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Financial Services

SME Insurance

A golden opportunity for banks

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The global banking market is currently facing a perfect storm. With lending less attractive due to rising risk and funding costs, and competition for deposits driving interest spreads into negative territory, banks are increasingly looking for new sources of fee income to make good the shortfall. But fee income is becoming harder to find: the historical bancassurance model whereby banks harvested commissions for recycling their deposit base into single premium life investments is no longer viable in a world of tight liquidity. This short bulletin looks at a source of fee income which most banks have underexploited: small commercial insurance cover. Technological advances and a dramatic shift in value towards distribution make this opportunity more attractive and more achievable than ever.

Introduction

A time-strapped entrepreneur juggling the demands of a start-up contacts her bank to set up employee payroll services for her three employees. "Have you taken out compulsory employers liability cover? We offer it as an add-on to all our payroll services", prompts her relationship manager. How convenient would she find it to solve both problems at once, and how likely would she be to turn to the bank for future insurance needs? The owner of a successful medium-sized business – 100 employees and growing – is seeking a substantial commercial mortgage. Why not offer commercial property cover as well?

Banks have long recognised the profits to be made by offering personal lines insurance, gaining share in both life and non-life segments. But commercial insurance has received much less management attention, with the result that most banks punch way below their weight. Our estimates suggest that getting commercial insurance right could add as much as 20% onto banks' total revenues from the SME (small and medium enterprises) sector.

A cottage industry industrialises

For years, the world of SME insurance operated like a cottage industry, with thousands of small brokers or agents serving local customers. Risk assessment and price setting was done manually by specialist underwriters relying on their judgement and years of experience. Distribution was only marginally profitable as heavy administrative costs ate up modest revenues per customer.

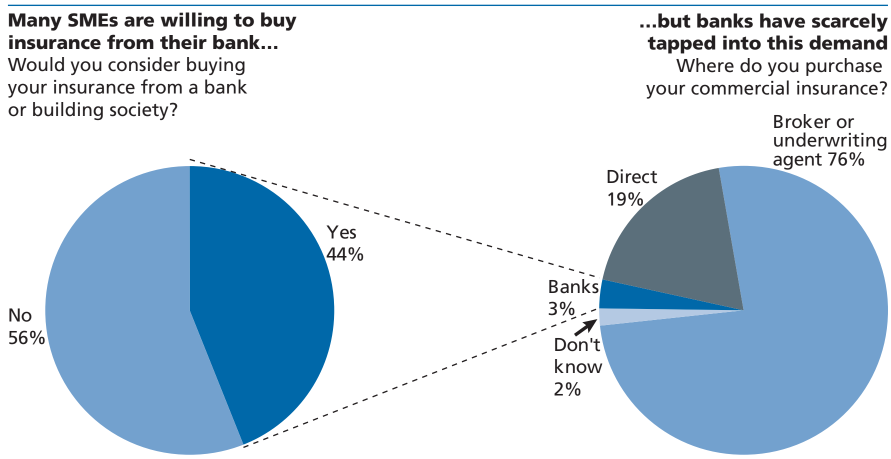
This is changing as technology is able to automate the end-to-end process of selling and underwriting simple commercial risks. The commoditisation of products and automation of pricing has made the business of selling SME insurance much simpler. While face-to-face advice is still important for many customers, it has become much more feasible for banks to bring the sales process in-house, dramatically driving down costs.

At the same time, small business owners are increasingly willing to use new channels – particularly the micro businesses (under 10 FTEs) who account for over half the SME market in most countries. In 2000, for example, only 2% of micro businesses in the UK used direct channels to buy insurance. By 2005, our estimates suggest that figure had grown to 15%.

Banks – an attractive alternative

With agent or broker dominance of this market no longer assured, banks have an opportunity to present themselves as an attractive alternative to self-service. They already have the relationship. They have privileged access to start-ups and small companies and they are in a position to identify and meet changing needs as the businesses grow. Many high street banks now have in place some kind of SME insurance offer, but it is clear that these moves are a long way from delivering their full potential. For example, Exhibit 1 shows that while 44% of UK SMEs would consider buying insurance from their bank, only 3% actually do so.

Exhibit 1: Untapped opportunity



Source: Datamonitor SME survey, Q1 2007

What will it take to succeed?

Banks wishing to seize the opportunity and share in this profitable market should not underestimate the changes to systems, processes and organisational culture that will be required. We see four keys to success:

1) Shelf space and management attention

Make insurance a priority. Banks that have made successful moves into bancassurance have made this an explicit priority, led from the top. Small business relationship managers may be uncomfortable introducing a discussion of insurance needs with long-time customers. Their confidence in their own ability to talk intelligently about insurance may not be high.

Management needs to be very clear on expectations, set performance targets and reward achievement. Time must be invested in educating relationship managers on new offerings and their economics: which products are in highest demand from business owners and most profitable for the bank? The right sales model must be chosen: referral to an insurance specialist for split commission or banking relationship managers licensed and trained to sell simple insurance products?

Cultural differences that frequently exist between the banking and the insurance sides of the business are often exacerbated by organisational structures and reward systems that keep them in silos or even in competition. There will be a need for mechanisms to build understanding, relationships and a sense of common purpose. Tried and tested methods developed in retail bancassurance can help to overcome these challenges.

2) Sales processes that reinforce the effort invested

In any referral model, it takes some effort and practice to ensure that lead handover to the agent who closes the deal is done efficiently and well. Exhibit 2 outlines typical challenges and ways to overcome them.

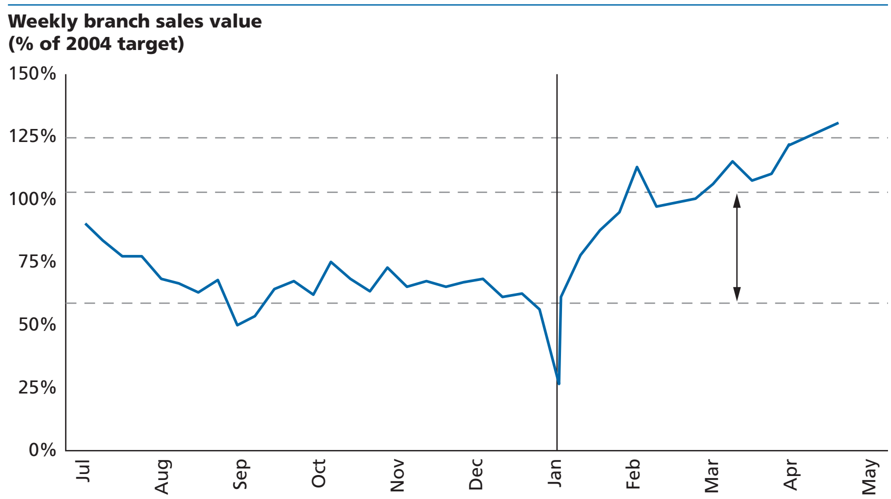
Exhibit 2: Efficient lead handover

Typical challenges	Potential remedies
▪ Lead generator does not know how to recognise needs – or, more commonly, is unable to assess the quality	▪ Formal classroom training supplemented by in-the-field guidance on quality
▪ Lead generator cannot persuade the customer to talk about an extended product offering – typically lack of product knowledge is one underlying cause	▪ Training for lead generators on the range of products offered and techniques for overcoming objections
▪ Lead handover process is cumbersome – leads get lost during handover or are not acted on	▪ Streamlined processes (automated handover or low-effort manual systems) and active management of leakage (e.g. reconfirming appointments)
▪ Concern on the part of the lead generator that the recipient will damage the customer relationship – by delivering poor service, selling inappropriate or poor quality products	▪ Frequent interaction between generator and recipient to strengthen relationship, and incentives that encourage collaboration

3) Incentives that make it worthwhile

"I've told my team over and over again that they need to sell more insurance. Why isn't it happening?" This is a common complaint of leaders who feel they have done all the right things, communicated the importance of this new line of business, built a solid product offering and invested in training. More often than not, it's because the compensation system is telling the team something else. If they're not being appropriately rewarded for sales, most won't make it a priority. Introducing appropriate incentives is key, and designing those incentives is usually not difficult. A well structured incentive scheme which recognises both the effort involved in a sale and the value accruing to the bank can have a dramatic impact on performance, as shown, for example in the case study in Exhibit 3.

Exhibit 3: Incentives drive results – one company's experience



Source: Oliver Wyman analysis

What can be more problematic is ensuring that management information systems are capable of ensuring that sales are accurately tracked and appropriately credited to individuals based on their contribution to making the sale.

4) Product offerings tailored to the sales process

Banks and insurers understand that different customers need different products, and insurance offerings typically vary by firm size and by trade. But to accelerate their bancassurance sales effort, banks need to ensure that the product range is more sympathetic to the sales process. Generalist banking sellers need access to a set of product packages aligned to trade segments. The products need to be simple to explain with limited underwriting and modular components – divided, for example, into covers you need to have (e.g. employers liability), covers you should have (e.g. builders' contract of works), and covers you might want (e.g. insurance of own tools).

One of the most powerful cross-sell mechanisms for bankers is to develop product bundles such as commercial loans with property cover; trade finance with cargo/goods in-transit coverage; or term loans with key man insurance. Building a successful SME bancassurance business will not be straightforward – banks will only realise significant revenue contribution with a much greater investment of time and resources. As with retail bancassurance, there will be a learning process as local successes are gradually rolled out across the network through the consistent application of best practice. However, the alignment of declining banking profits, increasing insurance distribution margins and supportive structural change in the insurance landscape convince us that the time is now ripe for SME bancassurance.

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