

Current Market Conditions Require Precision Guided Growth

By Fritz Yohn

Having spent the last few years slogging through a thorough reunderwriting process, many carriers are now feeling a sense of urgency about replacing their discarded premium with profitable business. But just how do you go about growing premium in a way you won't live to regret?

A big part of the answer to that question lies in embracing the truly dynamic nature of markets—in being alert to individual business class and regional trends that will compromise or confound a carrier's best-laid plans. Especially in today's environment, those who translate this understanding into process and practice will find themselves well rewarded.

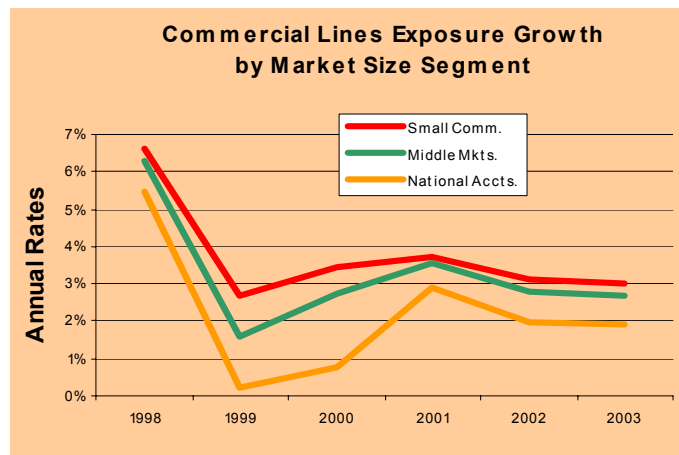
A confluence of factors is leaving carriers little room for error if they hope to set themselves apart in the performance arena this year and into the future. Underwriting profitability has become increasingly necessary at the same time untested exposures and a precarious economic environment seemingly stack the odds against it.

To be sure, with war fueling an already trenchant uncertainty, the near term economic outlook promises to challenge carriers as they pursue increased premium volume. While opportunities always exist, it increasingly takes a finer grained look at industries

and geography to successfully exploit market openings.

Part of the need for more careful analysis rests with the fact that economic conditions impact market size segments differently, as Chart 1 illustrates.

Chart 1



Middle market business (firms with 50–999 employees), for example, is disproportionately affected, both negatively and positively, by economic circumstances. The segment routinely

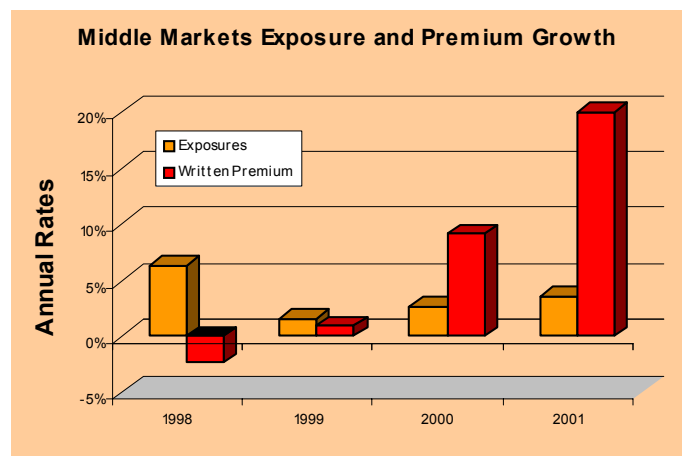
experiences more volatility in exposure growth patterns. Given the particular vulnerability of middle market business, a special touch is required to yield sustainable returns.

In contrast, small commercial business is more constant in its exposure growth, making economic timing in this segment less critical to performance. And while national accounts can be volatile, the alternative markets provide somewhat of a buffer in this

segment's written premium, since ART mechanisms tend to absorb an increased share of premium equivalents during periods of firming rates.

But a strategy predicated on a broad view alone could leave carriers regretting this year's new production achievement a few years down the line. Basing strategy and tactics solely on a sweeping view of size segments or sectors makes it all too easy to

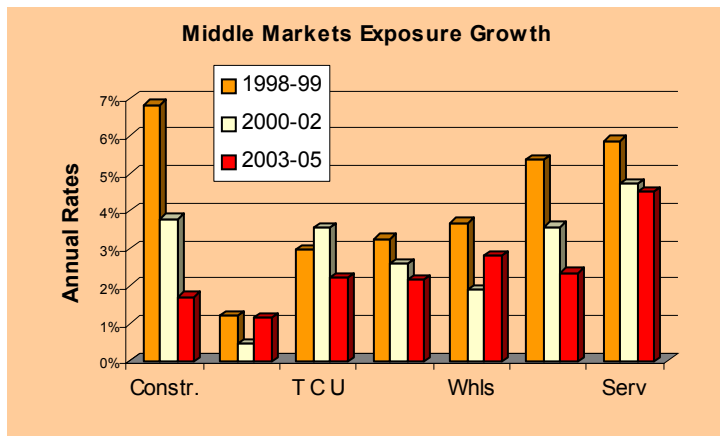
Chart 2



find yourself pursuing the same high profile markets as your competition—with the predictable pricing and profitability results (Chart 2).

A closer look at the middle market segment, for instance, shows a broad-based slow down in demand both this year and into the next few years, as reflected in exposure growth (Chart 3). For carriers with a middle market focus, this muted demand for insurance coverage, and the concomitant reduction in premium, will make new business growth objectives trickier to achieve—and confidence in its profitability more fleeting.

Chart 3



MarketStance measures exposure as the expansion of insurable values in property, liability, workers compensation and commercial auto, integrating and modeling data from a range of government and industry sources to capture an up-to-date view of market dynamics. That assessment demonstrates that there has been an important retrenchment in exposures over the past two years as the economy moved from rapid growth through the quasi recession.

Construction, which constitutes a significant share (17 percent of the exposures) of the middle market segment, was the main contributor to this reduction, with Finance, Insurance and Real Estate (FIRE), along with an atypical decline in the Wholesale sector, adding to the weakening. Significantly, this greater than expected drop off in demand was also accompanied by a decline in the services sector, which has traditionally provided carriers with an easy way out of middle market constriction.

Looking ahead, absent an economic sea change, the construction sector is likely to

experience a further deterioration in exposure growth as record low interest rates inevitably lose their ability to compensate for constrained revenues and

income. FIRE (making up roughly 4 percent of the middle market) will continue to shrink, following a longer-term trend that is a function of consolidation more than short-term economic reversals.

Services has seen a drop off in expansion of late. Looking forward, however, the sector does provide opportunity in that it represents 41 percent of expected middle market demand growth in 2003-2005.

The drama in the going forward picture is provided by the wholesale sector, which is rebounding to more regular expansion patterns, and in manufacturing. Currently, the wholesale sector represents 8.7 percent of the middle market, while manufacturing concerns account for 18.3 percent of the middle market business exposures.

It is important to recognize, however, that conditions within sectors – whether services, wholesale or manufacturing – are not uniform. There are significant variations in the prospects for individual business classes, with location frequently coloring the picture to the good and the more troublesome.

In manufacturing, for example, overall revenues increased by more than 7 percent on average during the fourth quarter of 2002. In particular, strong revenue growth has been seen in the electrical equipment, textiles and apparel and semiconductor industries, while important industries such as computer equipment and industrial machinery have seen more recent gains. At the same time, vehicle-related manufacturing has suffered a setback, while the prospects for other transportation-related manufacturing and metal heat treating are also less than robust.

Significant changes are also afoot in the geographic spread of middle market exposure growth. As Chart 5 illustrates, while growth of housing and populations during the 1990s in the West and Southeast is, by now, a well recognized trend, the follow along to

Chart 4

Middle Markets Insurable Exposures		
	Share of 2001 Exposures	Share of 2003-05 Exposure Growth
Mining	1.6%	0.2%
Construct.	16.8%	11.3%
Manuf.	18.3%	8.2%
Tran, Comm, Util	15.3%	13.6%
Retail	12.9%	11.0%
Whlse	8.7%	9.8%
Fin, Insur, RealEst Service	3.5%	3.3%
	22.2%	41.2%

those shifts will be the emergence of a new set of states important to middle market focused carriers. California, North Carolina and South Carolina are giving way to the likes of Nevada, Arizona, Georgia and Florida.

At this juncture, carriers have little room for mistakes in performance. It will take both a careful

and constant reevaluation of market opportunities to achieve sustained underwriting profitability.

By routinely assessing detailed SIC-level data (data compiled at the level of Standard Industrial Classifications) and looking for the intersections between market demand and carrier strengths (be they footprint, specific expertise or products), carriers who appreciate the power and potential inherent in the dynamics of today's markets can more closely align their resources and energies to the unique opportunities that offer them the greatest returns. Said another way, those carriers willing to approach the market without bias will be the first to spot the opportunities --and the first to know when good markets are about to change.

Carriers who are sensitive to the way market dynamics may challenge even well founded

notions about target classes and account size are more likely to make the tactical corrections critical to performance.

Frederick Yohn is the developer of "MarketStance," a market analysis tool for U.S. commercial property-casualty insurers and a registered trademark of IntelliStance, LLC, in Middletown, Conn. Contact MarketStance at 888.777.2587 or visit us on the web at www.marketstance.com.

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Chart 5

