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UNTANGLING DISTRIBUTION

Service or commodity?

Life insurers being forced to choose in an uncertain time

by Sam Turner

A convergence of forces has obsolesced virtually every element of the traditional paradigm of the U.S. life insurance business — the products sold, who sells them, and how they are sold. Signs of stagnation and obsolescence are apparent in industry statistics such as the following based on LIMRA research.

- The percent of households asked by a producer to buy life insurance has declined since the mid-1960s — and by about one-third since the mid-1980s alone.
- The percent of households owning "producer-sold" life insurance has declined since the mid-1970s and probably by approximately one-third since the mid-1980s.
- The number of full-time life insurance agents has declined continuously since the mid-1970s and probably by about one-third since the mid-1980s.
- New individual life insurance policy sales have declined to the lowest level since at least the Depression and probably by about 45% since the mid-1970s and about 30% since the mid-1980s.
- New individual life insurance premium sales have been stagnant since the mid-1980s, the approximate date when the initial wave of low-load universal life products introduced in the late 1970s was substantially replaced by new products with heavy back-end surrender charges.
- Americans continue to reject cash value life insurance as a viable accumulation vehicle. Americans have flocked to buy alternative accumulation products, but as judged by relative growth, they have rejected cash value life insurance in favor of annuities and mutual funds.

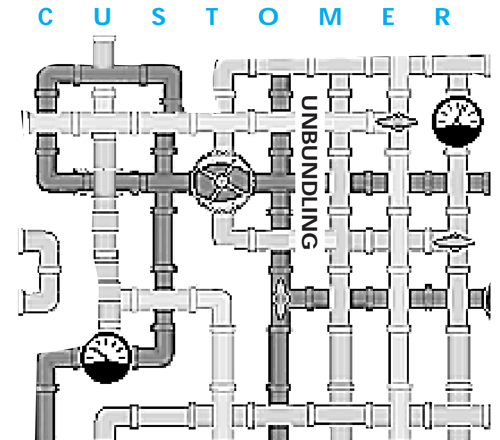
Emerging trends

As a new paradigm for the life insurance industry evolves, several key elements are becoming apparent in emerging trends.

The unbundling of manufacturing and distribution: The modern life insurance industry started with bundled manufacturing and distribution, the latter being characterized by controlled, exclusively aligned career sales forces. We then witnessed three sequential shifts:

- The disenfranchisement of the industry's career sales forces
- Re-aggregation of individuals previously comprising those sales forces into stand-alone marketing entities comprised of independent producers (called producer groups, marketing companies, etc.)
- Most recently, initial signs of reacquisition of those marketing entities by the life insurance industry as well as by banks and others

The unbundling of protection and savings: It is easy to recall that the initial universal life product design (introduced in the late 1970s) represented an unbundling of protection and savings. It is important to note, however, that individual buyers had already forced that separation, and they are continuing to force that separation — one purchase at a time. This is clearly apparent in the dramatic split in the industry product mix from cash value life insurance to term life insurance (protection) on the one hand and to annuities (savings) on the other, each of which reflects lower "loads" than a traditional bundled product would impose. To the extent that buyer actions are driven by a "better deal," low-load products will be the winners. To the extent buyer actions are driven by resistance to the inherent complexity of traditional bundled products, simplicity and disclosure will win the day.



The unbundling of products and services: The first two trends noted have been observable for some time and continue to unfold. The third — the unbundling of products and services — is of more recent vintage, but nevertheless of equal significance. It is manifested in three growing practices, primarily in the high-end market: "blending" (i.e., combining low-load riders with a more traditionally commissioned base policy), charging fees for services outside the product, and disclosure of compensation. Unbundling of products and services also is manifested in the changing role of sales intermediaries and in the emergence of new players in the game. For example, most of the work (services) performed by producers today falls outside the scope of their agency relationship with carriers. Clearly, products and services are becoming unbundled.

The winners

The market for individual life insurance can be viewed as broadly segmented into "service-intensive" and "commodity." In my judgment, professional intermediaries will survive only in the former, the latter being dominated by direct and quasi-direct, low-cost

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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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