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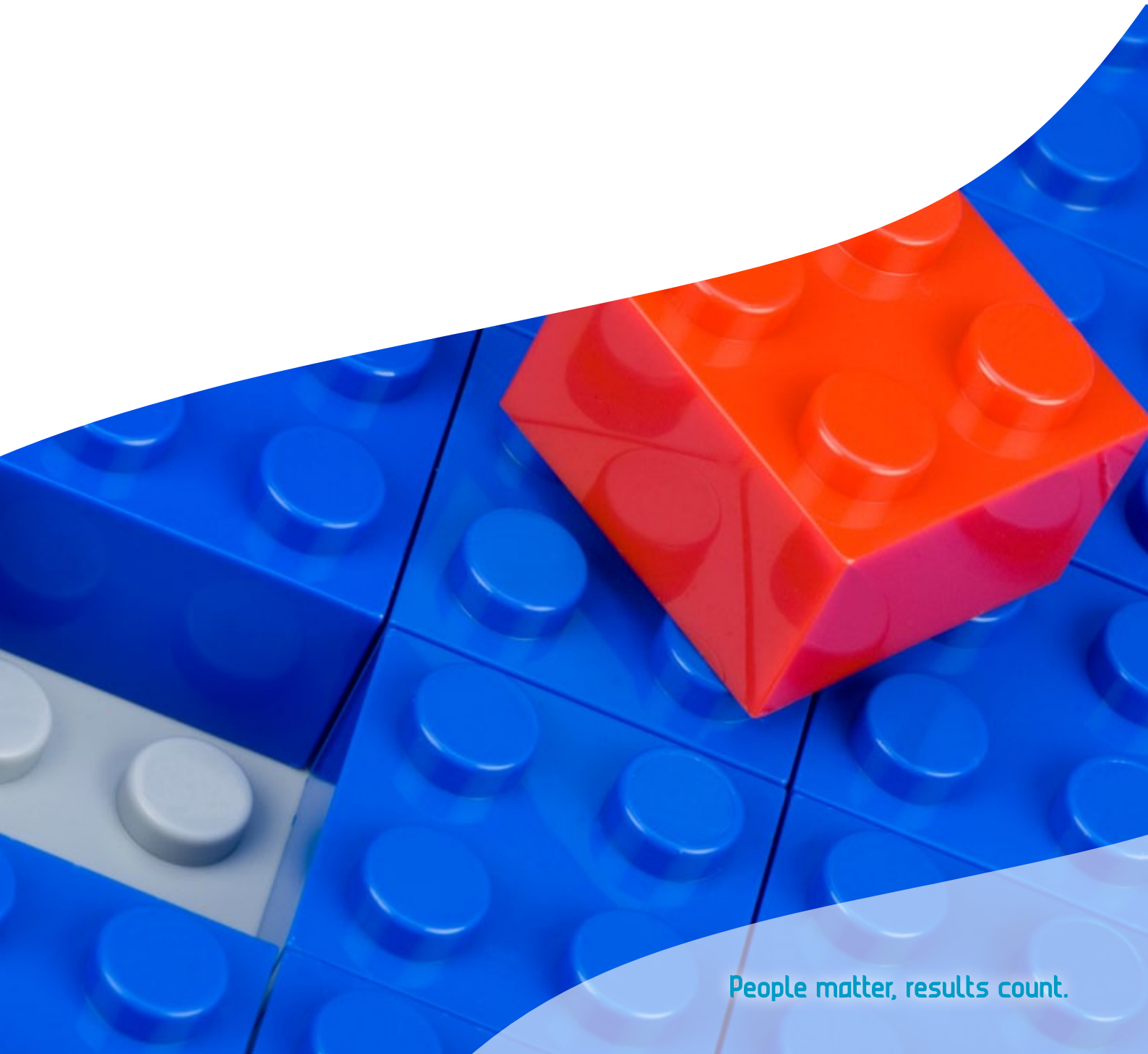
Life Insurance | the way we see it

Analytics: A Powerful Tool for the Life Insurance Industry

Using analytics to acquire and retain customers



People matter, results count.

Contents

1 Introduction

Life insurance has always been a competitive business. Today, amid uncertainty and rising costs, insurers can increase top and bottom-line growth by acquiring and retaining the most profitable customers. However, identifying profitable customers and keeping them requires a structured customer relationship management strategy.

An important tool for customer relationship management is analytics. Analytics can be defined as "…studying past historical data to research potential trends, to analyze the effects of certain decisions or events, or to evaluate the performance of a given tool or scenario. The goal of analytics is to improve the business by gaining knowledge which can be used to make improvements or changes."[1]

In the life insurance industry, analytics can help a company create a comprehensive roadmap for managing the entire lifecycle of a customer, from acquisition to lapse[2] or maturity. Analytics also helps an insurer gain an enterprise-wide view of a customer to gather insights and identify opportunities across all business lines.

In this paper we will look at how analytics can help life insurance companies acquire and retain customers.

[1] http://www.businessdictionary.com/definition/analytics.html

[2] When a policy lapses, it usually occurs because one party fails to act on its obligations or one of the terms on the policy is breached. For example, an insurance policy will lapse if the holder does not pay the premiums. The right given by an options contract will lapse when the option reaches maturity, at which time the holder will no longer possess the right to buy or sell the underlying asset. (Source: www.investopedia.com)

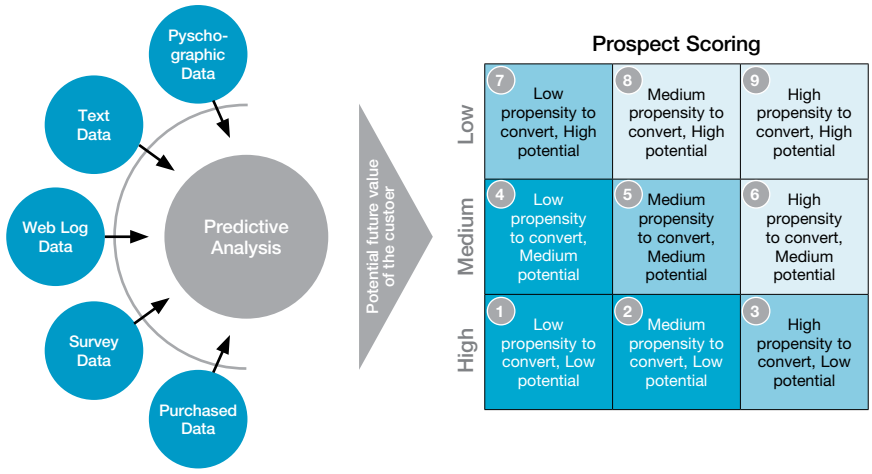
2 Analytics Support for Customer Acquisition

Analytics can reduce the cost of customer acquisition by optimizing the results of marketing campaigns. The challenge for most insurance companies, given their fixed marketing budgets, is to decide where to allocate resources to obtain the best marketing return on investment. Predictive modelling helps address this problem.

Predictive modelling for customer acquisition looks at a combination of psychographic, text, web-log, or survey data regarding prospects. When the data is fed to the analytics engine, predictive modelling can uncover hot spots for prospect scoring.

The prospect scoring model shown in Exhibit 2 takes into account both the propensity to convert each prospect and their future potential. These two factors help an insurer create specific market segments and build appropriate strategies and activities for each segment. Each lead can be given due importance according to the segment in which they reside.

Exhibit 1: Model for Prospect Scoring During Customer Acquisition



Source: Capgemini Analysis, 2011

Prospect scoring models can be very successful in improving the efficiency of customer acquisition activities, but scoring models cannot be static—they must be updated frequently to reflect the changing market conditions and to verify whether an insurer is getting the correct response. During each update the insurer should add, remove, or modify the model's parameters for the most effective results.

3 Analytics Support for Customer Retention

3.1. The Impact of Policy Lapse on Revenue and Profit

Policy lapse is a concern for most insurers since it often occurs within the first policy year and prevents insurers from recovering the initial expenses of policy acquisition. The sooner a policyholder leaves an insurer, the less likely the insurer has recouped the acquisition costs and the policy is contributing to the company's bottom line. That is why insurers focus on reducing lapse rates, particularly for the most favorable customer profiles.

3.2. Methods for Reducing Policy Lapses

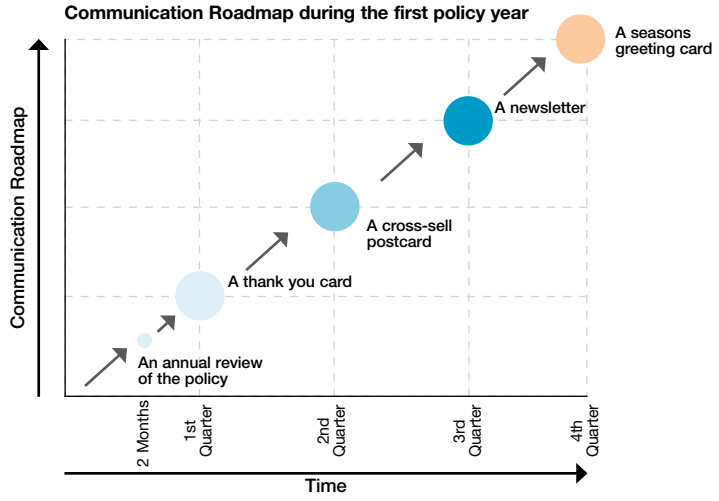
Multi touch Point Program

A multi-touch point program with appropriate message content and frequency brings down the chances of lapse during the first and corresponding policy years.

For every additional policy sold to a current customer, the insurer:

- Earns more revenue as a result of repeat purchases and referrals
- Saves costs due to lower acquisition expenses and the efficiency of serving customers who already know the insurer

Exhibit 2: A Sample Customer Touch-Point Program



Source: Capgemini Analysis, 2011

Cross-selling

Another way to reduce lapse is to deepen the relationship with existing customers by selling them new products. Cross-selling expands the relationship and helps reduce attrition. Analytics play an important role in cross-selling campaigns by:

- Determining the next-best products for existing customers based on the typical buying patterns of customers with similar demographic characteristics
- Uncovering customer segments that are most likely to respond within the existing customer base

An insurance company should use a staggered approach to reap the maximum benefit from a fixed marketing budget

By staggering campaigns, insurers can closely target customers with high Customer Relationship Value and high risk of lapse

In the long run, an effective combination of cross-selling and up-selling can help offset the negative effects of lapse and increase the value of the relationship.

Cross-selling for existing customers

Within a particular product portfolio, there are a number of policies that go into lapse status. It does not make sense for an insurer to try to activate each lapse case. The driving factors which prevent an insurer from doing so are:

- Cost. Sending reminder letters or calling every customer will result in significant costs.
- Effort Optimization. Within a product portfolio, an insurer has different types of customer profiles. For the insurance company, some customer profiles are desirable, some standard, and some loss-making. To increase profits, insurers will focus on specific policies to be activated and not take an umbrella approach.

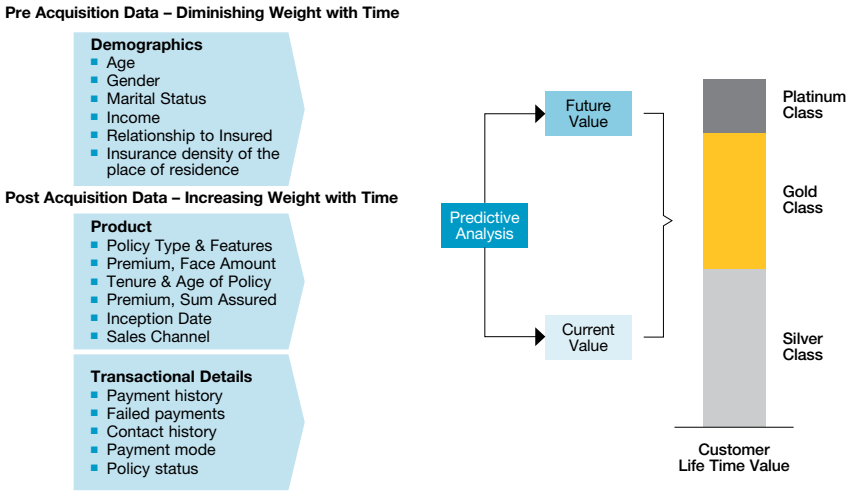
3.3. Using Analytics to Prioritize and Focus Efforts

Analytics can be used as an effective tool to prioritize and focus efforts in two ways.

Customer lifetime value

A framework can be created to determine customer lifetime value based on demographics as well as transactional details. For a new customer, customer lifetime value is normally determined using only demographic details. As the customer relationship grows, the insurer gets more information about the customer's transactional behavior and can also leverage this new data source for determining customer lifetime value. The general rule is to put more weight on transactional details than demographic details when the relationship crosses the one year mark.

Exhibit 3: Model for Predicting Customer Life time Value



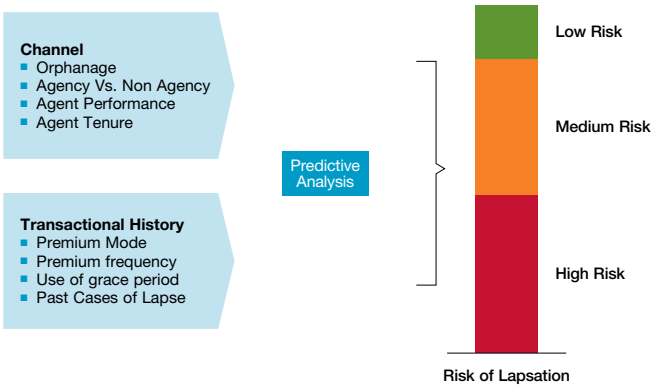
Source: Capgemini Analysis, 2011

This analytics model can help insurance firms classify their existing clients into *Platinum, Gold,* and *Silver* categories.

Risk of lapse

Similarly, analytics can help build models to predict the risk of lapse. Risk of lapse is dependent on the servicing channels as well as transactional behavior of the policyholder.

Exhibit 4: Model for Predicting Risk of Lapse



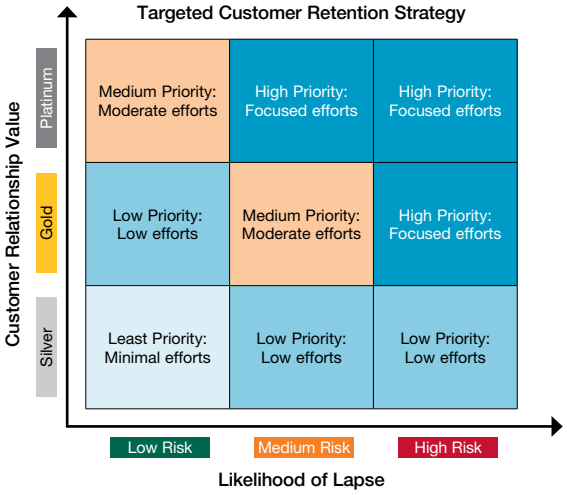
Source: Capgemini Analysis, 2011

Once risk of lapse has been determined, customers can be classified into *Low, Medium,* and *High* risk categories.

3.4. Comprehensive Customer Retention Strategy

Once an insurance company has developed these two metrics, it can develop a comprehensive customer retention strategy to determine where to apply the focus for lapse reduction.

Exhibit 5: Comprehensive Customer Retention Strategy



Source: Capgemini Analysis, 2011

A customer retention strategy is developed using two metrics:

- Customer Life Time Value: Determines the total value the customer will bring to the insurer
- Risk of Lapse: Signifies the risk the customer carries to drop his or her policy at any point in time

Both of these metrics will have different values at various points in time.

4 Conclusion

Most insurance companies are in the early stages of using predictive analytics so there are very few insurers with well-defined analytics processes and measures of success. The most commonly-cited barriers for employing exploratory or predictive analytics are start-up costs, processing expense, interoperability, and lack of expertise. For this reason, many insurers have outsourced analytics programs to IT vendors so the vendor teams develop, maintain, and enhance the models.

Predictive analytics can help insurers increase customer satisfaction, increase product sales, and make their marketing efforts more effective. The return on investment of marketing efforts is currently the most significant driver behind investments in predictive analytics.

About the Author

Soumya Chattopadhyay is a Senior Consultant in Capgemini's Strategic Analysis Group within the Global Financial Services Market Intelligence team. He has over six years of experience in strategy, business, and technology consulting.

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