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A Changing Industry: An Analysis of the Effects of Direct-to-Consumer Advertising on the Insurance Industry

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Abstract

Direct-to-consumer selling is a shift in the strategies of many companies. As technology continues to play a prominent role in business, companies need to adapt to accommodate, and take advantage of, new opportunities that become available. Many insurance companies are now focusing on improving their direct-to-consumer selling efforts and attracting consumers with new online selling platforms. This thesis looks at the changes inside and outside of the industry that led to this direct method of selling and the impact that this has on the intermediaries in the industry, with a focus on property and casualty businesses. Additionally, this thesis takes an in-depth look at some insurance companies' results and sentiments when implementing a direct-to-consumer selling platform.

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Introduction

The insurance industry is undergoing changes. Technology's role in business continues to grow and become more prominent, and the insurance industry is reacting. Agents sold the overwhelming majority of insurance products for as long as insurance has been around, acting as an intermediary between the consumer and the insurance-provider. Now, however, insurance companies are broadening the ways they sell insurance by using digital solutions, and they are selling directly to consumers.

Background

Companies have been selling insurance directly to consumers for over a hundred years, but it has not gained prominence until recently. Back in the early 1800's, The Hartford became the first insurance company to pursue the idea of direct insurance selling methods. The Hartford had an agency network, but wanted to expand their services outside of these connections. The company began to advertise in locations outside of this network, and offer insurance through an application in the mail that would go directly to the company's secretary. While The Hartford believed this would be a worthy endeavor, this was not the case. Consumers did not seem ready to buy insurance without an agent, so the company shut down this operation.

Insurance products were originally mainly sold at banks. This continued until the 1916 National Bank Act limited the selling by banks. However, this was changed with "the 1999 Gramm-Leach-Bliley Act, which said that banks, insurance companies and securities firms could affiliate and sell each other's products" ("Buying Insurance: Evolving Distribution Channels"). Now, consumers have many options when it comes to choosing how to buy their insurance and the birth of digital selling is increasing the number of options again. As internet use increases, the opportunities for direct selling become more viable.

A Changing Industry

The shift to buying insurance online reflects the changes in consumers' buying habits. Consumer buying patterns are quickly changing. Online sales have continued to prove to be the desired method for consumers. Black Friday sales for 2016 demonstrate this as well. A survey done by the National Retail Federation found that, of all the Black Friday shoppers in 2016, "44 percent went online and 40 percent shopped in-store" and the gap between online and in-store sales is expected to widen in the future (Smith).

A reason for the shift is simply because of convenience to the consumer. More consumers are now searching for products on online websites such as Amazon, as opposed to traveling to a brick and mortar store. Consumers can be guaranteed to receive a product within a short span of time. Many companies are now also guaranteeing next day delivery, making online ordering an even more viable option. Additionally, customers are no longer restrained to searching for insurance, or any good or service, during normal business hours. In the case of insurance, an insurance buyer does not need to wait until his or her agent is available in order for them to find an insurance package that is right for them.

Even with a change in the buying habits of consumers, the insurance industry is still behind other industries when it comes to digital marketing. While the use of direct-to-consumer insurance is rising, intermediaries are still responsible for the majority of sales, with "more than 60% of insurance contracts sold" being sold by an intermediary (Swiss Re 4). These intermediaries can be agents, brokers, banks, or other affinity groups. Agents top the list of intermediaries, as they are responsible for the biggest percentage of sales. For many people, having a relationship with an agent is part of the reason they enjoy the security and peace of mind that comes with insurance. The agents get to know the customers and the customers truly rely on the agents to find the best insurance products available to them, especially when a consumer has complicated needs to manage their risk.

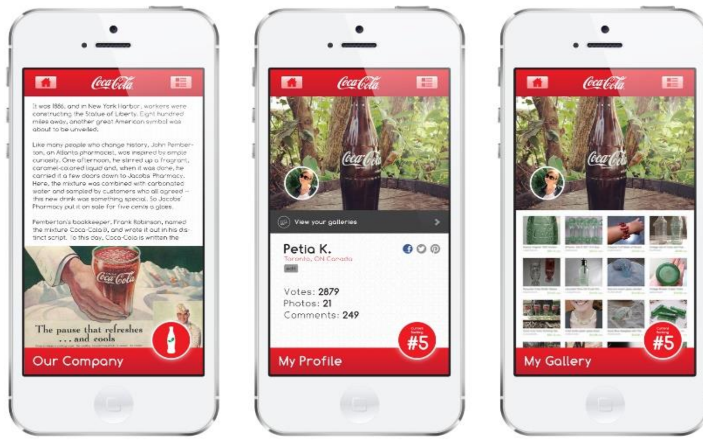
An agent is extremely helpful given that neither the insurer, nor the insured, have access to all the information that is available. The average insurance customer is not aware of what insurance products best suit his or her needs, or which company provides the best value given those specific needs. On the other end, the insurance company does not have a way to know all of the details of the customer, such as the true extent to which their behavior is considered risky. Overall, intermediaries need to "adapt their business models to meet the varying needs and preferences of customers, while at the same time keeping the costs of integrating and maintaining multiple distribution channels under control" (Swiss Re 1).

Brokers and agents can encounter restrictions based on specific laws. Each state requires separate requirements for the licensing of its agents. This means that intermediaries "must complete separate applications, pay separate licensing fees, and meet different pre-licensing and continuing education requirements established by each state in which they seek to be licensed" (U.S. Department of the Treasury). The National Association of Registered Agents and Brokers works to oversee this process and streamline it as much as possible. The main goal of this association was to allow clients who are moving to a new state to be able to continuously buy insurance from their previous broker. While this association does aid the process, brokers must still pay additional fees and follow certain regulations to ensure that they are compliant with the rules of each state. An online platform eliminates these factors, which could have an impact on how much insurance consumers are paying for their products, depending on their seller, since licensing fees can be taken out of the picture. Again, direct selling is ensuring that customers are receiving their products for a low price and in a convenient manner.

Vertafore, the largest provider of insurance technology, recently released an annual report examining the independent agencies in property and casualty insurance. 49% of the agencies responding for this report claimed they are "'very optimistic' about the future success of their agency compared to just 29 percent who felt optimistic in 2015" ("How Independent Agents Are Feeling About Growth, Technology and Disruption"). One of the reasons for the lack of optimism in 2015 was because of the fear that insurance carriers were becoming more skilled in the use of predictive analytics. In the past, intermediaries would have the best access to in-depth information about customers that would allow them to predict and analyze what insurance products best fit the customer's needs. With insurers becoming more capable of their pricing, underwriting, and marketing practices, this questions the necessity of independent agents as they lose the competitive advantage they have held for so long. However, agents are responding to this by utilizing new technologies to enhance their operations and compete more effectively to show their value in the industry.

The use of technology will certainly continue to grow. The majority of agencies surveyed are currently, or are planning on, increasing their technology budgets to use business software that will further enhance the agency's services. Consumer relationship management tools seem to be one of the most popular software platforms that are being further developed and utilized. This includes using more mobile-friendly platforms as well. Vice president of industry relations for Vertafore, Bruce Winterburn, states how "year-over-year survey analysis shows agents have remained bullish on mobile CRM investments, which have helped attract and better service new and existing customers. The industry activity coupled with revenue increases across both P/C lines have contributed to this renewed sense of optimism" ("How Independent Agents Are Feeling About Growth, Technology and Disruption"). Intermediaries need to make themselves completely available to their consumers, whether it be in person, over the phone, or through mobile devices.

As stated previously, insurers are lagging behind businesses in other industries when it comes to adopting certain digital components. For example, most insurance companies lack a robust social media presence that most consumers seem to expect from a business. When comparing the Coca-Cola app with the Liberty Mutual Insurance app, many stark differences are immediately apparent. Companies like Coca-Cola pride themselves on engaging consumers with their products through features of their app and their social media presence. The Coca-Cola app that is pictured allows users to build a community based around the products that are offered. Users make a profile, submit and browse drinks being made by other users, communicate with others, and can see nearby Coca-Cola vending machines all through this one app. Meanwhile, the Liberty Mutual app provides users with some basic functions, such as allowing users to make payments or report claims. While insurers are making progress in regards to their accessibility, there is no question that companies in other industries have a much more engaging digital presence compared to insurance companies.



(Vuong)

(Liberty Mutual)

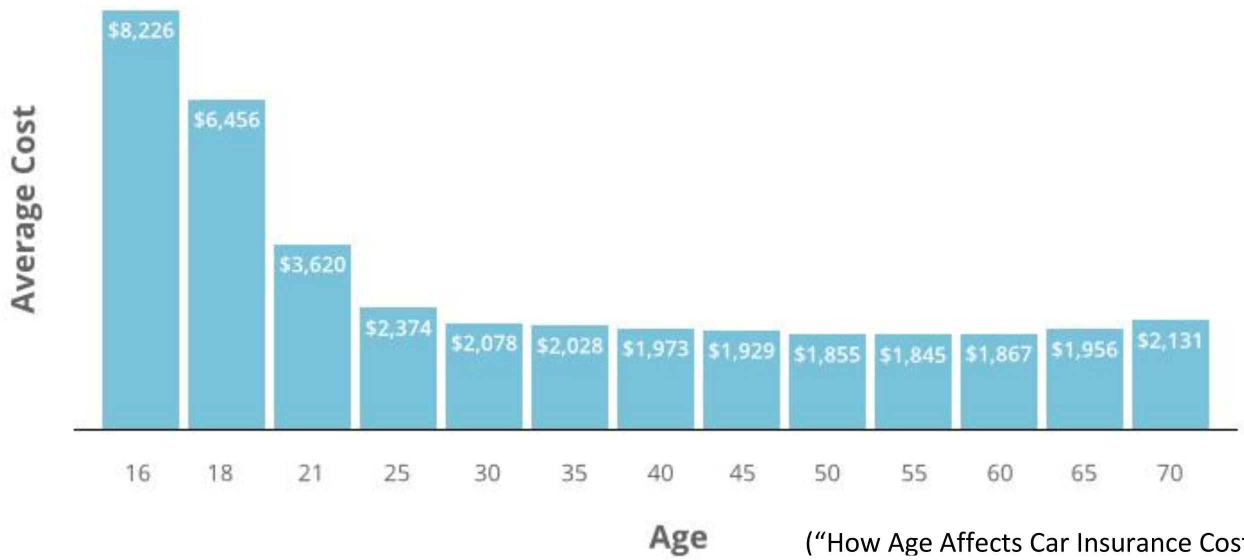
Looking at a company's phone application may seem like a useless way for consumers to identify where they would like to buy their insurance products from. Realistically, however, consumers demand the same level of sophistication from their insurance companies as they would any other company. This is especially true considering that with every new generation comes a group of consumers more technologically capable than the generation before. These individuals will need to be targeted in this way in order to remain engaged in the products being offered to them. Companies that are able to successfully implement themselves into this new, digital world will place themselves in an advantageous position.

Another important aspect of selling insurance is ensuring that customers have the same access to products regardless of the platform they are using to buy the products. It should not matter if the customer is buying insurance over the phone, face to face with an agent, or directly through the company's website. The experience should be as seamless, and identical, between platforms as possible. Consistency between platforms keeps customers engaged and helps the company's brand name, therefore boosting the firm's reputation.

The rise in online selling platforms results in more fierce competition between firms. Consumers have access to insurance rates and can easily compare the rates that they find. Having all this access to information gives the consumers more buying power and puts a strain on insurance companies as they must battle for their customers. Insurance providers will need to make provide platforms that look engaging and simple at first glance, and also offer a direct experience that immerses consumers and delivers a satisfying experience. This will be necessary to ensure that consumers are not interested in jumping to another seller at their first opportunity. Additionally, since the relationship a consumer may have had with an agent is not a factor with this type of platform anymore, this makes the pricing of the insurance to be even more prominent in the decision making process.

The other factor that can improve a company's performance in this type of market is the brand name recognition. When insurance rates are the same, or close to it, consumers will chose to go with a company who they trust. Given that insurance is necessary for consumers when they are most in need, they will want to ensure that the insurance provider they are choosing has a positive reputation.

Customers that are most interested in buying insurance online directly from an insurance company are generally younger consumers who are technologically savvy. These young customers who are seeking insurance are also usually more prone to accidents. Therefore, they are considered to be riskier by insurance companies. This is why insurance contracts for younger people usually contain higher premiums. For example, the cost of auto insurance changes drastically with age. Younger drivers must pay a much higher premium than older drivers, because young drivers get into more accidents than drivers that are experienced. This is reflected in the graph below, which compares the cost of auto insurance by age, by averaging the rates of more than twenty different insurance providers.

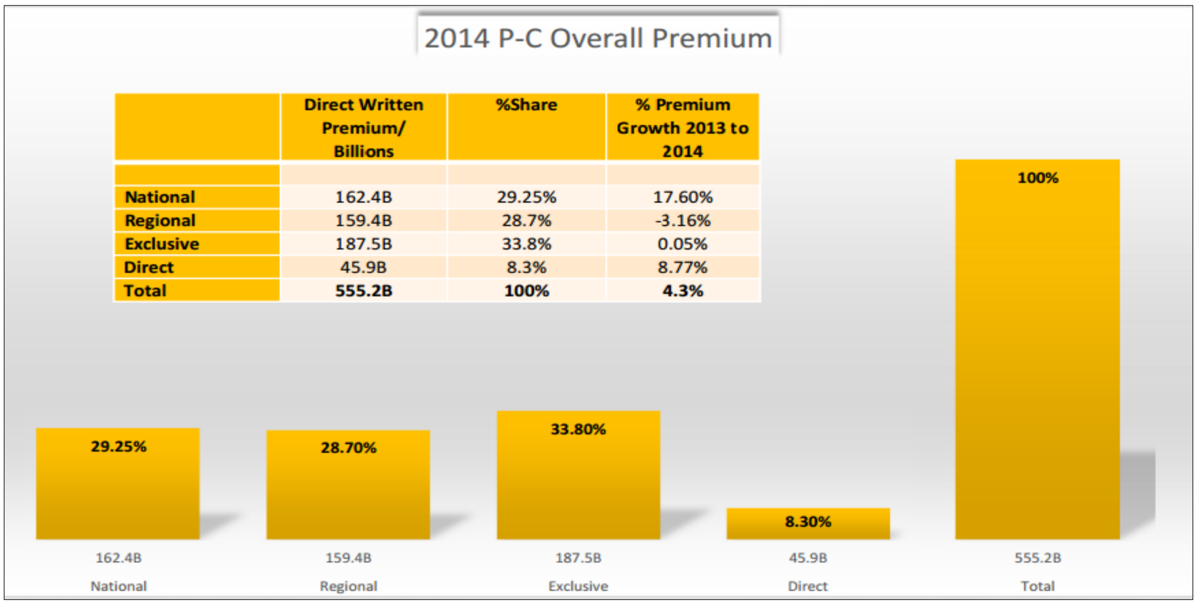


("How Age Affects Car Insurance Costs")

Given that there are varying rates that may apply to consumers based off of their demographics, certain customers may attempt to exploit this to their advantage. One of the most important reasons intermediaries are so prominent in the industry is due to their in-depth understanding of the customers' qualities and needs. This allows an accurate insurance package to be provided to the buyer. However, if the intermediary is taken out of the equation, this means that companies will need to rely more heavily on their customers self-reporting information. This opens the door for customers to modify their information in order to obtain a better premium. They may not be completely truthful or accurate when reporting information about themselves, knowing what things will result in them obtaining a more favorable insurance package. It will be up to the insurance providers to use their own data and analytics to offset these predicaments by becoming better at predicting the risk level of a consumer. Additionally, more regulations may need to be in place at both an industry and firm level to deter this type of fraud. These kinds of activities among consumers will certainly create more problems and concerns for the insurers in the industry, as they attempt to circumvent this situation.

Property & Casualty Distribution Breakdown

A look at the distribution channels of property & casualty insurance will reveal the overall trends seen in the industry. The Independent Insurance Agents and Brokers of America, Inc. compiled a report of the property & casualty insurance market for 2014. The figure below shows the breakdown of premium written between national, regional, and exclusive intermediaries, as well as the premium written to consumers directly.

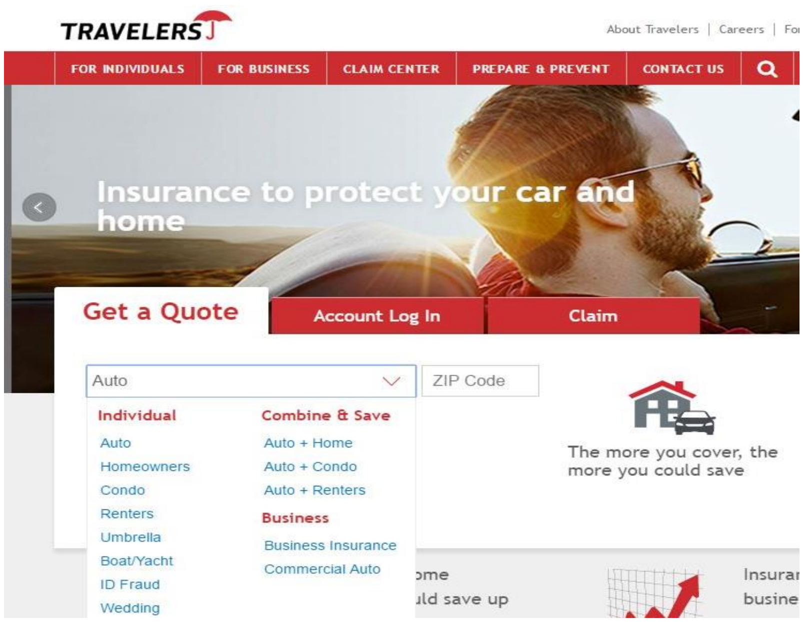


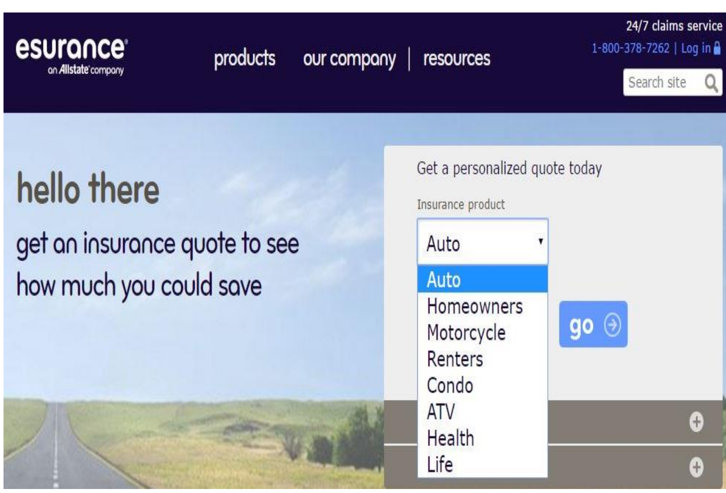
	Direct Written Premium/ Billions	%Share	% Premium Growth 2013 to 2014
National	162.4B	29.25%	17.60%
Regional	159.4B	28.7%	-3.16%
Exclusive	187.5B	33.8%	0.05%
Direct	45.9B	8.3%	8.77%
Total	555.2B	100%	4.3%

(Independent Insurance Agents & Brokers of America, Inc.)

This figure reveals some interesting insights. First, it clearly demonstrates how direct premium accounts for a only small portion of the total premium written. The use of intermediaries still make up 92% of the total premium written, though this has been decreasing in recent years. Steady growth in the premium written directly to consumers shows that this platform is becoming more of a staple in the minds of insurance customers. However, the rate of growth for this type of business is slowing. From 2012 to 2013, firms' premium written directly grew by about 9.7%, compared to the 8.8% growth seen from 2013 to 2014 (Independent Insurance Agents & Brokers of America, Inc.). This steady, but slowing, growth is a reflection on some of the feelings that firms have experienced when dealing with a direct-to-consumer platform.

It should also be noted that most insurers only offer certain types of insurance packages directly to consumers. Personal lines are generally more amenable to this type of platform, since shoppers can enter in their own personal information and get feedback and quotes easily right after. Within that classification, auto and homeowner policies are the most widely searched and advertised online. Screenshots below of the homepages of three different insurers show that these types of policies are promoted the most.





Company-By-Company Analysis

Travelers

Taking a closer look at specific insurance companies provides insight into the different approaches taken by each company. For example, Travelers, the only property casualty insurer included in the Dow Jones Industrial Average, takes a very conservative approach to their direct-to-consumer strategy. Travelers is known to be a very risk-averse company and changing the way they do business certainly contains its share of risks. With this in mind, Travelers began marketing their products directly to consumers in 2009, focusing on their personal insurance products.

Travelers prides itself on its continued maintenance of agent relationships. By keeping its agents pleased, Travelers believes that this benefits the company and has a favorable impact on its success. When Travelers was first considering adopting a plan to sell insurance directly to customers, and removing the intermediary, concerns about the impact that this may have on the agent relationships were extremely important to the company.

Additionally, the very nature of the customers that direct-to-consumer insurance would appeal to are somewhat inconsistent with Travelers' business plan. Reaching out to consumers who are generally known to be risky would be a gamble that may be seen as out of character for the company. This line of thinking has led to Travelers being more conservative in its pursuance of selling insurance directly to its consumers.

Travelers originally only used direct selling for its personal lines. However, last year, the company began to sell insurance directly to small businesses in the United Kingdom. The online platform "uses clear and understandable language and simplifies the insurance-buying experience for small business owners" ("Travelers to Offer Small Business Insurance in UK via

Online Platform."). This can be considered the company's first step into expanding its online platform to a bigger audience. In reality, this small business platform in the UK does not include a wide audience. The platform is only for businesses with less than ten employees and less than $3.7 million in revenue.

Travelers' entrance into direct selling has not been extremely successful for the company. In the company's 2015 10-K, it is explained how the "direct-to-consumer initiative, while intended to enhance the Company's long-term ability to compete successfully in a consumer-driven marketplace, is expected to remain modest with respect to premium volume and remain unprofitable for a number of years" (Travelers). The direct-to-consumer business increased the company's overall combined ratio by 0.5% in 2015, yet the company will continue to maintain the platform. It is interesting to note that Travelers is one of the only property and casualty insurers that separates the impact of the direct-to-consumer platform from their overall combined ratio. It is apparent that the company is trying to distinguish between its normal operations, where the company thrives, and its lagging direct marketing business.

Travelers is aware that it needs to keep up to date with the newest trends in the industry. The company feels to pressure to expand how it is offering its products, despite the fact that this selling method may conflict with some of the company's previous strategies. With that being said, the direct-to-consumer premium written in 2015 was 26% higher than the year before, indicating that there is growth despite the service still being unprofitable.

Allstate

Allstate is an insurer that pursues the direct-to-consumer business in a much more focused manner than Travelers. Allstate is comprised of different brands that each market varying products, and pursue different strategies. The direct-to-consumer products are marketed under the “Esurance” moniker.

Esurance is continuously expanding its product offerings into different areas of the US and has experienced success while doing so. For example, in 2015, the company was able to expand its homeowner’s products from 14 to 25 states. The focus and scope of this company, compared to others, are what help to set it apart in the minds of consumers. This, however, does not mean that the platform is any more successful when it comes to profits.

Like Travelers, Esurance has struggled in covering its losses for the direct selling platform. Esurance has consistently experienced an underwriting loss since its inception in 2011. In 2016, the company continued this trend with an underwriting loss of $124 million. Despite operating at the loss, the company has been showing signs of improvements based on many measures. The gross written premium and number of policies in force have increased from 2015 to 2016. The underlying combined ratio has decreased as well, from 108.4 to 105.2. These are all good signs for the company. However, like with many others who are selling insurance directly to consumers, the operations remain to be unprofitable.

Liberty Mutual

Liberty Mutual is actually slowing down its direct-to-consumer business in some areas of the company. This is the opposite of what most companies appear to be doing. Liberty Mutual “is discontinuing direct distribution to mid-sized businesses and now plans to distribute its commercial property/casualty insurance products in the middle market exclusively through independent agents and brokers” (Simpson). The company was struggling while trying to market its products directly to these mid-sized businesses, which Liberty Mutual defines as businesses with a total account premium between $150,000 and $1.5 million.

This action was seen as a strategic decision since "95 percent of middle market business insurance is sold by insurance agents and brokers, not through direct distribution" (Simpson). Many companies who meet this criteria prefer the communication with an independent agent. Oftentimes, these mid-sized companies do not have the risk management services internally that are commonly seen among larger businesses. This results in these companies requiring decision-making assistance outside of their company, and independent agencies satisfying this requirement.

Future Trends

The world is becoming increasingly connected and goods and services are now available in a faster and more convenient way than ever. As businesses and consumers adapt to these changes, insurance will change as well. Currently, insurance marketed directly to consumers attracts younger customers, since they are more technologically savvy. Insurers do not always desire these kinds of insurance contracts, since historically these consumers carry the most risk. This means insurers will end up paying out more money for claims and retain less of the premiums they charge.

This will not always be the case though. These young, tech-savvy consumers who are using online platforms to buy insurance will grow up. As they grow older, their risk level will drop, making them more desirable to businesses. Additionally, these consumers who grew up buying insurance products online will continue to use these platforms, since they are now comfortable with the format. This will cause insurance providers to invest more in their direct selling platforms to continue to service these customers.

While the consumers who were the early adopters of direct-to-consumer insurance grow older, a new generation of young consumers needing insurance will appear. These new buyers are very likely to be even savvier with technology than generations before, making online platforms their first stop for their insurance needs. Also, given that insurance companies will be investing more in their online selling platforms to meet demand, these platforms should be the most streamlined, advanced, and user-friendly systems to date. The direct-to-consumer insurance market will thrive in the future.

Changes in consumer preferences, the growing availability of information, and the transition period for insurers creates new possibilities for all stakeholders of the industry. Moving forward, insurance-buyers will have many opportunities to change providers. The potential for this will cause companies to strengthen their efforts to retain customers. Retention is already an important factor for companies and the increasing power that buyers are experiencing will make this issue even more vital. Also, as some insurance companies struggle to adapt to a new platform, this creates the opportunity for new competitors to enter into the market. While this industry may not be the most inviting for new entrants, a firm that can effectively capture market share through a robust online platform has strong potential during this time. This may result in a situation that is similar to how Amazon has experienced major success, as traditional brick and mortar companies attempt to adapt in an era driven by online commerce. In fact, two-thirds "of insurance customers would consider purchasing insurance products from organizations other than insurers" showing a widening market is possible in this type of environment (Luu and Conway).

Independent agents will need to adapt to the growing demand of direct selling platforms. Insurers will continue investing in analytical analysis tools to properly price and market their products. Agents and brokers will need to do the same, in addition to making themselves available to consumers at all times. The best case scenario for independent agents would be that they can keep up with insurers' investments in data and technology, while also demonstrating the value they provide that a big insurance company cannot. Agents have the ability to build important and meaningful relationships with customers, therefore making their knowledge of the products offered and the consumers' needs extremely valuable. These relationships need to be adapted to new societal changes. Intermediaries will need to make themselves available in any way the consumer desires, whether that is through social media or a phone application.

There will always be a need for agents, especially in complicated cases and for consumers who feel more comfortable consulting an intermediary. However, it does seem that most consumers will be attracted to the ease and convenience of buying policies directly from an insurer. As companies invest more in these direct selling platforms, relationships with intermediaries will be hurt, as they are losing customers and realizing that insurance companies are not prioritizing the needs of agents over the desires of consumers. In the future, it seems that intermediaries will struggle with the shifts in consumer buying habits.

Conclusion

While "the insurance industry tends to operate along traditional lines, and insurance companies with deep roots have been slow to adopt digital tools and business models", change is inevitable for this industry (Mengebier). Many firms are in a period of transition. They are working on platforms that will appeal to the shifting consumer preferences. This push to digital and direct marketing may seem like common sense to most people. However, it is interesting to note that many insurers appear reluctant to make these alterations. Many traditionally strong property & casualty companies, such as Travelers and Liberty Mutual, appear to either not consider a direct to consumer platform as part of their main business, or show signs of slowing down the use of these platforms.

The future of this industry depends heavily on the intermediaries. Agent sales have dominated the market for many years. These companies that may seem hesitant to implement new direct platforms are fearful about what impacts these changes may have on insurer/agent relationships. Intermediaries will need to demonstrate their value in order to survive in the insurance industry of the future.

Even with intermediaries' attempts to show their significance, a market where consumers can go online for all their insurance needs is inevitable. Each passing generation results in markets that are increasingly driven by online commerce. In the end, direct-to-consumer insurance selling platforms are causing changes in the industry.

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