



Brownridge
& Company
Insurance

What's New at Brownridge & Company Insurance

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Consumers Believe Retail Prices Unfair



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We know clients notice price changes when they're going up, as in a hardening market, but don't appear to notice very often at all when prices go down.

Now, there's new knowledge about consumers' perceptions of prices, retail prices at least, and it's not welcome news. Researchers found consumers generally believe retail prices are unfair because companies make big profits. On average, consumers estimated grocery store profits at 27%, while the Food Marketing Institute reports that the average profit in 2001 ranged from 1% to 2%. Consumers also assumed the markup on clothing items in a department store approached 100% of costs.

The researchers tried providing information about cost factors such as inflation, but the perception that prices were unfair still stuck in the minds of most consumers. Even when survey respondents were 'cued' with information about a store's costs or benefits, they held onto their beliefs.

Similarly, researchers went so far as to suggest that a department store might have more selection, better service, and a more pleasant atmosphere. They also referred to critical retail costs such as labour, rent, maintenance, high fashion inventory, administration, and promotion.

All in all, providing information about a store's costs or advantages didn't have a significant effect, but it did move perceptions a bit. So the researchers think a marketing opportunity may exist for what they call 'adventurous' retailers. They point, for instance, to the pharmaceutical industry, which advertises its heavy R & D spending.

The researchers also concluded that some costs issues should not be raised at all, including bonuses paid to senior executives, and promotional costs. And, they found that while consumers were inclined to accept high prices for high quality, they considered high prices arising out of margin strategies or inventory risks as less fair. (Pricing and Fairness: Do Your Customers Assume You Are Gouging Them?, Marketing at Wharton)

Dear Friends:

By the time you read this, insurers will have succeeded in securing whatever capacity they can afford from their reinsurers. The capital crisis for the industry is real, and the ripple effects right down to the consumer are severe.

After years of being ravaged by the soft market, the industry lurched into a tight market at a time when the investment climate was, and still is, one of the weakest since the 70's. So, the combination of poor underwriting results, poor investment returns, eroded capital bases with no new capital on the horizon, chaotic reinsurance markets, and massive increases in the cost of capacity, leave the industry with only two avenues to pursue – underwriting profit and expense reduction.

One sure route to underwriting profit is for prices to recover back to the level that consistently delivered combined ratios of less than 100. That level hasn't been seen by the industry as a whole since 1978 – a rather staggering reality. Insurers generally enjoyed fairly decent investment returns, thus “allowing” the combined ratio at times to be considerably higher than 100. Those predictable investment returns also encouraged the tight market periods to be relatively short – usually two years. Those eras didn't experience the financial scandals that we've seen over the past year, nor did they ever experience a 9/11. Neither did they see a dot com bubble-burst and tech crash, the magnitude of which was shocking. Investment markets were more stable in those previous cycles, and there was an undercurrent of confidence in the belief that blips were truly temporary, and that investment returns, while not Herculean, were sustainable.

No more. The world has inexorably changed and smart people have awakened from their slumbers. There truly is new risk in the insurance world that was never before fathomed, not just in day-to-day risk selection but also in pure preservation of capital. The industry, from investors and reinsurers on down, has been shaken to its core; indeed, it has been forced to finally realize what its core really is.

Just as North America will never feel safe again and strict security measures are becoming a part of daily life, the financial world will build similar cocoons and is already in the process of doing so in all sectors. The insurance sector is no different. The cost of capacity is dear, and every rate increase that brokers and clients see includes a large chunk just to pay for the capacity that an insurer has to buy from a reinsurer. These are fixed costs that have to be passed along on every risk, good or bad. When an insurer has to pay those costs on every dollar of premium it writes, very little discretion can be allowed at the underwriting desk.

I'll go out on a limb right now and predict that at least for the next decade, we will not see the hyper-competition that the industry has brought upon itself in previous loose markets. I believe that there will be two more years of price increases, out of necessity to replenish capital and cover capacity costs, followed by a period of stabilization with some minor softening.

The industry will have no choice but to responsibly control the elements of its business that it should have some control over, those being underwriting results and cost containment.

Yours truly,

P. A. Parkin

Chief Operating Officer