

A decorative graphic in the top left corner consisting of a grey, stylized letter 'F' with a thin grey line curving from its base towards the right, ending in a small, four-pointed star shape.

**Value Creation**  
**Some thoughts for Private Motor**

Presented By Colin Brigstock

ISA Seminar

September 2008



A common business planning mantra:

**“We want to achieve profitable growth”**



A decorative graphic in the top left corner consisting of several curved, overlapping lines in shades of grey and white, creating a sense of motion or a starburst effect.

A common business planning mantra:

**“We want to achieve profitable growth”**

**How much profit?  
How much growth?**

**How do you balance between the two?**





## The Notion of Economic Value



**Value is only created when a  
company covers.....**

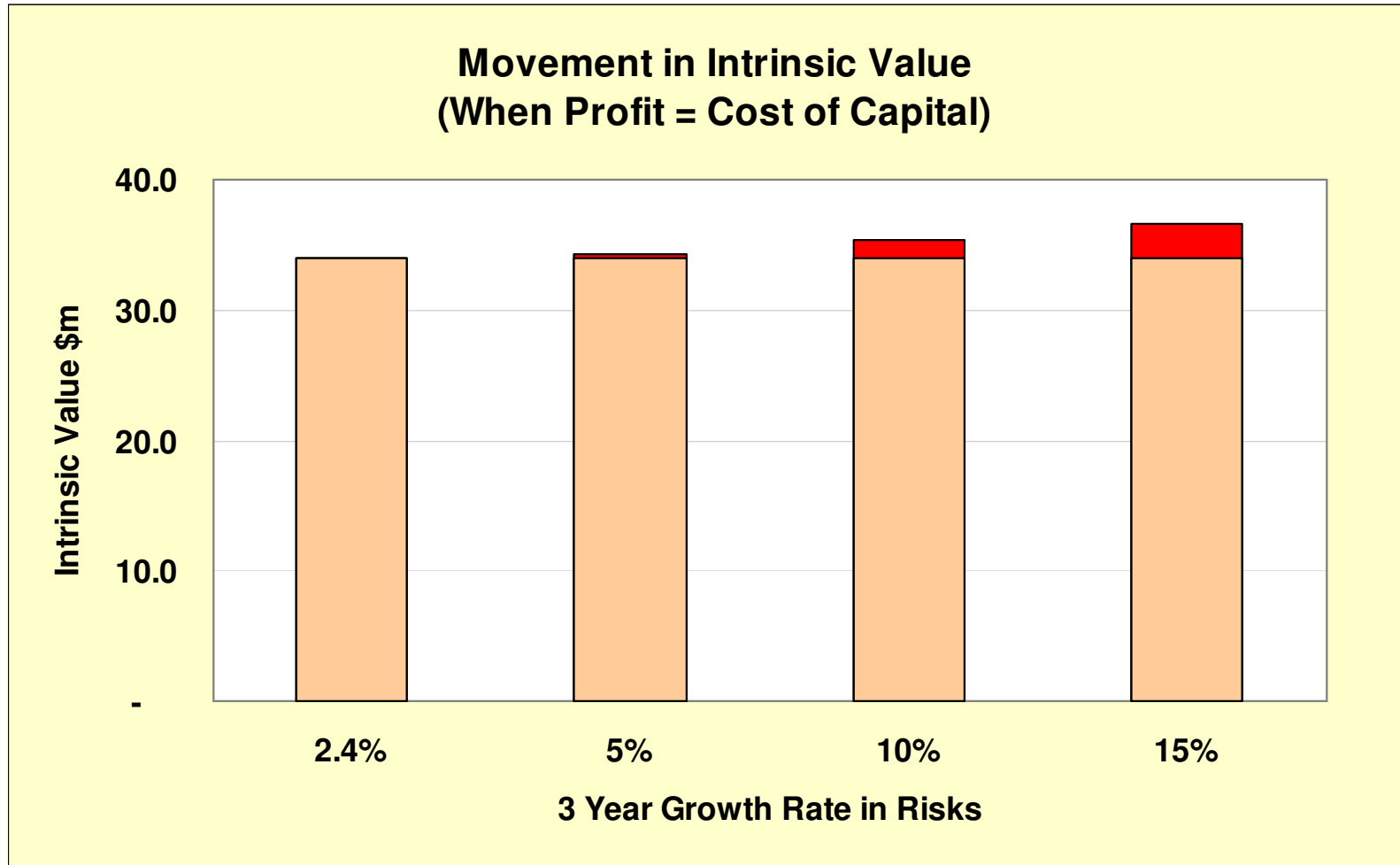
**all its operating costs**

***AND***

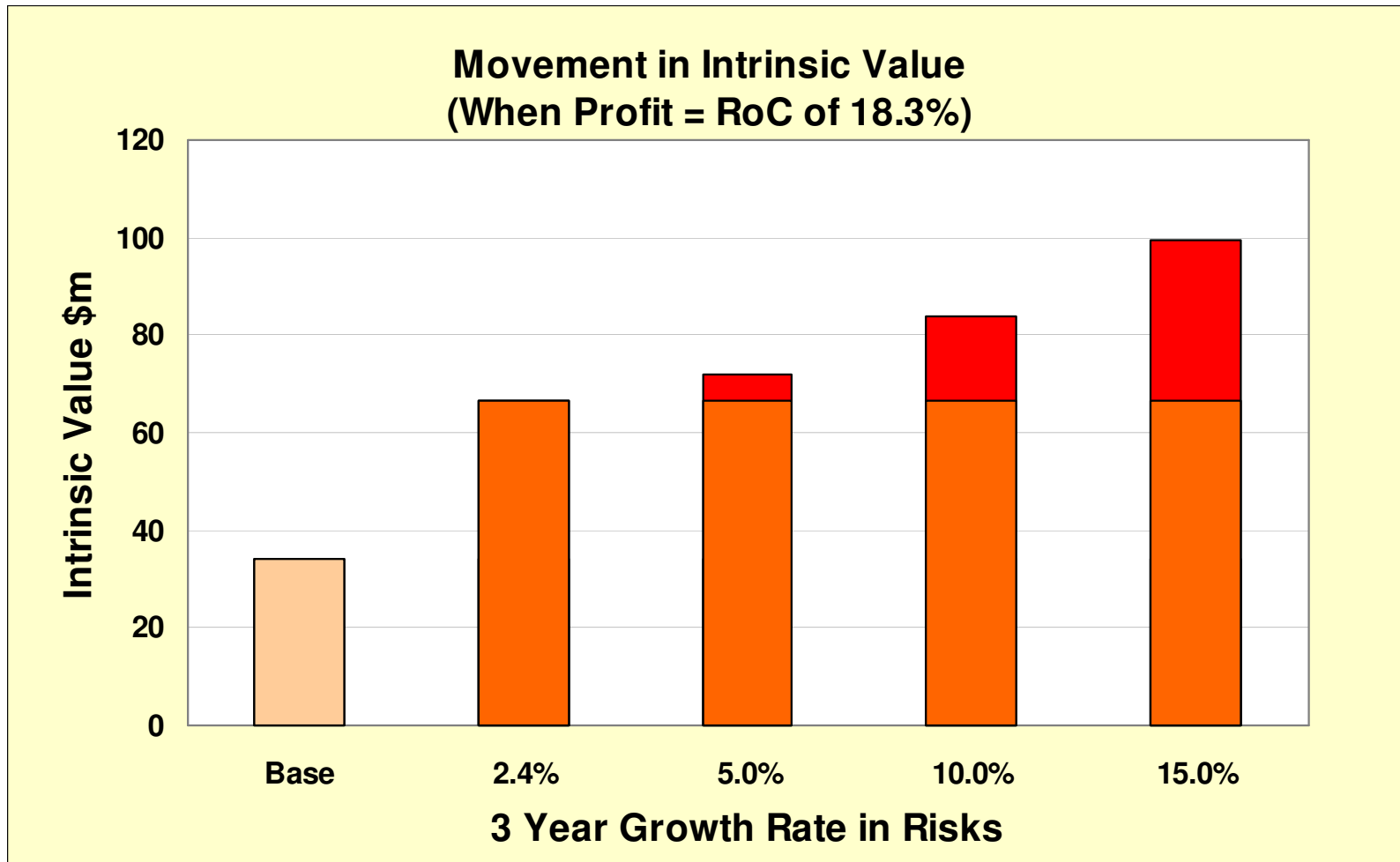
**the cost of its capital**



# When profit = cost of capital Growth per se appears almost worthless



# When profit exceeds cost of capital growth now starts to add value



# The Notion of Economic Value



**Value is only created when a  
company covers.....**

**all its operating costs  
*AND*  
the cost of its capital**

**Baseline:  
Profit margin must be sufficient to exceed  
cost of capital**



## The Growth dimension



- Listed insurers
  - ▶ Investors favour companies achieving better than system growth (i.e. increasing market share)
  - ▶ Key plank in **earnings growth** story
- Non-listed companies
  - ▶ Growth per se still seen as important
  - ▶ Measure of **vibrancy** & **continuing relevance**
- Baseline
  - ▶ maintaining market share





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**Increasing market share requires a sustainable competitive advantage**



# Sources of competitive advantage

## Where does Private Motor sit?



### Porter's Generic Strategies

<b>Strategic Target</b>	<b>Strategic Advantage</b>	
	<b>Low Cost</b>	<b>Uniqueness</b>
<b>Broad (Industry Wide)</b>	<b>Cost Leadership</b>	<b>Differentiation</b>
<b>Narrow (Market Segment)</b>	<b>Focus (Low Cost)</b>	<b>Focus (Differentiation)</b>

Porter, Michael E


*Competitive Strategy: Techniques for Analyzing Industries and Competitors*



# Private motor – almost a commodity?



## Porter's Generic Strategies

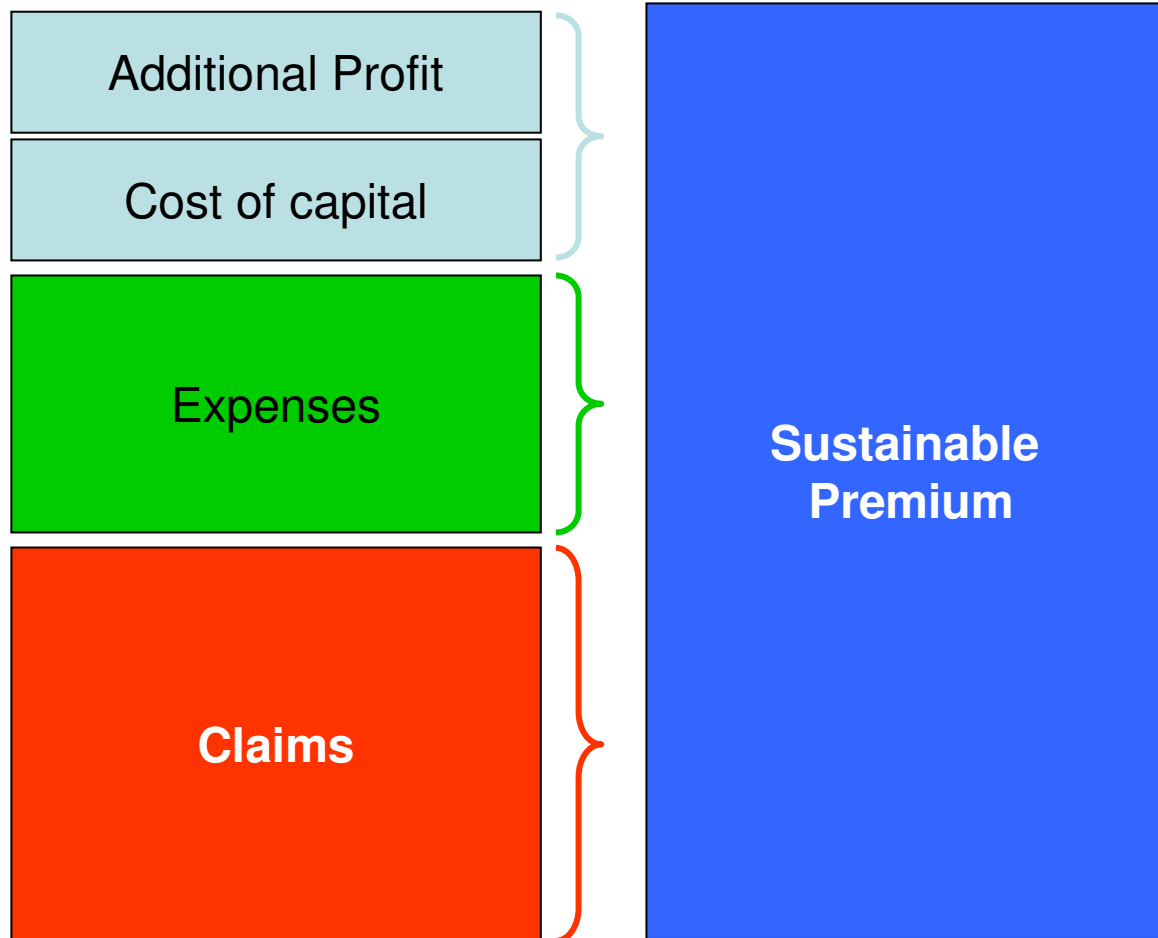
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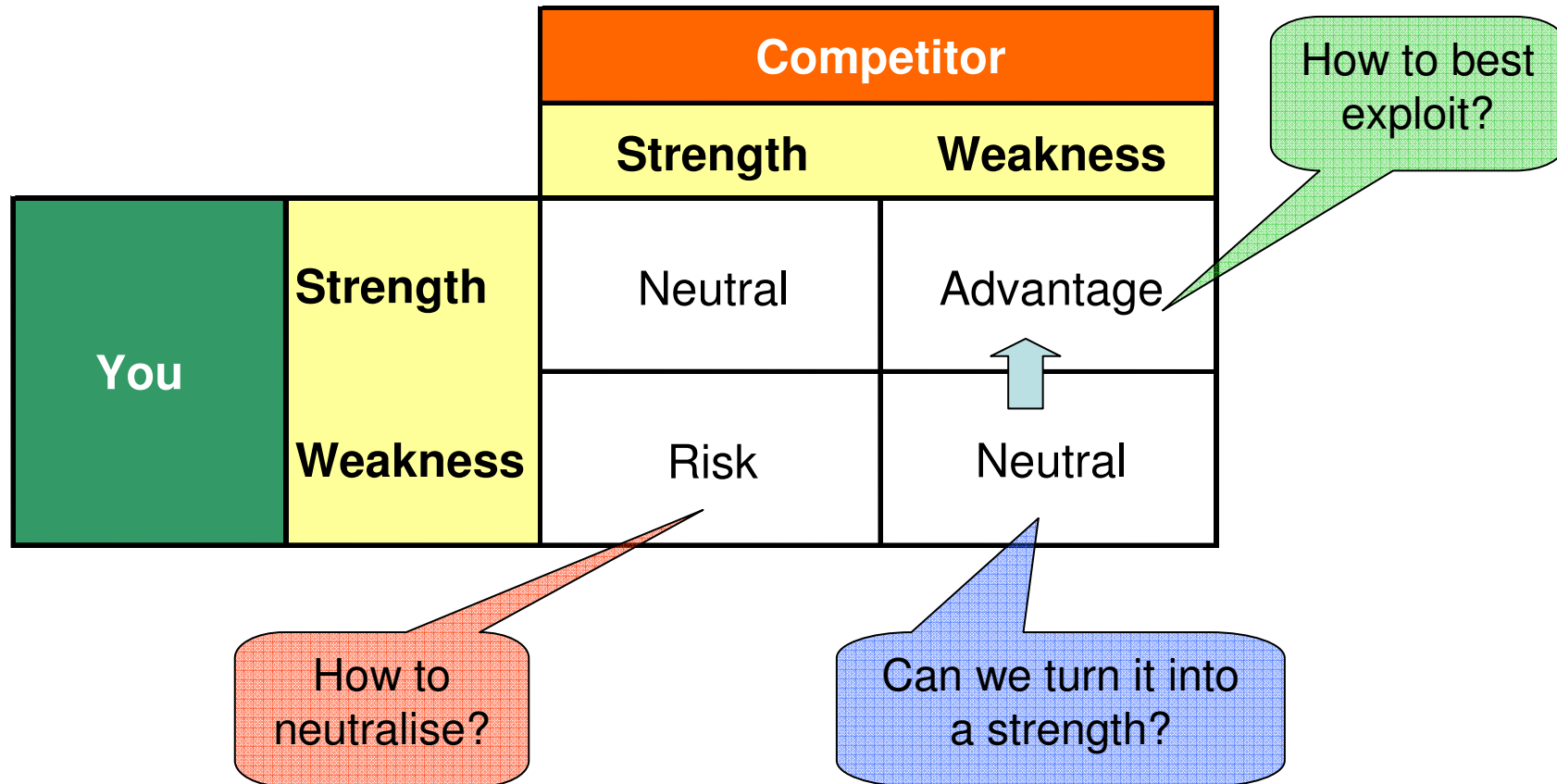
*Competitive Strategy: Techniques for Analyzing Industries and Competitors*



# Costs + target profit define an insurer's sustainable level of premiums



# The SW(OT) needs to be truly comparative



***What are your COMPARATIVE advantages – today and in the future?***



# Comparative analysis



Insurer A

Additional Profit

Cost of capital

Expenses

Claims

Insurer B

Additional Profit

Cost of capital

Margin

Expenses

Margin

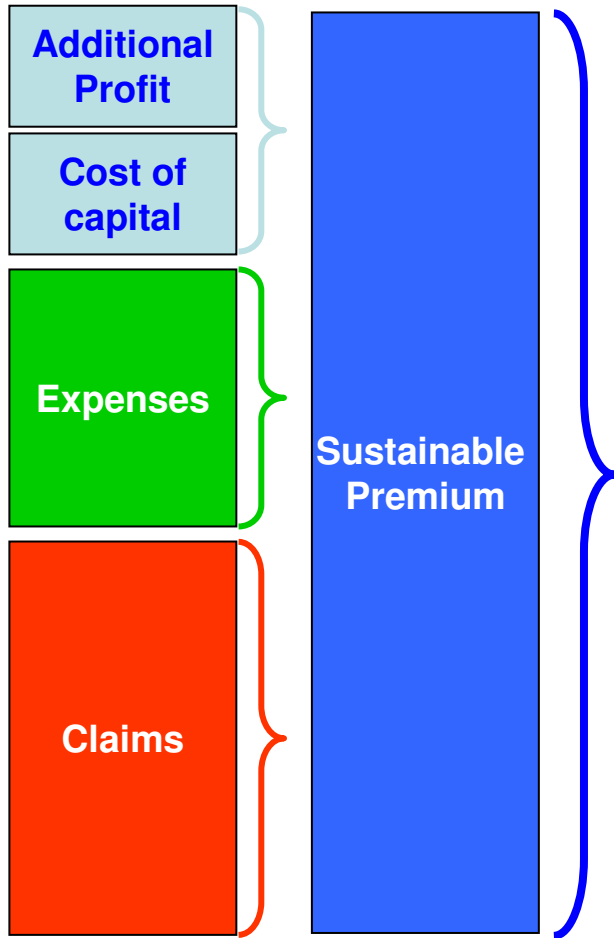
Claims



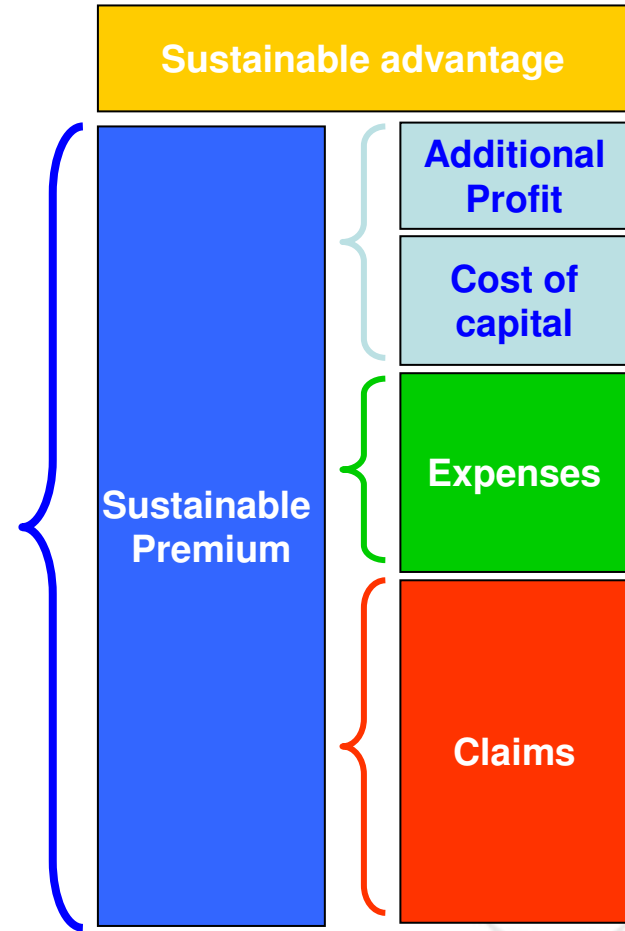
... and therefore any sustainable advantage



Insurer A



Insurer B



**It is your cost structure which determines how competitive your premiums can be**

# Economics of Motor



# Meeting Target Return on Capital



- How much capital?
  - ▶ Motor one of least capital hungry classes
  - ▶ MCR amongst lowest
    - Cam of 1.5 to 2.5 Leads to capital of approx 18% to 30% of NWP
- What return?
  - ▶ Depends on ownership, objectives
    - Mutual vs Listed
  - ▶ For listed, Cost of capital is about 10-11%
    - Returns targeted range from 15% to greater than 30%



# Implied COR Targets



Sample COR Derivation		
GWP		100.0
Reinsurance	1.0%	1.0
NWP		99.0
MCR (%NWP)	12%	
CAM	2.00	
Capital	24.0%	23.8
<b>Target ROC</b>	<b>20%</b>	
Profit a/tax		4.8
b/tax	30%	6.8
Invest Return on Capital	6.6%	1.6
Required ITR		5.2
Invest Inc on Ins Reserves		2.2
Required U/W Profit		3.1
<b>Target COR</b>		<b>96.9</b>



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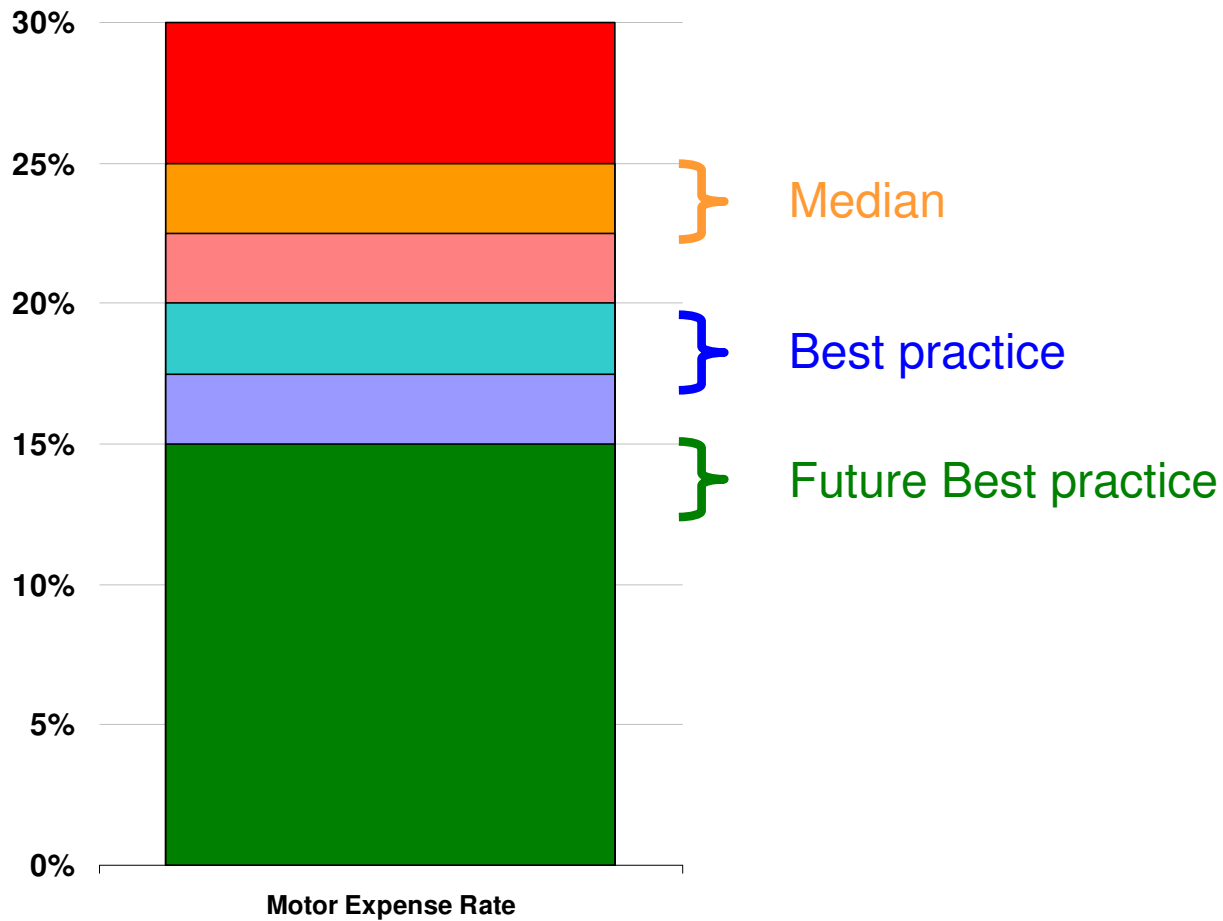
		Required COR				
		Capital as % of GWP				
		18%	21%	24%	27%	30%
Target Return on Capital	10%	101	101	100	100	100
	15%	100	99	99	98	98
	20%	98	98	97	96	96
	25%	97	96	95	94	94
	30%	96	95	94	92	91
	35%	94	93	92	91	89

Based on:

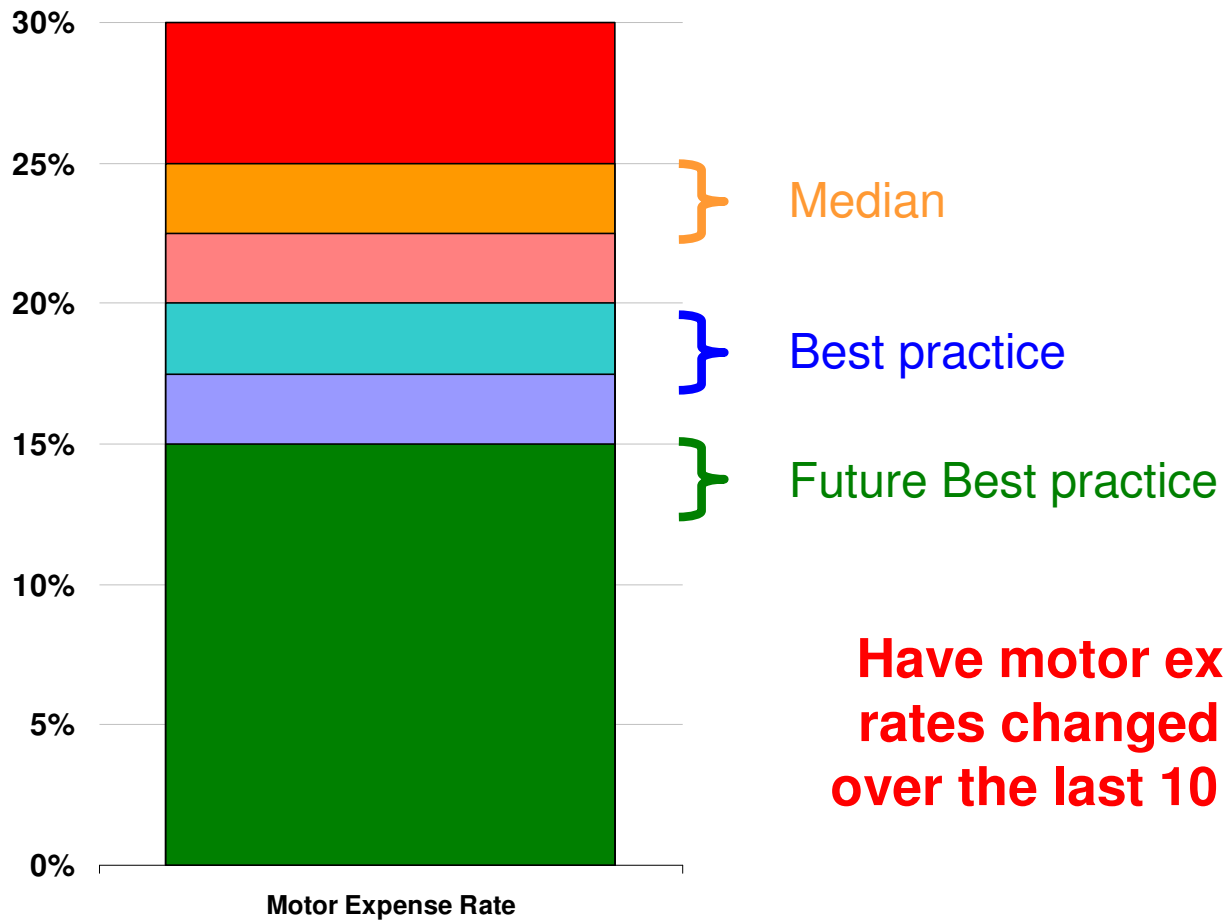
MCR as % of GWP of	12%				
CAM	1.50	1.75	2.00	2.25	2.50



# Motor: Expense rates



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**Have motor expense rates changed much over the last 10 years?**



# Implied Target Loss Ratios

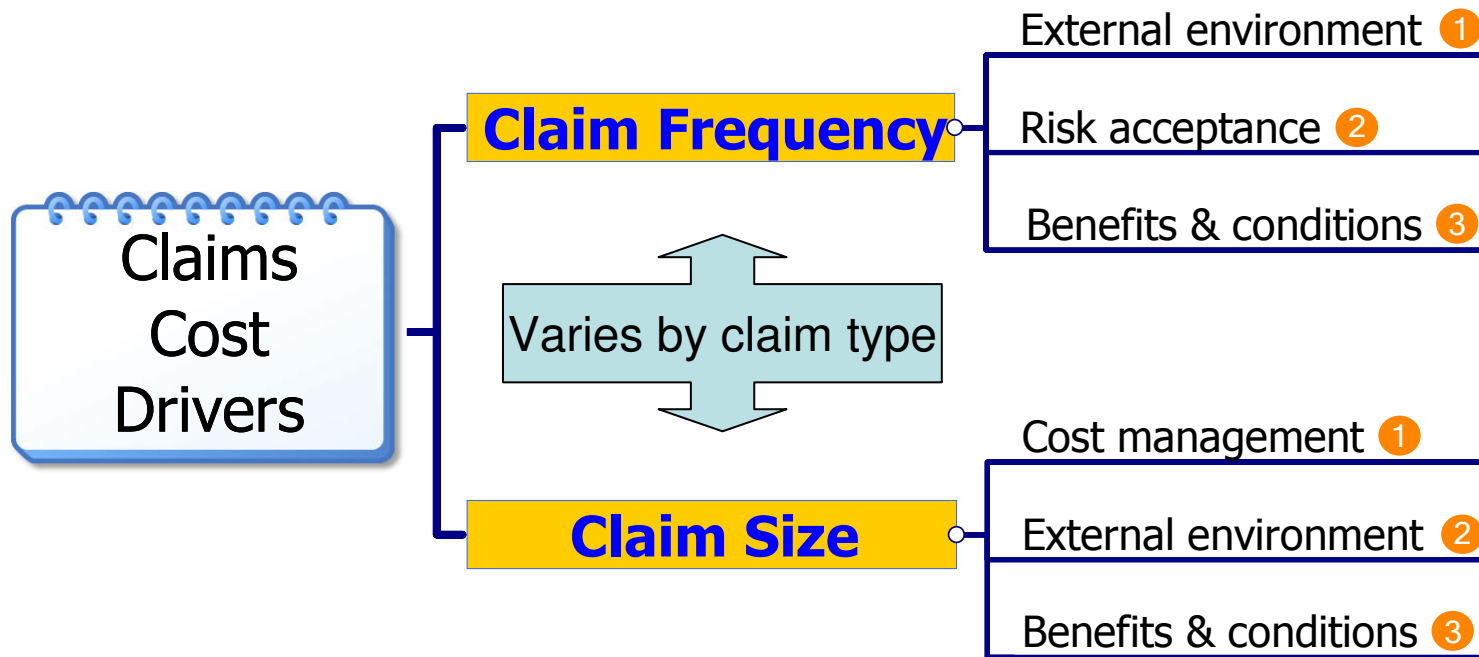


## Required Loss Ratio

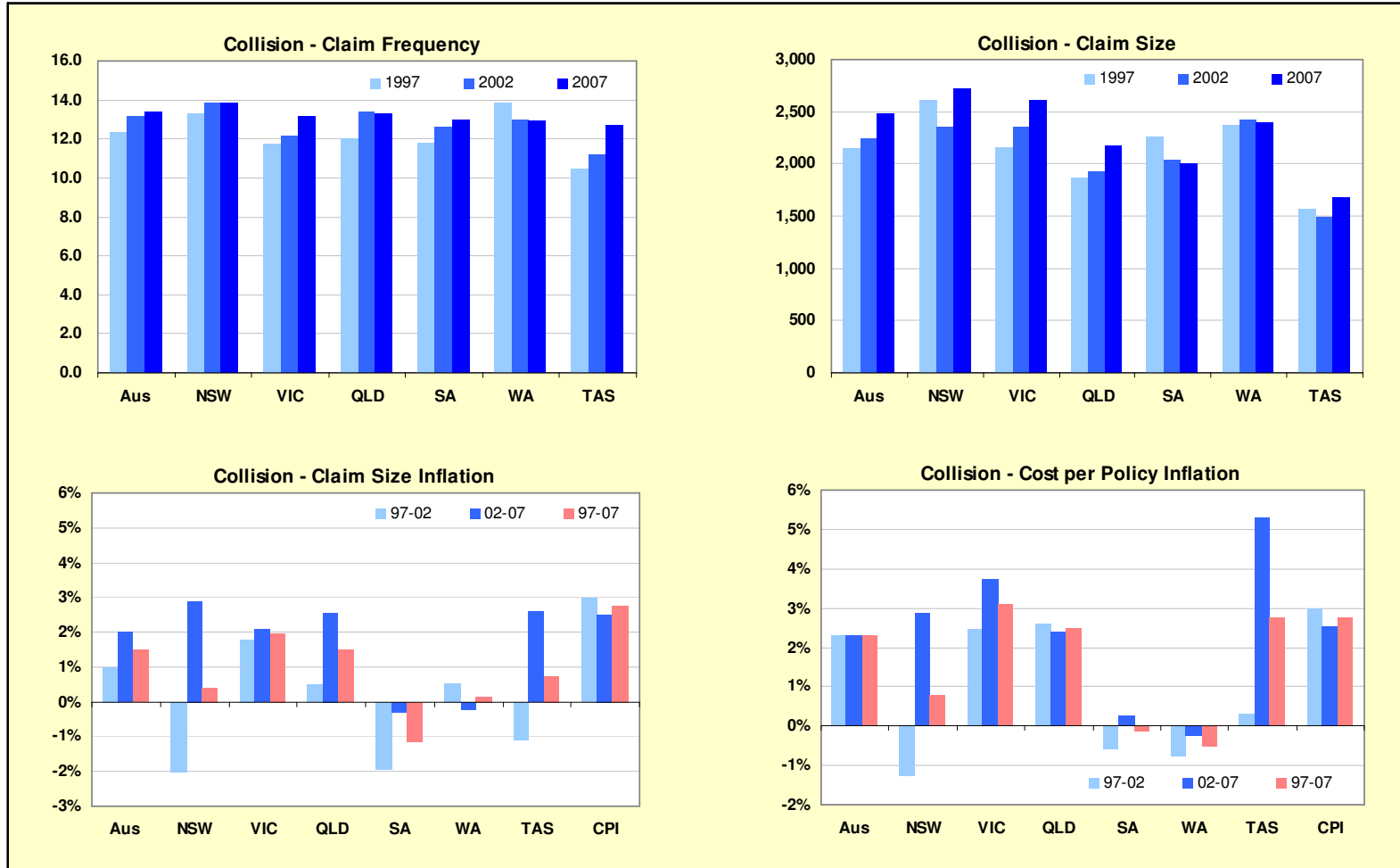
		Expense Rate % Premium				
		25	22.5	20	17.5	15
Target COR	100	75	77.5	80	82.5	85
	95	70	72.5	75	77.5	80
	90	65	67.5	70	72.5	75
	85	60	62.5	65	67.5	70



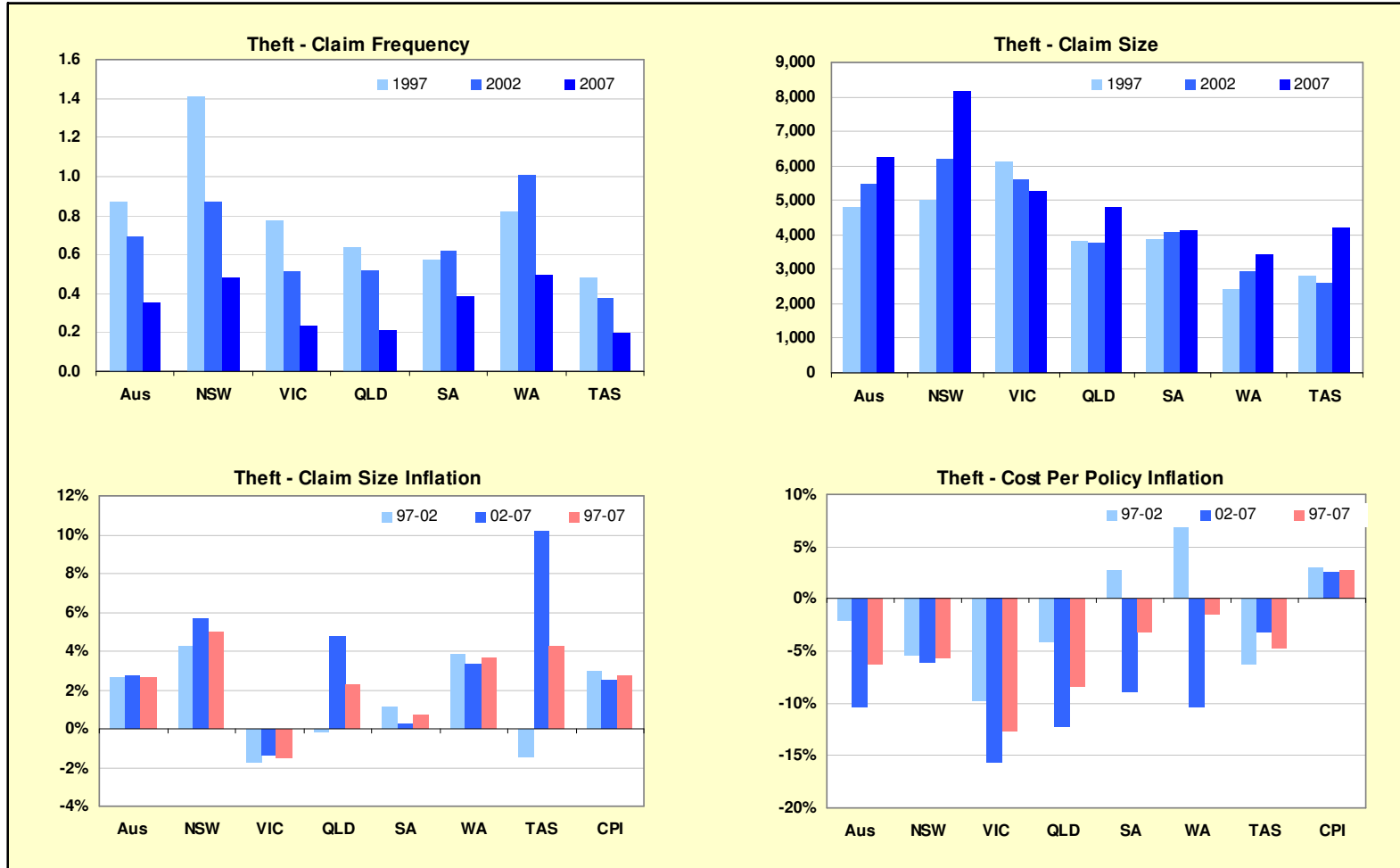
# The Claims Dimension



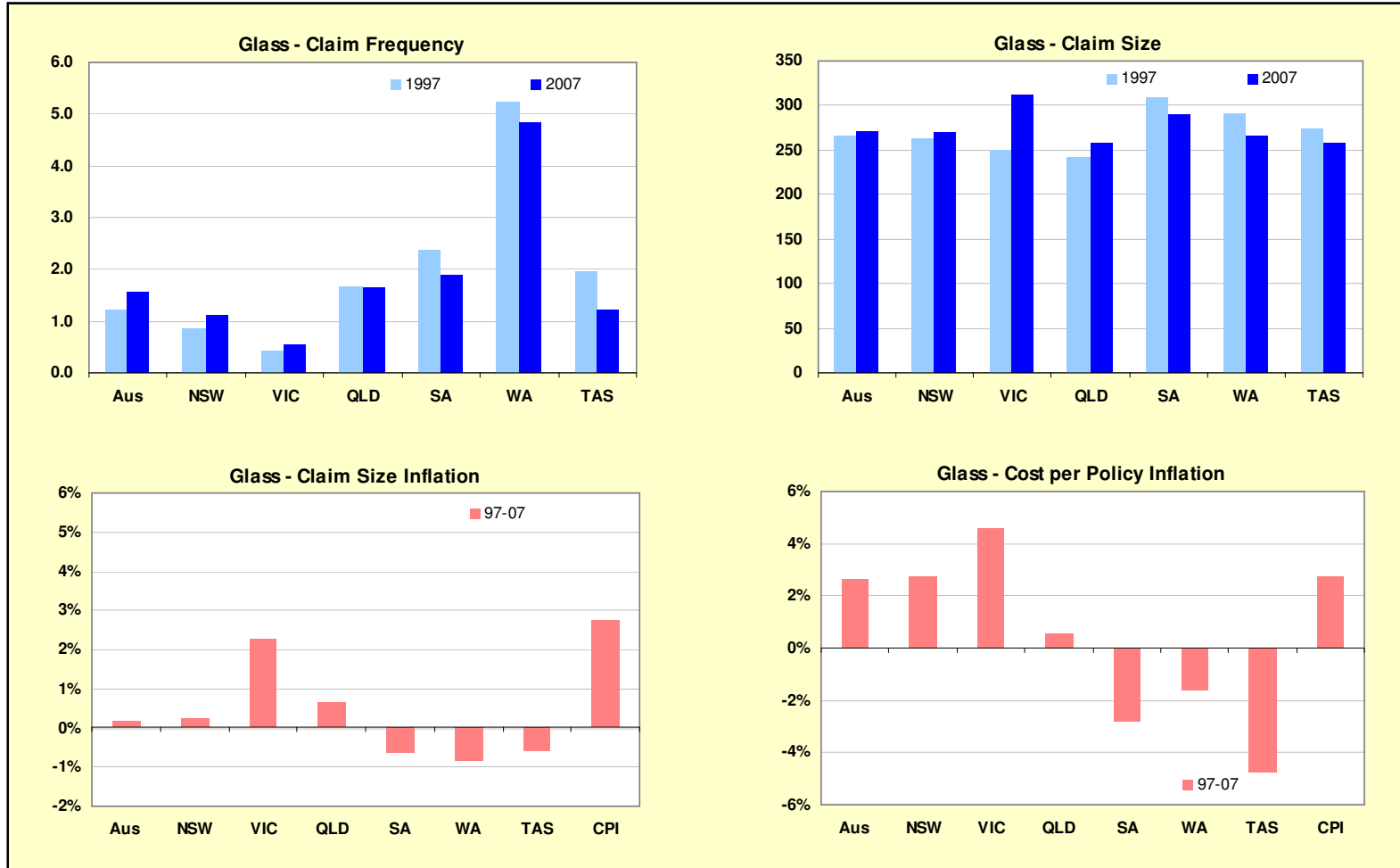
# Motor – Collision / Miscellaneous: Long Term Trends



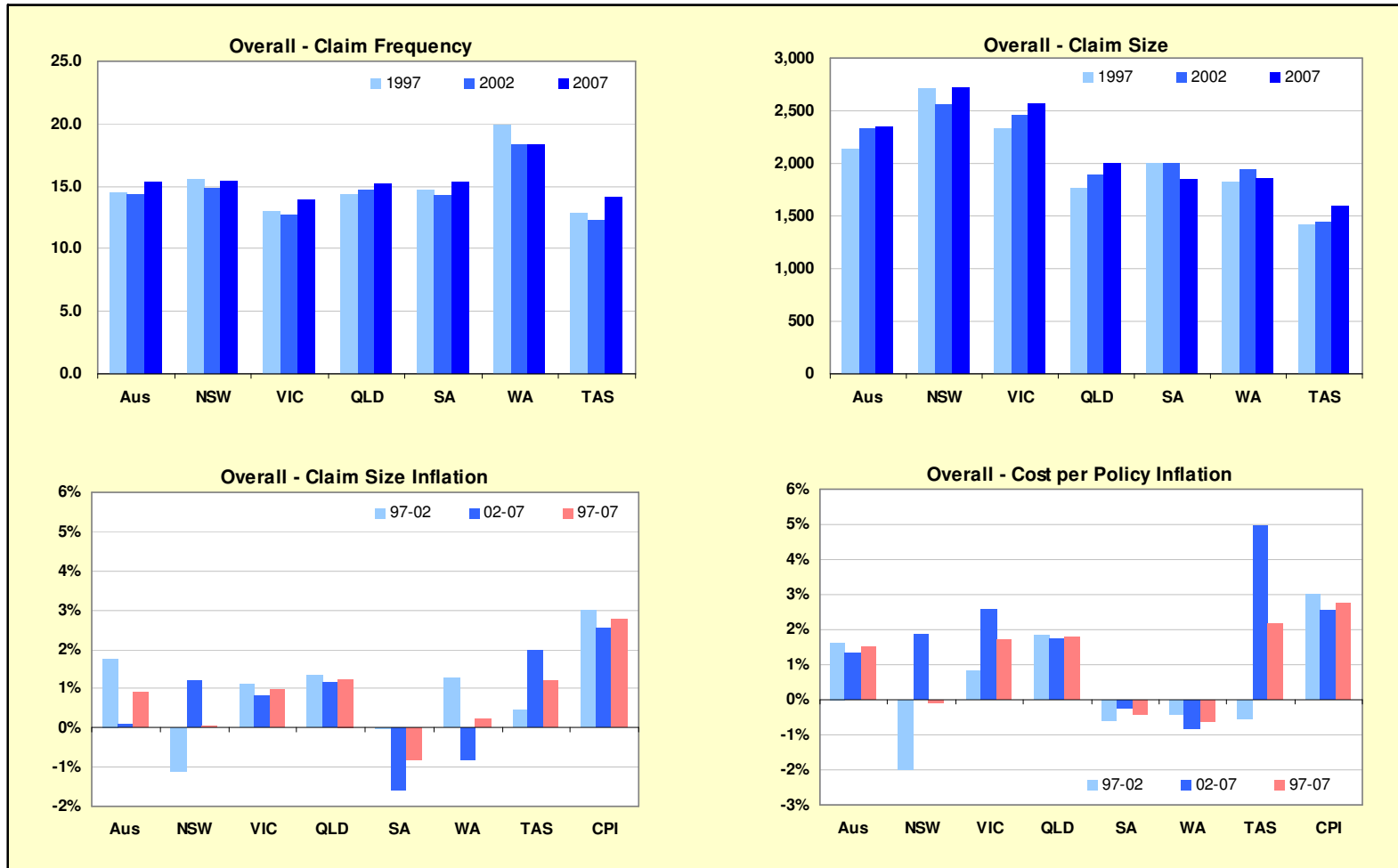
# Motor - Theft: Long Term Trends



# Motor - Glass: Long Term Trends



# Motor – All Claims (excl events): Long Term Trends





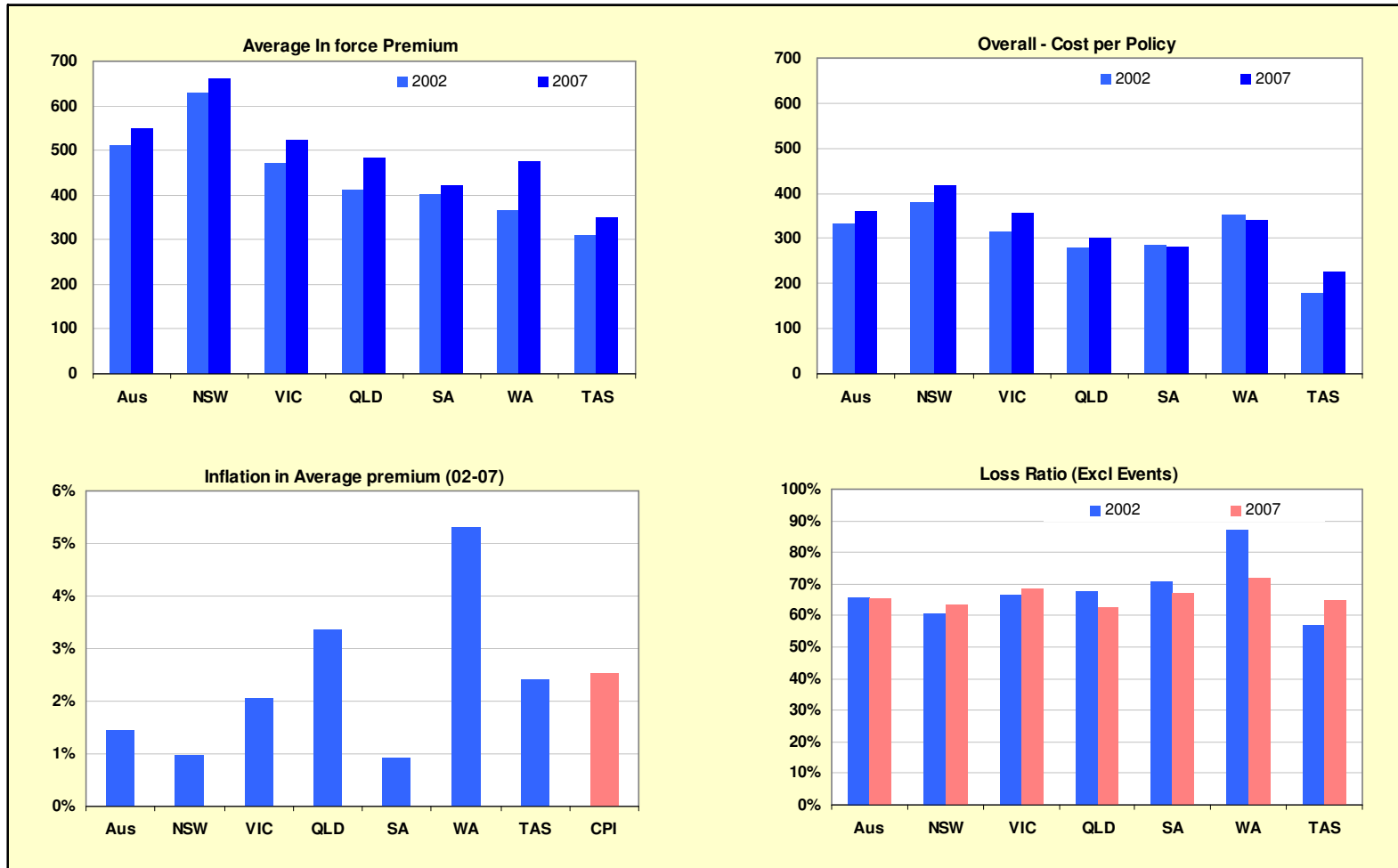
## Claims Trends – Key points



- Claims Frequency
  - ▶ Largely driven by external factors
  - ▶ Unchanged or increasing for collision offset by reducing theft
  - ▶ Varying windscreen benefit coverage across States reveals benefit differences
- Claim Size
  - ▶ Maintaining relativity to peers requires keeping claim inflation below CPI
  - ▶ Generating a sustainable competitive advantage means .... Mmm?



# Motor – Premiums Vs Claims



# Underlying Profitability - summary



- Loss ratios of the order of 65%
- Expense rates 25% and lower
- Imply CORs of 90% and less
- Which imply very attractive returns on capital of well in excess of 35%

## Required COR

		Capital as % of GWP				
		18%	21%	24%	27%	30%
Target Return on Capital	10%	101	101	100	100	100
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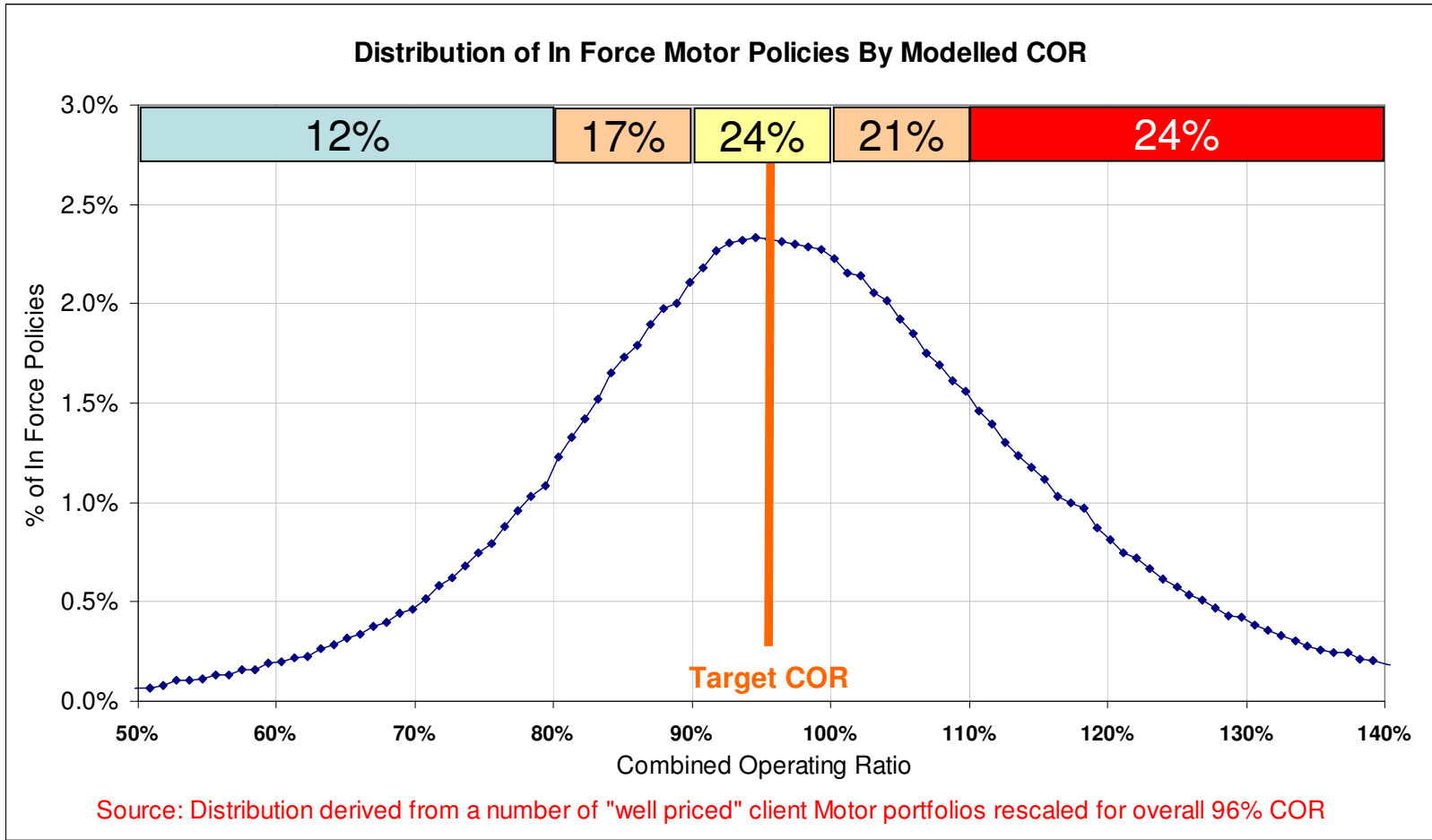
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**Are such returns sustainable over the medium to longer term?**



# It is not just about cost management - Motor pricing still a big "misfit"



# P&L By COR Group



COR Range	In Force Policies		Profit & Loss \$m						Capital	
	No (000)	% of Total	GWP	U/W profit	ITR	Net Profit	Cost of Capital	Econ. profit	Amount	ROC
<80%	25	12%	19.1	6.1	6.5	4.7	0.4	4.3	3.5	136%
Middle	127	63%	60.5	3.0	4.4	3.9	2.0	1.9	17.9	22%
110%+	48	24%	20.4	(5.1)	(4.7)	(2.9)	0.9	(3.8)	8.6	-33%
<b>Total</b>	200	100%	100.0	4.0	6.2	5.7	3.3	2.4	30.0	19%

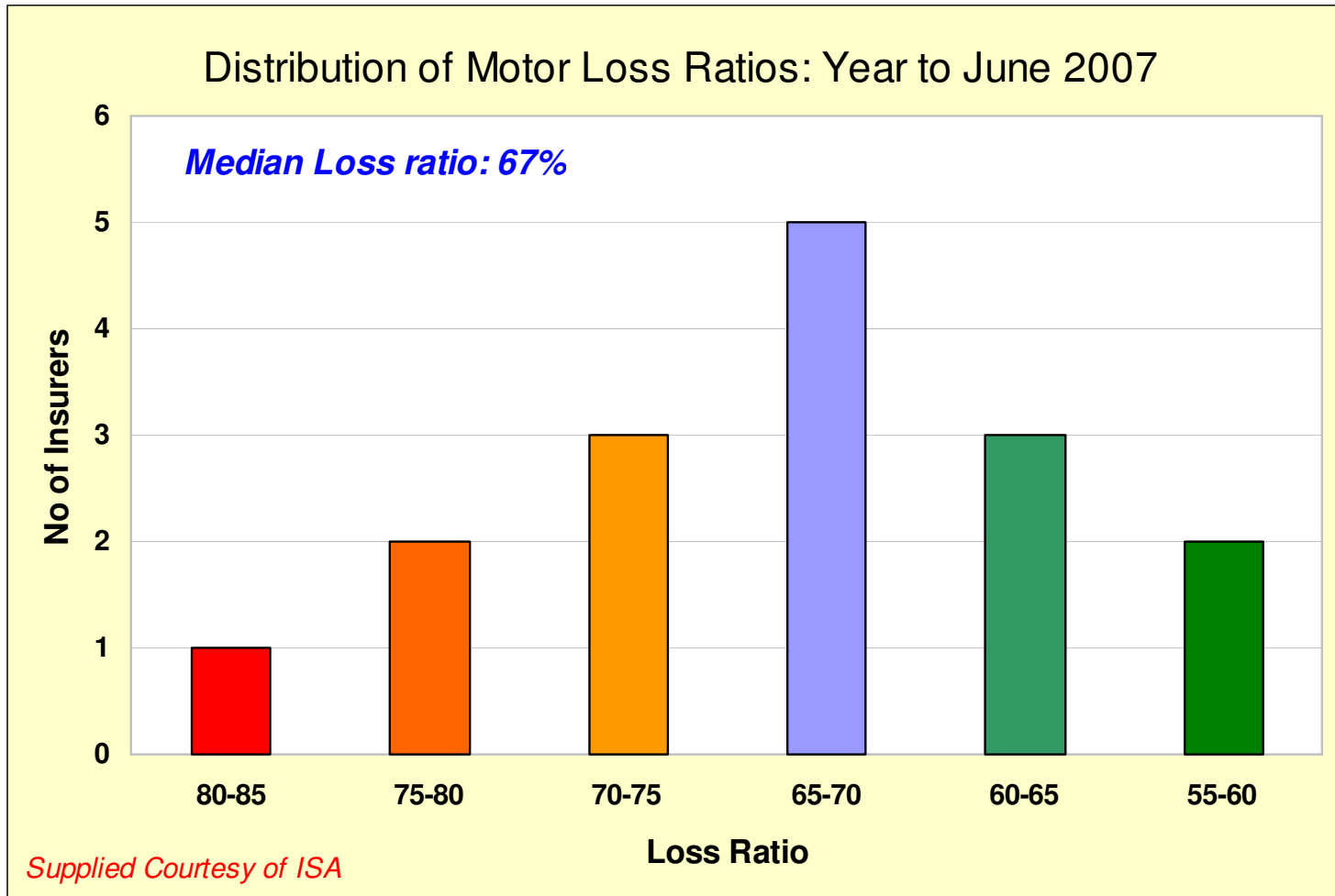
- There will undoubtedly be valuable segments in the business where sales will respond positively to lower pricing

**AND**

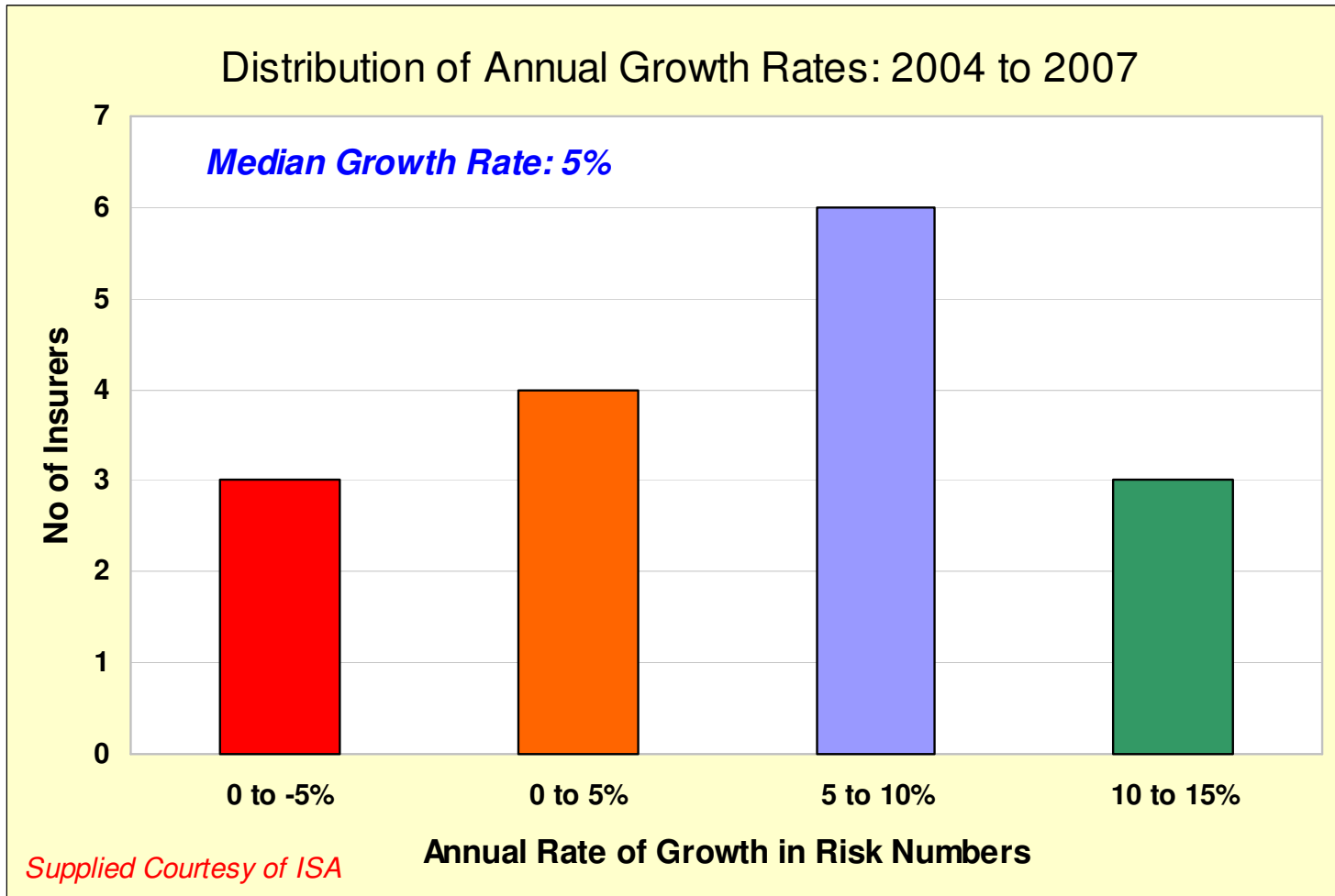
- There will almost certainly be segments where pricing should be significantly higher (and where it would be still value-creating if the business left because of a price hike)
- Targeted pricing matched against your best go at estimating technical prices is an important part of your weaponry



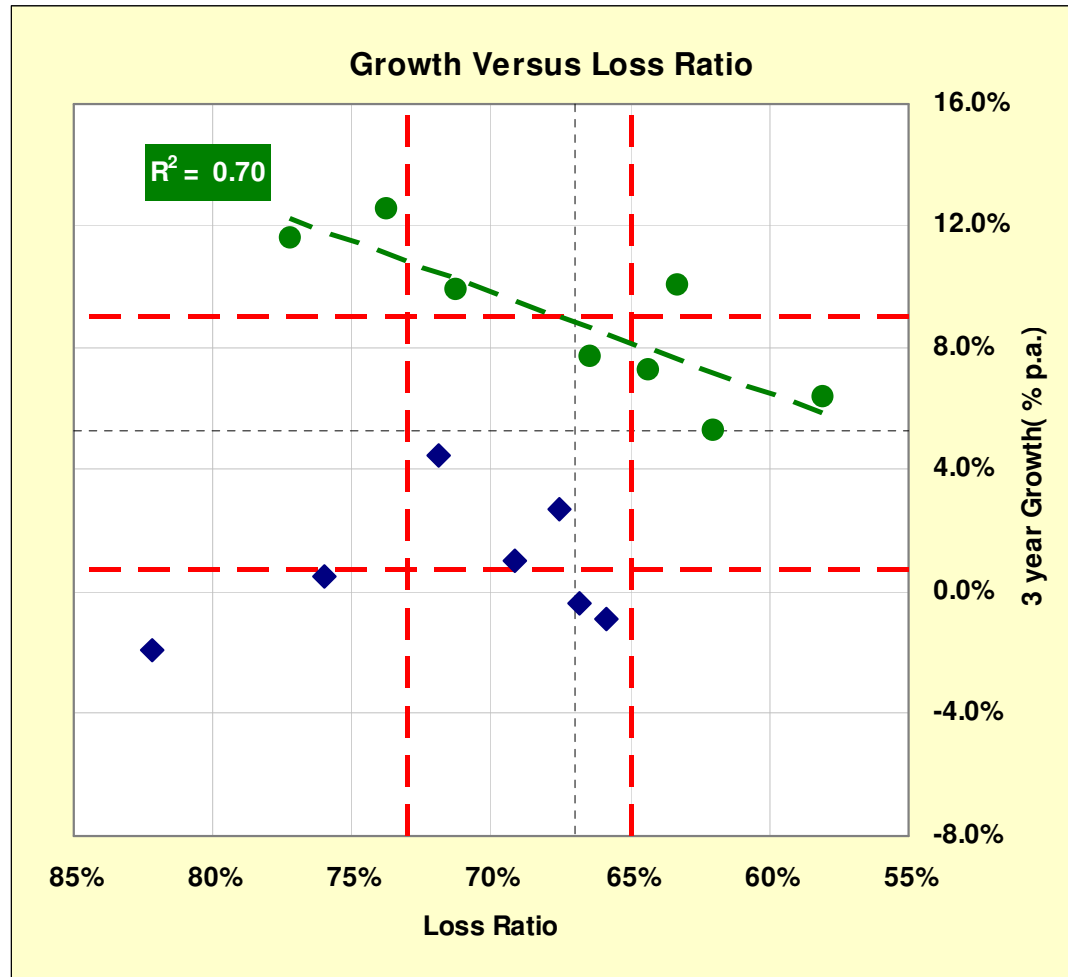
# ISA Motor Loss Ratios



# Motor: ISA growth rates



... while the trade-off is quite apparent, a number are top quartile on both dimensions



## Creating Value – key conclusions (1)



Profit not materially above your cost of capital?

- Single-minded focus on improving the margins in your existing business
- Cost reduction likely to be the biggest contributor
- Targeted pricing also important



## Creating Value – key conclusions (2)



### Achieving a healthy margin above your cost of capital?

- Treat it preciously
- Giving it up to chase market share is unlikely to be value positive
- If you want to aggressively target growth with price as a weapon:
  - ▶ Find some cost reduction to pay for it
  - ▶ Use pricing in a very segmented and targeted way



## Creating Value – key conclusions (3)



*Sustainable competitive advantage is largely about cost*

- Underlying trends for motor suggest
  - ▶ Currently experiencing very healthy returns. Are they sustainable?
  - ▶ Containing costs below economic inflation is a “ticket to play”
- Opportunities exist for smart(er) pricing to help deliver superior returns



A final point – competitive advantage is a game of comparatives, not absolutes



		Competitor	
		Strength	Weakness
You	Strength	Neutral	Advantage
	Weakness	Risk	Neutral



# A final point – competitive advantage is a game of comparatives, not absolutes



		Competitor	
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You	Strength	Neutral	Advantage
	Weakness	Risk	Neutral

Are you taking full advantage of the insight **ISA** statistics can give you?

Metric	Period	ALL ISA	XYZ	Other	XYZ Position	
					Rank	Rel
Market Share	Jun-07	100%	3.55%	96.4%	8	
	Jun-08	100%	3.63%	96.4%	9	
	<i>Chg</i>		0.1%	-0.1%		
Average In Force Premium	Jun-07	537	536	537	14	100
	Jun-08	555	553	555	13	100
	<i>% Chg</i>	3.4%	3.2%	3.4%		
Claims Per 100 Policies	Jun-07	15.2	14.4	15.2	7	95
	Jun-08	15.9	15.0	16.0	6	94
	<i>Chg</i>	0.7	0.5	0.7		
Average Claim Size	Jun-07	2,391	2,710	2,374	17	114
	Jun-08	2,443	2,765	2,426	19	114
	<i>% Chg</i>	2.2%	2.1%	2.2%		
Cost Per Policy	Jun-07	362	391	361	15	108
	Jun-08	388	414	387	13	107
	<i>% Chg</i>	7.2%	5.9%	7.2%		
Loss ratio	Jun-07	68	74	68	15	108
	Jun-08	71	75	70	11	107
	<i>Chg</i>	2	2	2		

Market Share, Premium  
Claims Experience  
Motor, Total, Aus

Position as at June  
12 months to June

Market Share:  
1 = Highest out of 19  
Other metrics:  
1 = Lowest out of 19

