

ICA #12

Objective:

Designing competitive positions that generate above normal returns / shareholder value (i.e. rents and market power profits)

Rents:

Resources, customer value and business scope

Building and using Pricing Power:

- **The power to price ($p > MC$) and influence supply costs**
- **More generally:**
 - **firm level (price customization)**
 - **industry level (capacity / 'demand' management)**
 - **supply chain level**

Capacity / Demand Management: Non-life insurance

- **Industry profit dynamic: 'structural' underwriting losses**
 - **structural price pressure:**
 - Deregulation (price to capacity; host to home)
 - Transparency
 - Entry at both 'production' and 'retail'
 - Unfinished consolidation / no European 'leader'
 - Huge overcapacity & sluggish demand
 - **expenses (e.g. marketing, distribution) increase while no strong E of Scale**
 - **claims have mounted, esp. in motor insurance**
- **Industry profit dynamic: 'anemic' investment returns**
 - **Low and stable R_{LT} has exhausted bond appreciation**
 - **'cost of customer debt' \uparrow while $R_{LT} \downarrow$**
 - **Investment returns cannot be counted on to increase ROE**

- **But ... underwriting returns should naturally increase**
 - **Capital constraints theory (capital ↓; MC ↑ → price ↑)**
 - **Saves all in the ST**
 - **Still structural pressures on supply (overcapacity ...)**

- **Fasten seat belts ...**

- **If the industry remains 'competitive' → competitive position?**
 - **Strategy recommendation in general ... :**
 - Create *more* value than competitors (so that you can create more surplus)
 - Consolidate position: sustainability?
 - Appropriate scope?

 - **Consumer surplus: Increase WTP & decrease price/cost:**
 - Treat customer as customer, not as supplier
 - Insurer one step removed from the customer ...
 - Agents / brokers managed in win/lose way (they do not mind more competition at 'production' stage)
 - Are subscale factories ... but cost was not an issue
 - Need heavy re-engineering to create win-wins with agents and win-wins with customers (NPD, segmentation ...)

 - **Consumer surplus: decrease cost**
 - From 'paying' claims to 'buying' claims services
 - Pursue scale / outsourcing effects:

	<u>Structural drivers</u>		<u>Operational drivers</u> ³⁵
	<u>Scale effect</u>	<u>Business Model Configuration</u> ^(*)	
Benefits			
Volume		- Traffic generation in store - Tightening of point of sales management - Centralisation of customer information	- Customer relationship management - Branding
Price			- Risk scoring - Branding
Costs			
Claims	- National	- Transfer of claim management from intermediaries to company's customer service platforms	- Procurement efficiency (from a paying mode to a buying mode)
Distribution & Marketing	- Limited		- Sales modelisation and diffusion of internal best practices
Administration	- National (potentially European)		- Offshoring
Support functions	- European		- Outsourcing of non crucial activities

(*) Illustration for independent intermediaries (agents, brokers)
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- Get efficiencies at the country level:
 - *France:*
 - Expense ratios are the lowest among F, G and the UK and decreasing
 - Claims ratios are close to AXA P&C average
 - *Germany:*
 - Comparatively good claims ratios and control
 - Expenses close to AXA P&C average
 - *UK:*
 - Very high claims and expense ratios
 - The claims ratio increases faster than the expense ratio
 - This suggest a need for 'buying'

- **Investment return analysis (see within AXA comparison)**
 - **Comparison among countries:**
 - France outperforms G and UK
 - **Comparison with the industry:**
 - AXA F outperforms F industry
 - AXA G almost in line with G Industry
 - AXA UK clear outlier

- **Non-life overall per country:**
 - **UK: AXA has been under-performing on all counts**
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 - **Germany:**
 - Turns in positive results, but
 - Compared to the industry is under-performing
 - Yet, G is improving in premiums and income
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 - **France:**
 - Has above average returns but is static in sales.
 - Expenses appear to be targeted for control
 - But the much higher than average expense ratio points to a lack of scale effects
 - Axa appears to harvest its French position (expense control, no growth, hi returns)
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- **AXA Non-life strategic issues: A Leader or *the* Leader?**
 - **M&A, Swaps still a key priority**
 - **Capacity control**
 - Reserve adjustments too easy → tighten!
 - Minimum solvency requirement too low
 - Build BTE by enacting EofSc – no choice
 - **Consolidate power in the supply chain**
 - **Implement strategies to increase consumer surplus**