Patterns of Internationalisation in Insurance*

by Mr. J. F. M. Peters**

My topic is "Patterns of internationalisation in insurance". In this context, I shall deal with this subject not just in theory but from personal experience gained in my own company where I have been directly responsible for such strategy over the past 10 years.

1. Historic development

It is strange looking back at my own company, and the insurance industry in general, to note that in the 19th and early 20th century there was historically a large international spread. However, for one reason or another after the First World War, there was a distinct retreat back into the home markets. I tried to obtain some figures to quantify this shift of emphasis but this task proved to be impossible. What I did find was that, in the last century, 30% of the revenues of the Dutch insurance industry came from outside the Netherlands whilst by 1925 this had collapsed to a mere 2%. Perhaps the reason for this decrease lays in the introduction of new and more stringent regulations in the 1920's but, more probably, it may have been a consequence of the disastrous losses which befell the industry. These were a direct result of the revolutionary events in Eastern Europe and subsequent enormous losses from investments in Russian and other European bonds. As a result we can say that, as an industry, we were in fact more International in the 19th and early 20th centuries but there was a sudden decline in the 1920's. The UK Insurance industry was, of course, still active in other countries but this was mainly following the flag in a large commercial empire. Many companies in other countries were also still active in other markets but this was usually through underwriting agents as opposed to subsidiaries, in foreign countries. Many companies have had underwriting agents in many parts of the world and, of course, many companies co-operate by agreeing reciprocal re-insurance. For many years this remained the limited extent of internationalisation. In the years after the Second World War we, and other European insurers, started acquiring foreign companies, mostly in European countries and, in the first instances, the U.S.A. The U.S.A. was the first main target primarily because there was a readily available supply. This was still a fragmented market with a lot of companies for sale. Many of us started acquiring U.S.A. businesses in the late 1970's

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and early 1980's. Later there was an expansion into the European market place where we thought a lot of profits could be made in countries such as Spain and, in some cases, Italy. We have now learnt our lessons from these early acquisitions on which we must now build for the future.

In that early period, considerable emphasis was placed on self sufficient local operations. We changed from remote branch offices and underwriting agents to fully equipped local operations under local management. We also tried to get to countries where we could build a real market share instead of having merely a minor underwriting capacity in one or other lines of business such as fire, transport etc.

2. Multi-domestic vs. global

This brings us to the question of multi-domestic versus global, which in itself is an interesting topic. Looking at advertisements on European television for ice cream, Gillette or American Express we can speak in terms of global products. In our industry however, especially in the personal lines, life and small commercial areas, we cannot really speak of global products. There are too many differences in each market. The fiscal treatment, especially on the life side is different country by country. Even with "1992" in mind we all know that differences will remain on the fiscal side, pension schemes, and almost everything else in diverse markets. Further variations arise from different legal systems whereby the liability in one country can mean something very different in another. The supervisory requirements also vary from one country to another. Here in Britain there is the renowned DTI. The DTI however, is a little bit different from the Bundesaufsichtsamt für das Versicherungswesen in Berlin. I do not know whether you have been there, but I have been to see the tariff clerk who has to approve tariff by tariff. He knows that there are differences and that these are here to stay. I have a wonderful story to relate about this subject. We tried to launch a new product with disability included and I personally went to Berlin at the end of the 1960's to ask permission for that particular product. The tariff clerk said it was a wonderful new product but that I needed German disability statistics covering 40 years. I pointed out that during that period we had the Second World War. He replied that this did not matter in the least as the rule clearly stated that 40 years was always required.

In each country there are existing distribution patterns. The UK has its own financial services act (which I hope we will never have in Europe) which means that the UK has a different distribution pattern from much of the rest of Europe. These differences cause insurance to be multi-domestic, rather than being international.

The cultures and languages are also different. A "motorcar product" today in Spain is a different product from motorcar insurance in Britain, Holland or Scandinavia. Very large differences remain and the conclusion is that in all these areas the international insurer has to be multi-domestic; he cannot be global. There are of course some sectors such as industrial risks, Lloyds, the London ILU market and international reinsurance which all face global competition. We know there is a trend, in some products faster than in others, away from multi-domestic towards truly international operations. One prime instance of this is group life.

3. Crucial issue

Now if a company is a multi-domestic operation the question then remains as to whether or not my subject is mainly concerned with the aspects of the internationalisation?

What is the group other than the addition of the parts? What is really the added value of the group? If all these things are being done what really is the extra value?

4. The importance of scale

This topic is of interest for more than one reason. In my opinion this is more or less the division between two aspects of scale. On the one hand there is the scale of each unit. If a group is multi-domestic we have to look at all the units and ask whether each unit is big enough and strong enough, whether it works in its market or whether it is merely a flag somewhere. Is the company really strong enough in its market, is it strong enough in its local distribution and in its administration? Does it have the right economy of scale or is it a specialist? All the units have to be tested and when I look at the annual reports of some of the companies represented here today, I think that many of the units may be far too small and not viable in the long term. In Spain for example, there are 30 to 40 foreign companies and of those companies over half have a unit that seems not to have the right scale and cannot compete very effectively in the market.

On the other hand there is the scale of the group when viewed as a whole. Here totally different considerations play a part and the two views should not be confused. When it is necessary to go to the international capital market in search of solvency, then the size of the group is of prime importance. On the investment side it is, at present, difficult to speak about the ECU, but sooner or later we will have a closer investment market in Europe and then size will mean something. Some of us have real skills. Not all of us, but some have real skills on the P & C side, on the pension side, or on the administration side. These can be used in the larger company and the know-how from one company can be used to benefit another.

The next item is management development. Our industry was not always an example of good management in many positions. This can be poorer than in many other areas of business and we really need good people. We have to compete. The insurance industry has to compete with many other industries to attract the right people for the future. Therefore the only effective way is through training the resources made available by the scale of the group. Train them, and train them for the whole team. Train them to work internationally. Although it is very difficult to use managers of one nationality in another nation's market at the highest level, technical and staff functions are more capable of exchange. Here are important advantages in grooming the top management of a company by providing international experience as part of their *earlier* career.

The last item is of course the opportunities. We know all the markets of today, but many new markets are opening up in developing countries like Turkey, Taiwan, Vietnam and Indonesia. There are many opportunities worldwide, not just today but coming in ten years time. Scale as a group is needed to meet this challenge and to seize the opportunities. So overall, when examining the importance of scale, we have to look at both the individual scale units separately and at the scale of the group as a single entity.

5. Why internationalise?

If we go back to the question of "why internationalise", we need to examine the concept of added value. When the scale of the group is exploited then added value can be obtained. We also have to look at the cross fertilisation of skills and the often repeated argument that for many of us the home market is too small.

Insurance is in the business of spreading the risks of one's clients. Creating an international insurance business can spread one's own risk; different national markets are unlikely always to experience the ups and downs of business at exactly the same time.

To a lesser extent I think we are also occasionally confronted with the idea of following the client, although this is not generally the case. Often we have found solutions for this, such as in the group pension area, where we have contracts and cooperation agreements between ourselves and still serve our clients in a way they appreciate. There is also the ambition of the management and, finally, the group size. This latter consideration is becoming a crucial issue in the international competition of tomorrow. The strange thing is, of course, that more and more people are compiling lists of which companies have the biggest income, which have the most assets, etc.

Today size itself is becoming a point of discussion, a point where analysts are looking at a company and are testing it. If we reach the conclusion that our business is multi-domestic and that in some areas we need increased size, this then means that we have to internationalise. We have to look therefore at the consequences of internationalisation.

6. Strategy and structure

Achieving scale in some areas means that we have to internationalise, and if we internationalise this in turn requires an international top structure and mentality.

This is of course an easy statement to make but it is not implemented by too many companies. We have to be honest to each other and for that reason I would like to discuss this topic further. In particular, the organisation has to follow the strategy and this aspect will be the subject of the second part of my talk.

7. Development of the top structure

In general, every organisation begins as a domestic company with a national board. In Britain, for example, the British have traditionally been responsible for the operations in Britain. Eventually there would appear a progressive CEO who would expand his domestic company by setting up or acquiring some foreign operations. The word foreign itself already implies different. It implies a strict division where the offspring look to the mother organisation for strength and financial support, it is the situation in which one or more national board members oversee the international operations and the staff both national and international work for the group. That was more or less the situation in the 60's and the 70's. All of you here who manage such companies can say whether or not you were operating as we at AEGON had been. That is to say a domestic company with some foreign operations.

After a while we entered phase 3, we became a group of multinational companies with still of course a strong home company and several foreign operations. AEGON reached that state more or less in the 80's. In that period we started to split the national and international responsibilities, staff were divided into holding, or group, staff and national staff. Yet it still remained a multinational company. Finally the fourth or last phase with the evolution of the genuine international company. In my view only a very few companies can claim to be in phase 4, an international company strong in the home market and in several other countries. This then brings me to some very simple questions for everyone. To every company claiming to be an international insurance company I ask: how many non-Englishmen or non-Dutch are there in your Supervisory Board, how many

non-English, non-Dutch are there in your Executive Board, which language are you using? There is another very simple test: are you speaking about foreign or overseas operations? If you use the word overseas operations or foreign operations you are still a multi-domestic company and not an international company. That of course is the final phase where there are no second class citizens in your group, where everybody is equal and the words foreign and overseas are banned. AEGON tries to be in phase 4.

8. Multi-domestic vs. international

This means as a consequence that we have to think and act globally. We all know that with a multi-domestic business with all the roots in the local markets you require local management. On the other hand you need an international strategy and international mentality.

Again I put the question to you, have all these conditions been fulfilled in your company? That is the critical question. Look at the German companies like Allianz, with enormous deals in the U.S.A., Britain and Italy. Look at what the Dutch companies have done. Look at what some of the British companies have done, what AXA has done. Ask them the question, have the conditions been fulfilled in their company? There are a lot of areas of attention but there are also a lot of areas of tension.

9. Areas of attention

Looking at the areas of attention, I would first like to discuss the role of the corporate centre in an international insurance company, the size of group staff, the added value of group staff, getting information, and of course the question of the corporate language.

The first area of attention is the role of the corporate centre in setting the direction for the company. This is the prime objective. In which lines of business are we going to expand, what are we doing with, for instance, inwards reinsurance? For some of us the questions may be in which countries or, in how many countries, are we going to be active? One of course has to choose between strategic priorities and financial constraints. We all have problems with solvency margins. Of course not all calculations are based on the same principles, but at least all of us examine our balance sheets and establish our solvency position. Everyone of us knows that solvency is both a requirement and a constraint. We have to provide the solvency for the units and this is one of the crucial items – at least in our company – on the agenda at our yearly strategic meetings where the provision of solvency for the units is one of the topics continually under discussion.

Another task of the corporate centre is the appointment of top management – who will be the number one in Britain, who will be number one in Spain, etc. Then there is the role of striving for synergy. Somebody once said teach the children to play with each other, which is another way of saying, push the synergy. At the very least it is desirable to explain to people, especially to those from the new markets, how to benefit from synergy. We just acquired from the Hungarian government, the major Hungarian life insurance company where we are now setting up a full system and where other units in our group can help the Hungarian insurance company Allami Biztosító with the implementation. This means encouraging exchange between the units. Encourage is the key word, because you cannot enforce such concepts. In other words: You have to stimulate bilateral agreements between countries and cannot rely on exchange mandated by the group.

There is of course another area of attention and that is the size of the group staff. Group staff is something very unique. First of all, if you have group staff, the question is should it be a large or small team. I am very much in favour of a very limited group staff. In numbers, AEGON has 90 people altogether in its group staff, excluding the members of the Executive Board and their secretaries. The cost of group staff is less than 3% of total cost, which I think is more or less in line with what is generally acceptable.

If you want to decentralise, if you want to give responsibility to the units in your group then you need a limited, but high quality, small staff group. If you want to run an international company with an international board, you need an international group staff as well. In this context, I am very proud of the fact that, at AEGON, our Chief Financial Officer is now an American.

Measure costs against total group costs, I already mentioned a norm of 3%, and balance staff costs against the cost of external advisers. Even when faced with the bills for consultants such as the actuaries, lawyers and accountants of this world, remember that you do need their services from time to time. Build for control and not for checking, it is vital to obtain, or at least try to obtain, control over current events and not be simply checking the past.

The third area of attention is the obtaining of information. I am sure there must be actuaries in this room, as well as many financial people. I was brought up as a financial man, and my statement to you is that official information is not always complete and adequate. The accountants and statisticians can send us much on the Run-Off of claim reserves, they can send us a host of other financial data, but we always need more. Therefore in a decentralised multi-domestic international organisation there is a need for an alternative way of getting information. Delegation means that you should be selective and get only the *important* data at corporate headquarters; this is the *formal* information; the informal information, very often the most important, you get by walking around. In my organisation I am famous for walking around. The story is that I spend a lot of time walking around the corridors, opening doors and asking questions. I believe it is the right way to do it and I am not planning to change it. You should visit all branch offices, talk to employees at all levels and listen to the customers to get additional information and a flavour of what all these people are doing. It is also important during these visits, that you never simply restrict yourself to the official programme.

Another area of attention is the corporate language. The corporate language is only a first step towards becoming an international group with an international mentality. This is a prerequisite for becoming an international group with an international mentality. This is not so much a cause for concern for the Englishmen present here. For you this is a very easy thing, as you know your language is more or less the best export product you have. For all other nationalities, of course, English is the only common language. But this is more than starting to speak a different language, it is more than just introducing a language. It means a lot to people that at least you try to speak to each other about every detail and not just official formalities. On the other hand the non native speakers have to understand that native speakers have some considerable advantages. Even when you speak English two or three days a week, the number of words you know are limited and you will never be able to use exactly the right expressions all the time. But it is still necessary to learn and understand the discussions on the topic of corporate language. We at AEGON officially introduced the English language some time ago and all our board

meetings are now conducted in English, even when there are only Dutch people present. The minutes, the reports, etc. are in English. The Supervisory board meetings are also conducted in the English language. We are also encouraging the exchange of people between the various countries, from mother country to subsidiaries and vice versa.

10. Top management is crucial for making it happen

I would like to say simply that top management is crucial for making things happen. If the corporate head is not going around pushing it then it will not happen at all, and there are always easy ways to walk away from it.

11. Areas of tension

There are areas of attention and there are also areas of tension. There is always the tension of central and decentral, the tension of synergy, the tension of different size of units and there are a few separation issues. The heads of our two UK units are present today and I hope I have identified sentiments reflecting what they may feel from time to time.

Decentralisation needs to be balanced with control. If you are in a real multi-domestic company working internationally, decentralisation means that you give a lot of responsibility away. However, it has to be balanced and controlled. You have to understand what is happening on the underwriting side, on the reinsurance protection side and so on. At the time of an international currency crisis, such as we had recently, what was essential was central control by our central corporate treasury department. It was absolutely necessary and that cannot be a point of debate.

You have to set the strategic guidelines for the group. What do we do, what do we want, in which direction do we want to go? This does mean from time to time that some units do not get the money to give the solvency for their own plans, but that the money is going to another unit. You need to have the local meetings not at Headquarters but at the local premises.

Then you come back again to the problem of the role of the corporate staff. The acceptance of the corporate staff, in our case 90 people, is essential. On the other hand I do not think that by being a corporate staff member you are immediately accepted by the local staff. You have to realise that you have to gain acceptance. That means you must pick up the telephone, be ready to serve, be ready to help, and be ready to give information.

The balance will shift backwards and forwards from one period to another. For example, as I said before, during the recent currency crisis we really increased control on the currency position. We will have, for example, much more central control on reinsurance protection for our group, because we have some worries about the quality and security of that protection. Synergy is a wonderful word to be found in all books on economics, but it does not come spontaneously. You have to work to achieve it.

The exchange of ideas and skills are at the heart of the matter. Again I would like to repeat that some of us are experts in some areas and others are experts in other areas and exchange of ideas is therefore a very essential ingredient. It greatly depends on and is influenced by the overall culture of the company. The top cannot force it downwards and it cannot be brought arrogantly by the top. It has to be pushed and brought together.

Synergy is achieved far more easily within the same types of business than between different types. Of course there is not much synergy, as we all know, between life and P & C. But these days there are some people who claim there is synergy between banks and life. Time will tell if they are right.

Then there is the different size of the units. That is another point which concerns us from time to time. I will first give you an outline of such differences in the AEGON group. We are very strong in the US in life insurance where we have an organisation which generates around 3 billion dollars annual revenue. Today we are the biggest non-American life company in the US. Another unit, for instance here in the London market, is highly specialised and very profitable. But it is a small company, totally different from the American operation. In our group all units are decentralised and any one can be much bigger than another. A unit can be too small, either because of its market perspective or because of its size within the group. However, we have to create a climate, put emphasis on size and importance of market position, understand that one unit is working in one market while the other unit is working in another market. If they have the right size for the market place then that is acceptable. It is important that size does not create or imply first and second rank subsidiaries. If units differ too much, then an organisational solution may have to be found.

Another area of tension is of course separation issues. Words people use like group unity and group culture must be more than mere words. We must really be an international group which happens to have its headquarters in The Netherlands. I have lived through three mergers in my career and I know from experience that immediately after any merger somebody always starts to speak about group culture. It is a word I hate a little bit simply because many of those people who are misusing it. It should mean that there has to be something which everybody understands that is to be part of the one family and that family means all together pulling forward as one. At AEGON we try to achieve that in totally different ways. We have for example our formal yearly international management conferences where we can really speak together about the strategy of the group, with a good exchange of ideas. Also from time to time we organise international social events where the family can relax and have fun together. I think that is as much a part of the group culture as the formal business. Integrity of the group, understanding each other, openness in communication, these are all part of a group culture. Create the inter-group exchange, be strong minded about separation movements, pick up the telephone and explain that it is not impossible. The last very serious item is that if you create open communication channels then you must set objective return requirements for all of them. Be open and clear about the solvency allowances and the growth implications so that everyone in the group is united and understands the strategy. Make sure the group units understand that they all have to make a contribution to earnings and not just to the revenue-growth of the company.

Well ladies and gentlemen, that is my presentation and I would like to just end with a statement made by astronaut Wally Schirra: "The thing that impressed me most, looking at the earth from outer space, was that the borders between countries were not visible". That is perhaps a little bit too distant for the insurance industry today, but on the other hand I do not think internationalisation is a mere hobby horse. I think internationalisation is, for many of us, an essential part of our strategy. However, if you say yes to internationalisation you cannot just do a little bit. You have to do it wholeheartedly and go for it fully with all its consequences.