer's or prospect's motivations and needs.
Each unique solution is automatically prepared by Acting Agent based on knowledge it acquired from the actuaries' and the predicted customer needs. As a result product misfit rarely appears.
3. Reducing the administrative burden of each producer. Acting Agent allows the producer to focus on the building of relationships and mastering sales dynamics.
4. Actively participating in each customer interaction alongside the producer by providing sales chemistry enhancement support throughout the interaction. Acting Agent adapts to each producer's stream of

thought and guides them through the soft side of selling. The result is increased overall productivity because some of the producers in the 80-percent group (the weaker set in the 80/20 rule) start performing with the proficiency of the 20-percent group (top producers in the 80/20 rule). In addition, it makes the customers' experience consistent and free from disconnect due to changes in personnel.

Provider's corporate distribution experts get access to greatly expanded critical information regarding the soft side of selling and put it to active use by reinforcing successful patterns and mitigating failing patterns.

With Acting Agent designers can manage risk, create products for each customer, manage product portfolios and perform the enforcer function, simultaneously. Designers can teach and program Acting Agent's engine and let it perform these functions on their behalf.

Acting Agent's generalized learning-based event prediction mechanism makes Acting Agent unique. It is not a black box. The events predicted are not life events in the customer's life, but mutual events (such as purchase, lapse, claim etc.) that occur between the provider and the customer. Life events, if occurred, are taken into account as one of the influences in predicting mutual events. Along with other flexible infrastructure tools Acting Agent makes it possible for a provider to bridge the distribution gap.

How is the Distribution Gap Quantified and Used?

The distribution gap is unique to each provider. It works in conjunction with the desired customer value that each provider wishes to deliver. It assumes that providers' goal is to maximize the value that they deliver to each customer and that each customer benefits from both the distribution aspects and providers' other operations. Optimal delivered customer value requires the providers to achieve and maintain a delicate balance between economic value to providers' distribution components and to the providers themselves.

Thus the distribution gap is quantified as providers' economic value added (PEVA), which is

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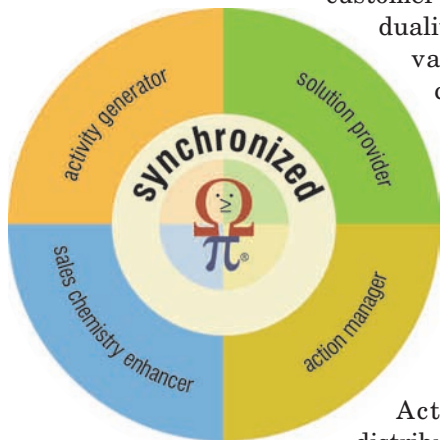
the economic value added to the provider without effect of distribution components, divided by the distribution economic value added (DEVA, which is the economic value added to the distribution components without the rest of the providers operation taken into account.

$$\text{Distribution Gap} = (\text{PEVA} / \text{DEVA})$$

Currently it is widely estimated that this ratio ranges between 0.005 and 0.25, which is heavily slanted toward the distribution aspects. As the distribution gap is bridged, this ratio will increase.

Providers follow a two-step process to set a goal for an acceptable distribution gap. First, they determine the desired overall customer value they wish to deliver. Then they use that value to define the distribution gap that needs to be bridged to meet the customers' expectations and their own efficiency requirements.

The Acting Agent process uses a specialized customer value called the "customer duality value." Customer duality value is measured from the customers' perspective, it is prospective and allows for separation of distribution aspects from the rest of the provider's operations. The result provides a way to map customer value directly into the distribution gap.



Acting Agent addresses the distribution gap. It takes a comprehensive approach to distribution. It does it in four synchronized steps (1) activity generation, (2) solution creation and delivery, (3) action management and (4) sales chemistry enhancement. (See image above.)

Activity Generation

Acting Agent generates activity by creating an optimal coordinated sequence of actions required to generate a desired event. It drives actions creating the desired event. The distributor no longer has to go searching for the customer. Acting Agent points them toward

willing customers and prospects at a time when the customer is most receptive. Lead generation is an automatic internal process of Acting Agent. Existing lead generation mechanisms may feed Acting Agent.

Solution Creation

Designers, customers and distributors together create the solution for each customer. It is not always possible to get an actuary to sit down with each customer and create a solution in a cost-effective manner. Hence, Acting Agent does that on their behalf. Without physical presence the designers effectively set boundaries and place their knowledge within Acting Agent to enable Acting Agent's engine to dynamically create and present a solution. Acting Agent acquires the knowledge by learning from both the actuaries' and customers' preferences. Only when a circumstance emerges that has not previously been encountered by the designer or learned independently by Acting Agent is the personal attention for the designer essential. Acting Agent brings all the tools necessary for a designer to both participate in each transaction and play the enforcer role simultaneously. The enforcer role includes profitability trade-off and compliance verifications as well as regulatory support.

Action Management

Action Management decreases producers' administrative burden and enables the providers to place themselves in a continuous improvement loop. Nothing is allowed to fall through the cracks. Providers get a real-time view of sales actions, which enables them to intervene in a timely manner so as to make the customer experience as efficient as possible. It also bridges the gap from a gross distribution perspective by ensuring that there is no disconnect between actions undertaken and corporate goals. As an overall mechanism this brings added levels of flexibility to the entire distribution process.

Sales Chemistry Enhancement

The soft side of selling is addressed by the sales chemistry enhancement. This does not eliminate the need for an individual's involvement but increases the chances of closing a sale once a contact is made. From providers'

perspectives this is an area where they have little day-to-day insight. They are often unable to manage each experience. Neither is there much institutional memory of this critical aspect of their distribution process.

The dynamics of moving the customer from a passive to an active state, and the participation of the designer, in fine-tuning the solution, is supported in sales chemistry enhancement. Acting Agent helps augment the producer's skills to help increase the probability of a close.

In summary, together these four synchronized steps bridge all the gaps and create an environment for growth.

Road maps

Prominent person-to-person financial services distribution philosophies, career distribution and independent distribution can benefit from bridging the gaps. We present these road maps based on Acting Agent as a distribution platform. Other distribution platforms may require slightly different paths. Further sub-categories of independent distribution are not discussed independently.

A common starting point irrespective of the distribution philosophy is to verify and customize the driving engine. In case of Acting Agent it is a generalized learning-based event prediction engine. Multiple levels of tests are essential to ensure that all the three main component gaps, which require different types of information and accuracies, are well supported.

Career Distribution

Providers with career distribution can then simultaneously start by partially bridging the distributors' gap and the designers' gap. Then proceed to bridge the customers' gap while completing the bridging of the distributors' gap.

Independent Distribution

Providers with independent distribution need to begin by bridging the designers' gap and the customers' gap, then provide the distributors with an optional solution to the distributors' gap with some extra loyalty toward the provider in return.



Conclusion

Bridging of the distribution gap will fundamentally alter the financial services industry. It opens a whole new path for actuaries to lead the transformation of a major client industry. Acting Agent provides a unified solution to long-standing industry problems and helps providers bridge the distribution gap.

Acting Agent Synchronizes:

- The customer's perspective with the provider's perspective, making it easier to satisfy customers and provide life-enriching solutions.
- Individual customer needs with unique solutions.
- Sales and service opportunities with unique solutions.
- Goals and philosophy set at the corporate level with actions throughout the company
- Producer performance with management expectations.
- New provider on-the-job training with best practices.
- Available resources with immediate customer needs. ▣