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STRATEGIC OPTIONS FOR INSURANCE COMPANIES IN THE 1990's

The Strategies of a Southern European Group

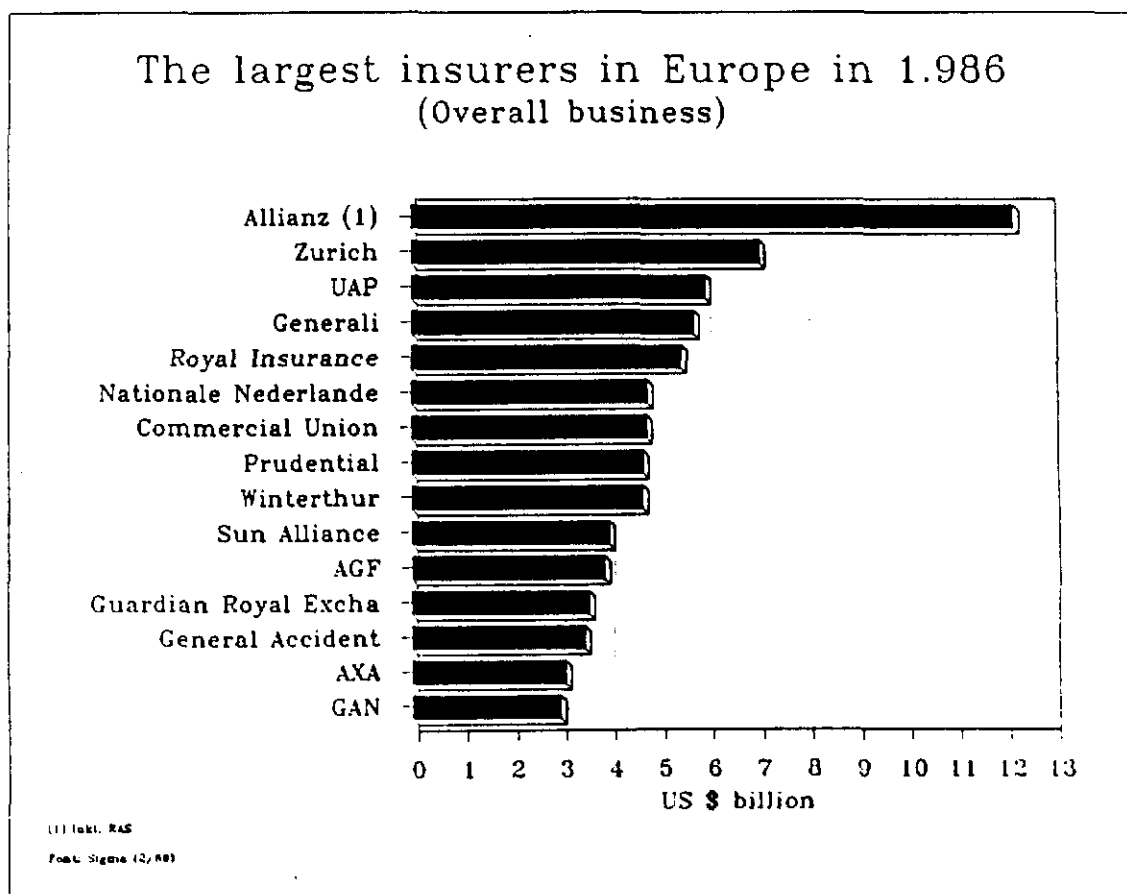
by Domingo Sugranyes
MAPFRE

1. A GLOOMY BACKGROUND

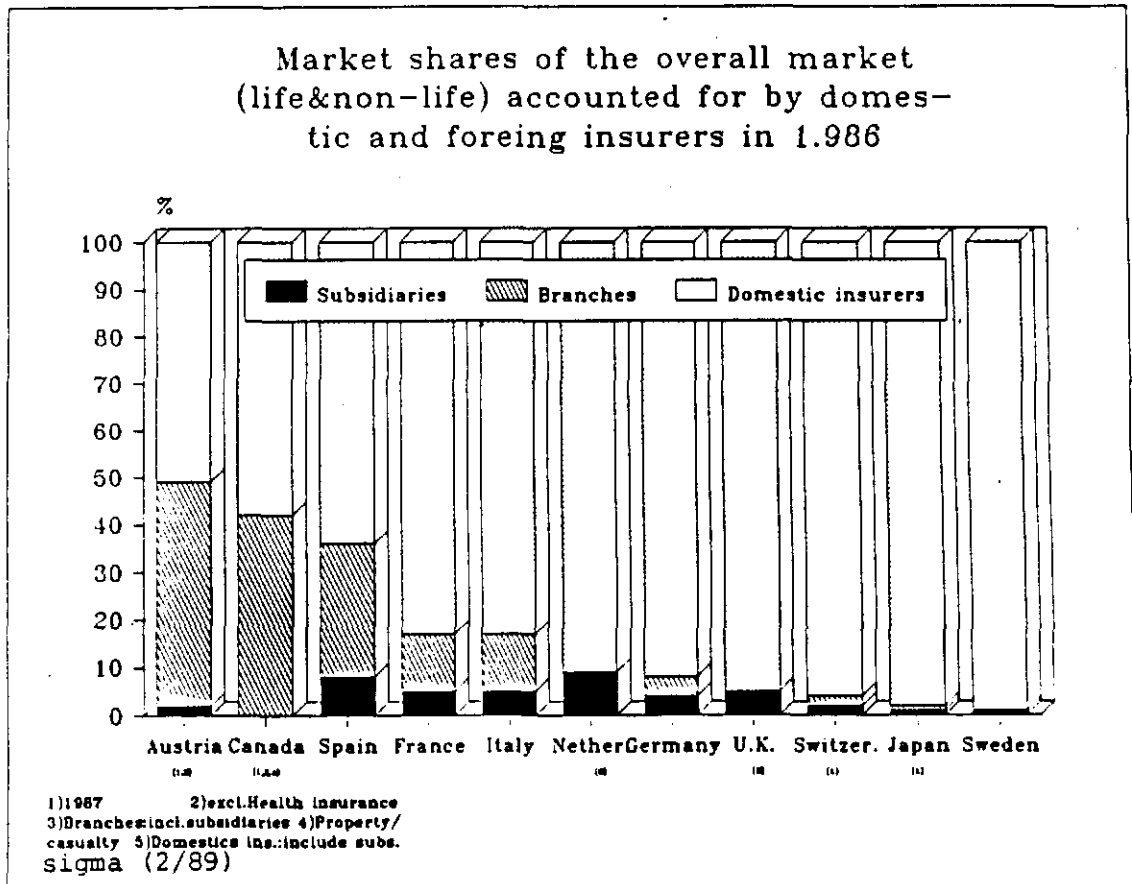
It is a great honour for me to speak here on such a challenging subject, and especially to do so after our excellent friends and colleagues of BALTICA. But I can't avoid asking myself: why did the organizers of this Conference ask MAPFRE to speak on this panel? We are certainly not one of those large "European" Groups -or, should one say, more accurately, Italian, German, Dutch, Swiss, or French Groups..... cultural differences are still strong among us! -which by their very dimension and power can naturally pretend to be already present everywhere in Europe, ready to act immediately in one single market. MAPFRE is a medium sized Group by European standards, with a very strong network in Spain, but only initial presence in Portugal and Italy. So why us?

In a recent issue (2.1989) of its excellent publication SIGMA, the Swiss Re gives an interesting view of the relationship between market-shares and size in each European Country. (By the way, I may say that we have courteously protested with the Swiss Re as the premium figure given for our group in 1987 is too low

by 20% approximately. I presume not all subsidiaries of the MAPFRE Group were taken into account in the calculation). The thesis in any case is not very favourable to a group like ours: all statistical evidence seems to indicate that, the larger the insurance market, the greater the average size of the leading insurers on that particular market. Thus the entire European single market, with its 320 millions inhabitants, will probably give raise to larger average insurers, and one might imply, right or wrong, that those already large today will grow more, by themselves or by acquisition, and profit more from a wider market. And as you well know, there is no Spanish group among Europe's largest insurers!



From another point of view, Spanish insurance in general also offers the image of weak resistance to foreign presence. While being one of the least concentrated markets on the continent, Spain also is, after Austria, the country with the largest market share accounted for by foreign insurers. It was about 30% in 1987 and was more in 1988.



All these figures have been commented upon and analyzed very often and I just wanted to mention them at the beginning, to set

the background which, on the whole, is rather negative and unencouraging for a group coming from one of the weakest corners of the European single market.

Not only are the odds against our expansion across Europe. Even in our own country the EC single market seems to challenge our position and future:

- Foreign insurers have the means to invest large amounts and acquire business, whatever the cost and losses involved, just in order to build-up their market share from which in future they could easily dominate Spanish insurance. This is happening to a certain extent now, and it is undoubtedly true that dimension as such is a strong starting point to take positions abroad.
- Consumers in regions of Southern Europe (Spain, perhaps Portugal, the South of Italy and Greece) seem to have a certain bias towards foreign companies and products, while the North, generally speaking, believes in its own companies. Thus for example there could be a flight towards foreign companies and foreign products in Life assurance, specially towards those denominated in Northern European currencies.

- Spain was until recently a relatively protected insurance market; margins are now due to fall as a consequence of competition both foreign and internal. This is true probably for Non-Life, Non-Motor mass products, where claims ratios in our country are still very good, and also for the Life business where margins are already growing smaller. That kind of competition already affected years ago the area of industrial risks, and the trend will continue.

- The cost of distribution will be the key to future success, and Spanish companies in general have relatively high external and internal costs, while banks and savings banks will be able to use their existing networks at a small marginal cost to distribute insurance.

So we are threatened on all fronts, both by foreign insurers and, on our own ground, by banks and savings banks. So what? I suppose you did not invite us here to hear the complaints or to look at the desperate attacks of some weakening Spanish bull. We are supposed to have answers, or at least to be looking for answers to all those ills. And in fact we are doing so.

But first of all I would like to give you an image of the Spanish market and MAPFRE's position.

2. MAPFRE ON THE SPANISH MARKET

The Spanish Insurance market is growing strongly in all classes of business:

I T E M S	1.985	1.986	1.987	1.988
LIFE	621	2.925	3.214	5.910
MOTOR	1.424	1.689	2.488	2.991
OTHER NON-LIFE	2.410	2.709	2.895	3.419
T O T A L	4.454	7.323	8.597	12.320

* in Million ECUs (year average rate)

** source: UNESPA

Insurance premiums per head were 89,3 \$US in 1.985 and 280 in 1.987; this is still low compared to most other European countries, but the trend is strong.

The spectacular increase in life premium however was partly due to a big boom in short-term Single Premium policies, which were actively promoted by some Insurance companies (mostly subsidiaries of Banks and even, in given cases, by three regional Savings banks) as a supposedly effective tax shelter. This was a negative fact for the Life Assurance industry: after two years the Government abruptly stopped this practice with

some adverse consequence for the good name of all the Insurance sector - something which was perfectly unfair since the problem was really created by other financial institutions. In any case situation will not affect life assurance for too long, since its attractiveness both as investment and (legal) tax-effectiveness remains untouched.

The ranking of the main Insurance Groups in Spain in 1988 looks as follows:

SPANISH INSURANCE: 15 MAIN GROUPS

G R O U P O W N E R	MARKET	TOTAL	LIFE
	SHARE	PREMIUMS	SINGLE P.
	%	ECUS.MIO.	% OF
			TOTAL P.
BANCO BILBAO-VIZCAYA	18.8	2.318,5	80,2
BANCO ESPAÑOL DE CREDITO	6.1	755,0	58,1
MAPFRE	5.2	636,8	12,1
BANCO CENTRAL	4.7	582,0	18,8
CAJAS DE AHORRO	3.7	456,7	84,6
BANCO HISPANO AMERICANO	3.2	392,2	62,9
ALLIANZ-RAS	2.9	363,4	49,4
ZURICH	2.2	267,4	7,8
MUTUA MADRILEÑA	2.1	256,0	0,0
CATALANA	1.9	231,9	11,8
WINTERTHUR	1.9	231,8	0,0
I.N.I.	1.5	182,2	50,6
GENERALI	1.4	175,8	34,9
BANCO SANTANDER	1.4	170,0	95,1
BANCO ZARAGOZANO	1.4	168,7	91,4

These 15 groups add-up to 58% of the whole market, which still has a very low degree of concentration. Among the largest groups 7 are owned by Spanish Banks, 4 are foreign owned, and only 4 are independent, MAPFRE being the largest.

Results are generally good, except in Automobile Insurance, where the adaptation to EC coverage standards means insufficient claims reserves and insufficient premiums for the sector as a whole.

MAPFRE's progress in insurance and reinsurance in recent years can be summarized in the following figures, which include foreign subsidiaries:

MAPFRE

	1.985	1.987	1.989
LIFE	8,167	16,616	E 33,000
MOTOR	15,369	37,250	E 46,000
OTHER NON-LIFE	15,223	24,081	E 71,000
WORKMEN COMPENSATION	19,685	30,081	E 45,000
TOTAL MAPFRE	58,444	108,028	195,000

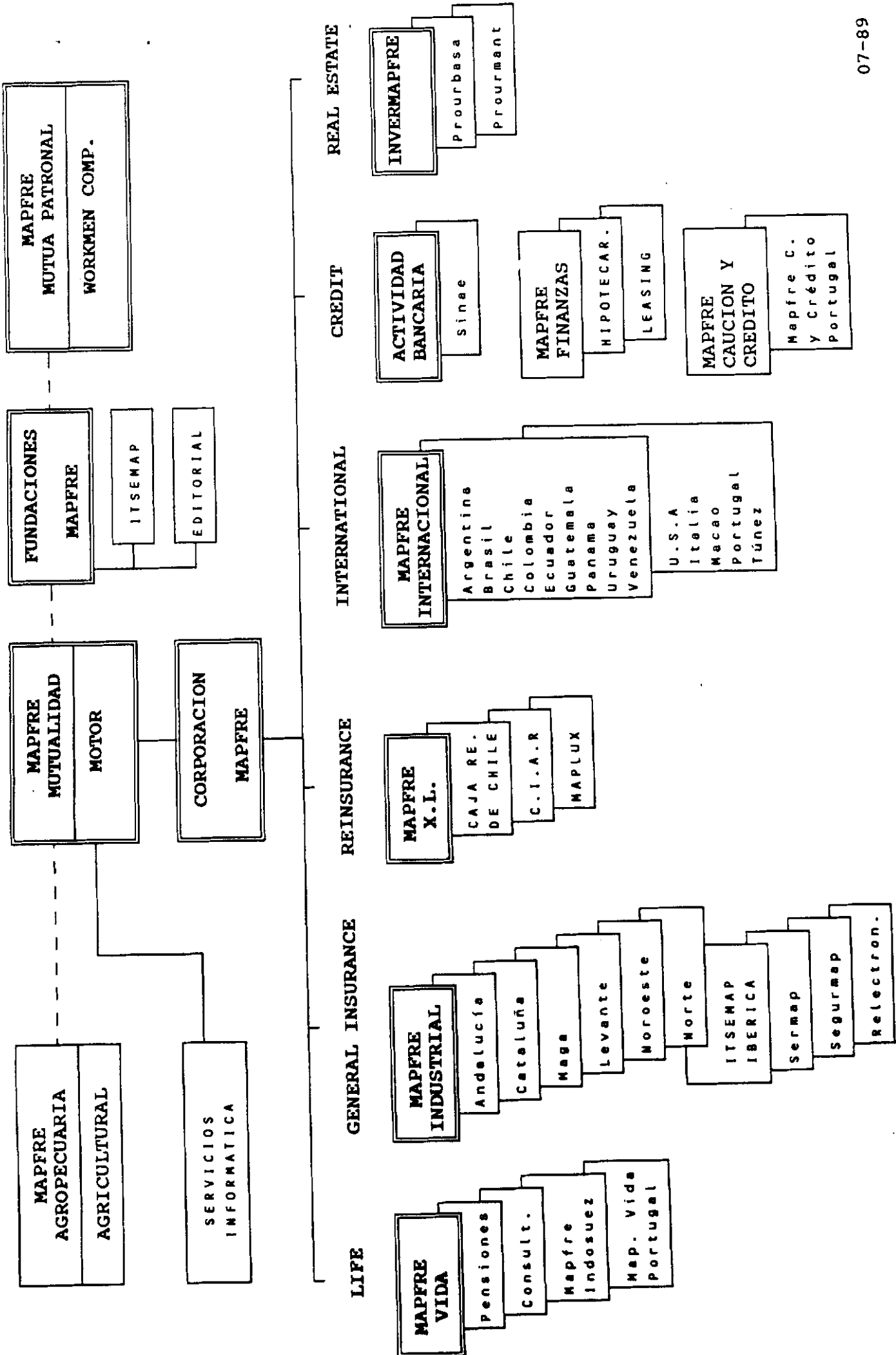
* in Million Ptas.

The MAPFRE Workmen's Compensation Mutual is separated from the rest of the Group as provided for by Spanish law, but it remains a very important part of our family, with more than 15% of the whole Spanish industrial workforce insured.

The origins of the "MAPFRE System" are in an agricultural landowners' mutual, created in the thirties to insure specially accidents on the farm. Its present development started in 1955, when it was a very small, practically bankrupt company. Today it is the first name which comes to mind to the Spaniard in the street when talking about insurance (according to a survey made by an independent institute, ICEA, in 1988).

At present we have 1.600 offices in Spain, which means every town and village. This large sales network is organized according to a "matrix" structure, with strong autonomous regional divisions combined with vertical technical and computer-system integration. Decentralization is extremely developed in the Group, both regionally and among companies specialising by products.

Here is a chart of the MAPFRE Company structure:



3. STRATEGIC VIEWS

The specific question I was asked to deal with is: what are the strategic options for a group like ours? One could certainly design several possible aims and policies in theory. But in practice things develop a slightly different way: MAPFRE has a set of strongly established principles of a rather general nature. Then we develop different strategies for each area of business and each geographical division according to opportunities and the human elements we have or can find in each of them. Our way of adopting aims and deciding on the ways and means to get to those aims remains until now very informal and pragmatic.

Our chairman Ignacio Hernando de Larramendi, in a recent speech given in Milan to the Association of European Cooperative Insurers, did a thorough analysis of the principles which guided MAPFRE's development first in Spain only, now in Spain and in other countries. Here is his list of "MAPFRE principles":

- Services based close to the client.
- Technical and operative specialization.
- A preoccupation with quality of service.
- Transparency and legality.
- Prudence and austerity.
- Flexibility and structural adaptation.

These principles combine strong fidelity to MAPFRE's original roots in the mutual system together with maximum flexibility, the most advanced computers and communication systems, and strong auditing structures.

To summarize all this in just one basic idea: as you have seen from our chart of companies, we have a great number of small, decentralized units. Whatever the structure -it was changed several times in the last few years and has to evolve as the group becomes bigger- the main thing is that each operational manager has the possibility and is encouraged to go as far as possible in his own business area (or geographical division), without limitations of a bureaucratic character. To maintain this aggressiveness and lack of barriers at all levels requires a constant battle against bureaucracy. As on the other hand you could easily fall into anarchy with such a complicated chart of companies and mini-sovereign managers, a balance has to be found between keeping this lively decentralization in the group and giving it a reasonable amount of organized structure. That is why, as I mentioned above, we have just reorganized into seven main autonomous operational units, and each of them will have in future its own separate personnel and computer systems, while the group structures will be reduced to a strict minimum (common principles, audit, common financial

policy). But above all, we hope to maintain a kind of organization where each single manager benefits from the whole, without having to suffer from it.

More precisely, what do we think we should pursue in each area of business?.

A. Market share increase in Spain

Spain is a strongly growing insurance market and there should be space for everybody. We certainly intend to profit as much as possible from our present advantage of having 1.600 offices everywhere in the country and a strongly motivated selling machine. We are going to do it as before, mainly by developing our own organization, and not through acquisition of other insurance companies. It would be very difficult to merge any existing Spanish agents or employee network with ours, given the strong differences in mentality, and operational habits. We did include in the Group another agricultural Mutual which had been founded the same year as MAPFRE, and is now part of our System under the name MAPFRE Agropecuaria. Another combined effort was made in the Canary Islands, where Mutua Guanarteme and MAPFRE joined forces to form MAGA, a company which has 30% of the local insurance market. But these were special cases of friendly mergers, not acquisitions.

In each class of business a special approach is needed:

- In the Motor Insurance business where, as mentioned, results are presently very bad, we believe that the future depends on good service to the insured. We have presently more than 122 quick claims adjustment and payment centres and a 24 hrs full assistance centre covering Spain and Portugal (with our own organization). An improvement in results will be obtained partly through higher premium rates, but above all through quick settlement, full control of the repair cost tariff (through our own repair and safety research centre) and permanent management control (our quick results assessment allows local managers to know their real business results within a week after each month end).

- In Life Assurance our network is evolving into a group of specialized financial advisors to families and private clients, with a range of products covering all types of mixtures between pure risk and mostly financial products. In spite of the image problems created by the "pólizas de prima única", already mentioned, we think combined "savings plus life" assurance products remain extremely attractive in Spain, both for return and for tax-efficiency,

and companies like ours, which were little affected by the "primas únicas" scandal, will quickly return to strong growth. As a complement for Life assurance we see the distribution of investment products, like investment funds, and we have therefore established a specialized "financial products factory", as a joint-venture with Banque Indosuez, which will be able also to act as stock-exchange intermediary and in merchant banking operations.

- In General Insurance our main effort is directed at private risks and homeowners policies. To cope with regional differences in style and thus come closer to the clients we have established six regional insurance companies which are autonomous from the point of view of the sales organization, though completely co-ordinated technically as far as underwriting guidelines. This should help us to increase very substantially our market share in coming years, in a market which still has a strong potential (only 24% of Spanish households have a modern home-owners combined policy), and which is more difficult to enter into for bank insurance subsidiaries or foreign competitors, which don't have a specialized and efficient network. We also have started to offer supporting services to our insured, like practical assistance to contract repair work at home or a centralized alarm system in Madrid.

When turning to industrial risks our approach is more selective. We are not specially interested in low rated and low-prevention risks, where one is bound to loose money. We think a different approach is needed, based on the risk management concept. This is something we are now working upon, not only in Spain but also as a European idea.

- In the Financial sector, although this is an Insurance Seminar, I should say that we have been active since many years in the area of Consumer Credit. We have more recently entered the field of Leasing and Mortgage Credit. A separate specialized company in our Group deals with quasi-financial insurance classes like Guarantee and Commercial Credit Insurance. But the new thing for MAPFRE this year is our entry into Retail Banking: we recently made an agreement with a Spanish medium-size bank by which we shall have in two years 90% of the shares of what will be called Banco MAPFRE, a full retail banking operation for wich we have just obtained the Bank of Spain's official authorization. All our Consumer Credit and Credit Insurance companies will become subsidiaries of the Bank. In 5 years Banco MAPFRE will have approximately 50 offices in all main

Spanish towns. In order to be able to consolidate separately Insurance and Banking operations we shall have to convert Corporación MAPFRE, until now a Reinsurance company, into a pure holding company; our guess is that the holding will have 60 bn pesetas own funds in 1992, of which about one third will be invested in the Bank and its subsidiaries. The Bank itself should by then have around 30 bn own funds, one third held by outside investors on the Stock Exchange. The Bank will have its own network of professionals, but it will obviously try to serve in the first place the Mutual's 1,5 million Motor insurance clients, and other clients in the Group.

- In the Property Area, apart from investing in Office Property in Spain and abroad (we own presently 457.037 sq meters of prime office space and have acquired already 133,893 sq meters now under construction), we are now entering the area of Property Development with our own company, INVERMAPFRE (already listed on the Madrid Stock Exchange). The first big development we are undertaking is a 40 floors office tower in the Barcelona Olympic Village area, which will then become one of the best office areas, very close to the center of Barcelona and on the new sporting port

area. Our development plans will later include another prime site in Barcelona, and further projects in Spain and other countries where MAPFRE operates.

To do all this at the same time as our international expansion, to which I will turn immediately, we need external financial investment. Our structure allows the MAPFRE Mutual to retain full shareholding control of the Group while attracting investors in Corporación MAPFRE, which is listed on the Spanish continuous (computer controlled) Stock Exchange, and in future also in other Units like the Banco MAPFRE, MAPFRE Vida, MAPFRE Industrial and INVERMAPFRE, each of them to become separately listed in future. Presently outsiders hold close to 50 per cent of the total investment in MAPFRE Mutual's subsidiaries, and they will have more in future as we multiply our financial structure. But MAPFRE Mutual and Corporación MAPFRE will always retain a majority share in all MAPFRE Companies, and the ownership of the MAPFRE Group is to remain stable.

B. International (and European) expansion

MAPFRE began to expand internationally more than ten years ago, at a time when most of our expansion in Spain was still to come. So international expansion was always considered

as part and parcel of our policy, and not something added because of a saturated market at home.

We looked in the first place towards countries of our same language and cultural families, i.e. Portugal, Latin America. Our direct insurance companies in Argentina, Chile, Colombia and other smaller countries, our branches in Portugal and our reinsurance offices in Mexico and Venezuela require a lot of time and effort, but relatively little money as Insurance and Property investments in those countries were and still are comparatively cheap. As reinsurers and providers of training and consulting services we have managed to establish ourselves as one of the major professional reinsurers in the Spanish and Portuguese speaking areas. In 1988 we acquired the majority of CAJA REASEGURADORA DE CHILE, the oldest and largest private Latin American reinsurance company, which we intend to support in its own autonomous development and which can be the base for other important developments in the area.

Our conversion to the European scene is more recent, something which will not surprise you too much. What can we do in Europe, among Insurance and Financial giants which seem to have already occupied all the main

positions? When I was starting to prepare this presentation last Summer, suddenly on the same day I read the news of VICTOIRE acquiring COLONIA - really a big news- and ROYAL INSURANCE buying LLOYD ITALICO from the FONDIARIA Group. Then came all the events you have been following like us on the insurance scene. These and other big realignments (apparently helped by strong financial leverage, something we have avoided until now) inevitably leave us with a certain taste of frustration: while we, good boys, keep talking about nice strategic options, others are acting, just buying and buying. Future will tell who was right. In any case, by conviction or because we have no other choice, we prefer a selective, and less expensive approach:

- For "mass risks", we are looking in the first place for markets with a strong untapped potential and the possibility of building a network in accordance with our "Weltanschauung". That is precisely what we did when we invested, together with Reale Mutua of Italy, in a small Sicilian company, which in some years could have a real capillar presence in Sicily and Southern Italy. Perhaps a similar approach can be used elsewhere We are on the search for opportunities.

- For reinsurance and Industrial Risks Insurance we have a strong base in Brussels. CIAR was created in 1975 (we were among the founders) long before any talk about 1992. The company now has its own premises at Rue de Trèves. Its capital and free surplus amount to 950 million Belgian Francs. MAPFRE is majority shareholder, and we have a distinguished group of six European companies as partners and shareholders. We hope to enlarge this base and develop a concept which, in addition to traditional Treaty and Facultative Reinsurance, could also effectively offer Risk Management services for industrial clients. Please excuse me for not entering into more detail on this subject, until we are completely ready. As a complement, just let me say that although we are not present yet there, we consider the London market (both for Insurance and Finance) still as a leading centre, at the same time in and outside Europe, and we are also preparing specific action to be there.

An ambitious plan, yes, but worth trying. Or should we just surrender to a world of giants? We think it is worthwhile trying to do something effective, hopefully in common with companies like ours, who are leaders in their home market but do not have yet a broad international operation.

Just a few final words about alliances. We have seen some groups going through "testimonial" exchange of shares as a kind of sweet "placebo" or substitute for big acquisitions. We also all know of clubs and other co-operative initiatives where partners are supposed to remain strictly equal. MAPFRE does not believe in these kinds of arrangements. We believe strongly in alliances with companies we like in other countries. But, to be effective, they have to have certain basic elements:

- The alliance in itself can be among equals who deeply respect each other, but there must be a leader (normally the majority shareholder) in each specific joint-venture company if one wants to avoid stagnation.
- Alliances should not be exclusive. Each partner must be free, even to go into other ventures in the same country.
- Rather than absolute equality among partners, one should look for conditions allowing each of them to get involved as far as he likes.

On those lines we think alliances are worthwhile; we have experienced them before and expect to do it again in future in several business areas, specially in Europe.