STRATEGIC ANALYSIS OF A SEGMENT OF THE CANADIAN OPERATION OF A LARGE MULTINATIONAL CORPORATION

by

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ABSTRACT

Marsh is the largest insurance broker in the world. It has been very successful in the risk management business, to a point where the company has between sixty and seventy percent of the market share across the country. To maintain its success and increase revenues, the organization is shifting focus to the insurance and benefits services segment. This segment of the industry is fragmented, and no single organization has significant market share. Marsh needs to find ways to increase the insurance and benefits services segment of the business to obtain a dominant position in this market.

The insurance industry has been in a hard market for three years and is currently starting to soften. Marsh is at a critical stage, as the global organization relies heavily on the company to generate significant growth. The softening of the insurance market will serve to reduce overall income levels to Marsh, making year over year growth targets more difficult to achieve. This paper focuses on the insurance and benefits segment of Marsh Canada Limited and analyzes ways the company can continue to grow the revenue base of the business to meet the mandated global goals of the parent company, Marsh & McLennan Group of Companies.

This paper begins by analyzing the insurance brokerage industry. An internal analysis and evaluation of four strategic alternatives to increase the insurance and benefits segment of the business follows. The alternatives reviewed include: creating a new separate company specifically for insurance and benefits services, acquiring a competitor, hiring staff, and finally maintaining the status quo. In conclusion, recommendations are outlined indicating the best strategy for Marsh to achieve sustained growth well into the future.
DEDICATION

This paper is dedicated to my wife Anita, whose love and support throughout the two year program has been integral to my successful completion. Thank you Anita for picking up the slack around the house over the last two years, and basically raising our two daughters Jayna and Lindsay with little additional help.

Thanks must also be given to both my family and my wife’s family for their additional help and support during this two-year time intensive program.
ACKNOWLEDGMENTS

I would like to thank my colleagues at Marsh, and there are too many of them to list, who provided help, advice, information and support while I completed both this paper and the program.

I would also like to thank Dr. Neil Abramson, for providing me with guidance and assistance throughout the project. Neil, thanks for keeping me on track, providing valuable insight and guidance through the paper. Your assistance and dedication to my project helped me to explore many alternatives and recommendations that will hopefully be implemented one day at Marsh.
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1 OVERVIEW

Marsh & McLennan is a large publicly traded global organization in the mature insurance industry with an aggressive growth strategy. As such, the global mandate is to grow both revenues and profits throughout the organization. Marsh Canada Limited is a small part (representing less than 2% of global revenue of the parent company) of the overall global organization, but must aggressively grow to meet or exceed the goals and objectives of the global company. Marsh Canada needs to grow all segments of its business, however, the focus is specifically on Insurance and Benefits Services (IBS), as this represents the greatest growth potential for the firm. The focus of this paper is on the IBS segment of Marsh Canada Limited and how to continue to grow the revenue base of the business to meet the mandated global goals.

1.1 Marsh & McLennan Companies

Marsh & McLennan Companies, Inc. (MMC) is a large publicly traded Fortune 500 company operating in over 100 countries around the globe. MMC is the parent company of Marsh Inc., Putnam, Mercer, and MMC Capital. It is traded on the New York, Chicago, Pacific, and London stock exchanges. Figure 1 is an Organizational Chart, showing the various related Companies that make up the MMC Group of Companies.

MMC Organization Chart

![MMC Organization Chart](image)

*Figure 1: Marsh & McLennan Companies Inc. Organizational Chart*
Marsh has been given a mandate to grow overall revenue on a global basis by fifteen percent, as it makes up the largest portion of MMC’s revenue and profits. There are two ways this can be done; by attracting new clients, or selling additional services and products to existing clients. MMC wants to try to prove itself as a growth company and distance itself from the traditional fluctuations of both revenue and profit in the insurance industry and its business cycle. The pressure will be squarely on Marsh globally to grow aggressively as the insurance market continues to change. Figure 2 shows a graphic representation of both revenue and operating income that is generated by Marsh and its sister companies, Mercer and Putnam, for the global organization in the fiscal year ended in December 31, 2003.

Figure 2: Revenue and Operating Income for MMC by operating Company

Figure 2 shows the importance of Marsh on a global perspective for the MMC organization. Marsh generates fifty nine percent of the revenue on a global basis, while the contribution to operating income is sixty seven percent. The financial results of Marsh will dictate the majority of the success, or lack thereof, for MMC as a whole in the coming years. The reason for this is Putnam continues to struggle with decreasing revenue and operating income resulting from the regulatory issues that arose in late 2003, and the resulting redemptions of assets under management from their client base. Putnam’s contribution to overall revenue and operating income will likely continue to decline for the remainder of this fiscal year. Mercer is anticipated to have modest growth, over the next few years.
Over the years Marsh has globally enjoyed a successful record of both revenue and profit. In the last five years revenue had compound annual growth of eleven percent, while operating income had five year compound annual growth of twenty one percent. Although this looks very strong, these percentages have been dropping over the last two years, which must have senior management very worried. Table 1 shows the compound annual growth of both revenue and operating income over the preceding five-year period for the years 2000 to 2003. The decreasing revenue growth rate obviously has senior management very concerned, and is the reason why Marsh is aggressively trying to grow revenue.

<table>
<thead>
<tr>
<th></th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Revenue</strong></td>
<td>19%</td>
<td>22%</td>
<td>15%</td>
<td>11%</td>
</tr>
<tr>
<td><strong>Operating Income</strong></td>
<td>19%</td>
<td>26%</td>
<td>25%</td>
<td>21%</td>
</tr>
</tbody>
</table>

*Table 1: Compound Annual Growth rate over previous 5 years*

### 1.2 Marsh Canada Limited

Marsh Canada Limited (Marsh) is a wholly owned subsidiary of Marsh Inc. It has more than 1,200 employees in thirteen Cities across the country with offices in eight of the ten provinces. The company is a professional services providing risk and insurance solutions (products and services) to clients in a large variety of industries including; for profit, non-profit and government operations. Marsh is an insurance broker, sourcing insurance policies and programs from insurance companies around the globe. Insurance broking services are provided to companies ranging in size from individuals, to large multi national organizations, with staff, assets, and operations around the globe.

The company provides insurance broking services, financial solutions, global risk consulting, and management of insurance programs for its client base. The industry is broken down into 22 specialized sectors. See Table 2 for a listing of the various sectors.

Marsh has broken its operating segments into two distinct parts, Risk Management (RM) and Insurance & Benefits Services (IBS). RM clients generally have revenues in excess of $250,000,000, and usually have a risk manager on staff. A risk manager is an individual employed by a company to be the internal expert on managing controlling, and understanding the
complexities of risk the organization faces. IBS clients are smaller than the client base previously mentioned, do not have a risk manager employed and include everything from multinational organizations, to individuals.

<table>
<thead>
<tr>
<th>Automotive</th>
<th>Insurance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aviation &amp; Aerospace</td>
<td>Marine &amp; Energy</td>
</tr>
<tr>
<td>Chemical &amp; Life Sciences</td>
<td>Media &amp; Entertainment</td>
</tr>
<tr>
<td>Construction</td>
<td>Mining</td>
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<tr>
<td>Environmental</td>
<td>Power &amp; Utilities</td>
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<td>Financial &amp; Professional</td>
<td>Public Entities</td>
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<tr>
<td>Forest Products</td>
<td>Real Estate</td>
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<td>Gaming</td>
<td>Retail</td>
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<td>Healthcare</td>
<td>Sports</td>
</tr>
<tr>
<td>Higher Education</td>
<td>Technology &amp; Telecom</td>
</tr>
<tr>
<td>Hospitality</td>
<td>Transportation</td>
</tr>
</tbody>
</table>

Table 2: Specialized Industry Groups within Marsh

1.3 Insurance & Benefits Services

Marsh has aggressively focused its efforts to grow the IBS business as this market segment has the greatest potential for continued growth and increased market share for many years to come. The company has a relatively small market share in this segment estimated to be less than ten percent of the overall market. No single broker has more than a ten percent market share of this class of business. Marsh is very well positioned to take a leading portion of the IBS market, which will help to achieve growth targets for several years to come. Although this analysis focuses on growth of the IBS unit for Marsh Canada, it should be noted that within this business segment there are two distinct parts. These smaller segments consist of middle market (MM), and small enterprise sector (SE). The overall emphasis will be on the middle market business.
1.3.1 Middle Market Business

Middle market clients are typically clients that pay Marsh in excess of $20,000 revenue on an annual basis but have sales of less than $250,000,000. Revenue is simply income to Marsh, while the clients insurance premiums for the year will likely be in excess of $100,000 per annum, most of which is remitted to the insurance companies providing the insurance coverage. The MM client base will often need customized solutions to their insurance needs, and can have international sales, operations, and assets.

1.3.2 Small Enterprise Sector

Small enterprise sector covers any clients that pay Marsh less than $20,000 in income per year. This can be anything from small companies, to individuals insuring their home or automobile. The goal when conducting this type of business is to provide a customized package solution to a larger group of clients. This gives Marsh both a competitive advantage and utilizes the benefits and efficiencies of economies of scale. It also allows Marsh to generate higher margins, while the client enjoys better coverage at reduced cost.

1.4 Insurance Industry

The property and casualty (P&C) industry in Canada is very large, with sales in excess of $27.5 Billion and controlled assets of $77.6 Billion in 2002. These assets are made up of government bonds, preferred stocks and common stocks. More than 200 P&C insurance companies were actively competing in Canada in 2002, ranging from provincial companies, to large international companies. The industry is very competitive with both Canadian insurance companies, and foreign insurance companies actively writing business. Brokers must be careful to ensure the financial strength and viability of an insurance company prior to placing business with them. It is not uncommon for claim payments to exceed the premiums collected on an annual basis for insurance companies. Insurance coverage with an insolvent company would not

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1 Insurance Bureau of Canada Website – General Insurance Industry Statistics: www.ibc.ca
be very helpful in the event of a claim, and would put a large strain on any client / broker relationship. Marsh Inc. has a dedicated team of analysts who monitor the financial strength of insurance companies around the globe to ensure they meet minimum financial guidelines.

1.5 Product Offerings

Marsh offers clients a broad range of services and products to meet their various risk needs. These products are generally P&C insurance coverage, and are provided from a wide variety of sources (insurance companies) ranging from individual auto coverage through to complex global layered placements. The following is a sample of some risks a client may face where Marsh might provide coverage:

1. Property insurance: assets (buildings and equipment) located locally or abroad (Fire, Flood and Earthquake).
2. Liability insurance: goods or services sold to others, and the risk that the product might cause damages to a third party.
3. Auto insurance: risks associated with the operation of a vehicle, including collision, theft, and liability.
4. Directors and officers coverage: coverage to protect directors and officers of a company against lawsuits.
5. Aviation Insurance: coverage for both owned and non owned aircraft.
6. Errors & omissions: coverage purchased by professional service firms for errors in its product. e.g. architects & engineers.
7. Employee coverage: health, workers compensation, life, disability etc.
8. Business interruption: coverage to compensate for the loss of operations at one of the locations.
9. Environmental coverage: risk of pollution or contamination from operations, or your product while under companies care custody and control.
10. Credit insurance: risk your customers will not pay for goods shipped.
11. Political risk coverage: risks companies face while operating in foreign jurisdictions whose governments may be unstable.
12. Cargo insurance: risk of loss or damage to product while in transit.
1.6 Industry Overview

The insurance brokerage market can be broken down into a few key or distinct parts, as follows:

- **Client**: An individual or company who faces some form of risk, and is looking to transfer some portion to a third party.

- **Insurance Broker**: A company such as Marsh or its various competitors who through the network of contacts locally, nationally, or internationally will source a solution to many risks faced by individuals or corporations.

- **Insurance Companies**: These companies accept the risk, or portions of it, in exchange for a premium based on the risk, exposure, and time frame. Some insurance companies have tried to bypass the broker in this transaction process by becoming direct writers (e.g. Canadian Direct Insurance which was owned by HSBC Bank, and recently sold to Canadian Western Bank).

- **Reinsurance Companies**: These companies take risks in excess of predetermined levels from insurance companies. It is a form of insurance that insurance companies purchase. Many insurance companies have reinsurance companies within their corporate umbrella.

1.6.1 Product Offerings

Insurance brokers offer a wide variety of insurance products to their customers depending on their needs, requirements, and desire to mitigate risk. Generally speaking, larger clients will need more insurance products because their risks and exposures are much greater than a small organization. The type of business and location of operations can also greatly influence the insurance purchases. Insurance coverage purchased by a client is traditionally called P&C insurance. A company may only need a few lines of coverage, or several, depending on their operations and assets. A few common lines of coverage will include a property policy, general liability policy, and automobile coverage. Depending on jurisdiction, workers compensation may be purchased through a state run monopoly such as the Workers
Compensation Board in BC, or through insurance companies, which is how it works in most states in the US.

### 1.6.2 Differences in Products Offered

The products offered by the various insurance brokers are generally homogenous. A customer could buy a liability policy from Marsh or any of its competitors, and receive virtually the same policy from a number of different insurers for a similar price. Larger brokers with more sophistication will use their size and expertise to obtain revised or customized policy wordings with broader coverage, referred to as a manuscript wording. For the uneducated consumer this will mean virtually nothing, as far as they are concerned, they are buying an insurance policy. The real value of the revised or broader policy wordings comes into play when there is a claim.

Broader policy wordings might respond to pay a claim when a regular off the shelf policy may not pay the claim. Manuscript wordings can offer more coverage, better coverage, and occasionally a more vague wording, which favours the insured. This will benefit the insured in the event of a claim.

### 1.7 Revenue Sources for Marsh

There are various ways Marsh earns revenue from its clients. This can be either on a traditional commission for the coverage provided, which can range up to 30 percent, or a fee for services, or a combination of both. Marsh is open and up front with its clients about compensation, and for some clients a detailed accounting of this is provided.

The majority of IBS transactions would fall within a commission based structure, with the majority of the commissions being in the 15 to 20 percent range for typical insurance policies. Generally for larger clients a client service agreement is prepared which outlines in great detail how Marsh’s compensation is arrived at. This will also specify the services Marsh provides and the scope of the commitments and obligations.

The other way Marsh earns additional revenue is with Market Service Agreements (MSA), sometimes referred to as contingent commissions. This is an additional commission paid
to the broker from various insurance companies. These additional incentives are based on volume, growth, and profitability of the business placed with the specific insurer.

1.8 Current Strategy

Currently the strategy being implemented across North America to grow the IBS segment of the business is to use the following approach. 1.) Target marketing 2.) Industry specialization and 3.) Employing risk practices and risk consulting services.

1.8.1 Target Marketing

A target marketing approach is currently being utilized in the company by placing ads in specific trade publications for various industry groups. An example of this is placing ads in forestry publications, to make companies aware of Marsh and the company’s focus on their specific industry group. The goal is to create awareness in specific industry segments, and to highlight it as an area of expertise for Marsh.

1.8.2 Industry Specialization

Industry specialization involves assigning various employees to work in a specific industry group. For example, a client manager may be assigned to the forestry group and handle primarily forestry accounts. This will allow for increased specialization and in depth knowledge of a particular industry sector and the specific risks and solutions associated with it. By having individuals look after clients in a similar industry group it will provide better opportunities to create customized industry specific solutions, better benchmarking information and knowledge about what the industry seems to be doing to protect against risk. Specialization is a very effective approach to a manage a class of business because it shows a commitment to the industry, and will often lead to referrals from clients or though connections made through involvement in industry associations and networking. Also, with specialization comes the opportunity of generating increased revenue opportunities by offering specializes risk solutions.
1.8.3 Risk Practice

The effective use of both the risk practice and risk consulting group (to be discussed in more detail in the value chain analysis) within Marsh can provide additional revenue opportunities to the company. These areas focus on specific issues, and ways of managing risk for clients. By using these resources with a client, they will see the value a firm like Marsh brings to the table. These services provide added expertise, foster trusted business relationships, and often create opportunities to sell additional products and services.

The risk practice is a great differentiator when dealing with both clients and prospects. The group provides specialized help in unique areas, and offers customized solutions through various risk transfer mechanisms. The overall goal is to provide differentiation and innovation, to both win and retain clients, while providing better services at lower costs.

1.9 Methods to achieve the Growth targets

Marsh is currently using several methods to achieve the growth targets through internal or organic growth, by developing resources and ways of doing business targeted at specific client groups. The company is also targeting specific industries, which have high spending on risk, including: construction, financial institutions, life sciences, and transportation. There are various methods being implemented to assist employees in this process.

1.9.1 Innovation

The company is allocating resources into product research and development. The current implementation strategy is to bring the specialization and approach used in the risk management process and adapt it to fit the IBS clients. (Both small and mid-market clients.)

1.9.2 Service

Through the use of both software, policies, and procedures, Marsh has developed a model to provide optimal service levels to clients. This service model, outlines the various times
during a policy renewal cycle that processes and procedures should be followed to ensure a smooth and fully informed renewal process. This will be discussed in more detail in the value chain analysis.

1.10 Scope of Strategic Analysis

This paper analyzes Marsh Canada’s prospects for growing the IBS book of business to meet the growth targets established by the parent company MMC. The goal is to maintain and enhance Marsh’s place as the largest insurance brokerage in the world. The paper will outline a few strategic alternatives to achieve the stated growth target (fifteen percent) for the IBS segment of the business.

The analysis will cover the following topics related to the Insurance Industry, Marsh Canada and more specifically the IBS Segment of the business:

- Chapter 2: An analysis of the industry, including Porters five forces analysis
- Chapter 3: Marsh value chain
- Chapter 4: Strategic alternatives based on industry analysis
- Chapter 5: Internal analysis of Marsh Canada, and the feasibility of the proposed strategic alternatives
- Chapter 6: Conclusions and Recommendations
2 INDUSTRY OVERVIEW

2.1 Industry Size

The global risk and insurance services industry is extremely large, estimated at $2.7 trillion dollars (2002). The P&C market in Canada is roughly one percent of the worldwide insurance market, with premiums for 2002 being $27.5 billion. An important point to remember regarding the insurance industry and data collected, is many placements are global in nature, with insurance being placed through insurance companies located anywhere in the world, for example in the US, London, or offshore tax havens such as Bermuda.

2.1.1 Industry Growth Rate

The insurance industry is a mature industry, growing over time, but at a very steady, slow pace. Figure 3 shows the premiums for P&C Insurance in Canada over a nineteen year period, showing slow, steady growth, with a spike in 2002 and 2003 because of large insurance losses such as September 11, Enron, and WorldComm etcetera that plagued the global insurance industry.

![Graph showing premiums and claims for P&C Market in Canada from 1985 to 2003](image)

*Figure 3: Net Insurance Premiums & Claims in Canada from 1985 to 2003*
A simple regression analysis of the net insurance premiums shown in Figure 3, indicates that there will be a decrease in premiums in fiscal 2004. The regression shows approximately a fourteen percent decline in fiscal 2004. This is followed by growth of about three percent for the next ten years. The regression data gives an indication of what can be expected, looking strictly at historical data, but it does not take into account new and emerging trends in the economy, business cycle, stock market return and general business insurance purchasing decisions. Both the regression analysis and emerging industry changes indicate that the rapid growth over the last couple years has come to an end.

There are very few opportunities to sell policies to organizations that do not already have some form of insurance coverage in place. New business and growth will come at the expense of another broker by taking their customers, or selling additional coverage and services to the existing client base. This will provide a broader range of products and services to a client throughout the year, through expanded business opportunities. There is also the possibility to generate growth through consulting services, and general cross-selling of products both internally and through Marsh’s sister companies.

2.1.2 Target Market in Canada

The P&C Market in Canada can be broken down into many segments (or types of coverage), the largest being personal insurance products such as auto and personal property coverage. This makes up the largest share of insurance premiums in Canada. Location is the most important success factor when a purchasing decision is being made. People are more likely to buy their automobile insurance through a broker near their home, because in BC they will pay the same price everywhere since ICBC is a provincially run monopoly. People will be willing to purchase their personal house insurance coverage through agents they trust and feel comfortable with.

It is very difficult to get data on the industry segments as a whole since every company has its own definition of the relative size and scope of the individual segments. To be consistent the Marsh definitions are being used to break down industry data into the various segments. It is generally believed that the industry can be broken down into three categories, RM, MM, and SE. As previously mentioned, Marsh has combined the two smaller segments into one group, called
IBS, to focus on growth. It is estimated that the MM is two times as large as the RM market, and the SE market is two times the size of the mid market. Given these rough parameters, the Canadian P&C market breaks down into the size categories illustrated in Table 3.

<table>
<thead>
<tr>
<th>Segment</th>
<th>Premium ($ Billion)</th>
<th>% of overall Market</th>
</tr>
</thead>
<tbody>
<tr>
<td>Risk Management</td>
<td>$3.930</td>
<td>14.3%</td>
</tr>
<tr>
<td>IBS: Mid Market</td>
<td>$7.859</td>
<td>28.6%</td>
</tr>
<tr>
<td>IBS: Small Enterprise</td>
<td>$15.718</td>
<td>57.1%</td>
</tr>
<tr>
<td>Total</td>
<td>$27.507</td>
<td>100%</td>
</tr>
</tbody>
</table>

*Table 3: Breakdown of Net Premiums into Business Segment*

### 2.1.3 Breakdown of Canadian Market by Type of Coverage

IBS SE is by far the largest segment of business in Canada, representing approximately fifty seven percent of the overall market. This presents a significant target for a growth opportunity, however location is the most important factor with the majority of this business, and Marsh is only located in major centres across the country. Additionally the high fixed cost structure and overhead of Marsh would make aggressive pursuit of most of this business unprofitable.

The IBS target market for Canada is generally the P&C market which has roughly $7.5 billion in premiums in 2002, or seventeen and a half percent of the overall market (see Figure 4). Marsh has the capability to provide auto and personal property, but generally does this through programs wherever possible to offer a better or less expensive product. If the company has supporting P&C business, for a client, often Marsh’s goal is to handle all aspects of a client’s insurance.

Figure 4, shows the breakdown of P&C Premiums in Canada by line of insurance coverage:
2.2 Scope of Industry

As the insurance broking industry is very closely related and intertwined with the insurance industry, one cannot analyze the broking industry without including aspects of the insurance industry. The broker force must sell the products offered by the various insurance companies and work with insurers to create new products, or enhance existing products. The scope of this analysis is the broking portion of IBS, which makes up 85 percent of the Canadian P&C market. (Excluding RM business)

The industry has been following a traditional business cycle for many years, with both peaks and valleys. During the few peaks the industry is characterized by high insurance premiums, which last for about a year and a half, then subside. Currently the market is in the early stages of softening, coming off a three-year peak called a hard market.
2.2.1 Current Hard Market

A hard market is characterized by high (often increasing) prices. The current hard market has been evolving since early 2001, and has lasted far longer than any hard market in recent history. The market is now starting to soften on certain lines of coverage, but the majority of coverage alternatives are either flat or seeing small increases. The insurance industry follows a typical business cycle like all industries, and will generally run opposite to the returns generated in the stock markets, with a lag of several months. The exception to this rule is when large claims are paid out for catastrophic events. In general, when the stock markets are performing poorly, and in a bear market, the insurance industry will typically be in a hard market. This is because the returns made from investments are not enough to cover underwriting losses, and provide an acceptable return to investors.

The opposite of a hard market is a soft market, which means the stock market is creating large returns for insurance companies through their investments. In a soft market the premiums charged, are typically lower, and the industry has more capacity for risk. Basically the companies are competing for premium dollars, so they can be invested in the stock markets. Insurers are doing this with the expectation that claims will occur with enough of a time lag to allow the premiums to earn a reasonable return in the markets.

There are many reasons and explanations for the hard market but to cover this topic in detail could be a paper of its own. Suffice to say that the key parts are cumulative losses and stock market returns. Over the last few years the industry has averaged an industry loss ratio of greater than 100 percent (see Table 4). The loss ratio is calculated by taking the total claims and expenses and dividing by net premiums earned. (anything under 100 percent is profitable underwriting).

<table>
<thead>
<tr>
<th>Year</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>Combined Ratio</td>
<td>105.9%</td>
<td>108.7%</td>
<td>111.0%</td>
<td>105.8%</td>
<td>101.4% *</td>
<td>100.3% *</td>
</tr>
</tbody>
</table>

Table 4: Loss ratio for 1999 to 2002 with estimates for 2003 & 2004

* 2003 and 2004 figure is an estimate

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The ongoing threat of terrorist activities and corporate malfeasance will have a continuing impact on the insurance rates in the future. Finally the fact that several reinsurance companies have exited the business and the remaining ones are requiring greater returns on their risk, will also put pressure on rates for specific lines of coverage.

In a hard market, the price for insurance coverage increases, which means the broker compensation will also increase as most remuneration to a broker is a percentage of the overall cost. In the hard market over the last couple of years, insurers have forced brokers to accept lower commissions when providing insurance quotes. This will occasionally mean the difference is revenue neutral, however, it is usually a great deal more work in this type of market to source and place the required coverage level for a client. In a hard market coverage that was once written by one insurer in the past, needs to have 3 or more insurers each taking a portion of the risk, and they must all agree on the price, and policy wording, which can be difficult.

Figure 5 shows the Underwriting Gain (Losses) for the insurance industry in Canada in millions of dollars, between 1985 and 2002. The Canadian industry has posted underwriting losses since 1978. These losses have been offset by gains earned from investment income through the stock markets.

Figure 5: Underwriting Losses in Canada from 1985 to 2002 ($Millions)
The underwriting results of the insurance industry are not completely indicative of overall results. When you factor in the profits made from investment income, the situation is not nearly as bleak. Table 5 shows underwriting revenues, claims, underwriting losses, gains from investment income, and profitability of the Canadian Insurance industry over the last seven years. The difference between the premiums less claims, and the underwriting loss is the overhead and administrative costs of running the business. The last few years have seen a dramatic decrease in the average return on equity for the Canadian Industry as a whole. The last two years have seen a dramatic decline, in fact 2002 was the worst year in history for insurance companies in Canada with a return on equity of only 1.7 percent.4

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Premium ($000,000)</td>
<td>$18,570</td>
<td>$18,608</td>
<td>$18,559</td>
<td>$18,728</td>
<td>$20,178</td>
<td>$21,242</td>
<td>$27,507</td>
</tr>
<tr>
<td>Claims</td>
<td>-13,210</td>
<td>-13,190</td>
<td>-13,768</td>
<td>-13,483</td>
<td>-14,790</td>
<td>-16,161</td>
<td>19,494</td>
</tr>
<tr>
<td>U/W Loss</td>
<td>-517</td>
<td>-421</td>
<td>-1,366</td>
<td>-1,027</td>
<td>-1,614</td>
<td>-2,155</td>
<td>-1,390</td>
</tr>
<tr>
<td>Investment Income</td>
<td>3,111</td>
<td>3,324</td>
<td>2,864</td>
<td>2,543</td>
<td>3,251</td>
<td>2,762</td>
<td>2,248</td>
</tr>
<tr>
<td>Profit</td>
<td>$2,594</td>
<td>$2,903</td>
<td>$1,498</td>
<td>$1,516</td>
<td>$1,637</td>
<td>$607</td>
<td>$858</td>
</tr>
<tr>
<td>Return on Equity</td>
<td>13.6%</td>
<td>13.1%</td>
<td>6.8%</td>
<td>6.5%</td>
<td>6.3%</td>
<td>2.6%</td>
<td>1.7%</td>
</tr>
</tbody>
</table>

*Table 5: Profitability of Canadian Insurance Industry over the last several years ($000,000)*

2.3 Five Forces Model of the Insurance Broking Industry

The following section analyzes the IBS segment of the insurance market in Canada using Porter’s five forces model, by assessing the overall power various participants of the industry have in their portion of the business transaction. This model analyzes the strengths of customers, suppliers, new entrants, substitutes, and rivalry amongst firms.

2.3.1 Bargaining Power of Customers

Customers are individuals and companies purchasing P&C insurance products. This can range from automobile insurance through to a complicated global placement of an assortment of various insurance coverage, and risk transfer vehicles. Customers can vary in their sophistication levels, and general knowledge and understanding of the insurance business. Many clients will allocate limited resources, and time to insurance transactions, and will view the purchase decision as a necessary evil, where the lowest price is the most important factor. This type of

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client will not recognize the benefit of a broker having the ability to modify, or enhance (if possible) an off-the-shelf insurance policy for their benefit. The IBS segment of the business will have customers who treat insurance purchases as a commodity based transaction through to clients who are willing to spend significant resources to understand, analyze, and appreciate the various risk transfer mechanisms available to suit their business needs. Currently customers posses moderate to low bargaining power because of the current hard market, and because they are required to buy some insurance coverage. One catastrophic loss could wipe out a whole company, which necessitates the purchase of some insurance products.

2.3.1.1 Customer Concentration

The customer base varies in size from individuals to large organizations with no large dominant customer. There is virtually no concentration in the market. Almost all companies purchase insurance, unlike other industries where a particular company might only have three or four very large customers who control the industry. (e.g. Coke and Pepsi dominate the Nutrasweet industry, if they switch to a different alternative sweetener, the industry would see sales drop substantially)

Customers are not able to band together easily to obtain economies of scale with their insurance purchasing decisions. This is because the industry is very fragmented, and clients are competitive, and would be unwilling to share detailed company information with others for fear of giving up a competitive advantage. Generally risks are unique to a given business and situation, where each must be analyzed independently for an overall risk and premium rating.

Larger IBS clients will have some minor strengths on their side, as they buy larger volumes of insurance products, and Insurers may want to attract larger portions of a client’s overall insurance coverage. This might mean other lines of coverage that the company offers, or knowing that they will purchase additional coverage during the year because of their operations or type of business the client is involved in. (e.g. a property developer with real estate holdings will likely continue to add additional properties, or build additional properties.) In the current hard market this would not be a common characteristic.
2.3.1.2 Capacity

Larger IBS customers utilize a wide variety of insurance products, with varying limits of coverage. In the current hard market, insurers are not willing to offer the same levels of insurance they once did. This in effect reduces the clients options for purchasing the required / desired coverage levels for their business. It can be difficult to place excess layers of coverage, even if the clients wants it, and is willing to pay a premium. Several years ago, many insurance companies would fight aggressively for large pieces of business. Now we are asking many to take a small part of the overall risk, as few are willing to step up and take a large share.

For the smaller IBS clients, switching costs are virtually nothing. People will renew their personal property coverage (house / car) where it is convenient. With provincially regulated auto insurance, customers know that they will pay the same price for the same coverage anywhere so convenience becomes critical.

2.3.1.3 Product Knowledge

Generally speaking, IBS clients have virtually no product knowledge. They view insurance purchases as a requirement, usually because their banks, customers, suppliers, and shareholders require insurance coverage in place to protect against the possibility of large losses. Many IBS clients will have operations outside of the particular Province where they are based. When insurance is placed for operations in different provinces, or internationally there can be detailed tax implications or product specific knowledge required. Clients with this type of business operation, have to be careful in selecting their broker, because only the larger sophisticated brokers will have access to and knowledge of these markets. Few brokers have the size, and global reach to assist clients in these transactions. If a client has international operations, they need to deal with a large broker with expertise, market knowledge and ability to place coverage in the jurisdictions. If a regional broker is used, the broker will need to have adequate connections and resources to place the coverage with an affiliated company.
2.3.1.4 Alternatives

Customers do have alternatives to dealing with a broker in their insurance transactions. They can choose to deal directly with the insurance company. There are a very limited number of companies willing to do this, and the lines of coverage offered in this manner are usually restricted to auto insurance and house insurance. Their target market is the personal lines insurance, which falls under the small enterprise section of IBS. Personal lines insurance products, where an individual goes into an office to buy their house insurance is not an area Marsh is focusing on, as location is critical to this business.

Clients can also choose to self-insure some or all of their risks. This can be limited by bank debt covenants and stakeholder requirements which often require certain insurance coverage be purchased. If enough companies decide to do this it will have an adverse impact on the insurance industry. Some IBS customers are currently doing this by choice as insurance costs go up, while others are being forced to because coverage is simply not available or is prohibitively expensive. When customers decide to self insure parts of their property, it is unlikely that they will start to insure them again in the future, unless the coverage is very inexpensive especially if they did not suffer any loss. A client will see little value in the insurance product, and consider a loss as a business risk.

2.3.1.4.1 Captives

A client can create a captive, essentially becoming their own insurance company. This is a form of self-insurance where customers can potentially generate profits if claims are low, and clients can also benefit from tax advantages through the use of captives. There are significant risks associated with this insurance alternative, because the captive will be paying claims, and if it happens to be a bad year, claim payments could adversely impact the financial strength of the Company.

A captive is a vehicle used primarily by large sophisticated clients. They need to understand the insurance business, and the risks / benefits associated with this insurance vehicle. Captives can be formed anywhere, some are domiciled in local provinces such as British Columbia, while other locate their captive offshore in exotic tax havens such as Bermuda. It is
also important to note that there can be large frictional costs associated with establishing and running a captive, which make this vehicle less attractive to most IBS clients.

Captives can also be formed with a group of companies, each participating in the losses of the group. They are generally difficult to operate in the long run because often joint and several liabilities can exist. If one participant has a particularly bad loss record, all members will pay for it, and there is not a big incentive for a good risk management program to prevent losses. If clients choose to insure some of their risks through this vehicle, a broker does not lose all the revenue, because a broker is usually hired to help administer and run the captive. Captives will usually purchase insurance coverage for very large losses. For example, the captive may cover the first $1,000,000 of every loss, and additional insurance is purchased for the excess amount.

2.3.1.5 Unbundling of Services

Clients with multiple lines of coverage, will occasionally use the services of two or more brokers to each handle their insurance transactions. This can be common for larger companies in more remote locations with fleets of vehicles, where they keep their auto insurance with a local company and have the rest of their coverage with a larger broker who can handle the more complicated risk placement. Some IBS customers will choose to have two brokers each handle a predetermined portion of the insurance program. This gives the client significant control, as each broker knows they could lose all or a portion of the client’s business if they do not do a good job. The use of two brokers keeps them battling to get the best prices and terms of coverage for the client, for fear of losing the business. On the other side of the equation, this can be a risky scenario for the client as gaps in coverage could occur as one broker is not looking after their complete insurance program.

2.3.1.6 Opportunities and Threats for Marsh relating to Customer Power

Marsh has both opportunities and threats related to customer power. The opportunities are; global reach to place insurance coverage around the world, and the ability and resources to find coverage for very specialized types of risk. Through market connections, and affiliated companies, Marsh is able to source additional capacity, and assist in arranging facultative insurance through a related company called Guy Carpenter. Most of these benefits are for larger
IBS clients, however smaller clients will benefit from the overall product specialization and knowledge. Because product knowledge is critical in the Marsh structure it is important that the company maintain its strong commitment to education.

Key threats that Marsh must be aware of are the low switching costs. A customer can switch easily from one broker to another, and if the account manager leaves Marsh to work for a competitor, they will often possess significant amounts of knowledge making it very easy for the client to switch to a competitor. Although large accounts have senior client contacts (the client managers boss, or office head), the majority of IBS clients do not. The company should arrange alternate or back up client managers who know and understand the client and their insurance program. It would also be beneficial to have senior contacts made available for all clients even if it is just providing a contact name.

2.3.2 Bargaining power of Suppliers (Insurance Companies)

For an insurance broker, suppliers are insurance companies who provide the risk transfer options for the clients. Suppliers in the current hard market have a very strong position, in their ability to influence the insurance market. Insurance companies can be small regionally based companies, national companies with or without a local presence, or global companies with or without a Canadian office. Insurance for a client can be sourced from anywhere. If the coverage is placed abroad, there could be tax implications for the client, and possibly the broker and/or the insurer. Although there are more than 200 insurers in Canada, approximately seventy-four percent of the business is written by the twenty largest property and casualty companies. When you consider that not all insurance companies will write all lines of coverage, this serves to further reduce the available options to place a client’s coverage needs. In general more insurance options are better, as the supply of capacity, and overall appetite is greater, which will help to reduce costs, and hopefully provide better coverage terms.

2.3.2.1 Additional suppliers

Other suppliers that can come into play to a lesser extent are re-insurers and capital markets. Re-insurers generally back up insurance companies on their risk portfolio. This means that an insurance company will take the first couple million dollars (or the predetermined level in
their contracts) of a single loss, and the balance will be deferred to one or more re-insurance companies. It is possible for re-insurance companies to participate, or offer re-insurance for a specific risk. This is called facultative re-insurance.

Capital markets may also be part of a risk transfer mechanism. Although insurance brokers are not always integral in these transactions, if the insurance marketplace becomes less accommodating to business risks the financial markets might step in. Financial markets already help companies transfer risk with financial instruments such as futures and options for commodities like pork bellies, lumber and currencies.

2.3.2.1.1 Financial Institutions

The federal government to date has prevented banks from entering the insurance sector, however credit unions and HSBC have been involved in the market, offering limited insurance services and products. At some point in the future banks will likely obtain the right to participate in the insurance industry. The threat of additional insurance companies with credibility, trust, and significant financial assets backing them up should cause concern to insurers. These companies could come into the market and compete aggressively, increasing the supply of available options, and driving down prices in the short term.

2.3.2.2 Claims History

Over the last few years, the insurance industry has been hit with significant losses, both in Canada and abroad. Because the insurance industry is truly global, a large loss in another part of the world will have an impact on insurance costs locally. There have been large events around the globe such as floods, storms, fire, earthquake etc. Other events over the last few years have had an impact on the insurance market such as the horrific events of September 11, and large financial collapses such as Enron, and WorldComm where financial insurance products (e.g. Surety) have seen significant losses. Also Directors and Officers policies are potential targets for law suits because of corporate malfeasance claims. The threat of terrorism was only a minor concern to Insurers for risks in North America prior to 2001. After September 11, companies were cancelling policies, or adding terrorism exclusions effective immediately. The Vancouver airport, and several others around North America where in jeopardy of being shut down because some insurance coverage was simply not available after September 11, 2001. (Ultimately the
Federal Government had to step in and provide the required indemnities to keep airports operational. Table 6 shows a listing of some of the larger insurance losses in Canada in recent history:

<table>
<thead>
<tr>
<th>Date</th>
<th>Location</th>
<th>Event</th>
<th>Loss ($000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>July / Aug 2003</td>
<td>Interior of BC</td>
<td>Fires</td>
<td>Not Available</td>
</tr>
<tr>
<td>May / June 2002</td>
<td>Southern Alberta</td>
<td>Flooding</td>
<td>Not Available</td>
</tr>
<tr>
<td>May 12-13 2000</td>
<td>Southern Ontario</td>
<td>Storm</td>
<td>99,477</td>
</tr>
<tr>
<td>Jan 1999</td>
<td>Southern Ontario</td>
<td>Snow Storm</td>
<td>99,821</td>
</tr>
<tr>
<td>Jan 1998</td>
<td>Quebec / Ontario</td>
<td>Ice Storm</td>
<td>1,539,503</td>
</tr>
</tbody>
</table>

Table 6: Natural Disasters in Canada in recent history

2.3.2.2.1 Claims Costs

The increasing costs of claims have had an impact on the overall market. Health and injury costs have increased rapidly over the years, causing larger losses and payouts. There have also been some large awards of damages through the court system for damages from asbestos or mould, especially in the US.

Another aspect of claims is the increased litigious nature of people both in Canada and the US. There is a tendency to take a case through the court system causing additional expense for insurance companies as they have a duty to defend. The litigious nature of some US states where awards for pain and suffering, and punitive damages, as well as legal costs are increasing dramatically, has caused some companies to reduce or eliminate lines of coverage available.

2.3.2.3 Capacity

Insurance companies can decide how much risk they are willing to take, and in what capacity. Because of this, and the mounting losses over the last few years, many suppliers have decided to restrict the supply of insurance coverage they were willing to provide for certain classes of business, locations, and events. When most insurance companies started to revisit their book of business over the last few years, they have generally decided to reduce their overall
exposure to certain risks. This had the effect of pulling capacity out of the market, making it much more difficult for brokers (representing their clients) to obtain the required/desired limits of insurance. When insurers are reducing capacity, this serves to increase their power in the transaction because there are fewer insurers willing to take a risk, and often it will take several companies each taking a percentage of the risk. A few years ago, one company would take the whole risk, and several companies would be aggressively chasing it.

2.3.2.4 Mergers & Acquisitions

There is an increasing number of mergers and acquisitions amongst insurance companies. This serves to reduce the available supply of alternatives to obtain competitive quotes. The companies are becoming larger, and more dominant in certain markets and classes of business. When there are a few very large companies that have most of the market share, an oligopoly type of market will start to occur, where they will have more power, allowing them to better control the markets they serve.

Occasionally insurance companies will decide to exit certain classes or lines of business. This portion of their book of business can either be sold to a competitor, or wound down. Either way, this will tend to increase the remaining insurance company’s strength as there are less competitors, or options for certain lines of coverage.

2.3.2.5 Niche Markets

Some insurance companies specialize in specific types of insurance business. If an IBS client was involved in business operations that are environmentally sensitive, or faced environmental hazards, there are only select companies willing to consider this coverage. (e.g. a contractor removing asbestos from a building). The few markets willing to look at this type of risk will often have specialized teams of people, who know and understand the specific risks associated with the class of business. This can be both: positive or negative, because if the key people involved in underwriting the business, change careers, or employers, there will be very few alternatives to place the coverage.
2.3.2.6  Forward Integration of Insurance Companies

There is always the threat that insurers will move along the value chain integrating their operations to control more of the process. Companies will do this by writing their insurance direct with the client, eliminating the need for a broker. This is more likely to occur with the personal property type of transactions (Auto and Property) with small IBS clients. For transactions other than personal lines, it would be very difficult for an insurance company to obtain, and maintain enough market share to survive.

2.3.2.7 Ownership of Business

The client of an insurance company is the broker. The companies ultimately purchasing the insurance coverage, are the clients of the brokers, and not those of the insurance company. Insurance companies invoice the broker for coverage, and the broker in turn invoices the client. Most agreements with insurance companies would address this issue, clearly defining ownership of the client. This allows brokers to shop their clients business around to various insurance companies to obtain the best coverage terms for their client. The structure of who owns the client serves to reduce the power of suppliers.

2.3.2.8 Opportunities and Threats for Marsh based on Suppliers Power

Marsh Inc. is the largest broker globally, and therefore places huge amounts of business with most global insurers. Many global insurers have offices in Canada, and Marsh places large volumes of business with these markets, and many other key markets. Because of the size of Marsh, and the volume of business placed, Marsh, has significant influence and clout in the market. This gives the company key contacts with senior people in insurance companies, which can help with placement of key risks. It also helps Marsh to maintain strong relationships with all the markets from the most senior executives, through to the underwriters who write the business. During the hard market Marsh has the opportunity to continue and try to enhance the relationships with suppliers, which is critical during these market conditions.
A potential threat Marsh needs to be cognisant of related to suppliers is, if Marsh decides to move a large amount of business to another insurer, it could severely impact or tarnish any future relationship. There are occasionally short terms gains that can be achieved by doing this, but long term it can only hurt the relationship, and the opportunities to obtain extra assistance from the market. If relationships have been severed, during the hard market it can be a big problem for a broker especially if there are limited companies willing to write certain lines of coverage. Another potential threat is some insurers favour smaller brokers, in an effort to combat the market power of large brokers such as Marsh.

2.3.3 New Entrants

There is always the threat of new companies entering the insurance broking business. These companies would compete directly for IBS business, likely starting with the smaller insurance and personal property accounts. The industry has few entry barriers and remains profitable, so the threat of new entrants is high.

2.3.3.1 Financial Results

Generally speaking, the financial results obtained by companies in the insurance brokerage business are good. The results of the large brokers for 2003 are summarized in Table 7. (note: the information was obtained from the annual reports of the various companies, and they do not all report information the same way for business segments. For example net income can be pre or post interest expense on statements.)

<table>
<thead>
<tr>
<th>Company</th>
<th>Revenue from Risk and Insurance Business ($000,000)</th>
<th>Net Income ($000,000)</th>
<th>Net Income as a Percent of Revenue</th>
</tr>
</thead>
<tbody>
<tr>
<td>Marsh</td>
<td>6,868</td>
<td>1,751</td>
<td>25%</td>
</tr>
<tr>
<td>Aon</td>
<td>5,677</td>
<td>829</td>
<td>15%</td>
</tr>
<tr>
<td>Willis</td>
<td>2,004</td>
<td>620</td>
<td>31%</td>
</tr>
<tr>
<td>JLT</td>
<td>577</td>
<td>154</td>
<td>27%</td>
</tr>
</tbody>
</table>

*Table 7: Brokerage Net Income as a Percent of Revenue*
As indicated in the table above, the brokerage business is very lucrative for the large brokers with net income as a percent of revenue ranging from fifteen to thirty one percent. This type of profit margin will tend to attract more competitors into the business.

2.3.3.2 Entry / Exit Barriers

The insurance brokerage industry in general has very low entry and exit barriers from a financial perspective. There are no real fixed assets or specialized equipment required to start up operations. In a simplistic form, all that is needed is office space, desks, a few computers and staff to start work. To exit the business, one can simply sell the book of business to another broker, and close the doors.

2.3.3.3 Staffing

Currently there is a shortage of skilled trained people in the insurance business. To work in a brokers office, and deal with clients and / or suppliers an employee must possess a valid license. A new entrant into the market will have to compete vigorously with established brokers for the key staff required to open and run a brokerage. Although employees are skilled workers, people are motivated by wages, and if the right salary level is offered, or opportunity exists, people will move to new employers.

For all IBS clients a new entrant will need well trained staff with experience to properly assess the risks and coverage required by clients. Any new entrant with limited experience in P&C business will find it very difficult to compete, as they will not have the knowledge, or understanding to properly place the business. New entrants will also lack an internal system to track and monitor client coverage and payment transactions, accounting issues, suppliers payments, and coverage purchased by a client.

2.3.3.4 Relationships

The insurance broking business is very relationship driven. This means that the relationship a broker has with the client can be critical in retaining the business. If a senior
person leaves a brokerage, it is not uncommon for some of their clients to follow them to their new employer.

Relationships with insurance companies also play a key role in this business. It is important for a broker to maintain a strong relationship with various underwriters and different companies. They will often help you out when you really need it. This can take the form of one or more of the following: fast turnaround time, better pricing, better coverage, taking more of the risk, or taking a portion of the risk when they really don’t want it.

2.3.3.5 Volume Commitments

Many insurance companies will only deal with specific brokers. Every insurance broker will sign an agency agreement with insurers they wish to do business with, which insurers use as a tool to be selective or limit the number of brokers they are willing to deal with. Complicating this point for smaller brokers, or new entrants into the market is the fact that most insurance companies will require certain volume commitments to do business with a broker. This means that many small, established brokers might only have one or two markets to place their P&C business with. In the current hard market, this can make it very difficult for established brokers with limited markets to find adequate coverage. A new entrant will have even more difficulty, with only promises of volume levels, and the fact that underwriters will not know or have built up a trust relationship with the individual submitting a risk.

2.3.3.6 Regulations

The insurance industry (both insurers and brokers) is heavily regulated in Canada, and is governed by both the federal and provincial governments. The insurance brokers also have a self regulating body, called Insurance Brokers Association of Canada (IBAC), which issues licenses, monitors continuing education requirements, and has the authority to discipline and suspend the license of a broker. The IBAC reports to the office of the superintendent of financial institutions. The federal regulations to date have prevented financial institutions such as Banks from entering the industry, and competing directly with brokers and / or insurance companies.
2.3.3.7 Direct Writers

As previously mentioned a few insurance companies are trying the direct approach in their dealings with customers. By doing this, they are bypassing the middleman (brokers) and trying to pass on the savings to their clients. This is not a big threat to Marsh’s IBS business, as these companies are targeting the personal insurance products. Marsh is not currently trying to aggressively grow that part of the IBS book of business, primarily because it is not a profitable segment of the business with the current fixed cost and overhead structure of the company. The goal is to grow where the company is able to add value to the transaction.

2.3.3.8 Consultants

For larger IBS clients, consultants are already trying to move in on traditional insurance broker areas of responsibility. The large global accounting companies are branching out in the services they provide to their clients, and offer a wide variety of consulting services in addition to the traditional accounting functions. There is currently a risk that one of the IBS clients may hire a consultant to perform some aspects of the brokers job in assessing and providing risk solutions for a clients business needs.

Accounting companies are in a great position to get in the door on this type of opportunity, and in a far better position than the insurance broker. Some of the advantages accounting firms have over a broker are:

- The accounting firm is a trusted company that digs into a company’s most confidential financial information on a regular basis. The accountants have instant access to the client’s assets, operations risks, and vulnerabilities.

- The accounting firm is in a unique position to recognize potential problem areas a client might have, and recommend additional consulting services. For example they will be involved in auditing operational and computer systems, and could easily point out inefficiencies or alternative suggestions.
They have contacts with the most senior people within an organization, including the President, and CFO. While brokers will occasionally have the ear of the CFO, brokers need to have a larger presence with the C-suite of executives (CEO, CFO, CIO, COO). Brokers should be pushing aggressively to have a risk committee as part of the board of directors functions, so company risk is brought to the forefront in decision making.

A review of the KPMG web site found that currently they have a risk consulting practice in several areas where Marsh or its sister company, Mercer provide consulting services, including:

- Risk Advisory Services
- Merger and Acquisition Services
- Intellectual Property
- Transaction Evaluation (Due Diligence)

Many clients trust their insurance purchasing decisions to the accounting department or CFO, and most accountants would prefer to deal with someone who can talk their language as opposed to an insurance broker advising them of risks. The consultants from an accounting firm will know the company's vulnerabilities, and if it is able to describe the risk from a financial perspective and the possible financial impact on the balance sheet and income statement, their comments will have a lasting impact. Both Marsh and Aon offer these services to their clients and the entrance of consultants could have an adverse impact on the industry in the coming years.

The recent corporate governance issues in the US, and problems with Arthur Anderson in have temporarily slowed down the increasing amount of consulting services being offered by accountants. This will likely only be short term, as the large accounting firms will find ways to maintain its independence, and continue to aggressively grow their organizations, by offering additional services to their clients.

2.3.3.9 Opportunities and Threats for Marsh based on New Entrants Power

With the low entry barriers for the insurance broking business, the lack of relationships and market contacts of any new entrant, will provide Marsh with a competitive advantage. It is
unlikely that a new entrant would be targeting IBS clients, except for the very small personal insurance products. Given a new entrant would not have a track record, other than that of the staff working there, it would be fairly easy to defend against that type of competition.

Alternatively, if a large global organization opened up in a major centre in Canada, they would likely start targeting the IBS business right away. This could pose significant problems for Marsh, as presumably they would have some senior connections with insurance companies. The new company would rely on new employees from other organizations to start and maintain old relationships with local underwriting staff. This new entrant would likely aggressively target key staff at various brokers as they start the process of trying to adequately staff an office and pursue business opportunities.

2.3.4 **Substitutes**

The threat of substitutes in the insurance brokerage business is low. There are currently no real viable alternatives available to replace a broker. On simple transaction based products such as personal lines, a broker could easily be replaced with a bank machine type of system, or an internet type of transaction. This is why direct writers have targeted the personal lines area as an entry point. In BC, even auto insurance must be done through a broker as the basic insurance coverage must be purchased through ICBC (provincially controlled auto insurer in BC).

The value of a broker becomes very apparent when dealing with difficult placements when many insurers are involved. The vast majority of insurers will only deal with brokers when providing insurance coverage, which means that any business will need to go through a broker.

2.3.4.1 **Captives**

When a company establishes its own captive, self insuring their risks, a broker will usually still be involved. Most captives have a level of insurance coverage for catastrophic type of losses, which will need to be placed through an insurance company by a broker. In virtually all cases, an insurance broker is very involved in the establishment and operation of a captive for the company on an ongoing basis.
2.3.4.2 Direct Writers

The only true substitute for a broker is when insurance companies write direct with the clients, thereby eliminating the need for a broker in the transaction. This is currently only occurring on house and auto insurance transactions and there do not seem to be any new players into this market other than Canadian Direct Insurance, which was owned by HSBC and sold earlier this year because they never turned a profit with the business.

Brokers need to be aware that there is always a threat that their role could be eliminated if the insurance companies on mass decided to write directly. If this happened, most would need to hire a consultant to manage the process, as clients do not have sufficient time and expertise to do this on their own. This would simply mean that the role of a broker would evolve.

Another variation of a direct writer is found in an arm of the Federal Government. Economic Development Corporation (EDC), has a mandate to help Canadian business conduct business abroad. On some lines of coverage, such as Surety, they are only supposed to help a company if traditional avenues are not available. Other products such as trade credit, EDC competes directly with Marsh, dealing directly with clients. The relationship between Marsh and EDC on this type of business is very strange, because even though Marsh competes directly with EDC for trade credit business, Marsh also helps them find coverage through traditional insurance markets for the business EDC has underwritten.

2.3.4.3 Opportunities and Threats for Marsh based on the Power of Substitutes

There are no real opportunities or threats for Marsh, as there are really no viable alternatives to dealing with an insurance broker. The real threat is if the insurance industry changes its approach to providing services and on mass tries to deal directly with clients. This is very unlikely to occur, because insurance companies would need to increase their staff levels substantially, and at the end of the day, it is unlikely that this would have any impact on their financial position.
2.3.5 Rivalry

Rivalry within the Insurance brokerage business is generally very aggressive. Through the early stages of the hard market, however, rivalry dropped to a moderate level, because obtaining the required coverage for a client was the biggest priority. Competition has been increasing rapidly in the IBS market recently, and will certainly be fierce over the coming years as the insurance market continues to soften. Table 8 lists the four global brokers (Marsh, Aon, JLT, and Willis), and two regional brokers (HUB Group and Western Financial (formerly High Alta Insurance), as well as a local broker (which is meant to represent any small regional broker with one or a few offices). The table lists various services or convenience options the brokers offer, and ranks their abilities on a scale of 1 to 5, with 5 being very strong.

Included in the table is a service score, which also ranks the products on a scale of one to five. This is meant to highlight from an IBS client perspective what the most important items on the list of services. This then allows for scores to tabulated for each broker, indicating their individual rank for a service multiplied by the product score. Adding all these figures will show the strengths and weaknesses various brokers have. The information in the table was from a survey of a few Marsh employees, and is meant to be a general indication for IBS business. The table could be completed with very different results, for each of the business segments within Marsh. Also, every employee would have a variation with different scores for all the services, and companies listed.
Table 8: Rivalry amongst brokers for IBS business

Table 8 shows how similar both Marsh and Aon are in the products and services they offer, and there is very little difference between the four large global brokers in their skill set, and the services they are able to offer clients. Not surprisingly the regional and local brokers come up short on product knowledge, and additional value added services, but also have respectable scores given their available resources.

2.3.5.1 Brokers

The broker force in Canada is very diverse in terms of size, location, and business strategies employed. There are more than 25,000 P&C insurance brokers across Canada. These range from very small offices of one or two people, to large well-staffed offices of several hundred employees. Table 9 indicates the four largest insurance brokers in Canada with offices
in several other countries. The largest brokers in order of size (global revenue) are: Marsh, Aon, Willis, and JLT. The table also includes two additional publicly traded brokers with regional offices in western Canada, called Hub International and Western Financial Group.

<table>
<thead>
<tr>
<th>Broker</th>
<th>Total Parent Company Revenue (Billion USD)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Marsh &amp; McLennan Group</td>
<td>$11.588</td>
</tr>
<tr>
<td>Aon</td>
<td>$9.810</td>
</tr>
<tr>
<td>Willis</td>
<td>$2,076</td>
</tr>
<tr>
<td>Jardine Lloyd Thompson</td>
<td>$0.719</td>
</tr>
<tr>
<td>Hub International</td>
<td>$0.286</td>
</tr>
<tr>
<td>Western Financial</td>
<td>$0.032</td>
</tr>
</tbody>
</table>

Table 9: Largest Global Brokers listed by Revenue ($ Billion)

2.3.5.2 Switching Costs

It is very easy and inexpensive for a client to switch the broker that represents them in their insurance transactions. There are no real financial costs involved in appointing a new broker to represent their needs. All the client needs to do, is write a letter to their insurance carrier appointing the chosen broker to handle their insurance needs, or specific portions of it moving forward. The hidden cost of doing this from the customer’s point of view, is the additional time it will take to familiarize a new broker with their specific needs. It can take a long time for a broker to become well versed in and fully understanding a client’s operations and needs. This is the reason why accounts will occasionally follow their primary contact (or account manager) if they change employers. There is also the risk of uninsured losses, or gaps of coverage to occur when a client switches brokers. Another complicating factor is the possibility that the new broker does not deal with one of the insurers providing coverage.

Brokers try to protect their client base from ex-employees by asking / demanding that employees sign a non-compete contract. This is usually signed when an employee starts working at an office, and will generally prohibit an individual from having any contact with clients or prospects they had dealings with while employed for a period of one year after leaving the
company. Pursuing an ex employee through the non compete, can be expensive and litigious. Some companies however, pursue ex employees relentlessly if they violate these agreements.

2.3.5.3 Skilled Employees

Rivalry in the IBS segment is very intense, and skilled employees are required to manage and look after client relationships. Over the last few years there has been a shortage of skilled employees, and as such, brokers are aggressively trying to lure employees away from their competitors. This has a two pronged impact to the company, in terms of creating an immediate need to replace that person, and the danger that the clients the individual looked after are now at risk of being taken by the ex-employee. Even though employees sign a non compete, they will often be encouraged to keep the lines of communication open with their old clients. Some brokerage offices will encourage a new employee to pursue their old clients, while others will do their best to uphold the terms of the agreement. The insurance broking industry is very relationship driven, and when key people leave there is often nothing tying an account to a specific brokerage company.

Another impact of employee turnover, is the significant cost of training new employees. There is always the potential for an impact either positive or negative on company culture and morale. The movement of staff amongst brokers, will tend to cause an upward spiral on wages and benefits.

2.3.5.4 Consolidations

The insurance broking industry and the insurance industry seem to be in constant acquisition / consolidation mode. Larger brokers such as Marsh and Aon are always be on the lookout for strategic acquisitions to both increase market share and revenue / profit. The impact of the consolidation activity means there are less choices available for a client to determine who will look after their business. The way the industry seems to be headed there will likely be two or three large global brokers, with the balance being regional or local brokers. Competition will continue to be very aggressive, and even if there are fewer large brokers they will continue to aggressively pursue each others book of business.
2.3.5.5 **Costs**

With the increasing competitive nature of the industry, reducing costs is going to play an important role in the future success of an organization. Insurance companies have been able to reduce commission levels during the hard market, and once it softens, some commission levels will increase again. Small brokers will need to ensure they are helping the underwriters by adding value to the transaction, or they may see further erosion in their commission structure.

To stay competitive in the broking industry, it is important for companies, to look for ways to reduce the overall cost structure, to survive the looming softer market. Because the larger brokers are publicly traded organizations, shareholders are demanding better returns on their investment, and an easy way to achieve this is to reduce internal expenses, as any gains go straight to the bottom line.

2.3.5.6 **Small Brokers forming Co-ops**

Many small community brokers have formed co-ops to allow them greater access to insurance companies. A small community broker might only have access to one or two insurance markets when trying to place P&C coverage. By forming a co-op, with other small brokers, it will allow their combined insurance premiums to increase substantially, allowing the group to access more insurance markets. The effect of this for brokers like Marsh is that small competitors will have a better chance of being competitive on smaller P&C accounts because they might be able to obtain quotes from five or six markets.

The lack of available markets is an advantage large brokers have over small brokers, which essentially forces small brokers to compete aggressively on personal insurance products because price differences would be insignificant. Also, most people insuring their home do not expect to get quotes from four or more insurance companies. Generally people are happy to get it done, and don’t bother to shop around.

Co-ops will have an impact on the competitive nature of the small local brokers, but will not tend to impact regional or large brokers, because larger brokers will already have access and strong relationships established with far more insurance companies.
2.3.5.7 Differentiation

When competing for business between brokers, a client will often make their choice based on typical insurance products the broker brings to the table, or often based on a long term relationship and trust built over time with either an individual or a company. It can be very hard to win an account if there is a long term strong relationship, however over time value added services can make a big difference in winning or losing an account. Marsh has a vast array of resources that can add value to a relationship, and often provide additional revenues to Marsh. Large brokers have the capabilities to bring varying degrees of services to the table. For many clients or prospective clients global reach is enough, while others will require and utilize many of the specialized services.

As a broker pursues clients in the mid and specifically the smaller market of IBS type of business, it becomes increasingly important to focus on delivering products that are priced very competitively. Most clients will not value many if any of the value added services, and will be focussed exclusively on price. It is important to have the market leverage to provide better priced products, with the options of value added services if and when the client needs them.

2.3.5.8 Technology

Technology differences amongst brokers are still evident, and can be a competitive advantage. Some brokers are technologically inept, in not having the ability to put together a professional presentation or package of information, while others invest significant resources into these areas. Occasionally a client may ask a few brokers to compete for their business through a request for proposal (RFP). If a broker prepares a presentation, or report, that is professional, easy to read, and concise, it will make a lasting impression and can go a long way to winning the business.

The use of the internet, and web based applications is also becoming a competitive advantage. Marsh has on line computer systems allowing a client to access specifics about their insurance policies / claims / rates etc. in a real time environment. This online access can have many levels, so some people will only have access to certain portions, while others will have
access to everything. Offering this type of system to clients is very helpful especially if they have multiple locations. It allows clients to disseminate real time information instantly to many locations, which help the client save time and money while having increased control and monitoring capabilities over their insurance program.

2.3.5.9 Global Capabilities

Clients will often seek out brokers with both International experience and capabilities, for a couple of reasons. First of all, they need the expertise and network of offices to handle their business, and secondly, they like the idea of dealing with a large well-respected organization.

Brokers with global capabilities have a large advantage in the current hard market, as they have the ability to source insurance coverage from different areas of the globe. This is critical when capacity is shrinking and a client requires insurance coverage that in not a desired class of business. Access to global markets, like London England are a significant advantage to brokers with this capability.

2.3.5.10 Value Added Services

Large brokers will tend to have more value added services to offer to a client, such as a claims department, and risk consulting services. Marsh and Aon, the two largest brokers in the country have similar services they are able to bring to the table for customers. Both companies have large local staffing levels with a wide variety of experts, and a global network of resources to tap into if and when needed.

2.3.5.11 Brand

Currently the large brokers have brand recognition in specific industries. They all seem to use a target marketing approach, usually advertising in industry specific publications for the target client base. Some small community based brokers advertise using a mass market approach such as radio. These companies will have a more recognizable brand in the local marketplace and community in general.
The problem with the current target marketing approach used by the large brokers, is if the individual in charge of insurance purchasing decisions happens to be in the accounting department, they might never read their company's industry specific magazines or publications. This means that the person making the buying decision might never see the industry specific adds, to gain awareness of either their current broker, or others who may be interested in their business.

Small local brokers do a much better job of getting their name into the community. Some will have commercials on local radio stations, or participate in community events in the local neighbourhood. One such broker is Pat Anderson Agencies Ltd., a company specializing in personal insurance products and small commercial customers. Their name and brand is more recognized and well known than any of the big four global competitors. Pat Anderson now has five agencies in the lower mainland, and the combined revenue and number of employees working for these offices would be a small percentage of the Vancouver office of Marsh or Aon.

2.3.5.12 Opportunities and Threats for Marsh based on Rivalry

Within rivalry, there are many opportunities for Marsh especially when competing against anyone other than Aon. Marsh and Aon have very similar skill levels in terms of product knowledge and centres of expertise, and a global organization. Smaller, global competitors have much less to bring to the table, and finally regional and local competitors bring even fewer benefits to the table. If Marsh wants to aggressively pursue IBS business, improving on some of the items discussed in Table 8 could help to reduce the few benefits small regional or local brokers have over Marsh.

Marsh could obtain additional locations in a more local setting, negating the benefit of location. Also with local offices, presumably the rent or lease commitments would be significantly lower than the current class A buildings were several floors are taken in the downtown core. With a smaller, local feel to the office, it would appeal to locals, hopefully encouraging additional customers.
There are many additional services Marsh can offer a client, such as having a dedicated team of professionals who monitor the financial strength of insurers globally, to ensure they meet Marsh minimum standards. There is no value in having a great insurance policy with an insurance company that is financially unstable, which could mean there is not enough strength in the company to pay all the claims. With local representation, it would make sense for the office to spend some money on advertising to create awareness, trust and loyalty. Any adds could also emphasize a community feel presence and commitment, with the added benefit of having global connections and benefits. Finally the ability to offer smaller clients customized package insurance products, which provide either, better coverage and / or a better rate giving smaller clients an advantage when dealing with Marsh.

The threats Marsh faces with rivalry amongst other brokers competing for IBS business is the lack of multiple locations for easy client access. Some clients will feel as though they are a very small client, in the huge corporate giant of Marsh, and they will not get the same levels of service as they would from a small broker, where they may be one of the larger accounts in the office.

2.4 Overall Industry Attractiveness

Based on the analysis presented, the insurance broking business is a very competitive business, but a very good business to be in. Profit margins are good, and people will always need to purchase insurance products. Most people in the country purchase insurance in one form or another, through auto coverage, property coverage, or health insurance products. The industry is mature, and a company with an effective strategy and business plan has great potential, however the overall growth of the industry in general will be marginal at best.

The brokerage industry is always dynamic and change is a constant. There are a few large dominant brokers in the industry, which clearly have strengths in specific areas, while the small local brokers have advantages in other areas. Low entry barriers make entry easy for an entrepreneur to start an insurance brokerage.
3 MARSH VALUE CHAIN

The Industry value chain is fairly typical in the insurance brokerage business, with a few variations based on the size, global reach, and resources of the broker. As Marsh is global, and looking to aggressively grow, the company has and continues to invest resources into key areas of the value chain. The internal value chain for Marsh consists of four basic steps, research and development, marketing, sales and finally service. This is the general flow of products and services through the company to the client. Figure 6 shows a graphic representation of the flow through the parts of the value chain to the client.

![Figure 6: Typical Value Chain for Marsh](image)

3.1 Research and Development

The larger global brokers have a definite advantage in this area of the value chain. Large brokers are able to invest resources (human and capital) into creating and modifying new products. The products consist of new or modified insurance policies, creating specialized solutions for clients, and continuing to develop and launch better technology enablers for internal and external use.

3.1.1 Product Development

Marsh has a team of people in the Toronto and other locations around the globe, who are responsible for creating new and innovative risk solutions (insurance products) to assist with the ongoing needs of specific segments of clients across the country. They work in collaboration with Client Managers to fill a void in the market. This group will create specialty programs with various insurers to provide a more comprehensive and lower cost insurance solution for specific industry sectors. The intent is to either bring capacity to a target area, enhance current coverage,
and provide it at a lower cost to bring in more business. An example of this is the current attempt to create a specific coverage package for electrical subcontractors. The development team of people work with insurers to create a specific wording which will assist in both providing coverage to existing clients, and help to offer something better to prospective clients when we are trying to earn their business.

The goal of the product development team is to focus on products that will give Marsh a competitive advantage in specific industries, or segments within an industry. This will allow the company to either protect market share, or allow for an opportunity to build market share in areas where Marsh lacks business by creating specific product solutions for an industry group. New products or enhanced insurance programs are developed by approaching various interested insurance companies and committing to providing either certain volumes of business, or working together to develop a large book of business in a target area. The coverage offered will need to be better than an off the shelf policy, by providing broader and better coverage, and also offer better pricing. Insurance companies are willing to do this because of economies of scale, and it helps them meet their growth targets.

3.1.2 Technology

Marsh invests heavily in various technology areas. These proprietary programs are developed for both internal and external use, to help facilitate the efficient and effective business transactions. Externally developed programs will deliver value and benefits to our clients, while often providing a benefit to Marsh, such as cost savings, or communication reduction because the client can access the information internally without Marsh assistance. Internal systems are designed to streamline the internal processes and provide relevant and meaningful information to various departments in the company.

3.1.2.1 Knowledge Exchange

The knowledge exchange has been in use in Canada for several years now providing colleagues with a forum to exchange information and questions. This electronic forum is available to employees across the country on a real time basis, and provides access to a wealth of information. It also provides a forum to ask and respond to questions posed by colleagues across
the country. The knowledge exchange allows employees to keep current with the changing markets, and specialty practices across the country, and ask for assistance or suggestions in dealing with their specific issue or problem. The system also archives all comments and information, so a comment discussed several months ago, can be easily accessed. This tool keeps information flowing quickly throughout the country, allowing better and faster knowledge transfer ultimately leading to better service for clients.

3.1.2.2 Stars SE

Stars SE is a web based risk management tool specifically designed for IBS clients. This web based system is a scaled down version of the customizable RM based platform. Stars SE is a platform for tracking and collecting claims information, analysis of the data, workflow management, and a powerful reporting feature with a comprehensive collection of report templates. This system is accessible twenty four hours a day, on a global basis, with multi language and multi currency capabilities. There are many different types of insurance coverage and claims that can be managed through this system, including Workers Compensations, General Liability, Property, Marine, and Aviation to name a few.

3.1.2.3 Internal Systems

Many of the internal computer systems in use at Marsh are customized software created specifically for the company, to integrate with various programs. The technology group is refining and enhancing an internal automated intranet based program called cansys. The goal of cansys is to help expedite the insurance renewal process, from gathering the relevant data, submitting the data, to an insurance company, issuing invoices for the coverage, tracking renewal information, and tracking the accounting function. This internal system has many capabilities and added features such as benchmarking capabilities and can be very flexible through the renewal process for the vast majority of IBS clients. Although this system is leading edge technology, and years ahead of our competitors, many refinements need to be completed. This system has many bugs, and can be excruciatingly slow, causing everyone to become very frustrated at times.

Although this system is designed specifically for IBS clients, the system needs to be simplified, to allow for a more simplified process. Currently the system has great capabilities,
however to get relevant data, the program needs to be simplified. As employees are able to see the benefits and results of inputting information, they will be more willing to enter in detailed information which will become more useful. Currently the system stores too much data, that is not always accurate, and is not often relevant or trustworthy.

3.2 Marketing

Marsh currently uses the target marketing technique to raise awareness and interest in the services and specialization the company is able to provide. By targeting certain industry groups, and specific clients, the company has been very successful, helping the company to become a leader in the RM market segment. This approach is well suited to the RM type of client, were the corporations are very large, and it is relatively easy to determine who the key people are. For the IBS market, a target marketing approach is not as effective. Clients are geographically diverse and decision makers are much more difficult to identify. Within an organization many people might get involved in making the insurance purchasing decision, or it may be left to one person, who is also involved in many other important functions in the company, such as legal, accounting or sales.

3.3 Sales

Marsh currently has a good sales structure within the organization. Offices have sales professionals, who are responsible for bringing in new clients and business to the company. This direct marketing approach works well because it is a very personalize which is what prospective clients want and need to address their individual concerns. Client managers at Marsh are expected to look after a book of business, or client base and also pursue new business opportunities. All employees of the company are encouraged to pursue additional revenue opportunities through either existing clients, or new ones. Employees are compensated through a salary, with the opportunity to earn additional money through the variable compensation program, which rewards for new or expanded business.
3.4 Service

Service is very important for most IBS clients, as relationship, and knowledge of a clients business are an integral part of building a long lasting and mutually beneficial relationship. To strengthen the relationship, Marsh is able to bring many additional services and resources to assist the client in their risk transfer strategies.

3.4.1 Client Service Model

The company has developed a service model to assist employees in providing optimal service levels to the clients. This should help provide standardized service levels to clients across the country, and ensure protocol is being followed to help with a smooth insurance renewal processes on an annual basis. The added benefit will be increased knowledge about a clients business and risks they face. The client service model outlines the various touch points and time frame a client manager should utilize when dealing with clients. Technology is being developed to assist employees in meeting these goals, with the ultimate objective being a cost effective tool to handle the clients needs. (See Appendix #2 to show the Client Service Cycle) This model is designed and used primarily for larger clients, but many parts are applicable for all clients throughout the renewal process.

The current client service model needs to be reworked to accommodate the focus on IBS. It is unrealistic to expect all clients to fit into the RM mould, from a service perspective. Marsh will also want to minimize the client contact especially the smaller clients to help reduce the delivery cost of products and services.

These client service models assume all clients want to be treated and handled according to a Marsh template. The reality is that many clients will find the process very useful and worthwhile, while likely an equal number would prefer to have their insurance process handled in a completely different manner, with either a more hands on approach, or a very minimal contact approach.
3.4.2 National Resources

National Resources encompass a few different forms within the organization, starting with people being appointed to be experts on specific areas of the business. These people are located in various offices in Canada, and among their regular responsibilities, field calls from colleagues across the country on their specialized discipline. An example of this is appointing an individual as the practice leader for Construction across the country. This person then becomes a contact person, or a source of information if a client manager needs help or assistance on a particular placement of construction related business. Marsh has also formed a Risk Consulting group, which offers a wide variety of specialized services to clients across the country.

3.4.2.1 Financial Security / Credit Monitor

Marsh has a dedicated team of people who constantly monitor the financial strength of insurance companies. The mandate is to ensure the insurance companies Marsh places business with have adequate financial strength. The concern is that if an insurance company becomes insolvent, they might not have enough resources to pay any claims, which should be a big concern for customers purchasing an insurance policy. This is a very minor part of the complete package of differentiated services offered by Marsh, but more effort should be made to enlighten customers of the benefits of this service.

3.4.2.2 Risk Consulting Practice

The risk consulting practice provides specialized services, covering a wide variety of risk exposures and solutions, many of which are indicated in Table 10. It is advantageous to offer these services to clients, however, realistically, only the larger IBS clients will have an interest in many of these products or services. It is still an advantage for Marsh to have the services, because the client will know the options are available should they ever be needed.
When any of the services mentioned in Table 10 are used, the revenue paid by the client for these services flows back to the office handling the account. By following the revenue stream back to the client manager and office, it encourages the client manager to take advantage of these services, and help to bring in additional revenue streams from their client.

Marsh has a group of people within the Risk Consulting group that will go head to head with the major accounting firms on specific risk related consulting opportunities. The idea is to target clients with revenues less than $100 million. Often these companies are private, and have a very limited use of consultants. The then proceed with the help of management to develop strategies to rapidly improve the companies overall risk management. Risk is broken down into the nine components listed in the table below. These components are then rated and evaluated to better understand a company’s various risk exposures to help plan risk transfer mechanisms.

<table>
<thead>
<tr>
<th>Asset management risks</th>
<th>People risk</th>
<th>Financial risk</th>
</tr>
</thead>
<tbody>
<tr>
<td>Compliance risk</td>
<td>Environmental risk</td>
<td>Product / Service risk</td>
</tr>
<tr>
<td>General Management Risk</td>
<td>Change Management risk</td>
<td>Technology risk</td>
</tr>
</tbody>
</table>

Table 11: 9 Categories of risk that pose the greatest threat to a Company

When a company goes through this process, there will be some risks identified that are insurable, others which are a pure business risk (i.e. not insurable). This provides a good tool for management to review and highlight risks within their operations. This is a service Marsh is able to offer clients and prospects, and none of Marsh’s conventional competitors are currently
offering this service, providing a key differentiation approach as value added services offered by the company.

3.4.3 Marsh Canada Securities

This is a new specialized part of Marsh Canada, which targets larger clients in the IBS segment with revenues in excess of $100 million and debt that is not publicly rated. The goal is to target companies looking to raise capital through a private placement debt offering. Traditionally this was not an option for the target class of companies because they are not rated, and can therefore not raise funds through traditional capital markets. This type of service is currently not available through traditional sources, and the only alternatives companies can pursue is through traditional bank debt. Marsh Securities is a very innovative service that fills a void in the marketplace, which should help to earn the trust and support of both clients and prospects. The banking industry is very supportive of this initiative as it is outside their current product portfolio, and they have no appetite to enter this market.

3.5 Key Success Factors of the Insurance Brokerage Industry

There are many variables that will help Marsh or any other broker succeed in the insurance brokerage industry. Outlined below are a few key areas.

3.5.1 Resources

It is very important for Marsh to know and understand what the needs and requirements are in the IBS segment to enable the aggressive growth plans for many years. There is no point in a small broker spending a lot of time chasing large accounts when they do not have the resources to properly quote and service the client, or the market connections to obtain adequate pricing. For large global brokers, it is equally as important to realize that they cannot compete effectively on the personal lines type of business for individuals (unless there is a program established making it a low touch higher margin class of business) because the overhead structure will make the margins unacceptable. Marsh needs to have adequate resources (human and capital) to grow the IBS book of business.
3.5.2 Build Strong Relationships with Clients

Building long term and lasting relationships with clients is essential to building a mutually beneficial relationship. It is estimated that it costs nineteen times as much to win a new client, than it does to retain an existing one. Because of this, it is essential to ensure client managers maintain strong relationships with the client base. It is also helpful to have senior client contacts for larger accounts so when a problem arises, the client can feel comfortable raising issues with a more senior person in the organization.

3.5.3 Provide Value Added Services

Customers are becoming more discriminating, and looking to see what value added services a company can bring to the table. It is very helpful and comforting for a client to know that additional services and areas of expertise are available, even if they may never use them.

3.5.4 Key strategic relationships with Markets

Now more than ever, it is important for brokers to build, foster and maintain strong amicable relationships with suppliers. A broker needs to always be cognisant of the suppliers target class of business, and abilities. Moving large volumes of business away from a market on mass can cause irreparable damage to a relationship, and during a hard market this could be critical. Relationships with suppliers need to be considered a partnership, even though the market goes through business cycles where the balance of power shifts between the broker and underwriter.

3.5.5 Develop systems to reduce costs

Profitability is critical in today’s economy. There will be increasing pressure to squeeze additional profits out of every transaction. If a company is able to automate their systems to reduce the work load, and amount of time information is handled, costs and overall workload on
each employee will decrease. This will free up employees time to either pursue additional business opportunities, or handle more accounts, further driving down costs.

3.5.6 Differentiation

Differentiation amongst brokers is critical in today’s business climate. Buyers are looking for value added services that can and will help them both now and in the future. Price is not the only variable in transactions although there will always be a client base that is only concerned about price. These are not the type of clients Marsh wants, because they will switch brokers to save $50, so the company might only have these clients for a year or two. Having the ability to tap into national and global resources for product expertise, at no cost to the client is invaluable in building and maintaining trust and a long lasting relationship.

3.5.7 Key Geographic Locations

Once a broker has decided which type of business they want to compete for, they can determine their best approach to various locations. Marsh does not pursue auto insurance from walk through traffic near the office, which is why there is no store front locations near busy shopping areas. Downtown locations are effective because many larger IBS clients are located in the downtown core of major centres across the country. As marsh continues to aggressively grow the IBS business, it will become important to have additional locations in a province like BC, to reach out to some of the target clients in the major centre in the interior or Vancouver Island.

3.5.8 Summary of Key Success Factors

Overall the industry is very competitive, and given the industry is mature, and little growth can really be expected on a global basis, companies must have and exploit their key success factors by utilizing their core competencies. If a company is to survive long term they must retain their client base, and continue to grow both revenue and profitability. Mergers and acquisitions are still common in the industry and will continue in the future, reducing options for both clients, in terms of Broker alternatives, and in terms of brokers, with available insurance companies to write business.
Clearly size will matter going forward in this industry, Insurance companies, will only want to deal with brokers committing to significant volumes of business, with integrated systems to help reduce costs, and streamline the transactional process. They will push broker commissions down, and smaller brokers will be powerless to stop this because of their small amounts of overall business with insurers.
4 STRATEGIC ALTERNATIVES

There are many avenues Marsh can pursue to aggressively grow the IBS book of business in Canada, which will result in increased revenues and hopefully increased profitability. I will analyze three alternatives listed below against the internal capabilities of Marsh. The fourth option is the most conservative option, which is to maintain the status quo.

4.1 Option 1: Marsh Lite

Marsh should create a new corporate entity to service and grow the IBS business. This new company should be a completely separate entity from Marsh with the resources and capacity to handle the complete range of IBS business. The focus of this market segment is very different from RM (Marsh’s Core Business Activity), and to compete effectively in this market a new approach should be taken. The new company should be organized, operated and managed entirely independent of Marsh, much like Encon Group and Marsh Private Client Services, which fall under the Marsh umbrella, but have no direct management links or direct ties to the company, except at the head office level. The new entity, which I will call Marsh Lite, will have a much lower cost structure, and multiple locations to meet the primary needs of the majority of IBS clients. Marsh currently has a high fixed cost component, making it very difficult to compete effectively in the smaller market segments such as the personal insurance products market. Marsh will need to acquire a regional broker with offices in strategic locations around the province or Country. The brokerage offices will need to have a good book of business, with adequate staffing levels to support it.

The concept here is to have a premium brand (Marsh) and a well-known high quality less bells and whistles brand (Marsh Lite). This idea works very effectively in other well-known industries like the auto industry with Accura & Honda, and Lexus & Toyota. Consumers know they will be purchasing a superior product from either alternative, however the premium brand provides higher value options and services. Splitting the company into two separate companies would allow for different service models, and cultures to exist, for the benefit of both client groups.
Creating a new brand (Marsh Lite) creates additional risks for the company such as brand dilution. The Marsh brand is known as a large global organization providing high service levels, specialization, product, and market knowledge with the capability of providing differentiated services to its client base. There is a risk that the creation of a new corporate entity specifically established to handle IBS clients is the separation could alienate some clients, who feel their business is better served by the RM segment instead of IBS. There is also the potential for reluctance of client managers to send what might be a prized and valuable account to either Marsh or Marsh Lite.

If Marsh decides to create a separate company name, the immediate acceptance of the new company and brand may be much slower than what is desired. This risk is offset in my opinion because the Marsh brand is not well know outside of the RM market, and the existing client base. For the most part, amongst the target class of business the majority of people have never heard of Marsh, and have no idea what line of business the company is in.

Although the creation of Marsh Lite is a drastic step for the company, it makes sense from many perspectives. First of all this will allow Marsh Lite to aggressively grow the IBS business, which will be the source for global growth for several years to come. The largest part of the insurance market is the personal lines insurance policies. By creating a new company and brand focussed exclusively on IBS business it will allow for future expansion into the personal lines business at some date in the future, when Marsh dominates the mid market segment of IBS clients.

Another important factor to setting up a new company is the definition of RM will need to be changed to not be so income driven. Attention should be paid to the type of risks, and additional services the client might need or require during the client service cycle. This might mean moving some clients into the RM segment, to provide the additional services they require.

4.1.1 Organizational Structure

The overall organizational structure of Marsh Lite should be very flat, with minimal management levels and additional head office staff. Multiple management levels add to the cost structure, and generally would not be needed. In my opinion, each province should have a
provincial or regional office, which would have a manager who is responsible for the various offices in the Province (some provinces may have to break this down further depending on the number and amount of business generated). Within the local offices an office manager, and depending on staff levels, type and size of business, a couple other managers may be needed. Internal support functions for specialized tasks could be provided at the regional level where economies of scale and specialization make strategic sense, such as marketing functions for difficult or specialized risks and the graphics and word processing department.

4.1.2 Regional Office Location

The regional office location, could continue to share office space in the current Marsh locations, as infrastructure already exists, and some synergies could be gained by sharing some of the overhead expenses. It should be noted that ideally the Marsh and Marsh Lite offices would be very distinct and operate independently of each other.

It might be worth looking at eventually moving the offices out of the downtown core in a few years, once everyone is over the initial change to a new company, or having another office close to the downtown core, and provide employees and clients the option of which office they would prefer to work with. This would mean substantial costs savings for office leases, and bring the office closer to the clients. Also the current office décor, in terms of meeting rooms, is very fancy and high end, which is generally not what IBS clients want to see. Some IBS clients have come in to the office and said “now I know why my insurance rates are so high, I have to pay for these fancy facilities”

Most IBS clients are located outside of the downtown business core, and an office location could be established in a central location that is much closer to where IBS clients are located. This would provide some additional benefits to the cost structure of Marsh Lite, namely cheaper office rent, for example a location in Burnaby in a high traffic location, with ample free parking and easily accessible by public transit would make it convenient for both employees and clients.
4.1.3 Resources

To acquire regional brokers with multiple locations throughout the country, in strategic locations will take significant financial resources. Once the purchase is complete, additional resources will be needed to integrate and train the new people on Marsh systems and technology. It will also be essential to ensure adequate staffing levels exist, to handle the newly purchased book of business. This might mean hiring or promoting current employees to manage and assist in the transition, also the company being acquired will have many good people willing and capable of handling this role as well.

4.1.4 Build Strong Relationships with Clients

Creation of a new corporate entity will help to build and enhance relationships with clients, because the office will likely be closer to the client’s location for existing Marsh clients. This will make it easier for both the client manager to drop by the client’s office, for a cup of coffee, and alternatively for the client to drop by the Marsh Lite office. If the new company has a real community feel, instead of that of a large multinational global organization (humungous broker), community involvement and support will help to build and strengthen the relationship. Clients from the acquired broker will deal with the same office but much greater value added services will be available which can be used to strengthen the relationship.

4.1.5 Provide Value Added Services

Given that Marsh Lite will be a separate entity from Marsh, the new entity will also need to offer clients some of the very successful value added services currently offered by Marsh. These include Marsh Risk Consulting and a scaled down version of their products and specialization. Additionally research and development of both products and technology will be important on an ongoing basis. With technology, a scaled down, functional system will be more appropriate and useful. It would be better from a cost and workload perspective to be more of a follower than a leader with technology systems. This will allow the systems to be in working properly, saving time and money when they are implemented.
4.1.6 Key strategic relationships with Markets

Marsh has built and continues to develop strong relationships with insurance markets. With Marsh Lite, operating as a separate entity, the overall business with an insurer will decrease, if the Marsh segment (RM) is not included. This is minor in the bigger picture, because with aggressive growth plans and the same senior contacts within the organization strong ties will continue to enhance and build a long term mutually beneficial relationship.

4.1.7 Develop systems to reduce costs

Once the overall expenses of setting up a new organization, and transitioning everyone into their respective places, the overall cost structure should be much lower. From a fixed costs, overhead perspective, the operating structure will be very lean, helping to reduce fixed costs. There will obviously be more leases which the company will need, but on a cost per square foot basis, local locations will be much more cost effective than class A building space in major centres.

Technology can be modified to make it a streamlined efficient system. This will help to reduce costs and increase efficiencies internally. If Marsh Lite is able to develop an efficient easy to use system, that will help employees do their jobs in an efficient and effective manner, it will further reduce the cost structure, as people will be able to handle greater volumes of work. Additionally the newly acquired company might have technologies in place that would work well instead of using the Marsh systems. As the company is new, all avenues could be explored to obtain the best systems for IBS.

4.1.8 Differentiation

Clearly Marsh Lite will provide differentiation from local brokers. With a global network, and access to insurance markets around the world, it will allow clients access to unique solutions, while still dealing with a local broker in their community. Additionally the value added services will be key differentiators.
4.2 Option 2: Acquisition

Marsh has been active in searching out acquisition targets to continue to grow both revenue, and profitability. The company is always looking for opportunities in key strategic locations, and business specialties. It would also make sense to purchase a small broker with key strategic locations in larger centres, such as (in BC) Victoria, Langley, Kamloops, Kelowna, and a Northern location such as Prince George to start with. This would greatly improve the location aspect, as many prospective clients prefer to support local business in their community. Another approach is strategic acquisition of a regional broker with an industry focus or specialization such as the construction business. The construction sector can be a very profitable, but a labour intensive area of the business.

Acquiring either a specialized broker, or a broker that looks after all aspects of IBS business, including commercial insurance will provide instant revenues for Marsh. This will also add additional staff (human capital), with expertise, and knowledge about their specific client base and needs. If the acquisition is in a specialized industry segment, such as construction there will be the additional benefit of instant credibility, if none previously exists, or enhanced credibility, for both Marsh and the broker being purchased. The newly acquired staff would be very knowledgeable in a particular specialized niche of the business. This will also provide long term growth opportunities, allowing Marsh to introduce many of our ancillary services and products offered both internally and through our sister companies. Historically, acquisitions have meant bringing the staff into the Marsh offices, ultimately combining the two groups into one location to save on administrative and overhead costs.

There are a few areas that senior management should be aware of, and closely monitor prior to and subsequent to an acquisition. As the industry is coming off the hard market, with select coverage prices decreasing on renewal, a large premium might be paid on a brokerage, paying more than it is worth. Generally an acquisition is be based on revenue of the brokerage, likely with some retention factor built in. This can cause long-term pain for short-term gain in Marsh’s overall financial position. If senior management pays too much for a given brokerage, based on the current inflated revenues, the short term revenue and profit boost may be offset by the inflated price and lack of revenues and profit to offset the higher acquisition price. It is also
worth noting that if revenue falls in subsequent years, it will be much more difficult to maintain a year over year growth rate of fifteen percent because in subsequent years much more growth will be needed to achieve the target numbers. Additionally, senior management must be certain that the corporate culture of the newly acquired company will fit into the Marsh culture, or that it will bring a new and needed cultural change towards where the organization wants to trend.

With the acquisition of a new company, Senior Management will have to be aware of the brand recognition and loyalty of the acquired broker. If Marsh simply acquires and amalgamates the smaller broker into the existing company, any brand awareness and recognition in the local communities will be lost. Historically, Marsh has adopted the name in conjunction with its own for large global acquisitions. This is easily seen by the recent evolution to the current Marsh name, a few years ago, the company was called Marsh & McLennan, then J&H Marsh & McLennan, and now Marsh. (The J&H was added because of the acquisition of Johnson & Higgins, while nothing was added with the acquisition of Sedgwick). Any acquisition of brokers in the IBS business would likely be smaller regional brokers, which would reduce the likelihood of changing the corporate name. Realistically the only reason why Marsh would incorporate the newly acquired brokers name into its own is if the acquired broker was a very large well established and recognized company, and there are very few of these operating in North America that are large enough.

4.2.1 Resources

An acquisition will require a significant capital outlay, to acquire a competitor, similar to option 1. Option 2 will require less financial resources than forming a separate company. With the newly acquired company, there will also be additional staffing to support and manage the acquired book of business.

4.2.2 Build Strong Relationships with Clients

With an acquisition, there should be no difference internally with a client manager's ability to build a strong relationship with their clients. Internally there will be no difference for client managers, and staff from the acquired company will continue their relationships with their clients. Clients from the acquired broker will have access to the value added services and
benefits of dealing with a large global organization. This should help to strengthen the relationship, and provide additional revenue streams for Marsh. It is also worth noting there will always be some clients, who simply refuse to deal with large global companies, and will move their business to stay with a locally owned and operated company. This is simply part of the business risk when acquiring a book of business.

4.2.3 Provide Value Added Services

Marsh will continue to offer and make available the value added services to all clients. This will benefit new clients, and provide additional revenue streams for Marsh. The MRC and product development teams are already in place and working well. The MRC staff levels might need to be increased if there are more opportunities presented with the new client base. This should not pose a significant problem, as MRC has very aggressive growth budgets, and if this helps them achieve the targets, it will be welcomed.

4.2.4 Key strategic relationships with Markets

Marsh already has strong relationships with the insurance markets. With the addition of new people and a larger book of business, it will only help to enhance the relationships. The newly acquired staff will also have existing relationships with various contacts at different markets.

4.2.5 Develop systems to reduce costs

Marsh is currently working to develop or enhance internal systems to reduce costs (e.g. Cansys). This trend will continue into the future, as Marsh is committed to improvements in service delivery and efficiency to help increase the bottom line.

4.2.6 Key Geographic Locations

Depending on the type of acquisition, and locations, Marsh might end up with multiple locations in a geographic region such as greater Vancouver. There might also be locations
outside the region, and depending on Management preferences can either be assimilated into the Marsh office, or run out of the new location(s). If the newly acquired offices are kept open, this will help to bring the Marsh services closer to the clients, and provide better geographic reach for the company. If the locations are closed which is the historical trend, then it is likely that many of the clients will move to a local broker, reducing the effectiveness and impact of the acquisition.

4.3 Option 3: Strategic Hiring of Key Staff

Marsh should decide on a key segment(s) of business within IBS that they want to target to increase their revenue and market dominance. The segment(s) could be any of the ones listed in Table 2. It can either be a segment where we have very little market share, or one where there is a reasonable market share. If Marsh concentrates their resources in a few target areas where the company can rapidly build market share, and dominance in the sector the long term impact on revenue will be very good.

There are several ways to approach this, but one of the best would be to plan in advance, being careful to ensure there is adequate support behind the scenes to handle the increased volume of business in terms of staffing etc. Marsh should then aggressively recruit knowledgeable skilled staff from competitors to both bring in the new business in their area of specialization, and service it moving forward. There are several approaches to this, but the company can either do this by office, or on a national basis picking key strategic areas to target. There should be a concerted effort to hire adequate staff from competitors, and it can be done on mass from the same broker across the country, effectively making them very vulnerable with their staffing levels being decimated in particular niches. Another approach would be to target smaller brokers with a specialization in the chosen target market, taking their key employees.

This is a departure from Marsh’s standard way of doing business, where each office is accountable for head count, and must justify each additional body with revenue prior to new hires being allowed. This approach will ensure there is adequate people to not only handle the current business the company has, but the new business that is brought through the door. The majority of people are working at full speed, and do not have the time to look after additional work loads with new business coming in the door.
Marsh will have to be careful because if it is decided to attack and decimate key strategic business areas, from another large global broker, there is very real chance that they will attack in the same manner. The result would then be swapping employees, which causes increased salary levels and training costs.

### 4.3.1 Resources

This option, will also require additional resources to assume salary levels in an office without the book of business to support it. This option will be less expensive than option 2, however it is a large deviation from historical preferences. The company will have the people in place, ready to handle the business before the aggressive sales process starts.

### 4.3.2 Relationships and Differentiation

As outlined in Option 2, many of the internal systems and procedures will remain in place. The addition of strategic hires, will only serve to strengthen relationships and differentiation capabilities of the company to provide a better product to clients.

### 4.3.3 Key Geographic Locations

By acquiring additional staff, unless this is done with the intention of opening offices in different areas, the company does not solve the problem of having only one location. The additional people will likely be added to the current office locations in major centres. This strategy will allow for increased capacity to handle more business, but the company is still restricted by location.

### 4.4 Option 4: Internal Growth

Currently Marsh is growing the book of business is through organic growth. This means employees are being pushed to handle their current workload and continue to maintain their sales philosophy by spending a certain percentage of their time in pursuit of new business. This has proven to work well with the compensation bonuses for new business. This strategy has many
benefits in that you maintain the same overhead cost structure, but increase the revenues causing a direct boost to the bottom line. This supports the company’s current policy regarding increased employee levels based on revenue. In other words, prior to adding additional staffing levels, the office must have adequate revenue to support the new staffing levels. This is a fiscally responsible and conservative way to continue to grow the operations of the company, but the results could be better if the company is willing to depart from its current policies.

4.4.1 Resources

This is of course the least expensive option from a capital outlay point of view. The structures and employees are already working for Marsh, and know the culture and systems that are in place. There are very little additional resources required to continue along this path to grow the business. The primary concern from a personnel standpoint is how much additional work can staff handle. Overall, work volumes have increased over the last few years with more demanding market conditions, and a push to increase revenues.

4.4.2 Build Strong Relationships with Clients

With the increased demands on staff, by increasing their current work load, this will unfortunately reduce the ability to build and strengthen relationships with clients. Client managers will be spending more time focussed on their work load and keeping their head above water, meeting client deadlines. They will have less time to build and foster a long term relationship.

4.4.3 Value added and Differentiation

All the key differentiators and relationships with markets that Marsh has developed and continue to use, will still be available with option 4. Nothing from a services and value added perspective will change. Clients will still have access to the resources and value added service of MRC and product development and specialization.
4.4.4 Key Geographic Locations

Option 4 creates a weakness in adding geographic locations. If this option is chosen it will be very difficult to open new offices without hiring additional staff and using more resources. Marsh has been successful to date in growing revenue internally, but this method cannot continue indefinitely.
5 INTERNAL ANALYSIS

Now the paper will focus on Marsh with specific attention again being focussed on the IBS Unit from an internal perspective. Several components under the heading of management will be reviewed, followed by the overall organization, and finally resources. For each of the alternatives the paper will discuss the actual capabilities for both implementing and wanting to implement each alternative and highlight any gaps that may occur.

5.1 Management

Currently Marsh has a strong management team, both in the local offices, and at the head office level. The management team and the company as a whole have undergone significant change over the years. They are very capable of handling and managing the organization through additional change to maintain the aggressive growth strategies. At Marsh, continuous change in structure, process and technology is a constant. The goal of senior management is to ensure there are opportunities for continued growth both this year, and well into the future.

5.1.1 Management Preferences

Senior management at Marsh Canada and at the global level are looking at various options to continue to grow the business, and improve the bottom line. The target growth rate is year over year growth of fifteen percent, and with the prospect of decreasing insurance premiums this puts additional pressure on everyone as the goal becomes more difficult to achieve. The current mandate within the company is to aggressively control expenses. Expenses at all levels of the company are being monitored in an attempt to reduce and minimize costs. Although this will not have an impact on the desired top line growth, expense reduction will have a direct impact on the bottom line.

Historically management has been generating technology improvements and pushing employees to handle larger volumes of business. This internal growth strategy, keeps costs low, because employees are simply doing more work with the same resources. Table 12 shows the
revenue and operating income generated per employee over the last five years. This table clearly illustrates that management is aggressively pushing employees to generate and handle much larger volumes of work than only 5 years ago.

<table>
<thead>
<tr>
<th></th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Revenue Per Employee</strong></td>
<td>$141,344</td>
<td>$136,571</td>
<td>$143,111</td>
<td>$155,526</td>
<td>$180,737</td>
</tr>
<tr>
<td><strong>Percent Change from Previous Year</strong></td>
<td>34.97%</td>
<td>-3.38%</td>
<td>4.79%</td>
<td>8.68%</td>
<td>16.21%</td>
</tr>
<tr>
<td><strong>Operating Income Per Employee</strong></td>
<td>$25,188</td>
<td>$26,971</td>
<td>$31,639</td>
<td>$39,211</td>
<td>$46,079</td>
</tr>
<tr>
<td><strong>Percent Change from Previous Year</strong></td>
<td>31.48%</td>
<td>7.08%</td>
<td>17.31%</td>
<td>23.93%</td>
<td>17.52%</td>
</tr>
<tr>
<td><strong>Number of Employees</strong></td>
<td>32,000</td>
<td>35,000</td>
<td>36,000</td>
<td>38,000</td>
<td>38,000</td>
</tr>
</tbody>
</table>

Table 12: Revenue per Employee

The current cost containment mandate will predispose management to look for the lowest cost alternatives. Marsh has been able to generate higher revenues and profits on a per employee basis over the last five years. This works out to a twenty eight percent increase in revenue, and an eighty three percent increase in operating income per employee from five years ago. This visibly highlights the aggressive attempts to control expenses over the years, and the success it has had on the bottom line.

Management prefers to chose the least costly option in their desire to grow the top and bottom line. The least expensive, and most conservative choice is option four. Organic growth will continue to increase the revenue per employee while driving down expenses, which will increase the operating income per employee. Management will look very good to shareholders when they see that revenue is increasing while expenses are increasing at a much slower pace.

The primary concern with this strategy is how much more work can individual employees handle. If employees are at or near the breaking point, many will leave to find jobs with less pressure (If there are any in the current business climate) causing increased costs for new employees and additional training costs. If people can handle more work, then it makes sense to keep pushing to improve the bottom line.
5.1.2 Management Capabilities

With the softening insurance market, global revenues are expected to decrease, without an aggressive growth strategy. This is why Marsh is so focussed on growing the IBS book of business as it represents the greatest potential for significant growth for several years. Table 13 shows the growth of revenue and operating income growth over the prior year.

<table>
<thead>
<tr>
<th></th>
<th>1998</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Revenue</strong></td>
<td>20.2%</td>
<td>35.0%</td>
<td>5.7%</td>
<td>7.8%</td>
<td>14.7%</td>
<td>16.2%</td>
</tr>
<tr>
<td><strong>Operating Income</strong></td>
<td>23.6%</td>
<td>31.5%</td>
<td>17.1%</td>
<td>20.7%</td>
<td>30.8%</td>
<td>17.5%</td>
</tr>
</tbody>
</table>

Table 13: Year over year growth of Revenue and Operating Income

The company has enjoyed significant year over year growth, and is aggressively trying to continue that trend well into the future. In 1998 and 1999 Marsh achieved significant growth of both revenue and operating income due to two large acquisitions. (Johnson & Higgins and Sedgwick) The growth rate dropped significantly in 2000 and 2001 as MMC was enjoying exceptional growth from Putnam (a sister company). This rapid growth by Putnam would have allowed Marsh to take a back seat, and likely focus the efforts internally on getting through the mergers. The growth rate in 2002 and 2003 is directly related to the increase in insurance costs seen around the globe with the hard market. Higher insurance costs mean increased commission for brokers. The rates have started to soften in 2004 especially in the US, and rate reductions are already being achieved in Canada now. This will decrease overall revenue, and operating income, as a large percentage of Marsh’s income is commission based.

As management capabilities are eagerly concerned with growing the overall revenue base, all of the four options will be acceptable. As acquisition produces instant results, any acquisitions would be acceptable to ensure the growth targets are met for this year. If adding new employees was an option (currently it is not) it would work well with current management capabilities. All it would mean is a manager might have a couple more people reporting to them. Management will also want to maintain the current option of internal or organic growth to achieve the desired results, which is why this option is still being perused.
5.1.3 Management Predisposition

Marsh has undergone significant revenue growth over the last few years, (see Table 13, or Appendix 1) gaining market share and representation around the globe. Clearly with the historical trends, management prefers to grow revenue through acquisition. This is a quick easy way to have a significant impact on overall revenue. With this strategy comes additional market share, well trained employees, and a stable book of business. This is a common method many companies use for both top line and bottom line growth, because the results are instant, and shareholders prefer to see quick results. The downside risk to this strategy, especially coming off a hard market, is the price paid to purchase a brokerage may be inflated because of the higher revenues obtained during the hard market.

June 29, 2004 MMC announced the formation of a new company, which brings together specialized parts of Mercer and Putnam (Sister companies of Marsh). This might indicate a willingness of senior management to explore the option splitting IBS away from Marsh under a new corporate name.

On July 8, 2004 the acquisition of Kroll Inc. received approval from their shareholders. Kroll is a risk consulting company, which will increase the available options and resources available through MRC. This acquisition will add about $500 million in revenue to Marsh annually. Although this price seems very high, it also must be noted that Kroll has grown rapidly over the last few years, and a premium was paid for the value of the brand of the company.

The management predisposition clearly favours option one and two. The management is predisposed to choose solutions that will address the growth requirements quickly. With the recent announcement at the end of June, it indicates MMC is willing to look at spinning off a new company if there is a good business reason to do so. There is also a willingness to incur the additional costs of creating and running a separate entity to take advantage of additional business opportunities

The one problem with this approach is the fiscal year is now more than half over, and any impact to the companies revenue will be minimal by year end. To complete another major acquisition takes significant amounts of time, and requires approval of the board of directors as
well as a majority of shareholders from the company being purchased. This process will often take more than six months to complete.

5.2 Resources

There are many resources the company can bring to the table to help employees do their job and come in many forms such as financial, human and operational. These resources are essential to conducting business, and provide a great deal of the differentiation Marsh is able to offer to clients.

5.2.1 Financial

Financially Marsh is a very strong company, with the resources and capacity to acquire competitors. There are ample financial resources available to make changes in terms of system, and procedures. The availability of the financial resources is of course based on the ability to convince senior management of the benefits (both short and long term) to using the capital for different purposes. The company would also be very cognisant of the impact in different spending patterns, on the bottom line as it will have a direct impact on shareholder value.

The financial resources can be raised for the right acquisitions or expenditures. This is indicated in the recent acquisition of Kroll Inc. by MMC for $1.9 billion cash. This transaction will certainly have an impact on the balance sheet of MMC, however given the current balance sheet strength, and continued treasury share repurchase additional capital could be raised through conventional debt or equity offerings. Marsh has repurchased treasury stock in excess of shares issued under employee stock compensation and purchase plans for many years. In 2002 and 2003 the difference was roughly $500 million, so clearly the positive cash flow of the company provides enough resources to meet expenses, pay dividends, and have additional funds for share repurchase and or acquisitions.

The financial resources of MMC are not unlimited, Table 13 compares some key financial indicators between MMC (Marsh’s Parent Co.) and Aon (The two largest global brokers). These ratios are key indicators used by financial analysts when evaluating a company and managements success or lack there of.
### Key Financial Indicator | MMC | Aon
--- | --- | ---
**Profitability Measures**
Profit Margin | 13.09% | 7.21%
Operating Margin | 21.36% | 12.47%

**Management Effectiveness**
Return on Assets | 10.66% | 2.66%
Return on Equity | 28.46% | 15.77%

**Income Statement Measures**
Revenue Growth | 11.00% | 11.20%
Earnings Growth | 12.80% | 34.80%

**Balance Sheet Measures**
Total Debt | 3.95 billion | 2.01 billion
Goodwill and other Intangibles | 5.79 billion | 4.509 billion
Total Debt / Equity | .616 | .478

**Cash Flow Statement Measures**
Cash Flow from Operations | 1.58 billion | 1.33 billion
Free Cash Flow | 1.18 billion | 1.18 billion

Table 14: Comparison of Key Financial Indicators between MMC and Aon

It is interesting to note that MMC has outperformed Aon in several of the above measures, however is falling short on both revenue and earnings growth. This is likely one of the big reasons for the aggressive push within Marsh at the current time. MMC has a higher debt / equity ratio than Aon, which may indicate it will become more difficult for Marsh to aggressively seek large acquisitions especially if they are all cash transactions. As the focus is to grow IBS, any acquisitions would tend to be more regional, hence very small purchases that would have minimal impact on the balance sheet. The earnings growth Aon has posted of almost 35% is not a true indication, as the previous year had very large write downs, causing the high (and very misleading) earnings growth rate.

Marsh has a fairly highly leveraged balance sheet with total debt as at March 31, 2004 of $3.95 billion, and a debt to equity ratio of .616 at year end, which is quite high, especially compared to others in the brokerage industry. With the recent acquisition of Kroll, the financial
parameters of the company changed significantly. When the cash acquisition price is factored in with the current debt, and being generous in suggesting the cash flow for the year of roughly $500 million was available for the purchase, it leaves additional debt of $1.5 billion to appear on the balance sheet. This will have a significant impact on MMC debt to equity ratio, changing from .616 to roughly .891. This is very high for a company such as MMC. Table 15 shows the total debt to equity ratio of various companies in the industry for the year ended Dec. 31, 2003.

<table>
<thead>
<tr>
<th>Total Debt to Equity</th>
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</thead>
<tbody>
<tr>
<td>AON</td>
</tr>
<tr>
<td>MMC</td>
</tr>
<tr>
<td>Willis</td>
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<tr>
<td>Hub</td>
</tr>
<tr>
<td>Western</td>
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</table>

Table 15: Industry Total Debt to Equity Ratio

The total debt to equity levels for the brokerage industry based on year-end data, showing that MMC is far more aggressive in the use of debt, which can be both a good or bad thing.

The pending balance sheet will likely preclude MMC from entering into any further major acquisitions this fiscal year. Senior management will always be on the lookout for smaller acquisitions. There is still a chance that a small acquisition in Canada is a possibility, because spending $100 million or so, on a few small acquisitions will not have a significant impact on the overall financial structure of the company.

Given the recently announced acquisition of Kroll, I would suggest that major acquisitions are not in the game plan for fiscal 2004. Senior management will likely still be looking for great deals, but on a much smaller scale than has been done in the past. Because of this a scaled down option two would be the best alternative given the current financial condition.

5.2.2 Human

Marsh is a large organization with 1,200 employees in Canada, and globally under the Marsh Inc. umbrella 38,000 colleagues around the world. With a staff of this size there is clearly
a very large talent pool to draw on for any changes to the IBS segment of the business. The employees are highly skilled and often possess very specialized knowledge.

A human resources problem Marsh has to deal with, while trying to juggle the requirement to grow, is living within the corporate guidelines established relating to hiring new employees. If an employee is being hired to replace a departing employee, there are no problems. The real problem arises when an office wants to increase staff in a department, or to put it another way, increase the head count in an office. Marsh Canada is allocated a head count increase from New York (Corporate Head Office), which is then allocated to each of the office heads for an office allotment to increase head count. For example, the Vancouver office might be allocated a head count increase of five for fiscal 2004. The office is then allowed to increase the staff levels by a total of five employees in the fiscal year. It would then make more sense for an office to hire more producers, and client managers while skimping on the support staff to obtain the required aggressive growth targets of fifteen percent. This could be an issue if a Manager has certain targets or goals required to increase their bonus, or if they were planning to leave in the near future. This type of scenario could always occur due to information asymmetry, and one has to hope and trust managers to look after the best interests of the company rather than their own. A scenario like this has the potential to create a short-term outlook at both growing and sustaining the business operations. More problems could be created in years to come, as support staff might have increasing turnover rates due to the increased work load, resulting in higher overall cost. It is interesting to note that fifty four percent of the staff at Marsh have been with the company for less than five years. Although it is difficult to determine exact numbers, I would assume the employee turnover is evenly split amongst all employees, from clerical to senior positions.

The head count micro management technique makes it very difficult for any manager to undertake an aggressive growth strategy in a particular market segment, because they will be unable to obtain the required staffing levels. In the current hard market, the amount of work required to place a piece of business with an insurer has increased over the last couple of years. This additional workload has been placed on the shoulders of all employees with little hope of relief, except that a softer market is approaching which should make life a little easier. Because

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5 North American Conference call with Mr. Peter Garvey, President and CEO of Marsh North America, March 29, 2004
of the head count issue, it makes more sense for senior management to acquire fully staffed offices, than to aggressively grow segments of the business organically.

Senior management should create a better way to manage the head count issue. A possible solution would be to allocate a rough salary level to the head count number. For example, the company might say an office can increase the head count by 3 people (Giving a individual salary level of $100,000) This would mean the office could hire 3 people at $50,000 per year, and two at $75,000 per year. This would allow managers to be fiscally responsible in negotiating salaries to stay within their allowable limit, but also encourage hiring of support staff, who are essential in the operations of the company. The slight modification in the application of the head count rule could help to decrease the work-load on an already overburdened staff, and encourage a long term approach to growth strategies, instead of a short term approach.

Given the current head count rule and its ability to tie manager’s hands in how they operate option two is the best choice. If a major acquisition is completed, the required staffing levels will already be in place to support the new business. This means there is less impact on current staff from a workload perspective, and they do not have to worry about how to work within the head count rule for the significant amount of new business acquired.

Option one three and four will clearly violate the head count rule, because additional staff will be needed to grow the business effectively. With option one, additional staff might be needed to support some of the administrative and management functions, which would also violate the head count provisions.

5.2.3 Operational

Marsh allocates significant resources on an ongoing basis both financial and human into the systems processes and resources to help employees perform their jobs. These resources are very important to enable differentiated products and services, and are the key ingredient that sets Marsh apart from the competition.
5.2.3.1 Human Resources & Accounting Services

Accounting and human resources (HR) are primarily handled in Toronto, ultimately reporting to New York, with minor functions being handled in regional and occasionally local offices. These functions vary in scope depending on the size of the office and whether it is a regional or local office. Like all bureaucracies, there is an infrastructure in place for accounting an HR functions. Often people in these positions prefer to remain in tight control of their domain, and try to increase their power and role within the organization. With this in mind, they would prefer to grow their group of staff, and centres of control. The best way to achieve this is if the company acquires a new company. This will bring more revenue and employees under their control, and with this comes additional staff for their departments from the acquired company.

HR and Accounting would prefer to go with option two. This allows rapid increases in responsibility, and power within the organization. Option one would split up their respective departments, and it would cause separate policies and procedures, with the many headaches involved in starting a new company. Option three and four allow for growth, but generally there would be no real impact on the HR and accounting functions. The workload would increase slightly but with only slight increases in staff, it is hard to justify additional bodies in support roles.

5.2.3.2 Space Availability

Currently offices are at capacity with regards to accommodating in additional staff. Marsh Vancouver is over capacity in the current location, and have only been a tenant in the current premises for slightly more than one year. Renovations are going to start very soon to acquire additional office space to make room for the over crowded situation that currently exists.

With the current space requirements of adding bodies, to an already overcrowded office space, option one and two sound ideal. If there is an acquisition, it will mean a large influx of people and a much greater office area. With option one, this might be the ideal scenario to start a separate location to grow and market a new brand, Marsh Lite.
Option three and four are very difficult to support from a space perspective. When Marsh entered into the lease arrangement for the Vancouver office they did not have the foresight to plan for expansion and growth. To re-do interior space, add floor space and purchase new desks, computers and the required installation cost is significantly more expensive when it is done piece meal. Because of the additional costs to either add new employees from other offices, or increasing head count as growth is achieved, it is expensive and very disruptive to the whole office to move people internally, and create new work stations in already overcrowded floor plans.

5.3 Organizational

The internal systems within Marsh have a large impact on how the employees work. Marsh invests heavily in systems and procedures to help employees get their job done efficiently and effectively. These systems include technology improvements, for both internal and external purposes, creating structures to reward and provide incentive to encourage employees to act in a certain manner. Finally the overriding culture of Marsh will be discussed relative the aggressive growth targets.

5.3.1 Technology

One of the areas of greatest concentration in terms of resources is the creation, upgrading and advancement of internal and external computer systems. Marsh invests heavily in technology. The IT department provides Marsh with many solutions that are efficient and effective, but an equal number of systems that are burdensome, bureaucratic, time wasting, and unrelated to our business focus. This department looks after software development, systems maintenance, and maintaining the integrity and security of Marsh’s networks and data. Technology enhancements can benefit either the client or employees of Marsh to help expedite the processing of various transactions. The company is seen as a leader in technology systems, and has won several awards for various client based software applications.

Because the department is so innovative and eager to continue to build new processes and systems, management would tend towards option 2. This will give the department more users, which means bigger better systems, and larger budgets to continue to be creative. With
option one, it is clear that first of all the department would be split up, and the idea and concept of option one is to be a follower, not a leader on the technology front. With options three and four, the differences in users and scope of creativity is limited to what is already ongoing.

5.3.2 Structures

Marsh has many internal structures in place to assist people in getting the job done. These structures take many forms from maintaining certain standards across the country in dealing with an insurance renewal, to ensuring compensation issues are structured appropriately to encourage employees to act in a specific manner for the best interest of the company.

5.3.2.1 Professional Standards

Internally Marsh has controls in place to monitor the quality of service to clients, and ensure that standards across the country are being adhered to. This is called professional standards, and the objective is to ensure file protocol is followed for the entire insurance placement process. The ultimate goal of this area is to reduce the errors and omission exposure the company could face if Marsh is ever sued. Any new employees starting at Marsh must learn the standards and protocol, as every company will have different rules and procedures. It will take time for new employees to learn and become comfortable with the standards (if that is really ever possible).

With the additional workload, to train new employees and give them time to understand and become conversant with the policies and procedures, option four would be the best alternative. With minimal increases in staff levels, new employees could easily be trained by people they work with, minimizing the additional workload of auditors. If large groups of employees were hired en mass, or with acquisitions, the number of new people needing training, and additional work load to review their adherence would be very time consuming and difficult. Option one would require a scaled down version of the standards currently being employed across the company, and would require additional resources to have a separate group for each company.
5.3.2.2 Specialization and Industry Focus

Marsh until recently was focused exclusively by industry specialization. This meant most clients (RM and IBS Mid Market) were allocated into specific industry groups based on their operations, such as Technology or Forestry. This caused problems because the company was trying to be all things to all clients. RM clients expect and had received excellent service, and this was starting to suffer to the point that some clients either left, or were threatening to do so.

In an effort to correct this stuck in the middle problem, employees and clients were grouped into either RM or IBS departments, to provide appropriate service to clients. This has allowed employees to focus on their client needs and appropriate service levels. This solution seems to have worked from a structural and operational perspective, in that clients are receiving the appropriate levels of service. In the long run this strategy has potential problems, as the company continues to focus on cost reduction. This is bound to impact service levels especially in the RM segment in future years.

To effectively compete long term it would be better to completely separate the two industry segments, by forming a new company, Marsh Lite. The new company will have a completely different cost structure, client service model, and culture within the firm. Marsh Lite will then have the ability and flexibility to quickly adapt to the changing market conditions and dynamics to stay ahead of the competition.

5.3.2.3 Hiring / Development / Compensation

Various aspects of hiring key staff are handled on a local or regional basis. All jobs are supposed to be posted internally, to allow current employees the opportunity to grow within the firm. Marsh is very proactive with employees in offering various educational and training sessions. The training sessions are run either by internal Marsh employees, or external experts are brought in to train many people at once. The company will also send employees to external courses for specific training if it is advantageous for their duties, and also conducts continuing education courses on line, and through video conferencing. This commitment to continued education and learning provides opportunities for employees to growth and be upwardly mobile within the organization. The commitment to education should help to attract the best and
brightest, which is the type of employee any company wants to employ. This type of internal program favours option three. It will help to attract employees while retaining what are hopefully the most valuable. With large acquisitions it is very likely many people will not want or appreciate additional education opportunities, and many might leave to pursue opportunities were there is less change and need for continuous learning of new technologies or value added services.

5.3.2.3.1 Retention of Key Employees

In today’s competitive business environment it is crucial to develop and retain the best employees. The competitive nature of the insurance brokerage industry and the increased work load, has created a shortage of skilled people in the insurance business. As the competition continues to increase, it will become increasingly important for Marsh to retain its best and brightest.

Marsh needs to develop ways to keep employees working with the company, as fifty four percent of employees at Marsh have been with the company for less than five years. This poses a significant burden to the organization in terms of additional workload to current staff, as well as the time and cost of training new employees. The company clearly needs to focus more efforts on the retention of key staff at all levels of the company, because the cost saving associated with retention of employees goes straight to the bottom line, as many expenses are avoided.

Employees at Marsh are all salary based, with an incentive program aimed at producing new clients. The incentive program is called variable compensation and has several different aspects associated with it, for various job descriptions in the company. Almost all employees in the company are able to participate in the variable compensation program, helping to build a framework for everyone to get involved to produce new business. This program really only provides limited bonuses to employees except for the few sales professionals. To make a significant impact on staff larger variable compensation plans for employees other than sales professionals would likely create better growth for the company.

In choosing any of the four options Marsh needs to ensure good staff stay. There is no point in pursuing option three if competitors are going to take Marsh employees. Some turnover
is to be expected in any business but excessive amounts are very costly. Recently Marsh (Vancouver office) has had many employees leave for competitors. The office has successfully enticed good staff from other offices, without the retaliatory counter strike. With the current success in retaining key people, and a very small scale strategy to undertake option three with two new hires, a full scale option three would be ideal, in what I think is Marsh’s ability to attack the competition when they are vulnerable. With a large acquisition (option one and two), it is very likely that some of the employees will be unhappy with their new role, or working with new teams of people. Disrupting the traditional flow and comfort zone people prefer to work within may lead to turnover of employees.

One advantage to pursuing option three is if Marsh wants to be absolutely ruthless to obtain and hopefully retain the best employees, the company could hire large numbers of people with the intention of only keeping a certain percentage. This plan would certainly make the stars rise to the top, so they could be offered great incentives to stay and keep producing, but in the long run this approach would backfire. Most employees would not want to work in a high pressure, high stress environment like that. Everyone would always be looking over their shoulder to see if they are going to be next. Additionally it would become very difficult to attract new employees once word hit the street.

5.3.2.3.2 Variable Compensation

Variable compensation is designed to encourage employees to generate additional revenue for Marsh through new or expanded business. The current plan encourages everyone to produce new, or expanded business, and rewards that activity with a certain percentage of the revenue to Marsh being paid to the producers, or initiators. There is no ceiling on the total variable compensation an employee can earn, with the exception of a per account maximum payment to an employee. This amount varies based on the job classification of the employee. Employees must also produce a minimum level of new business to be eligible to receive the variable compensation.

Most competitors offer forms of variable compensation to their employees. If Marsh chooses option one or two, and the acquired company had a better compensation program, or one the employees perceived was better the best sales people would not stay around long at the new
company. The compensation program would have to be better than other companies to entice people to join Marsh, or at least give the prospective employees the perception that the compensation plan is better. Option four is the best alternative for compensation plans, because competitors could easily improve their compensation plans to attract the best producers, or retain the best producers.

5.3.3 Culture

Marsh is a financial services company, and key part of a fortune 500 company listed on various stock exchanges. Because of this the company is always under the watchful eye and scrutiny of regulators and all levels of government. Marsh is in a heavily regulated industry, it is reasonable to expect the firm to be very bureaucratic in nature. Marsh seems to at times recognize this is a problem, because there are systems and procedures in place to monitor employees across the country. There is even a reward system in place to provide financial compensation to offices and employees within that office that do the best job of completing their administrative (bureaucratic) tasks.

The company is also trying to be a leader in technology, which requires a very different set of values and structures. Trying to maintain an entrepreneurial creative work force does not work well in a rules based bureaucratic organization. People tend to ignore the mixed messages that are being sent, and try their best to work within the rules and guidelines established.

Finally Marsh is trying to develop a strong sales culture within the organization. Some offices have done very well in adapting to this new culture. One of the major problems with the attempt at developing a buccaneer attitude, is the RM business at Marsh is very rules and service based. There is no real desire or need to change the RM culture because the RM client base will also be very bureaucratic and need to have a similar structure for interaction and service.

To aggressively grow IBS, a very strong sales culture would be very beneficial to helping achieve the growth targets for many years to come. This sales culture needs to be different than the RM culture, and the best way to achieve this is to choose option one. With a separate and distinct company the appropriate culture can be fostered to achieve optimal results. The big downside to this approach is many people who become employees of Marsh Lite, would prefer to
be in a bureaucratic structure with many rules and regulations. There is a good chance some employees will not stay, as they will not like the buccaneer type of culture. If the company chooses any of the other options there will always be a constant struggle around the culture, with the bureaucratic side winning out.

5.4 Overview of Internal Analysis

The internal capabilities of Marsh favour various different options depending on the specific internal structure. Table 16 clearly shows the preferences based on the internal analysis, which clearly favours option two, the acquisition of a regional broker.

<table>
<thead>
<tr>
<th>Management</th>
<th>Option 1</th>
<th>Option 2</th>
<th>Option 3</th>
<th>Option 4</th>
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<td>Specialization</td>
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<tr>
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<tr>
<td>Culture</td>
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</tbody>
</table>

Table 16: Internal Analysis
6 CONCLUSIONS AND RECOMMENDATIONS

The preceding chapters have provided an overview of both the brokerage industry, and Marsh. Several suggestions have been outlined to take a more aggressive approach to meeting the fifteen percent growth target both this year, and well into the future. The internal analysis overwhelmingly favoured option two, much to my disappointment. Given the recent acquisition of Kroll, the current financial position of the company might eliminate any acquisition strategies at the current time. Based on the analysis, I will assume there are some funds available to pursue smaller scale acquisitions, which will provide the geographic reach the company needs to continue growing IBS business now and for many years to come.

The internal analysis clearly suggests using the strategy to acquire competitors to achieve sustained growth levels in the IBS segment. This is essentially going down market from the traditional preferred class of clients (RM) who want and need the differentiation and expertise Marsh offers. These services have been critical in the success of the company to date. In pursuing an acquisition strategy, there is a very good chance it will lack focus and clarity in the long run. The company risks becoming stuck in the middle, by trying to be all things to all clients. The IBS market is very price sensitive, and will not want to pay for most of the value added services. Having these products and services available for clients, is a huge fixed cost that is difficult to recover and as all companies are trying to reduce costs, this could impact the services provided to RM clients. To reduce the likelihood of becoming stuck in the middle of two different strategies Marsh will need to have and maintain very distinct management teams and structures clearly separating the two business segments. This will allow employees and management to focus exclusively on their specific business segment, and meet the specific needs of the client base.

6.1 Acquisition of a Broker

The internal analysis strongly suggests Marsh should continue with its historical preference to acquire competitors. This is an easy way to achieve instant growth with the acquisition of a book of business, and skilled employees to manage the client base. The company will need to determine if they want to acquire a large book of business and maintain the current location structure of having an office in major centres only. Alternatively, a better choice for
long-term growth potential is to acquire offices with a presence in cities throughout the provinces.

Combining the acquisition strategy with the current internal push to grow organically (option 4) will help to achieve additional growth and revenue streams well into the future. Marsh will continue to pursue internal growth, and with an added sales force the future looks promising.

6.1.1 Cost Savings

With the acquisition of a competitor, many synergies and cost savings can be realized. Marsh already has significant support services, such as human resources, accounting services, and senior management. Some of the staff performing these functions at the acquired firm will not be required as Marsh's systems can adequately handle the increased work load likely with limited additional staff. Cost savings would also be achieved through the use of technology and some of Marsh's systems designed to increase efficiency. The company must also be careful not to overburden staff with administrative duties, or any cost savings through efficiencies will be lost.

6.1.2 Less Competition

By acquiring a competitor, it will serve to ultimately reduce the available competition in the industry. This is great for Marsh, as the company is becoming larger with a stronger team of professionals to assist clients. This will provide Marsh with a bigger market presence and strength when dealing with insurers.

6.1.3 Value Added Services

With the increased client base, and greater prospects for more growth using a larger sales and support staff, Marsh will have the opportunity to sell more of the value added services. With the acquisition of Kroll, it will be increasingly important to take advantage of their services, and having an increased client base will only serve to improve future growth opportunities for MRC type of products.
6.1.4 Differentiation

Marsh has built its reputation and success on having the ability to provide differentiated products, services and expertise to its client base. By maintaining the current structure with an acquisition, the company maintains the ability to offer the value added services. Following this course of action has short-term benefits, such as achieving scale effects through savings in administration and support services. Eventually this strategy will distract senior management in their push to reduce costs and expenses, which will in the long run, cause the company to become stuck in the middle trying to serve both market segments efficiently and effectively, while really not doing a good job with either segment. To maximize the scale effects of an acquisition, and instead of creating a separate company to handle IBS business Marsh should continue operating the internal units separately, however this is an ideal opportunity to create two separate brands. Structurally the management teams will remain separate and distinct as it currently operates, however clients and employees will be allocated to a specific brand or unit. Savings will be realized over creation of a new and separate company through shared support services. By having two separate brands it will create the needed separation internally and allow separate advertising and brand awareness campaigns for the selected target markets for both segments.

6.1.5 Brand Dilution

With any acquisition strategy, there is a risk of brand dilution. Either the current value of the Marsh brand is diminished by a down market acquisition of a company with less abilities and capabilities, or the acquired company loses any brand value in the local community once it has been amalgamated into Marsh. These brand dilution effects can be easily offset, by mounting an advertising campaign to educate and raise awareness of both Marsh, and the value of dealing with the largest broker in the world.

6.1.6 Marketing Approach

In my opinion, Marsh needs to develop and invest in a marketing plan to raise awareness, brand loyalty and trust for the Marsh name. Regardless of which strategic alternative is chosen, a
focussed marketing campaign should be undertaken because in my opinion it is critical to the long term success of the company.

With aggressive growth strategies for the IBS segment, a new marketing approach should be initiated. In greater Vancouver, the insurance broker with the best brand recognition is a company called Pat Anderson Agencies. They only have five locations, and do house and auto insurance combined with small commercial accounts. I would guess that roughly thirty percent of the working adults in Greater Vancouver have heard of, and would recognize the name of the company, and have an idea of what they do. On the other hand, I would guess that less than two percent of the people in Greater Vancouver would recognize the Marsh name, and even less would have any idea what the company does.

There are various approaches that can be taken to effectively and efficiently advertise using mass media. It is important to note that Marsh will need to be very careful about how much and what forms of advertising are undertaken. If competitors start to use the same approach, it will be a fruitless exercise because the companies will then need to continue to spend money, with no real additional benefits. It could become a situation were a company must advertise simply because the competitor does, and the absence of advertising would be very obvious. This is likely the case with Coke and Pepsi.

There are several themes that could be used when conducting an advertising campaign to reach the target audience. The professionalism of both the people and company could be highlighted. Ads could discretely emphasize the fear people have about major losses, which is the primary motivating factor for purchasing insurance, and build on the trust and reputation of Marsh to adequately protect their assets. Informational ads could run outlining various coverages that can be purchased that are not common, and many companies may not be aware of their existence, such as credit insurance, or warranty coverage.

The benefit of building a maintaining a strong brand will have long lasting benefits. I find it very interesting that the top fifty brands globally (see Appendix 3) do not include insurance companies. Several financial institutions are included in the list as are many other well recognized companies. In my opinion a well respected and trusted brand to protect peoples most valuable possessions would help convince people to chose Marsh over competitors, because of
the confidence and trust. (People are willing to pay more for Green Giant frozen vegetables as opposed to no name, simply because of the brand.) To conduct a full and strategic marketing and brand awareness campaign Marsh’s sister company, Lipincott Mercer would be ideally suited to help. As their business is based on brand management and they already have an excellent knowledge of Marsh and MMC.

6.2 Marsh Lite

I would recommend that the company look into the idea of creating a new corporate entity “Marsh Lite” which will encompass the IBS business. In choosing this approach, it is both an aggressive and bold step to position the company for future growth for many years to come. Although the current focus is to grow the IBS book of business, and particular the mid market segment, aggressive growth in this segment will only be possible for a certain amount of time. Once critical mass is achieved, there will be limited growth opportunities much like the current RM market where Marsh has a 60 to 70 percent share across the country. It will be many years before Marsh reaches that level of business, but it is better to look at the long-term opportunities.

With multiple locations, and a strong community feel to Marsh Lite will make it well positioned to grow well into the future. It is very important to come across as a local company that cares about the people and community in which it operates. The last thing Marsh Lite would need are ads appearing in local media mentioning humongous broker

The ideal strategy will be to acquire a broker, or several brokers with geographic locations that are in prime locations. Once the company has offices in smaller centres across the country, it will be well positioned for further growth to pursue the largest part of the insurance market in Canada. The personal lines category, which includes primarily home and automobile insurance represents sixty five percent of the P&C market in Canada, and it would be nice to have a profitable share of this market. It seems crazy to have an aggressive growth strategy for Canada, that omits the largest part of the insurance market, however with the lower cost Marsh Lite option, in four or five years an aggressive push into this segment will likely make sense. The key to competing in the small enterprise sector of IBS, is a low cost structure. Marsh Lite will provide this vehicle to ensure marsh generates the return on investment required to keep shareholders happy.
Marsh Lite will also continue to pursue organic growth (option 4) as this is a very cost effective way to continue growing the business. With a large geographic reach, the potential client base will increase rapidly. As the company brings in more clients, the spin off effects of selling MRC services increases, further enhancing top and bottom line growth.
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Hubb International Annual Report 2003
Marsh & McLennan Companies, Inc. Annual Report 2003
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Willis Annual Report to Shareholders 2003
APPENDICES:

APPENDIX # 1 MARSH GLOBAL REVENUES AND OPERATING PROFIT OVER THE LAST 8 YEARS

<table>
<thead>
<tr>
<th></th>
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<th></th>
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</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>1,907</td>
<td>2,789</td>
<td>3,351</td>
<td>4,523</td>
<td>4,780</td>
<td>5,152</td>
<td>5,910</td>
<td>6,868</td>
</tr>
<tr>
<td>Operating Income</td>
<td>363</td>
<td>496</td>
<td>613</td>
<td>806</td>
<td>944</td>
<td>1,139</td>
<td>1,490</td>
<td>1,751</td>
</tr>
<tr>
<td>Oper. Inc. Margin</td>
<td>19.0%</td>
<td>17.8%</td>
<td>18.3%</td>
<td>17.8%</td>
<td>19.7%</td>
<td>22.1%</td>
<td>25.2%</td>
<td>25.5%</td>
</tr>
</tbody>
</table>

Table 17: Revenue and Operating Income from 1996 to 2003

Figure 7: Graph of Revenue and Operating Income from 1996 to 2003
1. **Internal Account Planning**

This step is the beginning of the relationship with a prospect, or start of the renewal process for a client (8 Months prior to renewal date)

- Collect information & analyze client need
- Identify issues, exposures & possible Marsh solutions
- Benchmark program to industry best practices
- Review relationship at all levels
- Evaluate compensation requirements
- Outline proposed set of solutions & opportunity to bring value
2. Stewardship Review

Approximately 6 months prior to insurance renewal, (for large clients only)

➢ Understand client's future business strategies, and hold meeting with client to review the following:
  a. issues / solutions identified at account planning
  b. insurance market conditions
  c. last years achievements
  d. insured and uninsured exposure

3. Renewal Strategy Meeting

Approximately 4 months prior to insurance renewal

➢ Discuss clients objectives for the upcoming renewal
➢ Review the total cost of risk
➢ Discuss risk control strategies
➢ Present market strategy for each line of coverage
➢ Review exposure information requirements
➢ Review open items, timeline, key deliverables
➢ Review compensation arrangement for each line of coverage

4. Confirm Service Scope & Compensation

Approximately 2 months prior to insurance renewal date

➢ Present draft scope of services & compensation proposal
➢ Review risk control strategies proposal
➢ Provide Client Service Agreement for review and signature if applicable

5. Execute Transactions or Assignments

Risk Consulting (Value added services)

➢ BRC
➢ Claims
➢ Operational Asset Management (Loss Control)
➢ Workforce strategies
➢ Risk Technologies
Risk Placement

- Prepare Specifications
- Placement
- Post-renewal servicing

6. Monitor & Close Open Items

After insurance renewal

- Ensure proper documentation is sent to client

7. Client Feedback

Approximately 2 months after renewal

- Client Survey
- Client Dialogue
- Senior Relationship Officer Dialogue
### APPENDIX #3 TOP 50 BRANDS AND ITS VALUE IN 2003

<table>
<thead>
<tr>
<th>Company Name</th>
<th>2003 Brand Value ($) billions</th>
<th>Company Name</th>
<th>2003 Brand Value ($) billions</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Coca-Cola</td>
<td>70.45</td>
<td>26. Morgan Stanley</td>
<td>10.69</td>
</tr>
<tr>
<td>2. Microsoft</td>
<td>65.17</td>
<td>27. Merrill Lynch</td>
<td>10.52</td>
</tr>
<tr>
<td>3. IBM</td>
<td>51.77</td>
<td>28. Pfizer</td>
<td>10.46</td>
</tr>
<tr>
<td>4. GE</td>
<td>42.34</td>
<td>29. Dell</td>
<td>10.37</td>
</tr>
<tr>
<td>5. Intel</td>
<td>31.11</td>
<td>30. Merck</td>
<td>9.41</td>
</tr>
<tr>
<td>8. McDonalds</td>
<td>24.70</td>
<td>33. Nike</td>
<td>8.17</td>
</tr>
<tr>
<td>9. Marlboro</td>
<td>22.18</td>
<td>34. Kodak</td>
<td>7.83</td>
</tr>
<tr>
<td>10. Mercedes</td>
<td>21.37</td>
<td>35. SAP</td>
<td>7.71</td>
</tr>
<tr>
<td>11. Toyota</td>
<td>20.78</td>
<td>36. GAP</td>
<td>7.69</td>
</tr>
<tr>
<td>12. Hewlett-Packard</td>
<td>19.86</td>
<td>37. HSBC</td>
<td>7.57</td>
</tr>
<tr>
<td>13. Citibank</td>
<td>18.57</td>
<td>38. Kellogg’s</td>
<td>7.44</td>
</tr>
<tr>
<td>17. Cisco</td>
<td>15.79</td>
<td>42. Volkswagen</td>
<td>6.94</td>
</tr>
<tr>
<td>19. BMW</td>
<td>15.11</td>
<td>44. Harley-Davidson</td>
<td>6.78</td>
</tr>
<tr>
<td>20. Sony</td>
<td>13.15</td>
<td>45. Louis Vuitton</td>
<td>6.71</td>
</tr>
<tr>
<td>21. Nescafe</td>
<td>12.34</td>
<td>46. MTV</td>
<td>6.28</td>
</tr>
<tr>
<td>22. Budweiser</td>
<td>11.89</td>
<td>47. L’Oreal</td>
<td>5.60</td>
</tr>
<tr>
<td>23. Pepsi</td>
<td>11.78</td>
<td>48. Xerox</td>
<td>5.58</td>
</tr>
<tr>
<td>24. Oracle</td>
<td>11.26</td>
<td>49. KFC</td>
<td>5.58</td>
</tr>
</tbody>
</table>

*Table 18 Top Fifty Global Brands and the brand value*

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6 The 100 Top Brands, Business Week, August 4, 2003 p. 72