Article from:

The Actuary

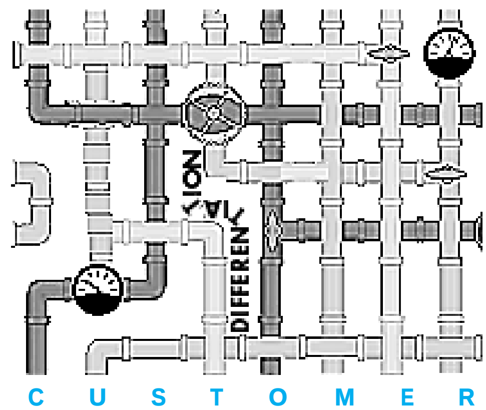
June 1999 – volume 33 - Issue 6

UNTANGLING DISTRIBUTION

Wanted: added value

Changes needed if independent brokers are to survive

by Christopher G. Greis



Independent brokerage agencies have been the alternative distribution system of choice by life insurers using methods other than the career agency system to bring products to market. Brokerage is a variable-cost, efficient, effective delivery system with a solidly positive growth dynamic. As appealing as these attributes may appear — especially to an insurer seeking a desirable alternative to an existing under-performing distribution channel — they may not be sustainable. Indeed, independent life brokerage may soon enter a period of decline unless the channel makes a dramatic effort to reinvent itself.

Reinvention must focus on enhancing value-added services to brokerage's traditional customer base — life insurance sales professionals — and then broadening that base to include all life insurance retailers, not just life agents. This reinvention will require significant effort.

Identification and development of value adds should be the brokerage community's primary method of differentiation. Such value adds may be the packaging of products in planning or assessment services; data base development, management, and mining; lead generation; and Web site development. Differentiation provides competitive advantage for the channel and helps erect barriers to entry by channel predators. Without differentiation and significant competitive advantage over other distribution methodologies, life brokerage will be relegated to niche status, where it may survive but certainly not thrive.

How has such an apparently desirable distribution segment found itself in a situation where reinvention is the only alternative to relegation to something less? The answer stems from this channel's tendency to rely on the marketing and processing of term insurance. Level term products have been aggressively marketed to insurance retailers and to consumers by most distribution channels, creating awareness and demand. Fierce competition among leading term insurers has led to a downward pricing spiral, creating an ongoing marketing opportunity for ever-decreasing rates. Finally, gross term compensation easily rivals commission margins payable on permanent plans; the leading non-New York term players offer a general agent commission plus maximum bonus totals in excess of 125%.

Term insurance, then, is lucrative and represents an excellent ongoing marketing opportunity. Brokerage general agents have focused their efforts on term with very impressive results. Increasingly, term represents a significant line of business when measured in revenue and in marketing expense, and the dominant line when measured in application count.

The huge volume of term applications in most medium and large brokerages has caused dramatic growth in expenditures for clerical support and in attention to processing-related infrastructure. Brokerage firms input application data into their agency management systems, establish and monitor fulfillment of underwriting requirements, and communicate status between and among their client carriers and client brokers. Much of the processing is redundant to home office functions and does little to shorten the four weeks or so required to convert a term application into a term policy.

Term consumes a substantial proportion of a brokerage's marketing effort and support infrastructure. In return, the term business delivers a major contribution to the bottom line. The problem with term, though, and the problem for brokerage firms now relying on a term line of business, is that term is a commodity product offering little potential for a wholesale intermediary to demonstrate value adds. Absent value adds, brokerage firms are little more than product wholesalers totally dependent on the product's viability. Why should independent brokers continue to exist? The only way a brokerage can answer this question is to differentiate itself in the marketplace, and the path to differentiation is to add branding (Chiquita) or to wrap the product in services — essentially, value adds.

Term insurance has a role in a reinvented brokerage distribution system where term is one part of an integrated package of products and services that are delivered by the broker to the re-tail customer. Independent life brokerage agencies must offer a host of value-added services to thrive, and these value adds must be compelling and be

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transferable among different lines of business.

If carriers manufacture products, which they do well, it will be up to independent brokers to develop packaging and a host of other services.

Remember the old lesson about why your last flight wasn't on Southern Pacific Airways? The railroads became so focused on railbeds and real estate that they forgot they were in the transportation business, and the business literally flew right by them. Independent life brokerage agencies cannot forget they are in the service business. If they think their business is purely product delivery, better methods of bringing product to market will pass them by.

Establishing and demonstrating value adds is a tough discipline. Differentiation isn't easy, and erecting significant barriers to entry by predators is a difficult, tedious process. A current trend and a potential bright spot in life brokerage is consolidation. Consolidation can produce revenue-enhancing synergies and expense-reduction synergies, but it offers something more — scale-based opportunity to create and offer value adds. Scale offers critical mass for production fulfillment, enhanced revenues to invest in the development of value-added services and to carry out process improvements, and human resources to continue the evolution of the independent brokerage model. At least nine consolidation endeavors involving independent life brokerage firms are underway at this writing, and if the objective is scale-based opportunity, the future for brokerage as a distribution system is very bright, indeed.

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Nolan, Harvard Business School Press, 1999), states, "... the biggest threat to the banking and insurance industries is the brokerage business." The authors emphasize that stock brokers will survive and become even more important in the financial services industry because of their low-cost operating structure. Of course, maybe the most important reason that brokers will deliver services at low cost and quickly will be the commitment to and the effective use of the Internet.

Bradley and Nolan make another important prediction. They say banks and insurers using conventional distribution face the possibility of a "winner's curse" because "they may win a substantial market share based on number of customers, but a modest market share based on total assets." This assessment should serve as a wake-up call and directional sign to those insurers committed to remaining viable financial services marketers in the next millennium.

At some point in the coming decade, an insurance company will perfect insurance marketing on the Internet. Very likely, this company will become a dominant force for Internet insurance sales because it will have established a brand name with the public and be recognized as a quality service provider. In other words, in a few years, Insurance.com will be just as well known as Amazon.com.

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channels. The central question then becomes, who will win in the service-intensive market segments? The simple answer is, those who learn to play by the new rules, fully understanding that they could require radical changes. Such changes include how professional intermediaries position themselves in the marketplace, the nature of the relationship between intermediaries and their clients, the products and services offered, how intermediaries are compensated, and more.

If all of the new rules were fully known, the only choice would be between old and new and the only risks would be those related to transition. However, some of the new rules are still evolving, with the result that multiple roads are being created and diverging. The exciting prospect exists that there will be multiple roads to success. However, one thing is clear: whatever the choice made, those facing the greatest risk will be insurers who remain in the old paradigm.

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