

The Actuarial Profession

making financial sense of the future


The Application of Strategic Theories to Non-Life Insurance Markets

Illustrated with reference to Property Cat Reinsurance

The team:

| | |
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Interactive Workshop: Please Join In!



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Agenda

- About Strategic Theory
- Applying Porter's Five Forces
- Model Limitations and Blue Ocean Theory
- Observable Strategies
- So What?

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- **About Strategic Theory**
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The Essential Problem
Modeling Your Business in the Future

What Is Strategy?

- Roots lie in the world of military combat
- Focus on the long term
- Focus on outperforming competitors
- Corporate vs Company Strategy
- Often confused with tactics
- Chess...

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What Is Strategy NOT?

- Companies sometimes claim aspirational goals they cannot actually control...
 - A 15% RoE over the cycle
 - The "insurer of choice" for ABC
 - A Top 5 writer of XYZ



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What Is Strategy?

A “Strategy” is a long term series of actions designed to take a company from its current state to its desired future state, and aims to provide a sustainable competitive advantage over other companies in the same market

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Types Of Strategy

Sustainable Competitive Advantage through:

- Differentiation
 - Delivering a product or service that is *perceived to be superior* to competitors
- Cost Advantage
 - Ability to deliver the same product or service as competitors but at *lower cost* (not necessarily price)

Either way can be focused (the so called 'niche player' or 'specialist') - But is this sustainable?

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Strategic Models

- Lots of models discussed in paper
 - PESTL
 - Value Chain
 - Product Lifecycle
 - Blue Ocean Theory
 - and more...
- We have selected one model to *interactively* apply to an imaginary Property Cat Reinsurer
 - 'Porter's Five Forces'

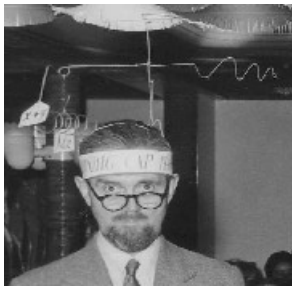
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The Annual Problem
Making Your Head Hurt in the Future

Porter's 5 Forces – Thinking Caps On!



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Porter's 5 Forces

Five key forces control profit flow around a market:

1. Industry Rivalry
 - Competitive behaviour between established players
2. Threat of Entry
 - How easy is it for new players to join in the fight?
3. Threat of Substitutes
 - Do buyers have any alternative the product in question?
4. Supplier Power
 - Do your suppliers have leverage over you (or vice versa)?
5. Buyer Power
 - Do your buyers have leverage over you (or vice versa)?

The Annual Problem
Making Your Head Hurt in the Future

Company Description

- Property Cat reinsurance underwriting company
- Large player writing large risks globally
- Subsidiary of a huge non-insurance group
- Strong capital base, stable AA+ rating
- Buy minimal amount of reinsurance
- Domiciled in Bermuda
- Been around and profitable for 10 years +
- Service the broker-fed subscription market

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F1 – Industry Rivalry

Competitive behaviour between established players

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F1 – Industry Rivalry

Competitive behaviour between established players

- Subscription market and extensive use of similar models tend to converge the pricing and coverage terms
- However, PCC is a dominant force, so able to cherry pick the “best” accounts

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Modeling Your Professional Practice

F2 – Threat of Entry

How easy is it for new players to join in the fight?

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F2 – Threat of Entry

How easy is it for new players to join in the fight?

- Significant barriers to entry:
 - Capital requirements
 - Need diversification – can't really write a small book
 - Need skilled underwriters and modellers
- Doesn't stop the new entrants flooding in when the time is right (e.g. post Andrew, Katrina??)

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F3 – Threat of Substitute

Do buyers have any alternative the product in question?

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F3 – Threat of Substitute

Do buyers have any alternative the product in question?

- Self insurance is not generally an option
- Larger customers may form a captive to retain some of the risk
- Cat Bonds can be a viable substitute, but again only really possible for largest customers

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F4 – Supplier Power

Do your suppliers have leverage over you (or vice versa)?

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F4 – Supplier Power

Do your suppliers have leverage over you (or vice versa)?

- Our suppliers in this context are our reinsurers and capital providers
- We spend relatively little on reinsurance (as a proportion of our gross premium income) so even though we need to buy it, our reinsurers have little meaningful leverage over us

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F5 - Buyer Power

Do your buyers have leverage over you (or vice versa)?

The Essential Problem Solvers
Modeling Your Mindset in the 21st Century

F5 - Buyer Power

Do your buyers have leverage over you (or vice versa)?

- Our buyers are our insured base
- They require protection from a secure reinsurer – our A Rating is very important to them
- In soft markets the brokers will try to leverage the buyer's power by shopping around the available markets – this is when we need to be confident and robust in our approach

The Essential Problem Solvers
Modeling Your Mindset in the 21st Century

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The Essential Problem Solvers
Modeling Your Mindset in the 21st Century

Model Limitations

- Many of the traditional models are static
- Internal or external focus (only)
- Take the environment as a “given”
- Validate strategy within these rules and bounds
- But there is another way to approach strategy...

The Annual Performance
Review 2011/12

Blue Ocean Theory & Value Innovation



The Annual Performance
Review 2011/12

Blue Ocean Theory & Value Innovation

- The search for uncontested market space
- Challenge all factors taken for granted:
 - Which can be eliminated?
 - Which can be reduced well below industry norm?
 - Which can be raised well above industry norm?
 - Which brand new factors could be created?
- Devise a fundamentally different value proposition to your competitors to open up a brand new market space with little competition

The Annual Performance
Review 2011/12

Blue Ocean Theory & Value Innovation

- Insurance examples of new value propositions:
 - Direct Line: Telephone sales
 - Progressive Insurance: Concierge claims service
 - Norwich Union: Pay-as-you-drive
- Challenge: Can you come up with a successful new value proposition for your company?

The Accidental Philanthropist
making them all sense in the future

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Observable Strategies

- Take a moment to think about "strategy" ...
 - Does your own company have a clear strategy?
 - Who developed this strategy?
 - Does it make sense?
 - Which other companies have a clear strategy?
 - Is a "good" strategy always a closely held secret?
 - What makes a company successful? Or fail?

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Observable Strategies

▪ Match the companies and strategies...

- | | |
|-----------------------|---|
| A. Berkshire Hathaway | 1. Cut out the middlemen |
| B. Direct Line | 2. Long term focus on growth in book value, complete disclosure, decentralised management |
| C. Renaissance Re | 3. Underwriting discipline, conservative reserving, avoiding aggregations |
| D. Gerling | 4. Large lines based on confidence in proprietary models and analysis |
| E. Fairfax | 5. Focus on profitable, expertise-driven segments; risk management... |

The Essential Pensions
Making Them Affordable for You

Observable Strategies

▪ Some are more obvious than others...

- | | |
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| A. Berkshire Hathaway | 3. Underwriting discipline, conservative reserving, avoiding aggregations |
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| E. Fairfax | 2. Long term focus on growth in book value, complete disclosure, decentralised management |

▪ A good strategy doesn't have to be a secret

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Making Them Affordable for You

Observable Strategies

▪ We asked an audience of 400 actuaries...



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Making Them Affordable for You

Our Survey Said...



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Finding Your Difference in the World

Our Survey Said...

- **Winners & Most Admired...**
 - Strong leadership and motivation
 - Clear focus and approach
 - Alignment of interests with this focus
 - Competence and Integrity
- **Losers & Least Admired...**
 - Converse of the winners!
 - Greed (Obsession with scale, under-reserving...)

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The Essential Problem
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So What?

- Strategy IS important: It determines what you do, how you do it and ultimately the relative success or failure of the company
- Strategy is commonly misconceived and (especially) confused with tactics. Objectives and tactics should *follow* a Strategy
- Many tools are available to help when setting or testing a company strategy and they can be applied to insurance

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Modeling Your Insurance in the Future

So What?

- What really matters for success in insurance?
- Is the delivery of a smooth earnings flow to shareholders totally incompatible with a “winning strategy” in insurance?
- Can the models help or are we just kidding ourselves with a load of airy-fairy stuff?
- Is Blue Ocean the best way ahead?
- There is no magic to this, but then we all knew that anyway...

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So What Can I Do Next?

- Read our paper, where you will find:
 - More details on everything covered today
 - Introductions to several more Strategic Models
 - A suggested practical approach to strategy setting
 - It isn't a heavy duty read!
- Surf the web
 - There's tons of stuff out there, some of it relevant...
- Find out about strategy setting in your own company, and possibly even get involved!

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Thank You For Joining In!



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