

BENCHMARKING OF INSURANCE PRODUCTS IN LATVIAN INSURANCE INDUSTRY

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Abstract:

To date there are no guidelines, laws, or standards in Europe to define how to market to consumers products, which are complex, information-rich, and hence cannot be easily compared to facilitate consumer purchase decision. Direct price/quality comparison of available insurance services is virtually impossible due to complex informational nature of the product and the role of intermediaries, who often market the products based on insurer's reputation and its "closeness" to that particular intermediary. As a result, consumers receive impartial information on the comparable standing of competing products, which results in sub-optimal functioning of the market. The purpose of this paper is to examine the product marketing information channels and methods in Latvian non-life insurance segment, and to identify whether consumers can receive comparable information on competing insurance products. This work is based on a case study. Data is collected using interviews with insurance brokers, and desk research.

Key Words: Benchmarking, insurance intermediation, product comparability, consumer purchase decision making

Introduction:

In 1999 Council of the European Union announced an ambitious vision of Europeans inhabiting Information Society (also dubbed as "e-Society" or "e-Europe") by 2005 (Council of the European Union, 1999). The vision of e-Europe was to bring forth "changes, the most significant since the Industrial Revolution" (Council of the European Union, 1999), creating a highly competitive Knowledge Economy. More than a decade down the road, we have learned the hard way, that the success of establishing informational economy (Castells, 1996) cannot be measured solely by the availability of services on the Internet (Daniel, Wilson, 2003).

One key distinction has to be made here between availability of information and knowledge (about products). Knowledge about content, quality, pricing of services, as opposed to information about services, facilitates consumers' weighed decision-making, whereas abundance of information leads to confusion and consumers' inability to make a favorable decision. Just like other markets, also insurance markets are characterized by incomplete information on both supply and demand sides, which may easily induce moral hazard behavior and adverse selection (Eckardt, 2007). The problem is that for incompletely informed consumers it is difficult to make benchmarking of services provided by competing insurance intermediaries. Among others it is due to transaction and search costs (Eckardt, R athke-D oppner, 2010).

One of the major economic sectors of European economy – insurance – is well positioned to stand among first in the formation of the New Informational Economy. In insurance business, information is "doubly important", as it is both "raw material and a product" (Castells, 1996).

Hardly any insurer in Europe does not present information about offered services on the Web or allow the citizens making transactions online (Kheng-Tan, Tan, 2009). However, to date, there are no unified insurance products' comparison (benchmarking) tools available to European consumers. Availability of such tools would serve in establishing grounded knowledge on the (comparable) quality and pricing of available services, allow communicating information on available services in

uniform and understandable format, thus helping individuals and enterprises make weighed purchase decisions.

The aim of this work is to examine the legal and practical premises for product information distribution in Latvian non-life insurance segment, to evaluate the degree to which consumers (can) receive comparable information on competing instance products. The departing point for this work is the assumption that insurance product benchmarking is a (missing) critical factor in transforming the insurance industry to meet the principles of Knowledge Economy.

Case study: non-life insurance services in Latvia

In this research we used a case study methodology to investigate the legal and technical premises for non-life insurance product information distribution in Latvia. A number of data collection techniques were deployed, namely: in-depth interviews with heads of industry associations, expert knowledge of one of the authors, and a desk research.

Three open-ended in-depth interviews of duration from 56 to 106 minutes were conducted with principals of the three Latvian associations representing instance industry. All interviews were audio-recorded, notes of interviews were written down.

To complement interview data, desk research on legal and technical aspects of service offering and information distribution was conducted.

There are 11 non-life insurance companies operating in Latvia. All of them are offering different kind of services, including online (e-)services. Insurance brokers are important “players” in communicating insurers’ product information to the consumers. Brokers are using different information and communication technologies to acquire information about insurance price offers using price calculators available on different insurers’ web sites, combining results in one offer and displaying it for clients in their web pages (or providing in person). Advances in e-commerce technology and fast growth in consumer use of the Internet has created a platform for online price comparisons (Robertshaw, 2012), which applies also to insurance industry.

One of the most popular aggregate e-services of an insurance broker is to obtain/calculate, compare prices and sell Motor Third Party Liability (MTPL) insurance to car owners. Here, the only criteria for comparison is price. For MTPL insurance such benchmarking is reasonable, because MTPL policy conditions are defined by law. However, in the case when other kind of insurance is to be offered, a substantial (level of) benchmarking of available on the Latvian market products and insurance services’ content and pricing must be undertaken by consumer or broker on consumers’ behalf. While knowledge obtained from such comparative analysis would be critical enabler of competition and transparency in the market, this kind of analysis cannot be easily performed due to legal and practical setup of the industry.

Insurance industry in Latvia is represented by 19 insurance companies and branches of foreign insurers (11 non-life and 8 life). Insurance companies operating on Latvian market offer to their clients all kinds of insurance including motor, property, health, life, as well as pension and savings insurance.

Eckardt (2007) explains that a number of institutions have evolved to mediate between consumers and insurance companies, such as exclusive agents or insurance brokers, who help to ease coordination and to further market transactions. Currently there are more than 80 insurance broker companies in Latvia, 45 of them are members of LIBA – Latvian Insurance Brokers Association. The aim of LIBA is to develop insurance brokers’ market, raise the quality of insurances services and representation of common interest of the members.

Information distribution channels in the insurance industry

Insurers distribute their products and information about them directly through their offices or websites, or indirectly through insurance intermediaries. Two important distinctions must be made in the product/process distribution process – that of instance mediation and intermediation.

Accordingly to “Activities of Insurance and Reinsurance Intermediaries Law”, insurance mediation refers to “the preparation of an insurance offer and other documents required for entering into an insurance contract, *the explanation of the provisions of an insurance contract and the rights and obligations specified in an insurance contract*, the performance of other activities required for

entering into an insurance contract, as well as the entering into and administration of the referred to contract” (Activities Of Insurance And Reinsurance Intermediaries Law, 2005, italics by the authors).

Accordingly to the same law (Activities Of Insurance And Reinsurance Intermediaries Law, 2005), insurance intermediary is an insurance broker, insurance agent or a tied insurance agent who, for remuneration, pursues insurance mediation in accordance with the procedures specified by this Law. Insurance intermediaries are insurance broker companies, banks, car dealers, and other legal entities whose basic activity is not insurance mediation.

Product information distribution channels

According to the law, only brokers are allowed to provide customers with advice, based on comprehensive analysis of several insurance offers provided by insurers. Brokers are playing dual role in the insurance market. They are acting as consultants for clients, and at the same time they are distributors of insurance products for insurers.

Insurers can endow brokers for risk underwriting and authorize them to take liabilities on insurers’ behalf. European Commission in its research about EU insurance market acknowledges that “this dual role is a potential source of conflict of interest between the objectivity of the advice they provide to their clients and their own commercial considerations. Such conflicts of interest can also arise from a number of sources linked to their remuneration, including contingent commissions.” (European Commission, 2007).

From conducted interviews it follows that insurance companies in Latvia remunerates insurance mediators for their services by paying commissions:

- it can be expressed in form of percentage from insurance premium for each concluded insurance policy; or
- commission is calculated from total amount of underwritten and collected premiums.

Amount of commission can vary accordingly to total volume of underwritten premium, and/or earned insurance premium loss ratio for each particular insurance kind.

Mediators – insurance agents and tied agents – additionally can receive commission for volume and remuneration for marketing services, if there is such additional agreement. The practice of remuneration and commission payments has been recognized as distorting product information delivery, as quoted in EC’s ruling: ”In respect to the insurance intermediaries, the market surveys and the public consultation highlight the fact that current market practices – in particular the lack of spontaneous disclosure of remuneration received from insurers and other possible conflicts of interest – create an environment in which business insurance clients, in many cases, are unable to make fully informed choices.” (European Commission, 2007).

Case analysis: towards unbiased information distribution channel

As a solution for the identified problem of potential conflict of interests in insurance products’ information distribution, the authors propose to create a new information channel for consumers. This new channel should be void of direct influence by commercial interests of insurance intermediaries. To cater for objectivity of product information, information gathering, aggregation, and dissemination functions should be assigned not to any one particular broker, but to an association of brokers. Insurance brokers are licensed by their professional associations, and they are experienced insurance professionals, so they can be considered as insurance field experts with widest knowledge about insurance products and services available in the market. If their tacit knowledge could be systematized, and expressed in standardized, explicit form, it would become valuable new alternative information aggregation method. As precedent for such insurance product information aggregation effort, existing similar initiative from LIBA can be mentioned. Since 2007, LIBA has been collecting information on insurance companies through its annual survey titled “Insurers’ performance evaluation by insurance brokers”. LIBA uses the gathered information to benchmark insurers against one another. All members of LIBA participate in this survey evaluating each insurer’s performance, according to 9 criteria, by giving marks from 1 to 5, where 1 is the lowest possible performance evaluation, and 5 is the highest evaluation.

Similar approach can be used to benchmark insurance products, developing insurance products' rankings. First step towards creation of such insurance product ranking should be development of product quality standards.

To date, there are no unified non-life insurance product quality benchmarking standards in Europe. Such standards would allow reduce the amount of information consumers are exposed to and serve in establishing grounded knowledge on the (comparable) quality of available services. Existence of quality standards for (insurance) services would allow communicating information on available services in uniform and understandable format, thus helping individuals and enterprises make weighed purchase decisions.

Implications for practice

Having examined legal background for product marketing in Latvian non-life insurance segment, it can be concluded that insurance brokers are the only intermediaries allowed to provide customers with advice, based on comprehensive analysis of several insurance offers provided by insurers.

However, insurance brokers are acting not only as consultants for clients, but also as distributors of insurance products for insurers. This dual role is a potential source of conflict of interest between the objectivity of the advice the brokers provide to their clients and their own commercial considerations.

Insurance brokers are insurance field experts with widest knowledge about insurance products and services available in the market. If their tacit knowledge could be systematized, and expressed in standardized, explicit form, it would become valuable new informational source, which can be used by consumers (or any other market player) to compare insurance products.

To make it possible to compare insurance products' information in a meaningful way, reference or/and ontology standards must be developed – to date, such standards haven't been developed in Europe (Janovs, Fomin, 2011). Development of standards for insurance product benchmarking would allow reducing the amount of information consumers are exposed to and serve in establishing grounded knowledge on the (comparable) quality of available services (Janovs, Fomin, 2011).

Having identified the lack of information distribution channels void of potential distortion of information due to the conflict of interests, we propose that insurance products' comparison (i.e., qualitative benchmarking process) can be undertaken by independent market player, such as industry association of brokers. The association undertaking the product benchmarking would establish a new independent information channel through which consumers would receive comparable information on competing insurance products. Moving the information gathering and systematization processes from brokers to the broker association would avoid potential conflict of interests and thus cater for objectivity of information.

Insurance brokers are not currently collectively involved in insurance product quality benchmarking and have potential to participate in this process if credible and efficient new information gathering methods and tools become available. Internet can be used as a platform for collaborative effort of the brokers.

Knowledge must be accessible to consumers in a simple and understandable form, such as ranking of insurance products. At same time, criteria and ranking formation principles must be clear and easily accessible for anyone interested.

Inasmuch as successful positioning and promotion of benchmarking contributes to the prevalence of knowledge, the knowledge leads to formation of opinion on competing products and services in the industry. Proper feedback mechanisms can help improve the original product offering if collective industry experts - brokers' opinions in form of rankings are fed back to the insurers.

Conclusion:

Research findings show that insurance brokers are the only market players which are allowed and capable to provide to consumers comparable knowledge on insurance products and services available in the market. However, there is a risk of information being distorted due to conflict of

interests, as brokers receive premiums and remunerations from particular insurers. Therefore, we suggest consumers would benefit if a new information channel was established.

In the earlier work (Janovs, Fomin, 2011) we suggested that industry representatives (associations) should establish mutually accepted qualitative product benchmarking criteria and standards within insurance industry. Having established standards for product comparability/benchmarking, the insurance industry through its associations could close the information gap the consumers are exposed to.

Establishment and promotion of new informational channel and handling of information according to mutually accepted format or standard would facilitate information exchange and reduce odds of impartiality in distributing information about insurance services by intermediaries, thus contributing to the improvement of the industry and economy as a whole.

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