

Strategic Analysis of Growth Opportunities for an Insurance Brokerage Firm within British Columbia

by

Jerry Chien
FRM, Global Risk Management Institute Inc. 2002

Project Submitted in Partial Fulfilment of
the Requirements for the Degree of

Master of Business Administration

in the
Faculty of Business Administration

© Jerry Chien, 2007

Simon Fraser University

2007

All rights reserved. This work may not be reproduced in whole or in part, by photocopy or other means, without permission of the author.



SIMON FRASER UNIVERSITY
LIBRARY

Declaration of Partial Copyright Licence

The author, whose copyright is declared on the title page of this work, has granted to Simon Fraser University the right to lend this thesis, project or extended essay to users of the Simon Fraser University Library, and to make partial or single copies only for such users or in response to a request from the library of any other university, or other educational institution, on its own behalf or for one of its users.

The author has further granted permission to Simon Fraser University to keep or make a digital copy for use in its circulating collection (currently available to the public at the "Institutional Repository" link of the SFU Library website <www.lib.sfu.ca> at: <<http://ir.lib.sfu.ca/handle/1892/112>>) and, without changing the content, to translate the thesis/project or extended essays, if technically possible, to any medium or format for the purpose of preservation of the digital work.

The author has further agreed that permission for multiple copying of this work for scholarly purposes may be granted by either the author or the Dean of Graduate Studies.

It is understood that copying or publication of this work for financial gain shall not be allowed without the author's written permission.

Permission for public performance, or limited permission for private scholarly use, of any multimedia materials forming part of this work, may have been granted by the author. This information may be found on the separately catalogued multimedia material and in the signed Partial Copyright Licence.

While licensing SFU to permit the above uses, the author retains copyright in the thesis, project or extended essays, including the right to change the work for subsequent purposes, including editing and publishing the work in whole or in part, and licensing other parties, as the author may desire.

The original Partial Copyright Licence attesting to these terms, and signed by this author, may be found in the original bound copy of this work, retained in the Simon Fraser University Archive.

Simon Fraser University Library
Burnaby, BC, Canada



SIMON FRASER UNIVERSITY
THINKING OF THE WORLD

STATEMENT OF ETHICS APPROVAL

The author, whose name appears on the title page of this work, has obtained, for the research described in this work, either:

(a) Human research ethics approval from the Simon Fraser University Office of Research Ethics,

or

(b) Advance approval of the animal care protocol from the University Animal Care Committee of Simon Fraser University;

or has conducted the research

(c) as a co-investigator, in a research project approved in advance,

or

(d) as a member of a course approved in advance for minimal risk human research, by the Office of Research Ethics.

A copy of the approval letter has been filed at the Theses Office of the University Library at the time of submission of this thesis or project.

The original application for approval and letter of approval are filed with the relevant offices. Inquiries may be directed to those authorities.

Bennett Library
Simon Fraser University
Burnaby, BC, Canada

Abstract

The forest industry within B.C. currently faces a number of significant economic challenges that are leading to consolidation and plant closures. The shrinking size of the forest industry is a major concern for Aon, the largest insurance brokerage firm in the world, and their Forest Products Practice (FPP) in B.C. The main question is how will the FPP maintain or grow its current revenue base in response to the shrinking forest products market.

The results of the analysis indicate that Aon's FPP has a number of significant opportunities to grow its current portfolio despite the economic downturns within the forest industry. The FPP must remain diligent in its efforts to retain existing clients and focus its attention on growing its book of business. Focusing on growth will be the only plausible countermeasure to consolidation within the forest industry, which is outside the FPP's control.

Dedication

I would like to dedicate this paper to my parents. Throughout the years, you have provided me with unconditional support and have made countless sacrifices for my future. I will forever endeavour to make you proud.

Acknowledgements

I would like to thank all of my group members for their openness, energy and commitment throughout the program. I have learned so much from each of you and I truly value the special friendships we have developed. The past two years were very difficult on all fronts. I will never forget all the support each of you offered. I wish all of you the very best in the future. Catherine – I can't wait to see the costumes you pull out for alumni events! Ric – I hope you keep supporting Diet Coke – I bought Coca Cola shares because of you! Martin – “Obviously”, I will have more crazy black sky ideas for you to shake your head at!

I would also like to thank the entire class, the instructors and the program. The different perspectives shared were enlightening and highly valued. This educational experience exceeded my expectations and I hope that our class will stay connected over the years. I would especially like to thank Mark Selman for his guidance and advice throughout this final project.

Last but not least, I would like to thank the Trifecta association. The successes and synergies achieved were truly unparalleled and impressive. I have no doubt that our adventures will continue to get bigger and better for years to come.

Table of Contents

Approval	ii
Abstract	iii
Dedication	iv
Acknowledgements	v
Table of Contents	vi
List of Tables	viii
Chapter 1: Introduction	1
Chapter 2: Overview of Insurance Industry	4
2.1 The Insurance Industry	4
2.1.1 The Property and Casualty (P&C) Insurance Industry in Canada	5
2.2 The Role of Insurance Intermediaries.....	7
2.3 Global Commercial Insurance Brokerage Sector.....	13
2.4 Commercial Insurance Brokers within Canada and British Columbia	15
Chapter 3: Overview of Organization	17
3.1 Introduction to Aon Corporation	17
3.1.1 Risk and Insurance Brokerage Services Segment	18
3.1.2 Consulting Segment.....	21
3.1.3 Insurance Underwriting Segment.....	23
3.1.4 Introduction to Aon Reed Stenhouse.....	24
Chapter 4: The Forest Industry within B.C.	26
4.1 Challenges Facing the Forest Industry Within B.C.	27
4.1.1 Global Competition for Market Share, Aging Capital Investments & Low Returns on Capital.....	27
4.1.2 The Softwood Lumber Agreement Between Canada and the U.S.	28
4.1.3 Reduced Demand and Declining Commodity Prices.....	29
4.1.4 The Strong Value of the Canadian Dollar Against the US Dollar.....	31
4.1.5 Continued Consolidation Within the Sector	31
4.1.6 The Mountain Pine Beetle Epidemic	32
4.1.7 Worker Safety in the Forest/Logging Industry	33
4.2 Addressing the Challenges Facing the Industry.....	35
4.3 Forest Products Industry Segments.....	38
4.3.1 Logging	38
4.3.2 Lumber Manufacturing	39
4.3.3 Paper Manufacturing	40
4.3.4 Secondary Manufacturing	41

Chapter 5: ARS BC Forest Products Practice	46
5.1 FPP's Strengths.....	55
5.2 FPP's Weaknesses.....	63
5.3 FPP Opportunities:	68
5.4 FPP Threats:.....	71
Chapter 6: Strategic Recommendations	78
6.1 Retaining Existing Clients	79
6.2 Cross Selling to Existing Clients	85
6.3 Attracting New Clients	86
Conclusion	89
References	91

List of Tables

Table 1 - Top 4 Global Insurance Brokerage Firms 14

Table 2 - Commodity Prices..... 30

Table 3 - Number of Employer Establishments in Canada by Employment
Size Category and Region Sawmills and Wood Preservation..... 48

Table 4 - Number of Employer Establishments in Canada by Employment
Size Category and Region Paper Manufacturing 50

Table 5 - Number of Employer Establishments in Canada by Employment
Size Category and Region Other Wood Product Manufacturing..... 52

The author of this report created all tables listed above.

Chapter 1: Introduction

The first chapter will provide an overview of the scope of the strategic analysis of Aon's Forest Products Practice with B.C.

The forest industry plays a major social and economic role within B.C. The economic health of the forest industry has a significant impact on the broad range of industries that help supply the forest industry or consume its products. The health of the forest industry within B.C significantly affects the insurance industry. Therefore, any downward economic trends within the forest industry negatively impact the portfolios of insurance brokerage firms. Currently, the forest industry within B.C. faces a number of significant economic challenges including consolidation within the industry and plant closures. This paper will deliver a strategy that will allow an insurance brokerage firm's forest products practice to sustain itself during the downward economic trends within the forest industry.

Aon Corp. (Aon) is the largest insurance brokerage firm in the world and currently operates four offices within B.C. (Vancouver, Victoria, Langley, and Kamloops). Aon designs and manages the insurance and risk management programs for a broad range of industries. However, the economic health of the

forest industry significantly affects Aon's bottom line. The forest industry accounts for nearly one third of Aon's revenues within B.C. Over the years, Aon's "Forest Products Practice" (FPP) has evolved into the largest forest products insurance and risk management practice in the world.

To develop a business strategy that will allow the FPP to cope with the downward economic trend within the B.C. forest industry, the FPP has to analyze the following:

- The underlying principles of insurance and risk management and the value that insurance, risk management, and intermediaries bring to businesses, and more specifically the FPP's clients;
- The resources available within the FPP and Aon – to help determine areas in which the FPP can improve its client service, revenue opportunities, and improve operational efficiencies;
- The current issues facing the forest industry in B.C. and the economics driving the industry – to help determine potential growth and shrinkage areas within the forest industry and the impact that it will have on the FPP;
- The composition of the forest industry within B.C. – to help determine the size and scope of the main manufacturing segments (i.e. lumber manufacturing, logging, paper manufacturing, secondary wood manufacturing, etc.) within the forest industry in B.C.;

- The portfolio composition of the FPP – to understand FPP’s revenue sources and identify penetration levels and potential opportunities within each specific segment (i.e. lumber manufacturing, logging, paper manufacturing, secondary wood manufacturing, etc.) and assess the opportunities for growth within the FPP portfolio;
- The competitive landscape in which the FPP operates – to determine the potential threats to its current portfolio and the obstacles it faces as the FPP attempts to grow its portfolio.

The analysis will lead to strategic recommendations that will help the FPP retain as much of its current portfolio as possible during this economic downturn within the forest industry and help the FPP further develop the size and composition of its portfolio.

Chapter 2: Overview of Insurance Industry

2.1 The Insurance Industry

To understand the value propositions that Aon's FPP offers to its clients, it is important to understand the products and services they sell and the insurance industry in which Aon operates. The FPP sells insurance and risk management products and it operates within the insurance industry. The following is an overview of the basic concepts and principles of insurance and the infrastructure of the insurance industry.

The insurance industry plays a critical role in an economy. Insurance allows people to run businesses, drive cars and own property by spreading the cost of risk amongst a larger base of people and businesses. While the basic theory is simple – the premiums of many policyholders pay a proportion of the compensation to the unfortunate few who suffer insured losses – some of the practicalities of measuring risk fairly and paying claims promptly are quite complicated.

Insurance companies primarily generate revenue from its premiums collected and its investments. In some instances, premiums collected are less than the amount paid out for claims and expenses. Profitable insurance

companies typically have to manage two critical processes: whom they choose to insure (underwriting) and where to invest their positive cash flow.

Insurance companies decide whom they choose to insure by analyzing data and more data! The underwriting process takes into consideration an extremely wide band of risks and exposures. Insurance companies attempt to analyze geographical risk, operational risks, environmental risks, financial risks, personnel risks, etc. They need to analyze the frequency and severity of past loss events and determine if they are collecting enough premiums to cover costs and future claims.

As much as the insurance industry relies on numbers and data, people play just as important a role. The people within the industry not only collect and analyze the data, but also make objective and subjective decisions based on the data. No matter what rules, policies and procedures are in place from an institutional perspective, the people within the industry have to ask the right questions and make the appropriate decisions.

2.1.1 The Property and Casualty (P&C) Insurance Industry in Canada

The Canadian property and casualty or “general” insurance industry includes the people and resources involved in providing all types of insurance other than life and health insurance. Automobile insurance, insurance for

homeowners and tenants, as well as a variety of commercial or business-oriented lines of insurance, such as liability or business interruption, account for most of the P&C insurance sold in Canada. The federal or provincial governments supervise general insurance companies operating in Canada.

Automobile insurance continues to be the largest single class of property and casualty insurance in Canada. Total premiums for automobile insurance are more than those for all other classes combined. Property insurance ranks second. The third category, liability insurance, provides protection in the event that the insured causes bodily injury or property damage to others and becomes legally obligated to pay damages. Liability insurance includes product liability, which protects the public for injury suffered due to defective goods and services.

The P&C Insurance Industry in Canada provides insurance protection for the majority of homes, motor vehicles and commercial enterprises throughout the country. There are at least 213 private property and casualty insurance companies competing within Canada. In British Columbia, the Insurance Corporation of British Columbia (ICBC) provides all compulsory components of auto insurance to the public and offers the majority of all other auto related supplemental insurance products.

2.2 The Role of Insurance Intermediaries

Aon is an insurance intermediary that develops and manages insurance and risk management programs. To understand the value that Aon's FPP brings to its clients, it is important to review what type of services intermediaries provide and what type of value they bring to the market place. The analysis within this section should identify areas where the FPP could leverage its role and skill sets with its clients and prospects and where and how the FPP would be able to differentiate itself from its competitors.

Insurance intermediaries play an important role within the insurance industry. Intermediaries typically have a broad knowledge of the insurance marketplace, including products, prices and providers, and an acute sense of the needs of insurance purchasers. Intermediaries represent a critical distribution channel for insurance providers and serve as important counsel to insurance purchasers.

There are several factors that intermediaries bring to the insurance marketplace that help to increase the availability of insurance generally.

Intermediaries help consumers understand the choices they have to manage their risks. Intermediaries can help identify what consumers need, and what options they have in terms of insurers, policies and prices. Faced with a

knowledgeable client base that has multiple choices, insurers will offer policies that fit their customers' needs at competitive prices. The FPP helps their clients understand the risks facing the forest industry and the options available to deal with those risks. The FPP also allows their clients to purchase all of their insurance products and obtain multiple quotes through one source thereby significantly reducing their search costs. Intermediaries also ensure that their clients are covered by reputable and financially stable insurance markets and are treated fairly within the marketplace.

Intermediaries help insurers in the difficult task of spreading the risks in their portfolio. Intermediaries work with multiple insurers, a variety of clients, and, in many cases, in a broad geographical spread. They help carriers spread the risks in their portfolios according to industry, geography, volume, line of insurance and other factors. This helps insurers from becoming over-exposed in a particular region or a particular type of risk, thus freeing resources for use elsewhere.

In the interest of long-term client and insurer relations, brokers have a strong incentive to ensure that all parties have the information they need so as they are able to enter into a mutually beneficial arrangement. Insurance purchasers and companies may come to a transaction with unequal bargaining power. A small- or medium-sized consumer may come to a transaction with significantly less clout than the large insurer with whom they need to do

business. An intermediary is often able to help balance the equation by leveraging its business volume with carriers, and thereby obtain better terms and conditions for the client. The FPP has a sizeable portfolio of forest industry clients. They are able to leverage this fact in securing better terms and rates for their clients.

Commercial insurance clients are generally professional risk managers. As sophisticated insurance purchasers, they realize that commercial insurance products are not commodities; rather, they are customized risk transfer tools. The price and terms of which are generally negotiated on a case-by-case basis. Placement of such risks can be a long and difficult process. Sophisticated commercial purchasers rely on their intermediary to fully understand and appreciate their insurance coverage needs and to find the coverages suited to address those needs.

One of the functions of some insurance intermediaries is to help clients manage their risks, improving their risk profiles and reducing the likelihood that an insured event will occur. Not all risks must be accepted as they are. When properly managed, risks can be controlled and minimized. Some can be avoided; others can be modified to limit their frequency or financial consequences. Risk management is the process of analyzing possible exposure to loss, reducing loss potential, and protecting financial assets. Businesses often look to their

intermediary to act as consultants on risk management and advise them on the best ways to mitigate risk.

Some intermediaries therefore represent their clients in all phases of the risk management process: helping clients evaluate risk exposures; implementing measures to minimize such exposures; identifying and facilitating the purchase of insurance products or risks management systems best suited to a client's insurance needs; and managing the claims process.

There are many ways to protect financial assets. Purchase of insurance is the traditional way to transfer risk, but there are other methods that intermediaries and their clients use to reduce risk. Use of alternative risk transfer mechanisms – such as forming a captive insurance company, accepting higher insurance deductibles, or setting up reserves to pay losses – are an example.

Risk management involves far more complexity than the simple purchase of insurance. A large part of the task is preventing risk in the first place. Some Insurance Intermediaries are skilled in the art of working with their corporate clients in analyzing and controlling risk, setting up safety programs and other risk control techniques, and arranging alternative risk transfer mechanisms, as necessary.

These activities and services are beyond those typically associated with the placement and servicing of a policy contract, and have contributed to the

evolution of intermediaries from their role as providers of basic brokerage services into full-service intermediaries, providing not only strict intermediation services, but a wide variety of fee-based risk management and consulting services, as well.

The FPP is heavily focused on representing their clients in all phases of the risk management process. The FPP is able to leverage the experiences of all of their clients to develop comprehensive risk management programs for each individual client. The FPP is able to help clients identify and then deal with the risks associated with the forest industry and those that are specific to their operations. The FPP helps clients qualify and quantify the risks they face and develop measures to mitigate the impact those risks will have on their operations. These measures could include implementing loss prevention / risk control programs, purchasing insurance, transferring or limiting risk through contracts, or other alternative forms of financing / transferring risks (i.e. self insurance, captives, etc.).

Insurance brokers are typically compensated in two ways:

1. Commissions from insurance companies
2. Service fees paid by the client

Insurance brokerages get paid a commission by the insurance companies whose policies they sell. Brokerages don't set the prices of insurance policies and they don't set their commission levels. Commission is earned over the term

of the policy. If the policy is cancelled before the end of its term, the policy-holder receives a refund, and the brokerage receives remuneration only for the earned portion. There are two types of commissions paid to brokers by insurance companies: *Fixed Percentage of Premium Commissions* and *Contingency Commissions*.

Fixed Percentage of Premium Commission Rates varies between insurance companies and product lines and typically ranges from 10% to 25% of premium.

Contingency commissions are programs designed to compensate insurance brokers based on the profitability of their book of business placed with an insurance company. This form of compensation is highly controversial due to the potential conflict of interest it represents for insurance brokers. For example, in the event of a claim, the broker is supposed to advocate on behalf of the client, however, a successful claim would adversely affect the compensation to the broker from the insurance company. Despite this apparent conflict of interest, this form of compensation is extremely prevalent within the small to mid-size brokerage community.

In some instances, insurance brokers will negotiate a service fee agreement with their clients for their services in lieu of receiving any form of commission from the insurance company. These agreements are common with

large sophisticated clients who have their own risk managers. The margins realized from fees are usually less than margins realized from commissions.

The vast majority of FPP's revenues are derived through service fee agreements. Property insurance is the primary source of revenue for the FPP and essentially all of these insurance placements are through service fee agreements. Other insurance products such as liability and mechanical breakdown insurance are typically commission based. Property insurance service fees are typically in the range of 10% of premiums whereas liability insurance commissions are in the range of 15% to 22.5% of premiums. Aon does not accept any contingency commissions or profit sharing programs with insurance companies. This allows Aon to truly advocate on behalf of their clients without any conflict of interest, which is a significant differentiator from its competitors.

2.3 Global Commercial Insurance Brokerage Sector

Over the last decade, the top end of the insurance brokerage sector has become more concentrated after a series of mergers and acquisitions. At the same time, the broker's role of placing and evaluating insurance risks has evolved somewhat in the direction of providing a broad range of value-added services. The strong growth of the leading players reflects the rampant

consolidation within the sector. Brokerage houses have been merging and acquiring smaller brokers in order to realize economies of scale and scope.

The top four global insurance brokers control over 55.5% of the market share (Datamonitor, 2004). Revenues are primarily generated from commissions, service / consulting fees and investments. Although Marsh & McLennan Companies, Inc. is ranked #1 in terms of revenue, Aon Corporation is the largest insurance broker in the world. Marsh's revenue includes non-insurance related revenue sources. Table 1 provides a revenue breakdown for the top 4 insurance brokerage firms:

Table 1 - Top 4 Global Insurance Brokerage Firms

	Name	Revenue (m)	Revenue Growth	Revenue Growth, 3 Years
1.	Marsh & McLennan Companies, Inc.	\$12,059.0	3.0%	2.1%
2.	Aon Corporation	\$9,170.0	5.4%	-1.8%
3.	Willis Group Holdings Limited	\$2,496.0	7.1%	5.4%
4.	Arthur J. Gallagher & Co.	\$1,594.7	3.4%	7.9%

Table created from data supplied by www.reuters.com on June 15th, 2007

The sector as a whole, and Marsh & McLennan in particular, suffered a severe blow when on October 14, 2004, New York Attorney General Eliot Spitzer filed a civil suit in the Manhattan State Supreme Court, bringing charges of fraud and antitrust violations. This alleged that, in some instances, clients were illegally

steered to insurers that paid the highest commissions. Moreover, that rigged bids for insurance contracts were solicited. Several other major insurance companies were also named in the lawsuit. These events have forced Aon and its competitors to be more transparent in its compensation structure with insurance companies and their clients.

2.4 Commercial Insurance Brokers within Canada and British Columbia

Insurance brokers are the principal distribution channel for P&C insurance companies in Canada. The client base of brokers is very diverse, ranging from individual clients to large commercial accounts. It is also sizeable, as brokers write approximately 80 percent of the personal and commercial insurance policies in the country. There are over 29,000 insurance brokerage offices located throughout all of Canada. P&C insurance brokerages are provincially regulated entities.

The top three insurance brokerage firms in the world all compete within the Canadian and B.C. market (Marsh & McLennan Companies, Inc., Aon Corporation and Willis Group Holdings Limited). In addition to these three companies, there are a number of other property and casualty brokers that play significant role in the P&C market within B.C.: Johnston Meier Insurance Agencies Ltd; Jardine Lloyd Thompson; Hub International Tos / Barton Insurance

Brokers; BCAA Insurance; CMW Insurance Services Ltd; and Reliance Insurance Agencies Ltd.

The following chapter will provide a broad overview of Aon Corporation and its different operating segments.

Chapter 3: Overview of Organization

3.1 Introduction to Aon Corporation

Aon's FPP is not an island in itself; the FPP is part of a corporation that is extremely diverse and rich in expertise and capabilities. One of the keys for the FPP to be able to cope with the changes in the forest industry will be the unit's ability to identify, understand and leverage the expertise and capabilities. This will help them keep and grow existing business and develop new business. The first step in this process is to understand the structure of the corporation and map out the resources available to the FPP.

Aon Corporation (Aon), incorporated in 1979, has three main operating segments: a) risk and Insurance Brokerage Services, which acts as an advisor and insurance broker, helping clients manage their risks, as well as negotiating and placing insurance risk with insurance carriers through its global distribution network, b) consulting, which provides advice and services to clients for employee benefits, compensation, management consulting, communications, human resource outsourcing, human resource consulting, and financial advisory and litigation consulting, and c) insurance underwriting, which provides specialty insurance products, including supplemental accident, health and life insurance.

The Company's clients include corporations and businesses, insurance companies, professional organizations, independent agents and brokers, governments and other entities. It also serves individuals through personal lines, affinity groups and certain specialty operations.

Aon is a *Fortune* 250 company and the largest insurance brokerage service provider in the world. Aon is headquartered out of Chicago, Illinois, United States. Aon Corporation's total revenue for 2006 was \$9.17 billion. Aon employs over 43,000 employees with 500 offices located across 120 countries.

3.1.1 Risk and Insurance Brokerage Services Segment

The Risk and Insurance Brokerage Services segment generated approximately 63% of the company's total operating segment revenues in 2006. This is the largest of Aon's operating segments. Risk and insurance brokerage and related services are provided by certain indirect subsidiaries, including Aon Risk Services Companies, Inc., Aon Holdings International, Aon Re Global, Inc., Aon Limited (U.K.) and Cananwill, Inc., and Aon Reed Stenhouse in Canada.

The Risk and Insurance Brokerage Services segment has two sub-segments: Risk Management and Insurance Brokerage, and Reinsurance Brokerage and Related Services. Risk Management and Insurance Brokerage encompasses the Company's retail brokerage services, affinity products,

managing general underwriting, placement, and captive management services and premium finance services for small, mid-sized, and large companies, including *Fortune* 500 corporations.

Aon's operations in the Americas provide products and services to clients in North, Central and South America, the Caribbean and Bermuda. Aon's United Kingdom, Europe, Middle East and Africa; and Asia Pacific operations offer similar products and services to clients throughout the rest of the world. Risk management services also include risk identification and assessment, safety engineering, claims and loss cost management, and program administration.

Retail brokerage has practice areas to deliver specialized advice and services in industries, such as entertainment, media, financial institutions, marine, aviation, construction, forestry, mining, healthcare and energy. As a retail broker, Aon generally serves as an advisor to corporate clients, and can arrange a spectrum of risk management solutions, including property, general liability, professional and directors' and officers' liability, workers' compensation and other exposures. The Company also provides affinity products for professional liability, life, disability income and personal lines for individuals, associations and businesses.

Aon's managing general underwriting units offer a range of insurance products and programs, which clients can access either directly, or through the

Aon Specialty Product Network (ASPN), which it developed as a single-point-of-contact for agent and broker clients who need specialty insurance solutions for their customers. The Company is also a provider in managing captive insurance companies.

Reinsurance Brokerage and Related Services offers advisory services in program design and claim recoveries. Aon's reinsurance brokerage services use financial analysis and capital market alternatives, such as transferring catastrophe risk through securitization. Aon Re Global, Inc., its subsidiaries and its affiliates provide reinsurance services to insurance and reinsurance companies and other risk assumption entities by acting as brokers or intermediaries on all classes of reinsurance.

The Company's reinsurance activities are principally focused on property and casualty lines. Its reinsurance activities also include specialty lines, such as professional liability, medical malpractice, accident, life and health. Services include advice, placement of reinsurance and alternative risk transfer financing with capital markets, and related services, such as actuarial, financial and regulatory consulting, portfolio analysis, catastrophe modelling and claims services.

FPP's revenues are primarily generated within the scope of the Risk and Insurance Brokerage Services Segment, in particular within the areas of property and casualty insurance placements.

3.1.2 Consulting Segment

The Consulting segment generated approximately 14% of the company's total operating segment revenues in 2006. This segment has operations in the United States, Canada, Europe, the Pacific region and South Africa. Through its subsidiary, Aon Consulting Worldwide, Inc. (Aon Consulting), Aon provides a range of consulting services in two sub-segments (Consulting Services and Outsourcing) that operate in seven practice areas:

- employee benefits, which advises clients about structuring, funding and administering employee benefit programs;
- compensation, which focuses on designing salary, bonus, commission, stock option and other pay structures;
- management consulting, which assists clients in process improvement and design; leadership, organization and human capital development; and change management;
- communications, which advises clients on how to communicate initiatives that support their corporate vision;

- strategic human resource consulting, which advises complex global organizations on talent, change, and organization effectiveness issues, including assessment, selection performance management, succession planning, organization design and related people management programs;
- financial advisory and litigation consulting, which provides consulting services, including financial statement and white collar investigations, securities litigation, financial due diligence, financial valuation services and other related specialties;
- human resource outsourcing, which offers employment processing, performance improvement, benefits administration and other employment-related services.

The Consulting Segment and the Risk and Insurance Brokerage Services Segment operate very independently from one another. In some instances, both segments work with the same client, but are unaware of each other's involvement. Collaboration between these two segments could lead to potential opportunities. These opportunities will be further explored within this report.

3.1.3 Insurance Underwriting Segment

The Insurance Underwriting segment has operations in the United States, Canada, Latin America, Europe and Asia/Pacific. This segment generated approximately 23% of Aon's total operating segment revenues in 2006. The Company classifies its insurance underwriting businesses into two sub-segments: accident, health and life, and property and casualty. Aon's Combined Insurance Company of America and Combined Life Insurance Company of New York (Combined) subsidiaries provide accident, health and life insurance.

The Company is an underwriter and distributor of specialty individual accident, disability, health and life insurance products that are targeted to middle income consumers in the United States, Europe, Canada and Asia Pacific. Combined also provides coverage in the senior market through its Sterling Life Insurance subsidiary. Sterling provides coverage in the medical care market. Aon offer a range of accident and sickness insurance products, including short-term disability, critical conditions and cancer aid, Medicare products, hospital confinement/recovery and long-term care coverage.

The Underwriting Segment works very independently from the other two segments within Aon. In many ways, this is necessary to avoid any conflict of interest issues. A conflict of interest issue would arise if Aon were the insurance

broker for a particular client and placed an insurance policy with an insurance market owned by Aon.

3.1.4 Introduction to Aon Reed Stenhouse

Aon Reed Stenhouse (ARS) provides commercial & personal insurance brokerage services and risk management solutions to clients within Canada. ARS has offices across the country segmented into different regions with its head office located in Toronto, Ontario. Within the British Columbia Region there are 4 offices – Vancouver, Victoria, Kamloops, and Langley. The FPP is based in the Vancouver office, which employs over 200 employees.

The BC Region provides insurance brokerage and risk management services to a wide range of industries. These industries include:

- Agribusiness & Food System;
- Automotive;
- Fine Arts;
- Healthcare;
- Heavy Industry;
- Hospitality;
- Pharmaceutical / Chemical;
- Professional Services;
- Public Administration and Education;
- Railway;
- Real Estate;
- Residential / Personal Lines;
- Technology & Telecommunications;
- Transportation - Trucking;
- Energy;
- Mining;
- Forest Products;
- Aviation and Aerospace;
- Financial Institutions;
- Marine;
- Construction Services;
- Entertainment;
- Manufacturing.

Of the industries listed above, BC has dedicated segment / practice groups for the following:

- Forest Products;
- Mining;
- Energy;
- Construction;
- High Tech.

In 2005, ARS generated \$202,713,028 in revenue across Canada. BCY accounted for \$30,923,441 (15%) of the total. ARS Canada had 37,227 clients on the books while BCY accounted for 4,851 of those clients. Average client size in terms of revenue across Canada was \$5,445. BCY's average client size was \$6,375. A large discrepancy exists between the average sizes of clients within each industry. Thus the difference in average client size is likely a result of a somewhat different product mix, including the emphasis on the forest sector which includes some larger than average clients.

Chapter 4: The Forest Industry within B.C.

The forest industry is one of the key economic drivers of the B.C. economy and represents a significant market for Aon. To understand how the FPP should move forward, it is critical to understand the issues prevalent within the forest industry in B.C and its infrastructure. It is also important to identify and map out the different segments within the industry. This will allow the FPP to analyze the composition of its portfolio in relation to the different segments and address any potential opportunities or threats within each segment and the industry as a whole.

According to the Council of Forest Industries, industry sales are responsible for approximately 43% of manufacturing shipments in BC and 13% of BC's Gross Domestic Product. Almost all of the wood produced in BC is softwood, used to make lumber, plywood, shakes, shingles, newsprint, and pulp and paper products. In fact, about half of the softwood produced in Canada comes from BC. The economic activity created by the forest sector is the largest single source of provincial employment, accounting for over 200,000 jobs.

The health of the forest industry within B.C. is a critical concern for the ARS BC region. The forest industry represents a significant portion of the

revenue base for the region. It is important that the ARS BC region stay on top of the key issues facing the industry. The issues currently facing the industry could dramatically change the landscape of the industry over the next few years.

4.1 Challenges Facing the Forest Industry Within B.C.

The following is an overview of the challenges currently facing the forest industry within B.C.:

- Global competition for market share, aging capital investments & low returns on capital;
- The Softwood Lumber Agreement between Canada and the U.S.;
- Reduced demand and declining commodity prices;
- The strong value of the Canadian dollar against the US dollar;
- Continued consolidation within the sector;
- Environmental changes - the mountain pine beetle epidemic;
- Worker safety in the logging industry.

4.1.1 Global Competition for Market Share, Aging Capital Investments & Low Returns on Capital

Approximately 80 per cent of the sales by the B.C. forest products industry continue to be destined for non-Canadian markets (Ministry of Forests and Range and Minister Responsible for Housing). A number of countries are

emerging as customers (China, India, etc.) while others are emerging as strong competitors (Russia, Brazil, etc.).

Significant pressure exists to maintain and improve B.C.'s competitiveness in the global market. This pressure is intensified by the relatively low returns available in the sector. PricewaterhouseCoopers, in their global survey estimates that the average return on capital employed (ROCE) for major forest, paper and packaging companies was 4.5 per cent in 2005. For listed Canadian companies, nearly half of which are based in B.C., the average return on capital employed was 2.5 per cent. These returns are expected to be lower in 2006 given weaker forest product markets.

4.1.2 The Softwood Lumber Agreement Between Canada and the U.S.

In September 2006, an agreement was signed between the U.S. and Canada to end the softwood lumber trade dispute. The seven-year agreement took effect on October 12, 2006. As a result of the agreement, B.C. forest products are no longer subject to U.S. countervailing and anti-dumping duties; however, a border measure is imposed when lumber prices fall below \$355 per thousand board feet. Unlike the countervailing and anti-dumping duties, funds collected as a result of the border measure will remain in Canada.

4.1.3 Reduced Demand and Declining Commodity Prices

In 2006, lumber prices continued to trend downwards (see Table 2). In 2007, lumber prices are anticipated to remain low because of reductions in U.S. lumber consumption due to a decline in housing starts, rising interest rates and higher energy prices. These factors should also have an impact on plywood, oriented strand board and other structural engineered wood products.

By contrast, the price of hemlock baby squares, a key coastal lumber product used primarily in the Asian market in the construction of traditional post and beam Japanese houses, remained steady in 2006 (see Table 2). In 2007, average prices for hemlock baby squares are expected to rise slightly to an average price of US\$610 per thousand board feet. The strength of the baby squares market is attributed to the stable and strengthening Japanese / Asian market. Despite the fact that the hemlock baby squares market is strengthening, it is doubtful that there will be any new companies formed or any new plants built in response. Many of the coastal mills capable of producing hemlock baby squares have curtailed production levels over the years, and should be able to respond to the market demand by adding additional shifts or making improvements to existing plants.

The slumping commodity prices for spruce pine fir lumber and the limited potential for growth within the “hemlock baby squares” market indicate a trend towards a shrinking lumber segment market for the FPP.

The following table indicates the commodity pricing for lumber, squares, pulp and paper from 2004 to 2006 derived from data obtained by Madison's Canadian Lumber:

Table 2 - Commodity Prices*

Product	Unit	Annual Average 2006*	Annual Average 2005	Annual Average 2004
Spruce Pine Fir 2x4	US\$/000 bd.ft.	297	355	392
Hemlock Baby Squares	US\$/000 bd.ft.	583	540	613
Northern Bleached Kraft pulp	US\$/tonne	674	611	615
Newsprint	US\$/tonne	667	608	550

* Year-to-date average as of December 2006

Pulp and paper prices rose throughout 2006 and are forecast to remain strong through 2007 (see Table 2). Despite the strong prices, the B.C. pulp and paper industry will continue to struggle to remain profitable due to its aging

capital investments, strengthening international competition, competition from different types of pulp, non-wood pulp and technological alternatives to paper, as well as rising energy costs. Due to the interconnectedness between the pulp and paper and lumber industries, the strength of the pulp and paper industry is an important factor in the health of the entire B.C. forest industry. The FPP should not expect to see any growth within the pulp and paper segment market.

4.1.4 The Strong Value of the Canadian Dollar Against the US Dollar

Throughout 2006, the Canadian dollar was strong against the US dollar peaking at over 91 US cents in May. In 2007, the Canadian dollar has continued to rise peaking at over 94 US cents in June. The strong Canadian dollar will continue to impact the B.C. forest industry by increasing the relative cost of production in B.C., and reducing B.C. companies' profits as most forest products are sold in US dollars.

4.1.5 Continued Consolidation Within the Sector

The industry has experienced a continuous trend of consolidation since the mid 1990's. Large forest products companies within B.C. continue to look to grow market share through acquisitions or building "super-mills." The return of countervailing and anti-dumping duties to manufacturers in 2006 resulted in a number of B.C. companies purchasing plants and operations in the U.S. It is

anticipated that small and medium sized lumber manufacturers will continue to be squeezed out of the marketplace. This will result in plant closures and curtailment of production.

4.1.6 The Mountain Pine Beetle Epidemic

British Columbia is currently in the midst of a Mountain Pine Beetle infestation that is unparalleled in Canadian history. The epidemic threatens to kill 80% of the mature pine within the interior of the province and has the potential to spread into the boreal forests of western and central Canada.

The Mountain Pine Beetle naturally exists in endemic populations within BC's forests. It plays an important role in the life cycle of Lodgepole pine forests. The beetles typically attack older, weakened trees and together with fire, create disturbances which are naturally regenerated by Lodgepole pine.

Successful fire suppression over the last century has resulted in an abundance of mature pine susceptible to attack. Combined with recent favourable climate conditions (warm winters and hot dry summers), ideal conditions exist for the Mountain Pine Beetle to extend its natural range and for the beetle population to explode. The only known way the spread of the beetle will be stopped is through prolonged periods of cold weather, a sustained period

of -25 degrees Celsius in the early fall or late spring and – 40 degrees Celsius in the winter.

By March 2005, the Ministry of Forests estimated that the beetle had infested over 7 million ha (and area equivalent to the size of New Brunswick) and killed over 280 million m³ (a volume equivalent to 4 times the normal allowable annual cut of the province). Today the area of beetle attack ranges from Mackenzie in the north, to Princeton in the South, to Smithers in the west and Cranbrook in the east.

The forest industry has responded by salvaging as much beetle attacked timber as possible before it deteriorates. This has led to increased economic activity in the form of timber harvesting, manufacturing and silviculture activities. In 10 to 15 years, however, timber supply issues will exist. Replanted stands will not yet be ready for harvest and the lack of pine trees in certain areas will promote high water content in soil (no evaporation through needles) and potential for erosion of topsoil through water run off and wind, potentially displacing pine with other tree species or grasslands.

4.1.7 Worker Safety in the Forest/Logging Industry

In 2005, there were a total of 45 deaths and 106 seriously injured in the forest / logging industry according to the B.C. Coroners Service and Workers

Compensation Board of B.C. (WCB). The number of deaths is more than 3 times higher than the previous year. According to the Public Service Alliance of Canada BC, "Workplace inspections by WCB have fallen by 44 percent since 2001, and the resulting value of penalties has dropped by 57 percent."

Relaxed regulations and cuts from the government have been blamed for this recent escalation in worker deaths. Recently revised regulations pertaining to logging contractors have allowed more logging contractors to enter the marketplace including smaller contractors. This also allowed major companies to contract out services in order to reduce payroll and benefits packages, which lead to individuals operating outside of corporate standards and sometimes without proper coverage. The government site safety inspection resources were stretched thin as result and the industry was unable to adequately police itself or implement adequate internal safety programs. That being said, the level of deaths within this industry even prior to the implementation of the relaxed regulations is inconceivable.

The deaths and serious injuries have dramatically increased the workers compensation costs for B.C. forest companies. Workers compensation premiums represent the largest insurance cost for B.C. forest companies. In fact, in most instances a company's WCB premiums are greater than all of its other insurance policies combined (property, liability, auto, business interruption, etc.).

4.2 Addressing the Challenges Facing the Industry

The current issues within the industry raise the following questions:

- How does one of the most efficient industries in the world become even more efficient?
- How should the industry respond to the mountain pine beetle epidemic?
- How could the industry diversify and strengthen its product segments?
- How does the industry expand its penetration levels within existing markets and expand into new markets?
- How does the industry do a better job of creating safer working conditions for its workers?

In many ways, the industry and the market are naturally responding to the efficiency issue. Consolidation within the industry, the emergence of “super mills” and the closure of small or inefficient mills are all contributing to improved efficiencies within the industry as a whole.

The forest industry is currently lobbying the government to increase the allowable annual cut (AAC) within the province. The AAC is the amount of wood permitted to be harvested in the province within a one-year period to ensure the sustainability and productivity of B.C. forests. Since 95% of BC's land base is publicly owned, the management of the forest resource rests largely with the

provincial government, which allocates the right to log crown land through the sale of stumpage fees and a regulated annual allowable cut.

In particular, the industry wants increased access and permission to cut a greater amount of mountain pine beetle infested timber. This would allow the industry to access cheaper timber and reduce its fibre costs. Their main arguments are that the beetle-infested timber must be harvested quickly before the timber becomes unsalvageable and that it would stimulate economic development and investment in provincial communities.

The pine beetle epidemic is expected to inject life into a relatively new secondary manufacturing segment – the wood pellet segment. The low cost residual fibre generated from lumber manufacturing operations could be used to manufacture wood pellets. Wood pellets are used extensively within Europe. This may help B.C. companies penetrate into new markets and diversify product lines.

The forest industry and the government are working together to support a market-based timber pricing scheme as part of its trade dispute resolution with the U.S. Appropriate implementation of this pricing scheme should prevent another costly trade dispute with the U.S., thereby securing market access to the largest importer of B.C. forest products.

In terms of creating safer working environments for its workforce, the government has tightened up its regulations pertaining to logging. The number of

on-site audits and inspections of logging operations has increased. Coalitions have been formed between logging companies, manufacturers, government, regulators, unions, the RCMP and private industry to address this problem. WCB has also implemented new laws which make directors and officers criminally responsible for gross negligent acts resulting in death or injury. This has definitely caught the attention of owners and executives. In 2006, forestry related deaths dramatically reduced from 45 to 14; however, the industry's goal is to have zero deaths. The industry has a long way to go to create a safer working environment for its workforce.

All of the challenges facing the forest industry within B.C. have led to a perfect storm. The forest industry is experiencing a major economic change. The number of major forest companies within B.C. is shrinking and although some international markets are opening up for B.C. forest companies, other markets traditionally dominated by B.C. forest companies are facing new and strong competition from international markets such as Russia, Brazil and China. Consolidation within the industry is expected to continue and fibre supply costs are expected to continue to rise. The FPP will have to cope with these changes within the industry by strengthening its penetration levels within the industry and diversifying its client base.

4.3 Forest Products Industry Segments

The forest industry consists of a wide range of manufacturers and service providers. The forest industry can be divided into a number of different major production segments. It is important to understand how the changes within the forest industry impacts each of these different segments. This will help identify the strengths and weaknesses within each segment and help the FPP identify any opportunities or threats that the FPP will be able to take advantage of, or neutralize.

There are four major segments within the industry: Logging, Lumber Manufacturing, Paper Manufacturing and Secondary Wood Manufacturing. The following is a brief description of each of these segments and some of its sub-segments.

4.3.1 Logging

The logging segment selects, provides access to, harvests, and grades timber for production in lumber manufacturing, paper and paperboard, and secondary manufacturing operations. The logging industry consists of foresters and woodland operators who manage timber cuts; and small and large logging companies who do contract work on behalf of manufacturing operations and / or independently.

Logging activities include: forest / timber management; road building; felling / bucking trees; skidding or moving trees or logs to a landing; constructing booms in boom grounds on land and on water; loading, unloading, sorting, grading, storing or processing trees and logs at landings, log dumps, sort yards, dry land sorts, booming grounds or mill yards; salvage and debris removal operation; and underwater logging operations.

4.3.2 Lumber Manufacturing

Lumber manufacturers in British Columbia are situated throughout the province and range in size from small and medium size operations to very large companies. The variety of lumber products they manufacture vary depending upon species and technical capability.

The B.C. forest industry is widely recognized as having two separate and distinctive parts: coastal BC and the interior. Many of the critical differences between these two regions revolve around their respective timber species and size of trees, as well as the types of timber mills, wood products, and mix of final markets. For instance, in the wetter coastal region the species harvested include Western hemlock, Douglas fir, Western red cedar, Yellow cedar and Sitka spruce. By contrast, most inland timber companies utilize species such as

spruce-pine-fir; commercial species here include sub-alpine fir, lodge pole pine and western larch.

The smaller coastal market is distinctive in that it has many more species of wood and a wider export market. Importantly, product lines in the coastal region include structural lumber that is custom milled for Japanese houses in special metric dimensions. These can be contrasted with more standard timber typically produced by the interior region's saw mills; 'two inch by four inch' (2 x 4) or '2 inch by 6 inch' (2 x 6) pieces milled principally for United States markets.

The coastal industry also specializes in decorative or 'appearance-grade' products, including wooden mouldings, value-added and secondary products such as flooring, as well as specially treated building materials (Coast Forest and Lumber Association [CFLA] 2002a). Because of this added-value feature, wood products from the coast sell typically for almost twice the price of lumber produced by interior sawmills. However, due to the higher costs of extraction together with environmental constraints, the expenses of operating timber mills on the coast are often more than double that of the interior.

4.3.3 Paper Manufacturing

In general, paper manufacturing is largely associated with the creation of pulp whether by mechanical or chemical means. Examples of manufactured

paper products include asphalt paper, building paper, coated paper, diapers, facial tissues, fine paper stock, groundwood paper, kraft paper and office paper. Examples of paper board products include include boxboard, paperboard stock, cardboard stock, corrugated cardboard boxes, coated, laminated or treated paperboard, milk carton board and stationary.

The majority of paper mill operations rely heavily on the residual wood products of lumber manufacturers in the form of wood chips. Wood chips are the primary fibre supply in the production of pulp and paper.

4.3.4 Secondary Manufacturing

Secondary manufacturers also known as value-added manufacturers in B.C. are often further grouped into eight other sub-categories. These categories include panelboards, engineered wood products, wood pellets, shakes and shingles, millwork, cabinets, furniture, and pallets and containers.

Secondary manufacturers are for the most part grouped into regional clusters for reasons of proximity to raw materials, clients, transportation routes, related companies, labour pool and R& D facilities. The majority of companies are situated in the Lower Mainland and Okanagan/West Kootenays with smaller numbers in Prince George/North Central and Vancouver Island.

Panelboards

Examples of panelboard products include plywood, Oriented Strandboard (OSB), Medium Density Fibreboard (MDF), and particleboard. Because of the capital involved in manufacturing panelboard products this type of production is often handled by medium and large producers. Species used in the production of some panelboards include Spruce and Douglas Fir.

Engineered Wood Products

Using a combination of wood products in layers, engineered wood products are manufactured to create products of increased strength and stability. Examples of engineered wood products include glue laminated timber, laminated veneer lumber, parallel strand lumber, oriented strand board, plywood, I-Joists and I-Beams, roof trusses and specialty engineered wood products. Species used in engineered wood products include Douglas Fir, Larch, Southern Yellow Pine and Poplar.

Wood Pellets

Wood pellets are a source of bio-fuel that consists of heat treated compressed sawdust which is used to generate heat and electricity in residential and commercial occupancies. The pellet fuel market continues to grow, serving emerging markets in the Far East and parts of Europe. In the United Kingdom,

wood pellets are used to fire massive generators to provide power to millions of people. In North America, as access to affordable fossil fuels diminishes, interest in the renewable, efficient power of pellets is growing.

The bio-fuel market is also expected to be a significant source of employment in the future. EU nations are expected to generate 250,000–300,000 quality jobs in this area over the next ten years

Shakes and Shingles

Used in roofing and siding, shakes and shingles examples include products such as tongue and groove siding, shiplap siding, and board and batten siding. Shakes and shingles are naturally resistant to water, sunlight, rot and are typically installed in their natural state. Cedar constitutes 96% of the wood supply used in shake and shingle production.

Millwork

Millwork companies produce doors and windows, moulding, flooring, architectural woodwork, turned wood products and stairs. Millwork projects vary in size and scope, ranging from small custom furniture pieces to larger works in airports, hotels and government offices.

Cabinets

BC cabinet manufacturers produce the following cabinet types: vanity, kitchen, cabinet doors and countertops. Depending upon the project type, volume of pieces and budget, the species used in cabinet construction vary greatly. A majority of cabinets are made from hardwoods (primarily Oak and Maple) although the use of various panel boards with a choice of veneer is very common.

Furniture

Furniture manufacturers in British Columbia vary in company size, location, products made, species used and markets served. Examples of some of products manufactured by BC companies include tables, chairs, desks, entertainment centers, arts & crafts furniture, ready to assemble (RTA), patio, office and commercial. Because furniture production depends largely upon the intended use and style both softwoods and hardwoods are used including Douglas-fir, Cedar, Oak and Maple.

Pallets and Containers

Pallet and container manufacturers produce items used primarily for the transportation of various items. Pallets come in standard as well as sizes custom

sizes. Container products include boxes, bins, crates, shipping and storage containers. Species used in production of pallets and containers include approximately 60% Spruce, Pine, Fir as well as Spruce and Douglas Fir panelboards.

Other Wood Products

Some examples of other wood products include poles & posts, veneer, instruments, wood novelties and wood crafts.

Of the four major segments described above, the FPP focuses much of its attention on the lumber manufacturing, paper manufacturing and logging segments, which represents approximately 90% of its revenue base. The following section will analyze the FPP's penetration levels with each of the four major segments and attempt to quantify the potential opportunities within each of these segments. The analysis will also identify opportunities within the FPP for diversification of its portfolio to help spread the risk of changes within the forest industry.

Chapter 5: ARS BC Forest Products Practice

ARS BC has a dedicated Forest Products Practice (FPP). The FPP works with eight of the top 10 largest forest products manufacturing companies in B.C. in terms of gross revenues. The FPP is a major player in the lumber manufacturing, paper and paperboard plants, panel boards and engineered wood products segments within the province.

In 2005, the FPP generated \$6,082,000 in revenue for the B.C. region – which represents the largest revenue segment within the region and accounts for approximately 1/5 of the region's total revenue. The FPP is a foundational piece of the region's operations.

In the forest products industry, the main risk management / insurance issues are property damage, business interruption, liability and personnel safety. "Property damage" refers to a company's physical assets including buildings, equipment and machinery, land, stock and inventory of raw materials, finished goods and supplies, etc. "Business interruption" is the loss in profits and the cost of continued expenses for an unexpected disruption in operations due to an insurable event. "Liability" is the risk of a third party claiming damages against

your operations for a negligent act committed against the third party. “Personnel safety” is the risk of injury or death due to unsafe working environments.

The FPP faces a number of immediate challenges given the changing landscape of the forest industry. The main question is – how should the FPP react to these changes to maintain or grow its current portfolio? To help build a strategy for this purpose, it is important to understand the composition of FPP's portfolio. The analysis within this chapter will breakdown the FPP's portfolio into different forest product segments and highlight the FPP's market penetration within these segments. This will help qualify and quantify the opportunities and threats within each of the segments and help determine the segments in which the FPP is strong or weak. The FPP will be able to use this analysis to develop specific strategies to cope with the impact that changes within the forest industry will have on the FPP's portfolio.

The following analysis breaks down each segment within the FPP in terms revenue generated, number of accounts, revenue ranges, average revenue per account, percentage of FPP book of business, penetration levels and potential revenue opportunity.

Lumber Manufacturing Segment

In 2005, the lumber manufacturing segment (sawmills and wood preservers) generated approximately \$2.7 million of the total revenues for the FPP. In total, there were 50 accounts providing an average of \$54,000 per account. This segment represents approximately 45% of total revenues for FPP.

According to Canadian Industry Statistics (www.strategis.ic.gc.ca) there are 476 lumber manufacturers registered in B.C. Only 63% of these manufacturers have more than five employees and 19% have more than one hundred employees. The realistic market potential would be anywhere in the range of 90 (476 x 19%) to 300 (476 x 63%) manufacturers given that the FPP typically would target companies with more than 50 employees. For this analysis, we will use the market potential of 195 manufacturers. Please refer to Table 3:

**Table 3 - Number of Employer Establishments in Canada
by Employment Size Category and Region
Sawmills and Wood Preservation**

(NAICS 32111) December 2005				
Province or Territory	Employment Size Category (Number of employees)			
	Micro 1-4	Small 5-99	Medium 100-499	Large 500+
British Columbia	177	209	91	2
Total %	37%	44%	19%	0.4%
Notes: * May not add up perfectly due to rounding				

This figure is based on *Statistics Canada, Business Patterns Database*, December 2005

This indicates that the FPP has approximately 26% of the market share as it pertains to the number of lumber manufacturers. If each lumber manufacturer represents approximately \$54,000 in revenue, the revenue opportunity would be equal to approximately \$7.8 million (145 x \$54,000).

Paper & Paperboard Products

In 2005, the paper and paperboard products segment generated approximately \$1.6 million of the total revenues for the FPP. In total, there were 15 accounts with a wide revenue range from \$3,000 to \$470,000. The average revenue per account in this segment was approximately \$107,000. This segment represents approximately 27% of total revenues for FPP.

According to Canadian Industry Statistics (www.strategis.ic.gc.ca) there are 87 paper manufacturers registered in B.C. Only 75% of these manufacturers have more than five employees and 31% have more than one hundred employees. The realistic market potential would be anywhere in the range of 27 (87 x 31%) to 65 (87 x 75%) manufacturers given that the FPP typically would target companies with more than 50 employees. For this analysis, we will use the market potential of 46 manufacturers. Please refer to Table 4:

**Table 4 - Number of Employer Establishments in Canada
by Employment Size Category and Region
Paper Manufacturing**

(NAICS 322) December 2005				
Province or Territory	Employment Size Category (Number of employees)			
	Micro 1-4	Small 5-99	Medium 100-499	Large 500+
British Columbia	22	38	16	11
Total %	25%	44%	18%	13%
Notes: * May not add up perfectly due to rounding This figure is based on <i>Statistics Canada, Business Patterns Database</i> , December 2005				

Table 4 indicates that the FPP has approximately 33% of the market share as it pertains to the number of paper manufacturers. If each lumber manufacturer represents approximately \$107,000 in revenue, the revenue opportunity would be equal to approximately \$3.3 million (31 x \$107,000).

Logging Segment

In 2005, the logging segment generated approximately \$1.1 million of the total revenues for the FPP. In total, there were 35 accounts with an average revenue of \$31,400 per account. This segment represents approximately 18% of total revenues for FPP.

There are 342 logging contractors registered in B.C. This indicates that the FPP has approximately 10% of the market share as it pertains to the number of logging contractors. However, the FPP indicates that the overwhelming majority of logging contractors are small operators. Therefore using the FPP average revenue would not be a good indicator of the market potential. Specific logging Industry data was not available for analysis from Statistics Canada.

Secondary Wood Manufacturing Products

In 2005, the secondary manufacturing products segment generated approximately \$682,000 of the total revenues for the FPP. In total, there were 48 accounts with a wide revenue range from \$3,000 to \$140,000. The average revenue per account in this segment was approximately \$5,000. This segment represents approximately 11% of total revenues for FPP.

According to Canadian Industry Statistics (www.strategis.ic.gc.ca) there are 508 secondary wood manufacturers registered in B.C. Only 53% of these manufacturers have more than five employees and 3% have more than one hundred employees. The realistic market potential (see Table 5) would be anywhere in the range of 15 (508 x 3%) to 254 (508 x 50%) manufacturers given that the FPP typically would target companies with more than 50 employees. For

this analysis, we will use the market potential of 135 manufacturers. Please to

Table 5:

**Table 5 - Number of Employer Establishments in Canada
by Employment Size Category and Region
Other Wood Product Manufacturing**

(NAICS 3219) December 2005				
Province or Territory	Employment Size Category (Number of employees)			
	Micro 1-4	Small 5-99	Medium 100-499	Large 500+
British Columbia	237	254	17	0
Total %	47%	50%	3%	0%
Notes:				
* May not add up perfectly due to rounding This figure is based on <i>Statistics Canada, Business Patterns Database</i> , December 2005				

Table 5 indicates that the FPP has approximately 36% of the market share as it pertains to the number of secondary wood products manufacturing. If each manufacturer represents approximately \$5,000 in revenue, the revenue opportunity would be equal to approximately \$4.35 million (87 x \$50,000).

- **Panelboards and Engineered Wood Products**
 - Total Revenue was approximately \$490,000
 - 20 Accounts
 - Average Revenue approximately \$24,500
- **Wood Pellet**

- Total Revenue was approximately \$27,000
- 2 Accounts
- Average Revenue approximately \$13,500
- **Millwork**
 - Total Revenue was approximately \$13,000
 - 5 Accounts
 - Average Revenue approximately \$2,600
- **Cabinets**
 - Total Revenue was approximately \$5,000
 - 1 Account
 - Average Revenue approximately \$5,000
- **Furniture**
 - Total Revenue was approximately \$132,000
 - 7 Accounts
 - Average Revenue approximately \$18,900
- **Shakes & Shingles**
 - Total Revenue was approximately \$0
 - 0 Accounts
 - Average Revenue approximately \$0
- **Pallets & Containers**
 - Total Revenue was approximately \$0
 - 0 Accounts
 - Average Revenue approximately \$0

- **Other Forest Products**
 - Total Revenue was approximately \$15,500
 - 8 Accounts
 - Average Revenue approximately \$1,900

Account Size Analysis

There are fifteen accounts in the FPP with revenues greater than \$100,000. The revenues on these accounts range from \$100,000 to \$650,000. The total revenue base for these accounts is approximately \$3.9 million, with an average of approximately \$260,000 per account. Therefore, the top 15 accounts in terms of revenue in the FPP account for approximately 65% of its total revenue.

There are seven accounts in the FPP with revenues between \$50,000 and \$100,000. The total revenue base for these accounts is approximately \$473,000, with an average of approximately \$68,000 per account. These accounts generate approximately 8% of the total revenue within the FPP.

There are ten accounts in the FPP with revenues between \$25,000 and \$50,000. The total revenue base for these accounts is approximately \$300,000, with an average of approximately \$30,000 per account. These accounts generate approximately 5% of the total revenue within the FPP.

There are also twenty accounts in the FPP with revenues between \$10,000 and \$25,000. The total revenue base for these accounts is approximately \$290,000, with an average of approximately \$14,500 per account. These accounts generate approximately 5% of the total revenue within the FPP. The remainder of the accounts within the FPP have revenues of less than \$10,000.

Therefore, the top 32 accounts in terms of revenue, account for approximately 75% of the practice's total revenue. The trend towards consolidation within the forest industry could have a dramatic impact on the FPP's portfolio. If any of FPP's major clients are purchased it could have a significant negative impact on the FPP's portfolio. However, given that the FPP works with eight of the top 10 forest clients within B.C., the FPP is in a relatively strong position and may actually benefit from consolidation within the industry as their clients may purchase companies that were not FPP clients. Unfortunately, the FPP has no control over how the consolidation will take shape within the forest industry and will need to develop an aggressive growth strategy to compensate for the risk of losing clients through consolidation.

5.1 FPP's Strengths

The FPP provides a wide range of services to its clients. Although some client relationships are transactional in nature, the majority of FPP clients are service intensive. The FPP typically acts not only as a client's insurance broker but also as their risk management consultant. The FPP is able to help clients identify and analyze their business risks and develop solutions / options to manage those risks. The FPP's ability to deliver this value and develop the most cost effective risk management programs for their clients is what separates them from their competitors. The strengths of the FPP include the following:

Service Quality

- *Unparalleled Forest Industry Expertise & Resources* – there are 33 members of the FPP team with extensive experience and expertise within the forest products industry. No competitor in North America has a larger or more experienced forest products team.

The team consists of:

- One practice leader – over 25+ years experience in the risk management and forest industry;
- Five account executives / risk management consultants – with over 100+ years experience combined in the insurance, risk management and forest industry;
- Four associate account managers – with over 70+ years experience combined in the insurance industry;

- Seven brokers – with over 100+ years experience combined in the insurance industry;
- Six associate brokers – with over 40+ years experience combined in the insurance industry;
- Four claims consultants – with over 60+ years experience combined in the insurance industry;
- Six risk control & health and safety consultants – mechanical, chemical, metallurgy, electrical and civil engineers with over 100+ years experienced combined in the insurance, risk management and forest industry.
- *Proven Track Record of Customer Service Excellence*
 - Aon is the top rated insurance brokerage firm in the world in terms of service, voted by “*the Annual London, England Insurance Survey 2006*”.
 - Aon clients, in particular FPP clients, have been long-term clients of Aon, many of whom have been working with Aon for over 20+ years. Many of these clients act as advocates for Aon and play a critical role as references to many of our prospects.

Product Choices

- *Customized Insurance Programs*
 - Over the years, the FPP has developed custom, tailor-made products to meet the specific needs of the forest products industry. Many of

these products are exclusive to Aon clients only and provide broader coverage than typical insurance policies. This is a major competitive advantage for Aon.

- *Access to Global Insurance Markets*
 - Aon is able to place business with insurance and capital markets around the world leveraging Aon's global reach. Many of the brokers in B.C. are regional brokers and are unable to access international markets.

Product Quality

- *Deals only with Reputable, Highly Rated Insurance Markets*
 - Aon has developed relationships with insurance markets that specialize in insuring forest industry clients. These markets are all required to meet certain credit rating standards and have a strong proven record of responding to claims fairly. Many insurance brokers do not have access to insurance markets that specialize in the forest industry and do not require the same criteria for the insurance markets they utilize.

Value Added Services

- *Risk Control / Loss Prevention*
 - Aon works with its clients to help them prevent losses from occurring, which in turn reduces insurance premiums and downtime. Risk control

is a major competitive advantage for the FPP. The risk control consultants in the FPP are considered among the best in the world. This is evidenced by the fact that the group consults with forest industry companies around the world including companies that are not Aon brokered clients. Many insurance brokers do not offer risk control services, and those that do are unable to match the group's expertise and skill sets within the forest industry.

- *Health and Safety Consulting*

- Aon works with its clients to develop worker safety programs to prevent personal injury accidents. Many insurance brokers, including Marsh, do not offer health and safety consulting services despite the fact that workers compensation insurance is equal to all other P&C premiums combined.

- *Networking Opportunities*

- Aon works with a wide range of industries and has clients all around the world. This network allows Aon clients to build relationships with each other. In many instances, we have introduced one client to another and helped forge business relationships. Marsh is the only other insurance broker who has a similar depth level to connect its clients together within their network.

- *Claims Advocacy*

- Aon is an independent advisor to its clients whenever a potential claim arises. Aon acts as an advocate for its client in ensuring that insurance

companies manage claims fairly and pay claims in a timely manner. Many insurance brokers, especially small to mid-sized brokers, are unable to provide to provide truly independent advice to their clients given the contingency commissions they receive. Aon does not accept contingency commissions or profit sharing from insurance companies / markets.

- *Bulletins – Industry Updates / Safety*

- Aon provides its clients with educational information about risks, incidents, market trends, etc. Bulletins help our clients stay on top of what is going on within their industry and the insurance industry. Clients particularly appreciate analysis conducted on incidents / accidents that have occurred recently. They use this information to help prevent the same incident from happening to them. No other insurance brokerage firm provides this type of information to its forest industry clients.

Brand

- *Trusted Brand Quality*

- Aon is the largest insurance brokerage firm in the world and is highly respected throughout the global business community. The FPP has a strong reputation within the forest industry not only in B.C. but throughout the world as well. Eight of the top 10 forest companies in B.C. are managed by Aon's FPP. Participation in industry events

including conferences have solidified Aon's FPP brand positioning over its competitors. Marsh has a trusted brand throughout the world as well, but lacks a significant presence within the forest industry.

Price

- *Reduced Premiums and Better Terms*
 - Aon offers the most comprehensive package of services to its clients. Despite this fact, Aon is competitive in price with its competitors. As the largest insurance brokerage provider within the forest products industry, Aon is typically able to negotiate the best premiums and terms for its clients. The FPP is able to benchmark and leverage its entire portfolio with the various insurance markets. Other insurance brokerage firms including Marsh have a difficult time negotiating with insurance markets given the relative small size of their portfolios.

Convenience

- *Reduced Search Costs*
 - Aon is able to provide its clients with a full range of services and products. Aon also has offices all around the world and are able to broker deals with interests across different countries and regions. Some brokers are only able to provide a limited number products from a limited number markets. Most brokers are not able to broker deals across regional or international boundaries. Marsh and Willis are the only other insurance brokerage firms in the world with the international reach that Aon is able to offer to its clients.

Global Resources

- *Access to Corporate Resources*
 - Aon has an extensive array of corporate resources such as marketing and communications, a customer relationship management (CRM) program, a strategic business planning / competitive intelligence group, information technology design and support team, and a wealth of human capital and expertise around the world. Having access to these resources may be the strongest competitive advantage that the FPP has over its competitors. Both Marsh and Willis have corporate resources, which support their business units, however, the quality and depth of Aon's corporate infrastructure, which includes marketing /

communication, IT, and its CRM program, is a major differentiator for Aon.

5.2 FPP's Weaknesses

The FPP is very good at what it does and client satisfaction surveys conducted in 2006 support this premise. However, the most pressing issue that the FPP has to deal with is – how the FPP is going to cope with the changes within the forest industry. The only way to deal with the changes is to attempt to expand, grow and diversify its portfolio. The biggest problem for the FPP is that all of their account executives / risk management consultants manage large books of business and have limited time to help the FPP expand, grow or diversify its portfolio. Without addressing the talent management shortage within the FPP, it would be pointless to look at opportunities within the forest industry because there would be no one available to chase down and service those opportunities.

Talent Management

- *Large Portfolios for Account Executives*
 - On average, each account executive within the FPP manages a forest products portfolio of approximately \$1.2 million in revenue. The average portfolio for account executives within the BC region is approximately \$600,000 in revenue. Therefore, account executives

within the FPP manage a portfolio approximately twice the size of their counterparts within the region. The size and complexity of their portfolios limits the amount of time in which account executives are able to service existing clients and limits their time and ability to chase down new business opportunities. The FPP was unable to respond to two tenders over the past year because no account executives had any time to respond to the Response for Proposal (RFP) issued by the respected forest companies. These were missed opportunities for the FPP directly related to the talent shortage within the practice.

- The main reason why FPP account executives on average have double the portfolio size of other account executives is because of the niche risk management expertise that is required to service forest industry accounts. There is a limited experienced talent pool within the insurance industry and the FPP has no formal training program to train new account executives within the practice.
- *Compensation Packages*
 - Account executives within the FPP are primarily compensated through their base salary. Their salary is typically related to the size of their book of business. In comparison, most account executives within the company generate the bulk of their compensation from the development of new business. Therefore, account executives within the FPP are less motivated to generate new business despite the opportunities available. On the other hand, if account executives

offload their accounts, they have to justify their larger salaries by generating new business. This creates an environment where it is “safer” for account executives to carry large portfolios. Subsequently, we have the people who are the most capable of developing new business trying to hold on to their current portfolio fearing the risk of not succeeding in generating new business.

- *Support & Succession Planning*
 - Account executives, for the most part, work in isolation and minimal support exists for their accounts. In other words, there is no succession planning for accounts. If an account executive leaves Aon / the FPP, the accounts are in jeopardy to a certain extent. In many instances, the account executive is the only client-facing representative of Aon. There is no one familiar with the accounts and a rippling effect occurs where overloaded account executives are given an even larger portfolio to handle. The FPP lacks a formal training / team focused approach that would make a transition, if necessary, more efficient.

Limited Penetration in the Secondary Wood Manufacturing Market

- *Limited Focus & Strategy*
 - The FPP has captured only a small percentage of the secondary wood manufacturing market in B.C. This is in part, due to the fact that account executives are overloaded with large portfolios and they have a limited capacity to develop new opportunities, however, it is also due

to the fact that there have always been bigger carrots for them to go after within the primary wood manufacturing segment. The FPP has never developed a strategy focused on developing new business within the secondary wood manufacturing market segment. The bulk of FPP clients within this segment have been obtained by circumstance (i.e. affiliation or partnership with clients within the primary manufacturing segment). The analysis of the secondary wood manufacturing segment indicates that the FPP has an estimated potential revenue opportunity of approximately \$4.35 million.

- *Limited Markets and Products*

- Given that the FPP has limited penetration into this segment, their access to insurance markets and products are also somewhat limited. This particular segment is more commodity and transaction focused and the FPP has not developed relationships with insurance markets that would be able to be competitive on a stand alone case basis. For its primary wood manufacturing clients, the FPP has developed comprehensive tailor made programs with various insurance companies that allow the FPP to leverage the size of its client base. The FPP has never really had any success in convincing these markets to consider insuring secondary wood manufacturing clients and has not cultivated any new markets for this segment.

Limited Awareness and Use of Corporate Resources

- *Weak at Cross Selling Products*
 - The FPP has had limited success in utilizing the resources available within Aon to cross sell services to their existing clients. This issue is particularly prevalent as it relates to the lack of collaboration between the Consulting Segment and the Risk and Insurance Brokerage Services Segment. The FPP should be able to cross sell Consulting Segment products to its current clients and approach Consulting Segment clients with the FPP's products and services.
 - In many instances, account executives are unaware of all the products and services that Aon is able to offer to its clients. In some instances, account executives are reluctant to attempt to sell other products or services outside their realm of expertise. There is limited structured support with Aon and the FPP to help account executives better understand the diverse products and services Aon can offer its clients.
- *Weak at Strategic Business Planning, Marketing and IT Support*
 - The FPP has not sufficiently utilized corporate support services to help grow its client base. The corporation has a strategic business planning office that could help them analyze the internal and external data / information that is relevant to the FPP. This business intelligence could help the FPP further identify its strengths, weaknesses, opportunities and threats. The FPP has not utilized the corporate marketing resources available to the group. The FPP has not launched any

marketing campaigns directed towards its prospects; instead, they rely on account executives identifying prospects and cold calling them. In addition, the FPP has not utilized the IT support available within the corporation to develop programs that would streamline the insurance renewal or quoting process to its clients or prospects.

5.3 FPP Opportunities:

Extending Penetration in Segments

- Lumber Manufacturing Segment
 - The FPP only has approximately 26% of the market share as it relates to the number of lumber manufacturing operations. This translates into an estimated revenue potential of \$7.8 million. Currently the FPP generates approximately \$2.7 million of revenue within this segment.
- Paper Manufacturing Segment
 - The FPP only has approximately 33% of the market share as it pertains to the number of paper manufacturers. This translates into an estimated revenue potential of \$3.3 million. Currently the FPP generates approximately \$1.6 million of revenue within this segment.
- Logging Segment
 - The FPP only has approximately 10% of the market share as it pertains to the number of logging contractors. The revenue potential for this market is difficult to quantify, but a potential opportunity still

exists within this segment. Currently the FPP generates approximately \$1.1 million of revenue within this segment.

- Secondary Wood Manufacturing
 - This FPP has approximately 36% of the market share as it pertains to the number of secondary wood products manufacturing. This translates into an estimated revenue potential of \$4.35 million. Currently the FPP generates approximately \$682,000 of revenue within this segment.

Cross-selling Opportunities

- *Risk Control Engineering Consulting*
 - Risk control engineering consulting is a service offered to forest industry clients designed to help clients prevent loss from occurring or to mitigate the impact of a loss on a clients operations. The service identifies the risks within an operation and develops recommendations and strategies to improve processes and design to address these risks. The primary goals for forest industry clients would be the prevention of fire / explosion and breakdown of machinery / business interruption.
 - In many instances, the revenue generated from risk control engineering consulting may be equal to or greater than the revenue generated from service fees or commissions generated on insurance premiums. On the FPP's largest account, risk control engineering

consulting accounts for nearly half of the revenue generated on the account. Approximately 30% of FPP's clients currently purchase risk control engineering services from Aon. Risk control consulting services are typically billed at \$150 to \$250 per hour or on an annual retained fee basis.

- *Health & Safety Consulting Services*
 - Despite the fact that employee health and safety is one of the main issues facing the Forest Industry, the FPP has no clients who purchase our Health & Safety Consulting Services. Health and safety consulting services are typically billed at \$150 per hour.
- *Directors and Officers (D&O) Liability Coverage*
 - Less than 20% of clients public or private within the FPP currently purchase D&O liability coverage. As legislation continues to evolve holding directors and officers' personally accountable for the actions of the corporation in relation to the impact those actions have on its stakeholders, D&O coverage should be incorporated into all corporate insurance programs.

Improve Efficiencies within the Insurance Renewal Process

- *Developing Information Technology Solutions*
 - The FPP has access to IT resources within Aon that is able to develop customized software to meet the needs of the practice and improve customer service. Currently, the insurance renewal process is an

unnecessarily onerous task for FPP clients. It is also estimated that 80% of support staff time is allocated towards handling the paperwork associated within insurance renewals. IT solutions are available that would help streamline the insurance renewal process that would make it easier for the client and FPP support staff to update and renew account information / policies. This would help improve efficiencies and improve customer experiences. These factors may be strategically important moving forward for the FPP as it copes with the changes within the forest industry.

5.4 FPP Threats:

State of the Forest Industry

The forest industry is currently facing a number of key issues that may dramatically affect the future of the FPP.

- *Plant Closures and Production Curtailments*
 - Lumber prices are currently at record lows and the Canadian dollar has risen dramatically. These economic conditions have dramatically altered the competitive climate upon which the forest products companies within B.C. operate. A number of FPP clients have been forced to permanently or indefinitely shut down their operations or curtail production levels. Plant closures and production curtailments

are forecast to increase over the next few years. This could dramatically affect the FPP's current client base.

- *Consolidation within the Industry*

- Because of the economic conditions, consolidation is currently rampant within the industry. With consolidation comes the possibility that your existing clients are purchased. Therefore, the FPP may lose clients solely due to consolidation, which is outside of the FPP's control. In addition, foreign investment is increasing within the B.C. forest products industry, which dilutes the insurance buying control of the ownership / management teams of existing clients.

- *Pine Beetle Epidemic*

- The pine beetle epidemic is also a major issue that will affect B.C.'s forest industry for the coming years. The epidemic, for the time being, is actually keeping fibre costs low for manufacturers'; however, this is a temporary benefit and will have a dramatic affect on the long term management of B.C. forests. In the long run this will inevitably increase the cost of fibre within B.C., which in turn, may cause more plant shut downs and production curtailments of existing FPP clients.

Competition from Brokers and Direct Insurance Underwriters

- *Marsh Canada*

- Marsh is currently the largest competitor of Aon's FPP. Marsh currently works with the largest forest products company in Canada and is a

significant player in the secondary wood manufacturing segment. Marsh has limited access to the forest products insurance markets. There are two main players in the primary wood product manufacturing segments: Factory Mutual Global (FM Global), and Lumbermen's Underwriting Alliance (LUA). Marsh is able to access only one of the two markets – FM Global. Over 65% of FM Global's book of business within B.C. is placed with Aon's FPP. Over 75% of LUA's book of business within B.C. is placed with Aon's FPP.

- Marsh currently uses an insurance market called Ace that writes business primarily in the secondary wood manufacturing segments. Ace will also write smaller operations within the primary wood manufacturing segment. The FPP is able to access the Ace market, but has yet to build a quality relationship with this market. Marsh's overall resources are very similar to that of Aon's. Marsh is the second largest insurance brokerage firm in the world. However, Marsh has limited resources and expertise specific to the forest products industry within B.C.
- Over a year ago, Marsh hired a new forest segment leader. This person was the branch manager for the LUA. Marsh's strategy was to go after LUA's book of business using Ace as their insurance market. This strategy has backfired so far, as the LUA has not lost any business to Marsh / Ace and has severed all relationships with Marsh.

Marsh is continuously pursuing Aon FPP's book of business, so it is critical to stay on top of what strategies they are employing.

- *Regional Insurance Brokers*

- A number of small regional brokers in the Kootenays, Okanagan and Central Interior control a portion of the primary and secondary forest products market. These local brokers have developed long-standing relationships with their clients and have access to the LUA market. They are able to compete against Aon's FPP by offering reduced service fees. In many instances their services fees are approximately 5% of premiums, where as the FPP charges a minimum fee of 10% of premiums to place property insurance policies with the LUA.
- The small regional brokers are not able to offer the services and advice that the FPP is able to provide to its clients. However, as long as these regional brokers have access to the LUA market they will be fairly competitive and able to offer a solid basic product line to their clients. The FPP has never chased this book of business given the alliance they have formed with the LUA. Currently, the FPP does not knowingly go after any LUA business with another insurance market. The FPP could attempt to have the prospect change only insurance brokers and not insurance markets, but it is a very difficult sell. Convincing the client to switch to a more expensive but better value alternative is difficult especially when there have been no pain issues in the past.

Direct Insurance Underwriters

- *FM Global and LUA*
 - FM Global and LUA are the two main property insurance markets for primary wood manufacturing segments. The majority of FPP's clients are placed with these two markets. Although a solid partnership has been formed with FM Global and the LUA, they both represent possible threats to the FPP. Both FM Global and the LUA have the capability to write directly with clients. In fact, both markets have clients in the forest products industry that they write directly without any broker involvement.
 - Legislation requiring insurance companies and brokers to be more transparent in disclosing its commissions and service fees was recently enacted. In the past, clients may not have truly realized the size of commissions they were paying to insurance brokers. If clients do not see the value their insurance broker brings to the table, they may either insure directly with the insurance underwriter or renegotiate the insurance broker's compensation structure. If they deal directly with insurance underwriters, they may have an opportunity to save 10-20% on their insurance costs in the short run.

New Entrants into the Market

- *Other Insurance Brokers*
 - Other insurance brokerage firms such as Willis Group Holdings Limited and Hub International Ltd. may also decide to enter this market place. Willis is the third largest insurance brokerage firm in the world and does have a few forest products clients within B.C. Willis focuses much of its attention on the small to medium size market. Hub International is the fastest growing insurance brokerage firm in the world. Growth has primarily been achieved through mergers and acquisitions of small to medium sized brokerage firms. Hub may decide that the forest products industry is attractive enough to enter.

- *Online Insurance Service Providers*
 - Another significant trend that the FPP has to keep a close eye on is the advancement of online insurance services. The internet has provided a forum for insurance brokers, banks and direct insurance underwriters to offer their services to a wide-ranging client base. In many instances, insurance is simply a commodity type product. As an organization, Aon faces a significant challenge moving forward. As insurance products become more commoditized and distribution networks expand (i.e. internet) the role of intermediaries will change significantly. Aon will have to find new innovative ways of differentiating themselves within

the marketplace. Although forest products insurance may not be a commodity type product now, it may evolve into one in the future.

The next chapter will outline the recommendations generated as a result of the strategic analysis of Aon Corporation's Forest Products Practice within B.C.

Chapter 6: Strategic Recommendations

The forest industry within B.C. currently faces a number of significant economic challenges that are leading to consolidation within the industry and plant closures. The shrinking size of the forest industry is a major concern for Aon's Forest Products Practice. The main question the FPP has to address is how the FPP will be able to maintain or grow its current revenue base in response to the shrinking forest products market. The main question that Aon has to address is – should it continue to invest its resources into the FPP or refocus on other industries within B.C. Therefore, the FPP has to develop a strategy that will yield a return that is significant enough to prevent the divergence of resources into other segments.

To achieve this, the FPP must develop a plan to address three key areas:

1. How do they retain existing clients?
2. How do they sell more products and services (cross selling) to existing clients?
3. How do they attract new clients into the practice (increasing penetration levels)?

The analysis of the insurance industry, forest industry, and the strengths and weaknesses of Aon and its Forest Products Practice has identified a number of opportunities and threats within each of the three key areas.

6.1 Retaining Existing Clients

The changes in the forest industry are making it more difficult to retain existing clients. Clients are shutting down their operations due to economic conditions and / or larger forest products companies are purchasing them. The FPP's competitors are also feeling the crunch and have started attacking the FPP's current book of business. The competitors are attempting to undercut FPP's service fees, are attempting to hire away senior FPP account executives and are teaming up with new insurance markets that are interested in buying their way into select segments within the forest industry. Clients may also cut the FPP out of the picture and deal directly with the property insurance markets that are able to insure these clients directly.

The FPP may not have any control over which forest companies are bought, sold or shut down, but the FPP does have control over the quality of service they provide to their clients. To help retain its existing clients the FPP has to continue to leverage its competitive advantages. These advantages include the expertise of senior account executives / risk management consultants of the FPP, the ability to leverage its portfolio size to negotiate the best deals and terms

for its clients; and the ability to leverage the corporate capabilities and resources of Aon. The FPP has to realize that it is easier and cheaper to keep existing clients than to attract new ones.

Succession Planning for Senior Account Executives/Risk Management Consultants

The most significant threat to the practice would be one of FPP's competitors hiring away one or more of FPP's senior account executives.

The analysis of the FPP's portfolio indicated that each account executive currently manages a book of business of approximately \$1.2 million in revenue. The FPP generates just over \$6 million in revenue. Therefore, each account executive manages approximately 20% of the FPP's portfolio. Given that these account executives work in relative isolation, most of the clients are more familiar with the account executive than they are with Aon and may be inclined to follow the account executive to whichever brokerage firm they work with.

Account executives may also leave unexpectedly for a number of different reasons without providing an appropriate transition period where the account could be transferred properly to another account executive. This lack of succession planning could also lead to a potential entry point for the FPP's competitors. Clients may see this as an opportunity to try another insurance

brokerage firm given that their main contact is no longer at Aon and their primary ties with Aon have essentially been severed.

To minimize the impact of an account executive leaving the FPP, a formal succession plan should be developed for each account. At a minimum, each account should be assigned a back up account executive that the client is familiar with. This back up account executive would attend and participate in all renewal and stewardship meetings with the primary account executive.

The first step required in this succession planning process is the hiring of entry-level or mid-level account executives. It takes approximately 2 to 3 years of training before account executives would be capable of managing complicated FPP accounts. Senior account executives within the FPP earn in the range of \$150k per year plus commissions compared to entry-level account executives who earn in the range of \$75k plus commissions. With a few years of experience supplemented by a formal training program, entry-level executives could take over certain accounts at a much lower base salary point. In addition, the entry-level account executives would lighten up the load on senior account executives and allow senior account executives to better service their existing clients helping in client retention.

Two of the six senior account executives within FPP will be retiring within the next five years. A third account executive will be sliding into a new position

within the organization outside of the FPP within the next year. This means that approximately 60% of the FPP's portfolio will have to be transitioned to new account executives over the next 5 years. If the average salary of a senior account executive is \$150,000, the FPP will be dropping approximately \$450,000 in base salaries within the next five years. The FPP will have an opportunity to swap out this base salary with salaries in the range of \$75,000 to \$100,000 per account executive. This differential in base salaries should suffice in supporting a formal training program that would help the new account executives understand the specific risks of the forest industry. Within 5 years, the base salary for these three account executives will be 1/3 less than the base salaries of the account executives they replaced.

Traditionally, whenever the FPP loses an account executive they would scramble and have to pay a premium to attract someone who can step in immediately and take over a particular book of business. Developing a formal training program would help alleviate the need for such a knee jerk reaction and would generate even more depth in the FPP. Increased depth within the FPP would further enhance the value proposition of the FPP, smooth out account executive transitions, and ultimately aid in the retention of clients.

Leveraging the Portfolio of the FPP

The FPP has to continue to leverage the portfolio it manages to ensure that their clients are receiving the best combination of rates and terms in the

marketplace. Given the conditions within the forest industry, FPP competitors will be aggressively attacking FPP clients to address the same issues the FPP is attempting to deal with. The FPP has to work with its current insurance markets to help them understand the challenges that the FPP will be facing from its competitors. Insurance brokers will be attempting to undercut brokerage service fees and insurance companies may attempt to undercut insurance premiums to buy business. The FPP needs to leverage the volume of business it places within existing insurance markets to ensure insurance premiums remain competitive in this market place. This does not mean that the FPP should match attempts by insurance brokers to undercut their service fees. Instead, the FPP has to emphasize the value difference that the FPP brings to the table and be ready to justify their service fees to clients.

The economic downturn within the forest industry could force FPP clients to evaluate the feasibility of cutting out the FPP and dealing directly with specific insurance markets. The FPP will have to re-enforce the value that an intermediary brings to the table in terms of claims advocacy, risk control engineering consulting, comparative quotes, reduced search costs, etc.

The FPP has to work with the insurance markets that are capable of writing insurance policies directly to help them understand the implications of offering policies directly to FPP clients. The FPP has to be firm with these insurance markets and be prepared to transfer policies to other insurance

markets if the direct insurance underwriters do in fact offer policies directly to FPP clients. Therefore, the FPP has to be continuously aware of the available markets in order to keep direct insurance writers from cutting out the FPP.

The size of the FPP portfolio should also be conducive for the development of newer more comprehensive insurance products tailored made to meet the needs of the forest industry. The FPP should be able to explore different insurance markets to develop more favourable terms

Leveraging Corporate Capabilities

A strategy for retaining clients could also involve increasing the potential switching costs to clients. If the FPP is able to develop processes that would make it difficult or expensive for clients to switch insurance brokers, the FPP will have higher retention levels as a result. Within Aon, numerous corporate resources are available to the FPP, which could make the FPP unique and valuable to its clients.

Corporate resources are able to create online platforms where clients are able to access all of the their insurance information online, custom designed databases that will keep track of all of their incidences and assign potential loss estimates for each incident occurred, custom designed risk matrix's to determine premium allocation for clients with multiple locations, etc. These corporate resources are available to the FPP at no extra charge to the FPP or the B.C.

region. The FPP should attempt to integrate itself more within their clients' day-to-day business operations. This would help strengthen the relationship between the client and the FPP, increase their potential switching costs, and ultimately aid in the retention of existing clients.

6.2 Cross Selling to Existing Clients

After reviewing the different products and services that Aon is able to offer its clients, it is clear that the FPP has an opportunity to cross sell additional Aon products to its current clients. The FPP should develop a list of products and services that Aon offers which may be of value to the forest industry. This list should be given to each account manager and each account manager should be required to review the list of products and services with their clients at each renewal. This process would not only help cross sell additional products and generate additional revenue for the FPP, but it would also help limit the FPP's potential errors and omissions exposure. If a client suffers a loss and the FPP did not identify or offer insurance products to cover that particular loss, the FPP may be held accountable for the loss. Account managers should be provided with the appropriate training and support to sell these products and services to their clients.

The services provided by the Aon consulting segment are an area in which the FPP could focus its initial cross selling efforts on. An analysis of the

FPP's portfolio indicates that none of the FPP clients utilize the services provided by the Aon consulting segment. The consulting segment on average generates approximately 22.2% of the revenue generated by the risk and insurance brokerage services segment. The FPP, which operates within the risk and insurance brokerage services segment, generated approximately \$6 million in 2005. The introduction of consulting segment services to FPP clients at a rate of 22.2% would equal a \$1.3 million opportunity for growth. The FPP may have to split the revenue with their consulting segment counterparts, but Aon as a whole would benefit tremendously. The cost of selling the consulting segment services would be minimal for the FPP, because the consulting segment would do all of the servicing and would be willing to support in the sales efforts.

6.3 Attracting New Clients

Prior to this analysis, the FPP assumed that it held an overwhelming majority of the forest products market within B.C. After comparing the FPP's portfolio with the entire forest industry market, it was apparent that this assumption was inaccurate.

The FPP currently has an estimated 26% market penetration within the lumber segment, 33% market penetration with the paper segment and 36% market penetration within the secondary manufacturing market. The total revenue opportunity would be greater than \$15 million, which is 2.5 times the

size of the FPP's total portfolio. This clearly indicates that there is opportunity for growth despite the economic downturn within the forest industry.

Marketing Campaigns & Sales Strategies

The FPP has been very successful over the years, despite the fact that the group works in relative isolation from the rest of the company. Aon Canada has recently formed a strategic business planning office and a competitive intelligence group that works with business segments across the company to develop strategic business plans. The FPP should work with this group to map out the universe in which it operates. This will also help identify the resources the FPP could leverage to target specific new business opportunities.

In the past, the FPP has depended heavily on individual account executives generating new business through their networks and cold calling prospects. The FPP has never had a coordinated marketing and sales effort supporting new business development. The penetration level analysis indicates that plenty of opportunities still exist within the forest products industry. The FPP should launch targeted marketing campaigns on the various segments within the forest industry. These marketing campaigns should help open the door for new business opportunities within the FPP.

To take advantage of these opportunities, the FPP should hire a number of entry-level to mid-level account executives that would be able to perform sales

calls. These new account executives would also alleviate the workloads of senior account executives, which would allow senior account executives to make sales calls on larger accounts.

If the total opportunity is estimated at approximately \$15 million, and the FPP sets its sights on capturing 8% of that market year over year, the FPP should hire three entry-level to mid-level account executives. Each account executive should be able to generate on average \$150,000 in new business annually. By hiring three more account executives at \$75,000 per annum plus commissions, the FPP could generate approximately \$1.2 million in new revenue annually year over year (8 account executives x \$150,000). An investment of \$225,000 plus training costs could yield up to a 500% return and grow the FPP's portfolio by 20% per annum. This growth would only be sustainable up to the point where the new account executives fill up their book of business. The account executives that will be retiring or leaving the practice within the next 5 years will also have a dramatic impact on the growth of the FPP. Therefore, developing a comprehensive succession plan is not only vital in retaining existing business, but also in growing new business.

Conclusion

Despite the current economic downturn within the forest industry in B.C., the forest industry will continue to play a critical role within the B.C. economy for years to come. Aon has to realize the importance of the FPP within the ARS B.C. Region as it accounts for 20% of its revenue base. The FPP holds a number of key competitive advantages over its competitors. Aon has to leverage these advantages of the FPP to grow the practice or face the inevitable decline within this segment due to the economic conditions within the forest industry and competition from within the insurance industry. A significant decline in the forest industry segment will ultimately have a significant impact on the ARS B.C. Region as a whole. Aon must view the FPP as a long-term investment in the future of the B.C. Region and continue to allocate appropriate resources to the FPP.

The analysis clearly indicates that Aon's FPP has a number of significant opportunities to grow its current portfolio despite the economic downturns within the forest industry. Although it is critical that the FPP remain diligent in its efforts to retain existing clients, the FPP has to focus its attention on growing its book of business. Focusing on growth will be the only plausible countermeasure to consolidation within the forest industry, which is outside the FPP's control. The

FPP can no longer rest on the belief that it operates within a saturated market when it holds only a third of the market share.

The FPP's expertise and their ability to negotiate the best rates and terms for their clients over a long-term basis are unmatched within the forest industry. However, these strengths have never truly been leveraged in developing new business opportunities. The FPP has to utilize the resources within Aon to develop sales strategies to attract new business or grow existing business. These sales strategies need to be supported by marketing campaigns and driven by business and market intelligence. The only way in which the FPP will be able to grow is by hiring additional account executives. The FPP will have to make this short-term investment in hiring and training these new account executives to preserve long-term sustainability.

Ultimately, the FPP has to adopt an aggressive disciplined sales approach to generate growth and a comprehensive succession plan to sustain the growth. If they do not, the FPP will dramatically feel the effects of the economic downturn within the forest industry in British Columbia, and fall victim to the growth strategies of other insurance brokers and insurance markets.

References

Baye, M., "Managerial Economics and Business Strategy", Irwin, 2005, Fifth Edition.

Boyle, Charles E., "Insurance Journal – World's Biggest Broker Faces Uncertain Future", February 7, 2005.

Broker Insights Quarterly, "Results of the World's Largest Brokers", March 2004

Business Insurance, "Ranking of World's Largest Insurance Brokers", July 19, 2004

Hovanesian, Mara Der, "Business Week Online – British Reserve? Forget That", September 27, 2004.

Insurance Information Institute, "Background on Insurance Intermediaries", 2004.

Roberts, Jack, "Risk & Insurance - Integro: Brokering on Integrity", August, 2005.

Winter, Ralph A., "Journal of Financial Intermediation 3 - The Dynamics of Competitive Insurance Markets", 1994.

Ministry of Forests and Range and Minister Responsible for Housing Website - www.gov.bc.ca/for/

Coast Forest and Lumber Association [CFLA] – www.coastforest.org/

Strategis, Industry Canada – www.strategis.ic.gc.ca

Aon Website – www.aon.com

Marsh Website – www.marsh.com

Willis Website – www.willis.com

IBABC Website – www.ibabc.com