

The Importance of Understanding Stages in Market Development

The history of the stages in market development provides useful insights for thinking about the future of insurance. The following describes insights that make the stages important to the insurance professional:

- *What new events could lead to a breakdown stage?* The current competitive situation in most property and liability insurance markets is forcing profit margins to be too thin for every participant to survive. Insurers wonder if the entry of banking into the market or the use of the Internet for insurance sales might be a catalyst for the breakdown stage and might result in the next change in underwriting cycles.
- *What events in the personal insurance market can change the economics of personal lines insurance?* A substantial change in the stock market, technology, competition, or the global market might be significant enough to create a breakdown stage.

If an event is identified that might lead to a breakdown stage, the following questions can help in analyzing the event's possible effects on the personal insurance market:

- *How might each event change the supply of insurance that personal lines insurers are willing to offer?*
- *How might each event be controlled by the current systems (regulations)?*
- *If a breakdown stage occurs, what might the eventual outcome be during a reorganization stage?*
- *How might my organization react or recover in the reorganization stage?*

Educational Objective 4

Explain how the personal insurance market is segmented. Describe benefits and limitations of market segments.

A **niche market** is a group of customers with specialized needs.

Personal Insurance Market Segmentation

The personal insurance market is so large that many insurers select a specific strategic market segment for operation. They focus on specific groups of customers, geographic regions, or **niche markets** based on customers or products. Insurers limit the scope of their market based on their history and expertise, the regulatory climate of the states in a geographic area, the competition, and specific customer needs. Only very large insurance companies approach the personal insurance market on a national basis.

National Market

Companies in the national market serve all or most of the United States. Many national insurers offer all personal insurance product lines. Insurers capable of offering personal insurance products must be large enough to offer their products over the extensive geographic territory. The following are the benefits to an insurer of operating in a national market:

- *Geographic spread of risk.* A national spread of risk decreases the likelihood that an insurer will have a single loss that threatens its continuation. A national insurer can concentrate policy writings in areas having a history of favorable loss results.
- *National product offering.* As policyholders physically move across the country, the national company can continue to offer insurance to the policyholder regardless of location. As individuals' lifestyles change or as they make career moves, the insurer maintains the customers.

Operating in a national market has some limitations. The following are those limitations:

- *Establishing and maintaining a national presence.* Establishing a national presence is an expensive process. An insurer must maintain visibility through continuous television, magazine, newspaper, and billboard advertising.
- *Maintaining service countrywide.* A national insurer incurs service expenses countrywide. Customers expect loss adjustment and customer service response regardless of their location. Service must also be available regardless of time zones.

Regional Markets

Regional markets can be composed of any grouping of states. A region might be limited to a geographic area such as the Northwest states or the New England states. Often, regional insurers start business in one state and expand into neighboring states. The following are the benefits to an insurer of operating in a regional market:

- *Knowledge of the local hazards.* Insurers that concentrate within a specific geographic region develop knowledge of the hazards unique to that region. For example, residential property underwriters recognize the problems inherent in specific types of heating and cooling systems used in the region, which allows them to underwrite with a high level of expertise and recommend effective loss control measures. Knowledge of the local hazards allows a regional company to select and price risks more effectively than an insurer who does not know the region. Regional insurers can be powerful competitors in their geographic areas.
- *Local recognition.* Regional companies can concentrate their marketing dollars in a smaller area than can national insurers, creating more recognition in a region. The physical presence of

the company also creates recognition. Producers or independent agents can develop a closer relationship with regional company representatives and underwriters because they can visit the insurer's office and establish personal contacts.

- *Dealing with limited or selected state regulations.* Dealing with regulations in many states requires a staff to interpret regulations and ensure company compliance. Limiting the number of states also limits the number of sets of regulations and the time required to ensure compliance in each state.

Operating in a regional market has the following limitations:

- *Regional loss concentration.* Regional concentration exposes an insurer to a significant number of losses from a single catastrophe. Freezing, windstorms, hail, forest fires, and floods can create losses that might jeopardize the regional insurer's ability to survive the loss. Regional concentration increases an insurer's need to purchase catastrophe reinsurance, which can be a substantial expense.
- *Expansion problems.* For regional companies, growing requires entry into new product lines, entry into new states, or use of new distribution channels. Expansion and the addition of new customers bring with them the costs of uncertainty and experimentation.
- *Loss of customers from the region.* When a customer leaves a regional insurer's territory, the customer must cancel his or her insurance with the insurer and establish insurance with another insurer. Some people move frequently because of their jobs. Many others change jobs and move for career advancement. The regional insurer will lose a percentage of its policyholders because it cannot move with its customers.

Customer Group Markets

A customer group market can consist of selected groups of customers based on occupation, affiliation, or risk characteristics. For example, teachers, military officers and enlisted personnel, and high-risk drivers are customer groups that have been targeted by insurers as customer group markets.

The following are the benefits to an insurer of selecting a customer group market:

- *Knowledge of customers' needs.* An insurer that concentrates on a particular group of customers can identify the needs of those customers with more accuracy than can an insurer that seeks customers from the general population.
- *Products specific to the customer.* By identifying customers' needs, an insurer can tailor products and services to better meet those needs, increasing the chance of obtaining and retaining those customers.
- *Selection of customers known to be profitable.* As an insurer selects a customer group, it can select those customers known to be profitable. For example, if college graduates are identified as

policyholders with a low frequency of losses, an insurer can target this group, reduce premiums accordingly, and increase the chance of obtaining and retaining these customers. High-risk automobile insurance can also be a profitable customer group for an insurer; the insurer prices the risks appropriately, gains efficiencies in claim settlement, and writes coverage for the customer group profitably.

A customer group market has some limitations:

- *Limitations in expansion.* Once an insurer has absorbed a large portion of a customer group market, it might have difficulty expanding. If the insurer is offering homeowners and personal auto insurance to the customer group, the addition of other personal insurance product lines will not create significant premium increases. Personal umbrella, inland marine floaters, and watercraft policies either have low premiums, or they are required by a limited number of customers. To expand, the insurer must broaden the customer group; to do this, the new group must have the same needs and risk characteristics as the original group, or the insurer must develop new products and price structures for the new group. A differentiation of this type might be difficult to justify to state regulators if the differences are not statistically obvious. For example, an insurer attempting to justify a different set of rates based on an insured's occupation or school affiliation might be prohibited from doing so on the basis of unfair discrimination.
- *Dealing with countrywide service problems.* If the customer group that the insurer has selected is located countrywide, the insurer might encounter the difficulty of addressing regulations and customers' service needs in all states without a customer base that is large enough to support the expense.

Niche Markets

Some insurers elect to service a niche market. Personal insurance customers have a wide variety of interests, hobbies, activities, and possessions that can create exposures requiring insurance protection. Many of these can be an opportunity for a niche market.

The following are keys to niche marketing:

- Understand the customer.
- Understand and customize the product to meet the customer's needs.
- Determine the best distribution channel(s). Evaluate the distributors' needs, strengths, and areas for cooperation. Create strategic partnerships.
- Maintain competitive advantages in the face of copycat competition.

As examples, substandard personal automobile business was a niche market for many insurers in the 1980s. (It has now grown to a product line for many standard insurance companies, so it is no longer considered a niche.) Urban homeowners business markets are