Prepare to profit

David Priebe says the best reinsurers think long-term, even while reacting with agility to short-term events

Tactics should not come first. However, that is where many firms turn as soon as the market begins to change. They may spend years reacting to a soft market, while the time might be better spent preparing for the next hardening. And that day, undoubtedly, will come. For many, a mega-catastrophe would prompt a reactive response; the lack of preparation would translate directly to a lost opportunity. Those who plan now, on the other hand, could capture profitable market share later.

Strategy comes first. This sounds obvious, but in the heat of the moment, it falls victim to expediency. Market conditions dictate near-term decisions, resulting in a de facto strategy over which firms often surrender control. The market, effectively, defines the strategies for reactive companies. Since the market is always changing, firms that focus only on the short-term may unknowingly suffer market-induced change rather than strategic results.

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A measure of relief

Some short-term thinking does provide a measure of relief, and it does play a role in both soft and hard market management. There are times when it pays to plan to the quarter without thinking five years ahead, however, these conditions should be rare. With the next market change difficult to predict, (re)insurers should use current conditions as the foundation for strategic planning, with contingencies to address further softening or a rapid recovery. Operate with the assumption that conditions will stay soft but be ready for the situation to change.

Before tightening the proverbial belt, acquiring or divesting a business unit or making other drastic changes, a firm should decide what it wants to accomplish, regardless of market conditions. Is it content to be a niche player? Or, does it aspire to become a diversified carrier? The plan may be to operate lean and mean or to take the opposite approach, investing heavily in innovation. Whichever course is chosen should become the platform for all future efforts, as these decisions will shape the tactics to be selected and implemented. Action should follow identity.

This sort of thinking is widely accepted. Unfortunately, there is often a gap between theory and execution. An evolving marketplace, the needs of shareholders and increasingly sophisticated buyers tempt (re)insurers to trade the ideal for reality. In the case of the latter, today's events drive the decision-making process. When disaster strikes, for example, (re)insurers seek new sources of capital to refresh their balance sheets. (Re)insurers tend to manage to the present. The acquisition of capital tends to involve short-term thinking, with capitalisation resulting from the availability of traditional sources followed by the sparing use of more exotic alternatives. It tends to be market-determined, not strategic or intentional.

In a softening market, the same underlying dynamic is at work. Incremental pressures lead to incremental responses, such as several waves of cost-cutting. As the impact of the catastrophe wanes, (re)insurers change incrementally, cutting rates (or seeking less cover) bit by bit, as warranted by a slowing market.

The market sets the (re)insurer's trajectory for the future, the (re)insurer effectively cedes the responsibility for decision-making to the market. Consequently, the market itself can co-opt the strategic planning process. It is easy to overlook this problem, as the implications take time to compound. When viewed as a whole, though, the problem becomes clear. Fortunately, the resolution is straightforward, as well. (Re)insurers need to take back control of their strategies from market forces. Deliberate action is crucial. This process starts with defining strategic objectives. Craft a corporate identity, and decide what you want to accomplish with it.

Poised for growth

The point is to poise the organisation for growth. With companies thinking and acting more strategically, they would be positioned more advantageously for execution. The overriding objective should be both near and long-term. By focusing on short-term profitability and growth, while positioning for outsized returns when the market hardens, strategic-thinking firms will be first in line for growth when conditions improve.

The cost of being strategy-deficient can be severe. When the market hardens, everyone will be chasing the same premium dollars. To capture the new largesse, they will scramble to hire and try to cram long-term projects into shorter timeframes. The risk of failure will be high, as will be the cost of success. Competition for capability will be fierce, and the absence of lead time will force (re)insurers to pay a premium for what they want. Those that made strategy-driven adjustments during the soft market, meanwhile, will be poised to deliver — and to benefit. re

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