Insurance companies: Want to steal your competitors' customers?

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Researchers from the United States published new research in the INFORMS journal *Marketing Science* (Editor's note: The source of this research is INFORMS), which sheds light on just how much it may take for the companies to profitably "steal" customers from their competitors. Frequently, the managers focus on customer acquisition cost when deciding if to poach customers from the competitor. To that extent, the managers may downplay the other factors, such as future cost to serve of poached customers. The researchers demonstrate that switchers can generate as much as 21 percent higher cost to serve as equivalent own customers. This brings an important caveat when designing marketing strategy.

The study to be published in the July edition of the INFORMS journal *Marketing Science* is titled "Skimming from the Bottom: Empirical Evidence of Adverse Selection When Poaching Customers," and is authored by Przemyslaw Jeziorski from the University of California at Berkeley, Elena Krasnokutskaya from Johns Hopkins University, and Olivia Ceccarini.

The study authors arrived at their conclusions after analyzing the Portuguese car insurance industry, which is an established, multi-billion-dollar market. They selected the insurance industry because they knew that it would present measurable factors that are similar to several other service industries, such as credit markets and retail.

They were able to use individual-level data on insurance claims from a

leading Portuguese auto insurer which showed that in the insurance industry, the average customer who switches from one insurer to another generates a 32 percent higher volume of liability claims than the average customer who does not switch.

Further, they found that commonly employed actuarial screening mechanisms can only partially alleviate this problem.

"Screening based on factors we could observe and a detailed driving history accounts for than 50 percent of the adverse selection," said Jeziorski. "We found that the average customer who switches insurance companies is approximately 20 percent more risky than the 'nonswitcher.' This suggests that drivers exhibit a large degree of unobservable patterns of riskiness and that higher risk is often correlated with customers who switch insurers."

The researchers found that current insurance company pricing does not reflect this risk gap.

To address the risk gap and determine optimal pricing strategies for customers who switch insurance companies, the researchers decided to focus on patterns they could observe, which included how long those customers were with a particular insurance company.

They found that higher-risk drivers tended to be with an insurance company for less than two years or less. They concluded that customers who have been with an insurer for less than two years are "significantly more risky than the otherwise equivalent customers with three or more years of tenure."

"We found that 20 percent of clients churn within one year," said Jeziorski. "Some of those customers frequently switch insurance companies, and 35 percent of customers that incur a claim do not renew

their contract."

Jeziorski added, "Such selective attrition can explain the relationship between tenure and riskiness. We also found that switchers with bad driving histories generate a 100 percent larger volume of claims than customers who do not switch but have the same driving histories. Even among drivers with excellent driving histories, customers who exhibit a pattern of switching insurance companies generate 38 percent larger claims."

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