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Bancassurers no more

Australian banks' mindset offers clues for years ahead

by Mark Turner

Banks in Australia have been extraordinarily successful in selling investment products, both insurance-based and mutual funds, over the last 10 years. During that time, the big four retail banks have gone from a 2% share of new insurance premiums to around 22%.

Despite this success, talk to any bancassurance executive and you will only hear stories of as-yet untapped potential and radical plans to realize that potential. You also might be told that bancassurance is no longer the right term to use.

The bancassurance scene in Australia has been one of experiment and change, with a variety of different models being tested and discarded, as the big players seek the optimal strategy. The big four banks — ANZ, Commonwealth, NAB, and Westpac — now control their own life insurance and mutual fund companies. ANZ started its insurance operations with the acquisition of a life company, while the other three grew their life companies from the ground up.

Discussions of strategy in bancassurance tend to center on a limited number of key areas of debate, which I canvas below. Many of these issues are inter-linked, and bancassurers strive for a coherent and consistent approach.

Two distribution models

Bancassurers in Australia have considered two main generic models: the product model and the advice model. While this is an enormous simplification, it's a helpful way to understand alternate strategies.

The "product model" is based on simple, low-cost products that sell themselves. Under this model, the product "sits on the shelf" alongside other bank products and, suitably supported by advertising, etc., is bought by the willing public. Often, insurance products are packaged with standard bank products to improve sales. Banks are very comfortable with this model as it tends to fit well with their established mode of operation in respect to product positioning, marketing, and distribution.

The "advice model" generally takes the form of leads generated through bank branches being passed to specialist advisers. Products are more complex and should support higher margins.

In Australia, the advice model has been the favored approach for the big four banks, although both approaches have been used. However, the banks' success has been greatest in the area of simple, single premium products. It may be that the advice model is partly a legacy of the perceived wisdom on how life insurance must be sold. Certainly there are sales compliance issues that can drive companies to the advice model. However, I would speculate that the product model may gain in importance in the future.

Developments continue to arise in distribution. Two examples are direct mail campaigns and, more recently, telemarketing. Both have had notable successes.

Client management issues

Several issues can be broadly classified under the heading "client management."

In general, banks do not have integrated systems that would allow them to identify all relationships they may have with a customer. Australian banks have long recognized that improved customer databases are a major opportunity for them. Improvements in technology are at last likely to see these opportunities realized. There are some issues related to privacy legislation, but it would seem possible to develop and implement a sensible commercial product with appropriate privacy protection.

Investment products need to compete for the attention of the distribution with a wide range of other bank products. They may even be seen as a threat, simply cannibalizing the deposit base of the bank.

Banks are wrestling with the problem of developing consistent pricing approaches across all products, which will to some extent help them manage the cannibalization risk. The preferred models are based on discounted shareholder profits, taking into account the cost of capital — models very familiar to those from an insurance background. As might be expected, there are major practical issues in carrying through this approach, relating to cost allocation, capital allocation, and product persistency studies.

The holy grail for banks in client management remains a good understanding of the lifetime value of a customer. Shareholder value added, by product, for each sale is a critical building block towards this goal. This, together with appropriate customer segmentation studies, should lead to substantially improved performance over time.

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The final and most difficult step in aligning goals and performance is tying incentive compensation and employee appraisals to balanced scorecard results. Great care needs to be taken in designing such programs to ensure they link the proper incentives to the right balanced scorecard factors. When a program is well designed, such a linking can provide a powerful alignment of individual and corporate motivations.

Scoring the scorecard

A growing number of companies — such as FMC Corporation, Mobil Oil, Sears, The Principal Financial Group, and Nationwide Financial Services — have implemented various aspects of the balanced scorecard. Kaplan and Norton say that as companies broadened their perspectives beyond the merely financial and strived to measure key business drivers, they clarified their strategic vision and have more closely aligned divisional, departmental, and individual performance with that vision. Implementing the balanced scorecard is an evolutionary process, which will take its own path within each company. To do it well, a company should plan on a significant investment of time and resources. The payoff may be worth it.

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Integrate or specialize?

Historically, Australian banks' insurance operations have grown up as individual, specialized divisions of a bank. Over the years, there have been a number of pushes to integrate bank and insurance operations. The potential advantages of such integration could be great. Most notably, integration is seen as a way to overcome perceived cultural differences that may have a material impact on sales. Integration is seen as particularly attractive on the distribution and marketing side. Commonwealth Bank recently implemented sweeping organizational changes aimed at integrating the various areas of the bank.

Full integration may have a downside. In particular, a product can become lost in a large bank without a champion to support it. Further, specialized skills related to insurance and investment products need to be maintained. ANZ Bank is known to believe in the importance of maintaining a separate team focused on insurance and investment products.

Consistent scorekeeping

The issues related to pricing approaches are clear. Less obvious are those related to risk management and capital allocation, which also impact pricing and scorekeeping. Multiservice providers are only just beginning to address these issues in Australia. The traditional approaches to risk management in banks, fund managers, and insurance companies are very different, reflecting the range of risks faced. This was never much of an issue before the rise of the multiservice providers, but now it has become critical to be able to assess risks of varying nature on an even-handed basis.

Without being underpinned by a coherent approach to risk management and capital allocation, attempts to price consistently and operate consistent scorekeeping may not be successful.

It is plain that many executives from a banking background find insurance risks, such as AIDS and sales compliance risks, hard to assess and rather unnerving. Insurance executives might find similar discomfort with banking risks if they aimed to run a banking operation.

Is 'bancassurance' the right term?

The debates set out above all seem to be heading toward a different sort of institution than might be characterized as a bancassurer. Australian companies now regard themselves as financial services providers rather than banks, insurance companies, mutual funds, or, indeed, bancassurers.

With this mindset in place, it may be clearer to see how the above debates might be settled. Here are some speculations on possible resolutions.

In regard to the product model and the adviser model, a true financial services provider may be driven towards the product model. The critical deciding factor may be the need to develop a consistent value proposition to put to the customer. It is difficult to sustain a position where product pricing is inconsistent among products which may be seen as substitutes for each other. The future focus may be on customer needs rather than products.

On the issue of customer management, it seems inevitable that the present trends will lead to a single coordinated marketing effort focused on the customer rather than on product segments.

On the issue of integration, I believe that further integration will occur, but the need for product champions and experts will remain. Financial services providers are likely to operate a variety of distributions supported by an integrated marketing approach.

On the issue of the consistent scorecard, I see the development of common risk management and capital allocation standards as being one of the critical areas yet to be faced — and one that will be faced now that the financial services mentality prevails.

As a final thought, I should warn those in the United States who look to Australia for interesting bancassurance models that they are looking at a moving target. The industry is reinventing itself rapidly at this very moment. Exciting times are ahead.

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