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**DEVELOPING A DIFFERENTIATION STRATEGY OF A CAPTIVE INSURANCE COMPANIES CASE STUDY
OF PT XYZ**

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Abstract— *PT. XYZ (XYZ) is an Indonesian captive insurance company which provides various general insurance products. In this research, XYZ's differentiation strategy will be crafted by going through the strategic management process by using SWOT and five forces analysis. Based on the result of the environment analysis, XYZ's differentiation strategy are determined and discussed. In a nut shell, XYZ's strategy is to "achieve its vision e.i. To be The Most Admired General Insurance Company by offering innovative risk protection solutions."*

Keywords: captive insurance company strategy, strategic management, differentiation strategy.

1. Introduction

The Indonesian insurance industry has grown rapidly for the last decade. A study by PT Infordev Aditama reported that it grows more than 20% per year. However, the insurance industry only contribute 1,7% to GDP. Total gross insurance premium of Indonesia general insurance industry in 2010 is 28 trillion rupiahs and in 2011 is 32 trillion rupiahs. PT. XYZ (now hereafter called XYZ) is one of the major players in the Indonesian general insurance industry. Current studies have shown that XYZ has always won prestigious awards from years since 2004. Most of XYZ Insurance revenue comes from group business (captive market), around 65%, the rest (35%) comes from non-group business. XYZ sells mainly motor insurance products (63%) and only 37% of its portfolio consists of non-motor insurance products.

In line with the mission of XYZ Insurance to expand the line of business in Non-motor Vehicle Class of business area, it seems that the current strategy needs to be shifted to this sector. In doing so, a new strategy is essential to develop and introduce new non-motor insurance products. This research project focuses on this important issue and is structured as follows. It will begin with the profile of XYZ Insurance followed by exploration of business issue, business analysis and solution, strategy implementation and conclusion & recommendation. Conceptual Framework. Recently, insurance industry has grown into a huge, dynamic and prolific industry in Indonesia and overseas as well. The emergence and growth of middle class consumers in most countries and the increase of companies dealing in a diverse of industries need cover to anticipate and cope with the uncertainty. The cover (insurance) is also required as a buffer to business longevity.

Life insurance industry growth was around 20% between 2006 to 2010. Meanwhile, in average, the gross premium of non-life insurers grew 20% in the same period. In 2010, combined growth of insurance industry, life and non-life, was 18.19% and profit increased 22% from 2009. On the other hand, 19 non-life insurance companies booked decreasing premium income although profit of general insurance companies increased by 29.33%. According to data of Biro Riset Infobank, there were 12 non-life insurers and 2 life insurers who have capital less than IDR 40 billion. Minister of

Finance requires insurance companies to have capital of IDR 40 billion by the end of 2010, IDR 70 billion by the end of 2012 and IDR 100 billion by the end of 2014. These capital requirements are set to cope with the dynamic business growth and to maintain the financial health of insurance companies. The regulator (Indonesian government) forces the insurers to have RBC (risk-based capital) of 120% to minimize the risk of unpaid claims.

In 2011 several insurance companies were taken over by new investors, such as Avrist, MNC group, BESS, Malacca, BCA and foreign investors due to the inability of their shareholders to inject more capital and the opportunity of business growth offered by this industry. Early in 2012, Jaya Proteksi, one of top motor insurance players, was acquired by ACE INA, a Switzerland-based global insurance company. The majority of new investors are financial institutions who want to synergize their businesses within one stop financial solution by setting up an insurance company to create a vertical integration.

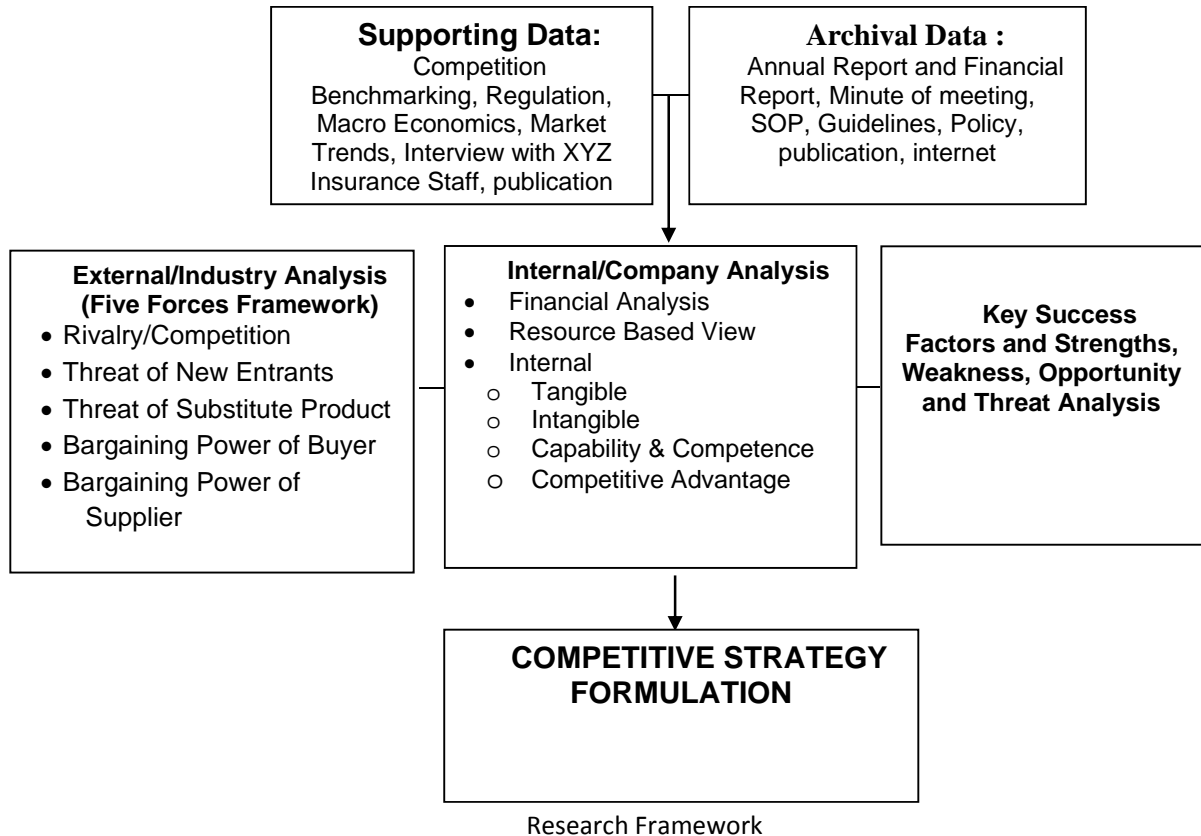
Indonesia is the fourth most populated country in the world with about 250 million people. This fact together with the growing of middle class in the country and its economic growth have attracted many new investors to enter the insurance market. Another important reason is that the insurance penetration in Indonesia is still considerably low. In fact, insurance penetration in Indonesia is the lowest among ASEAN countries. Compared to Japan, for instance, whose one citizen has two insurance policies (200% penetration rate), insurance penetration of Indonesia is below 1%, meaning total policies issued are less than 2.4 millions (InfoBank July 2011; Axco Report 2011) in general insurance. While in life insurance, the number of individual policy was 9.43 millions in 2011 (Investor Magazine, July 2012). It means that the life insurance penetration is much more higher than general insurance. It may suggest that most Indonesians still perceived that life insurance is the main business of insurance and they were not familiar with other insurance products. Of 85 non-life insurance companies, top 10 companies contributed about 54.97% of the premium income and 75 companies booked about 45.03% of premium income. It may suggest that the top 10 companies have been dominating the industry. The most difficult position was experienced by 20 lowest performing general insurance companies that are struggling to increase capital requirements and to compete with the 65 companies.

Insurance companies that fail to achieve capital requirement of IDR 40 billion by March 2011, were required to make a business plan submitted to Minister of Finance and subject to close monitoring. The companies that have fulfilled this requirement are still haunted by the capital requirement of IDR 70 billion by the end of 2012 and IDR 100 billion by the end of 2014. Even there is no enforcement of the regulator; insurance companies must build their financial strength by adding the capital to expand the business. Without adequate capital, insurers are hard to compete and employ risk management as the basic principle of insurance business.

Until the time of writing this final project report, PT XYZ Insurance is still capable to appeal around 5% of general insurance domestic market in Indonesia in terms of net premium income. Therefore, in order to achieve its objectives, PT XYZ Insurance must continuously evaluate and analyze its strategies and performance to measure the economic and financial impacts of the company's previous management policies in several aspects, like investments, operation, capital, and company strategies. The results to this evaluation and analysis can be used to assess the condition of general insurance industry externally and internally (of PT XYZ Insurance itself), and also to develop relevant appropriate strategies needed to win the competition in the Indonesian insurance business.

2. Research Framework and Methods

Based on the strategic management process, the research will be organized using the conceptual framework depicted in.



The input of the research will be the business issue, which is “XYZ needs a Strategy”.

In the process phase, analysis of the business situation will be performed, which include external environment analysis of XYZ and internal situation analysis of XYZ.

The external environment analysis consists of:

- **The macro environment analysis**, where the macro environment conditions that have impacts to the company
- **The industry environment analysis**, where industry environment competitiveness is being analyzed using the five-forces model of competition (Porter, The Five Competitive Forces That Shape Strategy, 2008)
- **The competitor environment analysis**, where the company’s competitors are being mapped.

The internal situation analysis consists of:

- **The resource based analysis** (Barney, 1991), where company’s resources and capabilities that are competitive advantages are being identified.
- **The SWOT analysis**, where the company’s Strength, Weaknesses, Opportunities and Threats are being identified.

The output of this research will be the a differentiation strategy for sustainable growth.

Another output of this research is the implementation plan for XYZ as a base for executing the strategy.

A. Method of Data Collection and Analysis

The methods of data collection used in this research include interviews, field study, observation and archival study. Interviews will be done with individuals who are responsible in running and monitoring XYZ’s management. These primary sources include management executives and advisory board of XYZ. Unstructured interviews with the identified primary sources will be performed.

Observations are also used to learn from experiences and behavior of XYZ’s performance, customers, suppliers, competitors and human resources.

Archival is done extensively for finding the suitable theoretical backgrounds, gaining information on the macro environment, industry environment, and competitor environment, company documents including policy, guidelines and minute of meeting, publication and reports.

B. Analysis of Business Situation

1. Macro Environment Analysis of XYZ

The following is the result of the macro environment analysis based on the PESTEL dimensions. In the political dimension, it can be observed that the government's increasing awareness in capital requirement and supervision are a barrier entry for new insurance company. In the economical dimension, it can be observed that the promising economic growth of Indonesia will create ample opportunities for insurance need.

In the socio-cultural dimension, it can be observed that transformation of culture in Indonesian society to become more appreciative of quality, standards and efficiencies, will create a conducive environment for insurers providers in offering and implementing their risk solution. In the technological dimension, it can be observed that smart systems and internet of things are going to be a big trend, in which, XYZ is one of the pioneers to implement these technologies. In the legal dimension, it can be observed that agent certification, regulation on product registration and implementation of IFRS are quite a challenge in Indonesia, but it can be done. From the five dimensions analysis, we can derive a conclusion that there will be ample opportunities for insurance companies in Indonesia.

2. Industry Environment Analysis of XYZ

According to (Porter, *The Five Competitive Forces That Shape Strategy*, 2008), the attractiveness of an industry depends on the strength of the five competitive forces that influences the industry. These five competitive forces model will be used to analyze the attractiveness of the general industry in Indonesia. In this industry, the competitive force coming from new entrants is basically weak. It can be concluded that entering this industry is not easy. First finding and maintaining human resources who has expertise is not easy. Second, developing network outlet which is required for ensuring the quality of service and accesibility. Third, high massive capital requirement are required to gain market in this industry.

The second competitive force comes from the supplier position. Insurance company need reinsurance back up to cover larger risk than its financial capacity. Reinsurance will smooth the underwriting result. There are very limited reinsurance company in Indonesia and foreign reinsurers offer higher reinsurance price than local reinsurers. This makes the bargaining position of insurers weak. The third competitive force comes from the buyer's position. The market for insurance industry in Indonesia is growing fast; therefore the industry players will have the luxury to choose the buyers that suits their strategy. The fourth competitive force comes from substitute products. The substitute of insurance product would be self-insurance, alternative risk transfer and non-insurance risk transfer. Insurers will have a weak competitive force toward the product substitute, since there are there alternatives.

The last competitive force comes from the existing competitors. Due to the fast growing market of the industry, and the fact that each player has their own market segments, competitive force from the competitors are generally moderate. Based on the fact that competitive forces from all five directions are generally weak, we can derive the conclusion that the insurance industry is an attractive industry.

3. Competitor Environment Analysis of XYZ

Most local captive insurance companies are also selling motor and property insurance products. They normally propose risk solution for a certain market segment, for example leasing company, banking, corporate client or others. These companies are using the needs-based strategic positioning and access-based positioning. Needs-based positioning because normally they try to fulfill the needs of

their existing clients. They use access-based positioning in order to make themselves available to prospective customers through direct sale, using intermediary or strategic partnerships with other companies which have access to the customers.

Insurance ratio analysis of top 6 captive insurance companies: XYZ, Simas, AAB, Aswata, ACA and TPI was conducted. XYZ's close competitors include Astra and ACA. These three companies are also using needs based positioning because they are trying to fulfill the needs of their existing clients, while they use the access-based positioning in order to make themselves available to prospective customers through direct sale, using intermediary or strategic partnerships with other companies which have access to the customers or marketing intelligence to find access to the customer. Despite being competitors, these companies can also cooperate with each other in order to cover high sum insured risks.

4. Internal Situation Analysis of XYZ

SWOT analysis of XYZ in a Nutshell in following paragraph. The competitive advantage resources and capabilities which are being identified in the Resource-Based Analysis become the Strengths of the company.

Strengths

Based on the previous internal company analysis, the followings are the strength factors own by XYZ Insurance:

- Strong financial performance, big asset value and high equity
- Strong corporate and product brand
- Nationwide network coverage, has more than 40 outlets
- Operational excellence
- Good service and improvement culture
- Have vast amount of customer database
- Associated and linked with group (captive) : Bank ABC and DEF Finance
- One of the best sharia insurance operator in the market

Weaknesses

- Lack of non-motor insurance knowledge and support especially in remote outlets
- Very tight close monitoring from Bank ABC
- Limited non-motor reinsurance capacity especially for account with very high of sum insured.
- High portion of captive business (65% of total portfolio)
- High percentage of motor insurance business (70% of total portfolio)

Opportunities

- Strengthening retail (personal line) insurance products
- Expanding to under penetrate market
- Open branch or subsidiary in ASEAN countries in response to AFTA in 2015
- Business alliance or partnering with business partner
- The growth of Indonesia economy
- The growing of middle class
- The growing of Islamic Economy in Indonesia
- Sharia Insurance (takaful) is a product of choice and become a lifestyle
- Insurance awareness, need and the coming of compulsory insurance products

Threats

- Coming of foreign insurance company from ASEAN countries
- Financial Service Authority
- Non-motor tariff

- Declining in motor business
- Global recession
- Price of reinsurance
- New regulation on limiting growth
- Catastrophic event and natural disaster
- More strict regulation
- More strict monitoring of the regulator
- Financial Institutions especially bank form their captive insurance companies

C. XYZ's Differentiation Strategy

XYZ aims to grow sustainably and profitable by employing a differentiation strategy as follows:

1. **Increasing non-captive insurance business to reach the same level of premium income as captive's.**

The dependency in captive business have to be reduced. The ideal portfolio ratio between captive and non-captive is 50:50. In 2011 the ratio was 65:35. The captive premium income was Bank Danamon, around 30%, and the rest (70%) from XYZ Finance.

2. **Developing innovative retail non-motor insurance products to balancing motor insurance premium income by creating product and service innovations to boost business especially from non-captive and non-motor insurance business.**

As of 2011, XYZ motor insurance business is around 70% of the company portfolio. If XYZ want to balance between its motor and non-motor insurance business, the question is which non-motor product to expand?

XYZ have to grab property, marine and accident & health insurance premium since these Insurance Class of Business rank number 2,3 and 4 in term of premium booked by the general insurance industry (AAUI, 2012)

XYZ may continue the innovation using e-insurance application such as:

- Extending e-policy to non-motor insurance products
- Extending e-claim to non-motor claims
- Creating e-report to consolidate all essential report
- Creating e-reinsurance module for ease of reinsurance placemenet and monitoring.

3. **Using existing customer database, network and partnership to expand sale**

Doing a cross sale to existing or even ex-customer is a good strategy to boost XYZ business. Concern mainly will be focused on non-motor and non-captive business. XYZ have 453 active agents who sell mostly motor insurance products, 450 car workshop partner, 2 computer sole distributors, 2 bicycle manufacturers, one hand phone distributors and 2 motor car sole distributors. These business partners must be encourage to sell XYZ's products.

In addition, having 5.7 million customers is an advantage. XYZ can offer other insurance product to these customers and create marketing initiatives & promotions to expand sale production from these existing customers.

4. **Enhancing operational excellence in managing non-motor business**

In the initial establishment, XYZ was set up to write motorcycle insurance only from it parent company (XYZ Finance). Then after XYZ was acquired by PT. Bank Danamon Tbk in 2004, there is a need to cover non-motor insurance especially from Bank Danamon.

The first step is by developing operational infrastructure to support existing non motor business to selected office outlets where they act as a hub for the nearby outlets. The next step is to increase the other outlets operational infrastructure to enable them operate the non-motor business.

5. **Expanding business by acquisition, going regional, vertical integration or increasing takaful business.**

There are some options to grow XYZ business faster::

- Acquire local insurance companies which have big non-motor insurance portfolio
- Open branch or subsidiary in the foreign country mainly in ASEAN countries in response to ASEAN community (AFTA) in 2015.

- Establish companies that support its business such as repair car workshop, insurance broker or even invest in reinsurance companies
- Boost and spin off its takaful business unit

Conclusion and Recommendation

Conclusion

The main objectives of this final project report is to evaluate the strategic position of PT XYZ Insurance using both internal and external strategic analyses and to formulate appropriate alternative strategies to pursue in order to achieve its mission to be the most admired general insurance company in Indonesia. Based on the comprehensive analyses, below are the main conclusions of this report.

1. Indonesian insurance business is a relatively highly intensive competitive industry. However, PT XYZ Insurance has enjoyed an ideal position of being the market leader of general insurance in Indonesia. However, many challenges faced by the company in its efforts to realize its mission to be the most admired general insurance company in Indonesia.
2. Five appropriate alternative strategies have been identified for PT XYZ Insurance. They are: (1) increasing non-captive insurance business to reach the same level of premium income as captive's; (2) developing innovative retail non-motor insurance products to balancing motor insurance premium income by creating product and service innovations to boost business especially from non-captive and non-motor insurance business; (3) using existing customer database, network and partnership to expand sale; (4) enhancing operational excellence in managing non-motor business; and (5) expanding business by acquisition, going regional, vertical integration or increasing takaful business.

D. Recommendation

In order to win in the market in the future, PT XYZ has to reshape its strategy by focusing on developing retail non-motor insurance products mainly in Property, Marine and Accident & Health Insurance Class of Business by using its existing strength in retail operational excellence, enhancing its superior motor insurance business, while keep improving its retail non-motor operation. By doing this, PT XYZ will not rely too heavily on its captive market. At the same time, it can expand its market by providing broader choices of services for customers.

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