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New Evidence in the Definition of Strategy for Global Insurers

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Abstract

The article shows how multinational corporations in insurance compete in the risky and complex global arena after the financial crisis, providing a conceptual model linking key cross-border operational drivers to international strategies; drawn largely from public data and qualitative interviews made to managers with involvement in the strategy of insurers throughout Asia, Europe, Latin America and USA. The existing literature justifies the different international strategies of multinational insurance companies on external factors in the creation of value, which are somewhat away from the reality of their decision-making processes. This research leads us to focus the formulation of the strategy on more concrete business drivers, with the specific goal of generating cash-flows and create shareholder wealth. It concludes that, by following the framework described, managers can rethink where to compete globally, and scientists can add conceptually to the current body of knowledge in insurance through new research on corporate strategy.

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1. Introduction

An important aspect of the strategy of insurance companies is to define their key business drivers; in this article we conduct an exploratory research to examine the definition of international strategy in multinational corporations in the insurance industry before proceeding with more in-depth research on their results of these strategies.

A key issue in the insurance industry is how insurers compete in the global arena after the 2007-2009 credit crisis (Eiteman et al., 2010), and to which aspects they are giving relevance, and if it is possible to conceptualize a global or holistic framework that will help to understand the key international strategies, for a subsequent evaluation of their performance and value creation; as in order to maintain their competitive advantage, global companies in general, and insurers in particular, should adapt their strategies to the market and the economic environment (Chung et al., 2010).

The existing literature on the subject found justification for the different strategies of the insurance sector in the need of international diversification (growth), in the impact of regulation in the sector, in the best allocation of resources (optimization capital), and in maximizing their shareholder value; that is, in the external factors of value creation, something a bit away from the everyday reality of insurance companies, but that undoubtedly influence their strategy formulation.

International diversification in services companies do not always have a positive effect, evolves over time and is affected by economic cycles and geographical areas where they compete, but there is general agreement that adds value, provided that is adjusted to risk and to financial leverage (Capar and Kotabe, 2003). In insurance, in particular, it adds value as the insurance market growth rates in emerging markets are far in excess of those available in most developed countries (Berry-Stölzlea et al., 2010), though there are a number of important strategic questions to consider when establishing or expanding operations in emerging markets, as growth rate, current size or emphasis on insurance product diversification.

In the case of the financial sector, it is normal that both the regulatory framework (Ma and Pope, 2008) and the legal and tax environment (Hancock et al., 2001) have a significant effect on the strategy of insurers and in their competitive advantage. This can also be seen in Solvency II (Directive 2009//138/EC), which has raised significant interest on trade liberalization, market share concentration, and the levels of national wealth and government expenditure on social security retirement benefits across all regions.

For this same external line, the pressure from the markets for maximizing shareholder value in insurance (Babbel and Merrill, 2005) has also played an important role in the allocation of capital to the different units and operations of an insurance company, as well as the decision of expanding or contracting the lines of business (Gründl and Schmeiser, 2007).

With respect to the above aspects, the regulatory and the market pressure, suggest the convenience of considering the role of governance in the setting of the strategy, as for example, in the countries where investor protection is weaker, it has helped in consolidating the value creation in the insurance industry (Boubakria et al., 2008), although it leaves open the question of which creates more value in this situation and why, whether domestic or international transactions.

In this paper, we try to examine whether the formulation of the strategy could be based on more concrete business drivers: In the internal or operational aspects of the business, with the specific goal of generating cash flows and create shareholder wealth after the credit crises (Bradley et al., 2012).

Our assumption on the development of the strategy, and that it would shape the positioning of each insurer specifically, takes into account the following drivers: 1) Give full service coverage to customers, wherever they are; 2) Diversify risks to increase the financial strength of the company; 3) Find talent in the world, which is becoming increasingly scarce; 4) Improve operational synergies looking for cost reduction; 5) And access to capital for operations.

This study is important for the insurance business for several reasons. First, the slower growth of the insurance business in mature markets is forcing companies to expand internationally looking for markets with a higher growth potential. Second, by knowing the key business drivers, insurance companies can implement a properly planned and executable strategy. Our study provides a clear analysis of global evidence that is useful for insurers to define client and market strategies. It is important that insurers develop the appropriate global strategies for growth; this will require an industry analysis to be available for the company management in the decision process, as well as a detailed knowledge of products, channels, and clients. Our study provides a recent qualitative analysis to help insurers to examine new investment opportunities and the challenges of conducting business on a global scale.

In our paper, as a result of the analysis and comparison of these drivers in the insurance companies, we have found some common strategies followed in the industry: general / global insurers; life / health specialists; non-life (property / casualty) specialists; and, interestingly, non-internationalized regional or local insurers, with their own strategy style.

We hope to contribute to the study of the strategic problem of international business, in any circumstances or economic environment, from the internal or tangible point of view of value creation and its impact on cash flows. And that all other issues, such as growth or profitability, go behind or are implicit in them, which means that research on strategy in the insurance sector has still to focus on the concrete operational aspects, which is saying a lot in these turbulent times ahead (Swiss Re, 2014).

Some interesting questions arise from our research, which of these strategies are the most appropriate to each competitor?, which one provides higher margins?, which one has less competition or even which one creates more value?; subject that we leave for a future research. In this paper, we focus on answering the following question: which are the current international strategies in the insurance industry at the end of the financial crisis?

2. Data and methods

The general approach of this exploratory research is first to analyze the annual reports of several insurance companies in Europe, Asia and the USA (16 in total) with different business models. A summary of the sample is described in Table I.

As this reflects only some part of the insurance strategies, the publicly listed ones, we have complemented it with other primary data in order to get a more independent view: Qualitative interviews with managers (15 in total), who have some involvement in the strategy of their firms or their business lines, we have interviewed managers in insurance companies from Europe, Latin America, and USA. Although samples are perfectly representative of the huge number of competitors within the insurance sector globally; we have achieved a reasonable and coherent range. A summary of the sample is described in Table II. Confidentiality of insurers and interviewees is maintained.

Regarding the interviews, we have used a basic outline as a guide, rather informal and open about their competitive strategies, type of businesses and performance, with the idea of collecting all the nuances of their opinions and comments. The interviews lasted on average about one hour and have been conducted in person and by telephone, made from September 2014 to January 2015. The scope, therefore, has been to have the vision of the different strategies of global insurers during the financial crisis, and try to find a conceptual scheme, if it exists, through the reality of companies with their strategies, which is of general application for insurers.

The objective of this paper is not to prove financially with market data if companies that focus on certain strategies create value or not, this is left for future research; which could be done in two ways: By identifying who is successful in creating value and see their strategies, or by analyzing the companies that use the strategy drivers and the results obtained in the creation of value in the markets.

The main limitations of the approach are those of the methodology (qualitative analysis of annual reports along with qualitative interviews with executives), because the sample is relatively small (16 insurers and 15 interviews), and interviews relatively short (about an hour), some by phone, they do not capture the extent or the nuances that we would have liked, but its coverage is enough to provide a significant evidence.

2.1. Qualitative comparative analysis

To examine how the opinions from managers affect business drivers (outcomes) we use a qualitative comparative analysis methodology (see Ragin, 1987, and Cress and Snow, 2000, for detailed description). This technique allows the identification of the multiple variables affecting outcomes. This increases the possibility of identifying the outcomes through the different variables employed in the analysis, it makes the analysis simple by only considering relevant variables and excluding the irrelevant ones. Thus, when some variables were thought initially to lead to an outcome and the interaction with insurance managers shows that a particular variable is irrelevant then it can be eliminated, thus simplifying the analysis. Qualitative comparative analysis allows us to identify the relevant variables that affect a particular from the multiple possible variables initially considered, which would not be possible with conventional quantitative methods.

We construct “truth tables” based on the variables as obtained from the interviews; we have used statistical software for coding truth tables. Then we examine the consistency and persistence of the answers in relation with the outcome, we examine whether these variables are common among managers and are indeed relevant to the outcome, we also identify contradictory variables. The objective of this analysis is to identify the different variables that affect the selected outcome and to select the appropriate variables that are consistently relevant from the other cases. Finally, we interpret our results and analyze whether they make sense and challenge or refine the initial outcomes.

3. Results

The objective of this section is to present the most important findings on the formulation of the strategy in the insurance industry, identifying the main successful competitive strategies in the international context that allow insurers to be differentiated from the competition and create the basis for value creation and generation of sustainable future cash flows.

In order to provide conceptual clarity and ease of understanding, following the advice of the interviewees (80% of them) and based on what is reported explicitly in the annual reports analyzed, we have restructured the competitive strategies of the insurance sector in strategic drivers or dimensions, that is, in the essence of creating value, not only to shareholders but also to clients and society as a whole. Those managers suggested that, the combination of the different needs of each market or the different visions of business requires different emphasis and attention on each of the strategic dimensions, forming the differentiation and value proposition of each insurer.

This scheme of strategic dimensions is presented conceptually in a way to facilitate its visualization and use throughout the research, helping us to understand the different business models, different ways to compete and create value for insurers in the international business context, that on the other hand is based on the classical and widespread differentiation of the operational areas of the company: Front, Middle and Back Office (Dias et al., 2012).

3.1. Client value

This dimension is the center of the corporate strategies of insurers, where they often seek sustainable competitive advantage and the differential value relative to the competition. Among the ways to compete in this dimension (the proximity to customers, or front office), we have collected answers such as geographic diversification (for example, compete in Europe and USA, and not in Asia), the form of the distribution of their insurance products (through their own agents, brokers, a sales network or multichannel), as well as brand management, pricing policies, not to mention the entry of new competitors in specific niches.

Of particular importance, for the managers interviewed, is the management of commercial networks (the form of distribution), which in turn is in itself a function of the markets served and products sold. This means that insurers are using the channels that best fit the customer needs and expectations, their history and experiences of the market in which they compete: it is not the same managing brokers than tied agents, bancassurance or a sales network, as they have slightly different needs and different forms of remuneration and motivation. Even customers are not entirely their own, of the insurance companies. In any case, these strategies help the organization to learn and to improve, to stress operations, to increase the financial capacity and to provide opportunities for talent.

3.2. Risk selection and talent management

These two dimensions, though they are not considered part of the front office, but of the middle office, are both seen as fundamental pillars of value and proximity to the customer, according to nearly all the managers involved in the study. As for talent management, business line managers feel they are in the knowledge business, and this is brought by the people, through the processes of care and customer value, brand image or innovation (Hernandez and López, 2013).

But the main risk associated with the insurance business is that the actual cost of claims arising out of contracts differs from the estimated amounts when the contracts were calculated. To avoid this, the premiums must be sufficient to cover the total costs of the insurer, including claim costs, and commercial and administrative expenses.

The underwriting risk exposure depends on the underwriting procedures of the insurer to control the quality of the risks accepted, the prudence in assessing premiums, the risk exposures and the ability to underwrite risks (Martínez and Hernandez, 2010). Misguided subscription decisions, as highlighted mainly by the CFOs interviewed, have a direct impact on the profitability of insurers, both in the inadequate levels of premiums to cover the insured risks, such as higher losses than expected; and in the need to divest before than expected the funds to settle the claims. Therefore, for their insurance company, maintain a proper acceptance and risk management policy is crucial for their survival, profitability, and long-term reputation, as well as the strategies of transfer of risk (reinsurance).

3.3. Operational and financial excellence

The operational back office was also identified in the research as a source of creating competitive advantage internationally. Insurance companies perform different types of activities, such as underwriting, relationship with customers, policy administration, claims management, economic and financial activity and a range of business support activities and services that are essential and have very different characteristics.

Due to the crisis, the insurance industry has refocused its operations and technology strategy in controlling costs, wondering about the services that can more clearly differentiate them from the rest of insurers, on how they can manage customers in the most efficient way possible and better than the competition.

Based on the evidence from the financial reports and from the interviews made, the financial management of resources, such as investment policy or merger and acquisitions, often contribute decisively to the creation of shareholder value and cash flow generation for international insurance companies. Although there are also external factors (systemic risks) that affect investment performance, it is very important to implement controls and manage the risks of the investment portfolio to reduce the impact of poor yields and returns (Hernandez and Martínez, 2012), given the liquidity risk (sale prices lower than expected) and the risk of asset-liability management (mismatch between investments and liabilities).

4. The role of business drivers. Discussion

The way insurers compete internationally is very diverse, and can be synthesized primarily in a combination of the dimensions just discussed. With the customer in the center, according to data and the interviews made, insurance business models are based, on general terms, either on a specific product, such as life, given their financial capabilities and product distribution, which revolve around the other dimensions; in a market, where it has a well-developed penetration and differentiation, also with high entry barriers; in one specific form of distribution, the most suitable to the customer-product; or in a combination of two or all of these mentioned dimensions.

As seen in Table III, there are virtually no pure models, all are a combination of several of them, though usually prevail one over each other. For example, global or general insurers, with life and non-life operations, usually have their business and management separated into two more or less independent areas, but both share certain back office operations, brand image, and even the same distribution channels.

The most successful international models are developed below (summarized in Table IV), the ones that create more value and of greater premium volume, which are repeated in the different local and global markets studied. Table V presents the results from the qualitative comparative analysis of the four main business models.

4.1. Generalists / Global Carriers

This model is widely spread internationally (see Table III), either globally with operations in all markets, customer segments and product lines; or locally in the region. It is the natural way to grow for insurers, as one of the interviewees point out, usually at the expense of profitability. One common example identified is a company specializing in a local market and in a specific product, looking to expand its operations into other markets, doing the same activities with the same distribution strategy tailored to the country, and broadening the company's product portfolio. Growth and volume is achieved, allowing access to new markets, optimizing operational capacity and reducing risks. At the same time, synergies in the middle and back office would be sought, both for reducing costs, and for operational consistency and focus of the organization towards the same goals.

These general / global insurers are obliged to manage all dimensions (drivers), generating resources to invest in technology and information systems, given the complexity of operations, diversification of channels and customers with a number of geographic areas. But they also tend to leave gaps in the markets where they operate: very specialized segments with high margins and customers not conveniently served according to their needs; distribution channels reluctant to cede power to these majors multinational companies; risks not addressed by standardized information and control systems; and other additional problems such as bureaucratic and unmotivated staff or increased risks in the management of global investment due to the pressure for the short-term results and institutional requirements, among others.

Regarding distribution channels, global insurers have to manage a wide channel network, such as exclusive channels (own agents, own sales force and direct sales via phone or internet) and non-exclusive channels (broker companies, independent financial advisers, banking networks and other insurance auxiliaries), which usually vary from market to market.

4.2. Life / Health Specialists

This business model is based on the distribution of life and health products, with a presence in multiple international markets, with a clear dependence or specialization on financial capacity and investment management (back and middle office), given the linkage results in economic cycles, in particular to interest rates and the evolution of financial markets (Mckinsey & Company, 2014).

Life insurers, which have not yet fully recovered from the impact of the financial crisis (Koijen and Yogo, 2014), are seeing reduced sales in many markets, especially in the more mature ones, so they generally, according to the comments from the interviews made to managers of life insurance companies, are focusing their strategies to allocate resources to the markets that offer higher profitability and stronger growth expectations, trying to improve outcomes by selling more, and in turn optimizing the brand and their best practices.

One of the most successful distribution channels in the selling of life insurance in Europe, and to a lesser extent, in America, is through bank branches (*bancassurance*), taking advantage of the extension of the network of bank branches and the consideration of life insurance as a financial product (Capgemini, 2014).

4.3. Non-Life Specialists (Property / Casualty)

Some of the interviewees pointed out that good management of the operations of non-life insurance requires core disciplines, among the most cited were: an understanding of the risk exposures that can cause losses for each policy, a conservative assessment of the likelihood of any exposure to cause losses, and the establishment of a premium that allows profits after the costs of the expected losses and operational expenses. Therefore, non-life insurance has to focus or take into account two key drivers: underwriting and risk diversification, and investment management.

4.4. Regional or Local Insurers

These are a group of insurance companies, which focus on a region or country that work only with a certain type of insurance product or group of products. Japanese, Chinese or Indian insurers are especially large in the life insurance business, among other reasons because of the vastness and potential of their markets and the legal obligation to take such risks in these countries.

But for generalist insurance companies with a regional or national focus, the multichannel distribution scheme prevails. For the managers interviewed from these companies, international expansion and extension of its products is the natural step for these regional insurers, which have created a sufficient capital base and customers, and with efficient operations and costs under control. The challenge of these insurance entities is often having access to diverse markets with very different cultures and languages.

5. Conclusion

As noted at the beginning of this research work, the insurance industry is an internationalized, profitable and attractive sector that has endured the economic crisis and financial instability in an exemplary manner, and is well managed and capitalized against the increasing natural disasters and their costs, which in theory is going to have its solvency strengthened with the implementation of Solvency II in Europe and the protection it would provide against systemic, systematic, and individual insurer's risks.

Our thesis on the development of the international strategy, which would shape the positioning of each insurer in particular, had in mind the classical drivers in creating value in the insurance industry, such as customers, risks assumed, talent, operational excellence and access to capital. Of these, we have been observing that in the post-crisis environment, to cover total service to customers, wherever located, remained the main focus of global insurers to create value, as well as the diversification of risks to become the financial fortress expected of insurers, and improve operational synergies looking for cost reductions, which ultimately have allowed the insurance industry to maintain the confidence of the market.

For researchers and analysts in competitive strategy and insurance, the findings above, much for its simplicity and common sense as to the methodology of collecting the information from management, may benefit in general to focus their research to the needs of managers and insurance companies in the strategic processes, helping them to review and measure tangible criteria of value creation which is the aim of this paper. In particular, this study may help reframe various decision-making processes of multinational insurers from a practical point of view, such as its operational activities, business strategies, and organizational structures, focusing them now on cash generation, aligning them to what analysts typically look for.

These findings and drivers' approach are also relevant to insurance managers and professionals in general, as strategy and operations are in the very nature of multinational companies, so having an approach based on the intuitively important aspects of insurers can help them to think about the strategic processes and its improvement.

This means that managers have the right tools to set their strategies, they should rely on their knowledge and intuition, because they are leading their insurer's strategy right. Furthermore, the majority of global insurers is doing it in similar terms, focusing on the same main drivers, the ones that create value, and they are doing it comparatively well, or at least they are not having survival problems in times of crisis, but implies that they should remain distinct in their core competencies within these drivers: customers, operations, financial strength, risk management and talent.

Fortunately, there are still many uncertainties and opportunities after the economic crisis which is now being left behind, but as shown in the present study, we are optimistic about the future of the international insurance industry, as it is well positioned, giving sufficient attention to the key aspects of their business, with stable and expanding models, from which they can learn, correct courses and improve strategies, such as the ones that we have tried to analyze here, increasing their international presence to diversify sources of cash flows and maintain a sustainable business to be able to survive the next financial and economic crisis.

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Tables

Table I. Description of sample "Annual Reports"

This table presents the business model and the country of origin of several insurance companies in Europe, Asia and the USA as obtained from their annual reports in 2015.

	Insurer	*Business Model*	*Country*
1	ACE Limited	Property/Casualty	Switzerland
2	Aegon	Life/Health	Netherlands
3	AIG	Generalist/Global	USA
4	Allianz Group	Generalist/Global	Germany
5	AXA	Generalist/Global	France
6	Berkshire Hathaway	Property/Casualty	USA
7	China Life	Regional/Local	China
8	Chubb	Property/Casualty	USA
9	Direct Line Group	Property/Casualty	UK
10	ING Group	Life/Health	Netherlands
11	Legal and General	Regional/Local	UK
12	Lloyd's	Property/Casualty	UK
13	Nippon Life Insurance	Life/Health	Japan
14	Prudential PLC	Life/Health	UK
15	The Hartford	Regional/Local	USA
16	The Life Insurance Company of India	Regional/Local	India

Table II. Description of sample "interviews"

This table presents statistics about the sample of qualitative interviews with managers.

	Business Model	*Company size*	*Country*	*Responsibility*
1	Property/Casualty	Medium	Argentina	Chief Financial Officer (CFO)
2	Life/Health	Medium	Brazil	Business Line (BL) Manager
3	Generalist/Global	Large	Colombia	Chief Marketing Officer (CMO)
4	Regional/Local	Medium	Portugal	BL Manager
5	Property/Casualty	Medium	Spain	CFO
6	Life/Health	Large	Spain	BL Manager
7	Regional/Local	Medium	USA	BL Manager
8	Generalist/Global	Medium	USA	BL Manager
9	Generalist/Global	Medium	UK	CMO
10	Property/Casualty	Medium	Netherlands	CMO
11	Regional/Local	Medium	India	BL Manager
12	Life/Health	Small	UK	CMO
13	Regional/Local	Medium	France	CFO
14	Regional/Local	Small	China	BL Manager
15	Property/Casualty	Medium	Netherlands	CMO

Table III. Global insurance companies by revenues

This table presents the ranking of global insurance companies by revenues in 2013, the revenue figure is expressed in millions of USD.

	Company	*Revenues*	*Country*	*Business Model*
1	Berkshire Hathaway	182,150	U.S.	Property/Casualty
2	AXA	165,893	France	Generalist/Global
3	Japan Post Holdings	152,126	Japan	Life/Health
4	Allianz	134,636	Germany	Generalist/Global
5	United Health Group	122,849	U.S.	Health
6	Assicurazioni Generali	115,224	Italy	Generalist/Global
7	Munich Re Group	83,844	Germany	Property/Casualty
8	Prudential PLC	81,868	U.K.	Life/Health
9	China Life Insurance	80,909	China	Life/Health
10	Zurich Insurance Group	72,045	Switzerland	Property/Casualty

Source: Insurance Information Institute (2013).

Table IV. Business Models - Drivers Matrix

This table presents the most successful international insurance models, the ones that create more value and of greater premium volume.

Business models /Strategies	***Business drivers prevalence***
Generalists / Global Carriers	Client value (front office), based on offering a wide range of products in all markets
Life / Health Specialists	Distribution (client value, front office) and financial capacity/investment management (financial excellence, back office)
Non-Life Specialists (Property / Casualty)	Underwriting and risk diversification (risk selection, middle office) and investment management (financial excellence, back office)
Regional or Local Insurers	Proximity to the customer with competitive advantage in their market (client value, front office)

* It should be mentioned that outside the United States, insurance is differentiated between life (which has to do with people) and non-life (property damage and assets) instead of life / health and property / casualty.

Table V. Qualitative Comparative Analysis

This table presents the results from the qualitative comparative analysis of the four main business models; each variable represents a business driver. 0, 1, and 2 represent no evidence, some evidence, and strong evidence, respectively.

Business models	***Variable A***	***Variable B***	***Variable C***	***Outcome***
	Client value (front office)	Risk selection and talent management (middle office)	Operational and financial excellence (back office)	Value creation and sustainable future cash flow
Generalists / Global Carriers	2	1	1	1
Life / Health Specialists	2	1	2	2
Non-Life Specialists (Property / Casualty)	1	2	2	2
Regional or Local Insurers	2	1	1	1