The Application of Strategic Theories to Non-Life Insurance Markets
Illustrated with reference to Property Cat Reinsurance

The team:
Veekash Badal
Mark Flower
Sejal Haria
Roger Massey
Buu Truong
Martin White
Matthew Ball
Graham Fulcher
Mark Julian
Peng Kee Ooi
Graham White
Richard Winter

Interactive Workshop: Please Join In!

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

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
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.

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?

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’
Agenda

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

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**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)?
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

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
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??)

F3 – Threat of Substitute

Do buyers have any alternative the product in question?
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

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
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

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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…

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
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?

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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?
### Observable Strategies

- **Match the companies and strategies...**

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<td>A. Berkshire Hathaway</td>
<td>1. Cut out the middlemen</td>
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<td>B. Direct Line</td>
<td>2. Long term focus on growth in book value, complete disclosure, decentralised management</td>
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<td>3. Underwriting discipline, conservative reserving, avoiding aggregations</td>
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<td>4. Large lines based on confidence in proprietary models and analysis</td>
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<td>5. Focus on profitable, expertise-driven segments; risk management...</td>
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### Observable Strategies

- **Some are more obvious than others...**

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- **A good strategy doesn’t have to be a secret**

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### Observable Strategies

- **We asked an audience of 400 actuaries...**
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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- So What?
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.

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...

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!
Thank You For Joining In!

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