

# A Checklist for Profitable Growth in Challenging Times

By Fritz Yohn

You've got to feel sorry for those commercial lines staffers charged with planning for 2005. When more hurricanes, softer pricing and contingent commissions are the top issues in 2004, it's tough to get excited about commercial lines' prospects for 2005 and beyond.

While it's well nigh impossible to plan for changes in next year's hurricane cycle, planning for the changing economy's expected impact on commercial lines is surprisingly straightforward. Indeed, growth forecasts can be made specific to the state and line of coverage – even to the market size segment and class of business.

Therefore, it's possible to take advantage of forecasted growth patterns to offset the deleterious impact of further softening in commercial lines pricing, thereby actually improving underwriting results.

Not convinced? Well, think for a moment about the gasoline business, and specifically, trying to expand revenue and preserve margins if and when crude oil prices start to decline. In such a case, where would you rather try to expand revenues?

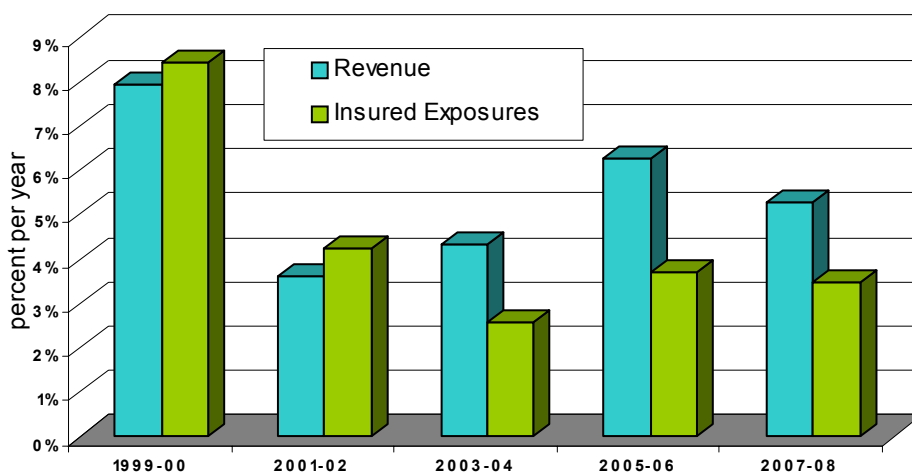
In states where demand is shrinking because of weak economic conditions, both demand and

declining crude pricing are working against efforts to boost revenue. Any top-line revenue growth in these states inevitably will come with the expense of rapidly deteriorating margins.

In contrast, in strong growth states rising demand for gasoline will naturally offset at least some of the impact of national declines in pricing. Moreover, if gasoline distribution between states is imperfectly fungible, strong demand growth in a given state may be sufficient to keep pricing near current high levels. This would enable gasoline distributors focusing on strong growth states to both grow revenue and preserve margins.

Still not convinced of this example's applicability to improving results in commercial lines? Well, Chart 1 shows pretty clearly that growth in insurable exposures rises and falls with the ebb and flow of the national economy. Moreover, this trend is even more pronounced than the cycle in business revenues; from a torrid pace of 8.4% in 1999-2000, core lines' exposure growth fell to a

Chart 1: Growth in core lines insured exposures and business revenue

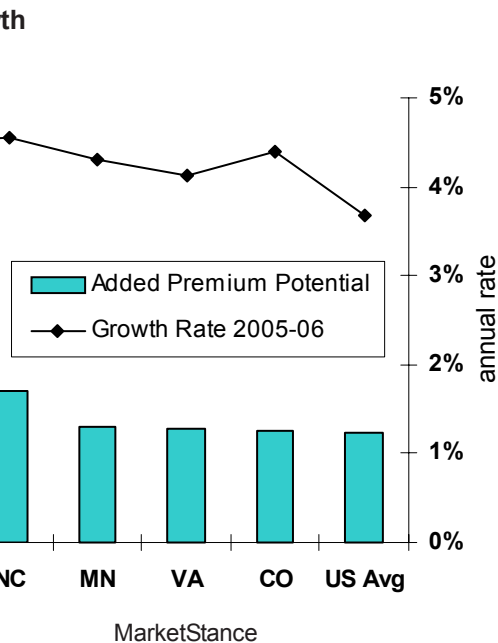




state, translates into the creation of substantial new premium potential. In fact, each of the above named states is forecast to generate \$250 million or more in new premium potential in 2005 and 2006. Together, these four states are expected to account for a remarkable one-quarter of the premium potential added across the entire US.

In terms of insurable exposure dollars rather than forecast growth rate, by the way, California remains the top contributing state. By virtue of its huge size, California is forecast to account for almost 16% of the insurable exposure dollars generated next year. As mentioned above, however, its sub-par growth forecast is expected to make it much more difficult for carriers to convert these added exposures into written premium in the face of an anemic growth pace and generally softening rates.

At this point, the careful reader may ask: “What is a carrier to do if its territory encompasses few, if any,



**Checklist for Profitable Growth in Challenging Times**

- ✓ Increase focus on states where:
  - Exposure growth is forecast to be strong
  - Size of state provides a stable base for rate making
- ✓ Reduce writings in states with very weak forecast growth
- ✓ Write cautiously in states with exceptionally strong growth
- ✓ Reduce emphasis on lines of coverage forecast to have weak growth

of the states with good premium growth prospects?” Well, even within more moderate growth states such as New York, Massachusetts or Oregon, profitable growth likely is achievable by focusing on sizable classes with above average growth potential. In these states, a carrier also can limit its exposure to softening pricing by reducing its writings in lines of coverage that are forecast to have the weakest exposure growth. As they say, the devil – and the payoff – is in the details of business class, line of coverage and territory.

Indeed, solutions such as these may not be as practical for a carrier with a more mature book of business. State insurance regulations with respect to non-renewal and cancellation actions have to be taken into consideration. There also are agency relationships and contracts to consider — not to mention issues with the carrier’s own employees and infrastructure.

However, certain actions can be taken on the total book, or specific classes/territories, that can have the intended impact. Certainly, changes

in attitudes toward new business opportunities can be taken. Adjustments to pricing credit and debit direction also can be used to effectively shape the book. New agency appointment decisions can be altered, and any options available with MGAs exercised. All of these types of actions can be suggested by exposure trend analysis and will move the book in the desired direction without negative external problems. Lastly, if any merger or acquisition activity is in the air, exposure trend data analysis should be considered a must.

*Frederick Yohn, PhD, is the developer of the MarketStance market analysis tool for the U.S. commercial property-casualty industry. MarketStance is a registered trademark of IntelliStance, LLC., in Middletown, Connecticut. www.marketstance.com. 888-777-2587.*

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