Where is My Market? How to Use Data to Find and Validate New Commercial Lines Market Niches

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How–to Use Data to Find and Validate New Commercial Lines Market Niches

By Lisa Sayegh, MBA, ARM

Entering a new insurance market is not a decision to be taken lightly. Market segment analysis is a lengthy process, and finding the right data is just the beginning. Being able to make meaningful comparisons of data from various sources and across insurance lines is the key to identifying profitable markets. Fortunately, there are data sources and tools available that can help with the analysis, as well as provide quantifiable assessments of your niche-market recommendations. Here are some critical elements to keep in mind as you go through the process.

An approach to help insurance marketers identify profitable segments in an industry where costs can be unknown for a multiple year period:

1. Identify Your Company Strengths
2. Define Market Segments That Utilize Your Strengths
3. Validate Your Selections
   - Validate Using Insurance Data
   - Additional Considerations When Identifying Markets
   - What Data Is Available?
   - Using Multiple Data Sources
4. Provide High Quality Prospects

Why segment?

The segmentation process guides the marketer through defining market characteristics to enable comparison across slices of the market or segments and from which, attractive markets can be decided on. Consider two examples. A major insurer successfully used segmentation to identify optimum markets with established distribution channels by overlaying selected segments to agent territories. Another company learned that an adjacent state was not nearly as attractive for growth as expected, for reasons other than the regulatory environment of the state. Their initial expectation of the adjacent state was based solely on lower distribution costs. It turned out that by segmentation analysis, they found tremendous promise in a third region. This new segment was so attractive that it justified increased distribution costs to access the market.

Identifying target market segments is an iterative analytical process. The market researcher begins the analysis by identifying segments on a high level basis, then continues with further segmentation criteria to validate findings and to hone in on optimum market segments. Insurance market data can be used at all levels of the analysis to improve validations of the selected market segments. Use of data in the initial phase of the analysis should help your business canvas the markets and identify the most profitable segments. Once these initial segments are proposed, together with your business experience and knowledge of your business, data can be collected and monitored to help justify your selections. The data provides management with quantifiable assessments of markets and eases their decision process. It also should be emphasized that it is necessary to review current market penetrations on an ongoing basis to identify changing business environments.

All companies intuitively segment to a certain degree, but conducting the delineated segmentation analysis in this article can result in higher profitability. As per the example above, a company identified a profitable niche and decided to extend their program to the adjacent state. Via this analysis, the insurer found that expanding into a third region – not their first choice – provided a better opportunity. Particularly in these changing times, a company can easily miss profitable opportunities without segmentation analysis.

Identify Your Company Strengths-

The marketer would evaluate their business and company strengths by first identifying areas with performance success and then identifying the characteristics that make these areas successful. The marketer can look at functions within the company, such as underwriting, loss control and claims management - or industries, et al. Benchmarking can show that a company's book of funeral homes has fewer slips and falls than the funeral homes industry standard or that a closed-claim that is 3 days shorter than a comparable business.

If a company is unknown to a market, it appears that costly efforts would make it unreasonable to succeed in a new line of business where it's unknown. This analytical process can help the company to identify strengths that would be portable to what seemingly is a non-related business.

Company strengths can also be expertise in a pertinent industry segment. A company known as an auto coverage provider that decides to introduce coverage for high-price dwellings would need to assess costs associated with introducing their services to a marketplace that is unfamiliar with them. These costs can include advertising, new distribution channels, etc. Companies can have specialists on hand with skills that transfer to other industry segments. For example, inspectors for boiler and machinery can help to underwrite some types of manufacturing risks. Companies' sales distribution channels are also an asset not to be undervalued. Do your distributors have excellent people skills and show profitable returns on offering homeowner coverages? Can that be expanded to provide home-based business coverage, or businessowners coverages?

There are many sources of industry standard data that marketers can use to benchmark against, much of it not insurance-specific. Some brokers will provide comparative performance data of your company against their entire book. Many insurance associations may have pertinent information. One that comes to mind is the National Restaurant Association that conducts its own survey of insurance costs. (Note that only participants in the survey can access the information). The Risk and Insurance Management Society (RIMS) conducts a survey of the self-insured market that provides some industry slices.

Define market segments that utilize your strengths

Once you identify your strengths, you need parameters to define the market segments that utilize your strengths. This is a challenge for most of us but ultimately worthwhile. Effort expended to identify your own company strengths pays off when you can identify segments that correlate to those strengths.

Industry can be a critical segment definition as it enables you to compare results across line of insurance. Industry premium and loss information is typically categorized according to risk classification code that is specific to line of insurance. This risk classification-code-based data does not lend itself to easy market analysis. Comparison across individual lines of insurance with their different classifications is difficult and so, it is difficult to identify trends that can be applied to their industries. A prime example is the commercial auto line, which is categorized by weight of vehicle and distance of travel. If you identify a particular truck as very profitable, how can you apply that to other industries when you are not sure which industries use that type of truck?

Other parameters include:

- Demographics like geography play a major role in insurance costs as we are a regulated community and results can differ drastically in different geographies.
- Statistics such as sales or payroll can be helpful to identify risk potential.
- Business parameters such as size of risk can be critical to your analysis highlighting cases where the industry average differs greatly from a particular business-size result.

Validate Segment Selections with Premium Potential and Profitability-

The validation of the selected segments generally starts with non-insurance data as it is more abundant and cheaper. As things get refined, it moves to insurer data which is more scarce and more expensive.

Now that the segments have been identified, the marketer needs to support his/her findings. At this stage, it is important to use insurance specific information for the validation. Few industries have to calculate expenses that are paid over a period of years when determining profitability. Business demographics are valuable up to a point. A proposed market segment may show a large number of potential customers, but this may or may not be correlative to premium potential in the market. The number of establishments shows the number of potential customers. Compare the premium to number of establishments to ascertain the average premium and decide if that is a market segment that fits your business approach. Let us say your distribution channel supports companies with higher premium policies. Then you wouldn't be interested in a segment with a large number of establishments resulting in low average premiums. Make sure to check that the average premium per establishment is reflective of the market segment activity. A few outliers such as a few jumbo companies can skew the data and distort an average for a segment that may still be an option for your company.

It has always been a challenge for insurance marketers to obtain profitability data for analyzing markets. Pricing for policies is based on aggregated insurance information using classification codes.

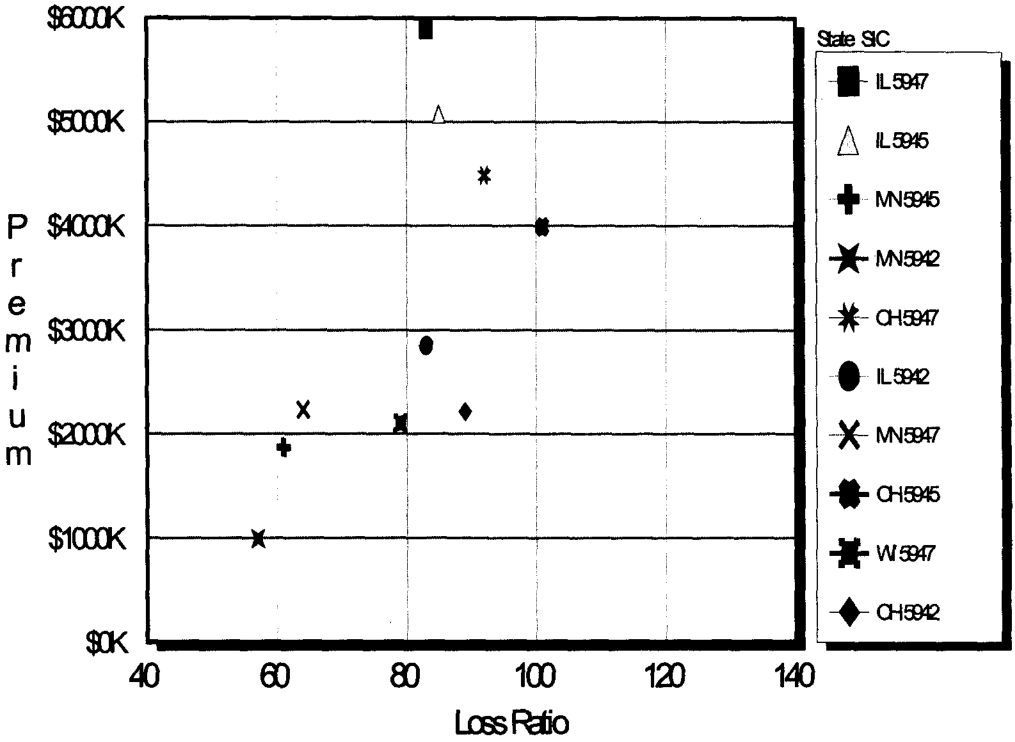
Classification codes reflect insurance risk and since risk characteristics vary by line of insurance, classification codes vary by line. As an example, ISO's classification scheme for General Liability has different class codes for restaurants with or without cooking, and/or with alcohol. The Commercial Fire and Allied line has a single code applying to all restaurants - including bars as well. For analyzing markets, class codes may not provide optimum information to enable comparison across niches. Even after identifying a classification code that provides good results, it would be difficult to apply these results to a particular industry and then apply to other industries. Therefore, it is helpful to be able to study the data by industry segment. To compensate for the lack of actual insurance statistics by industry, models were developed to "translate" insurance data collected by classification code to reflect an industry group.

One product that offers data for industry specific loss ratios by line of business for the three major lines is ISO's Market Profiler derived from modeling. This data can be used for profitability segment analysis.

An example of an analysis that can provide useful information quickly is to compare segment activity based on premium to loss ratio. The below graph compares activity for three 4-digit Standard Industrial Codes or SICs from the 5900 Miscellaneous Retail market segment - book stores (SIC 5942), hobby, toy and game stores (SIC 5945) and gift shops (SIC 5947). These selections are from the central region of the United States - Illinois, Wisconsin, Minnesota and Ohio.

The graph analyzes one year of activity. Other factors play a role in selecting optimum segments for your business, but at a glance, the segments for SIC 5947 in Illinois and again in Illinois for SIC 5845 show large premium opportunity with a comparatively reasonable loss ratio. Also attractive is SIC 5942 in Minnesota showing high profitability but with lower premium potential. The go/no go decision may depend on the ease of access to the Minnesota market.

PREMIUM VS. LOSS RATIO



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Other analyses that can be conducted include evaluating trends – both historical and forecasted. Does the segment show reasonable sustained growth over a period of time or less reliable spiked growth? Forecasted data tells you if a trend is expected to continue. Some forecasters concentrate on industry, some on geography. Especially of interest to insurers when selecting markets would be expected premium growth or contraction.

Trending analysis can be conducted by SIC, by geographic selection, by line of business, etc. The below example shows the trend of the same data selection as above by 3 lines of insurance. (The forecasted years' premiums are based on history, economic and geographic forecast statistics, not price changes). The results are sums representing premiums of the 4 selected states. The example shows healthy growth in the general liability area, with commercial property also showing consistent growth. Annual growth in workers compensation seems to be questionable and bears further investigation.

Trend By Line

Conventional Premium- ($000's)

	1997	1998	1999	2000	2001	2002	2003
Line Of Business	**$PREM**	**$PREM**	**$PREM**	**$PREM**	**$PREM**	**$PREM**	**$PREM**
Workers' Compensation	5,742.88	6,196.22	6,689.67	6,527.55	6,580.21	6,727.10	6,822.86
Annual % increase	7.45%	7.89%	7.96%	-2.42%	0.81%	2.23%	1.42%
General Liability	6,606.47	6,759.85	7,328.01	7,827.93	8,204.38	8,652.13	9,106.23
Annual % increase	11.24%	2.32%	8.40%	6.82%	4.81%	5.46%	5.25%
Commercial Property	13,350.30	14,014.55	14,880.96	15,725.05	16,161.39	16,743.64	17,326.78
Annual % increase	1.96%	4.98%	6.18%	5.67%	2.77%	3.60%	3.48%

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An additional factor playing a role in segment validation is concentration. Do the number of players in the field leave room for additional penetration? Or do you have sufficient added value that you are confident to gain market share even against a major market holder?

These analyses raise "red flags" that warrant further investigation – the marketers should draw conclusions based on multiple data results and business savvy.

Additional considerations when identifying markets

Once the market segment is validated with supporting insurance information, there are additional checklist items.

- The cost to sell to the selected segment. Have you identified Georgia as an expansion state when your distribution is in California? As mentioned above, an insurer identified with personal auto would need to educate the marketplace when entering a new market. Costs to do so should be taken into any profitability measurements.
- As with any insurance decision, regulations should be examined to determine applicability of new program entry.
- New trends should be evaluated to determine the effect on your choices. The data source types listed below for marketing analysis include general news. If you were

conducting the analysis 10 years ago, would Internet companies have even showed up on the radar?

- An easy "sell" to management is cross selling. Can your identified segments or programs utilize the current customer base? The familiar is the most comfortable.

<u>What Data is Available?</u>

The below is a sample list of data sources. More importantly, it shows the types of data available for your analysis.

- Business information – provides demographic information such as location, sales, number of employees. Examples of sources are Dun & Bradstreet and Claritas / ABI. These sources are usually geared to specific company information and can be pricey options for initial market research when looking at industry slices at a high level.
- Insurance Statistics
  - AM Best- excellent source of data representing the aggregate of insurer-reported data on the Annual Statement - Page 15. However, AM Best provides only state totals, not industry specific information. This makes it difficult to use in market analysis.
  - Property & Casualty Statistical Agents – some of the statistical agents that collect information from insurers in accordance with regulatory requirements are the AAIS, ISO, NAII and NCCI[1]. NCCI aggregates workers compensation for about 80% of the states. ISO collects an estimated 70% of the commercial lines markets data (without workers compensation) for 11 lines of property & casualty lines. Other statistical agents may have strengths in one or more specific lines of insurance. The data is typically geared for pricing and actuarial analysis, is collected according to risk classification codes and may be difficult to apply to industry segment analysis.
  - State Insurance Departments- They may provide information on an individual company's rates which would be helpful when assessing new market penetration. The challenge is that each state has different rules on how to access the information. Using anecdotal sources, we're told that some states only enable access using a pen, not copying. Some states do not allow any access. Access differs, is not consistent and may be time consuming.
- Other insurance information includes access to Public Protection Classification used in fire rating, Fireline (brush fire data), and other geographic based information for fire rating and liability. Crime statistics can be valuable in assessing burglary and theft. Auto types according to industry are available as well as other information that is useful when assessing risk.
- Government information – The government offers a wide range of commercial information: the County Business Pattern from the Census; OSHA for lost workdays

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[1] AAIS-American Association Insurance Services, Wheaton, Illinois
ISO- Insurance Services Office, Inc. Jersey City, New Jersey
NAII- National Association of Independent Insurers, Des Plaines, Illinois
NCCI- National Council of Compensation Insurance, Boca Raton, Florida

and other valuable workers compensation information; and the Bureau of Labor Statistics for a wide variety of other information.

- Association information – As mentioned above, RIMS is a source for self-insured information for those marketers targeting very large accounts. The National Restaurant Association is an example of an industry group that collects insurance information.
- Forecasting – Economic forecasting information can be used when assessing future trends. Even if not insurance specific, it can help identify areas of growth. For premium forecasting, ISO's Marketwatch tracks the change in renewal pricing which can be used for a trend analysis.
- News
- Your own data - Your own company data has tremendous value. If the information you need is not available in your current system, check to see if the information is on applications being received by the company but not coded.

Using multiple data sources

Items to question when comparing statistics across multiple data sources include:

- What constitutes a counted business? If a home-based business earns $1,000 a year, is it considered a business?
- How are leased employees handled?
- Is the information comparable i.e. can it be headquarter vs. branch location specific? Does it reflect the entire insurance market including the primary and self-insured portion?

When ready to integrate data across data sources, identify a denominator that applies to both sources. The easiest seems to be industry identification. Currently we use the government defined Standard Industrial Code known as SIC. There are over 900 4-digit SICs or industry slices available. SICs are being replaced by North American Industry Classification System (NAICs). The design of NAICs codes is expected to be easier to apply to insurance applications as it is more process oriented as well as more relevant to our current economy.

Integration across multiple data sources can be on an aggregate level and still provide very useful information. Other denominators for integration can be business size and geography. The Census Bureau - County Business Pattern defined over 10 sizes that are commonly accepted in the industry.

Analyzing with your own company data

Your own company data can become a benchmark tool if you can easily compare segments, however defined. To look at performance by industry, append SIC or NAICS to commercial account records. If you are not capturing this information at policy inception, you can submit your companies with their addresses to a business information provider that matches company by address. This will enable you to obtain SIC or NAICs. Address matching methodology typically identifies over 50% of your book. Business data providers can also offer a wide range of additional data sources. For future analysis, develop a way of appending additional business variables to your account records. Valuable data available include postal data which offers zip code-to-county mapping. And as mentioned above, you may be capturing valuable data already such as length in business, etc.

Provide High Quality prospects

Now that the analysis is done and findings have been validated, you would want to access the potential customers in the identified segments. To ensure that only leads that conform to your segment analysis are selected, focus on those customer characteristics that were identified. Some of the data available through lead generators that enable you to further hone in on your target market include:

- Business contact information
- Premium estimates by line
- Geographic areas (metropolitan statistical area, zip code, county options)
- Business size (# of employees, sales)
- Type of corporation
- Additional data sources for specialty programs
- Computer and telecommunications infrastructure
- Expiration dates
- Credit information

Conclusion

As lead time for successful returns from a new program or market decreases and more stress is placed on pre-qualifying new market choices, the benefit of accessing accurate data and insurance industry data about market segments is increasingly important. A marketer can utilize the data most effectively by following a plan that includes defining and analyzing the needs and strengths of the company, and then identifying additional market segments that would most benefit from those strengths.