

## Insurance 2010: a comparison of views from both sides of the Atlantic

by Conny Dorrestijn & Melvyn Morrison

*Prior to the actual 'The Future of Insurance' conference, Banking & Finance invited the two keynote speakers (B. Joseph Pine II and Kees van der Geer) to participate in an informal interview in order to discuss ideas and compare views from the American and Dutch perspectives. Both of these speakers will publish their own books in September of this year.*

**Conny:** "Thank you very much Joe and Kees for joining us prior to tomorrow's conference. We are going to look at the future of insurance. First of all, I would like both of you to comment on why you took some precious time off to come and speak at our conference. What is your view on the need to talk about this topic?"

**Kees:** "Well, we want to show that we have an opinion about what is going on in the financial services industry. As a management consultancy firm, we really invest in thought leadership, showing the industry that we have a vision and that we can help companies realise theirs. With regard to why I am speaking tomorrow at the conference, as I mentioned, we are going to publish a book that will provide solutions for established financial services companies to create a new future within the rapidly changing market environment."

**Joe:** "Well, I think that it is incredibly important for the greater financial services industry to listen to the message that I have because no industry has done more to commoditise itself than financial services. This is because financial services companies view spending time with customers as costing them money, as opposed to an opportunity of creating profit and value."

**Conny:** "Joe, I know that you are also currently writing a new book. Can you elaborate on what we may expect from you in September, bearing in mind that Kees will also publish his book in September?"

**Joe:** "May the best book win! Is the book from Kees in English or in Dutch?"

**Kees:** "In Dutch."

**Joe:** "So you beat me by six months in Dutch. My next book is entitled 'Authenticity; What Consumers Really Want. My co-author, Jim Gilmore, and I discovered that in any industry where experiences come to the fore, issues of authenticity follow closely behind. And therefore, as we shift into an Experience Economy, with experiences becoming the predominant economic offering, authenticity becomes the new consumer sensibility - in other words, the buying criteria where consumers choose who to buy from and what to buy. Increasingly, they no longer want to buy the fake from the phony, they want the real from the genuine. Therefore, the number one business imperative for companies is to render their offerings to be perceived as authentic."

**Conny:** "You say 'render their offerings to be perceived as authentic.' How does this differ from 'offer authentic products'?"

**Joe:** "The two key words in there that differ from what you might normally say as 'offer authentic products', are 'render' and 'perceive'. So first of all, authenticity is perceived. The question is do you create this perception of authenticity within each of your individual customers, where two people can have the same experience or buy the same product, and have completely different perceptions of the authenticity of that experience and product because of their own background, because of their own environment, because of past interactions with the company, and so forth. So, one may perceive it as authentic and one may not. And the reason why we say 'render' instead of 'offer' authentic products, is because all products, all economic offerings, are by their very nature, inauthentic. You know the phrase 'selling out', and all economic offerings are, by their very nature, a matter of 'selling out'. So they are inauthentic, but you can render them to be perceived as authentic."

**Conny:** "I'm coming back to you because I've been privy to some inside information about your book that will be called 'Bend or break' ('Buigen of barsten' in good Dutch). Really your book is all about how difficult it is to execute innovation and strategy, because in financial services, the inflexibility of the back office and the operations side seems to be so enormous that it's very difficult to turn this around. Can you give us some key messages from this book?"

**Kees:** "Well one of the key messages is that we have to be aware of the fact that the financial services industry is undergoing a transformation. Like it or not, you really need to adapt your organisation, otherwise new business models will really erode your market share or your profitability. The message is that established companies need to make their business more flexible, to ensure that they don't end up being a legacy themselves. The central idea is that because of the change in consumer behaviour, technology and regulation (and all of these are changing at the same time), the industry is now undergoing a fundamental transformation. The rules of the game are being rewritten. For example, business models that were perhaps successful in the past, are now becoming obsolete because they have become too complex, too costly and are not transparent. On the other hand, there is also room for new business models that can now be successful, even though this was not possible five years ago. Examples are Binck and Alex in the online investment market, Argenta in the mortgage market or Voogd & Voogd in the general insurance market. But the central question of our book is 'how can the very large established companies change their models in order to stay in business in the long run?' We foresee that they will really have to make their organisation much more flexible in terms of customer interaction and customer contact, in terms of the products and services that they deliver, in terms of managing the value >

chain and in terms of making the internal organisation much more compact and less complex in order to be able to adapt to the changing environment.”

**Conny:** “Have either of you been able to see big companies doing this without cutting themselves up into small pieces?”

**Joe:** “It is incredibly difficult to be able to do this. It’s much easier for a small company to have the necessary flexibility from the very beginning (even though it is very difficult to maintain the flexibility), than it is for a large company to add it on. For example, my old company, IBM, has not done a bad job in this respect. I worked for IBM for 13 years and left in 1993, and the presumption within the company at that point was that it was going to be broken up. And if the board did not make some changes in the management, it probably would have been broken up. Moreover, the new CEO, Lou Gerstner, decided that there was too much value in the various bits and pieces, and being a one-stop shop plus having the market power due to the size of IBM, they decided to keep it all together. But what it meant is that various parts of the business had to work more effectively with each other. In particular, with the shift from goods (the hardware) to services, the services were much more flexible than the hardware business. And one of the key things (and I don’t know if this is in your book, Kees), when it comes to flexibility, the key organising principle of flexibility is modularity.”

**Melvyn:** “Would you also say that the engrained mentality of large companies as opposed to small new starter companies also plays a role in terms of flexibility?”

**Joe:** “Yes, absolutely, because the number one issue that large companies have is this mind set that tends to be from inside to outside, from push rather than pull. They focus on the product rather than on customers and they focus on efficiency and cost rather than on flexibility and

▼ *Kees van der Geer*



responsiveness, which gets in the way of everything. It’s very difficult for many managers to be able to even see how to respond differently. They tend to do the same things that they have always done.”

**Melvyn:** “Exactly, so is adapting to change a major problem?”

**Joe:** “Right, but the problem is that they get different responses because the environment has changed.”

**Kees:** “It’s always the outsiders, the entrepreneurs who bring the ideas to the market. Established companies do not have to be the first movers, but they have to be state-of-the-art so that they can stay competitive in the market. For example, tomorrow I will speak about Nordea, a Swedish bank insurer that came into being following a merger of four bank insurance companies in Scandinavia in 2001. Nordea therefore had four different operating models that had to be integrated, and this presented a major problem for the merging companies.”

**Joe:** “Was this all four at once, or one at a time?”

**Kees:** “Yes, this was all four at once. It was quite a challenge, since they knew that in order to integrate, they would never reach consensus of agreement on every detail of their strategy and model. So they designed a new segmentation model, a new modular product model and a new Internet-based front end for the customer interaction. They used the best parts of the IT infrastructures of all four companies, and they totally transformed their old product portfolios into the new product model. So they immediately got rid of all the legacy.”

**Conny:** “And also the model allowed them to do that because it was not an opt-in /opt-out for leaving old products and practices in place. Incidentally, the gentleman who did a lot of this was speaking at the Banking & Finance conference last year. But what is amazing is that they had the audacity to say: ‘This is the model, and now there are no other flavours’, so they could have a much more stripped down, and much simpler back office.”

**Kees:** “They implemented without compromise. Compromises make your business complex. For financial service companies, especially insurance companies, the biggest problem is the complexity of their own organisation.



▲ *B. Joseph Pine II*

They are too big, their management and organisation structures are very complex and they have lots of legacy problems. Besides, the profitability of their old product portfolio’s really blocks innovation and presents barriers for real change within the company. On the other hand, Nordea showed how to make your company state-of-the-art again instead of maintaining all the legacy.”

**Conny:** “Now, I’m going to be really interested to see how people are going to respond to your books, because if you look at the market, the sentiment is to buy more companies and grow bigger fast by merging. Companies say that this is a prerequisite for them to survive in the future. This is also true if you look at all the burdens imposed by regulation, IT and cost. So on the one hand, they all want to buy and acquire and become bigger, and on the other hand, they perhaps need to operate as smaller units in order to stay afloat. Do you think that this is really the case, or do you think that some kind of new balance is called for?”

**Joe:** “One of the signs of commoditisation is when the industry consolidates. So consolidation follows commoditisation, because when industry commoditises, you generally have two choices:

- either you go with the commoditisation and you try to become the lowest cost producer, where generally only one or, at most, two companies can be successful. However, if they do this well, they can buy up a lot of companies and can effectively retain a position;
- or you do something different by not following this path, and try to create differentiation. However this is what is incredibly difficult since this requires a complete transformation of the back office. Moreover, it requires you to think differently about customers; if you want to do acquisitions, you are not doing it because you can get that back office synergy at lower cost, you are doing



it because are looking for good DNA in the company, you are looking for new ideas and strategies. In some cases, you may be placing bets that you do not know which one is the right one, but if you can learn from each one, then you can grow. But you have got to have a strategy that allows you to bring it into the fold so that you can in fact learn from it, as opposed to just keeping it on the sideline."

**Conny:** "Do you think that there is a conflict because, on the one hand, you are talking about consolidation, and on the other hand, you say that operating units should be smaller in order to be successful?"

**Kees:** "If consolidation and mergers only mean that we are increasing complexity, I very much believe that this is not the right way. The right way is to simplify. For example, a company like Reaal Verzekeringen in the Netherlands has taken over several companies during the last few years. They converted the product portfolio and took old systems out of service. So they integrated everything in their own operating model, thus simplifying their business. And of course, you may lose some customers or intermediaries during this process, but without doing this the cost of complexity would have become too high. And when you increase scale without reducing the cost of complexity, the benefits will not compensate. We have to make the business much easier, and I think that there are many ways of making organisations much more compact. For example, by working on straight-through-processing, by really focusing on your core business, by not managing the whole value chain within your own company, but by instead teaming up with external partners who are much better in delivering that activity than the financial services companies themselves. Thus, you make your organisation much more compact so that it is much easier to adapt to the market."

**Conny:** "We have mentioned the market a few times. Somehow, I get the feeling that an insurance company never looks at the market in terms of individual clients. Where do you think clients fit in? If you talk to them about consolidation, it's almost as though boxes are being shifted around. What do you think about this? Do you think that customers will ever wake up and start to make very different choices in financial services?"

**Joe:** "Financial services have a huge problem thinking in terms of individual customers. However, customers are individual, markets are collections. And when we think of markets, it gets very difficult to truly get down to an individual customer, and I think that that is incredibly important. My first book was called Mass Customization, which is about individually customising, but doing it on a low-cost, efficient basis, where the basis of that is again modularity. You modularise the offering, so that like LEGO building bricks, you create different offerings for different people, simply by connecting together the different modules that it takes to be able to do that. Financial services firms have a very hard time thinking in those terms, and very few do. One company that comes to mind in the U.S. in the insurance business is the United Services Automobile Association (USAA) which was actually formed back in the 1920's to service United States army officers in Europe. So it was actually formed as a sort of cooperative here in Europe, and then brought back to the States where it has its headquarters in St. Antonio, Texas, and now services U.S. military personnel around the world. The transforming point of that business was back in the 1970's and 1980's, when they realised that they had no single customer view, and that they needed one view of all of the products their customer held in order to create one relationship with them. So now they have this set of offerings on the shelf, modules in other words, that USAA can call

on at any moment in time whenever they have, what they call a 'life event', with one of their customers. Examples of 'life events' are: leaving the service, buying a new house, getting married, having a child, going back to school. They have a list of more than 250 'life events' that a customer can have, they have learned what are the sort of offerings that they tend to want at those times, and how they can help them manage these events. So in brief, they bring off the shelf elements together into a coherent offering that are appropriate to that particular 'live event'. So it's a way of getting down to that individual customer through the modular architecture that they have."

**Conny:** "Joe, can you tell us about any examples that you see in the U.S. whereby a really big established player was forced into taking action because of very agile, active, smaller players?"

**Joe:** "Well, it's funny, but the example that immediately comes to mind is a counter-example, and this is the automobile industry where General Motors and Ford and Chrysler are all in a huge amount of trouble. This is not because of small established players, but because of another big player, Toyota, that is destined to become the number one automobile manufacturer in the world. Moreover, the huge fixed costs in the industry make it incredibly difficult for a small player to truly make any meaningful inroads. I think in other industries where you don't have these legacy fixed costs, where you don't have an entry cost that is required to build a whole manufacturing plant, then you are going to see more of the effect where the small players are making a difference. For example, the Umpqua Bank in the U.S. is adopting the strategy of creating retail experiences instead of branches, where spending time with customers is viewed as an opportunity instead of as a cost. The objective is to encourage the customers to spend time in the branches by creating places that are more like cafes because they have comfortable chairs for people to sit in, instead of people having to stand behind imposing counters. The success of this approach has enabled this small bank to grow in leaps and bounds to become a regional player with hundreds of branches."

**Conny:** "Let's imagine a landscape where there are some very big players who can offer these services, possibly even to smaller banks, where as banks consolidate, smaller or mid-size players will also become more prominent. For example, research has shown that community banks are doing really well because they acquire some key staff who leave when the consolidating and merging big banks." >

**Joe:** "Yes and they get the staff who actually care about their customers and have a passion for their job."

**Conny:** "Most of the thinking around insurance in the Netherlands is still driven by the idea of solidarity, whereby many people carry the burden and insure themselves to provide services to one of those three or four who need it. Now if you look at the U.S. in particular, and you also see some initiatives in the UK, you see the emergence of individualism and people wanting products such as 'pay as you go' and 'pay as you drive'. Do you think that this kind of change in society will have a major impact in the insurance industry overall or will it just be a passing trend?"

**Kees:** "I do think that individualisation will be a continuing trend. When you are talking about the part of the insurance business where solidarity is important, the business is virtually ruled by the government, for example, in health insurance. This brings up the question of whether it should be regulated by the market or the government, and the government often intervenes to ensure that the market does not have too much leeway. However the individual insurance markets like life or non-life are very much individualised markets."

**Joe:** "When it comes to what are we insuring for, we are all very much individuals, and we are all different. What we want out of it, and what we bring into it, particularly in the case of health insurance, is very much individual. So you can for example look at what Achmea is doing, where they no longer just focus on the bad things that can happen to somebody and therefore what they need the health insurance for, but in fact, they focus on making their clients more healthy, so that they never have to call on the insurance. Then there is a whole list of things that each individual can choose from, e.g. I want this magazine, I want access to that fitness centre, I want this preventative care, etc., so this is going to make them individually more healthy."

**Conny:** "One of the other things that we talked about before is the concept of straight-through-processing, and designing and virtually converting a back office operation into a factory. How far are we removed from the point in time where insurance companies will start to produce in the same way as car manufacturers do? For example, on a car production line, it is possible to have 3000 different versions of a Golf, depending on the colour or fabric that you choose for your car. However, they all come from the same production line. Kees, you know some of the back offices inside out, what do you think?"

**Kees:** "We talked earlier about back offices, but I'm not just talking about back offices, I'm talking about the whole value chain of companies: it's a total delivery process, both the customer processes as well as the production processes. Moreover, the financial services industry is an information industry, that definitely should be able to outsource parts of our value chain to specialised companies. More than 90 per cent of the value chain of Dutch banks and insurance companies in particular, is still delivered in house, and if you compare this with the car industry, it may be that only 10 per cent is done in house and 90 per cent is outsourced. So we have a big step to make because it's not easy to stay in control of the business when we use external parties. This is something we have to and can learn in order to become lean and mean organisations. The insurer itself should orchestrate the client interaction, the product design and the risk management, but can purchase the market information, claims handling or processing from external partners."

**Joe:** "According to Say's Law, supply will create its own demand. But in this case I think that the demand for mass customised financial offerings is already there. Companies should start supplying these individualised products by first understanding individual customer need, and then go and get them fulfilled wherever the best resources for that particular offering come from. I agree with Kees that more modules should be outsourced to suppliers who can do it better than it could be done in-house."

**Kees:** "The best example of where this is already happening is the mortgage market. If you look at the foreign companies entering the Dutch market, for example Argenta, GMAC or the Royal Bank of Scotland, they simply use existing partners to outsource the distribution and the processing, and they orchestrate their business with a very small company in the Netherlands. This is an example where it has already been implemented, but when it comes to pensions, life insurance and non-life insurance, we are only at the beginning."

**Joe:** "I'm guessing that the key thing that they don't outsource is their client relationship, in other words, talking with the individual customer."

**Kees:** "Well, they use intermediaries (IFA's) or brokers who interact with the customer. These companies bring the brand and the capital and part of the product design, but that's about it."

**Conny:** "In order to create dramatic change, you always need a 'burning platform', with a very visionary and strong leader (like in the case of Nordea). However, money is still abundantly available in insurance. Do you think that there will be a sense of urgency if they don't change at some point? Will the change happen when the money runs out, or when will it happen?"

**Joe:** "The change will happen when and only when this sense of urgency is created due to lack of profit, whether >





this is because of the general commoditisation of the industry, or whether this is because of particular entrants who are siphoning off the best customers and the most profits. However, within each of these companies, there should be a visionary or at least somebody who sees that change is a must, in other words, that they cannot continue to do things the way they are."

**Kees:** "I totally agree. In particular, I do believe that the profitability of the financial services industry blocks change. In for example the P&C market, we already see that some intermediary companies currently have a problem because their portfolios are shrinking. New business cannot compensate for the loss of market share in their portfolio. However, with only little new business and excellent claims ratios, profits are at an all time high and reduce the sense of urgency."

**Joe:** "Because individuals are the least profitable in the early stages of the relationship."

**Conny:** "The Netherlands has one of the longest established and mature insurance markets, so there is little scope for growth in terms of population or product coverage."

**Kees:** "I re-emphasise our message, the stronger the call for very visionary and strong leaders to stand up if there is no 'burning platform' to change a company in the way that we just explained."

**Conny:** "Do you think that the 'banque assurance' model is good for innovation, or does this stifle innovation?"

**Kees:** "It depends on how you look at it. In my opinion, the focus of 'banque assurance' has so far been distributing each other's products. That's merely a distribution arrangement. For example, innovation will come to the fore when we have a fiscal level playing field, and this is going to happen very soon. You only

have to look at the life and pensions market, where banks and investment companies will try to enter the term insurance and pensions market with much better investment profits and lower costs than insurers."

**Joe:** "What I really like about the model described by Kees is the importance of the regulatory fac-

tor, because in insurance in particular, in both financial services and insurance, regulations get in the way of innovation as much as anything else. The shackles that they put on companies and what they can do and how they can compete, what they can add to the portfolio and so forth, can often provide such a tight stricture around them that they effectively cannot innovate very much. And being able to open all of that up and provide a level playing field is when you get a lot more innovation."

**Conny:** "Seventy per cent of the IT budgets in insurance companies is now being siphoned away for regulatory changes and compliance."

**Joe:** "This is just a drag on the industry that makes it a drag on the entire economy."

**Conny:** "So would less regulation be good? It's very difficult, it's almost a moral subject isn't it?"

**Joe:** "It's an economic subject, and economics show that less regulation is almost always good, because the freedom that allows for innovation to happen, and for markets to find the proper equilibrium in terms of who offers what to whom."

**Conny:** "If you are a really big company it is so hard to manoeuvre your tanker, and you almost want to be a flotilla of small boats. Would you therefore say that if you are a very profitable large player on the market, stop bothering with this strategy and just carry on with what you are doing, because otherwise you will waste your money on innovation. Would you like to comment on this statement?"

**Kees:** "Well, being state-of-the-art is a must. I think that when it comes to large companies I do not think that they will be innovators, but their large customer base, distribution power and powerful brands in the minds of

the consumers, are very important assets. I think that big companies that have all of these assets do not have to be the most innovative, but they have to be state-of-the-art in terms of cost and customer interaction, and in terms of products that they bring to the market. So innovation is not an aim in itself, but is necessary to keep pace with the market and the competition."

**Conny:** "Joe, do you think that this is very important?"

**Joe:** "It is very important, but it is not mandatory. What you have to realise is that if you do not innovate, if you do not differentiate through innovation, then you will be commoditised. You will be a commodity: this is the natural course. And again, one or two companies in any industry, in any geographic territory such as the Netherlands can be successful at that, but only, at most one or two companies. It is also not a very fun environment, it's not a very pleasant place to work when you have to focus relentlessly and absolutely on cost to be successful in the commodity marketplace. So if that is not your goal, if that is not your dream, then innovation becomes mandatory, then innovation becomes a must. And in particular in this industry, what we need to innovate around is going beyond financial services to financial experiences, to provide ways that we engage customers, and get them to want to spend more time with us in way that will lead to wanting to buy more offerings from us."

**Conny:** "We are going to encourage our readers to buy both of your books. If you could give me one message that you would like people to take away from your respective books and put into practice, what would it be?"

**Kees:** "In a changing market, flexibility and execution are the name of the game."

**Joe:** "The one message is that if you want to continue to have a successful business, you are going to have to be perceived as authentic, and this is an incredibly difficult thing that most of all requires that you first of all be true-to-self, in other words, you have to understand what yourself is and match that identity. Secondly, you must be what you say you are to others, that you recognise that how you represent yourself to customers has to match what they encounter. For the easiest way to be perceived as phony is to advertise things that you are not."

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