



"How much are those?"

Consistent, sustainable revenue growth is the surest path to superior shareholder returns

The top line is the bottom line in insurance

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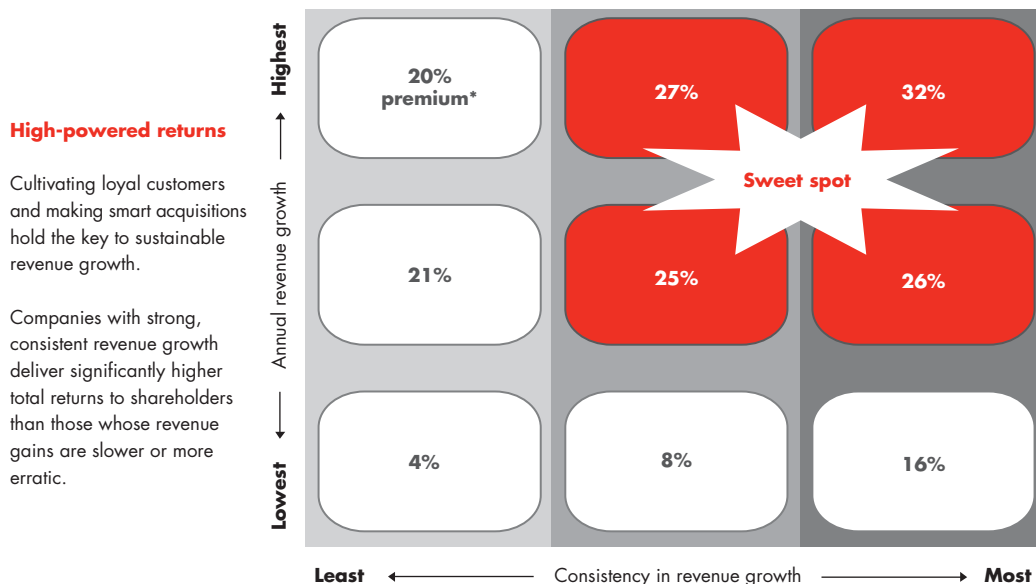
Consistent, sustainable revenue growth is the surest path to superior shareholder returns.

Buffeted by natural disasters, long cyclical troughs, roller-coaster investment returns, zealous regulators and changing rules, property and casualty underwriters—like all insurance companies—live in a world of risk. To tame those uncertainties, industry executives arm themselves with an arsenal of actuarial tools and arcane financial measurements that keep their exposure and costs under control. Of course, their passion for managing by the numbers helps them run a tight ship. But what truly propels property and casualty industry leaders to reach their peak performance?

A global investigation by Bain & Company of publicly listed property and casualty insurers found that just one variable—consistent revenue growth—reliably delivered exceptional total returns to shareholders. From 1994 through 2004, companies that posted strong, steady revenue gains generated total annual shareholder returns that were significantly higher than the stock index for their national market and their insurance-industry peers whose revenue gains were slower or more erratic. The relationship was particularly strong in more recent years. (See Figure 1.)

None of the many other industry yardsticks—including earnings growth or the bellwether combined ratio, which represents the percentage of total premium income spent on policyholder claims and operating expenses—consistently demonstrated statistically significant links to shareholder returns. (For a description of the Bain study, see “Looking for premium returns,” on page 8.)

Figure 1: Companies with strong, steady revenue growth produce premium shareholder gains



*Average annual total shareholder return premium over country index, 1999 to 2004.
 Note: Chart does not include insurers whose revenue growth rate was negative. The total shareholder return for this group was 5% below the national index average.

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High-performance insurers deliver what shareholders prize above all: revenue that increases at a brisk, steady pace. In our sample, as annual revenue increased, there was a corresponding rise in shareholder gains. On average, each additional percentage point of revenue growth generated an equivalent increase in the total shareholder return premium, or the amount by which shareholder return produced by the company beat its national index average. But growth also had its limits. Companies that posted flashier, but more erratic, growth rates exceeding 25% per year, on average, produced smaller incremental return premiums. Beyond that threshold, each additional percentage-point increase in top-line growth had a less predictable, and considerably smaller, impact on total shareholder return.

Identifying the paths to growth

Knowing that sustained top-line growth is the path to superior returns for investors is one thing; generating that growth year after year is another matter. With the exception of the brief cyclical peaks when premiums spike, property and casualty insurers have little

pricing power. And as important as cost-cutting generally is for fattening profits, our analysis shows that pursuing operational efficiencies does not, by itself, produce outsized returns for property and casualty insurers. In other financial services sectors Bain has studied, notably in retail banking, both revenue growth and tight cost controls were necessary for delivering superior results to shareholders. In fact, the surest pathway to top financial performance was to focus first on achieving efficiency gains and only then to pursue revenue growth.

What sets the top performers in the insurance industry apart is an ability to master two of today's thorniest growth challenges:

- High-performance insurers cultivate organic growth by identifying their most valuable customers and investing to increase sales to them; by recruiting new clients through referrals; and by raising retention rates.
- Insurers that rely on mergers and acquisitions to boost revenues make regular, modest-sized deals to add real value, and they integrate their new acquisitions quickly and seamlessly.

Like most companies, insurers set ambitious growth targets. In fact, financial services executives surveyed by Bain say that they aim to grow revenues at double their industry's pace, on average, and increase profits four times faster than the competition. However, just one company in 10, our studies have found, manages to create sustained value year after year. The principal reason so many end up disappointed is that they badly misjudge their ability to give customers what

77% The percentage of industry execs who thought their companies offered superior customer service. Only 6% of their customers agreed.

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they want. When Bain asked senior financial service industry executives if they believed their companies offered a superior customer experience, 77% said that they did. Yet just 6% of their customers agreed.

Our research and hands-on experience in advising insurance-industry clients on effective organic growth strategies and successful mergers and acquisitions yields insights on how the best companies do it.

Focusing on the customer is key

True customer-led insurers systematically track how well they meet or exceed their commitments across their entire customer base by applying an approach to winning customer loyalty that Bain calls the “three Ds.” Performance leaders *design* the right products and services for each customer segment, taking special pains to identify their most valuable clients and tailor their offerings to reinforce their relationship. They treat each contact with policyholders as an opportunity to excel and focus the entire company—from the boardroom to frontline agents—to *deliver* a superior customer experience. Finally, they *develop* their institutional capabilities to delight customers again and again as client needs and market conditions change.

Insurers that design and deliver exceptional value for policyholders and develop an institutional capacity to adapt earn handsome dividends through increased customer loyalty. Steadfast policyholders generate positive endorsements that increase new-customer referrals. They buy more products. And because they prize the service and product

On average, each percentage point increase in annual revenue growth delivered an equivalent rise in shareholder return.

value they receive, they tend to be less price-sensitive. Finally, by definition, loyal customers are less likely to shop around for lower rates or to defect to a competitor, vastly increasing their cumulative profitability over time. Our analysis shows that a 5% increase in retention rates corresponds to a nearly 80% increase in the lifetime value of the ongoing customer relationship.

The discipline of design

Insurance companies—indeed, companies in any industry—that aim to harvest the rewards of organic customer-led growth should excel at all elements of the design, deliver and develop package. Each of the property and casualty insurers that rose to the top of the list of steady growers recognizes the importance of making a strong commitment to these customer-pleasing traits. For example, Progressive Casualty Insurance Co., one of America’s largest auto policy underwriters, has been honing its skills for designing unique customer-focused experiences for more than six decades. Challenged in the early 1990s by larger rivals that had begun to encroach on its niche by selling competitively priced policies to higher-risk drivers, Progressive overhauled its claims-handling procedures. The company’s

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Bain analysis shows that a 5% increase in customer retention rates corresponds to a nearly 80% increase in the lifetime value of the ongoing customer relationship.

innovative Immediate Response program puts claims adjusters behind the wheel of service vehicles, dispatching them 24 hours a day, to assist policyholders as soon as an accident is reported. The initiative has cut the time needed to process most claims from a week or more to just nine hours.

Progressive has continually worked to nurture its talent for pleasing customers. The company is well along in a multiyear effort launched in 2003 to open customer service centers in markets where its policyholders are concentrated. Customers who take advantage of Progressive's "concierge service" simply inform the service center representatives if their vehicles are involved in an accident, drop off their car, and the agents take care of the rest. They offer rental cars on-site to get the policyholder back on the road; then they gather damage estimates, oversee repairs and ensure customers pick up their fixed vehicles. Such unrelenting focus on customers has helped boost Progressive's performance. Since 1994, premium revenues increased sixfold, to \$13.7 billion, and Progressive's stock price had risen to more than \$100 per share, up from \$15 per share a decade ago, before adjusting for a 4 shares-for-1 split in mid 2006.

The imperative to deliver

Companies that deal directly with their end customers know that delivering exceptional value is a challenge. But for insurers whose contact with policyholders flows primarily through independent agents, meeting the delivery mandate can be daunting. Cincinnati Financial Corp., a multiline commercial and personal property insurer focusing on small and midsize businesses and individual clients

across 32 states, is one high performer that shows how it can be done. Nurturing personal relationships—among underwriters, agents, field representatives and policyholders—is a core mission at Cincinnati Financial. The company approaches its goal to deliver exceptional value to customers by nurturing close relationships with its carefully selected network of more than 1,000 independent local agencies, aiming to be the No. 1 or No. 2 carrier for each. Cincinnati Financial draws the boundaries of its franchise territories with the expectation that every agent will know—and be in regular contact with—each customer personally. It reinforces its identity as its policyholders' hometown partner and neighbor by hiring field reps and claims agents from the local communities they serve. More than 25% of Cincinnati Financial's nearly 4,000 employees operate, unencumbered by corporate bureaucracy, out of home-based offices in the cities and towns where the company's policyholders and independent agents live and work. This sinew of personal contacts—from headquarters to field staff to high-contact sales agents—allows Cincinnati Financial to identify desirable risks and customize coverage for each policyholder. Cincinnati Financial tries to cement long-term relationships with clients by offering commercial policies with a fixed three-year premium, a practice that the company found reduces annual shopping by customers for lower rates and reinforces its reputation for delivering high value. The results: From 1999 to 2004, Cincinnati Financial's revenues climbed at an annual rate of over 11% compounded to \$3.6 billion, and its annual total shareholder return premium averaged 14%.

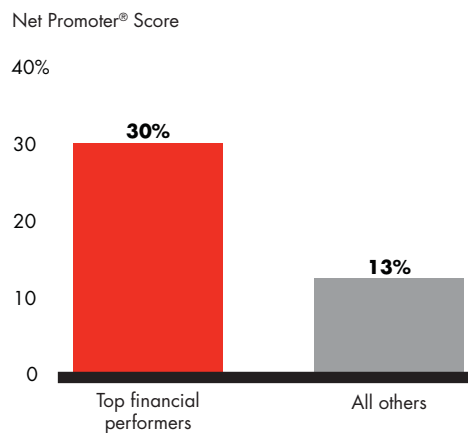
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The persistence to develop a customer-focused organization

Customer-focused insurers understand that the most reliable sources of revenue growth flow from retaining, increasing sales to and winning word-of-mouth recommendations from current policyholders. They know that the cost of alienating and having to replace an A-list customer can be staggering. But developing an institutional capability to anticipate how the customer base is changing and to respond to policyholders' evolving needs requires a discipline that pervades the organization and is practiced by every customer-facing employee.

Germany's Allianz Group, the globe-spanning, multiline insurance giant, has developed techniques for mastering that discipline using the Net Promoter® Score (NPS), a simple but powerful tool codeveloped by Fred Reichheld, a director emeritus at Bain & Company, and Satmetrix Systems, a customer experience management firm, to gauge how well an organization succeeds in cultivating loyal and profitable customers. More reliable than conventional customer-satisfaction surveys because it correlates directly with revenue growth, a company's NPS is derived from how customers respond to a single question: On a scale from zero to 10, how likely are you to recommend our company to a friend or colleague? The NPS is calculated by subtracting the percentage of detractors—those who answer six or below—from promoters—those responding with a top score of nine or 10. (For more on the relationship between Net Promoter® Scores and company performance, see Figure 2.)

Making NPS a centerpiece of its growth agenda, Allianz Group launched its Customer Focus Initiative (CFI) in early 2005 as an integral part of its effort to implant a strong customer-service ethos throughout the organization. As a part of the initiative, Allianz used NPS in pilot programs in Germany, the United States and Australia to accomplish two goals. First, it compared how Allianz stacked up against the competition by polling policyholders at random about their loyalty to their principal insurance provider. Second, it made NPS the cornerstone of an endeavor to elicit feedback from customers and intermediaries—such as brokers or banks—following their efforts to obtain advice, file a claim or

Figure 2: Companies that score high with customers consistently rank among the top performers financially



Net Promoter® Score is derived by asking customers, on a scale from zero to 10, how likely are you to recommend our company to a friend or colleague? NPS is calculated by subtracting the percentage of detractors (a score of zero to six) from promoters (a score of nine or 10).

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Only about half of the top-performing insurers studied were active acquirers. The other half stuck to their core business, knitting stronger bonds with current policyholders and recruiting new ones.

get a rate quote. Senior management reinforced its commitment to CFI by establishing procedures for reporting results throughout the organization and using the data to help Allianz's frontline representatives improve their performance. For Allianz, it was a revolutionary change in perspective.

As the company rolls out its Customer Focus Initiative in 2006 and beyond, Allianz aims to make policyholders its partners in its attempts to strip complexity out of its business processes while enhancing service quality across the board. With CFI providing a common discipline and rigor around the globe, local managers and frontline staff will be empowered to use the NPS tool to develop new-customer experiences that respond to local market and policyholder preferences, and they will be held accountable for results.

Customers are responding enthusiastically. As many as 90% of policyholders invited to share their opinion of the service they received consent to participate in follow-up calls with Allianz frontline employees. The steady flow of real-time customer feedback

helps Allianz ensure that policyholder preferences remain top-of-mind as the company restructures. "We are able to quickly measure the NPS effects on how claims are handled and fine-tune the process accordingly," says Markus Schröder, the global program manager for customer focus at Allianz. "NPS provides an early-warning mechanism that will prevent us from being too internally focused and helps reinforce our ultimate goal: Everything we do at Allianz should start and end with the customer's best interest in mind."

Master the merger

Mergers and acquisitions have been one of the principal avenues to growth in most industries, and insurance is no exception. But companies that travel the acquisition route often run aground on the "merger paradox": Most mergers undertaken in the pursuit of growth end up failing to create value for shareholders. Data on financial industry mergers from an ongoing global analysis of M&A activity by Bain & Company show that two years after the deal was announced the stock price of the median acquirer underperformed its industry index by 12%. For insurers, our analysis shows that big mergers have generally resulted in more volatile revenue growth that holds down returns.

Among the top-performing insurers in our study, only about half were active acquirers. The other half stuck to their core business, knitting stronger bonds with current policyholders and recruiting new ones. But done right, acquisitions can lift top-line growth and provide a solid base for further revenue expansion. Smart acquirers, the Bain analysis found, actively scout M&A opportunities across

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all phases of the insurance cycle. These high achievers typically focus on doing many modest-sized deals, gaining valuable experience by assembling a “string of pearls”—targeted deals that complement the core business. In contrast, insurers with strong but volatile revenue growth rates made far fewer but much larger acquisitions, and typically generated significantly lower average returns.

Since it became a publicly listed company in 1987, Fidelity National Financial followed this successful M&A route to become the largest title insurer in the United States and a major provider of information-processing services for credit unions, community banks and the real-estate industry. The experience Fidelity National gained through more than two dozen acquisitions since 1994 honed management’s skills for spotting the right companies to pursue and integrating them successfully. Each deal, moreover, was built on a sound, demonstrable thesis for how the combined company would create greater profits and boost shares. For example, the company set its deal-making sights on the

New York, California, Texas and Florida markets, which account for nearly half of all title-insurance premiums, with a view toward becoming the top underwriter in all four markets. With each acquisition it made, Fidelity National inched closer to its goal, finally achieving it with its purchase of a Florida company for an easy-to-digest \$115 million. Through such a patient accumulation of assets that tucked neatly into its established base, Fidelity National has raised its annual revenue growth rate to more than 32% between 2000 and 2004, and generated a splendid 23% average annual total shareholder return premium.

Property and casualty insurers that achieve top-quartile revenue growth and produce exceptional returns for shareholders often combine organic growth and a savvy acquisition strategy. Indeed, those that succeed in mastering the two skills weave organic growth and acquisitions into a virtuous cycle of revenue expansion, pursuing deals that reinforce their ability to deliver customer value. In the end, that approach is the only insurance policy any company really needs. 🎯

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Looking for premium returns

Screening criteria for the Bain study

- **How we selected the companies**

From an initial list of 706 insurers worldwide, we screened for publicly held companies that derived at least 60% of their annual revenues from sales of property and casualty products and for which at least five years of detailed financial data were available. The final sample included only companies from advanced economies of North America, Europe and Australia, for a total of 86 insurers.
- **The variables we tested**

Our regression analysis investigated possible correlations between total shareholder returns and 17 measures of business mix and financial performance, including total revenue growth, total net premium growth and profitability growth. Also evaluated were the averages for and changes in the companies' combined ratio, loss ratio, return on equity and return on assets, and the variability of the companies' returns relative to that of their market index (beta).
- **The time periods we covered**

We ran our tests on data covering the decade from 1994 through the end of 2004. We also evaluated successive three-year periods (1994 to 1997, 1997 to 2000 and 2000 to 2003); two five-year periods (1994 to 1999 and 1999 to 2004), as well as the most recent four-year period for which data could be obtained (2000 to 2004).

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Bain's business is helping to make companies more valuable.

Founded in 1973 on the principle that consultants must measure their success in terms of their clients' financial results, Bain works with top management teams to beat their competitors and generate substantial, lasting financial impact. Our clients have historically outperformed the stock market by 4:1.

Who we work with

Our clients are typically bold, ambitious business leaders. They have the talent, the will and the open-mindedness required to succeed. They are not satisfied with the status quo.

What we do

We help companies find where to make their money, make more of it faster and sustain their growth longer. We help management make the big decisions: on strategy, operations, technology, mergers and acquisitions, and organization. Where appropriate, we work with them to make it happen.

How we do it

We realize that helping an organization change requires more than just a recommendation. So we try to put ourselves in our clients' shoes and focus on practical actions.



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