Interview

FLEET ADMIRAL

The financial services world continues to change at a rapid pace. Alastair Lyons explains to Anthony Thomson his plan for keeping his flagship clear of the competition, and shares his thoughts on a few other critical issues for the industry.

Admiral is clearly a marketing-led organization, although you personally have a great deal of very varied experience in the financial services sector. I sense you are not a marketer by background, so what does marketing mean to you?

I'm not a marketer, but I'm a non-executive chairman. The important thing is that the organization is actually led by marketing men on the executive side – both Henry Engelhardt, the chief executive, and David Stevens, the COO, are from a marketing background. In terms of what marketing means to me, it is effectively being able to understand what the customer's requirements are, and then being able to design propositions that are actually directly relevant to those requirements.

It is very different from your previous experience, particularly in retail and even your time at NatWest, given that Admiral is primarily a response-driven business. Those companies I would regard as your direct competitors – the More Th>ns, the direct banks and the Churchills – spend quite a lot of money on brand advertising, whereas Admiral seems to be much more focused and primarily driven by direct marketing – so there must be quite a difference in terms of the strategies there.

We spend a reasonable amount on broadcast media, and particularly on TV. We are very selective about the media channels and slots that we use in terms of their cost-effectiveness – so quite a significant amount goes on daytime television, for example, and we measure every piece of expenditure on marketing against the return that we achieve on that investment. One of the areas in which we are extremely efficient as an organization is the return that we get from the marketing investment that we make.

Absolutely. Your return on expenditure is far superior to any of your competitors, and I guess they would love to know how you have managed to achieve such marketing efficiency.

Well I'm sure they would, but I am not going to tell you! It is something that has been built up over a long period, and effectively these are some of the team's core strengths. Before he started Admiral what now must be twelve years ago, Henry was in a direct marketing role in general insurance, so he has been doing this for a long time.

One of the core strengths is the quality of the information that is available to management at all levels in the organization, enabling them to assess whether or not the decisions they make have the desired impact. They look very, very closely at the actions they are taking and the planned results of those actions – be it marketing, be it pricing – and what actually happens in practice. That is off the back of the very detailed management information, which allows them to hone the proposition.

Has that contributed towards what is an extraordinarily low combined expense ratio?

The combined ratio is, as you know, a combination of factors. Firstly it is, as you comment, efficient marketing, which means that we get a good level of lead generation for the expenditure we make.

Secondly, it is very selective targeting of those parts of the potential customer base, which will give us a good loss ratio. Obviously, the loss ratio is the net result of the price that we charge and the claims experience with that particular customer, and we hone and tune our pricing model in the same way as we hone and tune our marketing spend.

And then thirdly, we are a very cost-effective operation in all respects. It is a very lean business, and we consider everything that we spend very carefully. Put those three together, add strong management, and you end up with a market-leading combined ratio.

I guess many of us first noticed you when you started targeting people like London drivers – people that other companies in effect did not want to take on. That segmentation strategy must have been a considerable risk.

Yes, I suppose it follows the adage that there is no such thing as a bad risk – just a mispricing risk – and again it is part of what I would categorize as being a learning organization – so we tend not to take very big bets. We will pilot something, see how it goes, learn from that, hone it, change it, then go back in and take it a step further – and that's very much the approach we would take, say, to starting in a new market segment.

We will build up an experience in that segment, and see how drivers' particular characteristics perform compared with the average, and then we will make the decision whether we want more of that type of customer or less, depending upon the combination of their claims

After qualifying as a chartered accountant with Price Waterhouse, **Alastair Lyons** joined the corporate finance department of Rothschild's and then moved into industry in 1979 as group treasurer at cider-maker HP Bulmer.

He stayed at Bulmer's for ten years, during which period the group significantly expanded both its UK and international activities. He then joined ASDA as divisional director of corporate finance, becoming finance director at ASDA Stores, the group's principal operating subsidiary, in 1990.

Alastair moved to National and Provincial Building Society as finance director the following year, becoming chief executive in 1994. With the acquisition of N&P by Abbey National in 1996, he joined Abbey's main board as managing director of the insurance division.

He became chief executive of the pensions specialist NPI in 1997, leading it, after a strategic review of its ability to compete effectively in a rapidly concentrating market, into its demutualization to become part of AMP.

In 1999 Alastair was approached by NatWest to become chief executive of its investment management arm, Gartmore. However, when Bank of Scotland announced its bid for NatWest, Alastair instead joined Ron Sandler's team as director of corporate projects, working on the restructuring that was announced as part of the bank's defence.

He left NatWest after its acquisition by Royal Bank of Scotland and, with the backing of 3i, established Partners for Finance in the spring of 2001 to provide specialist white-label manufacturing, administration and processing services to companies across the financial services sector.

Alastair joined the Department for Transport as a non-executive director in 2002, and is chairman of the department's audit committee and a member of its planning, performance and risk committee. He held similar roles at the Department for Work and Pensions (formerly the DSS) from 1997, having joined the board of the Benefits Agency in 1994. In 2001, he was appointed CBE for services to the DSS.

He has been non-executive chairman of Admiral since its management buy-out in 2000, and is also a non-executive director of Sesame, the UK's largest IFA network.

experience and the pricing that the market will take for that segment.

You clearly are very successful, with over a million customers and a very good profit as a percentage of turnover, but some have said that you have in effect been buying customers through your pricing strategy, and that this is not sustainable.
Nothing could be further from the truth. We actually take a low level of conversion of leads to customers. We are very selective in the customers that we take – we are certainly not buying them.

If we were, we would be experiencing much higher conversion rates than we currently do, because customers would be flocking to us as we would be particularly competitive on price. We have not sought to take a disproportionate share of the customer base.

We measure every piece of expenditure on marketing against the return that we achieve on that investment.

We grew strongly because we formed the view that it was actually the right point in the cycle to grow. Combined ratios were historically at a low point, so we felt that this was an opportunity to build our customer base profitably.

Of course, because we are operating so much lower in terms of our combined ratio relative to our peers, we are able to move the ratio a couple of points and still write extremely profitable business. We have said publicly that we are now throttling back on that – we are not going to grow as fast this year as we did last, because we are at a different point in the cycle.

There was a comment from Henry that premiums have probably fallen about 2% to 4% whilst claim costs continue to rise faster than inflation. So that would lead to that strategy, I guess.
Yes.

What's your view on the web?
Well, it is a key driver of the business, and again we have gone on public record as saying that the majority of our quotes, and also most of the policies that we write, are initiated on the Internet. We actually combine the Internet and the telephone in the overall sales process. So, even though they may initiate their business on the Internet, our customers are invited to contact us on the phone during the sales process in order to discuss anything about their policy, and that obviously builds the customer relationship that we have. The web provides an extremely efficient way for customers themselves to go through quite a lot of the sales process and to transmit data to us, and for us then to rate this and send back a quote.

Direct writing is not my area of expertise, but people who do work in this field tell me that one of the issues is that the retention rates for web business tend to be lower than those generated through contact centres.
We haven't seen that.

Possibly because of the combination of the web and telephone operators that you mentioned?
Yes

Do you see aggregators as a threat to your business? Clearly you have a very successful one in *confused.com*, so you may have a foot in both camps.
We do. Clearly, aggregators perform a function for those who are the most sensitive in terms of pricing, and one has to accept that motor insurance is predominately a price-based purchase. When we are competing for business through our Admiral brands, we are competing against the same providers that an aggregator will get quotes from. Typically, motor customers will seek four or five alternative quotes before making their decision, and one can be pretty clear about who they might go to. So I wouldn't say that we would view our business as being particularly threatened by aggregators, because we are already in a highly price-competitive business.

It has been suggested that anyone in their right mind would use an aggregator, on the basis that they only need to put their data in once and can then use it across fifty companies – and again the following year. Surely that in itself makes it a big threat to direct writing?
It obviously increases the ability of a customer to shop around and test pricing on a very regular basis. But direct writing has always been successful because it has been much more flexible and responsive to trends in the market place – to price movement and being selective in terms of the risks that it actually wants to write. So I am not saying that aggregators will not increase price competitiveness, but it puts a premium upon that selectivity, that speedy response, that pricing – so you always have to seek to be one step ahead of the market in terms of the particular risks that you want to write and retain.

We accept that, because we are in the direct writing business, we have to compete the whole time to win new customers and retain existing ones. We can't assume, as the broker market did for a long time, that just because you've got a customer they will renew with you.

You have been hugely successful in terms of your financial results but also in terms of staff satisfaction. You have been listed as one of the top fifty best places to work by the *Sunday Times* for the last two years, and in the top hundred before that, and you talk in your annual report about the importance of aligning staff behind the traditional values of your organization. Yet, of all financial services businesses, contact centres are probably the worst in retaining staff – so how do you get such tremendous staff loyalty?
Essentially, you could say that Admiral is one large contact centre. On the sales side and on the service and claims side, the majority of our people interact on a day-by-day basis with the customer. Admiral's philosophy is to involve its people and, as far as we possibly can, to make work

fun – to make the workplace somewhere that people enjoy coming to and get a lot of buzz from. It's a very informal and young environment – we have large numbers of people in their twenties.

Motivation and staff incentivization is a very important element – making people feel winners. We engender a very healthy competition between teams, to make everyone feel part of a winning organization. We also have a very open, informal and flexible management style so that we can react quickly to staff needs and concerns. These are the ingredients of good staff relationships, and the test for us is when we get people who leave us in search of greener grass but then come back six months later and tell us Admiral is a much better and more fulfilling place to work.

You have some outsourcing to India and South Africa. How do your staff feel about that?
It is on a small scale – we have fifteen hundred people in Cardiff and Swansea and only about a hundred in India and South Africa. The prime driver for outsourcing is not to reduce costs but to cover those aspects of the customer service – such as late shifts on Sundays – for which it is difficult to find people in Britain.

But outsourcing can attract adverse media attention – and in America it has become a political issue.
It can have an adverse effect unless you explain what you are doing and why. If we said to our UK-based staff that they had to work every second Sunday, our retention rates would go down because they just don't want to do it. If you put things in context, and you have an inclusive management style that shares what the business strategy is with your people, then you don't have these issues to the same extent.

We actually send volunteers out to India and South Africa for a few months at a time, as we believe that you need people with hands-on experience there to sort out the issues and to get a consistent business culture.

One of the things that interests me particularly about the Admiral business is that it is a true multi-brand strategy: Admiral, Elephant, Diamond, Bell Direct – Gladiator perhaps less so. I can understand why confused.com would be branded differently, but what is the value of a multi-brand strategy when all those resources could be put behind promoting a single brand?
In direct marketing, there are dis-economies of scale as you seek to increase the amount of business written under any one brand. As a simple example, you can only have one insert in Yellow Pages for any one organization. So the more business you try to attract within a single brand, the more you bid up the cost of the media that you can use.

Secondly, we do have very specific brand properties for our various brands. Diamond, for example, only writes for female drivers, so we seek to give it a brand persona that is attractive to women. Elephant is a pure Internet brand – one of the few brands with which you can do everything across the Internet: not just the initial purchase but routine service elements such as mid-term adjustments, changes of address and also making claims. So there we have sought to appeal to people who are natural Internet users, which is why Elephant has its particular brand persona.

So this approach allows us to be much more targeted in terms of our marketing to particular segments. Multi-brands also allow you to trial quite effectively – you can do something with one brand on its own which you

don't yet want to roll out to your whole customer base because you are not certain what the results will be. Another example of the learning organization.

What do you think differentiates Admiral Group?
Most obviously, Admiral is clearly different from the majority of the motor market in terms of its efficiency and cost-effectiveness.

Secondly, as we have just discussed, we have a multi-brand strategy rather than just a single brand.

Thirdly, Admiral is different in terms of its organizational style and culture. We seek to gain the best from our people by giving them the opportunity to develop as far as they themselves are capable. The vast majority of our management team are what you might term home-grown – people who have been with the business a long time, have moved through a variety of different roles within the company, and have developed into management roles that are totally different from those they envisaged when they joined us. We believe that if people have an inherent set of competencies around the way they make decisions, the way they think and their understanding of their particular sector, then they are capable of learning new roles as they go through. So this coaching organization actually gives us a great strength in depth within our management – we don't have to bring in specialists to fulfil specialist functions.

Combined ratios were historically at a low point, so we felt that this was an opportunity to build our customer base profitably.

I can see how the culture is a sustainable differentiator, but surely that isn't true of pricing?
I didn't actually say that pricing was a point of differentiation. Our point of sustainable differentiation is that we are one of the lowest cost direct writers. Pricing alone is not sustainable, but if you combine a very low cost culture with extremely effective marketing, targeted segmentation and very efficient claims processes, then that can work. I don't believe, for example, that it would be possible for someone to come in as a new market entrant and immediately compete with us on that basis, because the trialling and testing and culture-building that you need to get to our combined ratio takes time.

Most of the chief executives that I have asked have said that it's not your strategy that differentiates you but your execution.
I completely agree with that. It is a bit like food retailing, where I worked for a while. People think the job is all about marketing and range selection, and of course that is important, but it is the core implementation – getting the stuff through the supply chain, out of the warehouse onto the shelf, in the right quantities at the right time – that makes the real winners, as some retailers have found to their cost.

How do you see the future shape of motor and general insurance?
In Britain, brokers and direct each take about 40% of the private motor market, with brokers going down and direct going up. I would expect that trend to continue, and within direct for the proportion done over the Internet to grow as well, as more people become comfortable with the medium.

And I think there will be increasing concentration as well. Ten years ago, the top ten commanded about 52% of the motor market, but last year I think just the top five accounted for two thirds of the total. And obviously there is a very clear leader there in Royal Bank of Scotland, with Direct Line, Churchill, Privilege and Tesco – interestingly, another multi-brand strategy, which reinforces the point I made earlier.

Do you see your former colleagues in the supermarkets and major retailers as a threat to your business?
There are quite a number of them in motor insurance – Sainsbury's and Asda, for example – but it's only really Tesco that has any significant market share. All the rest are in low single figures – they will be there, obviously, but I don't see them as a major extra threat. They work in partnership with underwriters who are already competing with us anyway.

But what the supermarkets do have is thirty million people crossing their doors everyday – so a much lower cost of customer contact.
Yes, I agree with that, but I am still not certain how many people go for their weekly food shop and pick up leaflets at the check-out on motor insurance and *then* actually do something about it. As a customer, you are only susceptible to this for a relatively limited period at the time of your renewal. So I am not sure that the effect on customers will be any stronger than if they see a card on the Tube or an ad on TV.

I'd like to conclude by asking a few broader questions, tapping into your breadth of experience across the whole financial services industry. What do you think will happen to pensions? What can be done to close the savings gap – whether that is £27 billion or £40 billion or whatever?
I think in effect there are two gaps. There's a gap with regard to people's current availability of income, where

they have saved through their lives and are now getting to pension age. Many are now finding that their pensions are not actually what they thought they would be, and to make it worse, the lump sum surpluses that they were expecting on their mortgage endowments are not there either.

The second gap is in the amount being saved by people with a long time before retirement age – and I think that both gaps are significant.

As far as the former is concerned, I think that there will be an increasing use of the equity in property to bridge that gap, as there are an awful lot of people with properties worth significantly more than they could ever have dreamed of, but whose regular income is less than they thought.

In terms of future savings, I still think that pensions are sold and not bought. There is never a queue of people in their twenties or thirties lining up to buy a pension – they need to be convinced of the need to save consistently, and obviously also need the confidence in those savings. This is one of the issues that the one per cent world doesn't actually recognize. If the government is not going to put huge amounts of money into convincing people to save, and if the Australian solution of compulsion is politically unacceptable, then the private sector will have to do it. But it can't be expected to invest in marketing and selling pensions unless it is able to make a reasonable profit on that investment.

You say that compulsion (for employees) may be unacceptable, but do you think it is inevitable, directly or indirectly, for employers?

I have thought for quite a long time that it will come in one form or another. It may come through effectively a soft compulsion – for each amount that you save, we will add so much more …

"We" being the employer or the government?

I think the government, potentially. It may come through the employer but with cross-subsidies in the form of a benefit to the employer in taxation. But it is very difficult otherwise to get people to think thirty years hence – and you have to think thirty years hence if you are going to put away the savings that are necessary in a low interest environment to provide for a very long period of retirement.

And the problem is not just improved mortality but the perhaps even bigger issue of morbidity and the funding of increasing healthcare costs.

You are now really taking me outside my past experience, but so far private sector plans for long-term care funding have been, I think it is fair to say, relatively unsuccessful in getting any significant take-up. There haven't really been the tax breaks that would make people – particularly people who could afford the policies – jump at that type of vehicle, but in a sense long-term care schemes are just another form of tax-incentivized savings. Those that have been mooted have effectively rolled one form of tax-efficient long-term savings into paying premiums directly when the individual comes into care, so that the money that pays the care bills never actually passes through his pocket, and therefore is not subject to taxation. ◻

This coaching organization actually gives us a great strength in depth within our management – we don't have to bring in specialists to fulfil specialist functions.