State Farm and GEICO Case Studies: Using Segmentation to Uncover Profitable Customer Retention Opportunities

A Management Discussion Based on the 2009 Personal Insurance Retention AnalysisSM

Financial Services and Insurance Research Group
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Retaining Auto and Homeowners Insurance Customers in a Slowing Economy

Sales of new light vehicles in the United States have historically been sensitive to the ups and downs of overall economic conditions. Meanwhile, the personal auto insurance market has been remarkably stable during the past 5 years (Figure 1), according to financial data from Standard and Poor’s.¹

In this mature market, individual insurance companies tend toward a zero-sum game, where the growth of one company comes at the expense of another. To grow, an insurer must both protect its current book of business and conquest new customers. Given the significant cost involved in acquiring new policyholders, personal auto insurers have traditionally focused their efforts on maximizing policyholder retention—especially among those customers they view to be the most valuable, whether in the short or long term. The current U.S. economic recession, which most experts agree began in December 2007, has heightened the importance of customer retention. Insurers are working to shore up their retention rates as well as financials in the face of lackluster investment performance.

—5-Year Personal Auto Industry Premium Trend—

![5-Year Personal Auto Industry Premium Trend](image_url)

Source: Standard and Poor’s, based on statutory findings

For the past 5 years, J.D. Power and Associates has published average customer retention rates for each of the top insurers in the U.S. personal auto and homeowners insurance markets. The *J.D. Power and Associates 2009 Personal Insurance Retention Analysis℠* is based on surveys gathered from more than 275,000 auto insurance customers. The survey was fielded from January to March 2009 and benchmarks 32 of the nation's largest personal auto insurers. (See Appendix for a complete list of profiled insurers.) The complete retention analysis, which provides segmented retention performance and defection patterns for each of these profiled insurers, will be available by subscription to the *J.D. Power and Associates 2009 Insurance Shopping Study℠* which will publish in June 2009.

"The current U.S. economic recession, which most experts agree began in December 2007, has heightened the importance of customer retention."
This Management Discussion includes an examination of some of the pronounced variations in customer retention performance between customer segments of two national insurers, GEICO and State Farm, which will demonstrate the kinds of opportunities the full analysis will identify for each of the profiled insurers. In addition, a financial model and the underlying assumptions are used in a number of instances to estimate the incremental premium that select insurers may realize if they successfully apply targeted strategies to improve retention for segments of their book.

**Industry Retention Trends**

For the industry overall, auto policyholder retention has remained fairly stable at close to 89% during the past 5 years, according to J.D. Power and Associates’ research. However, individual insurer performance is more volatile. For example, Progressive has made significant strides in improving customer satisfaction and retention during the past 5 years while AIG has suffered significant setbacks during the past year, presumably as a result of their highly publicized financial challenges and related government assistance. (Figure 2)

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In segmenting auto insurance customers based on purchase behavior, there has been a remarkably stable 12% difference in the retention rates of households that bundle auto and homeowners insurance from the same insurer, compared with monoline auto insurance customers (95% vs. 83%, respectively, this year). This phenomenon was explored in detail in the J.D. Power and Associates 2008 Insurance Shopping Study Management Discussion, “Winning and Losing Customers in Personal Auto Insurance.”

Examing policy retention by generational cohort reveals that Baby Boomers (born between 1946 and 1963) renew at a significantly higher rate (92%), compared with Generation X (born from 1964 to 1984) or Generation Y (born from 1985 to 1991) customers, who renew at rates of 88% and 80%, respectively. Pre-Boomers (born before 1946) renew at the highest rate, 93%.
The Relationship between Customer Satisfaction and Retention

Since 2005, J.D. Power and Associates has tracked the relationship between customer satisfaction, customer retention, and profitability for each of the nation's largest insurers. (Figure 3) These analyses reveal a significant financial benefit to each insurer of increasing customer satisfaction, one customer at a time. Simultaneously, J.D. Power and Associates' research in the personal auto insurance marketplace highlights numerous performance improvement opportunities and their impact on customer satisfaction.

The value that a personal automotive insurance customer represents to their insurer is usually realized over the long term. For many insurers, individual customers do not become profitable until their third or fourth year of tenure—after the insurer recoups the costs associated with acquiring that new customer. Therefore, the extent to which insurers are better able to retain current customers has a direct impact on their bottom-line profitability.

“...For many insurers, individual customers do not become profitable until their third or fourth year of tenure—after the insurer recoups the costs associated with acquiring that new customer.”
Case Studies: State Farm vs. GEICO

Like the industry as a whole, both GEICO and State Farm are better able to retain older customers than younger customers. (Figure 4) Comparing the two insurers, State Farm has higher retention rates across all generational groups and is able to retain Generation Y customers (88%) almost as well as GEICO retains Baby Boomers (90%). However, GEICO’s retention rate among Generation Y customers underperforms the industry at only 78%.

To estimate the financial impact of increased customer retention, J.D. Power and Associates has developed a model based on conservative estimates of policy growth, profitability, and premium growth. Using this model, if GEICO could halve the Generation Y retention gap with State Farm, the improvement could yield more than half a billion dollars of additional premium over a 5-year period.

Source: J.D. Power and Associates 2009 Insurance Shopping Study

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State Farm Retention Driven by Bundling

The most recently available financials for insurers, which are for the 2007 calendar year, indicate State Farm is the largest personal auto insurer with an 18% share of the U.S. market, while GEICO is the fourth-largest personal auto insurer with a 7% share. Both insurers performed at or above the industry average in the J.D. Power and Associates 2008 National Auto Insurance Study, which measures customer satisfaction. While State Farm successfully retained 94.3% of its personal auto insurance customers from February 2008 to February 2009, in contrast, GEICO retained only 87.3% of their personal line auto business on an annual basis, significantly below the industry average of 89.6%. (Figure 5)

Based on findings in the J.D. Power and Associates 2008 Insurance New Buyer Study, more than one in five (22%) new insurance buyers reported switching from purchasing auto insurance via an Agent to purchasing via Direct, whereas only 15% made the opposite switch. GEICO, a Direct writer, benefits from this change in purchasing habits. As younger customers gravitate toward online buying for a growing number of purchases and financial transactions, it is not unexpected to find Direct writers—such as GEICO, Progressive, and Esurance—gaining a larger share of Generation Y customers, compared with State Farm.

State Farm and GEICO differ not only in their distribution models, but also in their core product offerings. One of State Farm’s competitive advantages in retaining auto insurance customers is its broad range of product offerings, including homeowners insurance, umbrella coverage, and financial products. Looking solely at monoline auto policy retention, GEICO and State Farm have very similar retention rates among these monoline customers. (Figure 5)

However, GEICO performs better at retaining non-bundled renters, compared with State Farm. While a rental insurance policy represents less profit for the insurer or commission for a sales agent compared to a typical auto policy, the future long-term value that such a policyholder represents can be significant, especially once they move from renting to owning a home or other dwelling. The insurers that hold the auto policies for this group have an advantage in transforming monoline auto policyholders into bundled policyholders, which translates to more brand loyal and profitable customers. GEICO has difficulty matching the kind of loyalty performance demonstrated by State Farm among bundled policy customers. (Figure 5)

If State Farm could successfully cross-sell rental insurance policies to just half their monoline auto customers who currently buy rental policies from other insurers, the improvement in retention for this group could generate approximately $50 million in additional premium revenue during the first year alone, and as much as $600 million of additional premium revenue during a 5-year period. This is based on the premise that none of the underlying assumptions change.

GEICO is particularly strong at peeling away the monoline auto business of customers who are shopping for bundled auto and homeowners policies. Furthermore, only 40% of GEICO monoline customers who entertain competitive offers defect from GEICO.
compared with 49% for State Farm. Thus, a portion of GEICO’s recent growth is attributable to the fact that they can capture auto policy sales from those shopping for monoline or bundled policies. GEICO is also better able to retain these customers if they entertain a competitive quote after becoming insureds. However, the risk of State Farm’s monoline auto customers defecting is mitigated by the fact that only 23% have shopped for auto insurance during the past 12 months, compared with 33% of monoline GEICO customers. If State Farm monoline auto customers shopped at the same rate as GEICO customers, and all other considerations remained the same, the additional attrition could cost the company an estimated $2 billion in lost premium during a 5-year period.\footnote{10}

Defection Patterns

Since no insurer retains all of their auto insurance customers during the course of a year, it’s important to understand where the defectors are going. Across the industry as a whole, GEICO captured an estimated 15% of all defectors who switched insurers between February 2008 and February 2009, which helps to fuel the company’s growth, given a market share of only 7\%\footnote{11}. State Farm, by comparison, captures only 9% of defectors, despite an 18% share of the personal auto insurance market.\footnote{12}

When looking at brand-to-brand defections, Allstate succeeds in conquering GEICO and State Farm customers at a rate 1.5 times greater than their overall industry conquest rate. Comparing State Farm and GEICO, State Farm conquers only one-in-ten GEICO defectors while GEICO in turn captures State Farm defectors at nearly twice the rate.

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**Where Are Defectors Going?**

<table>
<thead>
<tr>
<th>Brand Defected To</th>
<th>Industry Average Defectors</th>
<th>GEICO Defectors</th>
<th>State Farm Defectors</th>
</tr>
</thead>
<tbody>
<tr>
<td>GEICO</td>
<td>15.4%</td>
<td>N/A</td>
<td>17.8%</td>
</tr>
<tr>
<td>Progressive</td>
<td>11.1%</td>
<td>Progressive</td>
<td>11.2%</td>
</tr>
<tr>
<td>State Farm</td>
<td>9.0%</td>
<td>State Farm</td>
<td>N/A</td>
</tr>
<tr>
<td>Allstate</td>
<td>7.8%</td>
<td>Allstate</td>
<td>11.9%</td>
</tr>
</tbody>
</table>

\[\text{Source: J.D. Power and Associates 2009 Insurance Shopping Study}^{\text{SM}}\]

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Conclusion

The findings in this Management Discussion serve to demonstrate the variations in customer retention rates evident within each insurer’s book of business when segmenting customers by demographic and attitudinal traits. For each insurance company examined in the full analysis for the 2009 Insurance Shopping Study, there exist groups of customers for whom the insurer is less competitive in retaining their policies. Insurers that are able to identify profitable customer segments with room for retention improvement can develop strategies that are more effectively tailored around these customers’ individual needs.

The forthcoming full analysis delves further into customer segments and profiles psychographic traits such as early technology adoption, affinity for financial markets, and additional demographic traits such as gender, ethnicity, and education, among others. This analysis is available by subscription to J.D. Power and Associates 2009 Insurance Shopping Study.SM

Footnotes:

1 Standard and Poor’s, based on statutory filings (reported in 2008).
3 Financial premium forecasts assume no change in new business production; and 3% annual growth in premium per policy.
4 Ibid.
5 A.M. Best 2007 Insurance Industry Financials based on statutory filings (reported in 2008).
6 J.D. Power and Associates 2008 National Auto Insurance Study.SM
7 J.D. Power and Associates 2008 Insurance New Buyer Study.SM
8 Financial premium forecasts assume no change in new business production; and 3% annual growth in premium per policy.
9 J.D. Power and Associates 2008 Insurance New Buyer Study.SM
10 Financial premium forecasts assume no change in new business production; and 3% annual growth in premium per policy.
11 A.M. Best 2007 Insurance Industry Financials based on statutory filings (reported in 2008).
12 Ibid.

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Appendix (List of Profiled Insurers)

- 21st Century
- Auto Club Group
- Auto Club of Southern California
- AIG
- Allstate
- American Family
- Ameriprise
- Amica Mutual
- Auto-Owners
- Commerce
- Country Mutual
- California State Auto Association
- Encompass
- Erie Insurance
- Esurance
- Farmers
- GEICO
- GMAC
- Hanover
- The Hartford
- Liberty Mutual
- Mercury
- MetLife
- Nationwide
- New Jersey Manufacturers
- Progressive
- Safeco
- State Auto
- State Farm
- Travelers
- Unitrin Direct
- USAA
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Detailed retention, conquest, and growth data for the major insurers listed in the Appendix are presented in the full analysis included in the J.D. Power and Associates 2009 Insurance Shopping Study, to be published in June 2009.