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# Convergence in customer value management

**Pricing actuaries and marketing executives have historically been portrayed as coming from, and operating within, very different worlds. Yet with the changing face of mass market insurance, their metrics and objectives increasingly overlap suggest Stephen Jones and Ian Liddicoat.**

## **Introduction**

When it comes to breaking down silos, the notion of general insurance actuaries and marketing teams joining forces used to sound rather unlikely. Yet developments in personal lines insurance distribution and marketing have created conditions where such co-operation is becoming necessary for continued success.

Technology has changed the way consumers buy personal insurance products in the UK, fuelled particularly by the rise of internet price comparison sites (aggregators). The implications for pricing have been clear for all to see. With the consumer increasingly in control of how providers are evaluated, and with easy access to customer service feedback, the integration of factors relating to price and other insights has become a necessity within acquisition management.

The internet has made it increasingly difficult for motor insurers to achieve acceptable returns from pure underwriting. If they are to flourish in this environment, the ability to pool their pricing and marketing expertise to improve their understanding of customer behaviour and target offers effectively will separate the 'innovators' from the followers.

Although this seemingly radical trend towards functional co-operation pre-dates high levels of aggregator usage, recent distribution trends have

given it extra urgency. More and more, the co-operation of marketing and actuarial teams requires a business culture that promotes the understanding of data integrated at the individual customer level that is then used efficiently within customer facing and administration systems and in pricing calculations.

## **A near perfect market**

The UK market for motor insurance, and increasingly for household, is fast approaching what economists would describe as 'perfect'. Perfect that is for consumers, but decidedly tricky for personal lines insurers. The biggest factor in this transition has been the rise of aggregators, and the transparency that they have brought to the market.

Their biggest attraction to consumers is the ability to compare prices across a high proportion of the market and to deliver potentially material savings as a result. In the face of apparently relentless television advertising, almost any customer will eventually shy away from an insurer whose prices are out of step with the market, and the aggregators will increase the frequency of subsequent decision cycles.

But that is only the beginning in terms of insurers' needs to adapt to the aggregator environment. Perceived brand strength has a significant impact upon conversion rates, even where the companies are ranked initially by price. Strongly



branded insurers can outperform weak ones at similar rank by a factor of around four, and so providers need to build long-term brand equity in the minds of their target audience as well as pricing their products appropriately.

EMB's 'Quest' tracking study of insurance buying behaviour, conducted through the CCBFastmap Consumer Voice Panel, has highlighted some of the specific challenges facing the actuarial and marketing teams:

- Price sensitivity is increasing. In our latest study<sup>(1)</sup>, the proportion of people who would look for an alternative quote if their premium increased by only between 1% and 5% increased from 10% to 19%
- Over 70% of on-line consumers, however, claim they would not always buy the cheapest quote, but are influenced by other factors such as brand awareness and the financial stability of the provider
- Policy add-ons such as breakdown cover, courtesy car and protected no claims discount are popular and so need to be balanced with price

What is more, the aggregators continue to increase their share of new business sales. Datamonitor estimate that 52% of private motor new business was aggregator instigated in 2009, up from 44% in 2008, and it is commonly accepted that this figure will exceed 60% very soon. Customers familiar with this channel for motor are increasingly embracing it for their home insurance needs.

### Breaking down silos

In many insurers, pricing decisions lie in the hands of a pricing committee, within which the pricing actuary holds a key role and, whilst marketing will typically be represented, its focus is on brand. Outside of this forum, rarely do the paths of pricing actuaries and marketers cross.

In these circumstances, strategic and tactical decisions, particularly for the aggregator channel, become difficult. Who brings an integrated market view on the direction to take on issues such as underwriting footprint, brand advertising expenditure, understanding customer value, up-selling, pricing for competitiveness, product presentation, product features, protecting the customer relationship (and the list goes on)?

The explanation of why silos have developed is in part linked to the nature of insurance pricing. For many industries the price setting process is a function of cost base, brand positioning and the economic and competitor environment and is often used as a tactical device to smooth the sales curve. In such instances, the pricing function often resides within marketing. For general insurance, although these business drivers still apply, an individual price is also a function of very specific factors related to inherent risk, claims experience and long-term customer value.

### The greater good

The very sophistication of general insurance pricing should be good news for the marketing director - as custodian of customer needs and total marketing effectiveness.

At the heart of price optimisation projects are measures of elasticity that ultimately derive individual prices, but also provide a unique, behavioural insight into a single customer or prospect. If we combine this elasticity or behavioural measure with everything else we know about an individual, such as their channel preferences, affluence, life stage and so on, and can deploy this efficiently in both in-bound and out-bound communication, then a marketing director has a powerful capability.

This is an example of how consumer marketing is increasingly a highly technical discipline and one that is increasingly focusing on achieving a sustainable, financial return on investment. It is no coincidence that a number of insurers have appointed marketing directors from other data rich industries such as the FMCG (fast moving consumer goods) sector in recent times, where innovation in the use of customer data is commonplace. Far from having nothing to learn from marketers about the use of data, general insurance pricing actuaries have a lot to gain from the sophisticated segmentation and predictive modelling techniques that have been deployed on large data sources such as loyalty cards.

Building an appreciation for each group's analysis techniques is just one example of how pricing actuaries and marketers can at least begin to foster a spirit of cooperation.

### Ideas on convergence

#### 1. Segmentation

*Issue:* What offers and price points will appeal to which customer groups?

In customer acquisition the ability to target effectively and be price competitive, is compelling. Where retention is the goal, the ability to accurately flex prices with other factors such as service preferences also offers a genuine competitive advantage.

One of the things that marketing teams understand very well is how to use external data sources such as Call Credit and Acxiom to enrich their knowledge of customers. There are signs that pricing actuaries are trying to improve their models by incorporating more of these types of data, the most obvious examples being the use of factors relating to credit-worthiness. Although there are now good examples of such data being used for both targeting and pricing models, these techniques can be taken much further.

Cross-fertilisation of analysis techniques enables customer segments and associated, individual level propensities to be used as a profiling tool for pricing activities. Similarly the underlying segments can incorporate factors that are directly related to price elasticity to generate a more holistic view of both behaviour and opportunity within a single, integrated strategy.

<sup>1</sup> See our Briefing Paper: 'Counting the pennies' - <http://www.emb.com/EMBDOTCOM/UK/UK/Resources/EMB%20Briefings-counting%20the%20pennies.pdf>

This holistic approach to customer segmentation would provide tools for both functions and might comprise:

- Multiple scores held and maintained at individual customer level within segments and possibly managed by a series of business rules
- Marketing metrics enriched by pricing variables, possibly by means of scoring models
- Enriched value-based segmentation as a top tier for communications where one-to-one may be impractical, or for performance monitoring purposes
- A jointly developed customer value overlay applied to the street pricing process, with a controlled 'test and learn' contact strategy to validate the approach
- Actuarial propensity measures to identify high value customers who are important to meeting financial objectives

## 2. Data

*Issue:* An integrated view regarding the value of customer data is a pre-requisite.

Much of the activity discussed so far relies on an accurate, up-to-date view of a single customer or prospect maintained in a logical format and accessible technology. This requires other corporate functions such as IT and Finance to be part of an integrated strategy to build long-term customer loyalty on the basis of sound data. The logical outcome is a degree of customer loyalty that promotes dialogue and even greater detail about consumer preferences which is far more cost-effective than a downward spiral of costly acquisition and increasing churn. This approach requires that organisations adopt one view about their data strategy and how this is used to increase consumer engagement.

## 3. Analysis techniques

*Issue:* Actuarial and marketing analysis techniques should not be mutually exclusive.

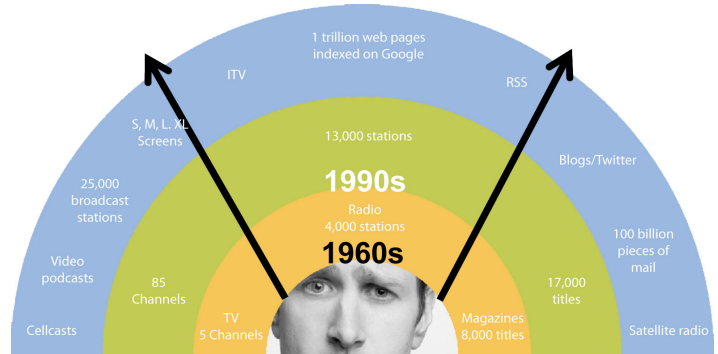
Actuaries and marketers alike need to be coaxed out of their respective comfort zones, in terms of the analysis techniques they apply. They should be encouraged to use the best techniques for the business problem and to take a common view of the appropriate tools and techniques. This is an issue for the board which needs to ensure that matters of strategy, culture or organisational structure don't derail the process.

There is no doubt that the descriptive modelling techniques commonly used in marketing can help the pricing actuary both as an input and an outcome of a fully integrated pricing strategy. In many respects we should refer to this as a customer value management strategy.

## 4. Media Optimisation

*Issue:* The media landscape has changed dramatically - firstly with the advent of the Internet and more recently in Google's dominance in performance based digital advertising.

The internet has already changed the way people buy motor and household insurance in the UK but it has also radically changed traditional communications channels. Google UK's advertising revenues surpassed those of Channel 4 in 2006, ITV1 in 2007 and total UK newspaper advertising in 2008. Media fragmentation has made the job of allocating marketing budgets effectively all the more difficult.



Historically, media optimisation techniques have focused on modelling historic performance at a crude unit of geography and have been dominated by media buying agencies. With the internet shifting control to the consumer, and marketing functions requiring an accurate assessment of financial return, this field of analytics is changing.

The price optimisation algorithms, pioneered in general insurance lend themselves perfectly to a much more granular approach to the optimisation of media mix and spend at household level. With a modelling capability that allows media effectiveness to be measured across the entire customer journey and the necessary scenario planning tools, these capabilities are increasingly residing within the client rather than the media agency.

## 5. Value measures

*Issue:* Convergence in pricing and marketing is not just advisable but a necessity and is a strategy that must be underpinned by a much broader approach to customer value management.

This means aligning several activities within a single framework, so for example at a practical level:

- Financial components of customer value models are consistent with pricing parameters and formulae
- Price-led offers are no longer tactical but highly targeted in the broadest sense
- Management of non-price levers is value-based, using a robust, test and learn campaign control cycle with metrics focused on sustaining long-term customer value
- Different corporate functions work to accepted definitions of 'customer value'

## Joining the circle

There is no doubt that the balance of price and value, particularly in the UK general insurance market is a difficult one to strike. This has been made more difficult by the increasing transparency in the market. This has ensured that both the pricing and marketing functions should have an equal interest in securing and developing brand equity in a manner we might not have predicted a decade ago.

Given this environment, pricing behaviour at an individual level is simply too valuable a measure not to be integrated into customer segmentation and then utilised in contact strategies for the benefit of the individual (a fair price) and the organisation (a fair margin). Similarly, being able to quantify the impact of brand equity on conversion rates at different aggregator ranking positions is just one of the growing list of tasks facing both pricing and marketing.

The future for these disciplines has to be one of communication, cooperation and increasing integration.

### **Stephen Jones is a director of EMB in the UK**

Stephen specialises in personal lines pricing and is a frequent speaker on leading-edge pricing techniques at industry events. Stephen's focus in recent years has been on assisting EMB's clients in developing and implementing best-practice price optimisation solutions, and in encouraging UK pricing actuaries to develop a greater understanding of the techniques deployed by their marketing colleagues  
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