Boosting Financial Performance Through Stakeholder Management

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The author looks at the critical challenge of cultivating stakeholder relations and how it can significantly impact the financial performance of an insurance company.

The fortunes of an insurance company depend on how it interacts with its key stakeholders: Investors who provide risk capital; clients who put their faith into the insurer's contingent promise to pay and entrust assets to it; employees who offer their intellectual capabilities to a business which is primarily knowledge-driven; and regulators whose core mission is to protect the interests of the individual policyholder.

It therefore sounds trivial that cultivating stakeholder relations is one of the most essential strategic management challenges. Given the specific features of the industry this imperative is particularly true for insurers. All the more surprising is the fact that this notion is neither adequately researched and conceptualized through academic endeavors nor properly reflected in corporate reality. Against this backdrop, we offer some answers to crucial questions such as: "How can stakeholder management help improve the financial performance of an insurance company?" and "Which are the organizational and process prerequisites for reaping the benefits of stakeholder management?"

The 'Stakeholder' Concept

First of all, the 'stakeholder' concept provides a theoretical framework for analyzing the relationships of a corporation with relevant constituencies in its industry, political, social, economic and legal environment. For identifying significant stakeholders, we suggest adopting the following selection criteria: (1) Relevant stakeholders to supply resources that are vital to the success of the enterprise; (2) They place something of value 'at risk', as such their wealth which is directly affected by the fate of the enterprise; and (3) They wield sufficient power to influence the performance of the enterprise, either favorably or unfavorably.

Mounting Relevance of Stakeholder Management

Identifying key constituencies in insurance is all the more important as the management of the industryís stakeholders has globally gained in importance since the 1990s. The deregulation of rates, terms and conditions has introduced a hitherto unknown level of volatility in terms of prices and available coverage, more often than not creating a gap between corporate actions and stakeholder expectations. Another driver of change is the trend towards more frequent and severe insured catastrophes. This development has not only raised concerns about the industryís claims payment

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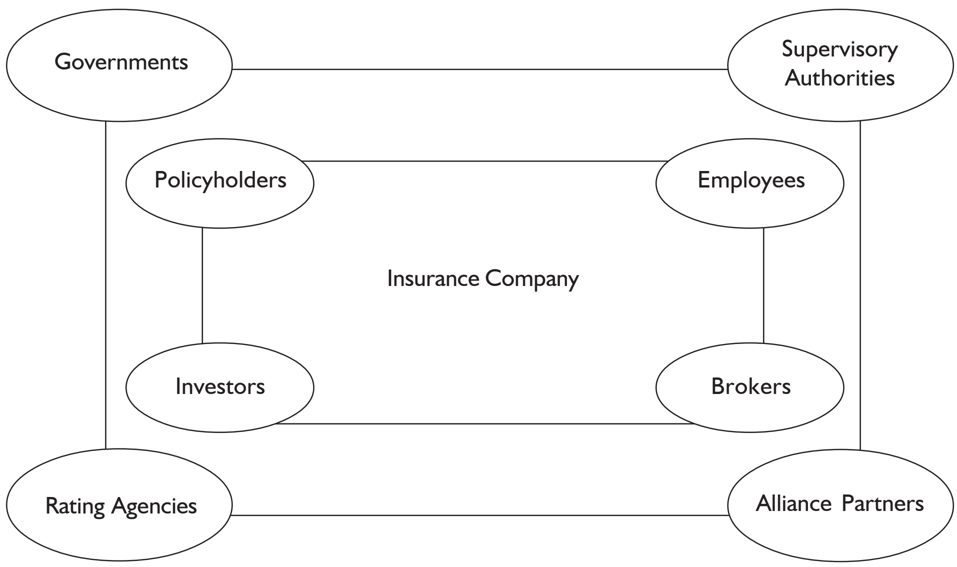
ability, but also forced insurers and reinsurers to increase rates and restrict coverage in order to manage their exposure. Actions like these obviously create challenges in terms of customer relations and the industry's overall public image. Another example is the shift towards risk-based solvency rules which align capital requirements to the risk associated with the underlying business written. These risk-based capital requirements are likely to have a major impact on insurers' portfolio of risks. Volatile lines of business are expected to be scaled back or priced in a way commensurate with their higher capital requirements. Policyholders will be faced with changes to both pricing and product availabilityóand insurers with a major stakeholder communication challenge.

Enhancing Corporate Value Drivers

Against this dynamic backdrop (see Figure 1), favorable interactions with multiple stakeholders are developing into a key contributor to corporate success in the insurance industry. Effective management of these relationships has the potential of enhancing the two most important corporate value drivers: First, the strategic and competitive positioning of the insurance company; and second, the long-term fundamentals of its business environment, e.g., industry dynamics and macro developments in the political, economical, social and technological arena. Stakeholder management can specifically enhance these value drivers by leveraging on internal strengths and capturing external opportunities. Our main proposition here is that the effectiveness of the insurance value chain and the company's ability to create and sustain competitive advantage crucially depends on how it manages its relationships with clients, shareholders and employees, i.e., those constituencies which provide it with the most-needed resources.

Figure 1: Insurers' Dynamic Stakeholder Environment



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To substantiate this reasoning we draw on Michael Porter's famous concept of competitive advantage. Porter basically argued that competitive advantage is a function of either being cheaper or different. The choice depends on the configuration of the corporate value chain, i.e., the way a company designs, produces, markets, delivers and supports its products or services. On this basis, an organization competes either through cost leadership or differentiation which allows it to command a premium price.

Lubricating the Value Chain

Based on our definition of stakeholders and their sensitivities we argue that effective management of these constituencies serves as a 'lubricant' of the value chain. Those companies pursuing a cost leadership strategy will need utmost flexibility in reconfiguring the value chain. They face the constant challenge of switching distribution channels, adjusting the labor force and outsourcing non-core processes. It is obvious that those players that can draw on sufficient goodwill among their key stakeholders will find it considerably easier to execute a cost leadership strategy and manage the conflicts which are inextricably linked to it.

The same reasoning is true for the strategic alternative, i.e., differentiation. One specific example is insurance marketing which is a function of a company's scope for differentiation. Regulatory and legal restrictions as well as societal attitudes towards insurance products and services determine the extent to which a company can pursue a differentiation strategy. This key determinant of marketing effectiveness can be shaped by systematic stakeholder management. As another example, underwriting decisions are not only driven by corporate considerations but can also be significantly influenced by compulsory insurance requirements and public expectations as to insurers' role in a 'caring society'. The industry's overall reputation with the public is a major factor determining the acceptance of underwriting decisions such as increasing rates, tightening terms and conditions or introducing exclusions.

Translation into Corporate Reality

The really interesting question though is how to apply these theoretical insights to commercial practice and organizational reality. Here, we offer two recommendations: First, to adopt a balanced and integrated approach to corporate messaging and, second, to more closely align the corporate planning/ strategy and communication functions.

Developing Well-balanced Corporate Messages

In light of the increasing relevance of stakeholder relations and their management, there is a strong case for an integrated stakeholder communication approach. Such an approach promises maximum consistency, quality and effectiveness. In this context, insurers' stakeholder communication requires, more than ever before, a balanced approach. It is not sufficient either for shareholders or other stakeholders to simply portray a company's current financial performance. In addition, more emphasis needs to be placed on the organization's future prospects within its socioeconomic environment. For this purpose, the ValueReporting approach as developed by PricewaterhouseCoopers serves as a benchmark. According to this approach, it is crucial to strike an appropriate balance among (1) financial and operating performance (the traditional focus of corporate disclosure), (2) the companyís vision, mission and strategic direction, and (3) its competitive position in the industry and overall socioeconomic context. The latter category is gaining in relative importance as stakeholders in insurance companies become increasingly sophisticated and sensitive to the sector's role in enabling and facilitating economic and social stability and progress.

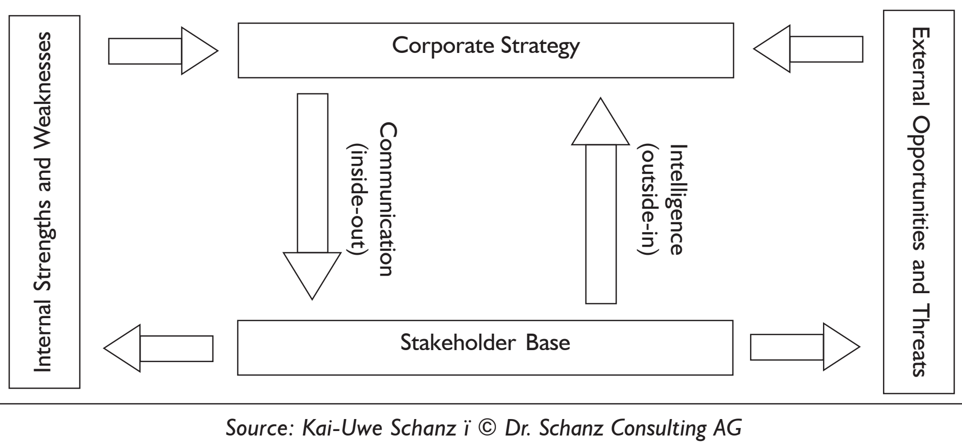
Such an integrated messaging approach not only helps to enhance corporate reputation and build reservoirs of goodwill, it also maximizes the chances of systematically capturing relevant stakeholder feedback which should be an important input for management's regular strategy review process. This leads to the second recommendation for corporate practice, a closer alignment of strategic planning and corporate communication. We suggest two main benefits which can be reaped from embedding an organization's stakeholder management process in its strategy development process.

First, the active shaping of key internal and external parameters which govern an insurer's strategic planning. For example, those companies excelling at investor relations management are set to benefit from a lower cost of capital. Another example, the productivity of an insurer's primary internal resource, its human capital, can be enhanced by effective employee relations, facilitating the achievement of strategic objectives. An insurer may even aim at influencing the overall socio-political environment, e.g., by effective regulatory and government relations leading to additional degrees of freedom regarding product development and pricing.

Integrating Stakeholder Views in Corporate Planning

Another major benefit from a closer alignment of strategy development and stakeholder management is the enhancement of the strategy process by a stakeholder-driven 'outside-in' view. Strategic planning processes are frequently internally biased. There is often a lack of capability for identifying and anticipating external trends and developments , their impact on the formulation of strategic objectives and the resources needed to achieve them. A systematic integration of stakeholder views and sensitivities into the strategic planning process offers a complementary 'outside-in' perspective which can help an organization to improve both the effectiveness and efficiency of strategy development (see Figure 2).

Figure 2: Stakeholder-based Strategy Development



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From an insurer's point of view it is highly recommendable to constantly review the organization's strategic objectives and respective resource allocation decisions against the backdrop of relevant views expressed by policyholders, intermediaries, investors, analysts, employees, rating agencies, regulators, government entities and the public at large. Strategic objectives need to be validated in regular intervals against relevant changes to stakeholder expectations and sensitivities. Failing this, an insurance company may pursue unrealistic or even detrimental objectives.

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