The Auto Insurance Industry

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Industry Analysis
The Auto Insurance Industry

Why Auto Insurance?

- One of the largest advertising to sales ratios
- Mostly homogenous product
- Advertising crucial to differentiation
- Different target markets across firms

Key Statistics

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
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</thead>
<tbody>
<tr>
<td>Revenue (2015)</td>
<td>$220.4 Billion</td>
</tr>
<tr>
<td>Profit (2015)</td>
<td>$22.0 Billion</td>
</tr>
<tr>
<td>Annual Growth (2010-2015)</td>
<td>1.9%</td>
</tr>
<tr>
<td>Annual Growth (Projected 2015-2020)</td>
<td>2.9%</td>
</tr>
<tr>
<td>Number of Businesses</td>
<td>1,958</td>
</tr>
</tbody>
</table>

Source: IbisWorld
The Basics of Auto Insurance

*Before we discuss the industry’s strategies, it is key to understand its product attributes*

<table>
<thead>
<tr>
<th>Auto insurance firms underwrite auto insurance policies, which are experience goods</th>
</tr>
</thead>
<tbody>
<tr>
<td>▪ Assign premiums</td>
</tr>
<tr>
<td>▪ Assume the risk of the policies</td>
</tr>
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</table>

<table>
<thead>
<tr>
<th>Two main categories of auto insurance</th>
</tr>
</thead>
<tbody>
<tr>
<td>▪ Liability insurance</td>
</tr>
<tr>
<td>▪ Comprehensive physical damage policies</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Two main distribution channels</th>
</tr>
</thead>
<tbody>
<tr>
<td>▪ Traditional (primarily insurance brokers and agencies)</td>
</tr>
<tr>
<td>▪ Online</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>How insurance firms make a profit</th>
</tr>
</thead>
<tbody>
<tr>
<td>▪ Only a handful of firms make a large portion of their profit on policies sold to consumers</td>
</tr>
<tr>
<td>▪ The majority of firms profit primarily from their investments</td>
</tr>
<tr>
<td>▪ Revenue streams primarily depend on renewals</td>
</tr>
<tr>
<td>▪ “The average State Farm policy holder has a collision claim every 19 years” – Dick Luedke, State Farm Spokesman</td>
</tr>
</tbody>
</table>

Source: IbisWorld
Insurance carriers are governed on a state level, but there is some level of uniformity among the states.

The National Association of Insurance Commissioners (NAIC) Accreditation Program

- Sets stringent mandatory standards for insurance firms
- Includes regulations for how much firms are required to hold in liquid assets

Statutory Accounting Principles (SAP)

- More conservative than GAAP
- Requires firms to have sufficient capital and surplus in order to cover insurance losses

The Dodd-Frank Act

- Subjects the insurance industry to monitoring by the Federal Insurance Office (FIO)
- Regulates reinsurance policies across all states

Source: IbisWorld
The Market for Auto Insurance

The market is split between the commercial market (12%) and the personal market (88%).

Major market segmentation by revenue (2015)

- Drivers aged 75+ 4.3%
- Drivers aged 65 to 74 6.2%
- Drivers aged 55 to 64 11.5%
- Drivers aged 45 to 54 16.1%
- Drivers aged 35 to 44 15.7%
- Drivers aged 25 to 34 16.4%
- Drivers aged 24 and under 17.8%
- Commercial market 12.0%

Analysis

- Drivers up to age 34 pose the most risk for firms, and therefore pay the highest premiums
- Different target markets for individual firms
- Relatively low brand loyalty between firms

Source: IbisWorld
The market for auto insurance is growing at a current rate of 1.9% per year since 2010.

**Auto Insurance Total Industry Revenue ($ Billion)**

- Demand primarily driven by the number of motor vehicle registrations.
- Profit margins depend on state-by-state regulations as well as natural disasters.
- Revenues depend primarily on renewals with existing customers.

Source: IbisWorld
As the economy and balance sheets change, so do the needs and responses of insurance firms.

**Basis of Competition – Cyclical Pattern**

*As auto insurance is mostly a homogenous good, firms tend to emphasize low price in advertisements*

### Hard Market

**Preimums and profits rise**

- Less focus on low price
- Greater focus on profitability and rebuilding surpluses
  - Increase in premium rates

### Soft Market

**Preimums and profits fall**

- Strong balance sheets
- Greater focus on winning market share
  - Focus on low price – firms aggressively price risk

**Takeaway**

*As the economy and balance sheets change, so do the needs and responses of insurance firms*
Key Success Factors

There are numerous variables that determines which firms succeed in the market

1. Ability to effectively manage risk
2. Management of a high quality assets portfolio
3. Having a cost effective distribution system
4. Possession of accurate information
5. Offer a range of insurance products
6. Disciplined underwriting process
7. Brand recognition

Source: IbisWorld
Porter’s 5 Forces Analysis

The market is classified as highly concentrated and mature

The Auto Insurance Industry

- High barriers to entry
- Heavily regulated industry
- Suppliers have power to determine prices
- Power of buyers differs between individuals and large corporate clients
- Strong competition between firms

Analysis

Source: IbisWorld
Widespread use of the automobile began after World War I, when cars were still fast and dangerous, but there was no compulsory form of car insurance.

Massachusetts becomes the first state to make auto insurance compulsory.

Other states begin to pass mandatory auto insurance laws.

Source: IbisWorld
Industry Concentration

Several key players dominate this industry, followed by many other smaller firms

Market share breakdown

Observations

- CR4 = 47.1
  - Top 4 holds nearly half of the market
- Herfindahl-Hirschman Index = 731.9
  - HHI < 1000, so market is competitive
  - Due to many smaller firms in “Other”

Key Players

- State Farm Insurance
- Allstate Insurance Group
- Farmers Insurance Group
- Liberty Mutual Insurance Cos.
- Other
- Berkshire Hathaway Insurance
- Progressive Insurance Group
- USAA Group
- Nationwide Group

Source: Insure.com
Industry Wide Advertising Strategies
We identified six advertising strategies commonly used in this industry:

- Reminder
- Persuasive
- Combative & Comparative
- Characterization
- Comical
- Adaptive
Reminder Advertising

Advertisements serve to remind consumers of a familiar product in a mature industry

**Observations**

- Industry has reached its mature point
- Consumers aware of the product
  - Little need for informative content
- Insurance plans require frequent purchase but infrequent use
  - Average person uses auto insurance every 19 years

**Examples of reminder advertisements**

**Product life cycle**

![Diagram of product life cycle]

- **Introductory**
- **Growth**
- **Maturity**
- **Decline**

**Informative**

**Reminder**

**Persuasive**
Advertisements attempt to change consumer tastes to boost demand spuriously.

### Observations

- Auto insurance is an experience good
  - Difficult to ascertain utility until consumption
  - Reputation is key
- Still relevant throughout product life cycle

### Examples of persuasive advertisements

#### Introductory

#### Growth

#### Maturity

#### Decline

#### Informative

#### Reminder

#### Persuasive

Source: IbisWorld
Advertisements attempt to shift consumer demand instead of affecting overall demand

**Observations**

- Stagnant growth in consumer base
- One consumer only purchases one plan
  - Firms must compete to shift demand away from each other
- Comparative advertising often evaluates:
  - Pricing
  - Quality of service

**Examples of combative advertisements**

**Licensed drivers in the US**

![Observations graph](source)

![Examples of combative advertisements](source)

Source: IbisWorld
Comical Content

Advertisements feature funny content to leave positive emotional impressions

Observations

- Auto insurance is a negative good
  - Consumers would rather not purchase or use it
  - Unpleasantly associated with accidents
- Auto insurance is complicated to understand
  - Informative content is dry

Why Humor?

"Nobody wants to sit around and talk about car insurance. In order to combat that, we needed to entertain. We needed to get people's attention."

Nina Abnee, Executive VP at Allstate

Interview with Ad Age

Examples of comical content

Source: Ad Age
Characterization of Brand

Characterization of the brand helps consumers differentiate the similar products

Observations

- Auto insurance is a homogenous
  - Apart from price, it is difficult to discern specific differences
- Firms must create an objective or subjective difference to prevent commodification
  - Advertising creates subjective difference

Examples of personalization

Guess which brands?

Characters are Competitive Advantages

- Once successful, characters can be used to:
  - Generate sales
  - Differentiate the brand
  - Target specific demographics
- Relatively risk free
  - Brand has complete control over behavior
- Difficult to copy successfully

Source: Ad Age
Adaptive

Firms are moving towards digital marketing, while maintaining use of traditional mediums

The Shift to Digital

- Marketing “Arms Race” has spilled over to digital, in an attempt to capture new drivers
- Capture attention
  - TV, print, YouTube, social media
- Guide selection
  - 48% of Millenials turn to the web first
  - “Insurance” is the most expensive keyword on Google as of 2014 ($54.91 CPC)
  - Search-based advertising effective since the consumer has already shown interest

Ad Avoidance

Other Mediums

Source: Word Stream
Firm Specific Advertising Strategies
Timeline of Advertising in the Auto Insurance Industry

**Personified brand icons rise in the 2000s, with GEICO leading the trend**

- **The Gecko (GEICO)**
- **Erin (Esurance)**
- **Flo (Progressive)**
- **Mayhem (Allstate)**
- **The Duck (Aflac)**
- **The Caveman (GEICO)**
- **Stack of Money (GEICO)**
- **Jake (State Farm)**

Source: Insure.com
The market for auto insurance is growing at a current rate of 1.9% per year since 2010.

### Analysis

- Overall, the industry has extremely high advertising expenditures.
- GEICO is a subsidiary of Berkshire Hathaway and therefore, has a very high advertising budget. Also, since it does not have agents, the money it saves is spent towards advertising.
State Farm puts and emphasis on their “old school” personal approach with 18,000 agents online

About

- State Farm is the biggest auto insurer in the U.S. and is a top 50 Fortune 500 company. Customers consistently give state Farm high ratings for their handling of claims. State Farm categorizes its different insurance coverage's under categories of auto, home, life and bank.

Target Customer

- Previously older demographic with a higher willingness to pay that valued a personal, but moving towards a younger demographic with a stronger online presence

Advertising Strategy

“Like a good neighbor, State Farm is there”
About

- Second largest auto insurance in the United States. In addition to auto insurance, GEICO offers customers products for their motorcycles, all-terrain vehicles, travel trailers and motorhomes. It is a wholly subsidiary of Berkshire Hathaway.

Target Customer

- Mid to upper twenties on a budget, male, buying insurance for the first time

Advertising Strategy

“15% could save you 15% or more on car insurance”
Progressive differentiates itself using its insurance rate comparison tool and insurance bundling options

About

- Progressive offers insurance for personal and commercial autos and trucks, motorcycles, boats, recreational vehicles, and homes. It’s the fourth largest auto insurer in the country and the largest seller of motorcycle insurance.

Target Customer

- Mid to upper twenties on a budget, female, buying insurance for the first time

Advertising Strategy

“Now that’s Progressive”
Nationwide prides itself in being an insurance that protects what is important

About

- Nationwide is one of the largest insurance and financial services companies in the world, focusing on domestic property and casualty insurance, life insurance and retirement savings, asset management, and strategic investments.

Target Customer

- Young adult males and females who are just starting families

Advertising Strategy

“Nationwide is on your side”
Allstate stresses to customers its accident forgiveness practice as well as agent support

About

- The Allstate Corporation is the largest publicly held personal lines property and casualty insurer in America. Allstate offers car insurance, home, property, condo and renters insurance, plus insurance for recreational vehicles like motorcycles, boats and more.

Target Customer

- Working parents with a mid-range budget and a desire for supportive customer service

Advertising Strategy

“Are you in good hands?”
Raw Data Analysis
We posed several research questions before approaching the Prime Time data

Research Questions

1. Is there a particular time during the year that the industry spends a significant portion of their money on prime time advertising?
   - Do all of the firms spend their advertising budgets at the same time?

2. Is there an association between total advertising expenditure and market share?
   - Is there an association between prime time advertising count and market share?

3. Do companies advertise on shows that correspond to their target market?
1.1. Prime Time Expenditure by Month

Is there a particular time during the year that firms spend a majority of their money on prime time ads?

Prime Time Advertising Expenditure By Month (Industry)

- As a whole, the industry spends the highest amount of advertisement expenditure in January and between September and October.
  - For the industry, there is a statistically significant difference for expenditures between months.

- High expenditure may be caused by the release of new shows in the fall and a resurge of viewers after the holidays. Low expenditures in summer may be due to airing of content that is less appealing (re-runs).
Do all of the firms spend their advertising budgets at the same time?

### Analysis

- **GEICO** spends the largest amount of expenditure on prime time. Its expenditure peaks between September and October, affecting the total industry expenditure on prime time.
  - For each firm, there is a statistically significant difference for expenditures between months.

- The other firms appear to maintain a relatively steady stream of advertising expenditures for prime time throughout the year.
2.1. Total Advertisement Expenditure by Firm, Market Share

Is there an association between total advertising expenditure and market share?

<table>
<thead>
<tr>
<th>Total Advertising Expenditure</th>
<th>Market Share</th>
</tr>
</thead>
<tbody>
<tr>
<td>$ Million</td>
<td>% Market Share</td>
</tr>
<tr>
<td>Allstate</td>
<td>9.93</td>
</tr>
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<td>Nationwide</td>
<td>9.93</td>
</tr>
<tr>
<td>Geico</td>
<td>10.24</td>
</tr>
<tr>
<td>Liberty Mutual</td>
<td>10.24</td>
</tr>
<tr>
<td>Progressive</td>
<td>4.97</td>
</tr>
<tr>
<td>State Farm</td>
<td>8.45</td>
</tr>
</tbody>
</table>

Analysis

- There is no significant relationship between the market share of the firms and the total advertising expenditures.
- A large number of advertising dollars does not necessarily correspond with large market share, but there is a weak association between the two.
2.2. Advertisement Count by Firm, Market Share

Is there an association between prime time advertising count and market share?

<table>
<thead>
<tr>
<th>Advertisement Count</th>
<th>Market Share</th>
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<td>4.97%</td>
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<td>State Farm</td>
<td>8.45%</td>
</tr>
</tbody>
</table>

Analysis

- There is no significant relationship between the market share of the firms and the advertisement cost.

- A large number of advertisements are not necessarily correspond with large market share, but there is weak association between the two.

- GEICO spends both expenditure and count on advertisements the most, perhaps due to its lack of agents.
3.1. Brand vs. TV Shows Relationship

*Do companies advertise on shows that correspond to their target market?*

<table>
<thead>
<tr>
<th>Brands and most advertised programs</th>
</tr>
</thead>
<tbody>
<tr>
<td>GEICO</td>
</tr>
<tr>
<td>HAWAII FIVE-O</td>
</tr>
<tr>
<td>2014 WORLD SERIES</td>
</tr>
<tr>
<td>PROGRESSIVE</td>
</tr>
<tr>
<td>FAMILY GUY</td>
</tr>
<tr>
<td>New Girl</td>
</tr>
<tr>
<td>GREY'S ANATOMY</td>
</tr>
<tr>
<td>NASCAR</td>
</tr>
</tbody>
</table>

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We recommend moderate investment into the auto insurance industry

1/ Stagnant growth
- Revenue is growing, but at a decreasing rate
  - Revenue primarily correlated with the number of registered motor vehicles
  - Consumers beginning to seek out other transportation options, primarily driven by cost constraints

2/ Structural change
- Perceived need for insurance may decrease in the future
  - While insurance is mandatory in certain states, the number of car accidents is steadily decreasing
  - This is driven by vast improvements to the safety features of motor vehicles
Advertising Recommendations

Advertising for auto insurance can already be found on most media platforms and practice different innovative advertising strategies.

1/ Spend More

- Due to prisoner’s dilemma, firms must continue to advertise heavily.

   - In 2013, GEICO surpassed Nationwide in market share, this was likely due to GEICO’s competitive advertising.
   - Firms must continue to advertise, if not advertise more in order to be vital players in terms of market share.

2/ Millennial

- Consumers coming of age to buy insurance are all potential customers.

   - State Farm reinvented itself to target the Millennial generation.
   - Like State Farm did, it is important that firms make their brand relevant to the younger customers.

Recommendations

- Re-prioritize budget in order to spend more on advertising.
- Target mid-twenties consumers who are entering the market.
Questions?