Opportunities Ahead

Five tips for navigating the U.S. small-business market.

by Kevin Mooney

The National Small Business Association estimates there are 27.9 million small businesses in the United States that create more than half of the country's gross domestic product.

Insurers—and other financial institutions for that matter—are not blind to the fact that this market provides tremendous growth opportunities, but it is difficult to reach. To date, few have cracked the market. U.S. brokers especially have struggled to effectively (and profitably) deliver insurance to this segment. But why? Simply stated, many don't stop to understand the segment. Here are five tips for navigating the challenges of delivering insurance solutions to the small-business market:

1. Accurately Defining 'Small Business'

What constitutes a small-business account? The United States Small Business Administration defines a small business as a company with fewer than 500 employees. But the factors that identify what is or is not a small business in the insurance arena vary from carrier to carrier and risk to risk.

Contributor Kevin Mooney is senior vice president for eCommerce at Torus. He can be reached at kmooney@torus.com

Indeed, insurance professionals have struggled to develop a clear-cut method for identifying these accounts. Some use number of employees while others use premium generated per account, limits requested and payroll.

The one constant is that no one method has become the industry standard. This has created uncertainty. There has to be a clearly defined standard to identify small-business accounts for insurance professionals to be able to work on risks together.

One method that stands out is business revenue. This factor is a true tangible component that clearly defines the small-business account from middle market or national accounts.

The SBA method of categorizing small-business accounts by the number of employees seems inappropriate for the purposes of assessing risk. A software development company might only have 25 employees yet it could produce software generating hundreds of millions of dollars in revenue. On the other hand, there could be a manufacturing company that has 400 employees but its business turnover is relatively small.

Although there are some exceptions, in which some small-revenue companies may have sizable assets such as apartment buildings and other real estate and for whom revenue isn't the most telling exposure measure, using revenue as the defining factor to categorize these accounts is by far the most comprehensive method.

Key Points

- **The Big Picture:** Most U.S. private employers are small businesses.
- **The Situation:** Few brokers have sold insurance to this segment profitably.
- **What Needs to Happen:** Brokers need a well planned strategy and an efficient approach to streamlining the quote-to-bind process.

2. Profitably Transacting Small Business

Another big piece of the small-business puzzle for insurance professionals is how to transact this business profitably. This is the core problem that has been driving potential insurance professionals out of this market for years. If an underwriter or account executive has to spend more than 10 to 15 minutes on this type of account, the already thin margin of profitability that exists in these accounts has been lost. In fact, spending any more than 15 minutes could actually create negative returns.

The return on investment for small-business accounts is so slim that if you don't have a structure in place that guarantees a light-to-no-touch approach, it won't be worth the time or investment to maintain a presence in this market.

So what is the solution? One approach is through online automation of the underwriting process. By having technology that is fast, convenient, easy-to-use and cost-effective, brokers can harness the potential this market segment presents. Indeed, when working with the smallest of profit margins, brokers must work to reduce points of human interaction and involvement down to the absolute minimum. (Some level of human interaction will always be an important component.) By enacting such an approach, the slim profit margins from this business segment are no longer reduced and a larger volume of business can be transacted.

3. One Size Does Not Fit All

Another trap that many insurance professionals face is treating small businesses the same way they do middle market or national accounts. Taking a one-size-fits-all approach with these accounts creates the potential to overwrite or underwrite the coverage. As already noted, efficiency is the key to managing and processing small-business accounts. The secret is that less is more.

The underwriting technique that needs to be applied to these accounts from a terms-and-conditions perspective should ideally resemble an assembly line rather than an artisan approach. Insurance professionals cannot afford to spend time applying specific endorsements and exclusions to each account.

Instead they need to "class code" to develop a package of endorsements. This provides maximum protection for the particular class of business but lessens the need to stop and analyze each specific risk. Indeed, negotiating terms and conditions is a waste of time: Once you begin a dialogue with a small-business client on the proper T&Cs to be used, any efficiency created goes right out of the window, and the little profit margin that exists will also be gone.

4. Offer Only the Specific Limits Requested

Another pitfall is offering a large block of limits instead of the specific limits requested by the insured. The thought process is that providing additional millions of dollars in limits for only a few hundred dollars more will bring a value-added proposition to the customer.

On first look, $2 million in additional limits for $500 seems like a great deal but in most cases, more is not better. Many small-business owners are on tight budgets. The difference between buying insurance and going bare on coverage can be $100. Remember, they buy only what they need.

A different approach is needed in order to be successful: a diverse appetite strategy that focuses on businesses that cover a broad spectrum of risks.

Looking at this from the carrier and broker perspectives, offering smaller, specific limits demonstrates a controlled and well-thought-out strategy to managing the portfolio's limits profile and can help regulate the available limits capacity. To be successful in this market segment, a consistent, class-code-specific approach to T&Cs must be provided.

5. Consider Systemic Risk

A common strategy for mitigating systemic risk is to focus on a select group or class of business in an attempt to write safe, low-hazard risks. This creates a false sense of comfort. It is wrong to assume that because of the size of small-business accounts they lack complexity and are therefore safer bets that will generate few or no claims. The real problem with writing a large concentration in one particular class code or group is the possibility of an unforeseen exposure emerging. The appearance of a new exposure can put the whole book of business in jeopardy. What was believed to be low-hazard business can now begin to generate a heavy volume of claims activity.

A different approach is needed in order to be successful: a diverse appetite strategy that focuses on businesses that cover a broad spectrum of risks.

Instead of a book of business with a concentration of similar risks with the same common exposure, there needs to be a diverse book with a balanced spread of risk. This will give a broker or carrier the ability to shut down a class of business with the knowledge that the impact to the overall portfolio would be minimal, as opposed to the threat of run-off or bankruptcy that can come from a limited risk selection.

In order to successfully venture into this vast, untapped niche, it is important to know the pitfalls. This market niche may be called small business, but do not be fooled. These are unique, sophisticated and complex prospects. Handling them requires a well-thought-out strategy and an efficient approach to streamlining the quote-to-bind process.

Above all else, expertise and knowledge in servicing the needs of the small-business customer and a true understanding of the marketplace is a must. BR

By the Numbers: U.S. Small Businesses

70 million — the number of people that work for or run a small business.

27.9 million — the estimated number of small businesses (5.9 million with employees, 21.4 million without employees).

64% — or 9.8 million of the 15 millon net new jobs created between 1993 and 2011 were for small firms.

43% — the percentage of high-tech workers employed by small businesses.

Source: National Small Business Association