A STRATEGIC ANALYSIS OF A PROPERTY & CASUALTY INSURANCE BROKER IN BRITISH COLUMBIA

by

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ABSTRACT

The purpose of this paper is to analyse the property and casualty (P&C) insurance brokerage industry in British Columbia and recommend strategies that would allow Westland Insurance, a British Columbia based insurance organization, to extend its leadership position in the industry, to grow its competitive advantages, and to increase its profitability.

This paper consists of five chapters. Chapter one presents an overview of Westland Insurance, its products and the markets in which it operates. An analysis of the property and casualty insurance brokerage industry in British Columbia is provided in chapter two. Chapter three presents and internal analysis of the firm. Chapter four identifies key issues facing the firm. Lastly, chapter five provides recommendations that address the issues identified in chapter four.

DEDICATION

I dedicate this project to my wife Julie. Without her sacrifice and support, I would not have been able to achieve this goal. Your understanding of the commitment needed to complete an undertaking such as this will forever be appreciated. Thank you for our daughter Philicia, who was born on the night of my first accounting class in January 2004. Thank you for all the nights you tended to our crying baby so that I could complete my papers. I love you and I look forward to a simpler time and when we can have extended conversations about nothing in particular.

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1.1 Introduction

Ever since the first woolly mammoth smashed through a hunter-gatherer's prehistoric camp, man has learned that putting all his eggs in one basket can have crushing consequences. Whether hunting for food or defending against common enemies, people found that sharing risk among the group minimized the risk to the individual. The sharing of risk is traced back as early as 5,000 B.C. when boat operators in China found it prudent to redistribute their cargo throughout several boats as they travelled down turbulent rivers.[1] The agreement being that if one boat capsized then all boat owners would share in the loss and no one operator would have to bear the loss alone.

Insurance is essentially risk sharing. It is a man-made mechanism for exchanging uncertainty with predictability and certainty. The purpose of insurance is to redistribute serious risk from the shoulders of individuals and spread it among a large number of people and organizations that are exposed to the same, or similar, risks. This is achieved by the fact that insurance premiums are paid by many people to cover the losses of the unlucky few.

Insurance is a product that most consumers buy, but few want to use. It is unlike any other consumer product on the market. You cannot see it, touch it, smell it, hear it or taste it, but without it, the world would be a much different place. A casual, carefree drive in a car would be non-existent since drivers could lose everything they had ever worked for if they were involved in an accident. How much would one be willing to spend on a home if there were no insurance available to cover it? Who would be bold enough to start a new business without being able to

[1] Insurance Brokers Association of Canada, *Fundamentals of Insurance*, March 1989, p.1.2.

manage risk through insurance? Insurance allows people to take risks, make investments, protect their hard-earned assets and provides peace of mind.

The purpose of this paper is to analyse the property and casualty (P&C) insurance brokerage industry in British Columbia and recommend strategies that would allow Westland Insurance, a British Columbia based insurance organization, to extend its leadership position in the industry, to grow its competitive advantages, and to increase its profitability.

This paper consists of five chapters. Chapter one presents an overview of Westland Insurance, its products and the markets in which it operates. An analysis of the property and casualty insurance brokerage industry in British Columbia is provided in chapter two. Chapter three presents and internal analysis with three objectives. First, to identify Westland Insurance's generic strategy and to analyse several strategic variables in order to determine the degree of fit between the variables and the organization's overall competitive strategy. Second, to conduct a value chain analysis in order to identify outsourced activities, core competencies, and competitive advantages. Third, to measure Westland's financial performance on a number of criteria and to compare its performance to what is considered "best practices" within the industry. Chapter four identifies key issues facing the firm. Lastly, chapter five provides recommendations that address the issues identified in chapter four.

1.1.1 Company Background

Westland Insurance is an insurance organization that focuses primarily on residential, automobile, and commercial insurance. It began operations in May of 1980 with the purchase of a single insurance brokerage office in Ladner, B.C. Today, Westland is comprised of two core business units, an insurance brokerage and an insurance company. The insurance brokerage has grown primarily from acquisitions and provides insurance services to over 125,000 customers through 25 retail offices located throughout British Columbia. The brokerage, named Westland

Insurance Group Ltd. (WIGL), has an annual premium volume of $94 million from which it earns annual revenues of $19 million. The insurance company, named Westland Insurance Company Limited (WICL), created in June of 1998 with the primary purpose of underwriting Westland's residential insurance, earns annual revenues of $22 million.

The structure of Westland Insurance makes it unique in the Canadian insurance industry. Westland Insurance is essentially an insurance broker that has vertically integrated backwards in the P&C insurance industry supply chain to include an insurance company. The insurance company is the manufacturer of the insurance product and is financially and contractually responsible for indemnifying a policyholder in the event of a loss. This is a distinctly unique structure for three reasons. First, although there are many insurance organizations that include both the manufacturing and selling of insurance policies in their scope of operations, practically all of them are insurance companies that have vertically integrated forward at some point in their company's history. A typical scenario includes an insurer for one of a variety of reasons deciding to either bypass or augment the broker distribution channel with a direct sales channel. Another scenario of forward integration includes insurance companies purchasing all or part of an insurance brokerage business. An example is Canadian Direct Insurance (CDI) which sells exclusively direct to consumers and does not have any broker distribution. Another example is ING which sells through broker distribution channels, directly to consumers via call-centers and web based applications through a company called BELAIR Direct, and which owns a minority share in Equisure Financial Network, a national insurance brokerage network. The second reason why Westland's structure is unique is that most insurance brokerage firms do not have access the levels of capital needed start an insurance company. Third, most insurance brokerage firms are owner operated and principals do not have the adequate knowledge of re-insurance, actuarial sciences, operations, or systems needed to create a start-up insurance company.

1.1.2 Product Portfolio

Westland Insurance Group Ltd. (WIGL), the insurance brokerage firm, distributes three core insurance products and one financing product. The three insurance products include: residential, automobile, and commercial insurance. The financing product is a monthly payment plan used to finance annual insurance premiums.

Table 1.1 Product Contribution – Westland Insurance

Product	2005	% of Total	2004	% of Total
Residential Insurance	$ 7,635,417	41%	$ 6,300,023	40%
Commercial Insurance	$ 4,214,882	23%	$ 3,432,468	22%
Automobile Insurance	$ 5,192,322	28%	$ 4,609,869	29%
Premium Financing	$ 719,087	4%	$ 643,570	4%
Other	$ 874,957	5%	$ 848,105	5%
Totals	$ 18,636,665	100%	$ 15,834,035	100%

Westland Insurance, 2005 Budget & Variance Reports

Table 1.1 summarizes the associated annual revenue associated with each product over two consecutive years and presents the contribution of each product as a percentage of the total annual revenue. Premium financing revenue of $719,087 comes from a pre-authorized monthly payment plan developed by Westland in 1997 to allow customers to spread their annual insurance premiums over 12 equal monthly payments. Other revenue includes profit sharing income, travel insurance revenue and revenues earned from managing claims on behalf of other insurance companies.

1.1.2.1 Residential Insurance

Residential insurance is insurance that protects the homeowners from losses or damage to their home or personal property and from damages to other people or property. Residential insurance is required by mortgage lenders and forms part of the mortgage agreement and ensures that in the event of a total loss that the mortgage lender is the first party paid, or second party paid in the case of a second mortgage.

Westland packages its residential insurance into three basic types: house insurance, tenants insurance, and condominium insurance. Westland Insurance Company Limited (WICL), which forms the insurance company arm of Westland Insurance, underwrites the majority of the residential insurance business. The only exception is that Lloyds of London underwrites all of Westland's high valued homes[2]. Westland only sells a 'best-of-breed' policy, which is a comprehensive or 'all risks' policy designed to include as broad as possible coverage for the policyholder. In the industry, all residential insurance policies typically fall into one of three categories. First, standard policies are the least expensive and most restrictive. Coverage is only for specific perils listed in the policy. Second, broad form policies typically have listed or named perils coverage for contents and broad, comprehensive coverage for the building. This type of policy tends to be in the more expensive than standard policies but less expensive than comprehensive policies. Third, comprehensive or 'all risks' polices have the broadest coverage and are the most expensive.

Residential insurance accounts for approximately \$7.7 million or 41% of Westland's total annual revenues in 2005. It is sold and serviced mainly through Westland's 25 retail offices, which range throughout British Columbia. Westland Insurance has 2 offices on Vancouver Island, 2 on the Sunshine Coast, 2 in the Sea to Sky corridor and 19 throughout the Lower Mainland. Hours of operation are generally 9:00 am to 6:00 pm Monday through Saturday. However, a few select offices are open from 10:00 am to 4:00 pm on Sundays. All of the retail operations fall under the responsibility of Jason Wubs, Vice-President of Retail Operations. The

[2] Westland defines a high valued home as a house that has a replacement cost greater than \$750,000. It is important to note that the replacement cost only includes the cost of replacing buildings or structures and does not include the cost of land.

division consists of approximately 150 insurance agents, 3 regional managers, a director of underwriting, and a sales and marketing manager.

1.1.2.2 Automobile Insurance

Automobile insurance is coverage for the risks associated with driving or owning an automobile. It can include collision, liability, comprehensive, medical, and uninsured motorist coverages. Ever since 1974, automobile insurance in British Columbia has been delivered to B.C. motorists by way of a government run monopolist insurer named The Insurance Corporation of British Columbia (ICBC).

An ICBC insurance policy is comprised of two parts, basic coverage and optional coverage. Each part is roughly 50% of an annual policy premium. The basic coverage is a mandatory insurance policy for all B.C. motorists and includes five kinds of coverage. The first coverage is third-party legal liability. This coverage pays claims against the insured made by other motorists for damages or injuries, up to a limit of $200,000, when the insured is found responsible for a crash. The second coverage is accident benefits. Accident benefits pay for medical expenses, rehabilitation costs, wage loss or death benefits. It covers the insured, members of the insured's household, or occupants of the insured's vehicle if injured or killed in a crash, no matter who is at fault. The third coverage is underinsured motorist protection (UMP), which provides coverage if the insured is injured or killed, and the motorist at fault does not have enough insurance to pay for the damages. The coverage is up to $1 million per person. The fourth coverage is hit-and-run and uninsured motorist coverage. Hit-and-run and uninsured motorist coverage pays damages of up to $200,000 if the insured is injured or killed by a hit-and-run or uninsured motorist. Lastly, the fifth coverage is inverse liability coverage. Inverse liability coverage covers the insured in the parts of Canada and the U.S. where the law will not allow the insured to recover losses from a driver who causes a crash.

The optional coverages are made up of three kinds of coverage. The first is collision coverage, which pays for damage to the insured's vehicle. The second is comprehensive coverage, which covers loss caused by fire, theft, vandalism and glass. Lastly, the third coverage is third party legal liability over and above $200,000. Optional coverages do not fall under the monopolistic control of ICBC. Several insurance companies other than ICBC currently offer optional automobile coverages.

Westland Insurance sells both basic and optional automobile insurance from its 25 retail locations. Westland brokers ICBC optional automobile insurance products throughout all of its offices with the exception of its two Victoria locations. These offices sell optional automobile insurance products for B.C. based insurer named Family Insurance. Automobile insurance accounts for approximately $5.2 million or 28% of Westland's total annual revenues in 2005.

1.1.2.3 Commercial Insurance

Commercial insurance is insurance concerned primarily with the protection of an insured's business or vocation. Commercial insurance products are typically more complex than residential or automobile insurance because there are more risks involved in business operations.

The commercial insurance operations, led by Sr. Vice-President of Commercial Insurance, Andy Luiten and Vice-President of Commercial Operations, Carolyn Nichols, accounts for approximately $4.2 million or 23% of Westland's 2005 annual revenues. The commercial division consists of two separate units, the special business unit and the general business unit. The special business unit focuses on the sale of small commercial policies, those with annual premiums under $15,000. Most of the growth in the special business unit is from leads generated in the retail branches and from referrals. The special business unit has enjoyed the most significant growth in the company over the past five years averaging well over 10% per year in revenue growth. Furthermore, with a profit contribution of over 60%, it year after year continues to boast the highest profit contribution in the entire organization. The unit employs eight insurance agents including Ms. Nichols.

The general business unit focuses on large commercial accounts, those with annual premiums over $15,000, but some of which are over $100,000. Also, the general business unit develops specific programs for business groups and associations. Current programs include dry-cleaners, churches, private health-care facilities, and private schools. Most of the growth in the general business unit is a result of referrals and canvassing of associations with respect to the specific programs. The unit employs 5 insurance agents, including Andy Luiten.

1.2 Growth: Westland's Roll-up Strategy

Westland Insurance has grown primarily through the acquisition. This contradicts traditional studies which show that 50%-70% of all mergers and acquisitions fail. The reasons for failure given in these studies were, acquirers pick the wrong target and/or pay too much for the acquisition, synergies were over-estimated and lastly, post-acquisition integration costs were under estimated.[3] This section explores Westland's acquisition success in terms of the framework given above and demonstrates how synergies are created from acquisitions and how they provide the impetus needed to successfully implement a roll-up strategy.[4]

1.2.1 Acquisition Selection & Value Establishment

One of the reasons given for why mergers & acquisitions fail is acquirers pick the wrong target and/or they pay too much for the target. Since its inception, Westland's primary growth driver has been growth by acquisition. This strategy is viewed a successful one by Westland executives and shareholders for three reasons. First, Westland performs above the industry

[3] Danny Shapiro, EMBA 651 - Managerial Economics Class notes, September 2003.
[4] Ed Bukszar, EMBA 607 - Strategic Management Class Notes, January 2005.

average in many operating measures[5]. Second, profitability, share price and market share increased after most acquisitions. Third, most acquisitions met the expectations of share holders[6]. Westland's acquisition success can be explained by exploring how it selects its acquisition targets and how it establishes the value of its targets.

1.2.1.1 Target Selection

In its 24 years of existence, Westland has made close to 40 acquisitions. It is the quintessential "binge acquirer"[7], starting first by purchasing small brokerages then increasing the size of acquisitions over time. It comes as no surprise that Westland has well defined criteria for selecting a target. These have been developed as a result of past experience and show evidence of efficiencies gained through learning.

All of Westland acquisitions are horizontal mergers and are categorized as either in-market or out of market acquisitions[8]. In-market acquisitions are purchases where Westland already has an office location in the same area as the target. Out-of-market acquisitions are purchases where the target operates in an area that Westland does not. Westland selects targets that complement its two core business units. Specifically, a good acquisition for Westland will involve a smaller, less cost-efficient brokerage that has a great location and a mix of residential, automobile and commercial insurance that roughly follows a ratio of 40:40:20. Additionally, if a brokerage has a good product mix but poor location and is in an area where Westland already has market presence, it could be a candidate for an in-market acquisition.

[5] Appendix B – "*Westland Performance versus Industry (2000)*"
[6] Interviews with Westland Senior Executive, Colin Thompson – President & CEO, JeffWubs – CEO & Chairman of the board, and Mathew Wubs – CFO.
[7] Daniel Rodriguez, "Don't Believe the Hype: Strategic Acquisitions Can Benefit Firm Performance," 2003.
[8] Harbir Singh, and Maurizio Zollo, "Creating Value in Post-Acquisition Integration Processes." The Wharton School Financial Institutions Center, (1998): 98-33.

1.2.1.2 Value Establishment

Insurance brokerages in B.C. have a standard method of evaluation that has for the most part been accepted by the entire industry. This method is based on the revenues of the brokerage's major product lines. An example evaluation can be seen in Appendix A – "*Market Value of a Sample B.C. Insurance Brokerage*". Since the evaluation is standardized across the industry, the risk of paying too much for an acquisition is reduced. Furthermore, since the value of the target is established up front, the competition between potential acquirers is really about who can apply the lowest costs. The only material risks are the ability to project costs accurately and the ability to maintain revenue. Given that it is goodwill that is actually being purchased, the maintenance of revenue is really a factor of location and customer service. For these reasons it is easy to see how an acquirer rich with acquisition experience and an intimate understanding of costs would benefit from learning economies and further reduce the risk of paying too much.

1.2.2 Synergies

The second reason given for why mergers & acquisitions fail is acquirers over-estimate the synergies expected from the transaction. This section discusses synergies gained from Westland mergers and acquisitions by exploring economies of scale, scope and learning.

In Appendices C, D & E are two examples of past Westland acquisitions. The examples chosen represent average acquisitions as it relates to income statements, average costs and balance sheet ratios. The first example represents an Out-of-Market acquisition and the second is an In-Market acquisition where the target and an existing Westland office were merged.

1.2.2.1 Economies of Scale

Since a firm is said to have economies of scale when its average cost falls as output increases, it is important that we analyze the average cost (ATC) and output (Q) before and after the acquisition in order to see if potential scale economies exist. In Appendix C, we see that before the out-of-market acquisition, the total output was 2,987[9] units and average cost was $78.65. After the acquisition[10], the total output was 3,652 units and average cost was $59.82. This results in a decrease of average cost of $18.83 and after accounting for non-acquisition growth which averages around 3% per year, a increase in output of approximately 19%. Thus, there seems to be evidence of economies of scale.

In Appendix E, we see that before the in-market acquisition, the total output was 5,387 units for the target brokerage and 1,867 units for the Westland office with which the target will merge. The pre-acquisition average cost of the target brokerage was $80.49 and $82.80 for the Westland office. After the merger, the total output was 6,723 units and average cost was $47.46. Again, after accounting for non-acquisition growth there seems to be evidence of economies of scale.

Through interviews with key Westland Insurance executives, some explanations for these economies of scale emerged. The first was how Westland was better able to exploit specialization of labour than did the firms it acquired. Most firms that are acquired are small, owner-operated businesses where the owner and/or insurance agents also act as accountants, marketers, human resource personnel, IT resources, janitors, etc. Since, Westland has either outsourced or centralized all of these functions, it allows each worker to concentrate his or her efforts on certain specific tasks that can be performed more efficiently. As well, Westland has centralized the commercial insurance department because of its complexity. This further allows for specialization in the sale of insurance.

As mentioned above, Westland has centralized certain administration and support functions. These departments are included in Westland's fixed costs and further allow specialization in the organization. Before an acquisition or merger, both Westland and the target

[9] Output is defined as quantity of insurance policies and policy financing plans sold.
[10] After acquisition analyses occurred after one full fiscal year.

wastefully duplicate these fixed costs. After the acquisition, these functions are transferred to the centralized departments usually without the need to increase the labour costs. The result is that fixed costs are spread over the larger output of the combined firms. The merger realizes scale economies by avoiding a duplication of fixed costs.

In 1995, Westland made a decision to invest substantial capital into the creation of an Enterprise Insurance System. One of the features of this system is that it allows for rating, quoting and issuance of insurance documents at the point of sale. On the back-end the policy data is electronically exchanged with the insurer. This dramatically reduces the average cost of producing a policy since there is essentially only one touch point in the process. This represents an estimated 80% reduction in the labour required to produce a policy using traditional insurance brokerage processes[11]. This is an economy of scale since Westland is able to create and maintain specialist machinery that reduces average total cost. It is not viable for smaller insurance brokerage firms to purchase this type of expensive capital equipment because their output volumes are too low to spread the cost of such machines.

The last example of economies of scale involves the indivisible labour characteristic of insurance brokerages. The indivisibility of labour occurs in small insurance brokerages where it is impossible to reduce the staffing levels below a minimum number of employees regardless of output. Since ICBC has essentially made the sale of auto insurance a retail venture, it is necessary to employ a minimum number of staff to keep the location open and to fulfil security needs. Mergers provide a mechanism for Westland to increase the output in these small brokerages without proportionally increasing labour costs. The result is an economy of scale since average cost decreases while output increases.

[11] Interview with Jason Wubs – Vice President, Retail Operations, Westland Insurance

1.2.2.2 Economies of Scope

The interviews revealed economies of scope as well, at both the branch or production level and at the firm level. About five years ago Westland introduced a policy-financing product called Pre-Authorized Monthly Payments (PMP). Today approximately 35% of all Westland clients have PMP plans. This product is managed through a module in Westland's Enterprise Insurance System and is tightly integrated with policy billing. During the sale of an insurance policy the creation of a policy financing plan shares the same input as creating an invoice. Therefore, economies of scope are created through mergers & acquisitions since targets either do not have policy financing plans or offer them as a separate product.

Further scope economies occur at the firm level. Westland's marketing department, accounting department, IT department and senior management all carry out their respective duties for all products. As well, Westland's Enterprise Insurance System provides processing and data storage across all product lines. This differs from most other brokerages in the industry who usually have different policy management system for each insurance product.

1.2.2.3 Economies of Learning

There is evidence that Westland benefits from learning economies as well. The average cost of acquisition for Westland has decreased over the years and is significantly lower than other acquirers in the industry. Currently, acquisition costs for Westland represent approximately 2% of the total acquisition[12]. The average in the industry ranges between 4%-6%. This decrease is attributed to learning because Westland has built up expertise over many acquisitions and handles many of the acquisition tasks in-house.

Operationally, Westland benefits from learning through the experience gained from being in business nearly 25 years. Westland's senior management cumulatively represents over 100

[12] Interview with Mathew Wubs – CFO, Westland Insurance

years of experience in the insurance industry. Over the years, Westland has fine-tuned production and administration methods and has effectively lowered average costs over time.

1.2.3 Post-Acquisition Integration

Learning can also be attributed to the decreased average cost of post acquisition integration. Through the experience gained in close to 40 acquisitions, Westland has developed various techniques and strategies for handling data integration, cultural assimilation and the implementation of new products and management structures. Examples of learning include a policy of removing the owner from the business. In past acquisitions, after buying a brokerage, Westland left the previous owner in place as manager of that office. In every instance, this arrangement failed. Failure was most likely caused as a result of the deals being cash or majority cash, leaving a manager in place that was once working night and day to keep the business going and was now dealing with a million dollar pay day. Inevitably, instead of focusing on managing the business he or she focused on the million-dollar windfall and the increase in leisure time.

In conclusion, Westland Insurance's strategy of growing through acquisition has been a successful one. In many ways, it is a classic example of a roll-up strategy. Westland has created several operational advantages that enable it to be more profitable than its competitors. Westland then uses the cash created by increased profits to purchase smaller or less efficient P&C insurance brokers. The acquisition creates several synergies as the operational advantages are implemented in the new firm. Westland realizes increased profits and the cycle starts over. As demonstrated graphically in Appendix F, Westland's success can be attributed to their ability to create operational synergies, ability to not over pay for appropriate targets, and to learning gained from experience and past acquisitions as it relates to integration and target selection.

2 CHAPTER TWO: INDUSTRY ANALYSIS

2.1 Introduction

The analysis presented in this chapter will be conducted on the P&C insurance brokerage industry in British Columbia. Insurance brokerages are firms that employ insurance brokers who, for compensation, commission or other things of value, aid in the procurement of insurance contracts for their clients. Insurance companies are both suppliers and competitors to insurance brokerage firms. This is because some insurance companies offer insurance directly to consumers through directly owned distribution networks such as call centers, web based insurance storefronts, and/or wholly owned insurance brokerages.

This section will present a competitive analysis using Michael Porter's five forces model of competition.[13] It will examine the threat of new entrants, the intensity of rivalry among existing competitors, the bargaining power of suppliers and buyers, and the threat of substitute products and/or services. Drawing from the above analysis, this paper will also provide an overall assessment of the attractiveness of the industry and will discuss the key success factors for the industry.

2.2 Industry Background

The Canadian property and casualty (P&C) insurance industry helps underpin the Canadian economy by assuming the financial risk inherent in many personal and business activities. In other words, the losses of a few are shared among all policyholders, making the lives of individuals and businesses more financially stable and making it easier for them to plan

[13] Michael E. Porter, "How Competitive Forces Shape Strategy," Harvard Business Review, (March-April 1979).

for the future. The industry is generally defined as including all lines of insurance other than life and health, although there are a few companies that sell a limited amount of sickness and accident insurance.

Generally, over half of the annual industry premiums are generated from automobile insurance, with most of the remainder coming from property and liability insurance. From a distribution point of view, there are two product lines in the industry, commercial lines and personal lines insurance. Commercial lines insurance generally includes property and liability insurance needed by commercial organization to cover the risks associated with operations and product liability. Personal lines insurance is designed to address the risks associated with personal residences and automobile insurance.

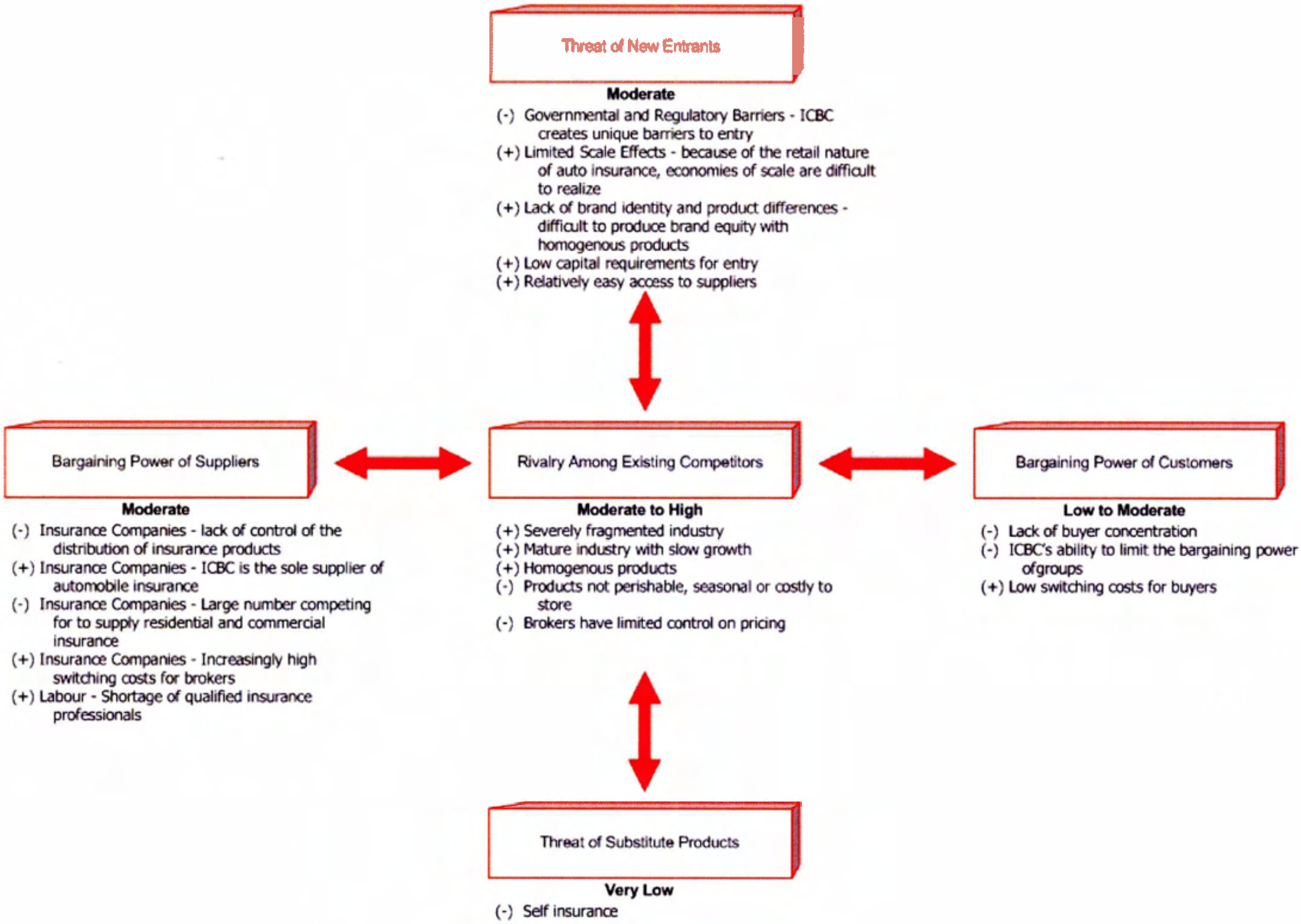
The Property and Casualty insurance brokerage industry in B.C. consists of approximately 750 brokerage firms distributing products for over 75 competing insurance companies. ICBC, a government owned monopolist of auto insurance, is the largest insurer in BC. Since its inception in 1973, ICBC has had a major influence over the structure and competitiveness of the B.C. insurance brokerage industry. ICBC has mandated that all insureds must visit in person an appointed ICBC insurance broker each year to renew their automobile insurance. As well, ICBC has made insurance premiums and commissions uniform across the province. As a result, ICBC has turned the sale of auto insurance into a retail venture for all competitors, and since consumers have no negotiating power, location has become a critical factor. Hence, the insurance brokerage industry in B.C. is characterized by many small owner operated businesses with no single firm able to establish a dominant position in the market.

2.3 Competitive Analysis

The essence of strategy formulation is coping with competition. Competition in an industry is rooted in its underlying economics and technical characteristics. The state of competition in an industry depends on five basic forces. The collective strength of these forces determines the ultimate profit potential of an industry. The Five Forces Model of Market Profitability is a strategic tool designed by Michael Porter to evaluate industry competitiveness.[14] This model examines the threat of new entrants into the market, the threat of substitute products, the bargaining power of suppliers and customers, and the rivalry amongst industry competitors. The following section analyses the competitive forces of the insurance brokerage industry in British Columbia using Porter's Five Forces Model.

[14] Michael E Porter, "How Competitive Forces Shape Strategy," Harvard Business Review, (March-April 1979).

Figure 2.1 P&C Insurance Brokerage Industry in British Columbia, 2005



Adapted from Porter, 1979

2.3.1 Threat of New Entrants

The threat of new entrants into the P&C insurance brokerage business is moderate. This is primarily a result of government regulations regarding the sale of automobile insurance in the province of British Columbia. ICBC "Autoplan" commissions represent anywhere from 50% to 80%[15] of total revenues for BC insurance brokers. Therefore, securing an Autoplan license is the single critical factor for entering the insurance brokerage industry in British Columbia. Other factors that influence the threat of new entrants are the ability of brokerage firms to create economies of scale, the level of brand identity and product differences, the capital required for entry, and the ability to access to suppliers.

2.3.1.1 Governmental and Regulatory Barriers (-)

Since the inception of ICBC in 1974, the distribution of ICBC automobile insurance products (Autoplan) has been the exclusive right of insurance brokerage firms. In the early nineties ICBC, in response to an over supply of Autoplan licensed agents, implemented a freeze on the issuance of new Autoplan licenses[16]. In 2002, a five-year Strategic Accord was renewed between ICBC, the Credit Union Insurance Services Association (CUISA) and the Insurance Brokers Association of BC (IBABC)[17]. The result of the cessation of new licenses has been the dramatic increase in value of Autoplan licenses. In thirteen years, the value of these licenses has risen from essentially $0 to a current market value of $275,000 to $300,000[18]. The moratorium on new licenses severely reduces the threat of new entrants into the BC insurance brokerage industry since the number of competitors is essentially capped and any new entrant would have to purchase the license of an existing competitor.

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[15] Interview with Colin Thompson, President & COO, Westland Insurance Group Ltd., February 15, 2005
[16] Autoplan licences are controlled by ICBC and allow an insurance broker to sell ICBC products a one physical location
[17] Insurance Corporation of British Columbia. "Service Plan 2003 - 2005," (31 December 2002):p. 4
[18] Interview with Jason Wubs, Vice President, Retail Operations, Westland Insurance Group Ltd., January 31, 2005

A critical factor in the above assertion is the recognition of the fact that although ICBC only regulates the brokering of automobile insurance it has a significant spillover effect on a brokerage's ability to sell residential and commercial insurance as well. Since ICBC has effectively turned the sale of auto insurance into a retail transaction, and since auto insurance accounts for the lion share of a brokerage's revenue, firms trying to broker insurance in BC without an Autoplan license will find creating opportunities for selling other types of insurance quite challenging.

Another regulation that reduces the threat of new entrants is Bill C-8. It protects against the threat of new entrants from the banking industry in two ways. First, it prohibits banks from selling insurance from their physical branch locations. Second, it prohibits banks from the simultaneous selling of P&C insurance products and financial products. Canadian banks have been lobbying for many years for the right to sell P&C insurance products. The economies of scope that could be realized with the ability to sell mortgages and home insurance at the same time, or simultaneous issuance of a car loan and automobile insurance are significant.

2.3.1.2 Limited Scale Effects (+)

A factor that increases the threat of entry into the BC P&C insurance brokerage market is the limited ability to create economies of scale. This is primarily a result of the retail nature of automobile insurance in BC. The requirement to have each insured visit in person an insurance broker limits the geographic scope of competition. Regardless of how large an insurance broker becomes, it is still forced to compete at a local level. This limits any market influence it might have as a result of its size. This creates a need for localized service and makes entry easier for potential entrants.

2.3.1.3 Limited Brand Identity and Product Differences (+)

Two related factors that increase the threat of entry into the P&C insurance brokerage industry in BC is limited brand identity and modest perceived differences in products. This holds true at varying levels for different P&C products. "Autoplan", ICBC's automobile insurance product, has enormous brand recognition but virtually no value or equity. This is because it is the quintessential homogenous product. Every insurance broker in BC sells exactly the same product with the same features for the same price. Some brokers sell optional insurance coverages (collision, comprehensive and third party liability above $200,000) through private insurance markets. This allows for some differentiation, but with the exception of a few, P&C insurance brokers in BC have not done a good job creating brand equity around these products.

Residential and commercial insurance products have very little brand equity as well. Most consumers choose their broker by methods other than brand recognition. These reasons include recommendations from family and/or friends, location, and advertisement s.

2.3.1.4 Capital Requirements (+)

The capital requirements needed to open a P&C insurance brokerage firm in BC low and do not pose a barrier to entry. The cost to enter the industry would consist of buying an Autoplan license, leasing or buying retail office space, hiring staff, purchasing office equipment and the cost of some local advertising. For a small insurance office, open six days a week the capital costs would be approximately $500,000 to $550,000[19].

2.3.1.5 Access to Suppliers (+)

A critical success factor for insurance brokerage firms is access to suppliers. Although critical, it does not generally act as a barrier to entry because of the large number of insurance

[19]Interview with Jason Wubs, Vice President, Retail Operations, Westland Insurance Group Ltd., January 31, 2005

companies present in the BC market. In BC, over 75[20] insurance companies supply the market with P&C insurance products. Insurance brokers have a comparatively straightforward process of gaining access to different suppliers because the competition for increased market share is high between insurance companies.

2.3.2 Threat of Substitute Products

The threat of substitute products in the P&C insurance brokerage business is extremely low. Insurance has no apparent substitutes except maybe for self-insurance, which is essentially not buying insurance and choosing to take the risk on ones self. Another variant of substitution is the choice of how much insurance coverage to purchase. This can take the form of increasing or lowering deductibles and/or increasing or lowering insurable limits of specific risks.

Since insurance is not an optional product the possibility of self-insuring or not buying insurance is eliminated. For example, all vehicles need to be insured at least with basic coverage in BC in order to be legally operated. When a vehicle is leased, the leasing company puts additional requirements on the optional coverages as conditions on the lease. Mortgage lenders require an insurance policy to be purchased for the duration of the mortgage. Most businesses require insurance to secure financing or to bid for jobs. In summary, there are no obvious substitutes that create a threat to P&C insurance products.

2.3.3 Bargaining Power of Suppliers

The bargaining power of suppliers in the P&C insurance brokerage industry is moderate. The most important suppliers are the insurance companies that brokers represent. Access to insurance markets is essential for brokers to compete since they supply or manufacture the product that insurance brokers sell. Other significant suppliers include suppliers of labour and suppliers of retail office space. The factors that impact the bargaining power of suppliers are the

[20] Stone & Cox Limited. *Provincial Results, The "Brown Chart," 2003 Report*, Toronto, 2002, pp. 18 – 27.

level of control insurance brokers have over distribution, the number of suppliers competing in the industry, the increasing switching costs for brokers, and the shortage of qualified insurance professionals.

2.3.3.1 Insurance Brokers Control the Distribution of Insurance Products (-)

A critical issue that is the center of much debate in the P&C insurance industry is who controls or owns the customer. Are policyholders clients of the insurance company or clients of the insurance brokerage? The answer lies in who controls the distribution of insurance products to the end user. In normal market settings, this control belongs to insurance brokers. They have the power to switch policyholders to different insurers on behalf of their clients at any time. Automobile insurance in BC is the exception to this rule since ICBC is a government monopoly.

In conjunction with the ability described above, brokers are also the major distributors of P&C insurance products. According to Canadian Underwriter, in 2003, brokers accounted for the distribution of 68.6% of automobile and property insurance in Canada[21]. This statistic however, is for provinces in Canada that have a private automobile insurance system. Taking into account that brokers distribute 100% of automobile insurance in BC, it can be estimated that in 2003 insurance brokers accounted for the distribution of 88% of automobile and property insurance in BC. The ability of insurance brokers to switch clients from one supplier to another combined with their control of the distribution of insurance products decreases the bargaining power of suppliers in the P&C insurance brokerage industry in BC.

2.3.3.2 ICBC is the Sole Supplier of Automobile Insurance (+)

A factor that increases the bargaining power of suppliers is the presence of ICBC, the sole supplier of automobile insurance in BC. Insurance brokers, in attempts to increase their bargaining power, have formed an industry association, the Insurance Brokers Association of BC

[21] Canadian Underwriter, "2004 Statistical Issue," Canadian Underwriter, Vol. 71, No. 5, June 2004: p. 71

(IBABC). As well, many insurance brokerages choose to use private insurers to sell optional automobile insurance products, but in reality, insurance brokers in BC are at the whim of the politicians and bureaucrats that control ICBC.

2.3.3.3 Many Competing Suppliers of Residential and Commercial Insurance (-)

It is reported that over 75[22] insurance companies supply the P&C insurance industry in BC with insurance products. With so many suppliers competing in a single industry, it is difficult for any one firm to gain market share. This holds true for the P&C insurance industry in BC, since no single insurance company has more than a 10% market share of the residential and commercial insurance market. The result is that the large number of insurers competing for market share reduces the bargaining power of suppliers in the P&C insurance industry.

2.3.3.4 Increasingly High Switching Costs for Brokers (+)

Another feature that increases the bargaining power of suppliers is the increasing switching costs for P&C insurance brokers. Three factors increase the cost for brokers switching suppliers. First, insurance companies are increasingly providing information systems for insurance brokers. This typically takes on two forms: insurers install proprietary systems in a broker's office (Lombard's LINCQ system), or insurers provide a broker-facing web application (Family Insurance, ICBC, Travel Underwriters). The common theme is that brokers are strongly encouraged, and in many cases mandated, to use insurance companies systems. This increases switching costs for brokers since in many cases brokers do not own the data and switching policies to another supplier would be very costly from a data entry point of view. Additionally, there are significant costs in replacing the insurance companies information systems, in re-engineering processes, and in training staff.

[22] Stone & Cox Limited. Provincial Results, The "Brown Chart," 2003 Report, Toronto, 2002: pp. 18 – 27.

Second, insurance companies reward volume and often force brokers to make premium commitments as a condition of their broker contracts. This increases a broker's switching costs in that it limits the number of suppliers that a brokerage firm can maintain.

Third, insurance companies sometimes finance a firm's acquisition of another insurance brokerage. In return for financing, insurance companies negotiate premium volume commitments with the brokerage. This locks in premium volume for the insurance company and enables the brokerage to grow through acquisition. It also increases the switching costs of the brokerage however, since the broker would incur penalties or other legal ramifications if it were to switch the business to another supplier.

2.3.3.5 Shortage of Qualified Insurance Professionals (+)

A factor that increases the bargaining power of suppliers is the recent shortage of qualified labour. In the last 5 years salaries of qualified insurance professionals has increased 25% - 30%[23].

2.3.4 Bargaining Power of Buyers

The bargaining power of buyers in the P&C insurance brokerage industry is low to moderate. Buyers of P&C insurance products include individuals, small businesses, large corporations, and professional associations or groups. The factors that influence the bargaining power of buyers are the lack of buyer concentration, the ability of ICBC to limit the bargaining power of groups, and low switching costs for buyers.

2.3.4.1 Lack of Buyer Concentration (-)

Although the number of buyers of insurance products is large, each purchase represents an isolated transaction. Insurance customers are very fragmented and have little ability to collude

[23] Interview with Lis Noth, Human Resources Manager, Westland Insurance Group Ltd., February 14, 2005

and influence prices. A factor that further limits the bargaining power of customers is the fact that insurance is often not an optional product.

2.3.4.2 ICBC Limits Bargaining Power of Groups (-)

Another factor that reduces the bargaining power of buyers is ICBC's ability to severely limit the power of large purchasing groups such as associations to reduce automobile insurance premiums. In provinces with private automobile systems, large associations are able to purchase insurance at discounted rates for their members. In BC, purchasing groups can only influence the pricing of insurance products other than automobile.

2.3.4.3 Low Switching Costs (+)

Low switching costs increase the bargaining power of buyers in the P&C insurance brokerage industry in BC. Regardless of where automobile insurance is purchased, consumers in BC can be assured they are getting exactly the same product for exactly the same price. Switching costs are low for residential and commercial insurance as well. The only cost is the time one spends procuring quotes and submitting applications for insurance.

2.3.5 Rivalry Among Existing Competitors

Rivalry among existing competitors in the P&C insurance brokerage industry in BC is moderate to high. This is due primarily to heavy fragmentation of both brokerage firms and insurance companies. Factors that shape rivalry amongst insurance brokerage firms in BC are the level of fragmentation in the industry, the fact that it is a mature industry with slow growth, the homogenous nature of its products, the lack of perishability and seasonality of its products, and the limited control brokers have on pricing.

2.3.5.1 Industry fragmentation (+)

The level of fragmentation in the P&C insurance brokerage industry increases rivalry for two reasons. First, the number of competitors in the industry is very high with no one firm dominating with respect to market share. This can be illustrated very clearly by looking at automobile insurance market in BC. Currently, there are over 950 appointed Autoplan brokers in BC, with the largest firm, Barton Insurance Brokers Ltd. controlling just 7.8% market share through its 52 locations. Figure 1 lists the top 15 insurance brokers determined by Autoplan revenues earned in 2003.

Table 2.1 2003 Top 15 Insurance Brokerage Firms by ICBC Commission Revenues

Rank	Brokerage	Commissions	Market Share	Locations
1	Barton Insurance Brokers Ltd.	$ 15,109,650	7.8%	52
2	British Columbia Automobile Association	$ 7,020,880	3.6%	24
3	Sussex Insurance Services Inc	$ 6,490,968	3.4%	23
4	TOS Insurance Services Ltd.	$ 6,129,346	3.2%	12
5	Atkinson & Terry Insurance Brokers Ltd.	$ 5,782,027	3.0%	16
6	Westland Insurance Group Ltd.	$ 4,866,455	2.5%	24
7	Johnston Meier Insurance Agencies Ltd.	$ 4,828,058	2.5%	21
8	All-West Insurance Services Ltd.	$ 4,708,231	2.4%	4
9	Capri Insurance Services Ltd.	$ 3,742,507	1.9%	9
10	Rand & Fowler Insurance Ltd	$ 3,127,046	1.6%	5
11	Thompson Valley Insurance	$ 3,030,396	1.6%	13
12	Coast Capital Insurance Services Ltd./Uselect	$ 2,870,839	1.5%	23
13	Koch B & Y Insurance Services Ltd.	$ 2,423,389	1.3%	7
14	Envision Insurance Services Ltd.	$ 2,262,146	1.2%	16
15	Falkins Insurance Group Ltd.	$ 1,853,454	1.0%	8
	Totals	$ 74,245,392	38.4%	253

Table 2.1shows that with the exception of the top firm the largest market share in the industry is less than 4%. Additionally, the top 15 firms account for only 38% of total market share. It also shows a positive correlation between market share and the number of locations which supports the contention that firms are forced to compete on a local level regardless of their size, thereby limiting scale effects.

The second reason industry fragmentation increases rivalry in the BC insurance brokerage market is that many of the competitors are of the same capability and size. Processes are largely influenced by insurance companies and are similar throughout the industry. These processes are supported by Broker Management Systems (BMS). There are 3 main suppliers of Broker Management Systems which together account for installations in 85% of BC brokerage firms. Since all of the Broker Management Systems generally support the same traditional processes, it is difficult for brokers to use technology to create efficiencies in the delivery or the maintenance of insurance products. Strategically, most insurance brokerages compete on price when selling residential and commercial insurance, and try to differentiate by securing good retail locations when selling automobile insurance. Additionally, usually all have the ability to sell a full line of automobile, residential and commercial products. A broker's ability to affect price generally is lowest with automobile insurance and highest with commercial insurance. Since brokers are somewhat limited in their ability to affect pricing, price competition is dampened and rivalry is decreased. Lastly, most retail brokerage locations employ between 3 and 6 employees.[24] Similarities in size and capabilities increase rivalry since it is difficult for any one firm to create a competitive advantage.

2.3.5.2 Mature Industry with Slow Growth (+)

The P&C insurance brokerage industry is characterized as a very mature industry with slow growth. The result is that rivalry among existing competitors is increased as brokers compete for market share. The demand for P&C insurance products remains very steady as it is an annual non-discretionary product for practically all customers. Growth follows the economy. In times of prosperity, as consumers purchase more cars or more expensive cars, more residences or more expensive residences, and as companies increase sales and operations, insurance premiums increase as well.

Key to the success of insurance brokers in BC is the creation of retail distribution networks. The rationale behind this assertion is twofold. First, since ICBC has turned the sale of automobile insurance into a retail transaction it has forced all competitors to compete at the local level. Second, since growth in the P&C insurance brokerage industry in BC is slow the most practical method of growth for brokerage firms is to increase market share through the acquisition of rivals. Therefore, in order grow, brokers must create multi-office retail networks that compete in local communities. A further advantage is that an increase the size of the firm increases the ability of brokers to create economies of scale and operational effectiveness. This in turn leads to further sustainable competitive advantages.

[24]Interview with Colin Thompson, President & COO, Westland Insurance Group Ltd., February 15, 2005

2.3.5.3 Homogenous products (+)

The homogenous nature of P&C insurance products increases rivalry in the insurance brokerage industry. For example, automobile insurance in BC has been made incredibly homogeneous because of ICBC and its monopoly power. ICBC has not only forced brokers in BC to sell the same product, but has forced them to sell it for exactly the same price. Because of extreme product homogeneity, the creation of any differentiators by Autoplan brokers is key. Brokers who have convenient retail locations, provide better service, or are able to create private brands on optional automobile insurance coverages can create sustainable competitive advantages. Additionally, although residential insurance policies can vary greatly in features and options, it is still perceived by consumers as a product with a high degree of homogeneity. Lastly, the effect of perceived or real homogeneity in insurance products reduces switching costs for consumers, which in turn increases rivalry.

2.3.5.4 Product not perishable, seasonal or costly to store (-)

A factor that reduces rivalry in the P&C insurance industry is that insurance products are not perishable, seasonal or costly to store. This reduces rivalry since time does not decrease the value of the product. Therefore, the insurance industry rarely sees dramatic price fluctuations due suppliers dumping excess supply into the market.

2.3.5.5 Limited control on pricing (-)

Perhaps the most significant factor that impacts rivalry in the P&C insurance brokerage industry in BC is the limited ability of brokers to change the price of the products they sell. This severely reduces rivalry because it restricts a broker's ability to respond to a competitor's actions. This is primarily the case in automobile insurance where ICBC mandates universal prices and commissions throughout BC. In the case of automobile insurance, location remains the key competitive factor.

Location is also a significant factor for firms competing for the sale of residential insurance, but price factors in as a substantially more dominant driver. Over 100 companies represented in B.C. alone, give customers many choices with whom to insure their personal assets. Direct-writers such as Canadian Direct Insurance have also attempted to turn residential insurance into a commodity, whereby the differentiation is limited and low prices determine customer choice. Since brokers are limited in their ability to adjust prices, they compete with the direct writer by providing convenience and good customer service.

Price is the compelling force of competition among brokerages competing for commercial insurance. Here, brokerages have the greatest ability to affect pricing and will try to lure clients through competitive pricing strategies often negotiated with their insurance company partners. They will attempt to develop niche markets by creating products that cater to a specific industry, offering enhanced product features and competitive prices. Building customer loyalty is key and most brokerages will attempt to retain clients through great service and concentrated relationship management. This is especially critical for larger accounts (accounts over $25,000), which is the primary focus of international brokerages.

Since brokers have little control on pricing, the creation of efficient, low cost production becomes a critical factor. Brokers that can realize operational effectiveness and create economies of scale can achieve sustainable competitive advantages. However, since the insurance brokerage industry in BC is severely fragmented, this remains a formidable challenge.

2.4 Overall Industry Attractiveness

In the previous sections, a competitive analysis using Michael Porter's five forces model of competition was performed on the P&C insurance brokerage industry in BC. Although it is a mature industry characterized by slow growth, the analysis illustrates that the industry is an attractive one in which to operate. There are several reasons that support this conclusion.

First, demand for insurance products is extremely stable. This is a result of the fact that insurance is usually not an optional purchase. Even in the midst of an economic downturn, insurance sales stay relatively steady and premium increases are realized.

Second, the industry is sheltered from large competitors entering the market by government regulations. A growing competitive threat to insurance brokers in the rest of Canada is direct writers[25]. ICBC protects insurance brokers in BC from the threat of direct writers through its monopoly of the largest revenue product, automobile insurance. ICBC helps protect against other new entrants as well. The moratorium on Autoplan licenses ensures that any new players that wish to compete in the P&C insurance brokerage industry in BC will have to buy an Autoplan license. This means that instead of gaining market share from the execution of strategies designed to take business away from competitors, new entrants must pay full value for the right to compete. Additionally, legislation protects insurance brokers from large financial institutions selling P&C insurance products from their branch locations. ICBC protects brokers from competition amongst existing competitors as well. By mandating a homogenous product, brokers are severely limited in their competitive response since they have no power to change prices.

Third, the fragmentation of the industry benefits insurance brokers and is not likely to change soon. There are many suppliers of insurance, none, with the exception of ICBC, have significant market share or bargaining power. The same is true for buyers of insurance, they are large in numbers but their ability to collude and effect pricing is limited. Fragmentation influences rivalry among existing competitors as well. The industry is characterized by many small competitors, all with relatively the same capabilities and no one single firm able to dominate the market.

[25] Direct writers are insurance companies that sell insurance directly to consumers by passing the insurance broker channel.

In conclusion, the P&C insurance brokerage market is an attractive one. Suppliers rely on insurance brokers to distribute insurance products more in BC than in any other province in Canada. This is because of the unique market dynamics that ICBC influences. What the future holds for this industry is largely based on political and regulatory changes that effect ICBC and Bill C-8.

2.5 Industry Key Success Factors

The purpose of this section is to identify the factors that determine a firm's ability to survive and prosper, namely its key success factors. To survive and prosper in an industry, a firm must meet two criteria. First, it must supply what customers want, and second, it must survive competition. The key success factors for the P&C insurance brokerage industry in BC are the creation of differentiators in the automobile insurance market, low cost production efficiency, and the creation of a strong distribution network.

2.5.1 Creation of Differentiators in the Automobile Insurance Market

The requirement for differentiation in the automobile insurance industry in BC is critical. This is because automobile insurance brokers in BC are not only forced to sell the same product with the same features, but are also forced to sell them for exactly the same price. The only logical response to product homogeneity and a restricted competitive environment is to compete on costs.

Not surprisingly, most insurance brokers in BC compete on costs, however, to the detriment of service. Customer contact points in most processes are dramatically reduced or eliminated. Insurance brokers' offices are characterised by large front counters which serve as barriers to the paper laden desks of over worked insurance agents. Customer visits are often viewed as interruptions to an agents work day and are consequently redirected to the most junior person in the office.

Westland Insurance competes on cost as well. However, unlike many of its competitors it does not do so at the detriment of service. One of Westland's key competitive advantages is the service it provides to its customers. Westland differentiates itself from its competitors through distribution, service, and product options.

The most important differentiator is through selective distribution by securing great retail locations. Great retail locations for insurance brokerages are those in high traffic shopping malls that include as their anchor a major grocer, a pharmacy, and a liquor store. Adequate parking is also an important convenience differentiator.

Secondly, another important differentiator that allows brokers to succeed is superior customer service. In the insurance industry the key to providing superior customer service is to have qualified, knowledgeable insurance representatives. Customers rely on brokers to take on their interests, make recommendations, and ultimately provide risk management services. Other customer service initiatives include value added services like Aircare and policy renewal reminders and convenient delivery such as web-based applications.

Lastly, brokers can create valuable differentiators by selling optional automobile insurance coverages. These coverages include comprehensive, collision and third party liability. Brokers can create additional value by branding these policies and by offering policy financing.

2.5.2 Low Cost Production Efficiency

Since for the most part brokers have limited control on pricing, a factor that enables a broker to survive and prosper is the ability to create efficient low cost production. Typically, the way in which this is achieved is through economies of scale and operational effectiveness. This creates a significant challenge for insurance brokers in BC since the industry is severely fragmented. There are however, three ways in which brokers can overcome fragmentation and create efficient low cost production.

First, insurance brokerages can develop scale effects in portions of the firm. One example is that brokers can exploit specialization of labour. Multi-location brokerage firms can achieve this by outsourcing or centralizing certain functions such as accounting, marketing, human resource management, IT, and janitorial services. The result is that it allows insurance professionals to concentrate their efforts on certain specific tasks that can be performed more efficiently.

If brokers centralize the functions mentioned above, then growth through acquisition can create economies of scale as well. Firms can spread fixed costs over the larger output of the combined firms. Acquisitions can realizes scale economies by avoiding a duplication of fixed costs.

Second, insurance brokerage firms can standardize procedures or operations. Typically, each insurance company has different processes for rating, quoting, applying for insurance, renewing insurance policies, and collecting premiums. Brokers who can standardize on any of these processes can achieve significant cost advantages.

Third, brokers can specialize in a customer type. There are many ways to segment the insurance market. Some of the more traditional segments have been based on professional associations, geographic areas and industry type. There are many success stories of brokerage firms that have specialized in providing insurance to these customer segments.

2.5.3 Creation of a Strong Distribution Network

Since growth in the P&C insurance industry in BC is slow, insurance brokerage firms can increase their chances of survival by creating larger, stronger distribution networks. Since automobile insurance is the key revenue item in the P&C insurance industry and since there is a moratorium on licenses to sell automobile insurance in BC, firms wishing to create larger, stronger distribution networks must acquire or partner with an existing brokerage. Critical to this strategy then is access to capital. Alternatively, insurance brokerage firms could look to creating strong distribution networks by focusing on convenience. Examples include insurance representatives that travel to customer locations or web based delivery systems that enable customers to buy insurance products anytime anywhere.

2.6 Conclusion

This paper presented an analysis of the property and casualty (P&C) insurance brokerage industry in British Columbia. Using Michael Porter's five forces model of competition, it examined the threat of new entrants, the intensity of rivalry among existing competitors, the bargaining power of suppliers and buyers, and the threat of substitute products and/or services. Also presented was an overall assessment of the attractiveness of the industry and the key success factors for the industry.

3 CHAPTER THREE: INTERNAL ANALYSIS

3.1 Introduction

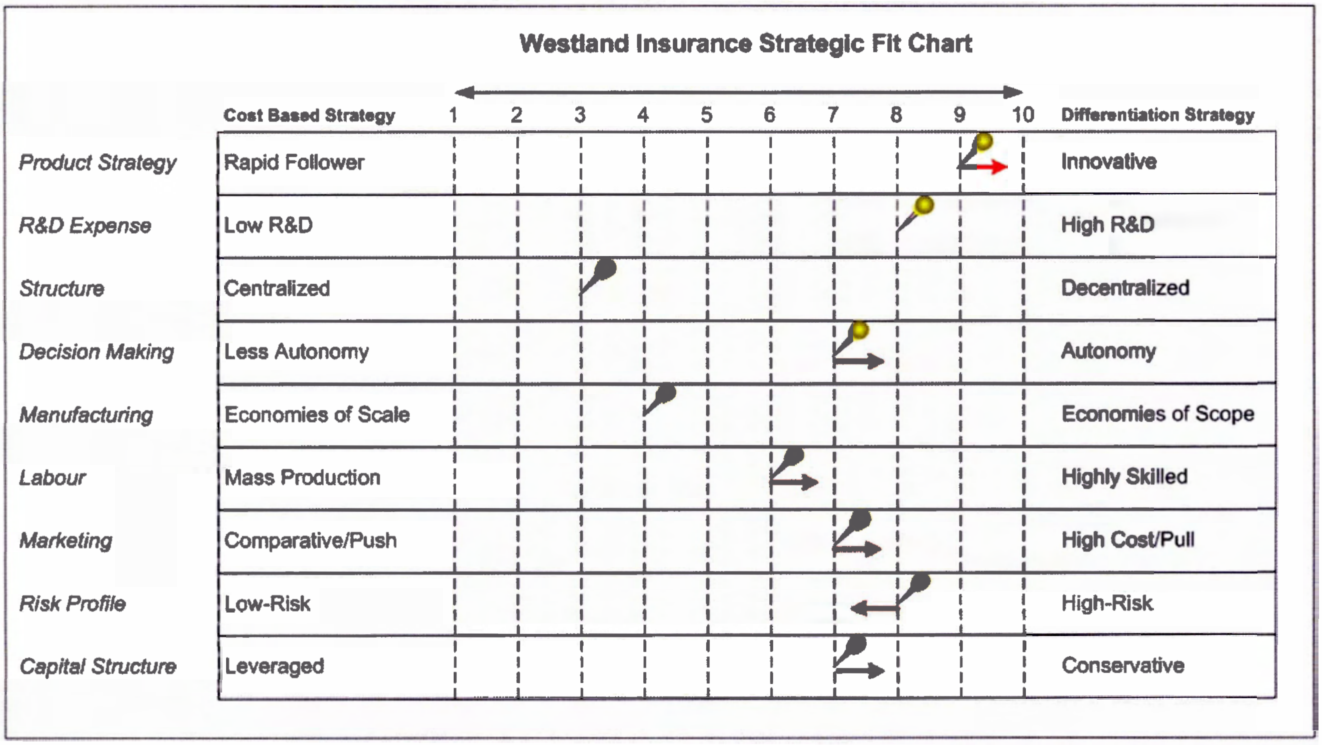
Chapter three presents an internal analysis of Westland Insurance. The purpose is to conduct a comprehensive evaluation of Westland's internal environment's potential strengths and weaknesses. The internal analysis has three objectives: First, to identify Westland Insurance's generic strategy and to analyse several strategic variables in order to determine the degree of fit between the variables and the organization's overall competitive strategy. Second, to conduct a value chain analysis in order to identify outsourced activities, core competencies, and competitive advantages. Third, to measure Westland's financial performance on a number of criteria and to compare its performance to what is considered "best practices" within the industry.

3.2 Strategic Fit Analysis

Strategic fit is achieved by organizations by continually refining core activities so that they are consistent with the company's generic competitive strategy. This section looks at Westland from a strategic perspective. First, it identifies Westland Insurance's generic strategy. Second, it analyses several strategic variables in order to determine the degree of fit between the organization and the strategy identified.

Westland Insurance operates with a differentiated/cost-based strategy. This is a very difficult strategy to implement since there is a very real danger of getting stuck in the middle. Westland creates cost advantages through centralization and economies of scale, and differentiates by providing insurance products and services that are perceived by customers as better than or different from those of its competition. The following chart, using nine strategic variables, illustrates the degree to which Westland Insurance fits with a differentiated/cost-based strategy.

Figure 3.1 Westland Insurance Strategic Fit Chart



Adapted from Bukszar, 2005

Practically all insurance brokers would say that the most important service they offer is providing a quality products for their customers. Quality in the insurance industry is generally measured by claims service and by the coverage provided in the insurance policy contract. Quality as a differentiator, however, proves problematic because of the inherent difficulties the consumer has in measuring quality before purchasing the insurance product. Claims service is difficult for consumers to measure since it can only be evaluated when one has a claim. The quality of insurance coverage is difficult to measure because of the complexity and language of insurance contracts. Therefore, insurance policies tend to be thought of by consumers as relatively homogenous products leading many insurance brokers to compete using cost based strategies.

3.2.1 Product and Service Strategy

Westland Insurance is unique in the insurance brokerage industry in that it has created several innovative product and service differentiators. Westland not only provides high quality as defined by claims service and insurance coverage, but also provides quality in distribution, convenience, financing, and delivery. These unique differences have generated customer value and have enabled Westland Insurance to charge higher than average premiums. Proof that customers actually perceive the differences as added value are in Westland Insurance's growth and retention rates which are both well above industry norms.

The differentiation strategy is illustrated well in Westland' delivery of automobile insurance. Automobile insurance in B.C. has been made incredibly homogeneous because of ICBC and its monopoly power. ICBC has not only forced brokers in B.C. to sell the same product, but has forced them to sell it for exactly the same price. In response to product homogeneity and a restricted competitive environment, Westland has chosen to differentiate on service and distribution.

Westland differentiates on service by providing services that competitors do not. First, Westland offices have been renovated to present a more relaxed, less bureaucratic tone. The large front counters that are commonplace in many insurance brokers offices have been replaced with areas where customers can sit down and conduct business at an agent's desk. Second, Westland is proactive in reminding customers that their automobile insurance is expiring and that they may need to take their car through Aircare. Attractive, heavily branded reminder postcards are mailed to policyholders with policy information and details of the closest Westland offices. Lastly, superior customer service is the focus of all staff training and performance reviews. All

Westland agents receive training on Westland's customer service standards through Westland College, an internal training facility created by Westland employees.

Product differentiation through selective distribution is achieved by securing great retail locations. Great retail locations for insurance brokerages are those in high traffic shopping malls that include as their anchor a major grocer, a pharmacy, and a liquor store. Adequate parking is also an important convenience differentiator. The best example of the importance of location is Westland's White Rock division. In 1993, the division earned annual auto insurance revenues of $40,000. That year the division was moved to a new shopping center in south Surrey that had as its anchor tenants a Safeway, London Drugs, and liquor store. Over the next 7 years the division's auto insurance revenues increased ten-fold to over $428,000 in 2001. The determining factor in White Rock's growth was its new location. That said, the organization constantly evaluates and re-evaluates the locations of its retail branches to ensure optimum growth potential.

A differentiation strategy can also be seen in the way Westland provides residential insurance, Westland's largest revenue product. The traditional approach to selling residential insurance, and one that is still dominant today, is for insurance brokers to fit their client to a insurance policy. Insurance brokers can represent from five to ten different insurance company markets. Each company has its own unique rating, underwriting, application process and policy wording. Clients apply for a new insurance policy with the assistance of their broker by completing an insurance application that is sent to an insurer for approval. If the application is approved, the customer will receive an insurance policy anywhere from 3 to 6 weeks later.

Westland's approach is unique in the industry. Rather than represent many different insurance companies and be forced to comply with many different processes, Westland created its own comprehensive residential insurance policy. Essentially, it is a best-of-breed insurance policy that includes the best options and limits available in the residential insurance industry today. Before the formation of its own insurance company, Westland formed partnerships with four insurance companies in which they agreed to underwrite the "Westland residential policy". In 1998, Westland created its own insurance company and replaced the four insurance companies with its own insurer.

Being able to offer a comprehensive policy gave Westland Insurance several unique advantages. First, it allowed Westland to create information systems that dramatically reduced the amount of time needed to capture information, rate, customize, and issue insurance policies. Westland was one of the first insurance organizations to introduced true point-of-sale underwriting, rating, and issuance of insurance polices. Second, it provides customers key delivery benefits. Clients can complete the entire application process with their insurance broker in about 15 to 25 minutes, and clients can walk out of the office with a customized insurance policy in their hands. Third, it allows agents to provide better customer service. Agents contact each client on the renewal of their policy in order to review coverage. This value added service helps ensure clients are adequately insured. This leads to better perceived claims service since in the event of a claim customers are more likely to have adequate coverage. The last thing a person wants to hear when they make a claim is that although they have insurance they have not bought enough coverage. This is a unique characteristic of Westland since most competitors have are swamped with processing paper, entering data into multiple insurance companies systems, and dealing with multiple insurance company processes.

3.2.2 Research and Development Expense

The resources Westland Insurance commits to research and development is tightly aligned with a differentiation strategy. Research and Development expense is primarily in the form of information system development. Because the nature of insurance is essentially a promise to policyholders, information systems play a key role in the manufacturing of the product (insurance policies). Therefore, in the insurance industry Enterprise Resource Planning systems and Customer Relationship Management systems are not the only business critical systems. Enterprise Insurance systems that store insurance policy information, rate policies and issue policies play an important role in a firms ability to differentiate and create competitive advantages.

Westland Insurance spends relatively high amounts on research and development compared to its competitors. It has, and continues to, commit funds for maintaining and enhancing information systems that reduce the time needed by agents to sell new insurance policies and renew existing ones. Additionally, information systems play a key role in economies of scope in that they enable insurance and financial products to be cross-sold.

The advantages that Westland Insurance has created through investment in the development of customized information systems provide key differences compared to other residential insurance providers. In Canada, insurance brokers are still the largest distributor of residential insurance policies, accounting for between 70% and 80% of all residential polices sold. In B.C., insurance brokers tend to be small businesses that do not have the resources or economies of scale to commit adequate resources to the development of customized insurance systems. They rely on packaged software that simply tries to make the traditional insurance application process more efficient. Other, non-broker, residential insurance distributors who could afford the investment, like insurance companies that sell directly to consumers and web-based distributors, are disadvantaged because they do not have same retail distribution network that Westland has and therefore do are not able to perform face-to-face transactions with their clients. All of these factors further create unique differences between Westland and its competition and are directly related to Westland's high resource commitment to research and development.

3.2.3 Structure

At first glance, since Westland has many locations spread throughout British Columbia, one may be inclined to think Westland has a decentralized structure. This however, is not the case. Westland's structure is relatively centralized for the following two reasons. First, the management structure is comprised of senior vice presidents and "C" level executives. The retail locations have essentially a senior insurance person supervising sales and scheduling staff. Second, human resources, accounting, underwriting, claims and information technology have all been removed from branch locations and centralized at corporate headquarters. Additionally, all corporate policies, financial decisions and reporting are made centrally. Decentralized structures tend to be associated with differentiated strategies since it is more sensitive to customisation, flexibility and localization. However, Westland has been able to achieve significant cost savings and efficiencies by operating with a more centralized structure. Westland's centralized structure helps ensure the viability of its differentiated strategy.

3.2.4 Decision Making

The autonomy Westland Insurance employees have in decision making varies depending upon their roles. A Customer Service Representative (CSR) who works in one of Westland's retail insurance offices has the least amount of autonomy. CSRs are primarily responsible for selling residential and automobile insurance. The sales process of both of these products is highly controlled by information systems. These systems control the rating and pricing, mandate which data must be collected, and dictate which coverages can be offered for a particular scenario. The underwriting process is controlled through a complex rights-based system where a CSR's user account has associated rights that control which tasks they can do themselves and for which tasks they will need approval. Correspondence with customers is standardized as well. Practically all letters that are sent to clients are a compilation of boilerplate phrases and formats. Emails and faxes are captured in a document archiving system and become a permanent record in a client's electronic file.

Within each retail office is a manager and/or a senior CSR. Managers and senior CSRs are experienced insurance people that have the ability to override or make exceptions to underwriting, pricing, and coverage decisions. If a manager or senior CSR overrides a system enforced rule or pricing calculation, the action is recorded so that the decision maker can be held accountable in future. As a result of this ability to make exceptions, each retail office as a group is fairly autonomous. Loss experience, sales and production reports, and retention reports are measured monthly per office rather than per individual.

Commercial insurance agents have more autonomy in decision making than personal lines CSRs. Since commercial insurance is significantly more complex the activities associated with selling and administrating it need to be more flexible and customisable. Commercial agents not only influence rates and coverages but also actually set them in some cases. The commercial department has several commercial package insurance programs where agents are responsible for completing all of the steps in the sales process. Agents evaluate risk and underwrite policies, they determine rates and pricing of policies, they determine which select coverages are needed, and they create and issue policy contracts.

Senior managers have the most autonomy in decision making at Westland Insurance. Senior managers are the people assigned with the responsibility for each division. There are seven senior managers at Westland. These managers oversee the following departments: retail operations, commercial insurance, information technology, accounting, administration and finance, claims, sales and marketing, personal lines underwriting. Senior managers are ultimately responsible for the operations of their departments. They set budgets, create and manage processes, create standards and policies, and align departmental strategies with corporate strategies. Four of the senior managers are also members of the executive team, which has the additional task of creating and implementing the corporate strategy.

3.2.5 Manufacturing

With regards to manufacturing, Westland benefits from both cost-based and differentiated strategies. This is because Westland focuses on both economies of scale and scope, with a slight emphasis on the former. Compared to the insurance brokerage industry in B.C., Westland enjoys economies of scale in several ways. First, Westland is better able to exploit specialization of labour than its competitors. Most B.C. brokerage firms are small, owner-operated businesses where the owner and/or insurance agents also act as accountants, marketers, human resource personnel, IT resources, janitors, etc. Since, Westland has either outsourced or centralized all of these functions, it allows each worker to concentrate his or her efforts on certain specific tasks that can be performed more efficiently. As well, Westland has centralized the commercial insurance department because of its complexity. This further allows for specialization in the sale of insurance.

Westland's growth through acquisition creates economies of scale. Since Westland centralizes administration and support functions, these departments are included in Westland's fixed costs and further allow specialization in the organization. Before an acquisition, both Westland and the target wastefully duplicate these fixed costs. After the acquisition, these functions are transferred to the centralized departments usually without the need to increase the labour costs. The result is that fixed costs are spread over the larger output of the combined firms. The merger realizes scale economies by avoiding a duplication of fixed costs.

In 1995, Westland made a decision to invest substantial capital into the creation of an Enterprise Insurance System. One of the features of this system is that it allows for rating, quoting and issuance of insurance documents at the point of sale. On the back-end the policy data is electronically exchanged with the insurer. This dramatically reduces the average cost of producing a policy since there is essentially only one touch point in the process. This represents an estimated 80% reduction in the labour required to produce a policy using traditional insurance brokerage processes. This is an economy of scale since Westland is able to create and maintain specialist machinery that reduces average total cost. It is not viable for smaller insurance brokerage firms to purchase this type of expensive capital equipment because their output volumes are too low to spread the cost of such machines.

The last example of economies of scale involves the indivisible labour characteristic of insurance brokerages. The indivisibility of labour occurs in small insurance brokerages where it is impossible to reduce the staffing levels below a minimum number of employees regardless of output. Because ICBC has essentially made the sale of auto insurance a retail venture, it is necessary to employ a minimum number of staff to keep the location open and to fulfil security needs. Mergers provide a mechanism for Westland to increase the output in these small brokerages without proportionally increasing labour costs. The result is an economy of scale since average cost decreases while output increases.

Economies of scope exist as well, at both the branch or production level and at the firm level. About five years ago Westland introduced a policy financing product called Pre-Authorized Monthly Payments (PMP). Today approximately 35% of all Westland clients have PMP plans. This product is managed through a module in Westland's Enterprise Insurance System and is tightly integrated with policy billing. During the sale of an insurance policy the creation of a policy financing plan shares the same input as creating an invoice. Therefore, economies of scope are created through mergers & acquisitions since targets either do not have policy financing plans or offer them as a separate product.

Further scope economies occur at the firm level. Westland's marketing department, accounting department, IT department and senior management all carry out their respective duties for all products. As well, Westland's Enterprise Insurance System provides processing and data storage across all product lines. This differs from most other brokerages in the industry who usually have different policy management system for each insurance product.

Westland continues to grow primarily through acquisition. This creates substantial economies of scale and allows Westland to focus on reducing cost structures which in turn ensure the viability its differentiated strategy.

3.2.6 Labour

Since most of Westland products are either very homogenous (automobile insurance), or have perceptions of homogeneity (residential insurance), the labour requirements are not highly skilled. Strategically, this does not align well with a differentiation strategy. Agents do not need to be particularly highly skilled insurance people to succeed at Westland. This is because in both automobile and residential insurance Westland only sells one insurance company policy, I.C.B.C's and Westland's respectively. Agents at Westland contrary to other insurance brokers only need to become proficient with one policy wording, coverages and rates. Furthermore, the information systems at Westland are very specialized to Westland insurance products so that agents can produce highly customized policies without being insurance experts. Westland does spend a significant amount of time training and hiring great sales people. This is an area where Westland's workforce has skill advantages over competitors. This variable is moving towards higher skilled labour. This is in response to plans to add insurance and financial products in future.

3.2.7 Marketing

Although Westland does not spend a great deal on marketing as compared to competitors of similar size, the efforts and resources it does commit are somewhat aligned with a generic differentiated strategy. Westland markets directly to the consumer through local newspaper advertising, local mailings and community sponsorships. Westland positions itself as a provider of quality insurance products and service. It does not compete solely on price and does not portray a "good enough" or an "as good as" message.

3.2.8 Risk Profile

In terms of financial risk, Westland would be considered high risk as compared to other insurance brokers. This is primarily because Westland is an insurer as well as an insurance broker. This variable is in line with a differentiation strategy because the creation of an insurance company was a key driver in creating many of the product and service differentiators that currently exists. However, at the same time, creating an insurance company dramatically increased the risk profile of Westland. This is because of the simple fact that as an insurance company Westland underwrites insurance risks and is responsible for indemnifying insureds in the event of a loss. The direction of this variable however, is towards lower risk. This is due to recent increases in capital surplus in the insurance company and the recent purchase of additional layers of catastrophe reinsurance. Although these recent events reduce risk, Westland will remain in a high-risk category compared to other insurance brokers as long as it operates an insurance company.

3.2.9 Capital Structure

Over the past six years, Westland has become more conservative with respect to capital structure. Several shareholder loans and long-term debt has been paid off in recent years. Currently this variable is measured at seven on the Strategic Fit Chart. Six years ago, it would have been measured at about four. Six years from now, under the current direction, the capital structure variable will measure an eight or nine. The current position of the capital structure variable and its future direction is very compatible with a differentiation strategy. It allows Westland more autonomy in that it allows debt covenants to be removed. It also allows Westland to retain more of the profits earned from the business and enables opportunism and the ability for Westland to acquire firms in a timely manner.

3.2.10 Conclusion

Overall, Westland Insurance has a moderately high degree of fit with a generic differentiated strategy. Strategic fit is strongest in three areas. The first area is product and service strategy where Westland has created some unique differentiators in distribution, delivery and convenience. The second area is research and development expense where investment in customized information systems has enabled key product and service differentiators to be implemented. The third area is Westland's risk profile where owning an insurance company has significantly increased the risk as compared to other competitors in the insurance broker industry. Since the market does not reward full-scale differentiation, Westland has honed its strategy by reducing costs and creating efficiencies. By centralizing its structure and creating significant economies of scale in manufacturing, Westland has increased the future viability of its differentiated strategy.

3.3 Culture

The combination of both an insurance company and a network of insurance brokerages gives Westland Insurance a unique footprint compared to other competitors in the insurance industry. With regards to insurance companies, most are regulatory capitalist and share several characteristics. First, they are usually large, old, bureaucratic organizations that are controlled through a sophisticated hierarchy. Second, they are principally concerned with risk mitigation in both the products they sell and strategic planning. Third, central to operations are a multitude of rules and insurance contracts. Lastly, all insurance companies are highly regulated by government.

With regards to insurance brokerages in British Columbia, most operate with an entrepreneurial worldview and share several similarities. First, the vast majority of insurance brokerages in BC are small, owner operated, first generation organizations. Second, in most cases, the owner does not have a college degree but is very entrepreneurial and profit oriented. Third, brokers are usually not so much concerned with risk mitigation but rather are more concerned with collecting commissions. Westland, being both an insurer and a broker, is affected by both the regulatory and entrepreneurial worldviews. The resulting footprint therefore, is less regulatory and more entrepreneurial than other insurance companies, but more regulatory and less entrepreneurial than other BC insurance brokers.[26]

With regards to people management, Westland Insurance scores moderately-high in its high involvement management practices.[27] Westland exhibits people first management in the following four ways. First, Westland offers substantial employment security. It has never had to downsize or layoff scores of employees due to economic downturn or management mistakes.

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[26] Mark Wexler, *The Four Faces of Capitalism: Structure and Change in Organizations*, September, 2004.
[27] Jeffrey Pfeffer, "The Human Equation, Building Profits by Putting People First," Harvard Business School Press, Boston, 1998.

`Second, Westland pays its staff, on average, higher than industry salaries. Third, Westland puts a strong emphasize on training and education. Lastly, customer service is considered one of Westland's most important competitive advantages and is advocated with evangelical zeal.

For all of its efforts to promote people first practices, Westland, fails in becoming a high involvement organization in the three ways. First, Westland does not practice selective recruiting. This is due in large part to a seemingly unending shortage in licensed insurance personnel. Westland tends to hire people based on technical skill rather than cultural fit and usually does not hold more than one interview. As a result, the percentage of new recruits that do not get past the three-month probation stage is moderately high. Second, although salaries are higher on average than industry, compensation is not based on company performance. Westland does not have a profit sharing program nor does it offer ownership of its private stock to employees. Additionally, the difference in wages across the different levels of the company is substantial. Third, information is not readily shared to all employees. Corporate financials and strategic are plans closely guarded by executives. Departmental performance including revenue and expense information is shared but only with the manager responsible for the department in question.

As a final point, it is helpful to position Westland in relation to other organizations in the BC insurance industry as it relates to Jeffery Pfeffer's concept of high involvement management.[28] This serves to focus Westland in comparison with other industry competitors. If all of the insurance companies and brokers in BC were measured according to Pfeffer's seven dimensions and mapped into a standardized normal curve (with positive deviations being more people oriented), Westland Insurance would most likely be somewhere between the +1 and +2 standard deviation.

[28] Jeffrey Pfeffer, "The Human Equation, Building Profits by Putting People First," Harvard Business School Press, Boston, 1998.

Overall, Westland's culture is very much harmonious with its competitive strategy. Westland's staff is able to differentiate on service because they are not burdened with non-insurance tasks and inefficient sales processes. They are highly trained insurance specialists supported by a team of senior insurance professionals, accountants, information technology professionals, and claims representatives. Westland promotes and rewards teams and communicates well the importance of people in its success. By promoting specialization through training, restructuring and process re-engineering, Westland has created significant cost advantages as well.

3.4 Value Chain Analysis

Westland Insurance operates with a differentiation strategy. It focuses on providing Property and Casualty (P&C) insurance products and services that are perceived by customers as better than or different from those of its competition. This proves to be a continuous challenge since many consumers perceive insurance as relatively homogenous product and since many of Westland's competitors use cost based strategies to compete.

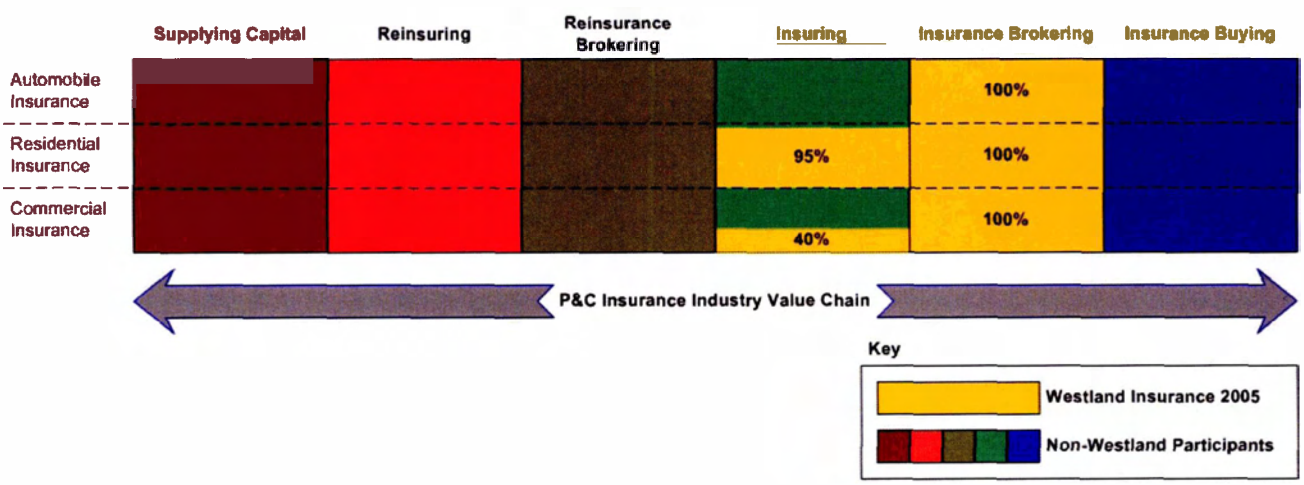
This section presents two value chain analyses. The first is an industry value chain analysis of the P&C insurance industry and the second is a firm-level value chain analysis of a P&C insurance brokerage, namely Westland Insurance Group Ltd. The focus of the firm-level value chain analysis was chosen for three reasons. Firstly, Westland Insurance Group Ltd. (the insurance brokerage) owns 100% of Westland Insurance Company (the insurance company). This is an extremely unique ownership structure in the North American insurance industry as it represents a rare case of an insurance broker vertically integrating backwards. Secondly, Westland Insurance Company outsources practically all of the core processes traditionally associated with an insurance company to Westland Insurance Group Ltd. Thirdly, the perception of the Westland Insurance brand is primarily one of a P&C insurance broker, this holds true for people both internally and externally.

3.4.1 The Property & Casualty Insurance Industry Value Chain

An industry value chain or *value system* (Porter, 1985), links a firm's value chain with the value chains of upstream suppliers and downstream buyers. The development of competitive advantages depends not only on the firm-level value chain, but also on the industry value chain of which the firm is a part. Westland Insurance illustrates this concept through a significant degree of vertical integration which allows it to better coordinate upstream and downstream activities than its competitors.

Figure 1 below contains the value chain for the P&C insurance industry. All the activities in the chain are divided by the three main products that the industry offers. This allows for a better representation of the level of backward vertical integration that Westland Insurance exhibits.

Figure 3.2 Industry Value Chain: P&C Insurance



Adapted from Porter, 1985

The P&C insurance industry value chain is made up of six distinct activities. The first activity is the supplying of capital needed to take on insurance risks. Capital represents the scarce resource or raw material in the insurance industry. Capital is the commodity that limits the amount of insurance that a company can sell. Capital is acquired through both traditional methods and insurance markets. Traditional methods include equity funding, options, bonds etc. Insurance markets refer to capital that is accessed through reinsurance companies. Capital accessed through reinsurance can be viewed as "rented capital" in that it is viewed like regular capital from a regulatory point of view. Insurance companies can meet their capital requirements through a combination of capital reserves and reinsurance. As an example, Westland Insurance Company has $4 Million in capital reserves. In Canada, the amount of insurance risk P&C insurers can take on is equal to a 3 to 1 ratio with the amount of capital reserves available[29]. Since Westland cedes away 75% of its premium revenue to reinsurers, it can underwrite up to $48 million $\left(\frac{\$4M \times 3}{0.25}\right)$ of insurance risk.

The second activity is supplying reinsurance. Reinsurance is an agreement between insurance companies under which one accepts part of the risk or loss of the other. Most primary insurance companies insure only part of the risk on any given policy. The amount varies between insurance carriers. The remainder of the insurance risk is covered by the reinsurance entity. The less primary risk that a company insures, the more premium it has to pay to the reinsurer. Reinsurance companies, therefore, are suppliers of capital or raw materials for primary insurers.

The third activity is reinsurance brokering. The reinsurance broker acts as an intermediary between primary insurers and reinsurers, representing the primary insurer. Reinsurance brokers structure, market and negotiate insurance programs for their clients and match their client's needs with several suitable reinsurance carriers.

[29] Interview with Matthew Wubs, CFO, Westland Insurance, March 15, 2005.

The fourth activity is insuring risks. This is the role of the primary insurer. The primary insurer is the insurance company that underwrites the risk and whose name is on the insurance contract. Primary insurance companies are highly regulated companies that traditionally assess and accept insurance risks, issue insurance contracts or policies, and adjust and payout claims.

The fifth activity is insurance brokering. Insurance brokers play essentially three roles in the insurance market. First, insurance brokers reduce the resources or costs incurred by insurance buyers when searching for insurers and those incurred by insurers searching for insurance buyers. Second, insurance buyers and sellers have asymmetric information on the product being sold, making it difficult for them to agree on the price and terms of the insurance policy. Insurance brokers solicit and provide information on buyers and sellers and make this information more easily understood to both parties. Since insurance brokers rely on long-term relationships, they have a strong incentive to ensure that no party takes advantage of the other. Third, insurance brokers are able to obtain better terms for their clients and are able to reduce the problem of asymmetric bargaining power between the buyers and sellers.

The sixth activity is insurance buying. This activity represents the end consumer in the insurance industry value chain. Insurance buyers of P&C insurance products include individuals, small businesses, large corporations, and professional associations or groups.

3.4.1.1 Westland Insurance's Footprint

Westland Insurance's footprint within the P&C insurance industry value chain is represented by gold shading as shown in the key. Additionally, a percentage is included to represent the level of involvement in a particular activity. For example, Westland Insurance participates 100% in the activities required to broker automobile, residential, and commercial insurance.

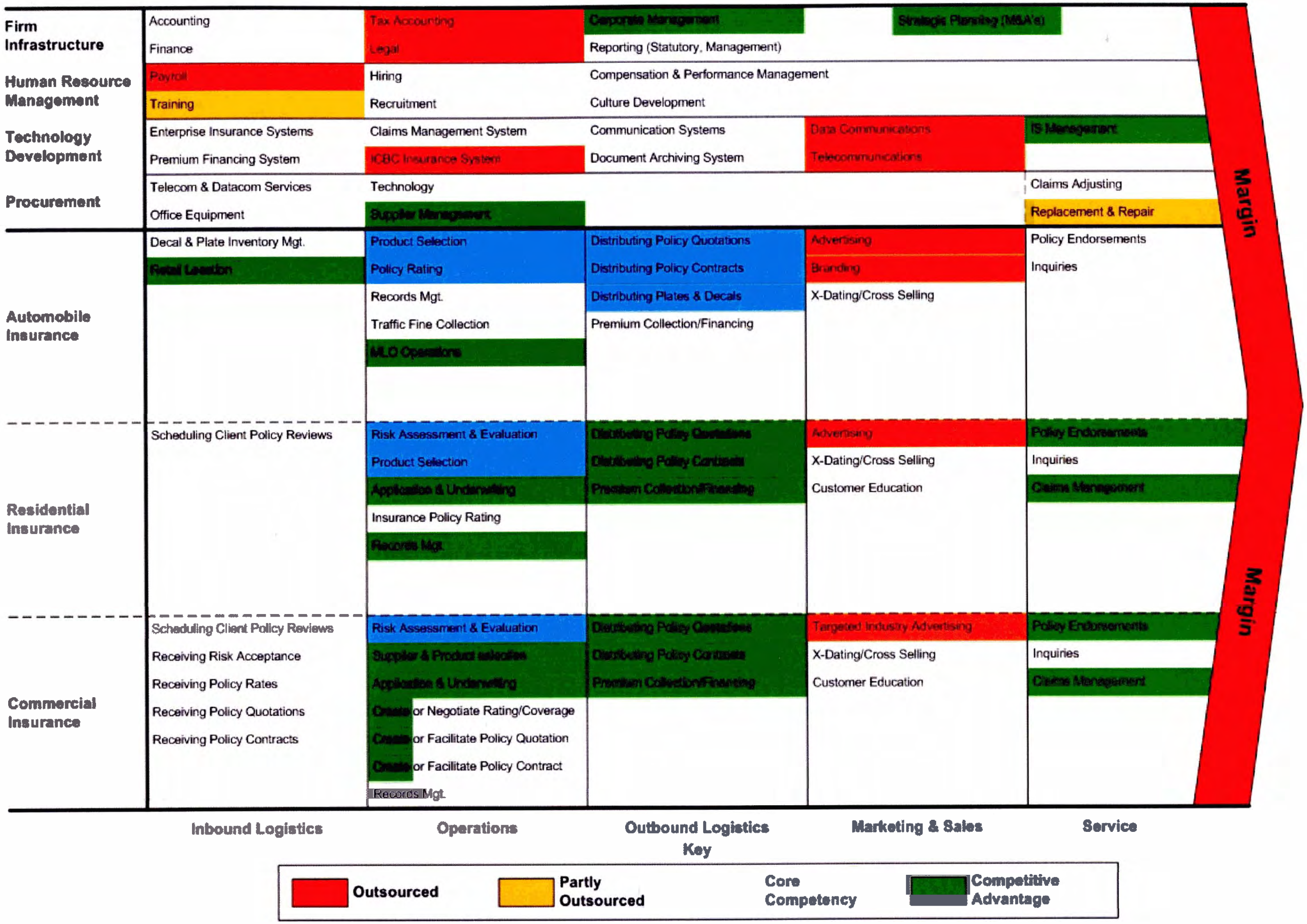
From an insurer's perspective, Westland is vertically integrated in two product areas. First, Westland Insurance Company underwrites or acts as the insurer for 95% of all residential policies that Westland Insurance Group Ltd. sells. Second, although Westland Insurance Company does not underwrite commercial insurance, the brokerage, Westland Insurance Group Ltd., acts as a managing general agent (MGA) for approximately 40% of all commercial policies sold. In an MGA arrangement, the brokerage assumes all of the activities normally conducted by the insurance company, including policy issuance, risk assessment and rating, and claims adjusting, while the insurance company simply underwrites the business financially. In return, the insurer pays commissions well above the industry norm[30]. Lastly, Westland does not perform any insurer activities for automobile insurance.

3.5 Westland Insurance Group Ltd.'s Value Chain

The following chart represents Westland Insurance Group Ltd.'s firm-level value chain. It models the firm as a series of value-creating activities in order to better understand how the firm creates competitive advantages.

[30] As an example, Lloyd's of London writes $117 million in premiums in British Columbia primarily through MGA arrangements it has developed with select brokers. Interview with Colin Thompson, March 9, 2005

Figure 3.3 Firm Value Chain: Westland Insurance



3.5.1 Firm Infrastructure

Two of the activities that make up the firm's infrastructure are outsourced. The first, Tax Accounting, includes all of the activities required to complete the annual tax returns for the firm. Westland currently outsources this activity to the accounting firm Deliottes. The second activity, Legal, is outsourced based on three distinct needs. First, Westland requires legal assistance for claim related matters. Occasionally, Westland is not able to reach a settlement with an insured through either regular claims indemnification processes or arbitration, and need to escalate the matter to a court of law. In these situations, Westland retains legal council from a law firm specializing in the legal matter at hand. Second, Westland outsources all matters regarding share issuance, shareholder votes, shareholder meetings, appointment and duties of directors and officers, and all other issues concerning the creation and regulation of a corporation to a law firm specializing in corporate law. Lastly, Westland outsources the service portion of its Legal Assist product to a local law firm. Legal Assist is a product Westland Insurance includes in its residential insurance contracts that provides its clients the ability to obtain legal advice at no additional cost or obligation to the policyholder.

Corporate management is one of Westland's competitive advantages. The reasons for this bold assertion are that when Westland's management team is compared to the management of its competitors, three distinct advantages are evident. The first advantage is the financial results that Westland achieves through short term financial planning. Westland emphasizes short-term planning, specifically through the use of its annual budget whose primary purpose is to project sales and expenses. The budget and more importantly the ability of management and staff to follow it can be viewed as one of the cornerstones to Westland's success as a company. In comparison, in the approximately 40 acquisitions that Westland has made over the last 20 years, none of the brokerages acquired had a budgeting and variance-reporting procedure in place and none enjoyed the level of profitability as Westland.

The second advantage is Westland's focus on people first management. Westland exhibits people first management in the following four ways. First, Westland offers substantial employment security. It has never had to downsize or layoff scores of employees due to economic downturn or management mistakes. Second, Westland pays its staff, on average, higher than industry salaries. Third, Westland puts a strong emphasize on training and education. Lastly, customer service is considered one of Westland's most important advantages and is advocated with evangelical zeal.

The third advantage that Westland has when compared to competitors is the experience, training and tacit knowledge of its executive team. Westland's executive team is made up of three senior executives and four junior executives. The senior executive team alone has over 100 years of cumulative insurance industry experience, at both the insurance company level and the insurance brokerage level. Together, the executive team has over 150 years of insurance industry experience. The junior executive team is includes two members with MBAs and one with a CA. The product of the executive team's experience and management training is Westland's most important advantage, tacit knowledge. Tacit knowledge underlies many competitive capabilities. It often reaches consciousness in the form of insights, intuitions, and flashes of inspiration. The capacity of ones mind to make sense of a previous collection of experiences and to connect patterns from the past to the present and future is essential to the innovation process.

In contrast, most of Westland's competition in the insurance brokerage industry in British Columbia, operate with a much more entrepreneurial worldview and share several similarities. First, the vast majority of insurance brokerages in BC are small, owner operated, first generation organizations. Second, in most cases, the owner does not have a college degree but is very entrepreneurial and profit oriented. Most have considerable insurance brokerage experience and certification, but have limited business training and education.

Another competitive advantage that Westland possesses is in the activity of Strategic Planning, specifically as it relates to mergers and acquisitions. This advantage takes into consideration traditional studies that show 50%-70% of all mergers and acquisitions fail. The reasons for failure given in these studies were, acquirers pick the wrong target and/or pay too much for the acquisition, synergies were over-estimated and lastly, post-acquisition integration costs were under estimated. Since its inception, Westland's primary growth driver has been growth by acquisition. This strategy is viewed a successful one by Westland executives and shareholders since; Westland performs above the industry average in operating measures[31], profitability, and share price. Additionally, market share increased after most acquisitions.

With regards to target selection and value establishment, Westland has a defined strategy in place. An attractive target acquisition for Westland involves a smaller less cost efficient brokerage that has a great location and a mix of residential, automobile and commercial insurance that roughly follows a ratio of 40:40:20. Insurance brokerages in B.C. have a standard method of evaluation that has for the most part been accepted by the entire industry. This method is based on the revenues of the brokerage's major product lines. An example evaluation can be seen in Appendix 1 – "*Market Value of a Sample B.C. Insurance Brokerage*". Since the evaluation is standardized across the industry, the risk of paying too much for an acquisition is reduced.

Learning can be attributed to the decreased average cost of post acquisition integration. Through the experience gained in close to 40 acquisitions, Westland has developed various techniques and strategies for handling data integration, cultural assimilation and the implementation of new products and management structures.

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[31] Appendix 2 – "*Westland Performance versus Industry (2000)*"

For example, many acquisitions involve the purchase of owner-operated insurance brokerage businesses where the owner is central to the operations of the firm. The owner is the manager, underwriter, human resources department, IT department or in other words “the boss”. In environments like this it is Westland’s experience that staff rarely feel overly empowered or have a strong sense of “team”. Additionally, in many cases the insurance policy and customer data captured in the acquired broker’s information systems has an extremely low level of integrity or validity. This makes automating the transfer of data into Westland’s information systems very difficult. A strategy that has worked very well for Westland involves the manual entry of data into Westland’s insurance systems. However, instead of putting this massive task on the shoulders of the newly acquired office’s staff, files are packaged up and sent throughout Westland’s network of offices. Overtime is paid to volunteers who work at night entering data. The staff at the newly acquired office is free to concentrate on learning about Westland’s products, processes, and systems. The benefits of this strategy are threefold. First, the acquired office staff is usually overwhelmed with feelings of support and being part of a team. Second, volunteers get an opportunity to make extra money. Third, the massive task of data entry is spread over a large work force and is usually completed in six to eight weeks.

Operational synergies created by mergers and acquisitions are twofold. First, economies of scale are created by the centralization certain administration and support functions. These departments are included in Westland’s fixed costs and further allow specialization in the organization. Before an acquisition, both Westland and the target wastefully duplicate these fixed costs. After the acquisition, these functions are transferred to the centralized departments usually without the need to increase the labour costs. The result is that fixed costs are spread over the larger output of the combined firms. The merger realizes scale economies by avoiding a duplication of fixed costs. Second, economies of scope are created at the firm level. Westland’s marketing department, accounting department, IT department and senior management all carry out their respective duties for all products. As well, Westland's Enterprise Insurance System provides processing and data storage across all product lines. This differs from most other brokerages in the industry who usually have different policy management system for each insurance product.

There are four other activities included in the firm infrastructure. The first activity is accounting which includes the systematic recording, reporting, and analysis of all financial transactions. The second activity is finance. The finance function allocates resources, including the acquiring, investing, and managing of resources. The last activity is reporting. This activity includes the process of summarizing and clearly communicating data needed for effective operational and strategic management and for the fulfilment of statutory requirements.

3.5.2 Human Resource Management

The Human Resources department in Westland is not an overly developed one. The department consists of one person whose main responsibility is to administer payroll and employee benefits. Most of the other human resource functions are performed by division managers.

The outsourced activities include Payroll and Training. Payroll is administered in house through a web-based application provided by ADP. ADP manages the distribution of payroll funds, employee benefit enrollment, and reporting. Training is partially outsourced. Leadership and customer service training is usually outsourced to various suppliers. Insurance training needs are met through a combination of Westland College and industry certified training classes. IT training is also accomplished through a combination of in-house classes and third party educators.

Westland College is an in-house training facility developed in 1999. It was developed in recognition of the fact that Westland employees need to have as good an understanding of underwriting insurance policies as they do selling them. Most brokerages in the industry represent external companies so an understanding of underwriting and risk management is not necessary. Westland's agents however, represents the interests of the firm's own insurance company so good underwriting skills are very important. Consequently, Westland formed its own internal training facility called Westland College. The objectives of Westland College demonstrated through its mission statement:

> "Westland College will educate our staff to be the most knowledgeable in the industry by providing training specific to:
>
> - Westland Sales and Service
> - Westland Products
> - Westland Underwriting Philosophy
> - Westland Leadership
> - Westland Computer Applications
>
> We will achieve this by drawing on the competencies and expertise of our staff as trainers and facilitators."[32]

Westland College provides training and education for Westland staff in all areas of their jobs. Current employees are used as trainers whenever possible in order to augment the learning process. Westland College has created a basis for guaranteeing that Westland's sales force will be among the most knowledgeable and educated in the industry.

Hiring and Recruitment activities are performed by a combination of division managers and HR department personnel. The focus of efforts in these activities involves the hiring and recruitment of certified insurance personnel or Customer Service Representatives (CSR). Currently, in 2005, this is a continuous process as there is a shortage of qualified insurance

[32] Westland Insurance Intranet Site – accessed June 26, 2005.

personnel. Hiring and recruitment in other functional areas like claims, information technology, marketing, and accounting are carried out primarily by the managers of that division.

Performance Management is the systematic process of monitoring the results of activities, collecting and analyzing performance information to track progress, and communicating results achieved, or not achieved. Employee compensation includes wages and salaries, employee benefits, and fringe benefits. Compensation and Performance Management activities are the responsibility of division managers. Typically, employees get performance reviews every six months and salary reviews annually.

3.5.3 Technology Development

Activities in this area include research and development, process automation, and other technology development used to support the value chain activities. Three activities in this area are outsourced. The first is the ICBC Insurance System. This is an insurance policy sales and distribution system that is mandatory for all BC insurance brokers that sell ICBC products. In 2001, ICBC released a new version of this system that is entirely browser based and uses the Internet for connectivity. Except for ensuring a quality, redundant connection to the Internet, Westland has no involvement in the development or maintenance of the system, which is solely the responsibility of ICBC.

The second and third outsourced activities are Data Communications and Telecommunications. Westland provides its data communication services over a virtual private network supplied by Telus. This is a managed service, meaning that Telus monitors, services and ultimately takes responsibility for the quality and availability of the service. In the past, Westland management of the corporate data network was in-house. The decision to outsource this function to Telus was made in 2001. Similarly, Westland outsources most of its telecommunications needs to Telus as well.

The resources Westland Insurance commits to research and development is tightly aligned with a differentiation strategy. Research and Development expense is primarily in the form of information system development. Because the nature of insurance is essentially a promise to policyholders, information systems play a key role in the manufacturing of the product (insurance policies). Therefore, in the insurance industry Enterprise Resource Planning systems and Customer Relationship Management systems are not the only business critical systems. Enterprise Insurance systems that store insurance policy information, rate policies and issue policies play an important role in a firms ability to differentiate and create competitive advantages.

In 1995, Westland made a decision to invest substantial capital into the creation of an Enterprise Insurance System. One of the features of this system is that it allows for rating, quoting and issuance of insurance documents at the point of sale. On the back-end the policy data is electronically exchanged with the insurer. This dramatically reduces the average cost of producing a policy since there is essentially only one touch point in the process. This represents an estimated 80% reduction in the labour required to produce a policy using traditional insurance brokerage processes[33]. This is an economy of scale since Westland is able to create and maintain specialist machinery that reduces average total cost. It is not viable for smaller insurance brokerage firms to purchase this type of expensive capital equipment because their output volumes are too low to spread the cost of such machines.

Westland considers its Enterprise Insurance System one of its competitive advantages because it provides key differences compared to other residential insurance providers. In Canada, insurance brokers are still the largest distributor of residential insurance policies, accounting for between 70% and 80% of all residential polices sold. In B.C., insurance brokers tend to be small businesses that do not have the resources or economies of scale to commit adequate resources to

[33] Interview with Jason Wubs – Vice President, Retail Operations, Westland Insurance.

the development of customized insurance systems. They rely on packaged software that simply tries to make the traditional insurance application process more efficient. Other, non-broker, residential insurance distributors who could afford the investment, like insurance companies that sell directly to consumers and web-based distributors, are disadvantaged because they do not have same retail distribution network that Westland has and therefore do are not able to perform face-to-face transactions with their clients. All of these factors further create unique differences between Westland and its competition and are directly related to Westland's high resource commitment to research and development.

There are five other technology development activities shown in Figure 3.3 that are used by Westland to support value chain activities. The first, the Premium Financing System, is a system that enables Westland staff to finance a client's insurance premium over 12 months. The system interfaces with the accounts receivable system and manages the periodic withdrawal of funds from clients bank or credit card accounts. The second, the Claims Management System, is a system that tracks the expenses and indemnification paid out in a claim, collects data on the type of loss and what was lost or damaged, and schedules adjusters and examiners time. The third, Communications Systems, include all systems that enable communications and knowledge transfer. This includes email, faxing, scanning, knowledge management systems, intranets, and training systems. The fourth, the Document Archiving system, is a system that captures in digital form all documents sent to or received from a client. All documents are indexed and stored in the archiving system so that they can be retrieved easily anytime, anywhere. The last activity, IS Management, is the task of managing all of the technology, processes and people involved in the activities above.

3.5.4 Procurement

Procurement is the function of purchasing the raw materials and other inputs used in the value chain activities. Since Westland does not manufacture a physical product, the procurement function is relatively small. Every few years Westland collects quotes on a few products and services. For example, approximately every five years Westland will request quotes for Telecom & Datacom services and the purchase of a fleet of office equipment. Additionally, Westland goes through the same process to purchase various technology components as required.

With respect to servicing insurance policies, specifically residential insurance polices, Westland procures the services of external claims adjusters. These external claims adjusters will in turn manage the procurement of repair and replacement services. Internal adjusters also fulfil this function. Hence, in Figure 3.3 the Replacement &Repair activity is shown as partly outsourced.

Westland does not produce a physical product. However, it does have a manufacturing function; it manufactures insurance policies. The providers of raw material are its suppliers, namely insurance companies who provide insurance markets and capital. Supplier Management is a critical activity in the success of Westland Insurance, and as such is listed as one of its competitive advantages. The reasons for this are twofold. First, through vertical integration, Westland is its own supplier of residential insurance. Therefore, one of Westland's greatest advantages in supplier relationship management is shown through the operation of its own insurance company. Westland is the only independent brokerage firm in B.C. to operate an insurance company. The advantage for Westland is independence and flexibility. For example, Westland Insurance Company pays the brokerage 30.5% commission for residential policies. The standard commission paid by insurance companies to competing brokers is currently 20% and falling. As continuing pressure is put on insurance companies to reduce brokerage commissions

Westland will be able to maintain commission levels provided it can continue to achieve sound underwriting results.

Second, and one that is often misunderstood by competing brokers, is the ability of Westland Insurance Group Ltd. to write business that is profitable for the insurance company. Those brokerages in the industry that can implement good underwriting strategies ensuring profitable business for their insurance company partners gain significant power. On the other hand, those brokerages that fail to implement good underwriting strategies and cause unnecessary underwriting losses for their insurance company partners run the risk of losing their contracts. When a contract is cancelled as a result of poor performance, a brokerage will likely find it difficult to replace business with other companies without making significant changes.

Although commissions paid to brokerages by their insurance company partners are fairly standard across the industry, those brokerages that can produce profitable business from an underwriting standpoint can garner additional compensation from their insurance company partners in the form of contingent profit sharing. Contingent profit sharing is paid to the brokerage after the end of an agreed upon period, usually a year, and the amount is dependent on the underwriting results for that period. In conclusion, Westland has achieved underwriting results significantly better than industry averages since the inception of the company.

3.5.5 Inbound Logistics

3.5.5.1 Automobile Insurance

The inbound logistics activities for automobile include Decal & Plate Management and the selection of retail locations. Each Autoplan appointed broker in BC has to receive license plates and insurance decals from ICBC and place them into an inventory. Plates and decals are distributed to policyholders as they purchase automobile insurance policies.

Retail location selection is considered an inbound logistic because location is the key factor in a customers choice of which automobile insurance brokerage to patronize. This is a result of the fact that ICBC has mandated that all insureds must visit in person an appointed ICBC insurance broker each year to renew their automobile insurance. As well, ICBC has made insurance premiums and commissions uniform across the province. As a result, ICBC has turned the sale of auto insurance into a retail venture for all competitors, and since consumers have no negotiating power, location has become a critical factor.

Westland's retail locations are an important competitive advantage since tremendous care is taken to secure great retail locations. Great retail locations for insurance brokerages are those in high traffic shopping malls that include as their anchor a major grocer, a pharmacy, and a liquor store. Adequate parking is also an important convenience differentiator.

3.5.5.2 Residential Insurance

Vertical integration has dramatically decreased the inbound logistic activities needed for Westland to broker residential insurance. Many of the activities discussed in the next section such as receiving rates, quotes, and contracts from suppliers have been eliminated since these activities are completed in the operations phase of value creation. IT systems have allowed insurance agents to complete these activities at point of sale and require no inputs from a supplier.

The only input required in the selling of residential insurance is the scheduling of client policy reviews. This activity occurs for both new customers and existing customers upon the annual renewal of their policy. Insurance agents contact clients to schedule a time when they can review their policy and their insurance needs.

3.5.5.3 Commercial Insurance

The inbound logistics of commercial insurance are examples of traditional insurance activities. Insurance agents collect application and underwriting information from the clients and send it to various insurance companies. Insurance companies respond as to whether or not they will accept the risk and if so what the rates will be. As well, many insurance companies then need to manufacture a quotation document and subsequently, if the client agrees to purchase the policy, needs to create the insurance policy document. It can take insurance companies anywhere from one day to six weeks to produce these documents. Brokers have to receive the policy quotation and policy contract documents and distribute them to clients. Additionally, in many cases there is significant communications between the insurance company and the broker in order to finalize these documents.

3.5.6 Operations

3.5.6.1 Automobile Insurance

There are five operations activities required for selling automobile insurance. Product selection and policy rating, the first two activities shown in Figure 3.3, are two of Westland's core competencies. Westland's tag line "Your best coverage is our only policy", acknowledges its commitment to these core competencies. Product selection is the process of matching a client's insurance needs with the most appropriate product. Because of the complexity of insurance, this requires agents that are trained not only in general insurance knowledge but also in the insurance products they are selling. Policy rating is the process of calculating an insurance premium based on the product and coverages selected. ICBC enables agents to complete both of these activities at point of sale through the provisioning of IT systems in every ICBC broker office.

The third activity is records management. ICBC requires brokers to retain original, signed copies of all insurance polices in their office filing systems for seven years. The broker is then recorded in ICBC's database as the "Agent of Record". Brokers need to be able to produce original copies in the event of a insurance claim that escalates to court.

The fourth activity includes traffic fine collections. BC insurance brokers collected $69.5 million in Motor Vehicle Branch debts and fines in 2000[34]. All ICBC appointed brokers in BC are required to perform this function.

The fifth activity, and a source of competitive advantage for Westland, is the operation of Motor Licensing Offices (MLO). MLOs are responsible for driver license testing, training and licensing. ICBC and the Motor Vehicle Branch have outsourced the operations of many of these offices to insurance brokers around the province. Having an MLO inside an insurance brokerage location is a considerable competitive advantage since it dramatically increases the flow of potential customers in and out of the office. Westland operates three MLOs, one in Princeton, one in Sechelt, and one in Whistler.

3.5.6.2 Residential Insurance

Risk assessment and evaluation involves the review and judgment of three key risk areas, the person, the insurable risk, and the use of the insurable risk. This is one of Westland's core competencies. Westland continually achieves significantly better than industry average underwriting results. A key component to this ability is the ability to assess and evaluate risks. Once a risk is assessed, a decision can be made as to what is the best product and what is the appropriate rate. Alternatively, a decision may be made to not insure this particular client or risk.

[34] Insurance Brokers Association of British Columbia. "Auto Insurance in B.C.," January 2002.

As mentioned above product selection is another of Westland's core competencies. Brokers not only select products but offer advice on coverage alternatives, explain new products or changes to coverage that have come on stream since the last renewal date, and identify potential problems or inadequate coverage areas, and advises the client accordingly.

The Application & Underwriting activity is one of Westland's competitive advantages. It is enabled through vertical integration and the creation of customized information systems. Westland's investment in the creation of a customized Enterprise Insurance System allows insurance agents to rate, quote and issue insurance policies at the point of sale. Since Westland owns the primary supplier, namely Westland Insurance Company, this dramatically reduces the average cost of producing a policy since there is essentially only one touch point in the process. This activity is a competitive advantage since competitors do not have the ability to commit adequate resources to the development of customized insurance systems nor are they vertically integrated with an insurance company.

The last two activities shown in Figure 3.3 are Insurance Policy Rating and Records Management. Both activities are made more efficient through the use information technology. Agents are able to rate residential insurance policies at point of sale and do not have to communicate with an external insurance company in order to secure a rate. Westland has an Enterprise Archiving System that allows CSRs to store all client related documents digitally. This reduces the storage, search and retrieval costs associated with records management.

3.5.6.3 Commercial Insurance

The first three activities shown in Figure 3.3, Risk Assessment & Evaluation, Product Selection, and Application & Underwriting are core competencies or competitive advantages for the same reasons as mentioned in the section above. The additional activities performed in commercial insurance involve the rating, quoting and issuance of insurance polices. Although

Westland Insurance Company does not underwrite commercial insurance, the brokerage, Westland Insurance Group Ltd., acts as a managing general agent (MGA) for approximately 40% of all commercial policies sold. In an MGA arrangement, the brokerage assumes all of the activities normally conducted by the insurance company, including policy issuance, risk assessment and rating, and claims adjusting, while the insurance company simply underwrites the business financially. When brokering commercial policies that are not under the MGA arrangement, agents must communicate and negotiate on behalf of their clients with insurance companies in order to create insurance programs, establish rates, create quotations and create insurance policy documents. When commercial policies fall under the MGA arrangement, the above tasks can be performed by the insurance brokerage. Subsequently, the activities are much more efficient and a source of competitive advantage.

3.5.7 Outbound Logistics

3.5.7.1 Automobile Insurance

There are four activities included in outbound logistics for brokering automobile insurance in BC. The first three, distributing insurance quotations, contracts and plates & decals, include providing written and verbal quotations and the distribution of the final product, a printed copy of the insurance policy and a plate and decal. These three activities are part of Westland's core competencies.

The last activity is Premium Collection/Financing. This activity is the collection of ICBC premiums through various payment methods. Additionally, it involves the administration of ICBC premium financing plan. CSRs can enroll their clients in ICBC's insurance premium financing plan called Autoplan 12.

3.5.7.2 Residential & Commercial Insurance

Three activities make up outbound logistics for brokering both residential and commercial insurance; all three are sources of competitive advantage for Westland Insurance. Distributing policy quotations and contracts are competitive advantages because both activities can be done at point of sale. This is made possible through a combination of customized information systems and either vertical integration with an insurance company or, as in the case of commercial insurance, and MGA arrangement.

Premium financing is a competitive advantage because of three reasons. First, it improves retention by breaking annual premiums into monthly payments. Second, it is another source of revenue for Westland. The Pre-Authorized Monthly Payment (PMP) product is a financial product funded and administered by Westland. Westland charges a 5% administration fee on the total premium financed. Third, the product is managed through a module in Westland's Enterprise Insurance System and is tightly integrated with policy billing. During the sale of an insurance policy the creation of a policy financing plan shares the same input as creating an invoice. Therefore, both economies of scope and competitive advantages are created since competitors either do not have policy financing plans or offer them as a separate product.

3.5.8 Marketing & Sales

3.5.8.1 Automobile Insurance

Westland does very little advertising and what little it does is outsourced. This decision is the result of the belief that an office's location is the only thing that truly matters in the acquisition and retention of automobile insurance customers. However, in the last few years, Westland has spent considerable resources on creating and managing its brand. Westland, with the assistance of a marketing firm, conducted a series of workshops and information sessions with the intent of articulating a new company vision that represented the competitive strengths of the company and that provided a clear strategic direction. Once the vision was developed, much work was put into developing a visual image to support the vision. A new brand image was created in late 2001.

The primary marketing and sales activity that spans across all product lines is x-dating and cross selling. X-dating involves recording the expiration date of a customers P&C insurance products. For example, a CSR would be expected to record the expiry date of a customer's residential and/or commercial policy while transacting an automobile insurance policy sale, or vice-versa. Cross selling, is the act of using the x-dates to solicit new business, essentially selling more products to existing customers.

3.5.8.2 Residential & Commercial Insurance

The first two activities shown in Figure 3.3, Advertising and X-Dating/Cross Selling, have the same characteristics as mentioned in the section above. The additional activity performed in residential insurance is Customer Education. This is accomplished in two ways. First, product brochures and information sheets are enclosed in all mailing correspondence with clients. These enclosures include information on additional products, coverages and risk mitigation techniques. Second, Westland's public website, www.westland-insurance.com, has various product and coverage information and an insurance glossary.

3.5.9 Service

3.5.9.1 Automobile Insurance

Four components make up the service activity for automobile insurance. The first component is Policy Endorsements. This process includes making changes and amendments to insurance policies mid-term. Examples include, change of address, change to the use of vehicle, and/or change of vehicle insured. The second component involves answering client inquiries.

These inquiries can range from questions regarding Aircare and/or drivers license to complicated insurance coverage questions.

3.5.9.2 Residential & Commercial Insurance

Policy endorsements form another competitive advantage for Westland Insurance. This is again created from the vertical integration of the insurance company (or an MGA arrangement as in the case of commercial insurance) and the use of information technology. Competitors process policy endorsements by collecting the change information and sending it to the insurance company. Usually 2 to 6 weeks later the broker will receive the amended policy document and will forward it to the client. A Westland CSR can complete the entire transaction while on the phone with a client. The amended policy is in the mail within a day.

Another competitive advantage is the claims management process. This is also a result of vertical integration with the insurance company or an MGA arrangement as in the case of commercial insurance. As a result of the efficiencies discussed in previous sections agents have the time to provide better customer service. Agents contact each client on the renewal of their policy in order to review coverage. This value added service helps ensure clients are adequately insured. This leads to better perceived claims service since in the event of a claim customers are more likely to have adequate coverage. The last thing a person wants to hear when they make a claim is that although they have insurance they have not bought enough coverage. This is a unique characteristic of Westland since most competitors have are swamped with processing paper, entering data into multiple insurance companies systems, and dealing with multiple insurance company processes.

3.6 Financial Analysis[35]

Any business has important financial concerns, and its success or failure depends in a large part on the quality of its financial decisions. Financial analysis is part of the financial decision making process in that it is needed in order to determine a company's financial condition. This section provides a financial analysis of Westland Insurance in order to ascertain its financial health as it relates to profitability, growth, and cash flow.

3.6.1 Productivity

3.6.1.1 Revenue Per Employee

Revenue per employee is an important ratio in the P&C insurance industry in BC. It is used extensively in the industry and measures the productivity of a brokerages sales force. It is calculated by dividing a brokerages total annual revenue with the total number of employees. A ratio between $80,000 and $100,000 is considered respectable in the industry, where a ratio over $100,000 is considered outstanding. Table 3.1 shows Westland's revenue per employee broken down by division.

Table 3.1 Revenue Per Employee (Excluding claims division)

Division	# of Employees	2004 Revenues	Revenue Per Employee
Retail Operations	96	$11,741,220	$122,304
Commercial Operations	13	$3,406,778	$262,060
Admin/Other	15	$407,498	$27,167
Totals	124	$15,555,496	$125,448

Westland's average revenue per employee at over $125,000 is far above what industry considers outstanding. Both operational divisions, retail and commercial, are well above industry benchmarks at $122,000 and $262,000 respectively.

[35] This section is based on data presented form an interview with Jason Wubs – Vice President, Retail Operations, Westland Insurance, on June 2, 2005

3.6.1.2 Payroll as a Percentage of Revenue & Total Operating Expense

Payroll as a percentage of revenue is another key ratio for insurance brokers. It is important because payroll expense is the largest expense brokers face and because the ratio measures the return that a broker gets from their investment in payroll. A ratio between 50% and 55% is considered good in the industry. Table 3.2 shows Westland's payroll as a percentage of revenue and as a percentage of total operating expense for the years 2000 through 2004.

Table 3.2 Payroll as a Percentage of Revenue & Total Operating Expense

	2004	2003	2002	2001	2000
Payroll as a Percentage of Revenue	37.3%	37.1%	40.2%	41.8%	42.1%
Payroll as a Percentage of Expenses	56.5%	56.2%	58.5%	58.1%	58.5%

In Table 3.2, Westland's payroll as a percentage of revenue for the last five years ranged between 37% and 42%. Also, notable is that it has been decreasing each year. Payroll as a percentage of total operating expense ranged from 58.5% to 56.2% over the last five years and is also in a downward trend.

3.6.1.3 Retention

The ability to renew insurance policies each year is a critical factor in the success of a P&C insurance brokerage business. The retention ratio is measured by dividing the difference between renewal premiums and cancellation premiums with renewal premiums. A ratio between 89% and 91% is considered good in the industry. Table 3.3 shows Westland's retention ratios for the last five years broken down by residential and commercial insurance products.

Table 3.3 Retention of Residential and Commercial Insurance Products

Year	Residential	Commercial
2000	89.7%	90.3%
2001	89.8%	94.9%
2002	90.3%	94.3%
2003	91.8%	96.2%
2004	91.1%	96.1%
Totals	90.5%	94.4%

Residential retention ranged from 89.7% to 91.8%, while commercial ranged from 90.3% to 94.9%. Both are considered good by industry standards and both are on an upward trend.

3.6.1.4 Revenue Growth

Growth allows Westland to attract and retain great people. This is important since service is one of Westland's competitive advantages and people are ultimately responsible for creating and sustaining this key differentiator. Industry benchmarks for revenue growth of larger P&C insurance brokers in BC is estimated at greater than 5% annually. Table 3.4 illustrates Westland's revenue growth over the last five years.

Table 3.4 Revenue Growth for Westland Insurance from Year 2000 to 2005

	Projected		Actual							
Product	**2005**	**Growth**	**2004**	**Growth**	**2003**	**Growth**	**2002**	**Growth**	**2001**	**Growth**	**2000**
Residential Ins.	$ 8,052	28%	$ 6,298	8%	$ 5,813	20%	$ 4,838	7%	$ 4,536	21%	$ 3,740
Commercial Ins.	$ 4,407	29%	$ 3,407	17%	$ 2,913	28%	$ 2,278	28%	$ 1,780	20%	$ 1,480
Automobile Ins.	$ 5,869	26%	$ 4,663	10%	$ 4,253	7%	$ 3,966	-1%	$ 3,990	8%	$ 3,699
Prem. Financing	$ 748	13%	$ 661	19%	$ 555	19%	$ 468	24%	$ 378	22%	$ 309
Other	$ 1,094	28%	$ 855	17%	$ 733	-37%	$ 1,171	38%	$ 851	11%	$ 770
Totals	$ 20,170	27%	$ 15,884	11%	$ 14,267	12%	$ 12,721	10%	$ 11,535	15%	$ 9,998

Westland has had revenue growth well above the 5% benchmark in all of the last five years. The projected growth in 2005 is 27% due to the acquisition of two insurance offices in December 2004 and three more in March 2005. Westland's growth is primarily the result of acquisitions and is becoming harder to maintain. The availability of good insurance brokerages that fit Westland's acquisition criteria is becoming harder to find. Organic growth over the last five years has been less that 3%. This is an area of concern for Westland's executive team as other methods of growth are needed in order to maintain growth expectations.

3.6.1.5 EBITDA Margin

Since EBITDA eliminates the effects of financing and accounting decisions, it is a tool that can be used to compare the operating efficiency between two firms. Therefore, the EBITDA margin is a key ratio because it can be used to analyse the profitability between two or more insurance brokers. EBITDA is defined as earnings before interest, tax, depreciation, and amortization. EBITDA margin is simply EBITDA as a percentage of annual revenues. Table 3.5 shows Westland Insurance's EBITDA and EBITDA margin for years 2000 through 2004.

Table 3.5 EBITDA & EBITDA Margin

Westland Insurance	2004	2003	2002	2001	2000
Revenue	$15,884,376	$14,267,037	$12,720,618	$11,535,301	$ 9,997,642
Expense	$10,177,502	$ 9,121,646	$ 8,531,847	$ 7,869,427	$ 6,835,870
EBITDA	$ 5,706,874	$ 5,145,391	$ 4,188,771	$ 3,665,874	$ 3,161,772
Net Operating Margin	35.9%	36.1%	32.9%	31.8%	31.6%

Westland's EBITDA margin over the last five years has not fallen below 31%. These are very strong results considering the average across all industries in North America is in the mid-teens. As an industry comparison, Table 3.6 presents the same measurements for Hub International, the largest brokerage firm in Canada, and Western Financial Group, another large broker in Canada. Westland's results compare quite favourably with both of these larger competitors.

Table 3.6 EBITDA & EBITDA for Two Large Competitors

Hub International	2004	2003	2002	2001	2000
Revenue	$ 360,850	$ 286,359	$ 219,960	$ 153,993	$ 95,240
Expense	$ 294,316	$ 216,365	$ 171,823	$ 123,291	$ 76,479
EBITDA	$ 66,534	$ 69,994	$ 48,137	$ 30,702	$ 18,761
Net Operating Margin	18.4%	24.4%	21.9%	19.9%	19.7%

Source: Hub International Annual Reports

Western Financial Group	2004	2003	2002	2001	2000
Revenue	$42,243,158	$32,666,023	$27,960,925	$22,408,445	$19,704,877
Expense	$33,788,075	$26,625,284	$22,784,675	$17,932,527	$16,298,444
EBITDA	$ 8,455,083	$ 6,040,739	$ 5,176,250	$ 4,475,918	$ 3,406,433
Net Operating Margin	20.0%	18.5%	18.5%	20.0%	17.3%

Source: Western Financial Group Annual Reports

3.6.2 Liquidity Ratios

3.6.2.1 Capital & Surplus Ratios

Westland's financial partners require that three key financial ratios be calculated on a quarterly basis. These ratios are its debt service ratio, its accounts receivable ratio, and its working capital ratio. The first of these ratios is the debt service ratio. It is the amount of cash flow available to meet annual interest and principal payments on debt. In general is calculated by dividing net operating income with the total debt. The debt service ratio is calculated in the Table 3.7.

Table 3.7 Debt Service Ratio

Debt Service Ratio	2004
Net Income	$ 4,082,302
Funded Debt (principal & interest)	$ 1,857,267
Debt Service Ratio	2.20
Bank requirement	1.25
Surplus over requirement	$ 2,225,035

Westland's debt service ratio of 2.20 is very healthy. It indicates that cash flow from operations can easily cover its current interest and principal payments.

The second ratio is the accounts receivable turnover. This ratio measures the number of times that the accounts receivable amount is collected throughout the year. A high accounts receivable turnover ratio indicates a tight credit policy. The industry benchmark for this ratio is 15. Westland's accounts receivable turnover is calculated in Table 3.8.

Table 3.8 Accounts Receivable Turnover

Accounts Receivable Turnover	2004
Annual Premium Sales (Not Including ICBC)	$ 42,402,354
Average Accounts Receivable Balance	$ 1,477,000
A/R Turnover	28.71
Average Days Outstanding	12.71

Westland's accounts receivable turnover ratio of 28.71 is outstanding. It illustrates that Westland collects its entire accounts receivable more than twice a month.

The third ratio required by Westland's financial partners is the working capital ratio. It indicates whether a firm has enough short-term assets to cover its immediate liabilities. It is calculated by dividing current assets with current liabilities. Westland's working capital ratio is calculated in Table 3.9.

Table 3.9 Working Capital Ratio

Working Capital Ratio	2004
Current Assets	$ 10,443,958
Current Liabilities	$ 7,148,150
Working Capital Ratio	1.46
Bank Requirement	1.05
Surplus Working Capital	$ 3,295,808

Westland has a working capital ratio of 1.46, which is higher than the bank requirement of 1.05, and has a surplus working capital in excess of $3 million.

3.6.2.2 Free Cash Flow Projections (5 Years)

Free cash flow is essentially a measure of how much cash a company has accounting for tax liability, debt payments and capital maintenance. It is a vital measurement used by a firm to calculate its ability to fund ongoing activities and growth. In Table 3.10, Westland's free cash flow is forecasted for years 2005 through 2009.

Table 3.10 Free Cash Flow Projections

Westland Insurance Free Cashflow Forecast - 2005 to 2009	**2005**	**2006**	**2007**	**2008**	**2009**
Net Earnings	4,074	4,567	4,828	5,099	5,426
Add Back Amortization	890	890	890	890	890
Add Back Depreciation	240	240	240	240	240
Change in Non-cash Working Capital	(1,512)	(978)	(629)	(995)	(969)
Net Cashflow from Operations	**3,692**	**4,719**	**5,328**	**5,234**	**5,587**
Capital Expenditures	(275)	(275)	(275)	(275)	(275)
Purchase of WICL Shares	(1,700)	-	-	-	-
Agency Purchase	(3,600)	-	-	-	-
Net Cashflow from Investments	**(5,575)**	**(275)**	**(275)**	**(275)**	**(275)**
Repayment of Long term Debt	(2,330)	(2,456)	(2,588)	(2,726)	-
Proceeds from Longterm Debt	4,500	-	-	-	-
Buyout of Clay by Jech Holdings	(2,500)	-	-	-	-
Proceeds from Subdebt (clay)	1,000	-	-	-	-
Shareholder Draws	(145)	(1,415)	(1,627)	(1,871)	(1,470)
Net Cashflow from Financing	**525**	**(3,870)**	**(4,214)**	**(4,596)**	**(1,470)**
Net Cashflow	**(1,358)**	**574**	**839**	**363**	**3,842**
Cash Balance Beginning of Year	**766**	**(592)**	**(18)**	**821**	**1,184**
Cash Balance End of Year	**(592)**	**(18)**	**821**	**1,184**	**5,025**

The forecast above assumes 6% growth in net income for the next five years and assumes that no acquisitions will be made during this time. As well, it includes significant annual shareholder draws. In this scenario, all of Westland's long-term debt will be paid off by 2008.

3.6.3 Conclusion

The financial analysis presented in this section illustrates that Westland is a company with a healthy financial position. The firm far exceeds industry benchmarks for 'good' performance on virtually all of the performance metrics and its cash position is strong going forward. The implications for Westland are that its current strategy is providing excellent results. From a strategic standpoint, Westland will want to ensure it can continue to achieve these financial results in the future.

4 CHAPTER FOUR: KEY ISSUES AND CONCERNS

4.1 Introduction

Through the various analyses (industry analysis, strategic fit analysis, value chain analysis, and financial analysis) presented in the previous chapters, a few key issues and concerns for Westland Insurance become apparent. Westland's growth primarily through acquisition is not sustainable, the possibility of political change leading to the dismantling of ICBC to allow more competition in auto insurance in B.C., and insufficient differentiation in Westland automobile insurance product are important issues that must be addressed by Westland's executive team.

4.2 Unsustainable Growth Strategy

Westland Insurance's growth primarily through acquisition of other BC insurance brokerages is unsustainable. It is important not to confuse this with sustainable growth rate. Westland does not have a liquidity problem. Rather, Westland's current growth strategy is unsustainable because the availability of potential acquisition targets is limited.

Table 4.1 Westland Insurance Growth Scenario 1

Assumptions:	
Growth % Target	15%
Average % Organic Growth	3%
Revenue Growth/Acquisition	500,000

	2005	2006	2007	2008	2009	2010
Revenue	20,000,000	23,000,000	26,450,000	30,417,500	34,980,125	40,227,144
Target Revenue Growth	3,000,000	3,450,000	3,967,500	4,562,625	5,247,019	6,034,072
Organic Growth	600,000	690,000	793,500	912,525	1,049,404	1,206,814
Acquisition Revenue Growth	2,400,000	2,760,000	3,174,000	3,650,100	4,197,615	4,827,257
# of Acquisitions Needed	4.8	5.5	6.3	7.3	8.4	9.7

Table 4.1 illustrates that in order for Westland to maintain a 15% annual growth rate it needs acquire enough insurance brokerages to account for a 12% increase in revenue. This is because under its current strategy, organic growth or growth from all other sources other than acquisition, accounts for only 3% of annual revenue growth. Since on average a brokerage acquisition adds approximately $500,000 to Westland's annual revenue, a 12% growth through acquisition equates to roughly five acquisitions in 2005, and increases to ten in 2010. Under this model Westland would need to make approximately 33 acquisitions in the next five years and approximately 98 acquisitions in the next ten years.

Simply stated, under the current market conditions there are not enough potential targets available for sale to meet Westland's acquisition growth goals. Each year approximately 2.5% of insurance brokerage businesses in BC are sold.[36] Some insurance brokerage businesses are multi-location but many are single location. Therefore, 2.5% of all insurance brokerage businesses in BC being sold translates into 18 to 25 insurance brokerage offices for sale each year. Of those perhaps half would meet Westland's acquisition criteria leaving between 9 and 13 brokerage offices as potential targets. Westland would essentially need to purchase all potential targets, which is highly unlikely due to "first right of refusal" agreements with insurance partners, seller's preferences, and competition with other consolidators. Even if Westland were able to satiate their acquisition needs in the short-term, the problem only increases as time passes and, in isolation, is not an appropriate long-term strategy.

4.3 Privatization of Automobile Insurance in BC

The current issues and discussions surrounding ICBC are that of privatizing the corporation. Since 1998, the Insurance Bureau of Canada (an industry lobby group whose members include major national and multinational insurance companies) and other groups have

[36] Interview with John C. McArthur, Chairman, AMAC Consultants Inc., June 15, 2005.

been pressing British Columbia to fundamentally change the way auto insurance is provided, essentially calling for the privatization of ICBC. Recently the current Liberal government of BC has joined the call with Premier Campbell in his election campaign promising to do what the IBC and other groups have been calling for.

The privatization of ICBC would dramatically change the competitive forces in not only the BC automobile insurance industry but in the P&C insurance industry as a whole. First, the threat of new entrants would move from moderate to very high since government barriers would no longer restrict other automobile insurers from competing in the BC marketplace. Additionally, brokers would not need an Autoplan license from ICBC to sell automobile insurance thereby negating the competitive effects that the current moratorium has on the industry today. Second, rivalry amongst existing competitors would move from moderate to very high. This is primarily due to the fact that brokers would be able to compete on price, which they cannot do presently. Third, without ICBC the sale of automobile insurance would no longer be a retail activity. The distribution of auto insurance could change dramatically, thereby eliminating the value of strong retail locations. Lastly, the marketing of insurance products would significantly change. Namely, insurance products could be packaged together and discounts offered for purchasing automobile insurance in conjunction with other insurance products.

Changes to the industries competitive forces inevitably lead to a change in the key success factors of an industry. Most significantly, it would change the importance of having good retail locations as a primary distribution method. As well, since the industry would undoubtedly consolidate, it would reduce the complexity of creating low cost production efficiency for insurance firms.

Westland's current strategy is based on the assumption that ICBC will remain in its current state. The dismantling of ICBC is a threat to Westland in that it could potentially negate its strong retail network. Also at risk are the cost advantages that Westland's currently enjoys. Since there would no longer be a need for retail offices the industry would inevitably become less fragmented and more centralized. This would make it easier for brokers to create economies of scale, standardize procedures, and specialize in customer types. Westland would be forced to evaluate how best to leverage its sales force, its technology, and core product lines.

4.4 Insufficient Differentiation in Westland' Automobile Insurance Product

In British Columbia private insurers are currently allowed to sell optional automobile insurance (excess liability, collision, and comprehensive); however, compulsory basic insurance remains an ICBC monopoly. Basic insurance provides protection for people, while optional insurance provides protection for vehicles. Several insurance companies other than ICBC currently offer optional automobile coverages.

Due to the extreme homogeneity of automobile insurance in BC, caused by ICBC mandating that basic insurance must be sold for exactly the same price with the same features, differentiation takes on even greater importance. Hence, as identified in the industry analysis, one of the key success factors for the industry is the ability for brokers to create key differentiators in the automobile insurance market. Many brokers respond to product homogeneity by competing on costs. Since payroll accounts for 50% to 60% of all expenses, cutting costs usually is achieved to the detriment of service. Many brokers have started selling optional automobile insurance underwritten by private insurers. Since optional insurance accounts for approximately half of a BC driver's annual automobile insurance costs, brokers can offer enticing price advantages. However, the key advantage to selling private optional automobile insurance is that it provides brokers with the opportunity to create significant differentiation. Private automobile brokers can offer unique policy options, branded products, policy financing, package discounts, and enjoy higher annual retention.

Westland has done an excellent job in reducing operational and processing costs that enable it to differentiate on service. It has also, spent significant resources ensuring that all of its retail offices are in good locations. However, Westland sells optional automobile insurance that is underwritten by ICBC throughout all of its offices with the exception of its two Victoria locations. As a result, Westland cannot package its automobile product with any other product. It cannot offer a Westland branded product featuring unique coverages. It cannot extend its highly automated and efficient policy-financing plan to automobile insurance products. It cannot measure its retention for automobile insurance since all policy data is kept in ICBC's enterprise systems and ICBC does not care or track which Autoplan broker renews an insured's policy. In short, Westland for all its efforts to create differentiation in the BC P&C insurance marketplace, is missing a huge opportunity distinguish itself from other competitors.

5 CHAPTER FIVE: RECOMENDATIONS

5.1 Introduction

The previous chapter detailed the key issues and concerns facing Westland Insurance. This chapter recommends various strategies and tactics related to the issues outlined in the previous chapter. These recommendations are based on the analysis conducted in the prior chapters of this paper.

From a broad perspective, Westland Insurance's strategy of growth through acquisition has been a successful one. Westland's roll-up strategy should be continued and should remain its first choice for growth. Westland's acquisition success can be attributed to their ability to create operational synergies, ability to not over pay for appropriate targets, and to learning gained from experience and past acquisitions as it relates to integration and target selection. Similarly, Westland should continue to operate with a differentiated/cost-based strategy. Although this is a very difficult strategy to implement since there is a very real danger of becoming stuck in the middle, Westland has been successful with it by creating cost advantages that enable its differentiation strategy. Since the market does not reward full-scale differentiation, Westland has honed its strategy by reducing costs and creating efficiencies. By centralizing its structure and creating significant economies of scale in manufacturing, Westland has increased the future viability of its differentiated strategy.

5.2 Create New Avenues for Growth

Table 5.1 Westland Insurance Growth Scenario 2

Assumptions:	
Growth % Target	15%
Average % Organic Growth	8%
Revenue Growth/Acquisition	500,000

	2005	**2006**	**2007**	**2008**	**2009**	**2010**
Revenue	20,000,000	23,000,000	26,450,000	30,417,500	34,980,125	40,227,144
Target Revenue Growth	3,000,000	3,450,000	3,967,500	4,562,625	5,247,019	6,034,072
Organic Growth	1,600,000	1,840,000	2,116,000	2,433,400	2,798,410	3,218,172
Acquisition Revenue Growth	1,400,000	1,610,000	1,851,500	2,129,225	2,448,609	2,815,900
# of **BC** Acquisitions Needed	2.8	3.2	3.7	4.3	4.9	5.6

In order to achieve its annual goal of 15% growth in revenue, Westland must create new mechanisms for growth that work in conjunction with its current growth strategy of growth through the acquisition of BC insurance brokerages. As shown in Table 5.1, if Westland increases its organic growth (or growth through means other than the acquisition of BC brokerages) to 8%, it would strengthen Westland's growth strategy in three ways. First, it reduces the number of BC brokerages that Westland would need to purchase each year down to meet its growth goals. Under this new scenario, acquisition of BC brokerages would only need to make up 7% of annual growth, which translates into approximately three to six acquisitions per year. Under current market conditions, this is a realistic goal. In fact, this number is consistent with the past three years in which Westland bought two insurance brokerages in 2003, four in 2004, and so far four in 2005. Second, other avenues of growth could prove to be less expensive than growth through acquisition. As shown in Appendix A – "*Market Value of a Sample B.C. Insurance Brokerage*", an insurance brokerage with $560,000 in revenue costs around $1,000,000 depending upon the mix of business. Although the return on investment of brokerage acquisitions is very good, it is possible that the same investment into other methods of growth could return much more over the long term. One such example is the investment Westland made in developing its policy-financing product. Total investment into technology development, re-engineering of processes, and training over two years totalled around $200,000. Annual revenue for this product will surpass $700,000 in 2005, having increased steadily from its introduction in 1998. Lastly, it creates a more balanced strategy for growth and reduces the risk of relying too much on one growth strategy. By creating other avenues of growth, Westland increases its ability to sustain growth through various market conditions and over the long term.

5.2.1 New Markets

In order to achieve its growth goals, Westland should look at new geographic markets other than British Columbia. Westland's rollup strategy has been refined over the last fifteen years and currently provides a powerful vehicle for growth and profitability. It makes sense for Westland to look at extending the strategy past provincial borders. What makes this proposal even more intriguing is that the three provinces in Canada that deliver compulsory basic insurance through government owned insurers are Manitoba, Saskatchewan, and British Columbia. The assumption being that since two of the other three western provinces have very similar automobile insurance distribution models, they are prime targets in which Westland can implement its roll-up strategy.

Westland is currently licensed as an insurance broker in BC, Alberta, and Saskatchewan. Becoming licensed in Manitoba is a relatively trivial exercise and does not present any significant challenges. Westland Insurance Company however, is only licensed to underwrite policies in BC. In order to extend its roll-up strategy past BC borders Westland must become a licensed insurer in the target province. Although not an insurmountable task, it is a heavily regulated and bureaucratic one, which will most likely take a full year to complete.[37]

In Alberta, private non-government insurance companies provide all automobile insurance. Automobile premiums account for more than all other classes of insurance combined. If Westland were to enter the Albertan market, it would need to collaborate with one or more insurance companies since the capital cost and market volatility of the automobile insurance market would make the option of underwriting it in Westland's own insurance company improbable.

5.2.2 New Products

Another growth strategy Westland could implement is to develop new product offerings. Westland has had considerable success in the past with commercial package policies. It has developed special insurance programs for churches, schools, dry cleaners, small business owners, and health care facilities. Each of these programs addresses the special insurance needs of a particular type of organization and ensuring the highest level of protection while offering the product at a competitive price. Westland could leverage on this experience and create more commercial package policies. Possible areas of development are packaged policies for: restaurants, golf courses, and software developers.

Financial products are another area where Westland could develop new product offerings. Services such as deposit brokering, mutual fund brokering, and mortgage brokering are all potential candidates. Mortgage brokering is of particular interest because of recent developments in the industry and because of its fit with Westland current retail delivery model. Since the late 1990's there has been a decided shift away from institutional based lending, to consumer-centered lending. Most financial institutions have turned to mortgage brokers as an alternative to

[37] Interview with Colin Thompson, President & COO, Westland Insurance.

maintaining expensive brick-and-mortar infrastructures. Westland could have several competitive advantages since it already has a mature, established customer base where one-to-one customer relationships have been developed. As well, it has over 20 retail storefronts in communities throughout the lower mainland of B.C. Since 40% of all sales in Westland are habitation insurance policies (house, condominium, and tenant), Westland has at its disposal, data on the number of mortgages a client has, who the mortgage lenders are, the value of the home and an approximation of when a client's mortgage(s) come due. Additionally, unlike banks, there are no regulations in place that prohibit Westland from marketing financial services to insurance clients.[38]

5.3 Solidify Supplier Partnerships

In order to manage the potential change that would occur to the P&C insurance broker industry in BC, should ICBC be dismantled and the market opened up to full competition, Westland needs to position itself so that it can benefit from such change. The key component to such a plan is the fortification of partnerships between Westland and domestic automobile insurers. The recommendation for Westland to solidify relationships with insurance company partners was chosen over two other alternatives for the following reasons. First, the option of underwriting auto insurance through Westland's own insurance company is appealing but the capital required to carry out such an initiative coupled with the volatility of the automobile insurance market make this option unattractive. Alternatively, collaborating with domestic insurers would eliminate the need for capital and ensure the brokerage would not have to bear the financial burden of a volatile automobile insurance market.

Second, the option of forming an MGA partnership with Lloyd's of London would enable Westland to maintain its independence, however, Lloyd's has a notorious history of taking a

[38] Regulations prohibit banks from including marketing material for insurance services in banking correspondence with their clients.

short-term view of the Canadian automobile insurance market.[39] Additionally, there are significant costs with developing an MGA with Lloyd's. Westland would be responsible for rating, risk selection, policy issuance, and claims handling. Since the number of automobile policies sold by the firm is dramatically higher than residential insurance policies and since automobile insurance has a higher frequency of claims, Westland would have to invest significant capital into technology and people. Since it is unlikely that Lloyd's would enter into any long-term agreement, Westland would be putting itself in a potentially weak position if it were to proceed with this option.

Creating strategic partnerships with domestic insurers would allow Westland to focus on leveraging its core competencies and extending its competitive advantages. Westland could apply the same strategies that it has for residential insurance to automobile insurance. It could use technology to reduce operational expenses in areas such as rating, risk assessment and evaluation, underwriting, and distribution. Westland would have the freedom to leverage key advantages in corporate management, strategic planning, and IS management to the brokering of automobile insurance. As in residential insurance, these strengths will allow Westland to outperform competitors in the automobile insurance brokering industry. Over time, strong performance will give Westland leverage to increase its bargaining power and independence from its supplier partners.

In contrast to many of its smaller competitors, Westland Insurance is in a good position to compete regardless of what changes the industry may undergo. Westland has a history of success because it has been able to create and implement strategies that reflect a deep understanding of the industries key success factors. In order to preserve its leadership position in the P&C industry in BC, Westland must continue to monitor the key success factors as the industry evolves.

[39] In recent years dozens of Lloyd's contracts in Alberta and B.C have been cancelled due to short-term losses. As a result, Lloyd's has developed a reputation among brokerages in B.C. (and Alberta) for having a short-term view to insurance.

5.4 Sell Private Optional Automobile Insurance

In order to maximize its differentiation opportunities, Westland offer optional automobile insurance underwritten through private insurers. A private automobile product offers Westland several advantages. First, the product can be fully branded as a Westland product, thereby increasing brand awareness and loyalty. Second, Wetland can further differentiate its automobile insurance offering by creating unique product features not available though ICBC. For example, Westland could include coverage for rental cars, higher third party liability, and "replacement cost" in the event of a total loss. Third, Westland's policy financing plan could be cross-sold to automobile insurance clients at point of sale, thereby increasing the firm's economies of scope. Currently, ICBC has its own financing plan called "Autoplan 12". Since an insured can cancel their policy or change vehicles through any ICBC broker, it currently limits the viability of offering Westland's policy financing plan to existing automobile customers. By offering a Westland product, this problem is eliminated since any policy changes would need to be completed by a Westland agent. Fourthly, private automobile insurance provides opportunities for cross marketing. Lastly, Westland would be able to better measure the retention of automobile insurance policies. Since policy renewal transactions would be stored in Westland's systems rather than ICBC's, retention reporting could easily be done for any frequency period.

Private automobile insurance provides opportunities other than differentiation as well. First, from a pricing point of view, Westland could package optional automobile insurance with other insurance products. Westland already has branded residential and commercial products that the private automobile product could be packaged with. Second, operational efficiencies can be created through by applying technology to eliminate redundant processes in the same manner as was done in the delivery of residential insurance. Third, strategically there is a significant advantage to collecting automobile policy and customer data. Most brokers do not collect vehicle or coverage data for automobile policies. Rather they rely on the insurance company systems to collect the data, apply the appropriate business rules, rate and issue the policy. If Westland were to sell private automobile insurance, it should use its own systems to do these functions. Not only would it be more cost effective but also having customer and policy data would give Westland an advantage over other brokers should the BC automobile market ever open to full competition.

APPENDICES

Appendix A - Market Value of a Sample B.C. Insurance Brokerage

Product Line	Revenue	Rate	Market Value
Personal Lines	$262,000	2 times	$524,000
Commercial Lines	$78,000	2 times	$156,000
Autoplan (& Private)	$218,000	1.5 times	$327,000
Totals	$558,000		$1,007,000

In the table shown in Appendix A, the sample insurance brokerage is given a market value of $1,007,000 based on the annual revenues for each product line and the associated rate. The revenues in the Appendix A table are typical of acquisition made by Westland Insurance over the past 5 years.

Appendix B - Westland Performance versus Industry (2000)

	Westland Average	Industry Average	Difference
ROE	16.4%	7.0%	9.4%
Gross Loss Experience	41.0%	51.0%	-10.0%
Claims Adjusting Ratio	5.0%	7.5%	-2.5%
Commission Income/Employee	$ 117,000	$ 67,000	$ 50,000

ROE, Gross Loss Experience and Claims Adjusting Ratio source: CI Magazine 2001 Statistical Review, Canadian Business Press

Commission Income/Employee source: Interview with Jason Wubs, VP, Operations Westland Insurance, November 17, 2003

Appendix C – Example of Out of Market Acquisition (New office)

Statement of Income (Pre-Acquistion)

ABC INSURANCE BROKERS LTD.
Statement of Income (Pre-Acquistion)
Year Ended December 31, 2000

Revenue	
Insurance Commissions	$ 282,297
Expenses	
Accounting & Legal	$ 4,494
Advertising & Promotion	$ 11,246
Automobile & Travel	$ 5,340
Bank Charges & Interest	$ 4,553
Dues & Subscriptions	$ 7,297
Insurance	$ 6,419
Rent - Premises	$ 48,875
Repairs & Maintenance	$ 3,844
Stationary & Office Supplies	$ 10,285
Telephone & Datacom	$ 7,315
Bad Debts	$ 1,334
Salaries	$ 117,286
Employee Benefits	$ 6,634
	$ 234,922
Net Income	$ 47,375
Cost Analysis	
Fixed Cost	$ 111,002
Variable Cost	$ 123,920
	$ 234,922

Statement of Income (Post-Acquisition)

WESTLAND INSURANCE GROUP LTD. (ABC Division)
Statement of Income (Post-Acquisition)
Year Ended December 31, 2002

Revenue	
Insurance Commissions	$ 395,647
Policy Financing	$ 7,655
	$ 403,302
Expenses	
Accounting & Legal	$ 1,123
Advertising & Promotion	$ 3,453
Automobile & Travel	$ 2,121
Bank Charges & Interest	$ 4,895
Dues & Subscriptions	$ 2,234
Insurance	$ 3,324
Rent - Premises	$ 44,982
Repairs & Maintenance	$ 2,354
Stationary & Office Supplies	$ 8,435
Telephone & Datacom	$ 11,654
Bad Debts	$ 323
Salaries	$ 121,347
Employee Benefits	$ 12,231
	$ 218,476
Net Income	$ 184,826
Cost Analysis	
Fixed Cost	$ 84,898
Variable Cost	$ 133,578
	$ 218,476

Short Run Average Costs

Branch Level - Out of Market Acquisition (New office)

Scenario	(FC) Fixed Cost	(VC) Variable Cost	(TC) Total Cost	(Q) Output	(ATC) Average Total Cost
Pre-Acquisition (ABC Ltd.)	$ 111,002	$ 123,920	$ 234,922	2,987	$ 78.65
Post-Acquisition (Westland)	$ 84,898	$ 133,578	$ 218,476	3,652	$ 59.82

Balance Sheet Ratios

Branch Level - Out of Market Acquisition (New office)

Scenario	Employees	Total Operating Cost	Total Commission Income	Operating Cost / Employee	Commision Income / Employee
Pre-Acquisition (ABC Ltd.)	3.5	$ 234,922	$ 282,297	$ 67,121	$ 80,656
Post-Acquisition (Westland)	3.5	$ 218,476	$ 403,302	$ 62,422	$ 115,229

Appendix D – Example of In-Market Acquisition (Pre-Acquisition)

Example of In-Market Acquisition (Merger with existing office)
XYZ and Westland Pre-Acquisition

Statement of Income (Pre-Acquistion)

XYZ INSURANCE BROKERS LTD.	
Statement of Income (Pre-Acquistion)	
Year Ended December 31, 2000	
Revenue	
Insurance Commissions	$ 587,342
Expenses	
Accounting & Legal	$ 4,080
Advertising & Promotion	$ 27,060
Automobile & Travel	$ 15,240
Bank Charges & Interest	$ 3,420
Dues & Subscriptions	$ 4,800
Insurance	$ 9,180
Rent - Premises	$ 42,240
Repairs & Maintenance	$ 7,020
Stationary & Office Supplies	$ 21,660
Telephone & Datacom	$ 17,580
Bad Debts	$ 6,240
Salaries	$ 255,420
Employee Benefits	$ 19,680
	$ 433,620
Net Income	$ 153,722
Cost Analysis	
Fixed Cost	$ 158,520
Variable Cost	$ 275,100
	$ 433,620

Statement of Income (Pre-Acquistion)

Westland Insurance Group Ltd. (Westland1 Division)	
Statement of Income (Pre-Acquistion)	
Year Ended December 31, 2000	
Revenue	
Insurance Commissions	$ 213,024
Policy Financing	$ 1,283
	$ 214,307
Expenses	
Accounting & Legal	$ 694
Advertising & Promotion	$ 1,692
Automobile & Travel	$ 998
Bank Charges & Interest	$ 2,599
Dues & Subscriptions	$ 792
Insurance	$ 1,500
Rent - Premises	$ 46,387
Repairs & Maintenance	$ 923
Stationary & Office Supplies	$ 5,643
Telephone & Datacom	$ 10,023
Bad Debts	$ 487
Salaries	$ 74,879
Employee Benefits	$ 7,965
	$ 154,582
Net Income	$ 59,725
Cost Analysis	
Fixed Cost	$ 71,738
Variable Cost	$ 82,844
	$ 154,582

Appendix E – Example of In-Market Acquisition (Post -Acquisition)

Example of In-Market Acquisition (Merger with existing office)
Westland1 Division merged with XYZ
Statement of Income (Post -Acquistion)

WESTLAND INSURANCE GROUP LTD.	
Year Ended December 31, 2002	
Revenue	
Insurance Commissions	$ 755,270
Policy Financing	$ 13,754
	$ 769,024
Expenses	
Accounting & Legal	$ 4,409
Advertising & Promotion	$ 7,435
Automobile & Travel	$ 7,652
Bank Charges & Interest	$ 8,743
Dues & Subscriptions	$ 1,320
Insurance	$ 4,567
Rent - Premises	$ 53,271
Repairs & Maintenance	$ 2,345
Stationary & Office Supplies	$ 16,754
Telephone & Datacom	$ 15,432
Bad Debts	$ 645
Salaries	$ 176,345
Employee Benefits	$ 18,834
	$ 317,752
Net Income	$ 451,272
Cost Analysis	
Fixed Cost	$ 122,573
Variable Cost	$ 195,179
	$ 317,752

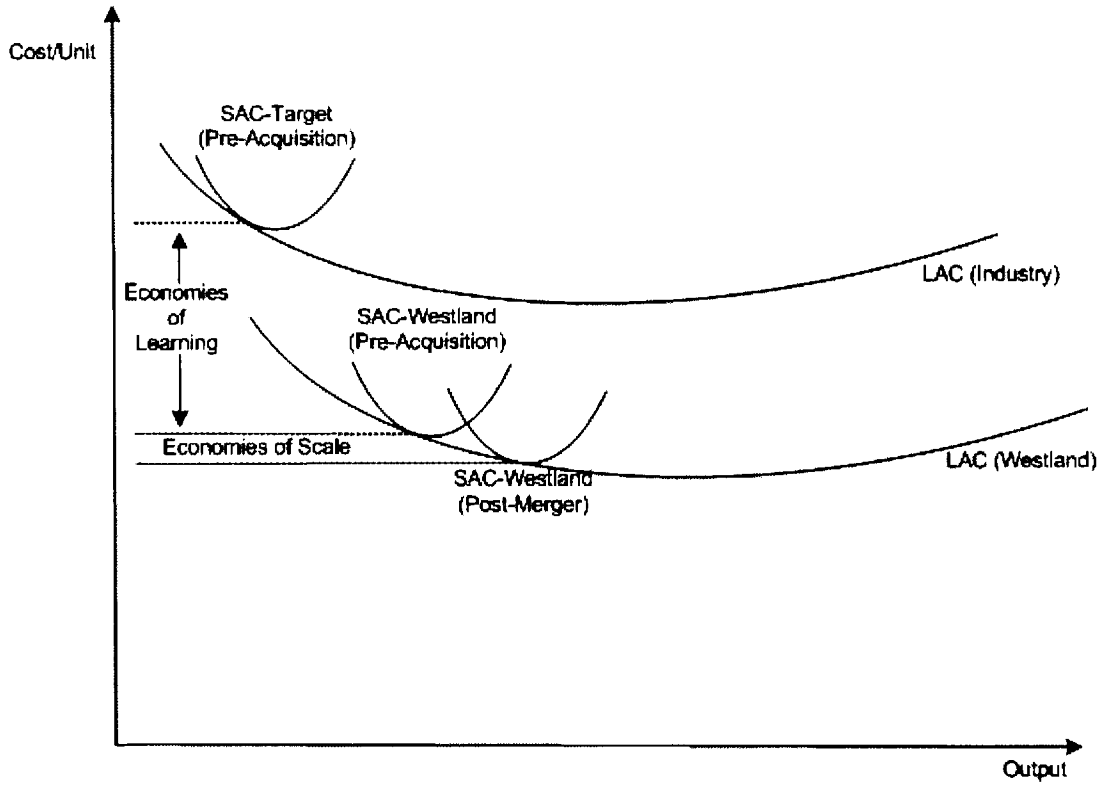
Short Run Average Costs

Branch Level - In Market Acquisition (Merger with existing office)					
Scenario	**(FC) Fixed Cost**	**(VC) Variable Cost**	**(TC) Total Cost**	**(Q) Output**	**(ATC) Average Total Cost**
Pre-Acquisition (XYZ Ltd.)	$ 158,520	$ 275,100	$ 433,620	5,387	$ 80.49
Pre-Acquisition (Westland Div1)	$ 71,738	$ 82,844	$ 154,582	1,867	$ 82.80
Post-Acquisition (Westland Div1 & XYZ)	$ 122,574	$ 195,179	$ 317,753	6,723	$ 47.26

Balance Sheet Ratios

Branch Level - In Market Acquisition (Merger with existing office)					
Scenario	**Employees**	**Total Operating Cost**	**Total Commission Income**	**Operating Cost / Employee**	**Commision Income / Employee**
Pre-Acquisition (XYZ Ltd.)	7.5	$ 433,620	$ 597,342	$ 57,816	$ 79,646
Pre-Acquisition (Westland Div1)	2.5	$ 154,582	$ 214,307	$ 61,833	$ 85,723
Post-Acquisition (Westland Div1 & XYZ)	6.0	$ 317,752	$ 769,024	$ 52,959	$ 128,171

Appendix F – Long-Run Average Costs & Synergies



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