

# Maintaining stakeholder trust in difficult times: What insurers can do

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## The background

The subprime crisis which hit the United States in summer 2007 and morphed into a full-blown global financial upheaval in autumn 2008 has taken a heavy toll on the insurance industry. Some industry players with significant financial markets and banking operations were seriously damaged by the dramatic deterioration of global credit conditions and suffered severe losses requiring public support or even bail-out measures. But these were spectacular exceptions, rather than the rule. The vast majority of insurers and reinsurers felt the impact of the credit crisis through realized and unrealized investment losses as well as increasing insurance claims from the D&O and E&O lines of business. As insurers are significant institutional asset managers and underwriters of liability risks these losses did not come as a surprise and were, in their large majority, well within the scope of corporate risk scenarios and models. The solvency position of most insurers weathered the financial tsunami and the industry as a whole did not pose any systemic threat to the global financial system – in stark contrast to the banking sector.

This comparatively mild assessment notwithstanding, the insurance industry's reputation and image have been dealt a blow, with stakeholders' eyes on the fate suffered by former industry icons such as AIG and Fortis, companies that were felled by their non-insurance operations. Policyholders', investors' and employees' trust in the sector has been dented – and the fact that other financial services players have suffered at an even larger scale is a cold consolation, at best. These losses in reputation and trust represent an extraordinary threat to an industry which basically sells contingent promises to pay and is, therefore, based on credits of trust and reputation awarded by relevant stakeholders.

## Why trust matters

Trust can be viewed as a bet on future contingent actions, with four major factors supporting it: (1) Reputation, i.e. a set of enduring collective stakeholder perceptions, opinions and expectations, (2) performance, i.e. the quality of business and corporate processes, (3) accountability and (4) appearance.

It is undisputed that trust is an indispensable ingredient of insurance business. Insurers are actually in the "business of trust". They sell contingent promises to pay, more often than not at a distant point in the future. This is particularly true for lines of business where settlement periods may run into decades, such as annuity policies. It

follows that, for the insurance industry, the trust of policyholders and other stakeholders is a necessary pre-condition for conducting business.

### **How to maintain trust in times of turmoil**

How can a solid and well-performing insurance company minimize collateral damage from a general crisis of confidence affecting the financial services industry? We suggest a simple answer: "Consistently deliver the promise and redouble your communication efforts".

From an economic perspective trust is rooted in repeated interaction which leads stakeholders to expect a company to perform and communicate in a certain way. Performance and communication can therefore be regarded as key ingredients of any systematic approach to building trust and reputation as well as to safeguarding these assets in times of crisis. Most insurance companies have weathered the storm of the subprime and subsequent financial crisis relatively well. Earnings have declined sharply but capital positions remained largely intact. Nonetheless, the woes of some former icons of the global insurance industry and the dramatic proportions of the banking crisis have led to widespread uncertainty among insurance stakeholders. In such an environment, companies who succeed in maintaining relevant stakeholders' trust and minimizing spill-over effects from general public sentiment stand to benefit hugely as investors, customers and employees are likely to defect from their less favourably perceived competitors.

#### *Deliver the promise*

The necessary condition for preserving stakeholder trust in trying times is to maintain corporate performance at expected levels. For this purpose, companies need to regularly and critically review their core business processes (e.g. product development, marketing, underwriting, claims management) and ask themselves: Do all these elements of the value chain continue to perform in a way which would prompt stakeholders to make favourable bets on a company's future contingent actions?

#### *Redouble communication efforts*

In times of crisis, stakeholders' thirst for instantaneous, comprehensive, transparent and understandable information increases exponentially. Corporate communication efforts therefore assume a critical role as severe industry crises may prompt customers to lose trust even in those companies who managed to escape relatively unscathed from the general turmoil. Maintaining performance of core business processes is therefore just a necessary condition for maintaining trust in times of turmoil. The sufficient condition is an approach to communication which takes into account stakeholders' specific needs for information and the risks arising from irrational collective behaviour driven by ubiquitous panic and gloom.

The credit crisis has demonstrated that even most venerable and reputable institutions can find themselves on the brink of demise within a few days or even

hours. In jittery and panicky markets, a 24/7 communication mode is of vital importance. For this to work, internal decision-making processes need to be defined which ensure an instantaneous response to short-notice challenges, i.e. rumours on a company's impending insolvency which spread at the speed of light.

Whether these requirements are met or not can decide the fate of a bank when it is faced with a run. Insurers are usually in a more comfortable position as contracts are more difficult to cancel for policyholders. Nonetheless, speed matters, especially in life insurance where cancellation rights exist. As regards shareholders, insurers face the same challenge as other industries in crisis-stricken market conditions: Quell concerns as they arise or face massive sell-outs.

Another key lesson from the credit crisis is the need for massive improvements in meaningful and understandable transparency. The complexity and opacity of certain financial products had grown to such proportions that even senior finance executive failed to keep pace with these developments – let alone ordinary investors or the public at large. Against this backdrop, transparency and simplicity are back in vogue – both in terms of product features and communication. “Keeping things straight and simple” will be a key success factor as investors, policyholders, employees and other stakeholders have lost their faith in complex and esoteric structures and wordings.

Another “golden rule” of corporate communication is to convey a consistent set of messages to all stakeholders. In times of smooth sailing consistent communication helps companies maximize their credibility and reputation with stakeholders. In rough waters consistency is a prerequisite to maintaining stakeholders' trust and to establish a reputation of good communication. Apart from content, consistency is about timing. Ideally, all main stakeholder groups, including employees, should be provided simultaneously with relevant, properly tailored information to stem an erosion of trust and morale.

A balanced messaging approach which incorporates internal and external as well as financial and non-financial aspects is likely to generate the maximum benefits in terms of quality and effectiveness of stakeholder communication. For this purpose, an integrated corporate messaging process is suggested. It is crucial to strike an appropriate balance between financial and operating performance, the company's vision, mission and strategic direction and, last but not least, its competitive position in the industry and overall socio-economic context. Demonstrating that an insurer is more than just a profit-generating abstract entity is especially relevant in times of crisis when reservoirs of trust are most jeopardized. Insurers are well-advised to constantly emphasize their vital contribution to economic and societal progress - from peak risk mitigation enabling entrepreneurial risk-taking and innovation to comprehensive financial protection offering “peace of mind” for millions of policyholders.

In times of crisis and uncertainty the credibility of individual companies tends to erode - more often than not regardless of objectively measurable differences in

performance. All the more important is the effective use of credible third-party bodies to substantiate views expressed on behalf of the industry or individual companies. Among such institutions are think-tanks known for expressing independent, research-backed views.

Optimizing the mix of channels deployed is another key challenge for corporate communications management – even in times of smooth sailing. In turbulent waters, this challenge mounts tremendously as the stakes are significantly higher, especially the downside risks. Especially in times of turmoil, retail insurers with millions of individual policyholders should focus their communication efforts on the print and electronic media. As confidence in the corporate sector unravels target audiences attach a particular importance to what they perceive as quasi-objective media reporting.

As uncertainty spreads and confidence wanes face-to-face communication gains in importance. This seems to be a truism based on common sense. Still, many companies fail to live up to this imperative when it would be most important to do so. Executive management needs to meet regularly with key constituencies such as opinion-shaping customers, major investors and employees across hierarchical boundaries. An effective stabilisation of the stakeholder base is a prerequisite to successfully navigating the corporate ship through troubled waters.

### **Rewards from pro-active stakeholder management in times of turmoil**

Conventional wisdom has it that stakeholder trust will yield commercial benefits; whilst its evaporation can quickly drag a firm to the brink of demise, and ultimately tip it over the edge, especially in banking when institutions face a run.

The trust of existing customers and a solid reputation with prospective clients is set to result in more successful business production, be it direct sales or business generated through intermediaries. This is particularly true for an intangible business like insurance whose benefits can only be assessed after concluding the respective insurance contract and making premium payments. Further, trust and reputation could even enable an insurance company to command a premium on market prices. In different words, both determinants of a company's revenues, i.e. quantity and price, could be favourably affected by trust and reputation.

In phases of turmoil, superior trust and reputation established in more stable times will pay off: The prospects of retaining business increase. It is even likely that a trusted company will expand its market share at the expense of less favourably perceived rivals. Durable trust and reputation may be instrumental in reshaping the marketplace and establishing a much stronger corporate position post-crisis.

On the capital markets, the first-class reputation of a company is likely to be rewarded in the form of an improved creditworthiness, and, in stable market phases, with a market valuation in excess of the book value. When the going gets rough companies with a superior reputation should benefit through less severe drops in their

share price, costs of capital rising at a slower pace than for its rivals and financial flexibility maintained at above-average levels.

## **Conclusions**

Even though their distinct business model makes insurers less vulnerable to an unexpected loss of confidence than banks (policyholder) trust remains a prerequisite to doing insurance business – be it the annual extension of motor policies or the conclusion of long-term life insurance policies.

In times of crisis, insurers need to maintain an appropriate balance between performance and communication management in order to preserve stakeholder trust and capitalize on the woes of more severely hit rivals. Despite organizational stress, rising claims (including fraudulent claims) and a multitude of other crisis-induced challenges insurers must maintain their operating standards across the entire value chain.

Apart from a continued focus on key business processes an insurer aiming at minimizing the impact of crisis needs to step up corporate communication activities to meet stakeholders' increasing needs for timely, relevant and transparent information disseminated through a carefully balanced mix of channels.

An insurance company who consciously manages its trust capital as suggested in this paper stands a good chance of weathering the worst fall-out from the crisis, emerge stronger from it and reap significant commercial benefits as soon as the crisis has receded.