At a glance

Auto insurers, particularly traditional agency insurers, are struggling to grow in a highly competitive market.

In a mature market, organic growth requires innovative ways to reach new customer segments and offer tailored value propositions.

One such innovation is taking place in the direct-to-consumer channel, and the majority of insurers are in a race to catch up.

The direct distribution dilemma — why success has eluded many insurers

Today's customers demand more choice, flexibility and value, and prefer doing business across multiple channels. Insurance buyers are becoming more comfortable with online and direct channels. Most insurers recognize this opportunity but have failed to take the necessary strategic approach to grow this channel.

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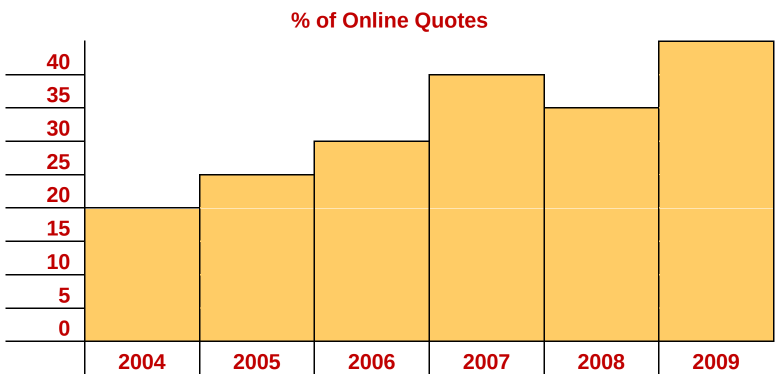
Embracing change to drive growth

The US insurance industry faces several ongoing challenges. It needs to fight commoditization, improve performance of existing businesses, identify new space for sustainable growth, and improve profitability. The economic downturn has created an environment in which consumers pay especially close attention to costs, demand transparency, and value trust. Accordingly, insurers need to make sure their value propositions meet customer expectations.

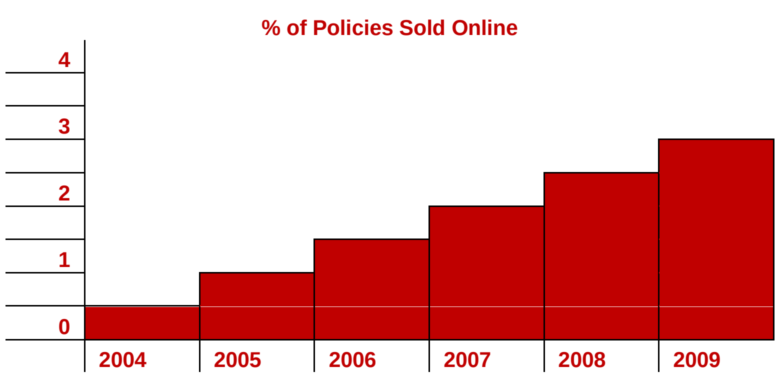
Organic growth in the insurance industry will not come through mere refinement of existing strategies and tactics, but rather requires innovative changes in business models and value propositions. One such innovation is taking shape in the way insurers reach customers; market, sell, and service their products; and, manage customer relationships through direct channels (online, call center, mobile, and online assisted).

A clear shift in customer preference is taking place. Today's customers demand more choice, flexibility, and value and prefer doing business across multiple channels. Customer expectations, which are shaped by technological innovations and their personal experiences, are steering the industry toward a "choice of channel" model that will make the insurer-consumer relationship far more interactive.

Over the last 15 years, the size of the customer segment that prefers agents as its primary means to buy insurance has diminished, while the direct preferred segment has doubled. Although the agency channel still dominates the personal auto channel share, the percentage of customers preferring the direct channel has grown from four percent in 2004 to more than 30 percent in 2010.[1]



Source: comServe online automobile report, April 2009



Source: comServe online automobile report, April 2009

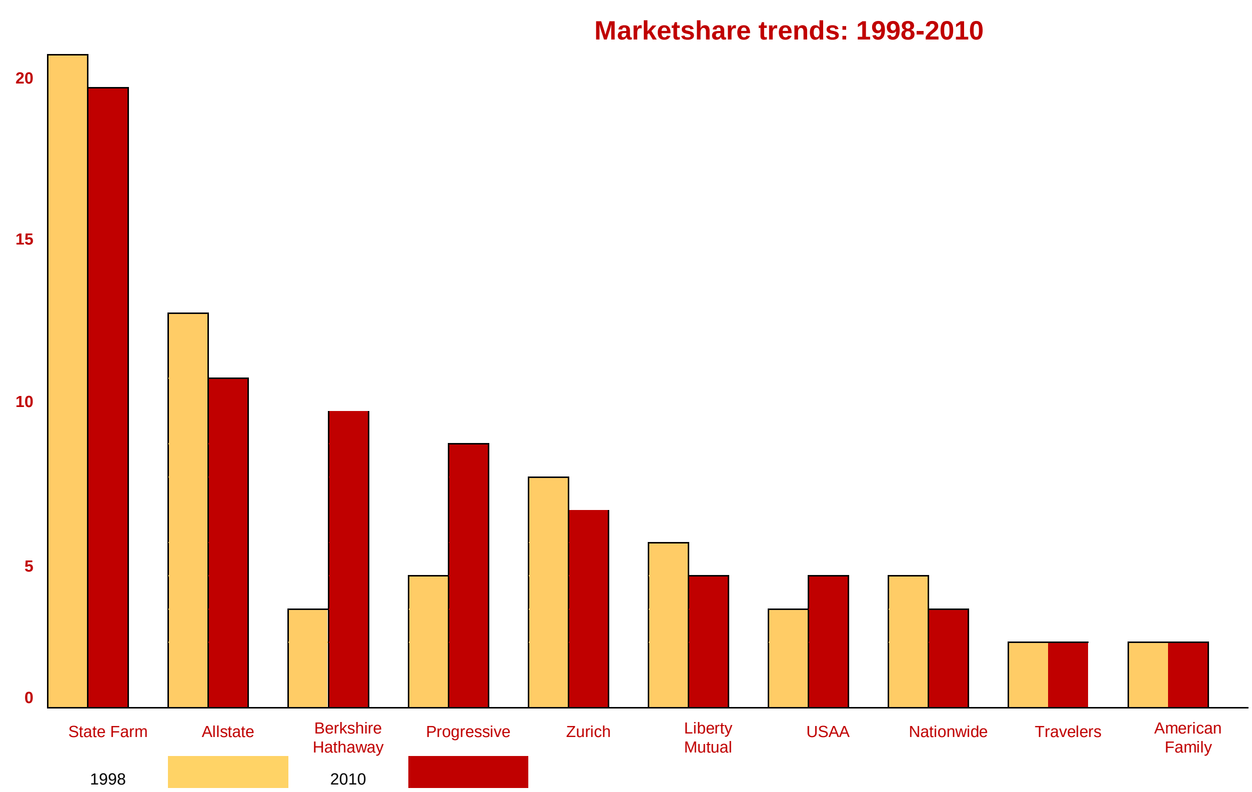
[1] Source: PwC research and analysis.

Insurance companies overall saw a 22 percent increase in the number of online auto policies in 2009 alone. Property insurance online prospect and quote volumes have grown significantly in the last few years, many bundled with auto insurance. The number of online homeowner quotes grew by 115 percent in 2008 alone.[2]

The shift toward the direct channel is not limited to personal lines auto and home. Life insurers are also exploring options to grow the direct channel. According to a recent LIMRA study[3], more than two million life policies (greater than 20 percent of total life policies sold) were purchased in 2008 via the direct channel. Recent investments in this channel by leading life insurers indicate they foresee future growth beyond simple term life products.

The landscape

In the United States, direct insurers in the personal lines P&C market are growing at the expense of traditional agency writers. Aggressive marketing, competitive pricing, user-friendly online tools, and innovative technologies are some of the tactics differentiating them from the pack. These companies have designed their business to cater to this channel and optimize their performance while the others struggle to catch up.



*Travelers experienced a very slight decline and American Family experienced a very slight increase between 1998 and 2010.

Source: SNL data; PwC analysis

[2] *Source: Online Property Insurance Landscape Report, Competeinc, January 2010*

[3] "Technology and the Distribution of Insurance," which is available to subscribers at www.limra.com.s

Insurers' attitudes toward the direct channel generally fall under one of the following three categories:

1) **Innovate: Searching for the next wave of growth**
These leaders of the pack invest in ways to use information more advantageously, as well as in well-designed operating models that support their current business. They bring innovative solutions to the market and currently lead in the direct-to-consumer market share. However, their challenge is in sustaining growth. They need to expand beyond mono-line insurance to create long-term value through multi-product relationships. The long-term success of these insurers will depend on their ability to scale their current model into a multi-product environment and continue to provide innovative offerings.

2) **Catch up: Needing a clear strategy**
A number of the larger captive and independent agency carriers have attempted to build direct channel capabilities, but their aspirations are not backed by clear long-range strategy, management commitment, and internal capabilities or talents needed to see them through the transformation. They also are concerned about upsetting their agents in spite of the eroding value of the channel. Most of the insurers in this category approach the direct channel as playing catch-up to the competition rather than differentiating their value proposition.

3) **Wait it out: Believing old approaches will prevail**
These insurers continue to depend on the personal relationships between their agents and prospects/customers to win in the market. They want to play on the strength of their current agency distribution and believe they can take advantage of the confusion created by the middle segment to win over agents and customers. While some of them are flirting with direct sales, most have yet to embrace the concept.

US personal lines P&C direct channel landscape

	Wait it out	Catch up	Innovate
Direct channel focus	• Dabbling but lacks conviction	• Trying to set the course	• Searching for sustainable growth and profitability
What got them here?	• Strength of agency channel • Fear of channel conflict • Limited brand recognition	• Lack of a clear strategy • Aspiration without full commitment • Fear of channel conflict	• Not bound by traditional distribution challenges • Willingness to innovate
What are they working on?	• Online quoting and generation • Shoring up back-end technology and data infrastructure	• Redefining channel strategy and operating model • Building on direct sales and conversion capabilities • Revamping consumer intelligence and marketing • Investing in infrastructure • Considering build-buy options	• Creating new product offerings • Bundling and cross-selling • Improving channel transition and interaction integration • Improving multi-channel customer experience • Focusing on retention • Investing in mobile and social media

Where companies miss the target

1) **Lack of a clear strategy —** Establishing the direct channel is not about building a website to quote and bind policies. Without a clear strategy, most competitors must play catch-up within the constraints of their existing operating model.

2) **Lack of channel integration —** Lack of channel integration hinders success. Customers want choice and the ability to do business their own way. The lack of channel transparency and integration often results in frustrated customers, disfranchised agents, and internal conflicts over channel revenue and profits.

3) **Lack of simplicity —** Insurers often port their inherent product/pricing/processing complexities over to the direct channel. However, in the absence of a trained agent to help a customer through these complexities, the channel could be difficult and frustrating for customers to navigate. This is one of the main reason insurers struggle to gain traction and fail to attract and convert customers online.

4) **Lack of commitment —** For agency carriers, embarking on a direct strategy is a big bet and can be risky. Insurers need time to build new capabilities, upgrade skills, and align product/pricing strategy and their operating model. However, given the competitive nature and market share erosion facing carriers, senior management often lacks focus and commitment on a single strategy. The shotgun approach to improving results is counterproductive to the long-term goal.

What experience has taught us: 10 key lessons

1) **Be deliberate —** Companies need to be decisive about their direction and commitment to direct distribution. They need to understand their target segments and define value propositions that will differentiate them from the competition and let that drive the decisions on brand, product, channel design and operating model.

2) **Make "simple, fast, and accurate" a core requirement —** Customers want simple and intuitive ways to assess their protection needs, answer the least number of questions, easily understand product/pricing options, obtain a binding quote in less than ten minutes, and feel confident about their decisions. Years of legacy complexities have made it difficult for insurers to achieve these seemingly reasonable goals.

3) **Simplify product architecture —** Keeping things simple begins with the product. Because no intermediaries help customers sort through product/pricing complexities in the direct channel, core product architecture needs to be simple to reduce the number of questions, trailing documents, and on-boarding requirements.

4) **Think and build multi-channel** — Design for multi-channel from the beginning. The forefront of the business architecture must address how prospects and customers can seamlessly navigate across multiple channels, how information and interactions can transition from online to call center to agency, and how channel economics can be measured and managed.

5) **Build digital marketing as a core competency —** Insurers need to drive quality leads to their websites and call centers. While some insurers have built experience in direct mail marketing, this alone will not achieve the desired results. Digital marketing (SEO, SEM, banner, SMS), social media marketing, mobile, and affinity are some of the strategies successful direct marketers leverage. As these skills are not a grass-roots part of the insurance industry, insurers should look outside their industry to acquire these talents.

6) **Create pricing sophistication —** Insurers cannot compete on price alone, but they still have to offer competitive pricing as a part of their total value proposition. Insurers' ability to create granular and differentiated risk segmentation based on unique customer data will drive their success in converting price shoppers to customers.

7) **Improve customer confidence in the purchase process —** Customers often obtain quotes online but buy through a call center or a field agent. Apparent lack of confidence in the product/coverage selection drives this behavior. Insurers need to find innovative ways to personalize the buying experience, including guiding customers through the purchase process with interactive advice and providing situation analysis based on customer profiles and needs.

   Another foundational enabler of customer confidence is data transparency. Insurers need to provide customers accurate and timely data during the direct sales process in order to answer potential questions, provide insights, show progress, and acknowledge actions taken. The need for data transparency, while important for all channels, is even more critical in the online environment as the lack of it often leads to customer confusion, frustration and disenfranchisement.

8) **Manage channel conflict head-on —** Most agents understand the choices and alternatives insurers face in the competitive marketplace. But it is up to insurers to clearly define the agent value proposition within the context of the new reality and show how both channels - agents and direct - can co-exist. This has to be a proactive rather than reactive measure. Agents are concerned about their future, and it is incumbent upon insurers to show them the economic viability of their profession.

9) **Test and learn before scaling —**This is a critical capability for an organization trying to win over consumers. Companies generally cannot predict how readily consumers will accept new features, functions, and offerings. However, the direct channel provides an information-rich environment that allows companies to test new features and offers and quickly adjust to consumer reactions.

10) **Acquire and deploy the right talent —** Well-qualified direct sales and marketing leaders are scarce in the industry. Although industry knowledge is critical, key talents in e-commerce, digital marketing, social marketing, and sales contact centers can also be found outside the industry. For product, pricing, and information technology, the industry must find emerging leaders who are willing to take risks and challenge the status quo.

Insurers caught in the middle must find the right strategy

Personal lines insurers should evaluate, or reevaluate, their multi-channel direct strategy to better compete in the market. They should define how they are going to differentiate themselves from their competitors and why their propositions would be compelling to customers. A strategic evaluation of the strategic choices open to them will help insurers to chart a clear direction for the future.

Key questions to consider

Market and Customer	• What does direct to consumer distribution mean for us? • Which market and customer segments should we target? • Do we have brand recognition? • How would we differentiate from competition?	**Operating Model**	• Should we create integrated or stand-alone channel infrastructure? • What core capabilities are required and what are the critical gaps? • Do we have the right leadership and experienced resources?
Product/Pricing	• Do we have the right products? • Should we have different product/pricing by channel? • Should we offer channel-specific incentives to consumers?	**Agent Value Proposition**	• What impact would it have on our agency channel? • How can it strengthen our agency value propositions?
Technology	• Is our technology infrastructure ready? • How can we leverage investments across both channels?	**Build vs. Buy**	• Should we build or buy capabilities? • Should we grow organically or acquire?

Conclusion

At a time when technology-driven innovations are giving consumers more insights into and control over their purchases, insurers cannot afford to be left behind. Consumers are demanding more choices, competitive prices, better service, and different ways of doing business. To meet these demands, insurers should acknowledge and embrace the shift in priorities toward the direct channel. They should carefully chart their future strategy and aggressively build a multi-channel sales and delivery model that allows them to compete and grow in a mature market.

For a deeper discussion about these issues, please contact:

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