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# Facing the future

## A study of present trends within the insurance sector

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**The goal and fundamental stand-point is that insurance companies are in business to make a profit. Insurance companies and their customers constitute an important part of the financial market that amounts to a corner-stone in the functioning economy of Sweden. The gains of the companies are for the benefit of the stockholders, policyholders, or both. The services of the companies are also essential to the stability and growth of the economy[1] and the individual company must follow its obligations to the public in order to continue as a private enterprise. The responsibility of the insurers towards the insured is thus not only a matter of liability according to current insurances policies but also a required social service.**

**The profit rates in Swedish casualty insurance were moderate during the entire 1980's despite the dominating marketshares for the domestic companies. The low profitability has partly historic reasons. They were all mutually owned companies and any surplus went back to the insured. The old barriers for protection have been abolished and most casualty insurers have become stockcompanies with the clear motive of making profit. The demands of efficiency and profitability have increased with the change of climate of business.**

### 1. Trends of Development

While cooperation has declined between the companies inside Sweden due to increased competition there is a need to cooperate with each other and in particular with foreign competitors in their international activities.

Internationalization has become inevitable for Swedish insurance companies. These altered conditions have to an essential degree followed changes in world insurance. Insurance companies enter new markets abroad in order to achieve competitive advantages.

The development which has taken place for the last ten years has made the European insurance market less gentlemanly and more competitive. A new balance of power is emerging within the insurance sector and between insurance and other financial institutions. Out of the 4,600 insurers in the EC, some of minimal size, there is a trend towards domination by a small number of insurers within each national market.[2] The surviving companies are those which achieve

1) Feldt, K-O, NFT 1/1992, p 5.

2) See Andersen, Insurance in a Changing Europe 1990—1995, 1990, p 3.

benefits of scale from increased incomes of premiums and have efficient control of the extension of losses.

The exposure of risks has increased and the internationalization of the regular industry puts higher demands on the Swedish insurer. When the Swedish industrial companies move much of their business activities abroad, the Swedish insurers must become international in order to maintain their customers. Thus, while the companies reduce their extent of cooperation on the home market they seek partners for international cooperation. The process of internationalization must be viewed together with other trends, especially that of deregulation. Due to the deregulation of particularly the European capital market, new possibilities exist to make investments, form alliances and engage in foreign business transactions.

The possibilities to expand within Sweden are limited. New casualty companies enter the market and segment profitable parts of the market. At the same time the foreign competitors are increasing their market shares in Sweden with new innovative products.[3] If the insurer will be able to meet the requirements of their large industrial clients they must increase in size like them. Instead several Swedish insurers may be forced to have the strategy to defend their strong positions on the home market. In spite of the real development the question asked should be if the national Swedish market or even the Nordic market has the appropriate size to meet the demands of tomorrow?

A principal motive for internationalization is to protect and develop those areas that the Swedish insurers are good at, and to satisfy the needs of their customers.

An effect of internationalization is that the large insurer increases even more. The costs for carrying out international intentions have so far been considerable. Much of the future competiveness relies on the positive dividends of these engagements.

Another element of this turbolent development is deregulation. The abolition of the Means Test in 1985 had a positive impact on the insurance market, causing lots of new companies to take up competition with the traditional ones. A further effect was the reduction of premiums in particular for larger risks.

Liberalization of the legislation has caused the previous clear separation of responsibilities, between the various providers of financial services, to diminish.[4]

The Swedish capital market was deregulated on July 1, 1989. The present development is instead to fulfil legal adapting of European Community law. Some changes were still needed and they were subsequently done to make investment in insurance stocks easier and thus giving room for integration.[5] However, some changes still remain.[6]

A result of the EEC-Treaty will be a higher degree of freedom for conducting business but also of greater risks.

In a changing international market it is important that Swedish insurers have the same legal possibilities to compete. An insufficient deregulation would cause serious disadvantages. For the areas of financial services including insurance  the EEA-Treaty seems particularly urgent.

No market of insurance is the other like. The stages of deregulation and harmonization also differ between the European insurers. The EEA-Treaty will not mean instant legal harmonization. According to the Third Non-Life Directive and the proposed Third Life Directive, a completely free market of services will be accomplished in 1994. It seems to be a

3) E.g UAP's grouplifeinsurance deal with Astra

4) See Andersson, op. cit., 1990, p 3.

5) See FRL 7:17 and the new 7:17a, SFS (1991:1023).

6) See Ds 1992:28 and SOU 1991:89.

widespread view among international executives and experts on insurance that the earliest date that some degree of uniformity can be expected is during 1995.[7]

There is an increasing need to strengthen the efforts of reducing administrative costs in the highly competitive reality of the every day insurer. One efficient method that is commonly practiced is to try to benefit from the development of computer science.[8] Large efforts are put into research of software products in order to improve the productivity and quality of system development work.

The Skandia Group has for instance created an electronically hooked global network with a decentralized operation, where fastness and access to information have become important factors of competition. In the future there is likely to come new channels of distribution based on electronic contacts. Also in collective solutions, like group pensions or insurance policies connected to a specific product — e.g. a car brand — even other participators, mainly banks, will sell insurances using electronic networks.

Among other recent improvements are e.g. Integrating administrative computer systems like FÖDUS by Folksam and Techno Data Container for increased computer security, introduced by Trygg-Hansa SPP.

To introduce new computer back-up support entails major capital expendable. Ensuring its success might require cooperation between several insurers.

Swedish insurers have lost billions of crowns as a result of the fall on the stock and property markets. The losses are considerable and have damaged the strength of these insurers and their credibility as direct insurers. The bankruptcy of the insurance company Svenska Kredit AB was a failure for the insurance market at large as a major financial institution and a severe blow to the reliability of its owners; Skandia, Trygg-Hansa and Wasa. Further losses in crowns and reliability must be prevented. The proper carrying out of the solvency control by the Financial Supervisory Authority deserves to be emphasized. A reputation of unreliability will jeopardize the process of internationalization.

The present Swedish economic crisis is obviously affecting some companies more than others, namely those with a high exposure in property and stock investments. The new companies currently benefit at the expense of the old traditional ones. The crisis has thus a structural impact. The economic crisis has recently become evident in the economic situation of Wasa Sak AB and the steps taken to save this company. However, the extensive economic difficulties are international problems.[9]

Considering the profit aims of the board of directors and the President of a casualty insurance company, it is hardly surprising that these companies act so that the generous state guarantee for banks also applies for the insurer they represent. The tax-payers become unprotected for the possibilities that the insurers will make use of the protection from the bank guarantee in the future. It also creates problems of competition, since not all casualty insurers have a bank within their group. The use of the bank guarantee has become an urgent issue since the purchase of Bohusbanken by Wasa.[10]

On a market with free competition those companies will sell, which have spent their assets on unprofitable investments and uncompleted efforts of internationalization and consumed their creditability. On the Swedish market of insurance this have not yet taken place, but a decline in rating is alarming.

7) See Andersen, op. cit., p 6.

8) E.g the development of Computer Aided Software Engineering (CASE)

9) Regarding the German experience see Zeitschrift fur Versicherungswesen 8/92, pp 190—195.

10) Sundqvist. Dagens Nyheter, 20/12, 1992. p A14 and Afrell, Dagens Nyheter, 13/12. 1992, p A12.

## 2. Strategies

Cooperation among insurers takes place in those areas where it exists a neutrality of competition in the arisen questions and where there is a gain in competition.[11]

To start with, the Swedish insurer may just nominate a local delegate to take care of formalities, soon however, a representative office may be necessary in order to gain contact. Mature activities will eventually need the support of local service companies, or the companies own local insurance company. Companies that are not familiar with the complexity of foreign markets have often relied on a local partner, with whom they have formed joint-venture companies. As loose co-operations have not proven very successful in the past, joint-ventures may in certain cases be a better alternative. Sometimes even mutual participation in equity has been established in order to facilitate the required local support. To buy competitors can be an effective method of carrying out a European or global strategy. However, this procedure is too expensive for several Swedish insurers. Cooperation along with specialisation seems to be inevitable.[12]

To acquire insurers or branches in other countries gives the acquirer the benefit of receiving a locally implemented organization. A further advantage is that with acquisitions the buyer receives a functioning company. Not all companies are available for purchase and those which are available are expensive. To instead establish a subsidiary will take more time. In addition, to create the goodwill of a new company is likely to be costly. However, it is a price for the gain in time to achieve the local presence. Difficulties can arise in the integration of the new company with the organization of the parent company.

A problem that may arise when starting new independent companies is the lack of funding. This became evident in the Njord experience.[13] The share-capital may turn out not to be sufficient.

Purchases can be used as an alternative to complicated mergers between banks and insurance companies such as in the case where Trygg-Hansa bought the Gota Banking Group.

With the purchase of banks the insurers receive resources to give customers full financial service. Purchases of banks can be seen as a reasonable broadening of insurance activities. A similar common ground between property and casualty (P&C) insurance and banking does not exist. The allfinance development has not involved insurers in P&C insurance neither in Sweden nor abroad. In addition, in the present state of economics with a general scarcity of funding, there is a tendency to only invest in one's own type of activities. However, the competition between banks and lifeinsurers will remain stiff.

An effect of the popularity of growth by acquisitions is falling levels of consolidation. This has become a reality for several leading insurers in both Life and Pensions business and for Property and Casualty. Thus, plans to achieve future expansion by capital demanding purchases must be reconsidered. It is likely that other methods of achieving close cooperation will progress in the future.

In particular the alliance has several advantages. Alliance is a form of integration that may demand less capital than the alternative to buy a competitor. In practice it has shown that mergers can have problems of their own. It takes time to harmonize different corporate cultures, even if valuations are relatively homogeneous like between the different Nordic cultures.[14]

To form alliances might be an attractive measure to those insurers that neither want to or are able to spend the time and sums to build

11) Interview with Erland Srömbäck, 3/4/92.

12) Försäkringstidningen, op.cit., 3/92, pp 20—21.

13) See the prefigure on the contrary opinion of the President of Njord in Försäkringstidningen, 3/1986, p 13.

14) Försäkringstidningen 1/91, op.cit.,pp 4—7.

a network of wholly owned foreign companies, nor loose its identity. An alliance is fundamentally based on cooperation. A problem might arise in the question of identity of the group itself. With a too loose connection between the members of the alliance, the various members of the alliance might consider each other as being aliens. A measure to create a mutual identity can be that each member of the group makes a financial contribution to the alliance.

An interesting new group is Eureko which includes Wasa, the Dutch company Avero Centraal Beheer (AVCB), British Friends Provident and Danish Topdanmark.[15] Through cross owning, cooperation is meant to be enforced among the new companies. Each participating company in Eureko will contribute. Eureko itself will become a holding company by acquiring 10 % of each of the founding companies. It is intended to be both difficult and costly to wound up the cooperation. The principal objective of Eureko will be to search for effects of synergy between the part owners, financially and in terms of their activities.

In addition, a close cooperation will be established in development of products and in marketing. An exchange of views is meant to stimulate progress. With the forming of Eureko, international cooperation is achieved to a lower estimated cost than if Wasa would rely on buying partners all around Europe.[16]

A merger with a foreign insurer can give the Swedish insurer the desired local presence on new markets. A problem with merging with a larger insurer is the risk of loosing all essential influence of management. To prevent this, each founder of Eureko holds a 25 % share of the company.

Another measure of making use of alliances is practiced by Folksam. Folksam has entered three different international associations, each for cooperation in specific areas.[17] This set of alliances enables Folksam to target its objectives in each area instead of relying on the success of one effort alone.

The opportunity to start a new insurance company is used not only by present insurers aiming for growth in new markets, or to realize an innovative concept of business, but also by the former clients of the insurance companies. New companies may find it less expensive to make use of brokers than to employ sales people.

What will the future mean in terms of Swedish casualty insurance? The strategic engagement in foreign insurers mean dangers as well as possibilities. If the efforts and costs invested in Home for Trygg-Hansa SPP and Vesta for Skandia etc are successful, they will open large future possibilities.

To achieve the effects of synergy from companies of different management is difficult. However, the development towards larger units is inevitable in order to achieve effective arrays of distribution and placing power to compete in big insurance engagements. A threat is the stiffer competition that will put pressure on premiums and margins on profit.

Furthermore, with increased capital costs and growing industrial groupings, many customers build up their own skill and awareness of their insurance needs. The multinational companies also have economic capability to absorb their risks. Some of the insured industrial clients have established captive companies or become joined partners in captive association pools.[18]

The trend to form captives on the other hand ”opens up” possibilities to sell management service to captive companies. The traditional insurers can also sell know-how in terms of risk management which are likely to be demanded

15) See Försäkringstidningen 3/92, pp 21—23

16) See Försäkringstidningen, op, cit, p 21.

17) Nordisk Strategisk Allians, Nordsam and Euresa, Annual Report Folksam. 1990, p 20.

18) See Servicemanagement, Norrman, p 46.

in the future. Folksam, for instance, has in 1992 created a service management company to fill this function. The Skandia Group and Trygg-Hansa SPP have already established such companies.

There are basically three different strategies for each company to choose among. First, the insurer is large, complete and has a global or European strategy. Secondly, the insurer is immensely strong and particularly strong on its home market. Thirdly, the insurer segments, becomes ”a small but well-cared company” with a high level of competence in its specific field of business. In order to meet the competition of tomorrow a modern insurer must probably fulfil one or more of the these requirements.

Since the conditions are constantly changing, there are obvious difficulties for most insurers to identify themselves with a suitable structure and to find the most effective strategy for their efforts on the market.

The fulfilment of a European strategy also requires considerable resources of personnel.

In order to find a long-term strategy an insurer must decide what market one desires to serve in the future. How is it carried out when a need for an international approach has been identified? Is the regional or local market sufficient? Is it instead required to make a European or global effort?[19] How is sufficient size combined with the desired extent of presence?

## 3. Future trends

An interesting field will be the handling of risks by government authorities. The development is awaiting the formation of companies of these authorities. Then the authorities themselves can choose their financing of risks.[20]

Their risks are increasing as a result of growing common value-system. Small companies will benefit if a European standard of riskmanagement develops. The need for skilled personnel is increasing as risks with special demands and character increase.

In the future it is likely to become more common with foreign takeovers of Swedish companies.[21] Does this also apply for insurance? The abolishing of differentiated shares will probably further stimulate such investments.

What will happen after a foreign take-over? The answer is difficult to predict and much depends on the purpose of the buyer. It is likely that the present direction of rationalization will continue. Efforts to reduce costs will eventually cause only those parts of a company that are most efficient and profitable to survive.

In search of large scale advantages less profitable parts of a company, or group of companies, will be wound up. There is also the risk that the insurance industry will face the changes that other industries already have met. Namely that more qualified functions of the companies move abroad. The foreign owner may for instance choose to place all financial know-how of the group at its head office, located outside Sweden. The reality may cause some Swedish insurers not to be the head company in an international group. Instead Swedish insurers may become subsidiaries in a global network where the management is situated in London or Frankfurt instead of Stockholm. At present the general lack of funding among the European competitors will prevent such take-overs. To buy a Swedish company is viewed to be too expensive for a share of a limited market.[22]

There is an increasing number of new commercial relationships. This development can be viewed, at least in part, as a reaction to

19) Ztv, op.cit., 8/92, p 191.

20) See SOU 1992:40.

21) Effekter av EES-avtalet på konkurrensen i Sverige, Konkurrensverket 1992,pp 47—52.

22) The same view was recently expressed in FT 1/93, p 28.

the move toward a single Community market. The development has been facilitated through deregulation. In Sweden, the present legal process is instead to conduct legal harmonization with the EC. The new established relationships between insurers can also be viewed as a reply to the allfinance development initiated by the banks. The development was a result of the declining economics of the entire banking sector. The allfinance has now come to a halt in lifeinsurance and it never took place in property and casualty due to lack of common ground with banking.

It is not only the capital strength of an insurer that determines his choice of reorganization. A long-term strategy must be defined and based on those analysis of how and where the insurer intends to conduct his future efforts. The purpose of a strategy is often to ensure local distribution and sometimes the purpose is to increase capacity or coverage. A fronting agreement is sufficient when a Swedish insurer only wants to provide insurance for Swedish customers on certain foreign markets. If the insurer has decided to engage on a new market and to compete with the domestic companies, this probably calls for a stronger presence on that specific market. The Swedish insurer then needs to purchase a competitor or to make use of merger or joint venture arrangements.

The choice of cooperation depends on the potential partner. In case of an equally strong partner, the Swedish insurer may, with small risk make an acquisition. On the other hand in underdeveloped countries he may choose a joint venture.

In a free financial market cooperation is stimulated through economics. A threat to free competition in the financial sector is the vaguely designed State bank guarantee. Its present, unprecise and unconditional wording will cause insurers and other financial institutions not to correspond to market forces, but to become included by the generosity of this guarantee.

With the establishing of links with other European insurers Swedish insurers receive access to the European market. To become a part of this market can be considered a necessary presumption for future survival. Through the access to the European market, Swedish insurers receive a better spreading of risks which is especially important concerning large risks.

Due to the development of society, the risk will continue to become more difficult, larger and more complex in the future. It will therefore be of increased importance to conduct management of risks including inventory and analysis of risks. For the common best it is preferable that the premiums are based on an international unity in term of technical calculations.

The insurance companies are under pressure to change from so many directions that the shape of the sector will inevitably be transformed in the 1990s.

The level of accepted profit is set by the stockholders and their continuous support. Patience and tolerance will be required on their behalf.