Competitive Advantage in the Service Industry

The Importance of Strategic Congruence, Integrated Control and Coherent Organisational Structure – A Longitudinal Case Study of an Insurance Company

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Abstract

Competitive advantage has received considerable attention. Few studies have however chosen a holistic approach taking multiple aspects and organisational levels into consideration. This research has the goal of filling parts of this void. The aim is to deepen the understanding of competitive advantage in the service industry by analysing how alignment of strategy, control and organisation structure on multiple organisational levels impacts competitive advantage of a service company over a long period of time.

Based on the idea of multiple factors and the importance of connecting different levels with each other, including production level, a framework for the service industry is developed based on the ideas of Nilsson and Rapp (2005). The framework is used to analyse the rich data gathered in a longitudinal case study of an insurance group embracing the environmental changes and the choices taken as well as the resulting competitive position.

According to the analysis, the Insurance Group is not ensuring an overall coordination of its activities, although there is a fit among some dimensions. The level of misalignment increased over the time, as a result of changes in the environment and less than consistent management decisions. Although the Insurance Group has been profitable and increased its market share since its foundation, the competitive advantage, measured as performance compared to market average, decreased. The declining performance combined with the increasing level of misalignment supports the assumed importance of reaching a consistent positioning among strategy, control and organisational structure. It can therefore be presumed that strategic congruence, integrated control and coherent organisational structure influence competitive advantage. However, due to the semi-protected insurance market the effects are weaker than they probably would have been in a more competitive and unpredictable market.

The Insurance Group inherited valuable and unique resources at its foundation. Their apparent stable value ensures the Insurance Group a competitive advantage, although no activities are undertaken to strengthen or even to maintain them. It can therefore be concluded that an integrated approach of competitive advantage where both positioning framework and valuable resources are used as complementarities seems to be beneficial when competitive advantage is studied.

Keywords: Strategy, Control, Competitive Advantage, Financial Service Industry, Insurance Industry

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1 Introduction

Understanding the dynamics of competitive advantage has been a subject that has attracted considerable interest within both business and the academy for decades (e.g. Ketchen et al. 2004, Teece et al. 1997). With the increasing competition due to technological revolution and globalisation, firms must ensure that they build and maintain the right competencies and that they dynamically adapt to environmental changes (Schilling and Steensma 2001, Hitt et al. 1998, Porter 1996) and towards customers’ shifting needs, processes and values (Prahalad and Ramaswamy 2000). Because of the enduring interest in the subject and the complexity of the question, there are multiple theories explaining how long-lasting competitive advantage can be achieved, each of them specialising in its own specific area (Ketchen et al. 2004). Among the definitions available for competitive advantage, Chakravarthy’s (1986) definition is used for framing the discussion in this study, as it provides broad insight of the subject. He sees competitive advantage and its resulting strategic performance as the quality of a firm’s adaptation to its environment, stressing that a well-adapted firm must be able to match its strengths with the opportunities in its environment. According to Chakravarthy this adaptation can be evaluated by the following factors:

- Whether the firm’s strategy is congruent with its industry structure and competitive context.
- Whether its organisational structure fits its environment and strategy.
- Whether its management systems fit its strategy.
- Whether its management style is tailored to the strategic context including the development of right competencies.

Multiple scholars from different research fields (e.g. Brignall and Ballantine 2004, Ensign 2001, Whittington et al. 1999, Shields 1997, Pettigrew 1992, Govindarajan and Fisher 1990, Lenz 1981, Miller and Friesen 1980a and b, 1978, 1977), like Chakravarthy, have highlighted the need for models where multiple factors and their interaction as well as the environment are considered when competitive advantage is analysed. Additional to the discussion of multiple factors, Bhimani and Langfield-Smith (2007), Luft and Shields (2003), Dansereau et al. (1999) as well as Glick (1985) point out in their studies in strategy, management control and organisational research, respectively, that cross-level models are necessary for a rich and valid explanation of the causes and effects of changes in
environment, strategy, control or organisation. That is, they state that the causes and effects need to be studied on multiple levels in a company, in order to increase the understanding how choices taken on one level influence the other levels and thereby a company’s competitive position. Most multi-level studies address only the corporate and the business unit levels. The functional level is seldom used as a level of analysis. However, as the functional level, especially the production function, is an important source of competitive advantage, a deeper understanding can be achieved by including this additional level in the research scope (cf. van Veen-Dirks 2005).

Although many scholars have highlighted these needs for many years, few models that fulfil these requirements have been presented. One exception is the conceptual model for competitive advantage based on strategic congruence and integrated control developed by Nilsson and Rapp (2005). In their model they highlight the importance of both strategic congruence and integrated control, taking internal and external context into consideration. Additionally to analysing multiple factors, they also include multiple levels in their model, pointing out that consistency between the corporate, business unit and functional level is also important for achieving high performance.

The discussion of Nilsson and Rapp has a relatively static emphasis – also according to the authors (2005: p. 195). The authors therefore suggest a more dynamic approach for future research on competitive advantage in order to enhance the understanding of the topic by analysing change over a longer time frame (2005: p. 211). Decades ago Rumelt et al. (1991) asked for more dynamic explanation and interest in time-based analysis of competition and the processes that select and coordinate the firm’s choices. Porter (1991a) in his article also encourages filling this gap, writing that while there has been considerable progress in developing models that explain competitive success at any given point in time, the understanding of the dynamic processes by which firms perceive and ultimately attain a superior market position is far less developed. In spite of the early calls for such studies, only very few have taken dynamic aspects into consideration, and decades later other researchers repeat the call for dynamic research in order to deepen the understanding of competitive advantage (Nilsson and Rapp 2005, Zajac et al. 2000, Lewin and Volberda 1999). Pettigrew et al. (2002), Zajac et al. (2000) and Ahrens and Dent (1998) state that a better understanding of how strategy, control and organisation structure function in practice can be obtained by conducting longitudinal field studies. This is in line with the suggestion of Nilsson and Rapp (2005: p. 212) to gather rich data over in-depth studies in order to deepen the understanding of the complex subject of competitive advantage.

In order to deepen the understanding of competitive advantage, this study empirically investigates how a service company’s competitive advantage over a long period of time is affected by changes in its environment,

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1 The reason for choosing the service industry is discussed later on in this chapter.
strategy, control systems as well as organisational structure. Furthermore the study follows Nilsson and Rapp (2005) by taking multiple levels – corporate, business unit and production on the functional level – into consideration. There has been limited empirical research to date examining these dimensions together, and whether or not they affect a company’s competitive advantage (Baines and Langfield-Smith 2003). This area is continually gaining interest however, due to the significant changes in the external environment faced by firms in all sectors of the economy since the 1980s and especially in the financial sector due to the worldwide effects of the on-going financial crises.

Based on the idea of multiple factors and the importance of connecting different levels with each other, including production level, a framework for the service industry is developed based on the above-mentioned model developed by Nilsson and Rapp (2005). The model is enhanced with service management theories in order to be able to analyse service industry in a more adequate manner. The framework supports the analysis of the rich data gathered in a longitudinal case study embracing the dynamic changes and the choices taken by the insurance company as well as their competitive position between 1995 and 2010. The research hypothesis is that strategic congruence, an integrated control system and a coherent organisational structure will strengthen the company’s competitive advantage.

Before presenting the research questions and justifying the relevance the study, the main concepts upon which the research hypothesis is based and the choice of industry are briefly discussed.

1.1 Strategic Congruence, Integrated Control and Coherent Organisational Structure

In this sub-chapter the main concepts – strategic congruence, integrated control and coherent organisational structure – are introduced for this study. A more detailed discussion of them is included in the theory chapter. Before the concepts are briefly presented, the contingency approach, which is the conceptual premise of this study, is presented.

A basic point of the study is a company’s interaction with its environment, that is, the matching of the company’s internal structures with

\[2\] Besides the dimensions mentioned, there are probably some more that affect a company’s market attractiveness; however, they are not included in the scope of this research project.

\[3\] A research programme (Strategy, Control and Competitive Advantage) conducts studies with the aim of testing and developing the framework presented by Nilsson and Rapp (2005). This study is part of the research programme and provides a purely service-oriented approach compared to the studies published so far in the research programme (e.g. Nilsson 2010, Sundberg 2009, Ahlström 2008, Anjou 2008).

\[4\] Environment in this study is defined as the market and the parties acting in the market. Environment is discussed in more detail in the theory chapter.
its environment. This study builds on a contingency theory approach. Bateson (2002) refers to contingencies as “if-then” branches, pointing out that design characteristics depend on an organisation’s particular circumstance, for example, on the degree of change in the organisation’s external environment. Moreover, this study follows the strategic choice perspective (Child 1997 and 1972) within contingency theory. That is, the environment is not seen as the only factor influencing the strategies and the structures of a company. In the strategic choice perspective, a company can affect its competitive arena in the long run as management has a wealth of means available to respond to environmental conditions. In other words, organisations are not seen as passive recipients of environmental influence (Child 1997, Bourgeois 1984, Miles and Snow 1984a, Lenz 1981, Miles et al. 1974). In this study, the adaptation process is therefore seen as a dynamic process subject to both managerial and environmental forces. That is, management has an active role in ensuring a strategic congruence, integrated control system and a coherent organisational structure.

Strategy is seen as the choices through which management responds to the company’s environment and matches its internal structures with the environment (Nilsson and Rapp 2005: p. 6, Ensign 2001, Zajac et al. 2000, Venkatraman and Camillus 1984). This matching is an on-going activity involving choices on different organisational levels. Strategic congruence is defined as a strategic consistency among choices taken on different organisational levels (Nilsson and Rapp 2005). Companies that coordinate strategies on different levels around their value-creating activities are expected to achieve competitive advantage compared to other companies acting in the same environment (Bengtsson and Kalling 2007, Goold et al. 1994). Fit among strategies on different levels and functions should therefore be a central component of competitive advantage (Porter 1996).

A control system is seen as a vehicle used for the formulation and implementation of the strategy. An effective control system can therefore be defined as the glue that holds the organisation together and makes it effective. As an organisation adapts to its environment and adjusts its strategy, the control system must also change to reflect the current conditions (Chenhall 2005, Malina and Selto 2004, Middaugh 1988). The role of control in this study is based on this integrated approach with strategy. However, an integrated control system not only supports the chosen strategy, but also integrates the control aspects on different organisational levels with each other. This integration provides a common frame of reference that facilitates communication between different organisational levels and ensures a transparency concerning the strategic choices taken (Nilsson and Rapp 2005: p. 9). The clear communication and transparency concerning the strategic choices taken support the alignment of activities within a company. A control system is however not only seen as a vehicle to implement a strategy but also as a vehicle that provides feedback to the management concerning the strategic choices taken. An integrated control system,
supporting the implementation of the strategy and an early feedback of the strategic choices taken, is therefore believed to provide the company with a tool to achieve competitive advantage.

The interface between strategy and organisation represents an important managerial area (Pettigrew et al. 2002) as the organisational structure also affects a company’s competitive advantage (Powell 1992, Lenz 1981). Changes in environment and strategy can initiate changes in organisational structure (cf. Powell 1992, Miles and Snow 1984a) but at the same time inertia within the organisational structure can influence the strategic choices possible to be implemented (Keats and Hitt 1988, Miller and Friesen 1980a and 1980b). As in a control system, a coherent organisational structure is intended to ensure that tasks are organised and managed in an efficient manner, supporting the strategic choices taken, and should therefore also influence a company’s competitive advantage.

All the above-discussed elements – strategic congruence, integrated control and coherent organisational structure – are believed to influence the competitive advantage of a company and are seen as complementarities as defined by Milgrom and Roberts (1995). That is, superior performance and competitive advantage are not believed to be gained by changing parts in isolation, but by combining the elements in a holistic approach. This holistic approach towards competitive advantage, where strategy, control and organisational structure are considered, is the baseline of this study.

1.2 The Industry Studied

The study focuses on the service industry, and especially the insurance industry. There were three main reasons for choosing this industry. Firstly, broad access to information was granted at one insurance company. Secondly, the service industry has not yet been studied as much as the manufacturing industry concerning competitive advantage. The changes taking place within the insurance industry due to the deregulation of the market was the third reason for the choice taken. In this sub-chapter the industry under study is briefly presented, first the service industry in general and thereafter the insurance industry.

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5 Milgrom and Roberts (1995) see complementarity as a way of giving precision to the notions of “fit” and “synergies” among the elements of an organisation’s strategy and structure. Complementarity means that activities are complements, doing (more of) any one of them increases the returns from doing (more of) the others (p. 181). Complementarity explains why it is difficult to change a system, and why centrally directed change may be important for altering systems. Changing just a few of the system’s elements at a time to their optimal values may not achieve the benefits that are available from a fully coordinated move, and may even have negative payoffs (Milgrom and Roberts 1995, pp. 190-191).
1.2.1 The Service Industry

In spite of the growing importance of the service industry\(^6\) and its changing environment\(^7\), most studies concerning competitive advantage have been conducted within the manufacturing industry. At the same time the changing environment implied and still implies a need for corporate repositioning and strategic thinking within the service industry (Dougherty 2004, Gidhagen 2002, Wilson 1988). Due to this a deeper understanding of strategy, control and organisation structure as a holistic system is increasingly important (e.g. Chesbrough 2005, Rust and Chase 1999, Karmarkar 1996, Schneider 1994). Although some conclusions can be taken from the studies conducted in the manufacturing industry, specific studies in service industry are relevant as the service industry differs in many areas, especially on the functional level, from the manufacturing industry (Johnston 1999)\(^8\). Due to these differences there is a need to understand the linkage between business positioning and more operational issues in the service industry such as production design, operational control, as well as the organisational structure and its impact on business performance (Verma et al. 2001, Johnston 1999, Chase 1996). In order to validate the interaction between the strategic and operational dimensions empirically, broad in-depth case studies are needed within service industry (Rust 2004, Chase 1996).

Although service management has been a well-established area of research since the late 1970s (Chase 1996), service production has not received much attention in research on service management (Johnston 1994 and Chase 1996 are two exceptions). One of the main reasons is that service management was, and still is, strongly rooted in marketing (Sampson and Froehle 2006, Chase 1996, Johnston 1994). This orientation seems to be slowly changing. Gupta et al. (2006), when analysing published articles on production and operations management, concluded that there is a trend towards more service-focused articles. However, they also stated that the weight in production management is still towards the manufacturing industry.

The call for broader studies concerning competitive advantage within the service industry, including operational dimensions, confirms the interest in the areas of this study. This call is especially valid for the insurance industry, as financial services have received much less attention compared to other service industries (Hatzakis et al. 2010).

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\(^6\) Both concerning its contribution to the gross domestic product and in terms of the workforce employed in the service industry.

\(^7\) The environment of service industries started to change comprehensively in the late 1980s when the competition was intensifying as new global players and technologies entered the market.

\(^8\) In the theory chapter these characteristics of the service industry are discussed in more detail.
1.2.2 The Insurance Industry

When studying changes in competitive advantage it is favourable to choose a company in an industry that is in the middle of a shift. The pattern of competition and market opportunities has been changing in the insurance industry in Europe for the last few decades. This is mainly due to deregulation in 1994, which has been forcing the insurance companies to reposition themselves on the market and to adjust their internal structures (Webb and Pettigrew 1999, Prahalad and Hamel 1994). In addition to the deregulation also technological and general economic change during the last decades has been creating a pressure for restructuring (Mahlberg and Url 2009, Haveman 1992). Due to all these factors the insurance industry is actually still in the middle of the shift. This makes it an interesting industry to study.

Middaugh (1988) writes that before deregulation, insurance firms were traditionally among the worst-managed companies. He sees the limited competition stemming from the high degree of regulation as a significant reason for this. Historically many organisations were more or less institutionalised as the sole providers in their region, or the service offered was so undifferentiated that customers continued using a certain provider just out of long-established habit (Ennew et al. 1993). Due to the environmental changes the insurers are facing an increased competition for customers. In order to succeed in the changing environment effective strategies based on an understanding of more complex interaction among multiple areas is needed (Hatzakis et al. 2010, Dougherty 2004, Gidhagen 2002, Oletzky 1998: p. 1). In other words, management issues like strategy, control and organisational structure are gaining importance within insurance industry.

The on-going shift and the higher focus on alignment between environment and the internal structures makes insurance industry an interesting area for a longitudinal study. This, together with the fact that broad access was granted by an insurance company, was the reason for choosing this company for the study.

1.3 Research Questions

As already mentioned, the aim of the research is to increase our knowledge and understanding of how strategic congruence, integrated control systems

\footnote{With the deregulation of the European insurance industry in 1994 an easier introduction of new products was enabled and the borders were opened for foreign insurers. Although the industry was deregulated in 1994, some areas such as product characteristics, capital requirements, information duties and legal constraints are still regulated. These constraints, however, do not prevent insurance companies from developing individual strategic options. Generally deregulation in other industries has been promoting competition, although some legal constraints remained (Shetty and Ross 1985).}
and coherent organisational structure influence an insurance company’s competitive advantage.

This is done by developing a framework for the service industry, including the aspects strategic congruence, integrated control and coherent organisational structure. With the support of this framework the collected rich data from the in-depth case study is analysed. Based on the conclusions from comparing the case data with the theoretical framework, the main research question can be reviewed. That is, do strategic congruence, integrated control and coherent organisational structure influence a company’s competitive advantage? Although the analysis focuses on the three above-mentioned aspects, the case data will also be analysed for complementary aspects that seem to affect the company’s competitive advantage.

In order to be able to discuss the main research question the theoretical definitions of strategic congruence, integrated control and coherent organisational structure will be compared with collected case data. Thereby the following questions will be highlighted:

- Strategic congruence: Do the theoretically defined combinations among corporate, business and functional level strategies lead to a strategic congruence at the studied insurer?
- Integrated control: Do the identified control mechanisms on the different levels enhance each other as predicted? Do the control mechanisms used in the studied company align with the strategy as theoretically foreseen?
- Coherent organisational structure: Do the implemented components within organisational structure support the strategy as expected in the framework?

Lastly, due to the longitudinal study, the dynamics of the alignment can be studied. Thereby it can be analysed how environment, strategy, control system and organisational structure align with each other and how this alignment seems to influence competitiveness over a longer term.

1.4 Contribution of the Study

The objective is to conduct research with relevance to practice and to provide support for practitioners (cf. Malmi and Granlund 2009). Otherwise as pointed out by Siggelkow “if theory talks only to theory, the collective research exercise runs the danger of becoming entirely self-referential and out-of-touch with reality, of coming to be considered irrelevant” (Siggelkow 2007: p. 23). Based on the idea of providing support for practitioners and

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10 The competitive advantage is measured by comparing the company’s performance to the market average.
following Pettigrew’s comment that “most jugular\textsuperscript{11} practical problems contain within them the most theoretically challenging research questions” (Pettigrew 1990: p. 274), the aim of the research is aligned to practical problems facing the insurance industry. As described in a previous sub-chapter the environment of the insurance industry has been changing over the last decade after being a stable, regulated and at the same time growing market. In order to succeed in this more competitive and mature market the insurers need to enhance their understanding of competitive advantage and how to ensure and keep it. Therefore the results of this study should be highly relevant to practice.

Although practical relevance is targeted, the academic contribution is the main criteria for a doctoral thesis. As discussed in the beginning of this chapter holistic, multi-level and dynamic perspectives have been identified as areas that need to be enhanced in order to deepen the understanding of competitive advantage. This study takes these calls into consideration in developing a framework, which is tested in a longitudinal, qualitative case study. The study should therefore also constitute an academic contribution, especially as there have been relatively few empirical studies, at least in contrast to the large body of analytical research, considering the relationship between strategy and internal control mechanisms on multiple levels and the effects on competitive advantage.

Additionally, the fact that the framework is developed for the service industry – where broad in-depth case studies with the purpose of refining the interaction between the strategic and operational dimensions and validating them empirically, are rare (Hatzakis et al. 2010) – should increase this study’s relevance from both the academic and practice points of view. A thorough internet search\textsuperscript{12} on different academic sites and insurance sites has shown that there has been very little research done in the insurance industry or actually even in the service industry studying the relationship of strategy, control systems, organisational structure, and competitive advantage. Although some studies were found\textsuperscript{13}, none of them has considered the range of aspects included into the holistic approach of this study. Three exceptions that have studied strategic fit in service organisations are Hill and Brown (2007), Smith and Reece (1999) and Nayyar (1992). The latter two studies look into the relationship between external aspect of fit and performance, characteristics of individual insurance service quality (Stafford et al. 1998, Crosby and Stephens 1987); Relationships between the insurance company and individual insurance intermediaries, insurance service productivity (Vuorinen et al. 1998); Value aspects of customer and employee loyalty (Reichheld 1996); Relationships within corporate insurance business and critical incidences (Gidhagen 2002); The insurance providers’ market orientation process especially within product development (Johne 1993); Definition of insurance service from a services marketing perspective (Gidhagen 2002, Meidan 1996 and 1982, Crosby and Stephens 1987, Majaro 1984 and 1982).

\textsuperscript{11} Jugular problems=problems causing much damage.

\textsuperscript{12} The following search strings were used “insurance” OR “financial services” OR “service” AND “strategy” OR “control” OR “organization”.

\textsuperscript{13} Characteristics of individual insurance service quality (Stafford et al. 1998, Crosby and Stephens 1987); Relationships between the insurance company and individual insurance intermediaries, insurance service productivity (Vuorinen et al. 1998); Value aspects of customer and employee loyalty (Reichheld 1996); Relationships within corporate insurance business and critical incidences (Gidhagen 2002); The insurance providers’ market orientation process especially within product development (Johne 1993); Definition of insurance service from a services marketing perspective (Gidhagen 2002, Meidan 1996 and 1982, Crosby and Stephens 1987, Majaro 1984 and 1982).
whereas Hill and Brown (2007) concentrate on internal aspects of fit mapping the level of internal fit and the corresponding characteristics of the market, operating strategy and service delivery system. None of the studies discusses both the internal and external aspects of fit and how they affect a company’s competitive advantage. Consequently there is still a void to fill.

Moreover the opportunity to be a part of a research team, all using the same tentative model as a base for a framework, but conducting case studies in different industries, should additionally increase the interest of the research from the academic point of view, as it provides a comparison of the data and conclusions drawn concerning competitive advantage from companies acting in different industries and environments.

Overall, the study contributes to deepen our knowledge of competitive advantage in the insurance industry by analysing multiple dimensions and their interaction with each other over time on multiple organisational levels. With the chosen holistic approach, looking into both strategic and operational aspects, the study helps to fill the identified void regarding competitive advantage in the service industry.

1.5 Outline of the Thesis

The next chapter explains the method used in the study. Thereafter follows the theory chapter, where the general theoretical frames for this study are discussed and the framework for the service industry supporting the analysis in this study is presented. Chapter four describes the case study, which is analysed with support of the framework in chapter five. In the final chapter of the report the conclusions of the study are summarised. The structure is illustrated in Figure 1.1.
1. Introduction
In this chapter the study is introduced by giving background information and presenting the research questions.

2. Method
In this chapter the choices taken within the research project are presented and explained.

3. Theory
The general theoretical frames and the tentative analysis framework for service industry used for the analysis of the case study are presented in this chapter.

4. Case Study
In this chapter the collected case material is presented.

4.1 Insurance Industry
The major occurrences within the insurance industry during the time frame studied are presented.

4.2 Case Company
The material collected during the case study is presented per insurance line.

5. Analysis / Results
The analysis of the empirical material with the support of the tentative framework is presented in this chapter.

6. Conclusions and Implications
The conclusions and their implications are discussed in this chapter. Also further research ideas are presented.

Figure 1.1: The structure of the thesis
2 Method Used in the Study

The method defines “how” the phenomenon is studied (Silverman 2000). This is the baseline for the validity or trustworthiness of the study and ultimately the conclusions drawn from the study (Keating 1995). Method refers to the choices made when planning and executing the study, that is, during preparation of the study, data gathering, data analysis and quality assurance of the data gathered and conclusions drawn. In this chapter the choices made concerning “how” in this research project are presented and explained.

As mentioned in the introduction this study investigates how an insurance company’s competitive advantage over a longer period of time is affected by changes in its environment, strategy, control systems and organisational structure. The study is theory driven. An existing tentative model is adjusted for the service industry and enhanced to fit the research questions. The data from the case study is compared with the framework, which is iteratively enhanced during the study.


The structure of this chapter is illustrated in Figure 2.1. In the forthcoming sub-chapters the elements and steps of this study are going to be explained and justified.
2.1 Study Preparation

In this sub-chapter the choices made during the preparation of the study are discussed. The consequences of a theory-based study are evaluated, the choice of case company is discussed, the time-span chosen is explained and the degree of involvement is reviewed.

2.1.1 Iterative Framework Based Study

To support the holistic approach where a huge amount of data concerning multiple factors are collected and analysed a framework built on existing theory is used as a point of departure for the research. The use of theoretical frameworks is an immense aid in designing appropriate data collection, in analysing data and in generalising the results (Yin 2003, Porter 1991a) as they reduce the complexity by filtering and structuring the contextual information collected in the case study (Pettigrew 1997, Scapens 1990). Prior theories also enable a clear research focus and the development of precise and measurable constructs (Eisenhardt and Graebner 2007, Eisenhardt 1989). Apart from supporting the collection and analysis of data a framework also increases the validity of the research process as the reader directly gets an understanding of what kind of data was collected and analysed as well as which dimensions were excluded from the study (Pettigrew 1997, Scapens 1990). Moreover, the framework, by explicitly presenting the researcher’s initial theories signals the perspective or bias that the researcher brings into the study (Pettigrew 1997).

The term framework is explicitly used instead of model for the theoretical constructs used to support the data collection, data filtering and data analysis. My choice of wording builds on Porter’s (1991a) positioning of models versus frameworks. Porter sees models as situation-specific and of limited complexity. Each model abstracts the complexity by isolating a few key dimensions whose interactions are examined in depth. The framework, on the other hand, encompasses many dimensions and seeks to capture much of the complexity.

The quality aspects of using a tentative framework is discussed in more detail in section “2.4.3 Internal Validity”.

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14 The term framework is explicitly used instead of model for the theoretical constructs used to support the data collection, data filtering and data analysis. My choice of wording builds on Porter’s (1991a) positioning of models versus frameworks. Porter sees models as situation-specific and of limited complexity. Each model abstracts the complexity by isolating a few key dimensions whose interactions are examined in depth. The framework, on the other hand, encompasses many dimensions and seeks to capture much of the complexity.

15 The quality aspects of using a tentative framework is discussed in more detail in section “2.4.3 Internal Validity”.

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Figure 2.1: Elements of the research method, around which the structure of this chapter is organised
However, the use of theoretical constructs to filter contextual information in case research is discussed intensively among researchers (Ahrens and Dent 1998, Atkinson and Shaffir 1998). Researchers like Dyer and Wilkins are critical that this approach will merely “confirm, disconfirm, or build upon existing theories”, rather than exposing “new relationships, new orientations, or new phenomena that current theory and theoretical perspectives have not captured” (1991: p. 617). The challenge is not to lose information by over-filtering case material through explicit theoretical concepts and to retain theoretical flexibility if the data collection does not support the a priori constructs in the framework (Scapens 1990, Eisenhardt 1989). In the case of this study, although the case study is based on an initial theoretical framework, the theories included are not followed as strict rules; they are more seen as guidelines or starting points. With an iterative design the opportunity to change focus, if the on-going analysis of the rich data collected in the longitudinal case study suggests this (Silverman 2000), is kept open. Following this approach the initial theoretical framework can be tested and further developed during the case study.

Through the iterative approach the theoretical framework is refined by continually mirroring the analysed data against the theories embedded in the framework. An iterative process or a cycling between theory and data, where new insights are continually accumulated, is a recommended process in case study research (Eisenhardt 1989, Hägg and Hedlund 1979) and is the creative process of the research (Pettigrew 1997). Through iteration the research conclusions are validated, and relevance outside the academic world is enhanced (Meredith 1993).

The research project can consequently be divided into three overlapping and iterative phases (illustrated in Figure 2.2):

1. Development of a tentative framework, which is used for the data collection and analysis. This framework is based on existing theories.
2. Conduct of an in-depth longitudinal case study, where data is collected and analysed.
3. Refinement of the framework based on the data collected during the case study.

*Figure 2.2: The iterative research design*
As mentioned in the introduction of this chapter, the framework is based on an existing tentative model, which is enhanced for the service industry. In order to adjust the original tentative model a literature review of existing theories is performed. The method for the literature review is discussed in the next section, whereas the result of the literature review is presented in the theory chapter.

2.1.2 Literature Review of Existing Theories

Generally, a researcher needs to be familiar with the subject to be studied (Gummesson 1991). Gummesson (1991) suggests two factors that contribute to this vital knowledge: the individual’s own personal experience from both private and working life as well as intermediaries as textbooks, research reports, seminars, experience from others, etc. In my case, my long experience in the insurance industry needs to be complemented with knowledge from intermediaries. Therefore, an initial literature review, with the aim of developing the initial framework, is conducted before starting the case study. Compliant with the iterative research process, the literature review is ongoing during the whole case study as new areas of interest are identified during the data analysis.

Relevant literature was identified, reviewed and analysed within areas of environment, strategy, control and organisational structure as well as the service and insurance industries. After interesting material was found, the references in these papers and books were reviewed in order to deepen the knowledge within a certain area. That is, a so-called snowball method was used. The snowball method increases the probability of finding relevant literature by providing a possibility of identifying previous as well as following research publications in a specific area. Based on the first review of the literature the initial framework was created and tested by collecting and analysing the data of the case company.

2.1.3 Selection of Case Company

The aim of this study is to understand the relationships between multiple factors influencing competitive advantage. Gummesson (1991) and Balogun et al. (2003) point out that if the aim is to understand in depth the mechanisms of relationships and their change over time there is no need to study a large number of case companies. Due to the time-consuming character of these studies it is generally not possible to carry out more than one or a very limited number of in-depth case studies in a research project (Gephart 2004, Balogun et al. 2003, Gummesson 1991). Concentrating on

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16 In order to find relevant theories, the key word “strategy” in combination with “environment”, “services”, “management control”, “production control” and “organisational structure” was used in different research databases containing published research papers from journals.
few or a single case study enables the researcher to be close to the phenomena of study, to concentrate on context and detail by visiting and observing many parts of the organisation (Balogun et al. 2003). Within this research project a single company is studied, although multiple units are studied within the single case company. The results from the different units are used for cross-case pattern searches and replication of the results across the case (Yin 2003, Eisenhardt 1989). In this case the data collected concerning the different insurance lines are compared with each other. Additionally a cross-case comparison of the research conclusions is possible as this project is a part of a research programme where parallel case studies are conducted using the same tentative model. This is discussed further in “2.4.4 External Validity”.

Focusing on a single company has certain limitations in terms of generalising the findings to a wider scope (Silverman 2000, Nilsson and Rapp 1999, Eisenhardt 1989). However, the target is not to find cases that represent and confirm set connections, but in one unique case to increase the understanding of a complex system of relationships among strategy, control systems, organisational structure, and competitive advantage. In these occasions there is a persuasive power in a single case (Siggelkow 2007). The aim is to look for “theoretical generalisations”, and not “statistical generalisations” (Scapens 1990). As early as 1979 Hägg and Hedlund pointed out the need to expand the term generalisation from an over-emphasis on data and observations towards an emphasis on broadening theory and the generation of knowledge. The theoretical generalisation of the results of this study is also discussed further in “2.4.4 External Validity”.

The selection of the case site for an in-depth case study is decisive for the outcome of the study. Several factors need to be considered when a study site is selected. The focus should be on identifying theoretically useful cases (Eisenhardt and Graebner 2007, Eisenhardt 1989), but at the same time access needs to be ensured (Gummesson 1991). Below the four criteria used for the study-site selection are listed:

1. The organisation under study should have been facing changing environmental conditions, suggesting possible need for internal change (Zajac et al. 2000).

2. As the research project is a part of a research programme, the programme criteria need to be taken under consideration. The research programme concentrates on the study of companies that have been more successful than the industry average. The case company must fulfil this criterion.

3. Access needs to be granted over a long time frame. To be able to make a long-running in-depth case study an open and intimate relationship needs to be established with the key informants (Gummesson 1991). Due to the delicate nature of the study (competitive advantage) assistance from a supporter inside the company is beneficial (cf. Regné 2003).
4. The researcher should be able to understand the empirical context so that specific relevant factors likely to affect change can be identified (Zajac et al. 2000). This contextual understanding is unlikely to be achieved without direct, first hand, and more or less intimate knowledge of the research setting (van Maanen 1979). Therefore there is a value in basing the research in an area with which the researcher is already familiar (Silverman 2000, Gummesson 1991).

The insurance company where I am employed was chosen as the case company for this research project, as the company fulfilled all the above listed criteria. Especially the fact that data can be collected during a period of environmental change supports the aim of the study. That is, by being able to study multiple changes within the identified dimensions and their interrelation with each other and the company’s competitive advantage, a greater level of understanding can be reached.

An additional major benefit of the chosen company is that it provides an opportunity to collect data and analyse the dimensions at a level of detail that is not generally accessible to outside researchers. As the research project was approved by the board of directors, it ensures an unlimited opportunity to select interview partners and to study internal documents. There are consequences of choosing a company where the researcher is employed, however. These consequences are discussed in “2.1.4.1 Degree of Involvement / Interference with the Case Object”.

2.1.4 Time Span of the Study

When investigating change, the time range chosen has to be capable of revealing the patterns and context of change. As this study looks into the firm's ability to transform itself, data over a long time frame needs to be gathered and analysed (Yin 2003, Silverman 2000, Porter 1991a). Whereas real-time data enables the researcher to observe changes as they unfold in their natural field, retrospective data is important for an understanding of the context and events leading up to the present situation (Pettigrew 1979). Therefore retrospective data should complement real-time data in a longitudinal research design (cf. Dawson 1997, Van de Ven 1992). On the other hand, real-time data collection helps to mitigate the bias of retrospective sensemaking (Eisenhardt and Graebner 2007). Consequently, what is needed is a real-time analysis complemented by a retrospective data analysis.

Miller and Friesen (1980a) in their study of published case studies empirically found that the average period of internal change, in their case strategic change, was six years, the shortest eighteen months, and the longest 20 years. Therefore the minimal time frame for the study should at least

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17 The bias is discussed in section “2.2.1 Collection of Retrospective Data”.
exceed the average of six years. However, not just the average time span of change but also the company’s historical events are important. Nilsson and Rapp (1999) point out the methodological problems that arise in a study of change when no critical events can be discerned. Gummesson (1991) also stresses the importance of including historical events, which he calls “milestone classifications”. For that reason the time frame of the study should be chosen to include some critical events that should be regarded as triggering the process of change.

Taking the time period of change and the critical events into consideration, a real-time analysis of five years, complemented by ten years of retrospective data analysis, is chosen for this study. 1995 is chosen as the starting point, as the case company was re-organised as a privately owned corporation in 1995. During the study period three major acquisitions were conducted, which can be classified as major “milestones” for change. In addition to the internal “milestones”, major critical external “milestones”, like 9/11 and the financial crises, occurred during the chosen time frame. Therefore sufficient critical events occurred during the time period under study that should be able to trigger a change in the identified dimensions.

2.1.5 Degree of Involvement / Interference with the Case Object

Many researchers have discussed the role of the researcher in a case study. Generally the researcher is more or less deeply immersed with the object of study in all kinds of case studies. This is often viewed as posing a methodological problem. Some researchers, such as Whittington et al. (2003) argue that academics should guard their relative independence, whereas others see it in quite the opposite way. Jönsson and Lukka (2006), for example, recommend that the researcher should deliberately make an impact in order to gain deeper knowledge.

As an employee I participated actively in strategic, control and organisational structure issues. I was responsible for various projects concerning control and organisational structure, and I was often involved in strategy discussions on corporate, business and functional level during the years I conducted my case study. Subsequently, I was an active participant in the area I studied. However, during the time frame of the case study I was never authorised to take decisions in these areas.18 Active participation provides opportunities for collecting case data, but it also involves major problems. Below the advantages and disadvantages of active participation are discussed both generally and for this study specifically.

The advantage of active participation is that the researcher, by interacting within the case company, has the opportunity, relative to nonparticipant

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18 Also, after being named a member of the Board of Directors for the Hungarian subsidiaries in 2010 I was not involved in the German decisions taken.
research, to understand in more detail what drives the actions (Jönsson and Lukka 2006, Balogun et al. 2003). By participating the researchers can put themselves into “the manager's temporal and contextual frame of reference” (Van de Ven 1992: 181). This sensitivity and understanding about the meanings and actions in the field mitigates the problem of misunderstanding the perspectives (Jönsson and Lukka 2006, Atkinson and Shaffir 1998) and increases the data quality (Balogun et al. 2003). A major additional benefit of being employed by the case company is the access to data that are otherwise inaccessible to scientific investigation (Yin 2003). In my case this means that I could easily identify and gain access to relevant informants and information. It especially enabled a broad and unique access to top-management as interview subjects. Gummesson (1991) mentioned these two aspects as the main advantages of a researcher being employed by the case company. He also writes that independent academics can collect data, but they are not exposed enough to the reality of real problems to visualise them as effects and generalise conceptual insights. Being an employee of the case company ensures, through the continual involvement, an early identification of these effects. The participation could however also lead to some disadvantages that need to be considered.

The major disadvantage of active participation mentioned is that the researcher is influencing events and is no longer in a position to report what actions might have been chosen, absent her/his participation. As a participant, the researcher may end up assuming advocacy roles within the group, contrary to the interest of good scientific practice (Yin 2003, Atkinson and Shaffir 1998). Thereby she/he might have produced potential biases and disrupt the actions that would otherwise be conducted (Yin 2003). Except the potential bias of disruption Yin (2003) and Gummesson (1991) mention more operative problems. One substantial problem involved from their point of view is the insufficient time for scientific research, as the participant role may simply require too much attention relative to the researcher role. As a result, the researcher may not have sufficient time to take notes or to raise questions about events from different perspectives, as a good independent researcher should do (Yin 2003). A similar problem mentioned by Atkinson and Shaffir (1998) is the common phenomenon of the researcher identifying with the group and thereby losing objectivity. Alvesson (2003) and Atkinson and Shaffir (1998) discuss additional effects coming from the observed persons. Firstly, they mention the desire by the subjects to be helpful to the researcher by telling the researcher what the subject thinks the researcher wants to hear. Secondly, Atkinson and Shaffir (1998) warn that the subjects might alter the situation so the subject will be presented in a more favourable light to the researcher or because of a perception that what is communicated will be reported back to a superior who expects a certain type of behaviour or answer. Although some of the disadvantages listed could be seen independent of an active participation,
their bias and mitigation are discussed in the context of this study in the next part.

2.1.5.1 Mitigation of the Disadvantages within my Research Study
The challenge with active participation is to recognise the issues that might produce bias and then to determine how to best deal with them. The aspects need to be considered seriously, especially as the credibility of a whole case study can be threatened in the event of bias. However, other researchers have mastered the same situation, for example van den Bogaard and Speklé (2003). One of the authors worked for the company under study. They point out that they gained insights from one of them being deeply immersed in the organisation studied, and also from being personally involved in the events described in the study. The situation permitted them unrestrained access to data and informants, and greatly facilitated interpretation of what transpired. On the other hand, they also point out that the involvement might have introduced some bias in the account. Below I will present the bias identified and the actions for mitigation chosen in this study.

Firstly, as stated by van den Bogaard and Speklé (2003), the focus of the study needs to be taken into consideration when judging the bias. In this study what is being studied is the content of strategic decisions, the associated control issues and the organisational structures implemented. The content orientation is less susceptible to subconscious bias than a more socially oriented study would have been. In order to limit the bias, as in the van den Bogaard and Speklé study, my own observations are not collected as case material, but only used as input for interview questions and document review. Secondly, I might take the advocacy role due to my involvement in some projects. However, as already mentioned I did not have any authority to make decisions concerning strategy, control nor organisational structure within the studied scope of the case company. The insights I gain by participating in some projects are only used to formulate clear interview questions and thereby effectively collect the decision-makers’ point of view concerning the topics. Thirdly, the combination of the colleague and researcher roles in daily work situations is a challenge to handle, especially the problem of when to take notes concerning an observation and when not to. Therefore, observation is abandoned as a data collection method. The observations are instead only used as input for the next round of interviews. Fourth, as a highly engaged employee I do identify with the company and the change projects I am involved in. Nonetheless, I believe that objectivity can be maintained due to the fact that multiple information channels were used for data collection. Additionally, knowing the company so well may increase objectivity, as none of the informants can present a situation in a more favourable light. In situations where informants might try to enhance reality in their favour, I have enough information to be able to ask for more details that ultimately lead to a more accurate picture. Lastly, my research colleagues also regularly questioned my double role, which makes me very
conscious about all the situations that could lead to bias. Overall, by recognising the disadvantages and early seeking for mitigation solutions, I strongly believe that my employee role was mainly beneficial to the study.

2.2 Data Collection

In this study both historical and current data is collected and interpreted. The aim is to collect rich data, which is content based, comparative (with the market), pluralist (competing versions of reality seen by different actors within the organisation and industry), and contextual (mainly environmental).

Longitudinal research can refer to a number of quite different types of data collection (Dawson 1997). It is therefore important to prepare what kind of information should be gathered, as the data collected need to be structured in order to be manageable (Melin 1992). In this case study the tentative framework with its identified dimensions and aspects\(^\text{19}\) is used to identify the relevant data. Additionally, in this study information is gathered from a lengthy epoch starting from the privatisation of the case company. In order to support the historical data collection the information is gathered based on a number of time-spaced sequential snapshots of critical events like acquisitions or environmental crises. From these snapshots more general trends and explanations are derived.

Knowing what you want to find out leads inexorably to the question of how you will get that information (Silverman 2000). A case study involves using multiple sources and techniques in data collection. This study follows Pettigrew’s (1990) recommended triangulated method for data collection, in order to strengthen the validity of the data:

- Documents to provide data in order to establish the chronology of events leading to change.
- Interviews to provide deep, subtlety and individual interpretation of the events and change.
- Direct observation, especially discrepancies between what was collected in the interviews and what actually was done. However, in order to mitigate the bias of being an employee of the case company, observation is only used as an input for the interviews. This input is valuable, however, as combining observation with interviews is deemed to be an important method in order to be able to reflect, crosscheck and analyse the data gathered (Dawson 1997, Leonard-Barton 1990).

The aim of triangulation is to use different methods or sources to corroborate each other (Silverman 2000). Gummesson (1991: p. 30) additionally points out that different methods need to be used to complement

\(^{19}\) The aspects are presented in the next chapter.
the analysis of changes within a company. The strength of using inter-method triangulation is not limited to the increased validity. It also ensures a deeper understanding of the issue being studied, as information from different sources can be compared with each other (Kober et al. 2007, Dawson 1997). As early as 1979, Jick pointed out that multiple sources are more useful to researchers as they sometimes lead to different conclusions. Jick states: “In fact, divergence can often turn out to be an opportunity for enriching the explanation” (1979: p. 607). Therefore the triangulation of evidence, through multiple data collection methods, enriches a researcher's interpretation of the data and thereby strengthens the conclusions drawn from the material (Eisenhardt 1989, Schwenk 1985).

The study is mainly based on first-hand information in the form of interviews. However, secondary data is also gathered from a variety of sources, both internally within the company and from public documents and archival records, in order to complement the first-hand information collected during the interviews. Additionally, direct observation is used as an input for formulating interview questions with the aim of gaining a deeper understanding. In the next sections the main methods and techniques of data collection used in this research project are described.

2.2.1 Collection of Retrospective Data

As mentioned above historical data is included in the study. Collecting retrospective data is always a challenge to some extent. There is a need to be cautious in the case of both documents (secondary data) and interviews.

Secondary data like documents are always incomplete, as history can never be documented in its entirety (Schwenk 1985). Even when archival data is available, a researcher must be cautious when interpreting the data (Golden 1992), as the researcher is normally not sufficiently familiar with the historical background to generate accurate conclusions (Schwenk 1985). Secondary material also always carries a message, sometimes one that is quite biased due to the purpose behind the document. The trustworthiness of a single document can be verified, however, by other documents or by information gathered in interviews. In this research the access to archival documents where decisions taken can be followed is very beneficial as they can be used to verify the interview data and to ask questions about documented decisions.

Asking informants to provide retrospective data also has its problems, as individuals in the organisation can be replaced (Lind 2001), as people seem to forget issues that were not considered important at the time (Huber 1985), and as they tend to interpret the past situation with the present values (Trost 2005). The stories are therefore always fragmented, open to interpretations

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20 Validity of the research project is discussed in more detail in section “2.4.2 Construct Validity”.
and often a matter of retrospective rationalisations and the shaping of an ideal image of previous times (Eisenhardt and Graebner 2007, Kober et al. 2007, Lind 2001, Schwenk 1985). Golden (1992) in his study showed that, due to faulty memory and/or due to attempts to cast past behaviours in a positive light, retrospective errors appear to occur systematically. Retrospective accounts of past facts are likely to be more accurate than accounts of past intentions, which are more subjective and therefore more vulnerable to the effects of cognitive biases and faulty memory (Golden 1992). In this study the bias is limited as multiple respondents are interviewed and as the information gathered from the interviews are compared with available secondary data. Nevertheless, the experience during data collection indicates that it is more difficult to collect rich data concerning reasons for change in the past than it is for more recent events.

2.2.2 In Depth Interviews with Key Informants

Interviews are the major source of data within this study. The aim of the interviews is to collect contextual data concerning changes within the strategy, control and organisational structure. Not only the content (“what”) is of interest but also “why” changes occurred. As the aim is to develop a holistic understanding with the support of an iterative framework, the interviews need to be flexible and allow new ideas to appear. Therefore semi-structured interviews are conducted. The use of semi-structured interviews ensures that all interesting aspects are covered and at the same time gives freedom to respond to and follow up conversations as they evolve. The idea is to ask simple and straightforward questions and get descriptive open-ended answers to these questions (Trost 2005, Yin 2003).

An interview guide was used in order to ensure that all main aspects were covered. It is linked to the theories integrated into the framework (Kalling 2007) and supports the data collection by operationalizing the research goals into interview questions (Trost 2005). The interview guide has five sections. It begins with the background of the respondent. Thereafter follows a section concerning the environment in which the company acts. The third section of the interview guide focuses on strategic issues, and the fourth part concentrates on control systems. The last section looks into organisational structure. The sections used and questions asked are dependent on the respondent’s background. The interview guide nevertheless ensures that the same topics are discussed with multiple informants in order to validate the answers. The guide is used as a general plan of inquiry, not as a precise set of questions that must be asked in specific words or in a particular order. Due to the interactive research approach the interview guide was updated as new perspectives were identified. The last version of the interview guide is presented in Appendix A.

Audio-recorded interviews enable the researcher to return to the data in its original form as often as wished. In this study interviews are however not
recorded. The main reason is the risk of not getting honest and rich answers. This risk is rather high as competitive company information, also about future plans, is discussed. A related reason for not recording is a political one, drawn from the fact that I am a colleague of the interview partners. Due to this fact there is a risk that an audio-recorder would make the colleagues answer in a politically correct manner. Additionally, it has been shown that informants become more spontaneous once the recorder is turned off (Warren et al. 2003). So, in this study notes are taken during the interviews. In order to capture the data nuances the interview reports were typed immediately after each interview.

As the study analyses retrospective as well as current information two different types of information are collected during the interviews:

1. Information about retrospective changes in the areas of environment, strategy, control and organisational structure. This data concerning changes is gathered based on sequential snapshots of critical events, which were identified during the internal and external document review.

2. Information on the current situation: Recurring interviews with the same interview partners are conducted in order to collect information about changes which had occurred during the past year (Glick et al. 1990) as well as changes foreseen for the next year. Data concerning the changes and the reasons for the changes are collected. The recurring interviews ensure that follow-up questions can be asked, due to diverse information received in other interviews or during observation or when complementary information is needed.

As the interviews are the main source of information, the accuracy of the information needs to be high. Therefore, these in-depth, semi-structured interviews are conducted with multiple informants occupying different roles at corporate, business unit and functional levels. Furthermore, several documents and archival records as well as observations are discussed during the interviews in order to triangulate the data provided by the informants. The multiple and recurrent interviews also enable the possibility of testing conclusions, by comparing the answers with the information already gathered from previous interviews. The validity of the information gathered is also dependent on selecting and getting access to the right interview partners. In the next section the selection process of the interview partners is discussed.

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21 This assumption is discussed in more detail in section 2.1.5.
22 The timeline is presented in Appendix B.
23 The quality of the data interpretation and analysis is discussed in more detail in section “2.4.3 Internal Validity”.
2.2.2.1 Selection of the Persons to Interview
Through the selection of numerous and highly knowledgeable informants representing multiple diverse areas the bias in information gathered can be limited (Eisenhardt and Graebner 2007, Leonard-Barton 1990). Therefore the qualifications of the informants are very important for the correctness of the data collected. The issue is to identify the right informants and to ensure that they correctly understand the area of investigation and that they provide veridical answers. The informants need to have access to information about current changes as well as decisions taken in the past. The informants are therefore selected from different levels in the hierarchy and from different functional areas in order to be able to collect information about the decision-making, the intention, the implementation and the follow-up of strategy, control and structural changes from different point of views.

Thanks to my employee role it was rather easy to choose informants within the areas of market/environment, strategy, control and organisational structure, on the corporate level, for the different insurance lines as well as for the subsidiaries. A preliminary list of informants was prepared and presented to top management. Due to the fact that all top managers were prepared to support the research project, access to information and informants was ensured. As a matter of fact some additional informants were even suggested by the top management. Due to the long time-span of the study, some of the informants could not give information for the whole time frame. In these cases complementary interviews were conducted with persons who had the position before and in some cases retired managers were contacted.

The first preliminary list of persons to interview presented to the top management was enhanced and updated during the whole research process. Ahrens and Dent (1998) named the method through which the researcher obtained a more and more complex overview by talking to a broad range of informants in different functions and locations “spreading the net”. The results of the “spreading the net”, that is the final list of interview partners and the interview dates is presented in Appendix C. The 91 interviews with 49 different persons lasted between one and two hours and were conducted between January 2006 and September 2010.

2.2.3 Document Review
As mentioned in the beginning of this sub-chapter secondary data material, internal as well as external, is used to complement the first-hand information collected through the interviews. As Yin (2003) points out documents are not always accurate and may not be free from bias. They should therefore be used carefully. For case studies, as in this case, documents are nevertheless important, to corroborate and augment evidence from other sources of data (Frow et al. 2005). The information from the documents reviewed was
elaborated both as background information for the interviews but also discussed during the interviews.

Thanks to my role as an employee in the case company and the overall support from top management, access was granted to all information requested. I gained access to executive summaries but also the raw data from which the summaries/conclusions were drawn. The real challenge was to find the right information in all the information available. As with the informants I “spread the net” more and more during the research project and worked my way from external information towards internal information. The documents reviewed can be divided into four categories, based on their origin and audience:

1. General external information provided by external experts concerning the insurance market including industry statistics as well as external analysis or newspaper articles concerning the case company.
2. External information provided by the case company including annual reports, the annual rating report and press releases. A book where the company’s history is presented falls into this category.
3. Customer and sales channel information collected by the case company for internal use including the customer and sales channel satisfaction surveys conducted repeatedly.
4. Internal information about internal decisions taken, including internal position papers, strategy and policy documents, the minutes of board meetings as well as annual strategic planning meetings where the market, strategy, control system and/or organisational structure were discussed. This category also includes organisational records such as organisational charts, reporting lines, and management guidelines as well as some internal project-based interview protocols.

After describing how the data is collected, the thesis continues with a discussion of how the data was reduced and analysed in the next sub-chapter.

2.3 Data Analysis

The overwhelming volume of data generated is a common hazard of all qualitative case study research (Leonard-Barton 1990, Miles and Huberman 1984). Although an analytic framework is used in this study to support data gathering, more disciplined and focused data gathering would probably help the data analysis. However, due to the iterative research approach, open for new input, which can be used to enhance the framework, too narrow a scope for data gathering is not applicable. Additionally, it is difficult to identify

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24 A complete list of document types reviewed is presented in Appendix D.
critical data in a real-time longitudinal study, while one is in the midst of the research. Therefore, the data gathered in this study is rather broad.

A second striking feature of case study research is the frequent overlap of data analysis and data collection (Yin 2003, Miles and Huberman 1994, Eisenhardt 1989). In order to benefit from the flexibility due to the iterative research approach of this study, a quick and repeating review of the data collected is important. This enables the research to aim in the most interesting direction in the next iteration in order to develop the framework further. For that reason, data is analysed between each interview round, in order to identify new important parameters for the framework. This is done by adopting two concurrent flows of activity described by Miles and Huberman (1984):

1. Data reduction and display: The first step in qualitative analysis, as Miles and Huberman (1984: p. 21) point out, is reducing the data into a manageable form. The aim is to reduce the data so that it can be organised in such a way that contradictory information can be identified and “tentative” conclusions can be drawn and verified.

2. Conclusion drawing and verification: This activity overlaps with the identification of data inconsistency. The conclusions are continually verified as analyses proceed. That is, the meanings emerging from the data are tested for their plausibility, their sturdiness, and their “conformability”. In other words, the conclusions are tested for their validity.

How these two flows of activity are used in this study is discussed in the following two sections.

2.3.1 Data Reduction and Display

Data reduction and display between the interviews enables moving back and forth among data, relevant literature and emerging theoretical patterns (Atkinson and Shaffir 1998, Eisenhardt 1989). After each interview round the interview notes are consolidated into one document per unit of analysis (industry, corporation, line of business). The data is categorised after the dimensions and aspects of the framework. This organised assembly of data permits conclusion drawing and action taking by enabling the identification of:

1. Inconsistent information within a unit of analysis, which needs to be sorted out or confirmed in the next interview round or by reviewing documents. If the inconsistency is not a bias due to data collection, the discrepancies are highlighted in the consolidated document and analysed in more detail when all information is gathered.

2. Missing information that needs to be collected in the next interview.
3. Information that confirms the dimensions and aspects of the framework as well as already gathered information.

4. Emergent themes or patterns of information that are inconsistent with the dimensions and aspects identified in the framework. These themes or patterns might lead to adjustments in the framework after further literature review and/or discussions with the peer researchers in the same research programme.

5. Adjustments needed in the data gathering due to the emergent themes or disconfirmed data.

Many researchers in the areas of strategy (e.g. Kalling 2007, Regnér 2003), control (e.g. Chenhall and Euske 2007, Ahrens and Chapman 2004) and organisational structure (e.g. Dawson 1997, Sutton and Callahan 1987) have used a similar method, enabling adjustments during the data collection. As the goal is to understand the case and not to produce summary statistics about a set of observations, refining data collection is allowed (Eisenhardt 1989). The ability to be able to quickly modify data collection or to cross-validate data during data gathering is a major benefit of utilising a range of different methods in carrying out research over time (Dawson 1997).

Data reduction also supports the decision when to stop collecting data. Saturation is reached when no main information is missing and no new inconsistent patterns of information are identified (Kalling 2007, Ahrens and Dent 1998). When “theoretical saturation” (Glaser and Strauss 1967: pp. 61-62) is reached the activity of conclusion drawing and verification gets more into the focus.

2.3.2 Conclusion Drawing and Verification

When saturation is reached the next step of qualitative analysis is to select and display parts of the reduced data so research questions can be answered and validated (Miles and Huberman 1984). This activity overlaps with the data inconsistency check performed during the data collection. During data reduction information is already analysed concerning its context and regularities as well as irregularities that are highlighted and partly analysed. However, the conclusions are vague at the beginning and the “final” conclusions usually do not appear until data collection is over (Miles and Huberman 1984).

A major task when drawing conclusions is to present the empirical evidence in an effective way (Eisenhardt and Graebner 2007). This can be done by developing patterns (Yin 2003, Ahrens and Dent 1998, Scapens 1990). In pattern development different perspectives are identified, and it can be determined how these different perspectives relate to each other (Ahrens and Dent 1998). In this study the dimensions (environment, strategy, control and organisational structure) of the framework support the development of patterns and the drawing of conclusions. The patterns from different business
units, during different time frames are matched with each other and with the patterns proposed in the framework. The patterns indicate how strongly the proposed patterns can be grounded in empirical evidence (Ahrens and Dent 1998, Sutton and Callahan 1987) and identify new insights that shed light or put emphasis on certain aspects of the framework (Kalling 2007).

After the patterns are compared, a second form of data analysis, explanation building, is used. During this analysis different possible interpretations or conclusions are reflected in order to produce rich explanations of the results (Kalling 2007, Alvesson 2003). In order to ensure the quality of the conclusions the quality of the research process needs to be adequate. How this is ensured is discussed in the next sub-chapter.

2.4 Research Quality

In order to distinguish research from common sense there is a need for quality control. Research built on qualitative data demands theoretical sophistication and methodological rigour as the researcher needs to show the audience the procedures used to ensure that the research is reliable and the conclusions valid (Silverman 2000). Although the quality issues have been included in the method discussion in this chapter, the following four aspects of quality in case research (Gidhagen 2002, Atkinson and Shaffir 1998) will be briefly summarised in this sub-chapter:

1. Reliability ensures that other researchers would be able to use the described case method and procedures as a blueprint for studying the very same case again, and arriving at the same findings and conclusions.

2. Construct validity applies primarily to the data collection phase and considers whether accurate operational measurements are used for the study.

3. Internal validity concerns the quality of the data analysis. Internal validity subsequently considers whether the research results are coherent with reality.

4. External validity is related to the issue of whether the results of this special case study may be generalizable beyond the present case study.

2.4.1 Reliability

Yin (2003) defines the goal of reliability as “to minimise the errors and biases in a study”. The general way to do this is to conduct the research so that another investigator could repeat the procedures and arrive at the same conclusions (Dubé and Paré 2003, Atkinson and Shaffir 1998, Gummesson 1991). One prerequisite for allowing other investigators to repeat an earlier study is documentation of the procedures followed. One way of fulfilling this requirement is to continuously document the method of data collection.
In this case study interviews are the main method of data collection. An interview guide that is altered during the iterative research approach supports the data collection. The interviews conducted as well as the interview guide with marked alterations were documented and could be used by a fellow researcher in order to replicate the data collection part or the whole study. Also, the secondary data reviewed is transparent and could be used for a replication. The insights that led to changes in interview questions over the time and which were available to me as an employee of the company would be difficult to replicate however. It is also questionable if another researcher, not being employee of the studied company, would be granted access to all the confidential material that was used in this study.

Replication of the present study thus is a highly hypothetical matter, and yet useful as a mental test of reliability. Reliability may be high but difficult to prove if other researchers are not in the position to replicate a study. Therefore the documented method of data collection and the collected data may be a more adequate measurement for the reliability of this study. Consequently the method of data collection, as described in sub-chapter 2.2, was given great attention from the earliest stages of the research project. In order to increase reliability, personal observations, for example, were only used as triggers for data collection but not as a direct form of data collection.

2.4.2 Construct Validity

Construct validity asks whether we are studying what we want to study (Atkinson and Shaffir 1998) by establishing correct operational measurements for the concepts being studied (Yin 2003), and if the obtained data is reasonable and correct (Yin 2003, McKinnon 1988). As pointed out by Abernethy et al. (1999: p. 8) the question is not “whether constructs are measured perfectly, since that is an impossibility. Rather, it is whether researchers do their damnedest to reduce measurement error and bias and can convince the critical readers, that they are successful enough”.

Establishing correct operational measurements refers to whether theoretical concepts are adequately reflected by the operational definitions (Modell 2005, Flynn et al. 1990) and the degree of consistency with which instances are assigned to the same category by the researcher (Silverman 2000). In this research project the dimensions in the framework were operationalized with the support of a literature review and co-operation with colleagues in the research programme. This study has a pragmatic approach where the operationalized measurements are used as guidelines to support the data collection and the analysis of the collected data. Especially in single in-depth case studies the researcher needs to ensure that the

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25 The aspects and the characteristics presented within environment, strategy, control system and organisational structure (presented in table 3.1-3.6) are used as a baseline for the data collection. In order to ensure that the necessary data is collected the aspects are integrated into the interview guide as presented in Appendix A.
findings are based on critical investigation of all data (Silverman 2000). Any finding or conclusion in a case study is likely to be much more convincing and accurate if it is based on several different sources of information (Yin 2003, Marginson 2002). A common procedure of ensuring that the data collected is reasonable and correct is to reflect the real system from as many angles as possible (Eisenhardt 1989, Jick 1979). This is a primary advantage of case research, as a major contribution of any case study is the ability to ensure both method and data triangulation in a systematic way (Atkinson and Shaffir 1998). Both forms of triangulation are used in this study. Interviews, constituting the main source of information, are especially validated. Answers from different interviewees are compared with each other (data triangulation). Confirmation from independent interviewees is interpreted as data having high truth value (Jick 1979). Interview data is additionally continually cross-referenced with other data sources like internal and external secondary data (method triangulation). Once data is collected and consolidated, it is presented to the case company for review. The discussion with the case company enables valuable feedback concerning the quality of the gathered material.

2.4.3 Internal Validity

Internal validity asks whether the researcher has taken steps to ensure that the evidence used to draw the conclusions is complete (Atkinson and Shaffir 1998). As pointed out by Abernethy et al. 1999 in cases where data is used to enrich and extend the understanding of empirical links between dimensions, as in this study, the question of internal validity focuses on questions like whether the dimensions are relevant and if relations among these dimensions have a high degree of plausibility. Therefore, in order to increase the internal validity in this case study, the procedures of data analysis need to be transparent. The procedures are described in sub-chapter “2.3 Data Analysis”. In this section the benefits of initial hypothesis and comparison with existing literature are discussed.

A framework with some initial hypotheses based on existing theory guides this study and its data analysis. These hypotheses are altered or verified during the data analysis by matching patterns observed with the patterns proposed in the framework. The initial hypotheses are important for the internal validity for two reasons (Atkinson and Shaffir 1998). First, they signal the bias or perspective that the researcher brings into the study. Second, there is strong evidence to suggest that where the researcher ends up, in terms of the revised hypothesis, will be heavily determined by where the researcher started, in terms of the initial hypothesis.

Eisenhardt (1989) and Yin (2003) recommend a comparison of the case evidence with both conflicting and similar literature to build internal validity as it raises the theoretical level, and sharpens construct definitions leading to conclusions. The juxtaposition of conflicting results forces researchers into a
more creative mode of thinking where multiple points of view are considered. Similar literature findings are important as well because they tie together underlying similarities, which normally might not be associated with each other. Both conflicting and similar findings are highlighted in this study when discussing the conclusions derived from the analysis.

2.4.4 External Validity

The issue of external validity has traditionally been conceived of as the extent to which the findings of a particular study can be generalised across populations, contexts and time (Modell 2005). Whilst traditional research has emphasised statistical inference as a basis for generalisations, an increasingly accepted alternative criterion, especially in case study research, is theoretical generalizability (Abernethy et al. 1999). That is, the researcher attempts to use the case data to illustrate and support more general, theoretical arguments (Abernethy et al. 1999). This generalisation is based on close iterations between existing and emerging theory and empirical findings (Lee and Baskerville 2003, Yin 2003, Eisenhardt 1989, Lindsay 1995).

The goal of case studies, just like this study, is to increase the understanding of a phenomenon by expanding and generalising theories (Atkinson and Shaffir 1998, Hägg and Hedlund 1979). That is, the results are mapped towards a broader theory and not on statistical generalisation with the aim to find “theoretical defensible regularities” (Balogun et al. 2003). Additionally, as pointed out by Sandelin (2008), due to the fact that this study examines distinct periods of firm evolution, it enables a comparative logic of analysis between the distinct periods of time. These comparisons are likely to reveal subtle similarities and differences between the case study periods that in turn lead to more sophisticated understanding of the dimensions analysed.

Gummesson (1991) also points out that case studies can be used as a basis for generalisation, especially if complex interactions are studied. Although he finds the possibilities of generalising from one single case reasonably good, at the same time Gummesson points out that replication of a case study extends its generalisation, and should be strived for also when complex interaction patterns are studied. Lindsay (1995) suggests a logic of replication for case studies when a contingency theory paradigm is applied, that is when there is a need to investigate and report how the dimensions are related. The suggested replication logic concentrates on finding “significant sameness” from a series of related studies. This should preferably take the form of a research programme, enabling researchers to generalise across studies in different contexts whilst remaining open to theoretical insights offered by each case study (Malmi and Granlund 2009, Gephart 2004, Lindsay 1995). The goal with the replication is to determine whether the same model holds for many sets of data in different industries (Pettigrew and Whipp 1991: p. 9). Also where the results of a replication differ this can lead
to further refinements of the theoretical framework (Yin 2003, Abernethy et al. 1999).

As this study is one of many case studies within one research programme using the same tentative model as basis, the results of the single case studies are comparable and can be used to increase the external validity of the conclusions of each single case study. Generalisations may then be possible to a wider range of organisations, concerning a broader range of issues, and with more certainty. As Scapens (1990: p. 270) states in his article about case study research “the objective of each individual case study will be to explain the particular circumstances of a case, and the objective of a research programme is to generate theories capable of explaining all the observations which have been made”. The comparison with the results of the peer research projects is included into the discussion of the conclusions of this study.

Having discussed the method used in the study, the thesis moves on to a presentation of the definitions upon which the study is based and the theories used within the framework.
3 Theory

This chapter presents the theoretical framework of the study. The chapter builds on literature in the fields of service management, contingency theory, competitive advantage, strategic management, management control, organisational theory and performance. In order to provide a setting for the theoretical position of this study, some important definitions are discussed in the first sub-chapters. The purpose is not to propose or add new definitions, but simply to present and justify the choices taken, as they serve as a foundation for the framework presented in the second part of this chapter. The aim of the framework is to support the understanding of how firms in the insurance industry may gain competitive advantage from their choice of strategy, control, and organisational structure. It will be used in this study for studying such choices over time in the case company. The structure of this chapter is illustrated in Figure 3.1.

<table>
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<tr>
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<tr>
<td>✓ Operational measures</td>
<td>✓ Corporate strategy</td>
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<td></td>
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Figure 3.1: Structure of the theory chapter

In the first three sub-chapters some general definitions are presented. First the definitions of service and insurance service are discussed. Then the concept of fit is presented. In the third sub-chapter the definition of competitive advantage used in this study is outlined. Thereafter the theoretical ideas of the tentative model, upon which the framework developed is based, are presented, and the reason for choosing the model is explained. In the forthcoming five sub-chapters the framework for this study is presented, one sub-chapter for each dimension as well as one presenting

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the whole framework. After the framework is presented a sub-chapter follows where performance or measurement of competitive advantage is discussed. The chapter ends with a summary and a discussion of how the general definitions presented and the analytic framework is to be used in the case study.

3.1 Service

Over the years, service has been defined in a variety of ways (Sampson and Froehle 2006, Cook et al. 1999). This diversity leads to some confusion, especially as different definitions can lead to different conclusions. Pioneering work in service research emphasised the differences between the service sector and the goods sector, with the understanding that goods-sector management was the mainstream form. In the last few years many researchers have disagreed with this (e.g. Vargo and Morgan 2005, Rust 1998). They state that service research needs to be defined from its own standpoint and not seen as a niche field characterised by its differences to goods. The general point of view is that, by analysing the value of usage, physical goods and service converge (Grönroos 2006, Grönroos 1994a, Normann and Ramirez 1993). This new orientation is based on a consumer, not a producer, point of view (Vargo and Morgan 2005, Vargo and Lusch 2004). Although finding that service research needs to be based on service characteristics and not seen as the antithesis to goods, this study has a producer point of view. Therefore the consumer value of usage view discussed currently within service research is not applicable as a definition for this study. Instead a process-oriented definition, which is more connected with the service production, is needed.

The ideas of the “Nordic School” are therefore chosen as a baseline. The main idea of the “Nordic School” is that service emerges in “open” processes where the clients participate as co-producers and hence influence the progress of the process and its output (Grönroos 2006). Even though the “Nordic School” is mainly marketing oriented, their models and systems to manage the interactive service process includes many issues, which are also relevant for service production. For example, seeing the clients as a partial employee has relevance on productivity, or developing ways to increase the service quality through engaged, well-informed and trained employees (Edvardsson 2005, Gummesson 1994). Based on the “Nordic School” ideas, service in this study is defined as a process, which is conducted at least partly in interaction with the client, and is enabled by the application of specialised competences.

Based on the above definition, the insurance offerings and their characteristics as well as the insurance service production will be discussed in the next two sections.
3.1.1 Insurance Offerings and their Characteristics

In this section the insurance offerings and their characteristics are outlined. The aim is to provide a foundation for the service production but also to the market positioning alternatives available for an insurer.

The insurance industry is based on the satisfaction of three major customer needs (Majaro 1982: 194):

- The need for security: Security is one of the basic needs of the human beings. In Maslow's theory on the “hierarchy of needs” safety and security needs are second after physiological needs like hunger and thirst. The insured person buying insurance accepts a relative small but definite financial loss to avoid a larger possible loss (of property or income). This makes the future more predictable, which psychologically translates into increased security, and applies to life insurance as well as other insurance lines.

- The need for savings: The need and desire to accumulate possessions and capital is part of the process of wanting to feel more secure. Life insurance in many countries provides a tax-efficient way of long-term saving.

- The need to meet legal or institutional requirements (e.g. motor third-party liability insurance): Within these requirements there is nothing emotional about the nature of the cover. The law demands it and the customer has to comply with it.

Insurance needs are fulfilled by more or less standardised offerings covering a certain type of risk. The standardised insurance offers are bundled into an insurance solution covering a client’s specific need. While fulfilling the client’s need, there are three particularities in the interaction between an insurance client and the insurance company.

- Firstly, insurance service is generally fraught with negative connotations. Any insurance relationship can be described as being affected by a generic mutual mistrust (Gidhagen 2002). It can be assumed that the client's contacts with an insurer are mostly of a negative nature, in the sense that one buys insurance out of necessity or to avoid a perceived risk, and this it is not really an “enjoyable” service. The client pays the premiums when the time is due, and the client contacts the provider when conditions have changed, which might even result in a higher premium level (Levitt 1981).

- Secondly, in the case of a claim the insurance company sees that there is a risk that the insured will try to be over-compensated. The insurance company is therefore bound to investigate the matter before accepting any claims, or it regulates the risk by including deductibles in the

26 An exception is special insurance solutions offered in wholesales. This part is however not included in the scope of this study.
insurance contract (Rapp and Thorstenson 1994: p. 35). The insured client, on the other hand, is equally aware that the insurance company will do whatever it can to lower the level of reimbursed compensation. This situation is referred to as an “insurance service paradox” by Gidhagen (2002).

- The third particularity can also be defined as an insurance service paradox as the primarily goal for the client as well as the insurance company is a non-delivery of the complete service. That is, both parties strive to avoid damage and the need for a claims settlement process (Gidhagen 2002, Majaro 1982).

The output of insurance is intangible, although several value-added services associated with the insurance may contain more tangible elements like risk consulting, policy including the terms and conditions as well as claims settlements (Mahlberg and Url 2009, Majaro 1982). Insurance is also a high-credence service, that is, it is difficult for clients to evaluate the full value and quality of the provided insurance service even after purchase (Crosby and Stephens 1987, Levitt 1981). Although the customers may be given something tangible to represent the service, like an insurance policy, it is important to bear in mind that the client has not bought an insurance policy but “protection” or “security” (Cowell 1980). The service therefore may remain intangible throughout the relationship, if the customer is free of damage (Gidhagen 2002, Schlesinger and Graf von der Schulenburg 1993, Levitt 1981).

Due to the fact that insurance offerings are standardised, intangible, high-credence, abstract and at the same time complex, it is a challenge for the marketing and sales functions to differentiate their offerings from those of the competition (Levitt 1981). As the client can only judge the value of the insurance in the event of claims, the insurance client is placed in a vulnerable position, especially as the way the insurance company manages the claims settlement may jeopardise the well being of the client (Hatzakis et al. 2010, Schlesinger and Graf von der Schulenburg 1993). Especially for long customer relationships such as life insurance, it also has to communicate a high probability that it will be able to fulfil is obligations in the (sometimes distant) future. Therefore the trust value, defined by Crosby et al. (1990) as a belief that “the service provider can be relied upon to behave in such a manner that the long-term interests of the buyer will be served”, is very important within financial services like insurance (Ennew and Sekhon 2007). Hence, it can be stated that an insurance provider is selling promises of future reimbursement, given certain conditions, and given the occurrence of

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27 The insurance becomes tangible (money is paid out) only if the customer suffers a loss (or by the saving product when the savings are paid out).
damage (Gidhagen 2002). Due to the limited tangibility of insurance offerings, clients need to choose their insurer based on the trust of future reimbursement in the event of a loss.

3.1.2 Insurance Service Production

The process-oriented service definition chosen for this research makes it obvious that production of service is different from the production of physical goods (cf. Gustafsson and Johnson 2003, Karmarkar 1996). Insurance service is a process that at least in the starting point is inseparable from client interaction. Clients initiate the service process as they apply for new insurance, inform the insurer about a change or notify the insurer about a claim (Meidan 1982). A precondition for fulfilling the needs of the client is therefore a successful interaction or communication between client and insurance employee (Sekhon et al. 2013, Ennew and Binks 1996). Insurance employees need specialised competences in order to collect the right information and to shape the right solution to fit the client’s need.

From the production point of view the challenges that arise from the customer being a co-producer is an area that needs to be taken under consideration when analysing insurance production. Looking at the long runtime of an insurance policy, insurance production can to a large extent be separated from the long consumption time of an insurance security (Blois 1984). Many rather short interactions between customer and insurer take place during the insurance policy period. All these interactions within the long runtime of an insurance policy affect a consumer’s satisfaction, even though they are of limited duration (Hatzakis et al. 2010). The employees in the frontline, with their competences and attitudes, are therefore a crucial source of differentiation, quality and, ultimately, customer retention for an insurer (Sharma and Patterson 1999). Therefore each service encounter is important to the client’s overall perception of the service and very important to manage within insurance service production. The interaction of clients can be seen as a resource-binding issue as well as an opportunity for greater customer satisfaction (Beaven and Scotti 1990). The choice depends on the market position the insurance company is striving to reach.

As the insurance offering and the service processes can to a certain degree be standardised, insurance companies have automated and standardised many activities through IT with the aim of ensuring uniformity and efficiency in service production (Hatzakis et al. 2010, Shostack 1987). However, due to the fact that the client is interacting in the service production, some uncertainties remain (cf. Frei 2006, Chase and Haynes 2000). The non-standardised parts are an opportunity to uniquely tailor the

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28 This is equal to the saving products with an intangible service of “security” due to the promises made regarding capital development and the more tangible service of paid capital at the end of the policy period.
service process to meet individual needs and expectations (Frei 2006, Beaven and Scotti 1990). Through higher service quality, supporting the intangible offering, customer satisfaction can be increased (Haywood-Farmer 1988). The main question is which objective the insurance company is aiming for – efficiency through standardisation or differentiation through intense customer interaction (Frei 2006).

With the characteristics having been discussed, the scope of insurance service production needs to be defined. In insurance production, as in many other service forms, operations consist of two quite different spheres of activity (Chase and Hayes 1991).

- One sphere is the service interaction or cycle of interactions between the customer and the organisation. The media by which these interactions are carried out constitute the firm’s service delivery system. Typical mediums are personal contact, telephone, paper documents and the Internet.

- The other sphere encompasses all activities that take place behind the scenes and constitute the “back-office” support system, for example processing paperwork. This sphere of activities is analogous to the production processes in a factory – work is conducted on things rather than people.

Both these spheres of activity are included in the insurance production scope of this study. The service production functions at an insurer included in this study are marked grey in Figure 3.2 below.

![Figure 3.2: Service production functions at an insurer included into this study](image)

Generally, the process starts with scanning and registration, if the customer request is paper based. Another important input channel is the telephone, and

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29 Figure 3.2 summarises my understanding of pertinent aspects of service production activities.
to a lesser degree e-mail and Internet, request. Insurance production comprises all new treaty requests (applications), all treaty adjustment requests and all information requests and claims requests. As insurance service production is defined as starting with a customer interaction in this study, the payment transaction is not analysed as a part of production (it is normally initiated by the insurer, based on the payment frequency or claims approval). Product development is also not included in service production, as the main emphasis of the study is the standardised insurance offerings. Their development is defined as a research and development function, which is separated from direct customer interaction.

This sub-chapter presented the process-oriented service definition used in this study and applied it to insurance service production. Additionally insurance offerings and their characteristics as well as the scope of insurance service production used in this study were outlined. The definitions are going to be used, both explicitly and implicitly when existing theories are integrated into the framework and when the collected case study data is analysed.

3.2 Contingency Theory and the Concept of Fit

This sub-chapter presents the contingency theory approach that was chosen. The aim is to provide a foundation for the alignment discussion in this thesis.

As mentioned in the introduction, this study builds on contingency theory. The contingency approach is based upon the premise that there is no universally appropriate strategy, control management system or organisational structure that applies to all organisations in all circumstances. Rather, it is suggested that particular features depend upon specific circumstances in which an organisation finds itself (Otley 1980: p. 413). The concept of fit is based on the assumption that organisations that exist in different environments must interrelate with the environment if the organisation is to perform well (Aragón-Correa and Sharma 2003, Ensign 2001, Lewin and Volberda 1999, Drazin and Van de Ven 1985). Successful interrelation with or adaptation to the environment is assumed to be directly dependent on the ability of top management to interpret the conditions facing the firm in an appropriate manner and to adopt relevant courses of action. This managerial choice or strategic choice perspective argues that organisations are not just passive recipients of environmental influence but that managers have free choice, including the opportunity and power to reshape the environment (Nilsson and Rapp 2005, Child 1997 and 1972, Miles and Snow 1984a). This alignment is in line with the neo-contingency researchers (e.g. Donaldson 2001, Ensign 2001, Lewin and Volberda 1999) who assert that dynamic adaptation is subject to both managerial action and environmental forces.
Contingency literature is fragmented and has been presenting contradictory results (Gerdin and Greve 2004, Ensign 2001, Chapman 1997, Drazin and Van de Ven 1985, Tosi and Slocum 1984, Miller 1981). One basic reason for the contradictory results is that different forms of fit have been used that are difficult to relate to each other. The consequence of this is that some results are claimed to be contradictory, even though this is not necessarily the case and that others are argued to be supported by previous studies, even though that is incorrect (Gerdin and Greve 2004). Although the aim of this study is not to compare the quantitative results with other contingency-based studies but to conduct a qualitative study explaining the relationships between strategy and control systems and their effect on competitive advantage, it is beneficial to clarify the concept of fit applied in this study.

In terms of the framework presented by Gerdin and Greve (2004), this study uses the holistic system approach as it examines how different combinations of strategy, management control and organisational structure affect the competitive advantage of a company. The study moreover builds on a belief that different degrees of fit exist and lead to different levels of performance among the companies acting in the same environment. The aspect of change modus, continuum or “jumps” between fixed states of fit, which was suggested by Gerdin and Greve (2004), is not applied. Instead the changes in fit and their effects on performance over a longer time frame are applied in this study. The level of fit is measured by the company's performance compared to the market and its performance over the previous years.

3.3 Competitive Advantage

In this sub-chapter the borderline of competitive advantage chosen for this study is discussed. Competitive advantage is a term that is generally used to describe the relative performance of rivals in a given market environment. An enterprise is said to have a “competitive advantage” if it is able to create more economic value than the marginal competitor in its market (Peteraf and

30 Gerdin and Greve (2004) distinguish between a single interaction approach (cartesian research) and a broader or holistic systems approach (configurations research). With the single interaction approach it is assumed that a limited number of factors offer explanations whereas the systems approach assumes that relationships can only be understood if many dimensions are analysed simultaneously.
31 Gerdin and Greve (2004) make a distinction between congruence and contingency approach. The congruence approach builds on the assumption that only the best-performing organisations survive and therefore are the only ones that can be observed. Consequently, there is no need to test the link with performance. The contingency approach on the other hand builds on the belief that different degrees of fit exist and that fit is defined as the positive impact on performance. Accordingly, it is assumed that low-performing as well as high-performing firms do exist.
Barney 2003: p. 314). As already mentioned in the introduction there are multiple different understandings of how “competitive advantage” is achieved both among practitioners and academics. Sometimes it is mapped with positional superiority in the marketplace, based on the provision of superior customer value or the achievement of lower relative costs. Other times it is mapped with interchangeability of “distinctive competence”, based on relative superiority in skills and resources. Taken together competitive advantage can be said to be based on two qualities (Pettigrew and Whipp 1991: p. 28): “The capacity to identify and understand the competitive forces in play and how they change over time, linked with the competence to mobilize and manage the resources necessary for the chosen competitive response through time.”

The definition above is a mixture of a market position perspective of competitive advantage that is grounded in an industrial organisation economics perspective, and a resource-based perspective focusing on the firm’s internal characteristics and views firms’ internal resources as the source of competitive advantage (Hoskinsson et al. 1999). This definition taking both perspectives into consideration is chosen as a baseline for competitive advantage. Before presenting the integrated approach the specifics of the market position and the resource-based perspective will be highlighted briefly.

### 3.3.1 Market Position Perspective

The market position perspective of competitive advantage is grounded in an industrial organisation economics perspective, where mobility barriers or market positions are the critical sources of competitive advantages that lead to superior performance (Hoskinsson et al. 1999). That is, competitive advantage is ascribed to external characteristics. Firms that can successfully adapt to market or industry pressures and requirements will survive and grow, whereas those that fail to adapt are doomed to failure and exit from the market/industry (Lado et al. 1992). Porter’s framework around competitive advantage is a broadly recognised contribution within this perspective (e.g. Barney 2002, Lockett and Thompson 2001, Hoskinsson et al. 1999). The starting point of Porter’s competitive theory is the recognition that “strategy must reflect two elements – industry structure and relative position within the industry – and that the two are distinctly different” (Porter 1994: p. 251).

For the first element, industry structure, Porter developed a basic framework, known as the “five forces”. The five forces model provides an analytical approach for assessing the attractiveness of a specific industry. The attractiveness depends on the interplay and strength of the “five forces”: threat of new entrants; threat of substitute products/service; bargaining power of suppliers; bargaining power of customers; rivalry among existing competitors (see left illustration in Figure 3.3). These forces determine the degree of competition, volatility and uncertainty in the competitive
environment, and hence the possibility and durability of economic rents (Porter 1980).

![Porter's five forces driving industry competition](image1)

**Figure 3.3 left side:** Porter’s five forces driving industry competition (Porter 1980: p.4) **Figure 3.3 right side:** Porter’s generic strategies (Porter 1980: p.39)

Industry structure tends to be relative stable. Industries do, however, go through periods during which their structures change markedly. It is during these structural changes that realignments of competitive positioning within an industry take place (Porter 1994). Porter’s theory of positioning is rooted in the concept of sustainable competitive advantage compared to other market participants. “Competitive advantage arises from discovering and implementing ways of competing that are unique and distinctive from those of rivals, and that can be sustained over time” (Porter 1994: p. 260). Porter (1980) describes three generic strategies through which a company can strive for a unique position within a specific industry: differentiation, overall cost leadership and focus (to the right in Figure 3.3).

A relative position within an industry leading to a competitive advantage is not achieved through simply choosing a strategic position that is different from rivals but also by ensuring that the operations are internally consistent (Porter 1994). The value chain, introduced by Porter in 1985, serves as a bridge aligning strategy with internal activities. Porter (1991a) sees similarities between the resource-based perspective and his own concept of the value chain. According to Porter the resource-based perspective pushes the value chain logic further, by examining the resources a company must possess in order to ensure consistent operations (Porter 1991a). Although Porter recognizes that specific skills and assets can yield a distinctive market position, he also points out that it is not competencies, capabilities or resources per se that are valuable, but internally consistent strategies (1994: p. 282).
3.3.2 Resource-based Perspective

The resource-based perspective was a counter-development to the market position perspective. The general opinion is that the market position perspective simplifies the strategic analysis (Priem and Butler 2001) and that correct decisions about a firm’s market position must take the resources that constitute its competitive advantage into account (Hoskinsson et al. 1999, Simon 1993, Barney 1991, Wernerfelt 1984).

The resource-based perspective builds on three assumptions: First, it assumes that firms within an industry are heterogeneous with respect to the strategic resources they control. Second, it assumes that these resources are not perfectly mobile across firms, and that heterogeneity therefore can be long lasting (Barney 1991 and 1986a). Thirdly, not all resources of a firm hold the potential to ensure a sustained competitive advantage. To have this potential, a resource must be valuable (it must exploit opportunities and/or neutralise threats in a firm’s environment), it must be rare and it must be imperfectly imitable or non-substitutable (Barney 1991). According to this perspective the primary task of management is to maximize value through the optimal deployment of existing valuable resources and capabilities, while developing the firm's resource base for the future (Grant 1996). That is, the type, magnitude, and nature of a firm’s resources and capabilities are valued as important determinants of its profitability (Priem and Butler 2001, Amit and Schoemaker 1993, Grant 1991). It is however not the resources and capabilities per se that matter, but their functionality and how they are used (Peteraf and Bergen 2003, Priem and Butler 2001, Wernerfelt 1984).

3.3.3 Integrated Approach to Competitive Advantage

Considering the discussion in the previous sections it can be concluded that the perspectives complement each other. The fact that this research considers both an external and an internal fit, a model that integrates both the market position and the resource-based perspectives, seems beneficial. The benefits of an integrated approach, paying explicit attention to both perspectives, has long been discussed by many researchers (Lockett et al. 2009, Grunert and Hildenbrandt 2004, Barney 2001, Priem and Butler 2001, Mahoney and Pandian 1992, Porter 1991a) and despite their antagonistic theoretical viewpoints, there is nevertheless broad consensus among researchers that the industrial organisation-inspired strategy concepts and the resource-based perspective are complementary approaches (Grunert and Hildenbrandt 2004, Foss 1996) and that a synthesis of the perspectives is an important step towards a more complete theory (Priem and Butler 2001, Foss 1996).

32 In this paper resources fulfilling the above listed requirements are called “valuable resources”.

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As the objective of this research is to analyse a company’s competitive advantage over a long time frame a dynamic perspective is used like illustrated in Figure 3.4. The market position of a company (Porter 1994) as well as its valuable resources need to be continuously aligned and realigned (Ambrosini and Bowman 2009, Kraatz and Zajac 2001, Amit and Schoemaker 1993) with internal resource profiles including dynamic capabilities and existing valuable resources as well as external environmental factors in order to achieve competitive advantage. The resources and market position a firm has built today are the results of past managerial choices about how to invest the resources of a firm (Porter 1991a). That is, the initial conditions or resources like customer-base, pre-existing reputations or skills influence the present choices available for a company (Teece 2007, Teece et al. 1997, Amit and Schoemaker 1993, Barney 1991). If a firm obtains valuable and rare resources because of its
unique path through history, it will be able to exploit those resources in implementing value-creating strategies that cannot be duplicated by other firms (Dierickx and Cool 1989). History matters also as a guideline for ongoing strategic decisions, in the sense that prior events and developments condition current choices, actions, and social processes (Farjoun 2002, Simon 1993). That is, past decision criteria and processes guide the level of discretion and innovation in present management decisions. In order to analyse this perspective a longitudinal or historical aspect, that considers why particular firms are able to get into an advantage position and sustain to keep that position, is included into the integrated model.

To sum up, in this study both the external perspective of a company’s market position and the internal resource perspectives are considered when a company’s competitive advantage are discussed. Additionally, a longitudinal aspect, similar to the ideas of Porter’s “chain of casualty” (1991a) is included in order to highlight the importance of the initial market position, the inherited and existing valuable resources as well as the past decision criteria upon which managerial decisions depend.

3.4 Tentative Model for Competitive Advantage

This study analyses the consistency among multiple dimensions on different organisational levels with the aim of seeing how their alignment affects the competitive advantage of a service company. In order to support the data collection and analysis, a framework based on existing theories and previous research is developed. Although no single theoretical framework or argument can be cited to support all of the included aspects, especially for the service industry, several previous studies have examined parts of them. As a starting point for the competitive advantage framework within service industry, the tentative model published by Nilsson and Rapp (2005) is used. The main concepts of that model are described in this sub-chapter.

According to Nilsson and Rapp (2005) a strong competitive position requires congruent strategies and an integrated control that aligns strategic planning and follow-up. The authors maintain that both external and internal fit are necessary in order to achieve competitive advantage. Lasting high performance is defined as a result of a strong competitive position. In the model, the control system represents the internal structure and is considered to be management’s primary instrument for developing and implementing strategies. The model takes into account not just the multiple dimensions of internal and external fit, but also three organisational levels: the corporate, business unit and functional level. The model with its main concepts is

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33 Nilsson and Rapp use a contingency approach when analysing the interdependence between environment, strategy and control system as well as how these interdependences affect the potential for being competitive.
The central concepts strategic congruence and integrated control are described in the next two sections. At the end of this sub-chapter the applicability of the model for service industry will be discussed.

### 3.4.1 Strategic Congruence

The firm is viewed as an open system. The environment is assumed to influence the firm, but in a longer-term perspective management can affect, at least to some extent, the degree to which the firm will operate in a turbulent or a stable environment. That is, in order to reach a strong competitive position, management needs to understand the environment in which the business acts and have a deep knowledge about the ways to use the internal structures of the business units to position its offerings on the market. This is the basis for strategic congruence.

Strategic congruence is defined in two different dimensions, horizontal and vertical. The horizontal dimension has to do with the alignment of the strategies with the company’s competitive arena as well as the overall strategic aims of the company. The alignment of environment and strategy is an on-going activity involving choices on different organisational levels. Strategy on corporate level reflects the decisions about in what business and market to act and compete, the company’s synergy potential and the degree of strategic coordination among the business units. Business strategy aims to develop and keep a unique market position for the product or service offered. The strategy on the functional level, that is, production strategy, focuses on the complexity and the flexibility required by production derived from the chosen market position.
The vertical dimension relates to the mutual consistency among choices taken on the different strategic levels. By ensuring congruence between the corporate, business and functional strategies, the decisions taken on all levels and within all functions are aligned and coordinated towards the same strategic direction. A company with strategic congruence thereby avoids suboptimalisation of different areas and functions. As Nilsson and Rapp (2005: p. 47) summarise “by strategic congruence we mean that the corporate, business and functional strategies of the firm are mutually consistent, with strategy at each organisational level appropriate to the firm’s competitive arena and strategic aims”.

### 3.4.2 Integrated Control

A control system is seen as a vehicle used for the implementation of the strategy. Integrated control also has a horizontal and a vertical dimension. An integrated control system well aligned with the company’s strategies simplifies the processes of formulation and implementation of strategies (horizontal dimension). Integrated control also emphasises the importance of similarity in the design and use of strategic planning and follow-up at each organisational level throughout the company (vertical dimension). An integrated control system facilitates the exchange of information between different organisational levels concerning strategic, tactical and operational decisions.

An important difference between the model developed by Nilsson and Rapp (2005) and other models is that in the former the alignment between strategy and control is studied on two levels of the company: management control and operational production control. Few models or studies consider strategies at multiple organisational levels and the fact that integrated control systems can facilitate implementation of these strategies (cf. Luft and Shields 2003, Ittner and Larcker 2001). Also, it is rarely considered how control at a higher organisational level affects control at a lower level. All these aspects are included in the concept of “integrated control” discussed by Nilsson and Rapp. Nilsson and Rapp point out that “Integrated control exists when strategic planning and follow-up at each organisational level are coherent throughout the firm” (2005: p. 93).

### 3.4.3 Conclusions concerning the Model

The model thus highlights strategic congruence as well as integrated control and takes both internal and external dimensions into consideration. Moreover, the model discusses multiple organisational levels, and it predicts that performance can be improved through aligning strategies and control systems with each other and the external environment. Due to these characteristics, the model with its main concepts is a good base upon which to develop the competitive advantage framework for service industry.
However, the model is based upon a market position perspective of competitive advantage. As discussed in the previous sub-chapter, a more integrated perspective of competitive advantage is used in this research. Therefore, parts of resource-based perspectives are also considered in the framework.

The model of Nilsson and Rapp (2005) is designed primarily for the manufacturing industry. As discussed in sub-chapter “3.1. Service” there are significant differences between these sectors especially in the area of production. Therefore theories that explicitly take the service-specific aspects into consideration need to be integrated into the framework. This will be discussed in the next sub-chapters. The requirements for selection are that the chosen theories or concepts are well grounded and empirically validated to some extent in prior research and that they fit with the service definition used in this study.

Connected to the amendments related to service theory, the internal administrative mechanism, which in the original model is based on the design and the use of control systems, will be enhanced with organisational structure elements. This is in line with other studies that have integrated the design of organisational structure, in addition to the design and use of control systems, to cope with uncertainty (van Veen-Dirks 2005, Govindarajan 1988). In line with Chakravarthy’s (1986) definition of adaption to reach competitive advantage, referred to in the introduction and given the importance of human resources in service production (Skaggs and Youndt 2004, Gustafsson and Johnson 2003, Chase and Bowen 1991), organisational structure is included as an enhancement of the internal administrative mechanism. This amendment is also supported by former studies within this research programme. The areas of adjustment, which will in detail be discussed later on in this chapter, are illustrated in darker colour, in Figure 3.6.

In the following sub-chapters the dimensions included in the framework for competitive advantage in service industry as illustrated in Figure 3.6 will be discussed in a service context. Thereafter the overall framework will be presented.

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34 The integrated perspective is a result of the iterative research method, the first version of the framework, just like the model developed by Nilsson and Rapp (2005), was based on a market position perspective.

35 Ahlström (2008), Anjou (2008) as well as Sundberg (2009) concluded from their studies base on the same tentative model that organisational aspects like coordination, human resource management and cultural values also affect the internal fit.
3.5 Environmental Effects

Competitive strategy is strongly interrelated with environment (Ward et al. 1996). An organisation's environment is defined as conditions external to the organisation, which influence the company’s behaviour (Hall 1972: p. 9). The external environment of organisations is viewed as a source of events and changing trends, which create opportunities and threats for individual firms (Aragón-Correa and Sharma 2003, Porter 1994, Milliken 1990, Lenz 1980). The task of interpreting an environment is a highly ambiguous one, as misinterpreting changes in the environment or the failure to notice changes may jeopardise a company’s future (Milliken 1990). The interpretation is strongly connected to managers' perceptions of the environment. Early researchers like Miles et al. (1974) and Negandhi and Reimann (1973) point out that an organisation only responds to what it perceives. That is, it is the managers’ interpretation of environmental issues that affects their decisions and actions (Aragón-Correa and Sharma 2003, Child 1997). Therefore, it is important not only to interpret environment from objective market surveys but also to map managers’ perceptions of environmental changes with the choices taken by them.

There is no widely held consensus concerning how the environment should be assessed and which aspects of the environment affect performance (Lenz 1980). This study follows Bourgeois' (1985 and 1980) definition of the external environment by taking hierarchical levels, their conceptualisation and attributes of environmental uncertainty into consideration. The hierarchical levels refer to different effects generated by
the general environment and task environment; conception refers to the environmental components, whereas the attributes indicate the uncertainty of the environment. These aspects will be discussed briefly in the next two sections, first the hierarchical levels and the conception on each level and thereafter the attributes of environmental uncertainty.

3.5.1 Hierarchical Levels of Environment and their Conception

As already mentioned in the introduction and in the previous sub-chapter, the alignment between the environment and strategy is discussed on multiple levels in this study. Therefore this study follows Bourgeois’ (1980) established linkage between the conception of environment and the hierarchy of strategies. The general environment is mapped with corporate and business strategy, whereas the task environment is mapped with functional strategy. Both general and task environment are important to use as aspects in order to ensure a full picture of the uncertainty a company is facing (Otley and Wilkinson 1988).

There is a consensus among researchers that managers can experience several different sources of uncertainty as they attempt to adapt an organisation to its environment (Milliken 1990). Miller (1993) and Lorenzi et al. (1981) empirically showed that individual perceptions had a significant impact on perceived uncertainty, especially when the definition of the environment tended to be “global” or “general” in nature. Therefore, an aggregated discussion is not beneficial concerning environmental uncertainty (Milliken 1990, Lorenzi et al. 1981). More distinct environmental components should be used (Miller K.D. 1993). Due to this fact, this study, just like Venkatraman and Prescott (1990), bases the conceptualisation of the general environment on Porter's (1980) five environmental forces. The five forces (new entrants, substitute products/service, suppliers, customers, and existing competitors), complemented with government and regulatory agencies\(^{36}\), serve to specify the environmental context. By focusing the environmental discussion on specific aspects, a more holistic picture that relies less on individual perceptions can be captured.

The participation of clients/customers in the service production process is a source of task uncertainty (Bateson 2002, Chase and Prentis 1987, Mills 1986). As Chase and Haynes (2000) point out, although blueprinting may create a structure for a well-defined and consistent process flow, having the customer directly in the delivery mechanism often leads to uncertainties. The level of task uncertainty depends on the level of client interaction allowed in the service production process (Chase 1981, Mersha 1990). Therefore the

\(^{36}\) Governmental and regulatory agencies are included as the insurance market is still partly regulated and thereby dependent on governmental decisions.
task environment in service production is considered to be dependent on the level of interaction with the client.

3.5.2 Attributes of Environmental Uncertainty

Most contingency models in the area of strategy, management control and organisational structure use uncertainty as an environmental aspect. “Uncertainty” refers to the unpredictability of environment or organisation that has an impact on performance (Miller 1993: p. 649). The definition of uncertainty has varied between different studies. Dess and Beard (1984) analysed the most common environmental classifications of previous studies and came to the conclusion that the used classifications could be summarised into three main attributes: munificence, complexity and dynamism. Empirical research has shown that dynamisms or the degree of change explains more variance in perceived uncertainty than do complexity and munificence (Miller 1988, Bourgeois and Eisenhardt 1988). It is important to highlight that it is not change per se, or even a fast rate of change, that creates uncertainty about the environment; rather, it is unpredictable change that is associated with uncertainty (Milliken 1987, Lorenzi et al. 1981). The unpredictable changes impede a company’s ability to plan its activities and thereby affect the possibility to forecast market development (Govindarajan and Shank 1992) as well as the design of the internal control systems (Collins et al. 1997). Based on its high impact concerning a company’s capacity to plan its activities and measure their success, this study focuses on unpredictable changes as the key attribute of uncertainty.

3.5.3 Environment Effects in this Study

In this study uncertainty is defined as the perceived inability to predict change on the level of the general environment and the task environment. An individual experiences uncertainty due to the lack of sufficient information to predict accurately or because it is difficult to discriminate between relevant and irrelevant data or requirements (Milliken 1987: p. 136). In Table 3.1 the aspects concerning environmental effects used in this study are defined. For each aspect the uncertainty to predict change is considered when environmental uncertainty is discussed and measured.

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37 Munificence: the extent to which environmental resources are available and accessible to firms in order to support sustained growth; Complexity: the level of information-processing requirements due to the number and diversity of competitors, suppliers, buyers, and other environmental actors that interact with the organisation and that firm decision makers need to consider when evaluating strategic choice; Dynamism: degree of changes that are difficult to predict in terms of both frequency and direction and thus increase environmental uncertainty for the organisation.

38 This definition is very similar to the one used by Nilsson and Rapp (2005) in their tentative model. They define uncertainty as the extent to which it is possible to foresee both major and minor changes in the firm’s environment.
Table 3.1: Environmental aspects used in the study

<table>
<thead>
<tr>
<th>Level</th>
<th>Aspect: Uncertainty to predict change within…</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Government / Regulators agencies</td>
</tr>
<tr>
<td></td>
<td>Existing competitors incl. market share instability</td>
</tr>
<tr>
<td></td>
<td>New entrants</td>
</tr>
<tr>
<td></td>
<td>Customers or demand instability (product cycles)</td>
</tr>
<tr>
<td></td>
<td>Substitute products/ service</td>
</tr>
<tr>
<td></td>
<td>Intermediaries as suppliers of customers</td>
</tr>
</tbody>
</table>

Although there are examples in the practice (for example Ryanair and the airline industry) when a company can drastically change the environment, this study mainly foresees that the environment changes affect a company. This statement is based on the fact that the case company during the time frame of this study was affected by the environment but was not in the position to change the environment itself.

3.6 Strategic Congruence in the Service Industry

Through the strategy a firm can co-align with its environment. Strategy can be seen as the mediating interface between environment and a company’s internal systems (Teece et al. 1997, Dent 1990, Mintzberg 1976). There is room for several successful strategies within a particular industry, as long as each company makes a different choice from those of its rivals (Porter 1991b) and as long as the strategy is supported with appropriate valuable resources and capabilities within the company (Snow and Hrebiniak 1980). Strategy is the way a company defines its business and links together its resources (Normann and Ramirez 1993). Through the strategic choices made to address changing environments, the internal structure of the organisation might also need to be altered (Hutzschenreuter and Kleindienst 2006).

Strategy is a wide field offering several different definitions and ways of studying it (Bhimani and Langfield-Smith 2007, Hutzschenreuter and Kleindienst 2006, Mintzberg et al. 1998, Dent 1990). With the development of the field, strategic research has become divided into two more or less separate branches: content research seeking to answer the question of “what” underpins a firm’s competitive advantage, and process research approaching strategic management from the standpoint of “how” firms’ strategies emerge over time (Mellahi and Sminia 2009). In this study the main interest is on the content or “what” underpins the company’s competitive advantage. When answering the “what” question the implemented strategy is of main interest. However, also the change, the “how” a strategy change is planned and implemented, is partly included in the analysis in order to get a deeper understanding of the connection between perceived environmental situation.
and strategic choices taken.\textsuperscript{39} This includes the formal strategy process where the intended strategy is defined as well as the on-going sequence of events and activities enhancing the intended strategy (Pettigrew 1992).

As mentioned in the introduction this study looks at alignment between multiple levels; therefore different strategic levels are analysed. The widely accepted three-level hierarchy of strategy used by Nilsson and Rapp (2005), originally suggested by Hofer and Schendel (1978), is also used in the service industry framework. The levels are illustrated in Figure 3.7.

![Figure 3.7: The three strategic levels and their interaction with the environment](image)

In the next sections the corporate, business unit and functional strategic level are discussed from a service industry context. After presenting the ideas on each level and their environmental interaction, a framework of strategic congruence between the different levels is presented.

### 3.6.1 Corporate Strategy

Corporate strategy is the pattern of major objectives, purposes, or goals and essential policies and plans for achieving those goals, stated in such a way as to define what business the company is in or is to be in (Andrews 1971: p. 28). Based on the objectives and the selected business, there is a need to identify, and develop, valuable resources and capabilities that supports the fulfilment of the chosen strategy (Collis and Montgomery 1998). It is the relation among and the value in sharing these resources and capabilities that are the central question in corporate strategy, not the products or service being offered (Bengtsson and Kalling 2007).

Nilsson and Rapp (2005) use Porter’s typology (1987) in their model. As Porter in his study included also service companies, this typology is also applicable to the service industry. Porter highlights that a corporation must

\textsuperscript{39} The “how” is not analysed based on a specific theory model. The background information for the implemented strategy is only collected in the interviews in order to give a deeper understanding of the implemented strategy.
bring some significant competitive advantage to the business units. The costs of various corporate activities must be offset by the benefits derived from the activities. That is, "a corporate strategy cannot succeed unless it truly adds value to business units by providing tangible benefits that offset the inherent costs of lost independence" (1987: p. 46). Some examples of shared resources or capabilities leading to synergies among business units are professional management, common valuable resources and capabilities, low cost of capital and shared value chains (Porter 1987). In his empirical study Porter (1987) identified four partly overlapping strategies that create value in different ways. As the four identified corporate strategies can be seen as a continuum from little parent involvement to dynamic activity sharing moderated by the parent, just the two basic strategic types are used by Nilsson and Rapp (2005: p. 64). Their definitions, provided by Porter (1987) are presented below:

- The portfolio management strategy builds on acquisition of undervalued companies that are kept highly autonomous. Due to the high diversification the synergy potential is rather low. Value is created through access to capital and through professional and objective corporate management guiding the acquired units. The capabilities of the management resources on corporate level is not connected to the business unit operations but to valuing companies and guiding them based on financial values.

- The activity sharing strategy is based on sharing activities among business units. In order to be successful, sharing must involve activities that are significant to competitive advantage, not just any activity. Sharing activities inevitably involves coordination costs that the benefits must outweigh. The activity sharing strategy requires an organisational context in which business units are encouraged to collaborate through implementation of integrating methods like cross-business-unit task forces and incentive system that rewards more than just business unit results. In this strategic concept the shared resources and capabilities provided by the corporation are usually closely connected to the business unit operations. Therefore the corporate management needs to have the adequate know-how to identify, develop and manage resources that are significant to the business units.

Valuable resources and dynamic capabilities can be easily integrated into Porter’s typology. As Prahalad and Hamel’s stress, the management of these resources, or core competencies, is the main value-adding function on the corporate level; “to consolidate corporate wide technologies and production skills into competencies that empower individual businesses to adapt quickly to changing opportunities” (1990: p. 81). Therefore, not just the coordination strategy but also which valuable resources and dynamic capabilities are coordinated and developed on the corporate level are going to be analysed in this study on the corporate strategy level. Although the business units
compete on the market and not the corporation as a whole, it is also important on the corporate level to pay attention to the environment (Nilsson and Rapp 2005: p. 49-50). Firstly, it is important for the corporate management to understand the environment in which the business unit operates. Secondly, especially in the activity sharing strategy where corporate management actively develops market-oriented resources and capabilities for its business units, corporate management needs to follow the market changes.

3.6.2 Business Strategy in the Service Industry

Business strategy – also called the competitive strategy of the business unit – refers to the choices taken concerning how to compete within the chosen industry in order to reach the set goals (Beard and Dess 1981, Hambrick 1981 and 1980) and gain competitive advantage (Porter 1980). Nilsson and Rapp (2005) choose Porter’s business strategy as a basis for mapping these choices, as it is clearly linked to the typology chosen on the corporate level, but also as the typology is widely accepted (cf. Allen and Helms 2006), internally consistent and has been empirically tested.\(^{40}\) Porter differentiates between two basic alternatives\(^{41}\) for business strategy, originally described in his book in 1980.

- Cost leadership strategy: The business unit achieves consistently lower costs than its rivals (Porter 1991b). In order to achieve a low-cost advantage, an organisation must have a low-cost leadership strategy, low-cost production, and a workforce committed to the low-cost strategy (Allen and Helms 2006). However, a cost leadership strategy is viable only if cost structures vary across competitors (Murray 1988). Twentieth-century companies established cost leadership through mass production, mass distribution and economies of scale. Today, value-enhancing cost-reduction strategies are less about cutting input costs or gaining economies of scale. The real breakthroughs in low-cost leadership come from rethinking the very core of the production process and product design (Malburg 2000). As long as the product maintains acceptable quality, the lower costs will lead to higher margins (Porter 1991b). The cost leadership creates little customer loyalty, as the

\(^{40}\) Several empirical studies have confirmed Porter's generic strategies (e.g. Miller 1988, Miller and Friesen 1986a and 1986b, Dess and Davis 1984 and 1982, Hambrick 1983c).

\(^{41}\) Porter also defines a third alternative strategy, a focus strategy, mainly for smaller players on the market. This strategy is, however, connected to the other two, as discussed by Lovelock (1992: p. 28): “A focus strategy differs from the two principal varieties in that it is based on the choice of a narrow competitive area within an industry. It begins with the selection of a particular buyer group or geographic area, or a decision to offer only a limited product line. In the target segment, focus strategies can be divided into those with a cost leadership focus and those with a differentiation focus.”

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customers choose their offering based only on price (Allen and Helms 2006).

- Differentiation strategy: The business unit focuses its efforts on providing a unique offering. The goal is to make the company unique in providing something that the market finds important (Porter 1991b). The unique or superior value to the customer can be offered through tailoring the offering to the customer, quality, special features, excellent service or convenient distribution channels. The quality may be real or perceived based on fashion, brand name, or image (Allen and Helms 2006). The uniqueness allows a premium price, which if costs are kept under control will translate into a superior return (Porter 1991b).

Nilsson and Rapp (2005) state that the alternative business strategies are connected to different environmental conditions. Therefore the choice of strategy should be connected with the ability to handle uncertainty within the organisation (Hambrick 1983b). Organisations pursuing a strategy in an environment that is associated with a level of uncertainty that they cannot manage within the organisation may be, on average, significantly less profitable than if they were to pursue another generic strategy (Zajac and Shortell 1989). A business unit following a differentiation strategy is likely to face greater uncertainty than a business unit following a cost leadership strategy (Govindarajan 1986, Hambrick 1983b) due to the difficulty of predicting demand for new products or service offerings (Miller 1988 and 1986) compared to the stable offerings and demand associated with a cost leadership strategy (Govindarajan 1988, Miller 1988 and 1986).

There are multiple examples showing that both cost leaders and differentiators exist in the service industry, although the model has not been widely tested empirically in this industry. At the same time, studies have shown that competitive advantage based on innovative differentiation is not easy to sustain in the service industry. The reason is that service offerings are more easily copied than physical goods are (Song et al. 1999, Fahy 1996, Tufano 1989), as they cannot be protected with patents (Edvardsson et al. 1995, Edgett and Parkinson 1994, Parasuraman and Varadarajan 1988). Therefore, service companies tend to use marketing or image to differentiate themselves from their competitors (Easingwood and Mahajan 1989).

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42 Only four empirical tests in service industries are known to the author: Powers and Hahn (2004) study in retail banking, Chan and Wong’s (1999) test in an international banking centre as well as the study of O’Farrell et al. (1993) in business service firms provided support to Porter’s typology; Kim et al. (2004), on the other hand, concluded that in order to be successful in e-Business, cost leadership and differentiation need to be combined. The study conducted by Miller (1988) included some service organisations but did not discuss service industry characteristics. Fitzsimmons and Fitzsimmons (2006) conceptually applied Porter’s typology to service industries, and Meidan and Chin (1993) used Porter’s generic strategies to map the strategies of building societies. However, empirical tests that especially take service characteristics into account are, based on the author’s knowledge, still limited to the three above-mentioned examples.
Especially for service companies with rather complex but standardised service offerings, differentiation in regard to image or reputation can be a basis for a strong market position (Ennew et al. 1993, Barney 1991). In order to map the activities of a service organisation more adequately, innovative and marketing differentiation are explicitly taken into consideration in the analysis of business strategy in the present study. The different strategies require different principal activities, skills and capabilities in different environments as illustrated in Table 3.2.

Table 3.2: Summary of characteristics of Porter’s business strategies including environment uncertainty (Information based on Porter 1980 as well as Miller 1988 and 1986)

<table>
<thead>
<tr>
<th></th>
<th>Innovative differentiation</th>
<th>Marketing differentiation</th>
<th>Cost leadership</th>
</tr>
</thead>
<tbody>
<tr>
<td>Uniqueness</td>
<td>A good/service or objective quality that is unique.</td>
<td>Unique image of the good/service or the company incl. subjective customer perceptions of quality.</td>
<td>Lowest cost producers in the industry.</td>
</tr>
<tr>
<td>Fulfilled through</td>
<td>Design, technology, customer service, or other attractive features.</td>
<td>Brand image through marketing and customer intimacy.</td>
<td>Efficient-scale facilities, tight overhead and cost control.</td>
</tr>
<tr>
<td>Principal activities to fulfil the goal</td>
<td>Acquire ability to charge a premium price through research, development of unique service offerings and service process.</td>
<td>Create brand loyalty through marketing expenditures, image management and customer relationship management as a foundation for charging a premium price.</td>
<td>Gain market share through aggressive pricing by using economies of scale, designing products/service offerings easy to deliver and/or by using state-of-the-art production equipment.</td>
</tr>
<tr>
<td>Environment</td>
<td>Turbulent and uncertain because of difficulty in predicting demand for new offerings.</td>
<td>Semi-uncertain as loyalty is more stable than differentiation based on innovation.</td>
<td>Stable, limited uncertainty due to predictable demand.</td>
</tr>
</tbody>
</table>

The different strategies logically lead to an emphasis on different principal activities. Still there is an on-going debate as to whether or not a company can have a differentiation and low-cost leadership strategy at the same time (Allen and Helms 2006). Porter (1980: p. 40-41) holds that a business unit cannot be both low cost and differentiated at the same time, as the generic strategies imply different principal activities. There have been studies that have confirmed Porter’s belief but also studies showing that the strategies
can be combined. The literature reveals contradictory results (Allen and Helms 2006). The discussion has concerned:

- **IT and flexible technologies that enable mass customisation as well as very efficient production processes:** However, new technology only provides a firm with a temporary advantage because imitation is inevitable (Mata et al. 1995, Roth and Jackson 1995, Porter 1994, Murray 1988), especially in service. Therefore, the initial advantage by technology needs to be combined with other capabilities in order to be sustainable (Mata et al. 1995, Leonard-Barton 1992).

- **Differentiation combined with high market share:** Although differentiation most probably leads to a high cost position, the company can achieve economies of scale through a high market share. Due to the fact that service production is a process with interfaces between client and service producer, the ability to save costs in production does not seem to hold in a service context.

- **Combination between marketing differentiation and cost leadership:** Although Porter (1996) sees differentiation through marketing only as a temporary phenomenon, which can only be observed during the early stages of a product life cycle, before the customers have learned to evaluate the product, it seems that image/reputation is more sustainable in the service industry. However, the combination is not trivial in the service industry either, as shown in some previous studies (cf. Sokol 1993). The marketing or brand promise needs to be fulfilled and backed up by the service production process (Abela and Murphy 2008, Johnston 1987, Grönroos 1983). Failure to deliver can harm the firm’s relationship with its consumers (Abela and Murphy 2008, Beirne 2002, O’Farrell et al. 1993), which consequently decreases a company’s competitive advantage.

There have been studies identifying firms that simultaneously compete with the low cost strategy and differentiation strategy without emphasising any of the above-discussed combinations. Instead, valuable resources and dynamic capabilities of the companies were identified to enable the combined strategy. The studies point out that it is likely that only some of the enterprises in any one industry may possess special talents and opportunities to beneficially compete with more than one competitive strategy (cf. Menor et al. 2001). Without having the support of valuable resources or capabilities the companies tend to become ‘stuck in the middle’

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44 Stated by for example Jones and Butler 1988, Karnani 1984.


46 For example, Menor et al. (2001), Chan and Wong (1999), Helms et al. (1997), Parnell (1997).
as Porter (1980) suggested. Looking at these results, it seems feasible that firms possessing the appropriate resources and capabilities will be able to adopt a viable multi-strategic approach leading to a real competitive advantage (cf. Lusch et al. 2007). Although it is difficult to obtain, the intermediate position is going to be included in the framework for competitive advantage in the service industry.

### 3.6.3 Production Level Strategy in the Service Industry

In order to achieve strategic congruence, functional strategies need to be mutually consistent with the business strategy (Nilsson and Rapp 2005). That is, the decisions and actions taken within the functional area, in this case production of service, must reflect the requirements derived from the firm's strategy (Nilsson and Rapp 2005, Smith and Reece 1999, Jelinek and Burstein 1982). In this study the functional strategy we focus on is production strategy, which, however, is given a broad meaning. It refers to the whole process of identifying the competitive priorities, organising the production after these priorities and ensuring that the organisation remains consistent with the priorities (Prajago and McDermott 2008, Menor et al. 2001, Chase and Hayes 1991).

Nilsson and Rapp (2005) choose to integrate the “product-process-matrix” of Hayes and Wheelwright (1979) in their model. Studies have proven that the product-process-matrix does not transfer well to service business and processes (Collier and Meyer 1998, Blois 1983). One of the main arguments against the model is its failure to consider the variability created by the existence of the customer within the system (Morris and Johnston 1987, Blois 1983). This is especially critical as customer interaction is the focal point of production activities in a service firm (Chase and Hayes 1991, Mersha 1990). Due to this difference, although Hayes and Wheelwright’s typology has been used for service production in some studies with less customer interaction (e.g. Nilsson 2010 in customised software development), it is replaced with a service-oriented typology.

Authors in the service management field have proposed several service typologies, dating back to Abernathy et al.’s ideas published in 1971. However, none of them has been either as pervasive or as useful as the “product-process-matrix” of Hayes and Wheelwright (1979) was for the manufacturing industry (e.g. Menor et al. 2001, Silvestro et al. 1992, McLaughlin et al. 1991). After reviewing the most common service positioning typologies, the typology developed by Silvestro et al. (1992) was

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47 Skinner highlighted the importance of the functional alignment as early as 1969. He warned that when companies fail to recognise the relationship between functional decisions and the higher-level strategies, they may become “saddled with seriously non-competitive production systems, which are expensive and time-consuming to change” (Skinner 1969: p. 136).
chosen here as it is widely accepted\(^{48}\) and detailed enough to discuss different positions available in one service industry. Silvestro et al. use production volume, defined as the number of customers\(^{49}\) served by a business unit per day, to integrate some previously disparate service criteria in service production management literature:\(^{50}\)

- Equipment/people focus: measures if the core element in the service delivery is provided primarily by equipment or people (Schmenner 1986, Thomas 1978)
- Length of customer contact per transaction: measured as length per interaction (Mersha 1990, Chase 1981)\(^{51}\)
- Extent of customisation (Johnston and Morris 1985, Maister and Lovelock 1982)
- Degree of employee discretion, or the extent to which service production personnel exercise judgement in meeting individual needs (Lovelock 1983)
- Service/cost priority of the service production:\(^{52}\) highlights the main priority in service production (Metters and Vargas 2000)
- Customer/production-focused processes: Customer-focused processes are effectiveness-driven emphasising sales and revenues, whereas

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\(^{48}\) However, the typology has also been questioned by some researchers: Collier and Meyer (2000 and 1998) criticise the model’s complexity. They also question the relationship between volume and process for classifying the services industry, as volume increases can be met by adding stores and branches and without changing the processes. However, as the model looks at the volume per unit and not for the whole company, this argument is not sound. Tinnilä and Vepsäläinen (1995) find the focus on internal operations unfortunate, but as this study looks at the internal service production function and not the market channels involved in the sales process, this argumentation can also be left aside.

\(^{49}\) All transactions are included; some may, and some may not, require the presence of the customer.

\(^{50}\) As a result of the iterative research process combined with literature studies, two major amendments to the original model are conducted. The division between front and back office was changed to production priority, and one criterion concerning information management was added to the framework.

\(^{51}\) The category of “length of customer contact per transaction” needs to be defined for the insurance company. Customer contacts in the insurance industry can be defined as maintenance-interactive with a continuous contact between the customer and the service-providing organisation (Mills and Margulies 1980). Therefore the “length of customer contact per transaction” is defined as the length per interaction and not as the customer contact time over the length of the overall customer relationship.

\(^{52}\) In the original model the criterion was “source of value added”, measuring where the main value is added – in the front office together with the customer or in the back office (Chase and Tansik 1983). This was changed during the study as the aim of de-coupling service production into front office and back office could differ as shown by Metters and Vargas (2000). Metters and Vargas argue that the traditional view in academic literature presuming that extensive de-coupling is needed to increase productivity (e.g. Chase 1981 and 1978) should be enhanced. They conclude that in certain business situations, de-coupling can be used to provide higher service. Metters and Vargas consequently argue that the de-coupling choice needs to be mapped against the competitive priorities of cost versus service and not always be associated with increasing productivity.
production-focused processes are efficiency-driven stressing costs (Chase et al. 1984).

- Centralised or decentralised information management: A higher need for information exchange is expected between functions in an environment where customer interaction is high (Hyvönen 2007, Davis et al. 2002).

The model shows that as the number of customers processed by a business unit per day increases, the general trend is as follows:

- The focus shifts from people to equipment.
- The level of customer interaction and the degree of customisation decrease, leading to lower customer contact time, and the level of personal judgement of front-end employees moves from high to low.
- Production emphasis moves from service to cost priority.
- The focus shifts from a customer-focused to production-focused processes.
- The emphasis moves from decentralised to centralised information.

Silvestro et al. (1992) suggest three types of service production strategies after clustering the characteristics and their correlations with volume (illustrated in Figure 3.8). These types are professional service, service shop and mass service. As service shop is positioned between professional service and mass service, it will not be used explicitly in the framework. Professional service production strategy is optimised for flexible production of customised service with high complexity and task uncertainty because of the interaction with the customer. Production is people-oriented, and the customer-focused processes are kept flexible due to the service orientation and task flexibility of the employees. Mass service production strategy is inflexible concerning process changes and new product offerings because of higher equipment costs (automation) and strict procedures. High volume standardised service is produced mainly with limited customer interaction. Due to the standardised processes and the limited customer interaction, the task uncertainty in the production is low.

53 In the original model the criterion was “product/process focus”: the degree of emphasis on “what” is purchased versus “how” it is provided (Johnston and Morris 1985). During the case study, this was changed, due to the difficulties in measuring product and process focus in a homogeneous matter.

54 Silvestro et al. (1992) in their typology did not consider information management supported by information technology. This criterion is vital, as information technology has become a powerful tool for strategy over the last decade (Porter 2001), especially in information-intensive service production, like insurance production (Chan et al. 1997). Generally, there are indications that companies with standardised processes with less coordination among entities (following more customer oriented strategies) have more centralised information systems than companies with more flexible processes (Hyvönen 2007, Bouwens and Abernethy 2000 (looking at goods manufacturing), Chan et al. 1997, Tavakolian 1989).

55 Silvestro et al. (1992) verified this integration and their model with gathered in-depth data from eleven service organisations.
3.6.4 Strategic Congruence – Interdependencies between the Strategic Levels

In the last three sections, strategic typologies for the corporate, business unit and production level were presented. They were presented as strictly opposite poles. This was done only to highlight the differences. In the analysis the strategies are not going to be treated as diametrical positions, but more interpreted as dimensions along which firms can score high or low (cf. Miller 1988). In Table 3.3 the aspects concerning strategy used in this study are summarised.

After discussing the strategies on corporate, business and production levels, the next step is to analyse which combinations can be assumed to achieve a high degree of strategic congruence. Nilsson and Rapp underline that a company, to be able to achieve a strong competitive advantage, “must possess a thorough understanding of the environments in which its business units operate, as well as extensive knowledge about ways to use the internal structure of the business units to position the product offering. Such understanding and knowledge will require strategic congruence” (Nilsson and Rapp 2005: p. 83). This means that the strategy at each organisational level needs to be well aligned with the firm’s competitive arena and the strategic aims of the firm. The alignment ensures a common logic about how to create value, and it acts as a guideline supporting the co-ordination between the strategic levels (Fonvielle and Carr 2001).

Environment is a main dimension used when analysing which combinations of strategies can be assumed to achieve a high degree of strategic congruence. The business mission and the chosen business strategies can be found in environments with different levels of stability (e.g. Nilsson and Rapp 2005, Simons 1990). Therefore the analysis is based on
the assumption of a strong link between the chosen business strategy and the degree of environmental uncertainty. The expectations on functional level, like service production, are usually derived from the company’s competitive position (Johnston and Lyth 1991). As the different business strategies emphasise different priorities they also have different requirements concerning service production and especially how to manage the task uncertainty (cf. Skaggs and Younlt 2004, Skaggs and Huffman 2003).

Table 3.3: Aspects of strategy content used in this study

<table>
<thead>
<tr>
<th>Level</th>
<th>Aspects</th>
<th>Characteristics</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate strategy</td>
<td>Corporate goals</td>
<td>Main aim of the corporation</td>
</tr>
<tr>
<td></td>
<td>Synergies between business units</td>
<td>High / low</td>
</tr>
<tr>
<td></td>
<td>Coordination strategy of the business units</td>
<td>Portfolio management / activity sharing</td>
</tr>
<tr>
<td></td>
<td>Valuable resources/ capabilities on corporate level</td>
<td>Identified valuable resources/ capabilities</td>
</tr>
<tr>
<td>Business strategy</td>
<td>Goal of the business unit</td>
<td>Main aim of the business unit</td>
</tr>
<tr>
<td></td>
<td>Competitive market position of the business unit</td>
<td>Innovative differentiation/marketing differentiation/cost leadership</td>
</tr>
<tr>
<td></td>
<td>Valuable resources/ capabilities on business unit level</td>
<td>Identified valuable resources/ capabilities</td>
</tr>
<tr>
<td>Production strategy</td>
<td>Main goals with production</td>
<td>Main aim of the production (service or cost focus, customer focus/ efficiency)</td>
</tr>
<tr>
<td></td>
<td>Production strategy chosen</td>
<td>Professional service/mass service</td>
</tr>
<tr>
<td></td>
<td>Characteristics of the production</td>
<td>Equipment/people focus, length of customer contact within service production, extent of customisation, degree of employee discretion, central/de-centralised information management</td>
</tr>
<tr>
<td></td>
<td>Valuable resources/ capabilities on production level</td>
<td>Identified valuable resources/ capabilities</td>
</tr>
</tbody>
</table>

Based in the level of uncertainty and the requirements concerning production processes, Silvestro et al.’s (1992) service processes can be mapped with the chosen business strategy model as illustrated in Figure 3.9.

Nilsson and Rapp (2005) additionally map corporate strategy to business and production strategy. They point out that an activity sharing strategy appears especially appropriate to combine with a differentiation strategy (p. 170). They argue that based on the long-term perspective of both strategies there is a baseline to develop, share and co-ordinate activities and decisions. Accordingly they also argue that a portfolio management strategy on the corporate level fits better with a cost leadership strategy based on the short timeframe followed by both types of strategies. This connection is also
included into the service industry framework, however, leaving some space for new interpretations due to the fact that valuable resources, capabilities and common activities managed on a corporate level could actually also support cost leadership on business level.

![Figure 3.9: The relationship between business strategy and service production typology](image)

The alignment ensures clarity about common goals and aims. This alignment is also a basis for an integrated planning and control (Nilsson and Rapp 2005), which is discussed in the next sub-chapter.

### 3.7 Integrated Control in the Service Industry


Modell (1995) wrote almost two decades ago that research in control systems in service organisations was still in its infancy. At best, control textbooks included chapters in which service organisations were viewed as...
special (i.e. exceptional) cases compared to “normal” manufacturing firms. Some early articles have been devoted to service organisations in the accounting discipline (e.g. Otley 1994, Lowry 1993) and management control has been touched on in the service literature (e.g. Gummesson 1994, Mills 1986) but a holistic overall discussion including operational aspects is still lacking (Hatzakis et al. 2010). In order to design control systems for the service industry there is a need to look beyond the narrow traditional conceptualizations of control. Modell (1995) as well as Mills (1986) highlights the importance to include process and social controls within service firms, as complexity due to customisation and a high level of client interaction increases in service firms, uncertainty over means-ends relationships reduces the effectiveness of traditional formal controls. Control in this study therefore refers to a broad scope of a “control system package” including formalised procedures and measurements as well as social controls as complementary means to maintain or alter patterns in organisational activity (cf. Malmi and Brown 2008, Otley 2008, Sandelin 2008, Huikku 2007, Berry et al. 1991, Brignall et al. 1991a, Flamholtz et al. 1985, Otley 1980). Different strategies require different task priorities, have different key success factors, and require different skills, perspectives, and behaviours. Thus, a continuing task within the design of control systems is to ensure that the package is consistent internally and with the strategy (Malmi and Granlund 2009, Sandelin 2008, Chenhall 2005 and 2003, Malina and Selto 2004, Langfield-Smith 1997, Abernethy and Chua 1996, Govindarajan and Shank 1992). The different controls and control systems, which are included in each level, are illustrated in Figure 3.10.

![Control System Package](image)

**Figure 3.10: Control system package**

The purpose of this sub-chapter is to discuss the different control and control systems integrated in the management and production control package from a service industry perspective and to align them with the strategic typologies described in the previous sub-chapter. The management control package and the production control package are discussed in the next two sections, whereas the last section is devoted to the integration between management and production control and the strategy.

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56 The concept of a package is used instead of an integrated system, as the different controls and control systems are often introduced and used by different interest groups at different times (cf. Malmi and Brown 2008).
3.7.1 Management Control in the Service Industry

The successful development and implementation of a business strategy is highly dependent on senior management’s access to relevant information when taking decisions. Systems support the selection, sorting and presentation of data. They are thereby an important medium shaping participants' perceptions of the organisation’s relationship with its environment (Dent 1990). The aim of a management control system is to provide a rational framework to formulate, communicate and implement strategies (Chenhall 2005, Abernethy and Brownell 1999, Simons 1994, Argyris 1990, Dent 1990, Simons 1990, Hedberg and Jönsson 1978). In this section both the control processes and the information in the form of performance measurements are discussed. In order to be able to structure the collected case data adequately control processes are discussed separately from the performance measurements, although both are integrated parts of the management control package.

3.7.1.1 Control Processes

Control processes are the means for an organisation to ensure that its strategies, plans and objectives are attained and refined (Otley 2008). Nilsson and Rapp (2005) in their model analyse the planning and follow-up processes. Through the planning and follow-up processes, the goals across the corporation, its business units and the functional areas of an organisation are coordinated and aligned (Dye and Sibony 2007, Flamholtz et al. 1985). Thereby their development can be controlled companywide to ensure that it is in line with desired organisational outcomes (Malmi and Brown 2008, Andersen 2000), or the feedback can be used to adjust the set goals or the chosen strategy (Nilsson and Rapp 2005: p.103).

It has been shown in many studies that depending on a company’s strategic choice different requirements are imposed on the control processes (Rogers et al. 1999, Kukalis 1991, Otley and Berry 1980). Although different requirements exist, several studies have consistently indicated that planning and follow-up are effective in all environments, also in dynamic environments (Andersen 2000, Hopkins and Hopkins 1997, Miller and Cardinal 1994). The planning and follow-up processes are just differently implemented in different environments (Grant 2003). Therefore, the question is not if control processes are implemented, but more how they are implemented. Many aspects and attributes have been used to characterise the processes in the different studies. The discussion will start with the characteristics used by Nilsson and Rapp (2005) in their model:

- Tightness of control summarises the way in which management chooses to plan the business and to follow up business performance (Simons 1987). Nilsson and Rapp (2005) draw a distinction between tight control with frequent and detailed monitoring of activities, where plans are treated as binding contracts, targets have high importance, and
deviations from plan are not acceptable, and loose control, where subjective targets are seen primarily as instruments of communication and deviations lead to informal discussions about new targets and not to serious consequences. Generally, the importance of the targets and thereby the tightness declines when large fluctuations in demand make the planning and co-ordination of operations more difficult (Nilsson and Rapp 1999).

- Their second characteristic is the time perspective, where a short-term perspective emphasizes quick results, usually based on monetary targets, and a long-term perspective focuses on laying a foundation for future profits and on attaining synergies between business units (Nilsson and Rapp 2005, Hoque 2004, Lindsay and Rue 1980).

The following four characteristics are added in order to enhance the understanding of the control process in the case company. The first three can be aligned with the overall characteristic “level of tightness” used by Nilsson and Rapp (2005) whereas the last one characterises management control on the corporate level.

- Formality of the processes: Formality of the planning and follow-up processes investigates the rigidity of the processes, that is, if they are strictly followed or if the processes can be altered and if independent decisions outside the formal control processes are accepted. Independent decisions allow the organisation to be more responsive to changing market conditions (Andersen 2004, 2000). A potential downside to autonomous actions is that they might divert organisational efforts, and lead to conflicting and counterproductive actions (Andersen 2000). Organisations acting in a stable environment, without urgent needs to respond immediately, tend therefore to rely more heavily on formal processes (Andersen 2000, Simons 1987).

- Level of integration: Level of coordination and integration of the functional planning processes, that is, if the different aspects, like the sales plan and the production plan, are aligned with each other. Successful companies following a differentiation strategy tend to increase the integration/coordination of the different control aspects as a means to manage increasing complexity and instability of the business environment (Hansen et al. 2003, Kukalis 1991, Lindsay and Rue 1980).

- Diagnostic versus interactive use: This characteristic analyses how the control system and information is used by management (Chapman 1997, Simons 1994, 1991 and 1990). In case of management-by-exception top

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57 Although there has been a debate in the performance measurement literature as to whether performance measurement systems are diagnostic or interactive control systems (cf. Simons 1999), this study follows the nowadays widely acknowledged view that also performance measurement systems can be used either diagnostically or interactively (cf. Tuomela 2005).
management gets involved only when defined targets are not reached. Regular interactive use of control systems on the other hand is a vehicle to focus organisational attention on strategic aspects and to use the information for organisational development. Firms following innovative differentiation strategies rely more on interactive controls than firms following defensive cost-leadership strategies (Henri 2006b, Abernethy and Brownell 1999, Simons 1995a, 1994, 1991 and 1990).

- Corporate control of business units: In the strategic planning approach the corporate centre is deeply involved in the strategic decision-making both in terms of the interdivisional opportunities and dependencies and in terms of the long-term direction of individual business units (Chandler 1991, Roberts 1990). In a financial control approach the corporate centre limits itself to setting and monitoring clear short-term financial objectives (Chandler 1991, Roberts 1990). The corporate control is usually mapped with the corporate strategy chosen by the corporate management in order to ensure effective and efficient corporate control (cf. Nilsson 2002, Nilsson and Olve 2001). Essentially, the higher the potential for activity sharing and utilisation of valuable resources and capabilities, the more coordination is needed between the business units (Nilsson 2000).

All the control process aspects discussed above are as applicable for service companies as they are for manufacturing companies. Therefore no service specific aspects are needed concerning the characterisation of control processes.

### 3.7.1.2 Information Characteristics of the Management Control System

Performance measurements are designed to present managers with information covering different perspectives, which in combination provide a way of translating strategy into organisational priorities (Chenhall 2005) and to deliver information concerning the organisation’s performance and its relationship with its environment (Henri 2004, Dent 1990). Therefore they need to be designed to deal with the uncertainty level resulting from the chosen business strategy (Nilsson and Rapp 1999) and to encourage and fuel the strategic dialogues that are considered desirable, partly based on how the organisation is structured, management’s philosophy of leadership etc. (Nilsson et al. 2011). An organisation’s ability to survive and function successfully in its environment depends therefore partially on the availability of information upon which its managers can act (Tuomela 2005, de Haas and Kleingeld 1999).

Performance measurements can be defined and characterised by using a broad set of various dimensions; drivers versus outcome measurements, subjective versus objective measurements, internal versus external measurements, and financial versus non-financial measurements (Henri
Nilsson and Rapp (2005) use one general dimension to characterise the performance measurements used within management control – the emphasis on monetary or non-monetary performance measurements. Monetary information is outcome-based and often associated with a focus on efficiency, whereas non-monetary measurements are more oriented toward performance drivers or the future. Often non-monetary measurements are subjective, focus on important aspects for the business and include external information. Firms acting in an unstable environment need more extensive information (Hoque 2004) provided by a broad scope of performance measurements to support their decision-making (Henri 2006a, Naranjo-Gil and Hartmann 2006, Bisbe and Otley 2004, Baines and Langfield-Smith 2003, Chenhall 2003, Bouwens and Abernethy 2000, van der Stede 2000). Firms acting in a stable environment on the other hand have a limited need for extensive information (Chong and Chong 1997). Their performance measurements focus on events within the own organisation, are mainly based on financial information and have an historical orientation (Rajagopalan 1997, Abernethy and Guthrie 1994, Govindarajan and Fisher 1990, Simons 1987). Due to the broad interpretation of monetary and non-monetary performance measurements no additional characteristics were included in the analysis. After discussing the processes and the information integrated into the management control system, all the aspects of the management control package will be summarised.

3.7.1.3 Summary of the Management Control System Package

Firms following different strategies and operating in different environments have different needs and therefore should design and use control systems in different ways (Marginson 2002, Ittner and Larcker 1997, Simons 1987, Govindarajan and Gupta 1985). Control systems can actually even hinder performance in some circumstances if measurements are used that focus attention on formal and rigid action plans and targets, when flexible and creative strategic responses may be more appropriate (Ittner and Larcker 1997). In this section the importance of integration between strategy and management control dimensions was discussed. The discussion concerning the control processes and the performance measurements is summarised in Table 3.4.

Table 3.4: Aspects of controls and control systems within the management control package and their characteristics mapped with strategy characteristics

<table>
<thead>
<tr>
<th>Aspect</th>
<th>Characteristics</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate strategy</td>
<td>Activity sharing</td>
</tr>
<tr>
<td>Corporate control system</td>
<td>Corporate control of business units through interactive strategic planning</td>
</tr>
<tr>
<td></td>
<td>Corporate control of business units through financial control</td>
</tr>
<tr>
<td>Aspect</td>
<td>Characteristics</td>
</tr>
<tr>
<td>--------------------</td>
<td>---------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Business strategy</td>
<td>Differentiator</td>
</tr>
<tr>
<td>Cost-leader</td>
<td></td>
</tr>
<tr>
<td>Environment</td>
<td>Unstable</td>
</tr>
<tr>
<td>Stable</td>
<td></td>
</tr>
<tr>
<td>Control processes</td>
<td>Loose control with subjective targets that are mainly used as instruments of communication</td>
</tr>
<tr>
<td>Tight control with frequent and detailed monitoring of fixed targets</td>
<td></td>
</tr>
<tr>
<td>Long-term perspective</td>
<td>Flexible process allowing independent decision taken outside the formal processes</td>
</tr>
<tr>
<td>Short-term perspective</td>
<td>Rigid and formal processes with integrated decision making</td>
</tr>
<tr>
<td>High level of integration and coordination of the different plans and reports</td>
<td></td>
</tr>
<tr>
<td>No or low level of integration and coordination of the different plans and reports</td>
<td></td>
</tr>
<tr>
<td>More interactive controls emphasising changing environmental conditions</td>
<td></td>
</tr>
<tr>
<td>More diagnostic controls</td>
<td></td>
</tr>
<tr>
<td>Performance measurements</td>
<td>Broad scope of long-term non-monetary based information of subjective nature and often including external information</td>
</tr>
<tr>
<td>Narrow scope of short-term monetary based internal information focusing on efficiency</td>
<td></td>
</tr>
</tbody>
</table>

In the next section the production control package will be discussed and mapped to the service production strategy.

### 3.7.2 Production Control in the Service Industry

Production control refers to the procedures and structures used to implement the chosen production strategy by controlling the production process, its resources and the administrative functions (cf. Nilsson and Rapp 2005). Anthony pointed out early that operational control takes very different forms in different organisations, reflecting technological and operating differences (from the 1980 edition of his 1965 book). Just like the management control systems, production control systems need to be designed and used with an awareness of a series of relevant contingent aspects, such as competitive environment, the organisation's strategy and its service process type (Brignall 1997).

Owing to the differences between manufacturing and service production – the nature of the output and the difficulty of measuring it, as well as the customer participation in the service production process – it is difficult to control service production with the same measurements that are used for production control in manufacturing (Chase and Tansik 1983, Mills et al.
1983a). Therefore the production control aspects used by Nilsson and Rapp (2005) are replaced by more service production specific aspects (cf. Modell 1995, Lowry 1993 and 1990). In the design and use of production control systems for service industry, there is a need to look beyond the traditional narrow conceptualisations of control. For example, process control and social controls are useful, especially as uncertainty about means-end relationships reduces the effectiveness of traditional formal mechanisms of control (cf. Mills 1986). Generally there has been very little research published about service production control (Hatzakis et al. 2010, Modell 1995). The aim of this section is to consolidate some existing ideas into an overall framework. The existing ideas are clustered according to the four production controls/control systems included into the production control package illustrated in Figure 3.10: production control priority, capacity management, social controls and type of information or performance measurements.

### 3.7.2.1 Production Control Priority in Service Production

Value creation in service is a balance between customer perceived quality and productivity (Gummesson 1994). The balance between productivity and quality is one of the principal issues in service production management, as both productivity and quality are indications of how well resources are used within production function (Van Looy et al. 1998, Siferd et al. 1992).

Although there has been a discussion for decades among researchers that quality and productivity could be optimised at the same time (e.g. Hart 1988), the opposite has been shown in service production (e.g. Kekre et al. 2009, Oliva and Sterman 2001, Vuorinen et al. 1998, Roth and Jackson 1995). This is especially the case in services processes with high customer

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58 However the parts capacity management and performance measurement are based on similar ideas, as discussed by Nilsson and Rapp (2005).
59 The same or similar aspects have been used by Poth and Nilsson (2010 and 2009) as well as by Poth (2008) in their theoretical discussions of production control in the service sector. Ahlström (2008) also used similar aspects in his study of strategic congruence and integrated control systems for organisations in the senior housing market.
60 The measurement of white-collar productivity has become increasingly important as the share of knowledge workers increases (Schroeder et al. 1985). However, service productivity has not been a main focus of services research (Küpers 1998) and the debate on service productivity is still only in its infancy (Vuorinen et al. 1998). In service industries productivity is more difficult to define and measure (Grönroos 1994b, Gummesson 1994, McLaughlin and Coffey 1990), not least due to the lack of description of what the output actually is (Lowry 1993). This problem is compounded by uncertainty as to whether the service unit is working at capacity and with the required quality at the time when measurements are made (Bowen and Ford 2002, Mills et al. 1983a).
61 Quality of service is concerned with generating customer satisfaction. Bowen and Ford (2002), Hays and Hill (2001), Johnston (1987), Parasuraman et al. (1985) and Grönroos (1984), just to mention a few researchers, define quality of service in terms of customer satisfaction, that is, by the degree of fit between customer expectations and perceptions of service.
interaction (Lovelock 1992). The reduction in time per customer, while enabling an immediate increase in productivity, gradually erodes service quality in the organisation (Rust et al. 2002, Oliva and Sterman 2001, Rust et al. 1995). Claims adjustment in the insurance industry was one of the first contexts in which eroding service quality was observed (Senge and Sterman 1992 as well as Senge 1990 based on a case study). The limited customer contact time, as a result of fast telephone-based claims adjustments, reduced customer satisfaction, as the customers could not see the procedural fairness (Senge and Sterman 1992).

Management must set priorities, choosing between productivity and quality, as productivity can be increased at the expense of quality and vice versa (Kekre et al. 2009, Vuorinen et al. 1998, Anderson et al. 1997, Lovelock 1992). The question whether quality or productivity should be prioritised is related to the market position of the company as well as the chosen strategy for service production (Frei 2006, Vuorinen et al. 1998). With productivity as the main production priority a company optimises its output and resource utilisation. This is important for companies following a cost-leadership strategy where standardised mass service production with a limited customer interaction is implemented (Silvestro 1999, Vuorinen et al. 1998, Silvestro et al. 1990). Service quality which leads to increased customer satisfaction should be chosen as the production priority for service industries following a differentiation strategy with professional service production processes allowing a high level of customer interaction (Kekre et al. 2009, Vuorinen et al. 1998, Silvestro et al. 1990).

### 3.7.2.2 Capacity Management in Service Production

In capacity management the demand from customers is balanced with the capability of the service production system to satisfy that demand (Armistead and Clark 1994). As the service industry is maturing and has become more competitive, the importance of capacity management has been increasing, although the increased use of IT systems has been partially replacing human capacity (Hatzakis et al. 2010, Ng et al. 1999, Pullman and Moore 1999, Harris and Peacock 1995).

In capacity management, not just costs but also quality goals need to be taken into account. Mabert (1986) found that service firms in an unstable environment tend to plan their capacity based on peak demand situations, resulting in substantial idle time during slack periods and increased costs. Heskett (1986), however, sees this tendency as reflecting an explicit decision to achieve higher quality. Thus, idle capacity might be maintained in order to establish and uphold quality of service (Lovelock 1992). In cost-conscious, productivity-oriented service organisations, however, there is an

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62 Heskett (1986) found in his empirical study of restaurants that the quality of service drops rapidly even when demand is as low as 75 per cent of the service firm's capacity. This was explained by the fact that the comfort of service users may be compromised if the capacity of the service firm is maximised.
emphasis on effective capacity utilisation (Siferd et al. 1992). The balancing of the capacity trade-off, between high productivity and utilisation on the one hand and high quality on the other should be aligned with the priorities followed in service production (Armistead and Clark 1994, Siferd et al. 1992). In addition to the priorities in service production, the level of customer participation in the service production is also an important factor when considering capacity levels. In service production with a high level of customer participation, smoothing production will affect the quality as it leads to long waiting times during peak hours, whereas in service production with limited customer contact, both backlogging as well as smoothing can be used to manage capacity without any sincere quality effects (Chase 1978).

With productivity as the main production priority a company optimises its output and resource utilisation. In these cases a company normally follows a level capacity set at an average demand. This is especially the case if there are available options to manage the backlog by dividing production activities from customer interaction. In cases where quality is the main priority, and especially in high customer-interaction production, capacity is set to be able to manage peak demand. In these cases slack capacity is accepted in order to ensure high quality and short waiting times for the customers.

3.7.2.3 Social Controls in the Production Control System

Social control is a critical tool with which managers can influence and direct the course of their organisations (Sandelin 2008, Tichy 1982, Schwartz and Davis 1981). It governs the way people relate to one another and to the customers in the workplace (Bharadwaj et al. 1993). Strong, well-adapted social control can therefore serve as a means for organisational control and management (Malmi and Brown 2008, Sandelin 2008).

Generally there are two basic monitoring or control mechanisms available to managers in service production: control of output and control of behaviour (Mills 1986). The degree of uncertainty inherent in the employee's task and the level of discretion allowed will determine the monitoring mechanisms used (Cook et al. 2002, Simons 1995b, Mills 1986, Schneider 1986). Nesheim (1990) concludes that control of behaviour is the "right" form of coordination when there is low predictability (e.g. intensive customer interaction) and high performance ambiguity (e.g. high intangibility). Standardisation of norms and values can thus be seen as an appropriate form of control when standardisation of work processes or control of output is not feasible (Sandelin 2008, Huikku 2007, Modell 1995, Denison 1984, Ouchi 1980). Whereas the standardisation of norms and values can be seen as a complement when formal output measurements are less applicable for influencing employee behaviour, formal measurement and evaluation

63 This part includes also results from research conducted in goods manufacturing. The input is included as the conclusions based on the level of the standardisation of the work processes and control of output is applicable in both service and goods production.
techniques are appropriate under conditions of low uncertainty (Gerdin 2005, Modell 1995, Otley and Wilkinson 1988). Looking at the production strategies used in this research project this would mean that production control in professional service is efficiently conducted through social control or peer control, whereas standard operating procedures and output control are more efficiently used in mass service production (cf. Silvestro 1999).

3.7.2.4 Production Control System Performance Measurements

The implementation of performance measurements in production control is very important, as controls are particularly important at the operational level of the organisation (Langfield-Smith 1997). It is vital that the performance measurements support the behaviour necessary to fulfil the priorities of the chosen production strategy (van Veen-Dirks 2005, Henri 2004). Almost none of the studies analysing performance measurements in production studied service production (e.g. review by Chenhall and Langfield-Smith 2007). Therefore some general conclusions from manufacturing studies are also included into this discussion.

Ittner and Larckner concluded in their review that flexible production strategies have been found to be positively associated with the provision of non-quantitative measurements and goals (Ittner and Larcker 2001). The absence of routines in these environments makes it difficult to specify performance standards, as optimal relationships between inputs and outputs for production tasks are usually not known. In this situation, efficiency/productivity-based performance measurements become less relevant (van Veen-Dirks 2005). Business units following a cost leadership strategy that operate in a more stable environment enabling stable production processes, on the other hand, were found to be positively related to the use of fixed performance targets with a focus on productivity and efficiency. Similar conclusions drawn from reviews of production control systems have also been discussed for service production by Sandelin in a telecom environment (2008), by Ittner and Larcker based on their empirical material of consulting companies and governmental agencies (1998), and by Bowen et al. (1989) as well as Chase (1978) in their conceptual papers. The performance measurement discussion on the functional level can be summarised by Collis and Montgomery’s (1998) conclusion that as resources and operations become more specialised, that is, less standardised, the value of moving from quantitative to non-quantitative control increases.

Additionally, it is also important to connect the performance measurements in production to the service production priorities discussed earlier. In professional service production quality-oriented measurements like customer retention and complaints (Silvestro 1999, Brignall 1997) as well as customer satisfaction (Roth and van der Velde 1991) should be included, whereas production or resource-utilisation-oriented measurements are well aligned with mass service production (Brignall 1997).
3.7.2.5 Summary of the Service Production Control System

The controls and control system within the production control package – production priority, capacity management, social control and performance measurements – make up a complex field which needs to be considered when managing service production. In this section the requirements have been discussed taking customer interaction, task uncertainty and the company’s strategic choices under consideration. The discussion is summarised in Table 3.5.

Table 3.5: Aspects of controls and control systems within the production control package mapped with environmental characteristics and service production strategy

<table>
<thead>
<tr>
<th>Aspect</th>
<th>Characteristics</th>
<th>Mass service production</th>
</tr>
</thead>
<tbody>
<tr>
<td>Service production strategy</td>
<td>Professional service production</td>
<td></td>
</tr>
<tr>
<td>Customer interaction</td>
<td>High due to customised service offerings</td>
<td>Limited due to standardised service offerings</td>
</tr>
<tr>
<td>Task uncertainty</td>
<td>High due to customer interaction</td>
<td>Low due to standardised offerings and processes</td>
</tr>
<tr>
<td>Production priority</td>
<td>Quality/Customer Satisfaction orientation</td>
<td>Productivity orientation</td>
</tr>
<tr>
<td>Capacity management</td>
<td>Chase capacity – Capacity set to meet peak demand</td>
<td>Level capacity – Capacity set at average demand</td>
</tr>
<tr>
<td>Control concept</td>
<td>Social control</td>
<td>Output control</td>
</tr>
<tr>
<td>Performance measurements</td>
<td>Non-quantitative process oriented measurements</td>
<td>Quantitative performance targets and measurements</td>
</tr>
<tr>
<td></td>
<td>Focus on quality oriented measurements like customer retention and complaints</td>
<td>Focus on production or resource utilisation</td>
</tr>
</tbody>
</table>

Now that both the management and the production control package have been discussed it is time to look at integrated control and to summarise the findings of this sub-chapter. This will be the subject of the next and last section.

3.7.3 Integrated Control in the Service Industry

Within an integrated control system a company aligns its control system with its strategy and links the controls and control systems in the management control and production control levels with each other. In this sub-chapter the alignment of control and control systems have been discussed on each level. In this section the interaction of the management control system with the production control system will be discussed.
Performance measurements are included into both management and production control levels. By aligning the measurement, a synchronisation of the information at the two control levels can be ensured (Henri 2004). It involves combining performance measurements so that production decisions can be assessed in terms of their coherence with management decision on the business unit and corporate level (Chenhall 2005). Without this fit, dysfunctional behavioural effects might occur on the different levels and functions, ultimately undermining the organisation’s overall performance (de Haas and Kleingeld 1999). However, at the same time it is important to highlight that the information only needs to be synchronised and does not need to be the same information, as the specific information needs differ between the different levels (Henri 2004, de Haas and Kleingeld 1999) and between production activities with different characteristics that may exist in an organisation. However, performance measurements are not the only vehicle to align management control with production control. All the controls and control systems when aligned with each other form an integrated consistent system where they complement and support each other.
In Figure 3.11 the dimensions of management control and production control are mapped with the strategic levels and each other, taking the level of uncertainty into consideration.

After discussion of the aspects of integrated control, the last dimension of the framework, a coherent organisational structure, is treated in the next sub-chapter.

3.8 Coherent Organisational Structure in the Service Industry

As already mentioned during the review of the original tentative model (see sub-chapter “3.4 Tentative Model for Competitive Advantage”), organisational structure was added to the model as one more part of the internal administrative mechanisms. There is ample evidence (e.g. Miller 1987a) that organisational structure affects performance (Kontes 2004, Lenz 1981). In contingency theory it has been shown that environment and strategy act as incentives for changes in organisational structure (e.g. Brickley et al. 1995). However, results also indicate that past organisational choices influence strategic choices (Miller 1988, Miller and Friesen 1980b) as existing structural arrangements within a firm serve as filters (Keats and Hitt 1988). That is, there are ties that unite strategy and structure in both directions (Miller 1986). When the organisational structure is aligned with the strategy, tasks can be organised and managed in an efficient manner, which also influences competitive advantage (Gebauer et al. 2010, Miller 1987b). Understanding the ties between organisation and strategy is therefore an important element of managerial analysis (Miller et al. 2004). As each organisational form enables some activities to be performed well while hindering others, choosing organisational alternatives inevitably involves making trade-offs (Galbraith 2002). As a result, any organisation is good at executing some activities but not good at other activities (Galbraith 2002).

In this study organisational structure is analysed on a company level including both corporate and business unit functions and service-production level, with the primary focus on the organisation of work in service production.

3.8.1 Company Level Organisation

The fundamental issue facing a firm is to ensure that decision-makers have the relevant support to make good decisions. In addressing this problem, all firms develop an “organisational architecture” (Brickley et al. 1995). There are multiple aspects of this, and in this study corporate functions, formal company structure and informal company structure are used due to their
relevance in the studied insurance company. The alignment of these parts to strategy and each other is discussed in this section.

3.8.1.1 Corporate Functions

Corporate functions are defined as corporate centres that provide support to the business units on the one hand and control them on the other hand. Few explicit attempts have been made to measure how much net value is added by corporate functions. This might have to do with the difficulty of estimating the value due to the fact that the corporate functions play multiple roles (Goold and Campbell 2002). The main role of the corporate functions is dependent on the level of interdependency among the business units and the level of activity or resource sharing (Collis and Montgomery 1998). Generally speaking, in order to optimise the value of the corporate functions, the less interdependence among the business units, the smaller the corporate office should be (Collis and Montgomery 1998).

In corporations with a high level of activity or resource sharing, the corporate functions need a good knowledge of the business units and their critical success factors, in order to be able to manage interdependent structures between and among the business units. If the parent functions have insufficient skills or poor staff support, they may hinder rather than support the business units. Besides just supporting the coordination among the business units, staff in corporate functions can add value by developing specialist expertise relevant to the business units (Goold and Campbell 2002). Weill and Ross (2004) looking especially at IT functions, point out that approaches with centralised expertise align well with strategies emphasising efficient operations. Due to the centralisation a high degree of standardisation can be enforced in the pursuit of low business costs. On the other hand decentralised approaches to expertise are more efficient in firms that are more focused on innovation and time to market. In these situations top performers minimise constraints on creativity and business unit autonomy by establishing few, if any, corporate experts and standards (Weill and Ross 2004).

3.8.1.2 Formal Company Structure

Organisational structures are established to coordinate work that has been divided into smaller tasks (Olson et al. 2005). The formal structure of the company refers to the coordination of the tasks based on internal pattern of relationships, authority, and communication (Ciborra 1996). The framework developed by Burns and Stalker (1961) integrates the above-listed aspects. It considers the fundamental dimension of organisational structure to be a continuum from mechanistic to organic structure (Burns and Stalker 1961). In spite of its age, this framework continues to be widely used when
organisational structures are described (Slevin and Covin 1997). It is argued and empirically shown that efficiency is maximised by a structure that is centralised in decision-making, formalised, and low on complexity (Donaldson 2001). Innovation, on the other hand, is maximised by a structure that is decentralised, low on formalisation, and high on complexity as knowledge is available within the whole organisation (Donaldson 2001, Rindova and Kotha 2001). Therefore, organic firms (informal, adaptable and loosely controlled organisations) have better performance in dynamic environments than mechanistic firms, and mechanistic firms have better performance in stable environments than organic firms (Burns and Stalker 1961).

However, a strictly organic or mechanistic structure is seldom the right choice. Rather, a balance between mechanistic and organic structures can be beneficial, that is, a combination of the different dimensions corresponding to the environmental situation facing the company. Therefore, this study will look at the organisational characteristics separately instead of using the strict mechanistic–organic continuum (cf. Galbraith 2002). As organisational structure has been a main interest for research for many decades, there are many aspects suggested to characterise it (Dunbar and Starbuck 2006). Reviews affirm that the structural dimensions to emerge most consistently in empirical studies are centralisation and coordination (Miller 1992):

- Centralisation describes the distribution of power (Galbraith 2002) by specifying authority and accountability (Malmi and Brown 2008), that is, whether the authority to make decisions affecting the organisation is confined to higher levels of hierarchy or not (Miller 1988). Centralised companies can be very effective in stable environments where the demand for updated environmental information is limited (Child and McGrath 2001). In a more complex and unstable environment, knowledge and expertise needs to be utilised without regard to the organisational hierarchy (Andersen 2004). Accordingly, responsibility and power will be decentralized to cope with environmental uncertainty (Child and McGrath 2001). However, as Galbraith (2002) argues decentralisation does not come free of costs. High decentralisation implies more time and effort in coordination and control. Thus, the

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64 Beside the well-established stream of research considering poles of mechanistic to organic structure, there is parallel research around alternative flexible forms for coping with hypercompetitive environments (e.g. Ciborra 1996, Volberda 1996, Heckscher 1994). However, after examining the characteristics of these alternative forms, a conclusion can be drawn that many of the suggested new organisational forms are justifications and rationalisations of successful adaptive organisations ( Johne and Davies 2000). In other words, they are very similar to the organic form described by Burns and Stalker as early as 1961 and can be more seen as a counter-positioning against the mechanistic, bureaucratic vertical forms with limited ability to respond to accelerating competition (cf. Volberda 1996).

65 For example Brown and Eisenhardt (1997) showed that semi-structures were implemented by successful innovative firms. Also Sunbo’s (1994) discussion around service companies offering mass modularised service is an example of a hybrid organisation form.
benefits of decentralisation outweigh costs in situations involving high uncertainty.

- Coordination of activities refers to the systems that are in place to ensure that representatives of the various functions and organisational units coordinate their activities (Malmi and Brown 2008). In situations with a high demand for flexibility and speed, the organisational structure shifts towards horizontal collaboration among diverse groups and functions rather than vertical chains of command (Kellogg et al. 2006, Child and McGrath 2001), which tend to be too slow in these situations (Hitt et al. 1998).

### 3.8.1.3 Informal Company Structure

The informal structure is also considered in this study, as the formal structures never succeed in conquering the non-rational dimensions of organisational behaviour (Selznick 1948). Informal structures, also affecting the way decision are taken and tasks confirmed, are important to analyse in order to get an overall understanding of how the tasks within an organisation are managed (Jackall 1988). This informal structure affects the systems of coordination, especially within hierarchical structures. In hierarchical structure, the formal links of coordination have been found to be too impoverished to support the real work of organisations (Heckscher 1994). As the informal structures are built through personal contacts, they do not necessarily involve those with relevant knowledge – or indeed all parties involved in the activity (Heckscher 1994). Furthermore this coordination often is conducted in the absence of senior management (Balogun and Johnson 2004) and thereby disconnected to the distribution of power. In this study the informal company structure is limited to comparing the informal ways of coordinating work to the formal coordination mechanisms used.

### 3.8.1.4 Mapping Company Level Organisation with Strategy

As with control systems, firms following different strategies and thereby facing different environmental uncertainty have different needs for coordination and therefore should organise themselves in different ways (Kontes 2004, Lenz 1981). In this section organisational choices on the company level were discussed taking environment and strategy into consideration. The discussed choices mapped to the corporate and business strategy are summarised in Tables 3.6a and 3.6b below. Although the aspects are mapped with the counterpoles, the reality is more seen as a continuum between the two main poles presented in the tables.

In the next section the workgroup organisation is discussed in the service production context.
### Table 3.6a: Aspects of organisational structure mapped to corporate strategy

<table>
<thead>
<tr>
<th>Aspect</th>
<th>Characteristics</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate strategy</td>
<td>Portfolio</td>
</tr>
<tr>
<td>Corporate functions</td>
<td>Limited corporate functions due to limited interdependencies among business units.</td>
</tr>
<tr>
<td>Centralised experts and standards</td>
<td>Efficiency strategies align well with centralised experts enabling standardisation.</td>
</tr>
<tr>
<td></td>
<td>Corporate functions supporting the coordination or activities and resources among the business units.</td>
</tr>
<tr>
<td></td>
<td>Decentralised approaches to expertise with few, if any, corporate experts and standards established.</td>
</tr>
</tbody>
</table>

### Table 3.6b: Aspects of organisational structure mapped to business strategy

<table>
<thead>
<tr>
<th>Aspect</th>
<th>Characteristics</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business strategy/Market position</td>
<td>Cost efficiency.</td>
</tr>
<tr>
<td>Environment</td>
<td>Stable environment.</td>
</tr>
<tr>
<td>Decision-making</td>
<td>Centralised top-down decision-making.</td>
</tr>
<tr>
<td>Integration / Coordination</td>
<td>Vertical chains of command are used for coordination</td>
</tr>
<tr>
<td>Informal coordination structure</td>
<td>Strong informal structures.</td>
</tr>
<tr>
<td></td>
<td>High level of coordination and information processing requirements are enabled through horizontal collaborations.</td>
</tr>
<tr>
<td></td>
<td>No real distinction between formal and informal structures.</td>
</tr>
</tbody>
</table>

### 3.8.2 Workgroup Organisation

Structural arrangements influence the efficiency of work, the motivation of individuals, shape the information flows and can help shape the future of the organisation (Chenhall 2003). Although its influence on production management has been recognised, the organisation of work, in connection with strategic congruence and integrated control, has so far received little attention in research (Gebauer et al. 2010, Van Veen-Dirks 2005). Given that human resources are highly involved in service production, it is of central importance to match the organisation of tasks with the requirements of service production. As a general proposition, service organisations tend to use, and to be more effective when using, a work organisation designed to match the uncertainty arising from the level of customisation and the interaction with customers in service production (cf. Larsson and Bowen 1989). When analysing the design of the workgroup organisation, consideration is given to the functional power of service employees combined with the formalisation of work processes, and the specialisation of
Functional power refers to the amount of work-related decision-making that employees exercise (Bell and Zemke 1988, Drazin and Van de Ven 1985, Mills et al. 1983b). Functional power is connected with questions of how problems are handled and who is responsible for making decisions about exceptions (Drazin and Van de Ven 1985). The amount of decisions that need to be made is connected to the level of uncertainty. When uncertainty increases, tasks cannot be standardised and formalised (Mills and Turk 1986). As exceptions are common, the hierarchy would become overloaded if every matter were referred upward. Therefore, a high level of functional power is an appropriate response to increased uncertainty on the task level (Andersen 2004, Mills and Turk 1986). In these cases the employees need to have access to information concerning the customer’s situation and the organisation’s priorities (Hart et al. 1990). Conversely, routine-based production, like mass service production, calls for simplified and standardised production procedures (Armistead and Clark 1994) that can be formalised. There are only a few exceptions, which can be handled by centralised decision-making (Govindarajan 1986).

Specialisation indicates the extent to which tasks are partitioned and whether employees are trained only for a limited number of activities or are encouraged to perform more activities (Heckscher 1994). In general, the greater the extent of specialisation, the more efficiently a subtask can be performed (Heckscher 1994). However, in order to process customers with different needs, that is, when a broad range of services or non-standardised services are offered, employees with customer contact need to deal with variability and cannot specialise to the point where they can perform only a limited set of tasks.

In addition to the aspects presented above, human resource policies, and the role of IT are also included in the analysis, as they play an important role in understanding the role of the production employees in the case company.

Human resource policies influence and frequently define employees’ mind-sets and skills (Galbraith 2002). The policies determine the importance or standing of service production employees in the company (Galbraith 2002), including policies of recruitment, selection, rotation, training, and development as well as management of the turnover rate.

There is limited research on the work organisation of service production. Verma (2000), Silvestro et al. (1992) and Mills (1986) are among the exceptions. As this area has not been extensively investigated in studies on service industries, some general ideas are included in the discussion.

It is important to distinguish between functional power and authority. Authority refers to making decisions for others whereas functional power or empowerment concerns making decisions for oneself (Mills et al. 1983b).
As the performance of the service delivery system is dependent on the employees and their skills (Chase and Bowen 1991), the human resource practices need to fit the market niche the business occupies or would like to occupy (Schneider and Bowen 1993, Miles and Snow 1984b). Different firm strategies require different role behaviours and skills from employees, and, thus, firms need to choose human resource practices based on the behaviours required by the employees to support the chosen strategy (Skaggs and Youndt 2004, Armistead and Clark 1994, Sundbo 1994).

In services, IT can be either a production tool or a production factor – that is, it can help workers perform their tasks or it can replace them (Harvey et al. 1997). Bowen and Youngdahl (1998) as well as Schlesinger and Heskett (1991) point out that service companies that follow a quality production priority place equal or greater emphasis on investment in people relative to investment in equipment, whereas mass service production use technology as a means of employee replacement.

Table 3.7: Aspects and characteristics of workgroup structure mapped to service production strategy

<table>
<thead>
<tr>
<th>Aspect</th>
<th>Characteristics</th>
</tr>
</thead>
<tbody>
<tr>
<td>Production strategy</td>
<td>Mass service production.</td>
</tr>
<tr>
<td></td>
<td>Professional service production.</td>
</tr>
<tr>
<td></td>
<td>Low task uncertainty.</td>
</tr>
<tr>
<td></td>
<td>High task uncertainty.</td>
</tr>
<tr>
<td>Functional power</td>
<td>Low level of functional power discretion.</td>
</tr>
<tr>
<td></td>
<td>High level of functional power.</td>
</tr>
<tr>
<td>Standardisation /</td>
<td>Highly standardised and formalised routines.</td>
</tr>
<tr>
<td>Formalisation</td>
<td>Limited formalisation.</td>
</tr>
<tr>
<td>Specialisation</td>
<td>High level of specialisation – narrow scope of tasks.</td>
</tr>
<tr>
<td></td>
<td>Low specialisation – broad scope of tasks performed by cross-trained employees.</td>
</tr>
<tr>
<td>Aim of technology</td>
<td>Technology is seen as means of replacement of production employees.</td>
</tr>
<tr>
<td></td>
<td>Technology is seen as production employee support.</td>
</tr>
<tr>
<td>Human resource policies</td>
<td>Service production employees are seen as replaceable operating parts whose costs need to be controlled.</td>
</tr>
<tr>
<td></td>
<td>Production employees are seen as strategic resources or assets to be developed.</td>
</tr>
<tr>
<td></td>
<td>Training limited to role needs.</td>
</tr>
<tr>
<td></td>
<td>Broad training.</td>
</tr>
</tbody>
</table>

Mass service production foresees a limited level of customisation and thereby client interaction. Due to this there is a limited task uncertainty within the production process, and the workgroup organisation can be systematised and standardised (Sundbo 1991, Johnston 1989a). Professional service production on the other hand offers highly customised services including a high level of customer interaction. These service organisations
need to be flexible in order to be able to handle the high level of task uncertainty (Sundbo 1994). In Table 3.7 the discussed work group organisational choices are mapped to the service production strategy. Now that organisational aspects on the company and workgroup levels have been discussed it is time to look at coherent organisational structure and to summarise the findings of the discussion. This will be the subject of the next and last section of this sub-chapter.

### 3.8.3 Coherent Organisational Structure

An organisational structure is considered coherent when resources and tasks as well as their coordination are well aligned and support each other, as well as the strategic position chosen by the company.

![Figure 3.12: Alignment of the organisational structure aspects](image)

This alignment has already been discussed for the company and workgroup levels. In this section the interaction of the two levels will be discussed. Similarly to the production control package the organisational choices can be seen as an integrated consistent system where they complement and support each other. The alignment is based on the uncertainty level existing in the
organisation due to the strategic choices taken. This is illustrated in Figure 3.12.

With the discussion of the aspects of coherent organisational structure concluded, all the dimensions of the framework have now been presented. In the next sub-chapter the framework for competitive advantage in the service industry will be discussed.

### 3.9 Framework for Competitive Advantage in the Service Industry

With the strategic congruence, integrated control and coherent organisational structure having been presented separately, the next step is to combine them into a framework for competitive advantage in the service industry. The idea behind the framework is based on the Milgrom and Roberts (1995) conception of complementarities, or the idea that superior performance and competitive advantage are gained not by changing parts in isolation, but by simultaneously combining all elements. Therefore multiple theories, which support each other, are integrated into a multi-dimensional framework of competitive advantage. This approach generates a rather detailed and broad framework that will be used to collect and analyse the longitudinal data collected at the case company and to support the conclusions drawn from the material. The level of environmental uncertainty is used to combine the respective theories within strategy, control and organisational structure with each other (cf. Chenhall and Langfield-Smith 2007). Especially the business strategy chosen – cost leadership or differentiation – leads to different levels of uncertainty in service production (cf. Skaggs and Huffman 2003) as well as in the internal structure, which needs to be managed by the company by choosing the right internal administrative mechanism (e.g. Nilsson and Rapp 2005, Simons 1990).

The aim of the framework is to highlight the desirable combinations in order to achieve a high level of efficiency and a competitive advantage for a service company. Two combinations of strategic congruence, integrated control and coherent organisational structure are presented: one for low and one for high environmental uncertainty. Due to the multiple dimensions integrated, there are a great many possible variations, so it is important to highlight that a company can be more or less successful based on the level of fit they achieve compared to the two desirable states presented in this chapter.  

After presenting the two advantageous combinations, the misaligned combinations will be discussed before the sub-chapter is closed with a discussion about an intermediate position.

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68 As discussed in sub-chapter “3.2 Contingency Theory and the Concept of Fit” the study builds on a belief that different degrees of fit exist and lead to different levels of performance among companies acting in the same environment.
3.9.1 Framework Based on Low Environmental Uncertainty

Business units or companies following a cost leadership strategy seek to achieve the lowest cost in the market through minimising adaptation costs and by obtaining economies in production (Hill and Brown 2007, Govindarajan 1988). On this premise, the business unit usually operates in a stable environment and a well-known narrow product market with predictable customer behaviour. Low production costs and economies of scale can be achieved by high-volume production of standardised service (Sampson and Froehle 2006, Heskett 1986) and low-contact standardised production processes (Bowen and Youngdahl 1998). Mass service production tends to be highly reproducible and predictable, owing to standardised service processes (Silvestro 1999, Bowen and Youngdahl 1998) and a low degree of customer contact (Silvestro et al. 1992). The personal element, or at least individual judgment, can therefore be reduced in the service production process (Hill and Brown 2007, Heskett 1986). A business unit choosing cost leadership can generally generate a stable environment for the service production; therefore, a high level of strategic congruence is expected between the strategies of cost leadership and mass service production.

To fit the strategy of cost leadership and efficient mass service production, both control systems, at the management as well as the production level, are focused on a financial control based on cost efficiency, resource utilisation, and productivity (Hill and Brown 2007, Van Looy et al. 1998, Brignall 1997), with tight control of operations based on short-term monetary information (Govindarajan 1988). The stable environment reduces the need for extensive information and enables a high knowledge of input-output relationships. Thus, it is easier to develop objective performance measurements and targets (Chenhall and Langfield-Smith 2007). Planning is therefore intensive with a high central involvement and target revisions are unusual (Van der Stede 2000, Govindarajan 1988, Simons 1987). As work in mass service is often performed on customer surrogates (e.g. forms), output-based control concepts based on time standards can be tightly defined and followed-up (Chase 1978). In regard to capacity management, the capacity in mass service production is optimised on average demand in order to be cost efficient (Chase and Tansik 1983). Since the documented standardised service processes used are easily taught, part-time and temporary staff is often employed to handle changes in volume (Silvestro 1999, Brignall et al. 1991b). As capacity is managed to utilise available resources (Johnston and Morris 1985) and to ensure high productivity (Chase and Tansik 1983), a backlog is allowed to build up at times of heavy demand. Due to the stable environment, where there is no urgent need to act immediately, cost-leadership organisations rely on formalised regulations, top-down centralised decision-making and vertical chains of command (Hill and Brown 2007, Donaldson 2001, Simons 1987).
Generally, the less uncertain and more standardised the production of service, the more tightly it can be coordinated, as very few unexpected problems occur (Nesheim 1990, Wemmerlöv 1990, Larsson and Bowen 1989). Due to the stable environment the organisation has time to adapt the standardised procedures to the changing environment (Bowen and Bowers 1986). Standard operating procedures are efficiently controlled by rigid hierarchical structures (cf. Kellogg et al. 2006, Verma 2000). Decision-making in mass service production is top-down, with problems solved by hierarchical command (Bowen and Bowers 1986, Drazin and Van de Ven 1985). The employees have and only need a low level of discretion (Silvestro et al. 1992, Drazin and Van de Ven 1985). Given the highly specialised (Galbraith 2002, Heckscher 1994, Simons 1987), reproducible tasks and a “scripted” customer interface, employees have relatively low skills (Heskett 1986, Drazin and Van de Ven 1985), and training is strictly limited to role needs (Heckscher 1994). Therefore, human resource management is not very relevant in mass service production systems. With the low level of skills needed, employees are easily exchangeable (Mills and Margulies 1980). Also, substitution of service workers with technology is rather common in order to increase productivity (Silvestro 1999, Levitt 1972). The automation of service production enhances the capacity of companies to measure and monitor employee performance (Armistead 1990, Collier 1983). All these factors ensure a very efficient organisation that fits a cost-leadership strategy.
The low environmental uncertainty combination is mapped with a portfolio strategy on the corporate level. This is well aligned with the short-term, rigid and tight financial control (Nilsson 2002). However, as already mentioned in the strategy sub-chapter a corporation could also enforce shared activities and resources with the aim of reducing costs. However, the coordination of shared activities is resource intensive and needs to be additionally saved by the synergies derived from the activity sharing. Therefore, the portfolio management strategy combined with a strict financial control seems to be the most desirable alternative.

3.9.2 Framework Based on High Environmental Uncertainty

A business unit with a differentiation strategy seeks to establish a market position through unique service, based on the service offering or company image. This type of strategy is usually found in turbulent environments with a high degree of uncertainty (Chenhall and Langfield-Smith 2007, Hoque 2004, Govindarajan 1988, Miller 1988 and 1986). Forecasting demand is challenging because of the dependence on competitor offerings and changing customer preferences. Service production must be able to handle such turbulence and rapid changes. Flexibility in service production is important (Hill and Brown 2007, Metters and Vargas 2000, Silvestro 1999, Bowen and Bowers 1986), as customised or even new service needs to be produced within the limited time frame that is expected by the customers (Hill and Brown 2007). With differentiation through customisation, employees assume an increasing role in adding value (Heskett 1986). A professional service production system is appropriate in these circumstances due to the following features: flexible production used for customisation, employment of skilled labour capable of performing a variety of tasks (Galbraith 2002, Metters and Vargas 2000, Bowen and Bowers 1986), and acceptance of a high level of employee discretion (Donaldson 2001, Silvestro et al. 1992, Drazin and Van de Ven 1985) that permits fast adaptation to changing needs of clients (Silvestro 1999, Silvestro et al. 1992). The production system therefore permits rapid reallocation of tasks among employees as needs change (Kellogg et al. 2006, Bowen and Bowers 1986, Drazin and Van de Ven 1985, Burns and Stalker 1961).

Since differentiators expose themselves to a broad environmental domain, they must monitor a wide range of environmental conditions and changing events (Simons 1990 and 1987). This information is needed to improve managerial decision-making in these uncertain occasions (Naranjo-Gil and Hartmann 2007, Chenhall 2003, Bouwens and Abernethy 2000). There is a need for flexible control systems with a non-monetary type of information, often including external information (Kald et al. 2000, Brignall 1997). The budget and follow-up process will be less important and thereby less rigid in view of the challenging forecast situation (cf. Nilsson and Rapp 1999). As the budget is reduced to a rough indicator, short-term monetary targets
included in the budget are supplemented with longer-term non-financial targets focusing on laying a foundation for future profits (Guilding and McManus 2002). Although differentiators might monitor outputs carefully and emphasise frequent reporting, meeting objective goals is not a high priority (Abernethy and Brownell 1999). In order to control the company in this uncertain environment, and to facilitate innovation and change, control systems are used in an interactive manner (Kober et al. 2007, Naranjo-Gil and Hartmann 2007, Henri 2006b, Bisbe and Otley 2004, Abernethy and Brownell 1999). Follow-up is often more informal, based on discussion at management meetings (Nilsson and Rapp 1999).

Also, production and consequently its control system must be able to handle uncertainty (Nilsson and Rapp 2005: p. 138, Johnston and Morris 1985) and to ensure high quality of service. To ensure high quality of service, with shorter waiting times, and to avoid lost sales, capacity is often set to match peak demand (Pullman and Moore 1999, Armistead and Clark 1994, Heskett 1986, Chase and Tansik 1983). In service differentiation, image is important; therefore quality control is given high priority within production control (Brignall 1997, Roth and van der Velde 1991, Silvestro et al. 1990, Johnston and Morris 1985). In addition, the use of non-monetary and more quality-oriented control information in production control facilitates integration with the non monetary-based management control system.

A high level of decentralisation as well as horizontal coordination is an appropriate response to increased uncertainty (Hill and Brown 2007, Bowen and Lawler 1992, Govindarajan 1986, Lawrence and Lorsch 1967) as it makes the organisation more flexible and thus more quickly adaptable to new market requirements (Bowen and Bowers 1986). It also encourages employee responsibility and initiative (Bowen and Lawler 1992). The goal is to be familiar with and to utilize the talents of employees (Silvestro 1999), as well as extend their know-how through broad training (Heckscher 1994). Human resource issues like hiring and training of staff, management, and ensuring employee welfare are very important (Silvestro 1999), especially as the substitutability of employees is rather low (Mills and Margulies 1980). The few middle managers within the work organisation have a supporting and a facilitating role (Manz and Sims 1996, Nesheim 1990, Peters 1987), and the style of communication between middle managers and employees is consultative (Verma 2000, Courtright et al. 1989, Bowen and Bowers 1986).

Owing to the high level of customisation due to the market position of differentiation, service production requires considerable customer interaction. To be able to handle the uncertainty, employees receive functional discretion and are empowered to seek their own solutions to customer requests (Silvestro et al. 1992, Larsson and Bowen 1989). This leads to mechanisms for loose control between managers and staff (van der Stede 2000, Verma 2000). A behaviour-oriented control concept is very efficient in these situations (Henri 2006a, Nesheim 1990). In order to assist
employees in their active role, decision support is needed (cf. Nilsson and Rapp 1999); and extensive information sharing is necessary (Heckscher 1994, Van de Ven 1976, Lawrence and Lorsch 1967, Barnard 1938). With these features, the organisation is flexible and responsive, essential attributes for a company operating in an uncertain environment, like firms with a differentiation strategy.

On the corporate level an activity sharing strategy with high level of corporate coordination of shared activities and resources seems to be adequate (cf. Nilsson 2002). Due to the dynamic market, support from the corporate level is beneficial as long as the corporate level has sufficient knowledge concerning the market conditions facing the different business units.

<table>
<thead>
<tr>
<th>STRATEGIC CONGRUENCE, INTEGRATED CONTROL AND COHERENT ORGANISATIONAL STRUCTURE BASED ON A HIGH ENVIRONMENTAL UNCERTAINTY</th>
</tr>
</thead>
<tbody>
<tr>
<td>Environment</td>
</tr>
<tr>
<td>-------------</td>
</tr>
<tr>
<td>High uncertainty/ Low stability</td>
</tr>
<tr>
<td>High uncertainty/ Low stability</td>
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<tr>
<td>High task uncertainty</td>
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</tbody>
</table>

Figure 3.14: Strategic congruence, integrated control and coherent organisational structure based on a high environmental uncertainty

3.9.3 Misaligned Positions

Based on the belief that there is a desired position based on optimal combinations, there must obviously also exist numerous combinations which are not optimally aligned. It would be impossible to go through all of them in this thesis. Therefore only two misaligned combinations will be discussed in this section based on choices taken on business and service production strategy levels.
3.9.3.1 Misalignment between Cost Leadership Strategy and Professional Service Production

The goal of a cost-leadership strategy is to create competitive advantage through low-cost production with minimal service adaptation or customisation. On this premise, the business unit usually operates in a stable and a well-known market with predictable customer behaviour. Therefore, the flexibility of a professional service production strategy (Silvestro et al. 1992) is not appropriate and probably far too expensive. The high level of customer interaction within a professional service production system, leads to high task uncertainty, as customers can provide an unexpected input into the production process (Bateson 2002, Bowen and Bowers 1986, Chase 1978). The handling of exceptions is directly related to the cost of the service production (Chase and Haynes 2000). Since the business and the production strategy are based on different premises, this combination will not achieve a high level of strategic congruence. Also, the different information and control needs at the business and service production levels lead to optimisation problems. Management control systems in companies with a cost-leadership strategy are focused on tight control based on objective short-term monetary or output information (Brignall 1997, Govindarajan and Fisher 1990, Govindarajan 1988), whereas the production system, which is based on flexibility, is difficult to manage with monetary information. The operational priorities of professional service production systems fit better with customer satisfaction and quality control than with high productivity (Vuorinen et al. 1998, Brignall 1997, Lovelock 1992). Additionally the coordination of tasks on company and production level seems very difficult to align. Tight control, usually implemented in cost-leadership firms that use vertical chains of command, is inappropriate in professional service systems where reliance is placed on coaching and social control (Henri 2006a, Silvestro et al. 1990). Overall, the combination seems to be a misaligned position that probably would not lead to a competitive advantage at least in the long run.

3.9.3.2 Misalignment between Differentiation Strategy and Mass Service Production

The combination of differentiation and mass service also shows little promise for reaching a high level of strategic congruence. A unit following a differentiation strategy operates in a turbulent environment with a high level of uncertainty. This environment also increases the task uncertainty that needs to be handled in the production (Gupta 1987, Govindarajan 1986). However, a mass service production strategy is optimised to handle production of standardised offering and is not designed to handle a high level of task uncertainty (Silvestro et al. 1992). The high emphasis on productivity makes the service delivery less willing to handle client-specific requirements (Roth and Jackson 1995). The difficulty of combining a differentiation
strategy with a mass service production strategy can also be expected to impact management control and production control. In view of the different goals of the two strategies, there are dissimilar information needs at the different levels. On the business level there is a need for wide-ranging information, including information on external parameters (Brignall 1997). A mass production strategy, by contrast, is efficiency-based and better managed with internal productivity-related measurements like resource utilisation, customers served, response time, cost and efficiency (Vuorinen et al. 1998, Lovelock 1992, Johnston and Morris 1985). However, a high level of productivity is negatively correlated with service quality, especially in environments where the service quality is the basis for a company’s differentiation strategy (Roth and Jackson 1995). The organisation of the production function in mass service production follows a rigid hierarchical structure (cf. Kellogg et al. 2006), with top-down decision-making and command-based management (Drazin and Van de Ven 1985). It is efficient in dealing with well-known tasks. However, it fits very poorly in an uncertain environment with a high level of exceptions (Bowen and Bowers 1986) due to its limited flexibility. Therefore, based on the different priorities at the business and service production levels, it is evident that this position cannot be considered potentially successful in the long term.

3.9.4 Intermediate Position

In this last section the possibility of reaching a competitive advantage by an intermediate position is reflected upon. An intermediate position implies a combination of differentiation and cost-leadership strategies. While Porter (1985) holds these strategies to be mutually exclusive because of limited company resources, other scholars (e.g. Menor et al. 2001) have contended that to be highly competitive a company must offer differentiated service at low prices. Also in the service industry the importance of managing this intermediate position is increasing, especially due to the increased price competition in most service industries (Sundbo 2002). Based on the different requirement derived from cost leadership and differentiation on service production, an intermediate position does seem to be difficult to maintain in the long-term. However, as already discussed in section “3.6.2 Business Strategy in the Service Industry” this position could be achieved with the support of valuable resources and dynamic capabilities, which can enable a company to build up concepts that allow it to hold an intermediate position for a number of years. Due to the fact that the optimal control system and organisational structure depend on the valuable resources and dynamic capabilities available to the company, no optimal standard combination is applicable for the intermediate position. Instead the discussion needs to reflect the specific situation based on the main ideas of alignment.

In the next sub-chapter the measurements used in this study to evaluate the alignments and the competitive advantage will be discussed.
3.10 Measurement of Competitive Advantage

As the last part of this chapter the measurement of the level of fit and thereby competitive advantage will be discussed. In sub-chapter “3.3 Competitive Advantage” the relative performance compared to competitors in a given market environment was highlighted as a measure of competitive advantage. This sub-chapter presents performance and how it is measured in this study.

As already pointed out it is important to determine how a firm performs compared to its industry competitors when assessing a firm’s competitiveness (Nilsson et al. 2011: p. 14, Allen and Helms 2006, Dess and Robinson 1984). The comparison of the company with the rest of the industry gives information on how its actions affect the competitiveness of the company. Although the connection between changes and the competitive situation is not straightforward, a comparison with the rest of the market gives a picture of the competitive advantage of the company (Meidan 1982). It is important to capture the development and change of firm performance over time (Farjoun 2002) as superior performance can be either temporary or sustained (Barney 1986b). Therefore, it is important not only to compare measurements year by year but also to compare the general trend over multiple years. This is especially important in the insurance industry, as natural business cycles or natural hazards can sometimes jeopardize a firm’s annual financial performance. In order to be able to compare the performance of the case company with market performance, the availability of historical company and market data is therefore important for the choice of measurements.

Many scholars have expressed the need for integrating multiple quantitative and qualitative measurements when ascertaining firm performance (e.g. Allen and Helms 2006, Skaggs and Huffman 2003, Love et al. 2002, Miller and Dess 1993, Chakravarthy 1986, Venkatraman and Ramanujam 1986, Steers 1975). As single indicators can be misleading (Pettigrew and Whipp 1991), no single performance measure is capable of discriminating competitive advantage (Chakravarthy 1986). Three common ways of measuring organisational performance are profitability (defined as return on assets), change in market share, and stock appreciation (Baum and Wally 2003, Chan and Wong 1999, Miller and Dess 1993, Judge and Miller 1991, Miller 1988, Robinson and Pearce 1988, Hambrick 1983b and 1983a). Although stock appreciation is a very interesting measurement of performance, due to the commonly discussed importance of shareholder value (Rhyne 1986), it cannot be used in this case study, as the company studied is not a public stock company. Therefore only the other two widely used outcome measurements, return on investment and market share, are used in this study. However, the specifics of the industry under study will also be considered. In the insurance industry the combined ratio, that is, the
ratio of operating expenses to premium income\textsuperscript{69}, is the main measurement of performance (Senge and Sterman 1992: p. 142). As this ratio is commonly used in the insurance industry it is included as the third performance measurement. All three measurements are available for the case company and the insurance industry in general.\textsuperscript{70}

As the three financial measurements give a narrow conception of business performance that centres on simple outcome-based indicators, a more long-term qualitative performance measurements will be added in order to capture a wider picture of the market position of the case company (Khatri and Ng 2000, Venkatraman and Ramanujam 1986). The case study company regularly conducts customer and sales channel satisfaction surveys. A market survey company that also conducts annual industry-level studies conducts these studies. Therefore the case study results can be compared with the overall insurance market.

In the discussion on competitive advantage, both quantitative financial measurements of performance and long-term qualitative measurements of performance are included. In this way both a competitor-centred assessment and a sales-partner/customer-focused assessment of a competitive advantage can be achieved (Day and Wensley 1988). The measurements used are summarised in Table 3.8.

<table>
<thead>
<tr>
<th>Measurements of performance</th>
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<tbody>
<tr>
<td>Financial/Quantitative</td>
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<tr>
<td>performance measurements</td>
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<tr>
<td>Profitability</td>
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<td>Market share</td>
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<tr>
<td>Cost ratio (the ratio of operating expenses</td>
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<td>to premium income)</td>
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<tr>
<td>Non-financial/Qualitative</td>
</tr>
<tr>
<td>performance measurements</td>
</tr>
<tr>
<td>Customer satisfaction</td>
</tr>
<tr>
<td>Sales channel satisfaction</td>
</tr>
</tbody>
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\textbf{3.11 Summary of the Theory Chapter}

The aim of this chapter was to present a conceptual framework for competitive advantage in the service industry. The aspects and the characteristics presented in this chapter in the environment, strategy, control system and organisational structure are used as a baseline for the data collection. In order to ensure that the necessary data is collected the aspects are integrated into the interview guide as presented in Appendix A.

The relationships drawn between strategy, control and organisational structure in this chapter are based on the necessity for the internal system to meet different requirements depending on the environment and choice of

\textsuperscript{69} Premium income is the revenue based on insurance sales.

\textsuperscript{70} The insurance association in Germany (GDV) publishes annual market information.
strategy. Each dimension included in the framework was described through juxtaposing extreme opposite positions. In reality we expect to find intermediary positions for these variables. It is also important to stress that the analysis of the case study results are not based on simple categorisation of the single aspects, but rather as configurations compared to the ideal combinations presented in this chapter. Although the ideal combinations should lead to the highest level of competitive advantage according to theory, combinations deviating from the ideal can still show a certain level of competitive advantage.

As strategic congruence, integrated control and a coherent organisational structure leading to competitive advantage make up a dynamic process, the next step is to test the usability of the framework in a longitudinal study of a successful insurance company. The consolidated data collected during the case study will be presented in the next chapter whereas the analysis of the competitive advantage based on the level of strategic congruence, integrated control and coherent organisational structure is presented in Chapter 5.
4 Case Study of an Insurance Group

The presentation of the case study findings is based on the theoretical dimensions and aspects as outlined in the previous chapter. A case study like this is extremely rich in content (cf. Kalling 2007). In consequence, under each dimension the aspects most important to understanding this particular case are highlighted and in the summary mapped to the aspects of the framework presented in the previous chapter.

Figure 4.1: The structure of the case study material presented in the next five sub-chapters

The case study material is presented in five sub-chapters. The information presented in the first sub-chapter originates from market data and market surveys, whereas the information used in the last four are based on information received from the case study company. First the insurance industry in Germany and its environment are presented. In the next sub-chapter the insurance group studied is introduced, including its history. The corporate strategy, control system and structure of the corporation are also presented in the sub-chapter. Thereafter three sub-chapters follow, one for...
each insurance line. In these sub-chapters the strategy, control system and organisational structure are presented. Each sub-chapter includes a summary where the findings are mapped with the framework developed in the previous chapter. The structure of this chapter is illustrated in Figure 4.1.

4.1 The Environment – Insurance Industry in Germany

In this sub-chapter the insurance industry in Germany and its development between 1995 and 2010 are presented. As the industry is regulated, the chapter will start by describing the regulation of the German insurance market. Then the German insurance market will be introduced, including its development between 1995 and 2010 and thereafter the main changes within each insurance line are discussed. In the last section, before the summary, the position and the strengths among the actors in the German insurance industry are discussed as well as their changes between 1995-2010.

4.1.1 Regulation of the German Insurance Market

The development of the insurance industry depends to a high extent upon changes in regulations and legal conditions (GDV Yearbook 2005). In this section the regulation of the German insurance market as well as its dependency on legal changes will be discussed with the aim to give background information about insurance market developments that are presented in the next sections.

The deregulation of the financial services within the “Single Market” programme of the European Commission changed the landscape for the insurance industry in Europe. Before 1994 national markets were closed to cross-border selling, and the national regulation of insurance sales limited competition among firms. After the deregulation the insurance companies are free to design and price their products themselves, and they are free to operate throughout the European economic area under a single license and home country prudential control (Mahlberg and Url 2009, Maurer and Somova 2007). The liberalisation of the European insurance market sharpened the competition in Germany (GDV Yearbook 1995), and it changed the conditions for the German insurance industry (GDV Yearbook 2007). One of the most obvious consequences of deregulation in the German insurance market was the increased fight for market share through reduced premiums and steep discounts. The price competition after 1994 reduced the expected revenue for potential entrants and deterred foreign insurers from entering the market. Consequently, entries and direct cross-border business in the German insurance industry has remained negligible also after 1994.

71 The insurance lines, consisting of regional insurance companies, are seen as business units in this case study.
Due to the price competition, however, profit margins also decreased (Swiss Re 2001 in Mahlberg and Url 2009) and the combined ratios, i.e. the ratio of claims payments plus operating costs to premium intakes, increased (GDV Yearbook 2009, Mahlberg and Url 2009). The intensifying competition has been forcing the insurers to rethink their cost structures, a process which resulted in a reduction in personnel levels (GDV Yearbook 2007). Although the number of employees has even increased in total since the deregulation, the premium income per employee has increased by 47% between 1995 and 2010 (GDV Statistic Yearbooks 1995-2011). This is illustrated in Figure 4.2.

Figure 4.2: Development of employees in the German insurance industry (left side) and the premium income per employee (right side) (GDV Statistic Yearbooks 1995-2011)

The consequences of the deregulation of the insurance market are similar to the observed effects of deregulation in other industries. Similar patterns of profitability, competition and market opportunities have been observed after deregulations in other industries (cf. Prahalad and Hamel 1994). However, there are differences to other industries, as the insurance industry, although deregulated, is still to a certain extent regulated by the authorities. This regulation has been traditionally rather strong in Germany compared to other European markets (Maurer and Somova 2007). Additionally governmental legislation influences the development of the German insurance market. The governmental decisions have led to major changes in the Germany insurance

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72 The decrease in the number of employees was enabled by the increasing investments in information and communications technology in the insurance industry (Mahlberg and Url 2009, GDV Yearbook 2007).
73 GDV, Gesamtverband der Deutschen Versicherungswirtschaft e.V., is the German Insurance Association. In 2010 their member companies represented a combined market volume of over 95 per cent.
74 The main goal of state regulation is to protect the insured by providing high credibility that the insurance company is able to meet its contingent obligations against the insured persons and policyholders (Maurer and Somova 2007).
industry between 1995 and 2010. Although insurers have been forced to change their processes and offerings, the legal changes have mainly supported the insurance industry in Germany. The only exception is the forced re-structuring of the health insurance line\textsuperscript{75} (Maurer and Somova 2007, GDV Yearbook 1995-2011).

4.1.2 The German Insurance Market and its Development 1995 – 2010

This section starts with a discussion about the historical background of the insurance industry in Germany, before the development of the insurance market and its profitability is discussed for the studied time period.

The German insurance industry has its origins in medieval times (Maurer and Somova 2007). The first public insurer in Germany was formed in 1676. Following this example, other public insurers were formed in nearly all German states during the eighteenth and nineteenth centuries. They mainly offered fire insurance to homeowners, who were often required by the authorities to insure their property. After several setbacks caused by natural and man-made disasters including the World Wars, the market has been successful in developing stable structures (Maurer and Somova 2007). Currently, with respect to premiums written in 2010, the German insurance industry is the fifth-largest insurance market in the world, after the United States, Japan, the United Kingdom and France (OECD Statistics 2012).

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{figure43.png}
\caption{Premium income development in Germany (MEuro) (GDV Statistic Yearbooks 1995-2011)}
\end{figure}

\textsuperscript{75} The restructuring is discussed in more detail in “4.1.3.2 The Private Health Insurance Market”.

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The insurance industry has been growing steadily since 1995, as illustrated in Figure 4.3. Since 1997 the biggest line in the German insurance market is life insurance (51% share in 2010), followed by non-life (31% share in 2011) and health insurance (19% share in 2010) (GDV Statistic Yearbook 2011). Even though insurance is still a growth industry, the growth rate in German insurance business has been decreasing constantly since 1950 (GDV Statistic Yearbooks 1995-2011). This is connected to developments in domestic demand and the financial disposition of private households (GDV Statistic Yearbook 2011), which was especially high during the post-war era (between 1951-1960), with an annual growth of over 11%, which declined to a level under 2% between 2000-2010.76 Price competition, especially in non-life insurance, is an additional reason for the stagnating growth rate (GDV Yearbook 2000-2011).

Figure 4.4: Development of profit after tax as percentage of premium income for the different insurance lines in Germany (GDV Statistics Yearbooks 1999-2006)

As mentioned in section “4.1.1 Regulation of the German Insurance Market” the profit margins decreased and the combined ratios increased after deregulation. As a counter strategy insurers tried more aggressive investment strategies and shifted their portfolio77 into high-yield asset classes. The market conditions in the second half of the 1990s allowed insurance companies to compensate for underwriting losses by favourable investment

76 Private households account for up to 80 per cent of demand for insurance services in Germany (GDV Yearbook 2008).

77 Often, years and decades will go by between the time premiums are paid and the time benefits mature. Insurance companies bridge this gap by investing customers’ premiums in various ways. The volume, quality, and structure of the investments serve as a guarantee that the benefits promised to policyholders can be fulfilled. Investment assets arise primarily from the investment of premium revenue and the reinvestment of profits. Though the acquisition of investments is not the actual goal for insurance companies, it represents an important element in providing the service of “insurance coverage” (GDV Yearbook 1995).
incomes. But beginning with 2001, years of falling share prices in combination with several natural and man-made disasters leading to increased claims costs resulted in decreasing profits as the decreased capital return on investments could no longer compensate for the increasing claims cost (Mahlberg and Url 2009). As illustrated in Figure 4.4, this affected all insurance lines but most seriously the non-life insurance line.

The importance of capital return on investments for the insurance industry is illustrated in Figure 4.5. In the left-hand graphic the underwriting results are shown, that is, claims and benefits are subtracted from the premium income. Only non-life insurance line shows a positive underwriting result, which can be used for covering the administration and the acquisition costs. Health has constantly shown a slight deficit since 1990, whereas life insurance is very dependent on the interest on investments.

![Figure 4.5: Left graphic shows the development of underwriting results in Million Euro (claims benefits withdrawn from the annual premium income). In the right graphic the interest income on investments is included (GDV Yearbooks 1999-2011)](image)

Looking at the net investment returns of the life insurance industry over the years 1991 to 2010, the average investment returns were very stable around 7.5% until 2000. The years 2001 and 2002 were characterised by a sharp decline in the investment results. The results thereafter stayed on a level around 4.5-5% until a new drop to 3.5% was reported in 2008 (see Figure 4.6). This overall decline was caused by a substantial downturn in the equity markets (which accounts for about 25% of the assets held by insurers) together with a sustained decline of interest rates for fixed-income investments (which determines about 65% of the average insurance asset

78 The peak in 2008 in life insurance is the result of decreased actuarial reserves due to the financial crisis. Life insurance companies increase and decrease their actuarial reserves depending on the capital return on investments during the year. When returns are good, the reserves are increased in order to balance years with less favourable returns.
allocation) (Maurer and Somova 2007, GDV Life insurance data 2008 and GDV Statistic Yearbook 2009). Although the average income on investments improved somewhat, the development is especially critical in life insurance, which is very dependent on the income on investments in order to be able to pay the guaranteed profits.

![Interest income on investments (Life insurance)](image)

*Figure 4.6: Interest income on investment (Life insurance German average) (GDV Statistic Yearbook 1999-2011)*

The decreasing interest on investments has been putting pressure on the insurers to increase their underwriting results either by improving their risk exposure or by restructuring their cost structures (Mahlberg and Url 2009, GDV Yearbook 2008). This development differs between the different insurance lines. Therefore each of them will be discussed briefly in the next sub-chapter.

### 4.1.3 Development of the Insurance Lines 1995 - 2010

The insurance offerings are in Germany divided by law into three different insurance lines: life insurance, health insurance and non-life insurance (Maurer and Somova 2007). In this section these insurance lines and their development during the study period are briefly discussed.

#### 4.1.3.1 The Life Insurance Market 1995-2010

Life insurers provide insurance coverage for dependents against the financial risk of death in exchange for a fixed premium. Additionally, they are important vehicles for long-term savings mainly used for pension payments. The life insurance business in Germany grew by 100% in the period 1995 to 2010 (from 45 to 90 billion Euro) (GDV Statistic Yearbook 2011). The market growth reflects the clear opportunity presented by an ageing population and their need for retirement products. The development of the
life insurance sector depends on the taxation and on the reform of the state-owned retirement system (Maurer and Somova 2007, GDV Yearbook 2008-2011). The inherent weakness of the social security system has raised public awareness that more must be spent on private old-age provision than in the past. Similar developments have been observed in other EU countries (e.g. Webb and Pettigrew’s study of the UK market published in 1999).

Due to some legal prerequisites that require annuity payments in the decumulation phase, especially the demand for annuity products has been increasing (Maurer and Somova 2007, GDV Yearbook 2011). Therefore the product mix in life insurance has been changing from individual endowment policies to life annuities, which are traditional products for retirement solutions. Also supplementary insurance policies, which provide benefits in case of accident or disability, have grown intensively due to diminished state protection whereas the collective policies including saving and saving protection have decreased. The change in the new business product mix is illustrated in Figure 4.7.

![Figure 4.7: New life insurance contracts split by type of insurance (GDV Statistic Yearbook 2011)](image)

Besides the changed product mix, there is an additional trend in the insurance market towards single premiums. Since 2005 more than 60% of new business comes from single premiums, and in 2010 single premium reached even 82% of new business premiums (see Figure 4.8). As the single products can be used as a short-term saving product that can easily be cancelled without losses, the German regulatory authority is following this development in detail, especially as the cancellation could be a risk for the

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79 Endowment policies or capital investment insurances consist of an insurance component and an investment component. The first provides death benefits, if the insured dies within the insurance period. The latter creates a cash value over time, which the insurance company must pay at the end of the insurance period or if the contract is terminated. Endowment policies with no investment component are called pure term life policies (Maurer and Somova 2007).
whole portfolio (Wichert 2010). This premium is very volatile, as it only supports the premium income of that single year. New business based on regular premiums, on the other hand, ensures a steady premium income for the long saving time of the contract.

![Figure 4.8: Life insurance premium from new business divided between single and regular payment (GDV Statistic Yearbook 2011)](image)

In addition to the changes in product mix, the tight link between the life insurance industry and the capital market, as discussed in the previous section, has led to some major structural changes. In order to compensate for the decreasing capital return on investments life insurance companies have been decreasing their administration cost ratio since 1995.

To conclude, the life insurance market has been constantly growing between 1995 and 2010. During the same time the product mix has changed from endowment to annuity insurance. Since 2005 the market has been growing more volatile due to the increasing number of single premium contracts. In addition to the changed product mix, the life insurance companies have faced increased pressure to lower their administration ratio in order to be able to compensate for the low returns offered by the capital market. Due to these changes the life insurance market has been getting more uncertain between 1995 and 2010.

### 4.1.3.2 The Private Health Insurance Market 1995-2010

In Germany, the main sources of health benefits are state statutory health insurance (SHI) and private health insurance (PHI) (Maurer and Somova 2007). The main challenge for private health insurers will remain the desolate finances of the state health programme and the resulting attempts by the state to improve them by limiting access to private health insurance (Maurer and Somova 2007). In health insurance there are full-coverage insurance offerings substituting for and supplementary insurance offerings
complementing the state health programme (Maurer and Somova 2007). If a private health insurer accepts a risk, it may not terminate the contract as long as the premiums are paid on time. It is also difficult for the clients to change insurers, as they lose their ageing reserves, which are built up over the years (Maurer and Somova 2007). In 2009 a legal change opened up a possibility of changing by allowing the insured person to transfer a part of the age reserve to the new insurer.

The premium income in private health insurance has increased by 103% between 1995 and 2010 (from 16 to 33 billion Euro). As illustrated in Figure 4.9 the part of population having full-coverage private health insurance has increased constantly, although the switching rules were made tougher in 2003 and 2007 (GDV Yearbook 2008). The growth has been continuing also in the turbulent and insecure years when the future of the private health insurance was heavily debated. The increase can partly be explained by the fact that state statutory health insurance was forced, due to financial limitations, to gradually reduce their coverage during the same time (Maurer and Somova 2007).

![Figure 4.9: Part of German population with a full cover private health insurance (GDV Statistic Yearbooks 1995-2011)](image)

Although new insurance types have been introduced, like the compulsory private nursing care insurance initiated in 1995 (GDV Yearbook 1995) and although the supplementary insurance clients have increased considerably, the main premium income still comes from full-coverage insurance. This is illustrated in Figure 4.10. However, the future of private full-coverage health insurance is much debated as mentioned. Due to its premium dominance (72% of the total premiums booked in 2010) full-coverage insurance is nevertheless very critical for the overall future of the private health insurance. Due to the increased amount of supplementary insurance with limited premium income, service production needs to be adjusted in order to be able to keep the administration cost ratio on an acceptable level.
To conclude, health insurance still seems to be a rather profitable insurance line. Its future is dependent on the results of the on-going debates concerning the overall health system. The health insurance industry is dependent on the premiums from the full coverage insurance, which brings over 70% of the total premium. A challenge that will probably increase in importance in the near future is the efficient treaty administration of the high number of supplementary health insurance policies.

### 4.1.3.3 The Non-Life Insurance Market 1995-2010

The non-life insurance business, also called property and casualty insurance, offers insurance coverage for a wide variety of risks as fire, theft, accident and general liability. It includes several insurance classes that do not always develop similarly (Maurer and Somova 2007). The non-life insurance industry in Germany has only been growing 11% between 1995 and 2010, from 50 to 55 billion Euro (GDV Statistic Yearbook 2011). This is considerably lower than in life and health insurance. As illustrated in Figure 4.11 the main non-life insurance class, motor vehicle insurance, has been decreasing in share and also in premiums (-2.4 billion Euro) during this time. All the other insurance classes on the other hand reported some growth in both share and premium (between 20 and 44% premium growth). Although motor insurance is the main reason for the low growth development within non-life insurance, none of the other insurance classes showed an increase comparable to life and health insurance. The main reason is that the non-life insurance market has a higher market penetration than life and health insurance market.
As illustrated in the left-hand side of Figure 4.12 the loss ratio for total non-life insurance has been relatively stable, ranging between 75 and 85 percent, since 1995. However the situation varies considerably among the insurance lines. Especially the property insurance loss ratio is very much affected by natural hazards, such as the winter storm “Lothar” in 1999, the storms and floods in 2002 and the hurricane “Kyrill” in 2007 (Maurer and Somova 2007).
When looking at the combined ratio (see right side of Figure 4.12), which from time to time has exceeded 100%, it is obvious that German non-life insurers are highly dependent on capital return on investments in order to show positive profits (Maurer and Somova 2007).

Customers’ ability to change insurance provider on an annual basis, without losing any reserves, intensifies the price competition in non-life insurance (Maurer and Somova 2007, GDV Yearbook 2005). This leads to more intensive competition in the non-life insurance market, as compared to the life and health businesses, where the insurer loses their reserves, at least partially, in the event of a change of insurer (Maurer and Somova 2007). Still, due to high interest income on investments, the non-life insurance is the most profitable insurance line (as illustrated earlier in Figure 4.4).

To conclude, the non-life insurance market has been developing into a rather mature market with increased price competition. In order to manage this price competition insurance companies have started cost-saving programmes concerning administration and claims management (GDV Yearbook 2008).

4.1.4 Actors in the Insurance Industry

After describing the regulation and the development of the insurance industry in general, this section will include a competitive analysis of actors in the German insurance industry by using an amended model of Porter’s five forces as illustrated in Figure 4.13. The analysis of the actors is, as in all other sub-chapters, limited to the time period 1995 to 2010. As the studied insurance company is a company under public law their special market situation is highlighted in the discussion.

![Diagram of Porter's five forces model](image)

*Figure 4.13: Model for the analysis of the actors in the insurance market (based on Porter 1980)*

### 4.1.4.1 Active Insurance Companies and New Entrants

The intensity of rivalry is greatest if the growth is slow (Porter 2008). This rivalry among existing competitors takes many familiar forms, including
price discounting, new product introductions, advertising campaigns, and service improvements (Porter 2008). As mentioned in the previous sections, competition based on price is rather dominant in the insurance industry in Germany. Mergers, acquisitions and alliances are usual methods for coping with excess capacity after deregulation of an industry (cf. Prahalad and Hamel 1994). The number of actors has therefore decreased in the German industry market after deregulation. There were 447 active life, health and non-life insurance companies competing on the German insurance market directly after regulation (in 1995). Fifteen years after deregulation, the number has decreased to 354 actors. As illustrated in Figure 4.14 (left-hand side) the decrease of 21% is rather equal in all insurance lines.

![Figure 4.14: Left: Active insurance companies by insurance line in Germany; Right: Number of insurance companies under public law (GDV Yearbook 1997-2011)](image)

German insurers are organised as stock corporations, mutual insurance associations, or insurance companies under public law (Maurer and Somova 2007). For the insurance companies that have the legal form of mutual associations or institutions under public law, there is still merger and acquisition potential, especially in view of Solvency II requirements, as they have restricted access to capital markets (Maurer and Somova 2007, Lier 2003). Especially, regionally organised insurance companies under public law are believed to gain synergies, which would enable them to lower their costs, if they were to merge into institutions operating countrywide

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80 An institution under the public law is a corporation whose existence and activities are regulated not by the set of private law regulations, but by those of public law, usually governing the relationship between the authority and the citizen. An institution under a public law is created by the authority's decree and serves a public purpose defined in that decree. This legal form has its roots in historical economic and state developments (Maurer and Somova 2007).

81 Solvency II is planned to be implemented in 2013 (GDV internet page on 28.07.2012).
(Lier 2003). However, countrywide consolidation is dependent on the owners of the insurance companies under public law. As illustrated by the flattening of the curve in Figure 4.14 (right side), there is a trend since 2003 towards cooperation instead of consolidation among the insurance companies (Müller 2010, Lier 2003).

![Figure 4.15: Market share of the ten largest insurers in Germany per insurance line (GDV Yearbook 1997-2011)](image)

Even though the number of insurance companies is decreasing, the level of concentration in the German insurance industry is still low compared with other countries and sectors (GDV Yearbook 1997-2008). As illustrated in Figure 4.15 the market shares of the ten largest companies have only grown slightly since deregulation.

Increasingly dynamic markets, limited room for growth and increasing pressure on profit margins have caused many insurers to seek growth. However, although there are scale benefits, the strength of an insurance company does not depend on size alone. It also depends on other factors like customer orientation, flexibility and speed of service (GDV Yearbook 1997-1999). The optimal company size of an insurance company depends largely on its respective client and market segments. As a result, insurers of considerably different size, client profiles, spheres of activity and distribution channels have been and will be successful in Germany (GDV Yearbook 1998). Due to market developments, insurers have been subject to considerable changes since deregulation, and these changes are expected to continue (GDV Yearbook 2000-11).

The slow growth of the insurance industry has been limiting the number of new entrants. The fact that new entrants can gain volume only by taking it from incumbents is a clear entry barrier. Additionally, as insurances are actively sold to customers, access to distribution or sales channels is needed. Access to distribution channels, like agent networks or brokers, is limited,
however. To build up a distribution channel takes time and is very costly. This is especially difficult, as the new entrants need to compete with the existing insurance companies, which have been building up relations with the sales channels for decades (cf. Pettigrew and Whipp 1991). As a result, access to sales channel is a high barrier for new entrants. However, this barrier is expected to decrease in importance over the next few years, if the acceptance of direct sales via the Internet increases. To conclude, during the time frame analysed, new entrants have not been a dominant threat to the existing actors.

4.1.4.2 Position of Buyers

The insurance consumers are divided into retail and commercial customers. The retail business dominates the market, as it accounts for approximately 80% of premium volume (GDV Yearbook 2010). However, the retail customers generally have limited negotiating power, due to their limited sums insured. Nonetheless, the trend shows that retail customers are becoming more demanding and better informed in general in financial services (Ennew and Binks 1996, Ennew et al. 1993, Johne 1993). Increased competition has entailed a certain undermining of customer loyalty, as a growing number of customers find it worthwhile to scan the market regularly for a better deal (Ennew et al. 1993). Insurers are therefore facing a decline in their long-standing stock of loyal customers (cf. Gidhagen 2002). This is especially the case in the non-life insurance line, as both life and health insurance lines benefit from high customer switching costs. The competition for client patronage has therefore intensified, with companies offering more advice, better information, and faster service (GDV Yearbook 1997).

A piece of old conventional wisdom is that the insurance industry is dependent on the size and distribution of the population as well as the national income. That is, the potential market for life insurance is larger when national income increases (Meidan 1982). In Figure 4.16 demographic developments in Germany and developments in disposable income are compared with the cost of living index. Demographic developments, with an ageing population, show the need for individuals to invest in life annuity or pension insurance and private nursing care insurance. In the long run the state social system will not be able to pay the benefits that people have been used to. The right-hand side shows the ability of the population to invest in private social insurance. During the years where the change in the cost of living index outruns the growth in disposable income, the German population on average has had a real income decrease, which limits the investment possibilities in private social insurance. Still there is a potential for growth in this area due to the increasing awareness that individual contributions are needed for old age reserves.

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82 This study only analyses the retail business of the case study company. Therefore only retail customers are discussed.
Increasing demands from customers concerning price and service as well as decreasing loyalty have been creating challenges for insurance companies. This level of uncertainty due to changing customer behaviour has been increasing during the time frame 1995–2010 and is expected to be one of the main challenges also in the future.

Figure 4.16: The demographic development in Germany on the left-hand side whereas the increase in disposable income and cost of living index is compared on the right-hand side (GDV Statistic Yearbooks 2009-11)

4.1.4.3 Substitute Service

In non-life insurance there are no substitute products offering a risk transfer, only the choice not to cover the risk. In health insurance the statutory health insurance is the only substitute. It is generally only life insurance offerings that are facing competition from substitute products. The life insurance industry stands for concepts that promote regular savings premiums that are invested on a long-term basis and paid out as a lump sum or as an annuity pension. Within this area there is increased competition from bank products like investment funds (GDV Yearbook 1998), especially as these products have been included into some of the pension reform tax-shielded funded systems. Due to the regulated investment rules, life insurance savings products cannot offer the same interest levels as bank savings have been able to. However, there are some paramount advantages of life insurance products, as they offer a guaranteed interest rate, assumption of biometric risks (such as early death or especially long life) and cover the risk of occupational disability (GDV Yearbook 2001). Although there is a threat from substitute products in the savings part of life insurance, insurance is actually a question of covering risks. Life insurance can be seen as unique in that it combines savings with guarantees and risk coverage. Therefore it can be concluded that the threat from substitute services is and has been low.

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4.1.4.4 Sales Intermediaries in the Insurance Industry

In the insurance industry, frequently the intermediary salesperson is the primary, if not sole, contact point for the customer both before and after the purchase. Often the salesperson symbolises the company for the customer (Crosby et al. 1990). Therefore sales channels have a very powerful position in the insurance industry. In order to limit the dependency on the sales channels, for decades there has been a growing trend in forward integration by using mechanisms such as direct sales via customer service centres or Internet, commissioned employee arrangements, and exclusive agencies on an employee basis (Webb and Pettigrew 1999, Venkatraman and Zaheer 1990). In order to balance the power of the sales channels, the majority of German insurers use a multichannel approach, engaging agents, brokers, banks, direct insurance, Internet, and other niche distribution channels as parallel channels (GDV Yearbook 2008, Maurer and Somova 2007).

Public insurers see a positive development in their long co-operation with Savings Banks, which are also institutions under public law. For a long time the results were mediocre. Although the target clients of both institutions are to a large extent the same, only around 15% of the bank's customers were buying insurance solutions from the cooperating insurer (Maurer and Somova 2007, Lier 2003). Their sales success has been developing well the last few years, however. In non-life insurance the new business part coming from the Savings Banks has increased from 12% in 2000 to 21% in 2008. In life insurance, where the banks have always been strong, it has increased from 64 to 70% in the same time period. In health insurance the ratio has also increased from 17 to 20% between 2000 and 2008 (Müller 2010). This increase was mainly due to active support for the Savings Banks provided by the insurance companies under public law. This development in the share of new business has however also increased the power of the Savings Banks vis-à-vis the insurance companies under public law.

As insurance products are actively sold to customers, the success of an insurance company is very dependent on its distribution or sales channels. This brings the sales intermediaries into a very strong position. The position has been strengthened by the fact that in an industry with declining growth, powerful sales are even more critical.

4.1.4.5 Summary of the Analysis Concerning Competition Among the Actors in the Insurance Industry

The position among the actors in the insurance industry has changed between 1995 and 2010, leading to increased competition among the insurance companies acting on the German insurance market. Although the threat from new entrants has not been increasing, the positions of both clients and sales intermediaries have been strengthened during the time frame. The declining growth and increasing pressure on financing investments has led to increased consolidation among insurers, although the
German insurance market is still less concentrated than other European insurance markets. Especially among regional insurance companies under public law continuing consolidation is possible. Overall the market situation has been getting more dynamic and thereby unpredictable and competitive.

### 4.1.5 Summary of the Development of the German Insurance Industry

The environment of the German insurance industry has changed substantially since deregulation in 1994 (Zietsch and Fürtjes 2005: p. V). Over the 15 years the environment faced by German insurance industry has been transformed from a protective and passive market to a more competitive one. This transformation is a result not only of deregulation, but also of the expanding capabilities of information technology and the intensified price competition due to the declining market growth. Changes in political and regulatory conditions during the reconstruction of the German welfare state have also required considerable adaptation by German insurers (GDV Yearbook 2008). In order to achieve positive results, internal efficiency and effectiveness are required. Because of the changes many German insurance companies have initiated a process of internal restructuring and streamlining of internal business processes in order to remain competitive in the changing market environment (Oletzky 1998).

#### Table 4.1: Environmental parameters, insurance industry around 1995 and 2010

<table>
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<tbody>
<tr>
<td><strong>Market characteristics</strong></td>
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<tr>
<td>Market development</td>
<td>Strong growth in all insurance lines until 1995.</td>
<td>Slow growth market - stagnation within non-life insurance.</td>
</tr>
<tr>
<td></td>
<td>Stable product offering.</td>
<td>Changing product mix within life due to legislation change.</td>
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<tr>
<td><strong>Change predictability concerning</strong></td>
<td></td>
<td></td>
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<tr>
<td>Regulation of the market</td>
<td>Deregulation of the market in 1994 led to increased fight for market share through reduced premiums and steep discounts.</td>
<td>Legislation challenges full-coverage health insurance, but supports life insurance.</td>
</tr>
<tr>
<td>Actors in insurance – active companies and new entrants</td>
<td>Market share among top ten rather stable.</td>
<td>Market share among top ten slowly increasing.</td>
</tr>
<tr>
<td></td>
<td>Consolidation among smaller insurance companies due to increased investment needs.</td>
<td>Consolidation mainly among public and mutual insurances due to investments and equity requirements.</td>
</tr>
<tr>
<td></td>
<td>In spite of the deregulation in 1994, hardly any new actors entered the German insurance market.</td>
<td>Very few new entrants, due to the price competition and entry barriers (mainly importance of sales channels).</td>
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### Table 4.1

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<tr>
<td>Actors in insurance – customers</td>
<td>Loyal customers, less information available for private customers.</td>
<td>Customers are more informed and price oriented, and less loyal especially in non-life insurance.</td>
</tr>
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<td></td>
<td>Belief in the national pension insurance.</td>
<td>Increased awareness of private life annuity or pension insurance.</td>
</tr>
<tr>
<td>Actors in insurance – substitute service</td>
<td>No substitute products, except general saving.</td>
<td>Substitutes challenge only life insurance, but it still offers unique risk coverage. Since financial crisis 2008 this threat from substitute fund products has decreased.</td>
</tr>
<tr>
<td>Actors in insurance – intermediaries</td>
<td>Insurance has always been a sales intensive service.</td>
<td>Power of the sales channels has been increasing as a result of the slow growth.</td>
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### Environmental predictability

<table>
<thead>
<tr>
<th>Level of uncertainty</th>
<th>Environment Around 1995</th>
<th>Environment Towards 2010</th>
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<tr>
<td></td>
<td>Although the competition started directly after the deregulation, the high level capital return on investments until the financial crisis in 2001/2 protected the market.</td>
<td>Level of uncertainty to predict change has increasing mainly due to legislative changes, increased competition among existing insurers, better informed, price-sensitive and less loyal customers, and increasing power of sales channels. This development hinders adequate long term planning within insurance industry.</td>
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</table>

The environment is one of the dimensions of the analysis model developed in the theory chapter. In Table 4.1 the aspects identified during the theoretical discussion in Chapter 3 are mapped with developments in the insurance industry 1995-2010. Taking all aspects into consideration, it can be concluded that the insurance market in Germany has been developing towards uncertainty. However, it is still a rather protected growth market. The challenges do not originate from outside the market, but from the rivalry among existing insurance companies. Legislation has been changing the competitive framework, but so far it has only posed a serious challenge in the area of health insurance. In all other areas, the legal changes have been limited to product mix preferences or strengthening customer rights of transparency. Since the financial crisis of 2008, developments that started in the late 1990s have accelerated noticeably. The days when the market was growing and allowing an excellent return on investment are gone. The old truth that “market share growth equals increased profit” is no longer applicable, as the market is stagnating and maturing (Oletzky 1998: p. 1).83

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83 Similar conclusions were drawn by Pettigrew and Whipp (1991: p. 55). In their study they also concluded, some years after the deregulation of the insurance market in the UK that
Future success is likely to stem not from market growth, but from the development of effective strategies based on an understanding of a more complex and competitive market. In the next sub-chapters the actions taken by one German Insurance Group to manage these market changes are presented.

4.2 The Insurance Corporation

In this sub-chapter the insurance group studied is presented, including its corporate structure and the regions where the insurance companies included in the group are active. After the presentation of the corporation, the strategy, the control system and the organisational structure of the corporation are presented.

This sub-chapter, along with the next three sub-chapters, is based on information received from the case company. The information received in the interviews is complemented by public and internal documents.\textsuperscript{84}

4.2.1 Background Information about the Insurance Group

In this section background information, like the history of the Insurance Group, the Insurance Group structure and the regions where its individual insurance companies act are presented. The aim is to give the reader an understanding of the Insurance Group.

The Insurance Group celebrated its 200\textsuperscript{th} year of insurance experience in 2011. In 1811 its predecessor was founded as a state agency with the task of taking care of real estate fire losses within the region. In 1995 the Savings Banks of Bavaria and Rhineland-Palatinate took over the insurance company from the state of Bavaria and re-organised it as a public insurer.\textsuperscript{85} In other words, when the newly formed insurance company commenced operations in July 1995, it was not starting from scratch. In 1995 the insurer was a conglomerate of a life insurer, a health insurer and two existing and one newly founded non-life insurers. The Savings Banks were already established as sales channels, the new Insurance Group was allowed to take over the monopoly real estate insurance portfolio from the federal state, and the municipality insurance portfolio was already well established.

During the fifteen years since its foundation, the Insurance Group has been acquiring other insurance companies and building up its corporate structure. The Insurance Group nowadays unites fifteen individual

\textsuperscript{84} The internal references per section are listed in Appendix C.2.

\textsuperscript{85} The insurance companies under public law are regionally organised and do not compete in each other’s regions.
companies and is the largest public insurer in Germany. With revenue exceeding seven billion euros and 6,500 employees, it is one of the ten largest primary insurers in Germany. With the slogan “we insure you as we would insure ourselves”, the group is involved in life and non-life insurance, with three regional brands. Additionally, the Insurance Group provides the common health insurance scheme of the public insurance companies operating throughout Germany. As a “regional insurer”, the corporate group emphasises regional competence and proximity to customers with the objective of being the regional market leader.

The Insurance Group has a rather complex structure. This is partly due to the fact that insurance companies in Germany are required by law to set up separate firms for life, health, and non-life insurance, respectively. Moreover, three additional points concerning structure need to be highlighted. The first is that although one of the group companies is officially the holding company where the results of the individual insurance companies are consolidated, it does not act as a holding company for the individual insurance companies. Instead, corporate interests are observed through Supervisory Board assignments. Thus, the members of the Bavarian Board of Directors have assignments in the Supervisory Boards of the insurance companies in the other regions.

The second point is the partly introduced sub-holding structure for the different lines of insurance. The group founded a holding company to manage and coordinate the health insurance companies. However, for the life and non-life insurance companies no sub-holding structure has been set up. Instead, governing boards for German-wide operational coordination of the life and a non-life insurance business lines were established. Because of the partly introduced sub-holding level, both the insurance lines and the regional insurance companies are regarded as business units in discussions on the strategy, control and organisational structure of the case study company.

The third point is the common Boards of Directors, an arrangement that was established to reduce the complexity of the group structure. All the insurance companies in a region have the same Board of Directors. This structure was introduced at the time of establishment in order to ensure common responsibility for profits and costs. This structure is intended not only to reduce complexity, but also to facilitate coordination within the region.

The insurance market development in general, and especially for non-life insurance, is tied to the general development of the region where it acts. The insurance premiums increase with increasing wealth, as wealth leads to more expensive cars and increasing house prices. The insurer is active in three regions – in Bavaria and the Palatinate, in Berlin and Brandenburg and in

86 In this study only the German-based insurance companies are included.
87 The governing boards do not have any decision-making power over the insurance companies, but can only recommend decisions to be taken by the regional companies. The governing boards will be discussed in more detail in “4.2.6.2 Formal Structure”.

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Saarland. Bavaria is a region with a stable financial situation and continuous growth. However, the positive development of Bavaria also leads to a more intensive regional competition compared to the rest of Germany. The other two regions are declining. However, due to the good position in the region, the Saarland-based insurances have been achieving an annual growth by winning market share from their competitors. Berlin and Brandenburg are price-sensitive regions with a weak level of consumption. The Brandenburg market is declining as young people leave the region, whereas the Berlin market, as an urban area, is increasing. However, Berliners are not seen as easy customers as they are used to having many alternatives to choose among. In general, as Bavaria is the main region, the Insurance Group is acting in an attractive region, enabling a good market position for the whole Insurance Group on the German insurance market.

4.2.2 The Insurance Group’s Interpretation of the German Insurance Market

Before presenting the market position of the Insurance Group and its development over the studied timeframe the interpretation of the market development based on the interviews will briefly be presented. All the interviewees find that the competition in the German insurance market has been constantly increasing since 1995 due to the maturity of the market and the more or less standardised products. This has led to a consolidation among actors. The consolidation process is expected to continue in the future, or even increase within the group of public insurance companies. The main reasons for the consolidation is an increasing profitability pressure and the fact that customers and sales partners trust growing insurance companies. As the market growth is decreasing, revenues can be significantly increased through consolidation. Although a consolidation of all insurances under public law would not increase the market share of the public insurers, it is believed to increase the efficiency among the insurance companies under public law.

The volatility of the insurance industry is also seen to have been increasing during the last few years due to terrorism, more frequent natural disasters and political uncertainties. The market is becoming more unstable and unpredictable, leading to diminishing planning stability. Also, the instability of the capital market is increasing the uncertainty especially after the subprime crisis in 2008. Due to the decreasing yield and uncertain stock markets, the technical losses from insurance business cannot be compensated for by the capital return on investments anymore. As a result the insurance

88 The interpretations of the insurance line market specifics are presented in the insurance line sub-chapters.
89 The public insurers would, if consolidated, be the second largest insurance group in Germany.
industry has become very cost oriented and more professional concerning risk assessment. This pressure is expected to continue for some time as the risk capital available has been decreasing and as safe investments are expected to bring only a very small yield also in the near future. The corporate CEO interpreted this development in a partly positive way as follows: “the pressure from outside enforces the corporation to react internally”. In the next section the market position of the insurance corporation is presented before the reactions to market changes are discussed.

4.2.3 Position in the German Insurance Market

The Insurance Group has exceeded average market growth since 1995, mainly due to its acquisitions. Between 1995 and 2010 the market grew 60%, whereas the Insurance Group grew 126% during the same time. As a result the Insurance Group has increased its market share from 2.8% to 4.0%. Annual growth and an annual comparison with the German insurance market are illustrated in Figure 4.17. With the market share the Insurance Group is the largest public insurer and gained position number eight on the German insurance market in 2010.

![Figure 4.17: Written premium and total costs for claims and indemnification of the Insurance Group in million Euro (left) and the growth rate based on written premium of the Insurance Group and the German Insurance Market (right)](image)

The regional insurance companies belonging to the group have different competitive situations in their individual regions. In the main regions, Bavaria and Palatinate, the insurers are market leaders with market shares between 18 and 19% based on premium income and even 38% based on
number of customers.\textsuperscript{90} Also the Saarland-based insurances are regional market leaders, with a market share of 25%, whereas the insurers in Berlin-Brandenburg are just small players with a market share of around 5%.

The split of the premium per insurance line, as illustrated in Figure 4.18 (left), shows that the portfolio is balanced between life, non-life and health insurance. This balance is seen as a basis for the insurer to exceed market growth for a long time period. From the profit part non-life insurance contributes the most (Figure 4.18 right side), although this insurance line is rather dependent on developments in the annual claims.

\textbf{Figure 4.18: Written premium split by insurance lines (left) and the profit contribution per insurance line (right) of the insurer}

As illustrated in Figure 4.19, also due to positive underwriting results since 1997, the insurer has been able, to combine this growth with a profit exceeding the market average. The financial position of the Insurance group has been confirmed with an “A” (Very Good) in all Standard & Poor’s ratings, which have been conducted annually since 2006. This rating could be kept, also during the financial crises, due to the stable profitability and solid financial resources. This is a result of the conservative\textsuperscript{91} and long-term based investment strategy. Due to the volatility of the stock markets and the decreasing yields since the subprime crisis in 2008, however, there is an increasing pressure to achieve good underwriting results. Nevertheless, showing positive results since 1997, there is an increased need to improve the underwriting results, especially as they have been declining since 2008.

\textsuperscript{90} Based on the external market survey FMDS 2006/2007.

\textsuperscript{91} “The insurer’s aim is to preserve the customers investments and not to enlarge them by taking high investment risks” according to the board member responsible for asset management.
The image of the insurer has been changing with its market position. This was described as follows by a board member responsible for sales: “In the beginning the Insurance Group was still a governmental agency, nowadays the Insurance Group is seen as a real competitor among the competitors”. In the external customer satisfaction survey “Kundenmonitor Assekuranz 2005”, the insurer received the highest score from all 27 German universal insurers offering all insurance lines. The insurer has been able to reach these high scores due to the high portion of satisfied fire building customers and due to the sales channels taking care of the customers. Although the customer satisfaction index (as illustrated in Figure 4.20) has been increasing, reaching the market average in 2007, the culture of a strong governmental background sometimes still symbolises a company that has “just reached halfway towards market orientation”. This can be seen in the customer satisfaction surveys where the insurer receives high scores for image and solid insurance company, but below market average for their service quality.

Some of the interviewees on the Board of Directors level highlight that although the insurer is developing better than the market, it has not been able to grow as well as the top three German insurers. Compared to these insurance companies the insurer has lost market share in some years (e.g.

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92 Market information is not published after 2006 by GDV.
93 Conducted by the market research company “psychonomics” in 2005 and 2006.
94 The Insurance Group can offer these customers a very good price due to the large monopoly portfolio inherited. Actually during the last few years the premium has even been lowered. As these customers additionally do not have a high claims frequency, they are in general satisfied with their insurer.
95 Stated by a top manager in sales.
2007). Also, if compared with the peer group per insurance line, the insurer is among the top five in non-life insurance growth; in the other lines the growth levels are not so impressive. In other words, the insurer’s growth has been exceeding the average level; however, in comparison with its peer groups the growth has not always been evident. Next the sales channels, the customers and the service offerings of the corporation will be discussed before the strategy on the corporate level is presented.

![Customer Satisfaction Index](image)

*Figure 4.20: Retail customer satisfaction rate development within German Insurance Market and the Insurance Group*

### 4.2.3.1 Sales Channels

Insurance is sold through the sales channels developing demand for the products during client consultations. Neither the service nor the products are seen as the main success factors in insurance; the sales channels are. This makes the insurance companies very dependent upon their sales channels. A main task for the insurance companies is to convince the sales channels to sell insurance products that are not so interesting or easy to sell. In order to convince the sales channels, there is a need to offer a good commission, adequate service (training and sales support) and good products. The commission is nevertheless considered to be the main convincing parameter.

The Insurance Group has a broad retail sales channel mix including banks (both the Savings Banks being the owners and the Bavarian Credit Union Banks), agencies just offering the products of the Insurance Group, as well as its own branch offices with own sales employees. The Insurance Group aims to have a well-balanced ratio between the sales channels that all follow different sales tactics and sales cultures. Since its foundation in 1995 the Insurance Group has been investing into developing the Savings Banks into a professional insurance sales channel. Their sales volume has been increasing and insurance business is now seen as a core business in the Savings Banks. In order not to become totally dependent on the Savings Bank sales channel the Insurance Group has been building up their own sales offices and supports the agencies as well as the Credit Union Banks as additional sales channels.
With the aim of increasing the quality of sales support, the Insurance Group conducts a sales channels satisfaction survey every second year. The responsible main department managers develop action plans as a response to the results. However, as the survey and the actions derived from it are not a focus area of corporate management, no real improvement can be seen over the time, as illustrated in Figure 4.21. The surveys are more to be seen as “a reminder of the long-term weaknesses” of the Insurance Group, as one board member commented. Overall satisfaction after a short improvement in 2006 declined again in 2008. The sales partners rate the market position, the product offerings and the claims handling high, whereas the satisfaction rate concerning treaty administration decreased for all insurance lines. The reason for this decrease was the introduction of the client and sales partner service centre, which will be discussed later in this sub-chapter.

In 2008, after long discussions, the Insurance Group started a direct Internet insurer, using a different brand. Internet has long been seen as a future sales channel in the insurance market. Its increased importance is due to the growing number of price-sensitive customers. The Insurance Group, with their high market shares in their regions feared they would lose market share if they did not offer this sales channel in addition to the more traditional existing sales channels.

4.2.3.2 Customer Structure
The Insurance Group does not have any special target customer group. The tactic followed as a regional market leader is rather to “catch all” available clients. Bavaria has for example 12 million residents. The Insurance Group in Bavaria has 13 million insurance contracts with 5 million regional clients. Although segmentation is becoming more important in the insurance market, the Insurance Group did very little in this field until 2008 when they
implemented customer segmentation. The idea is not to identify target
groups but to map products and sales material to the different segmented
customer groups. The implementation of the customer groups is seen as a
first step towards customer orientation and a customer group strategy upon
which a customer relationship management concept could be developed in a
later stage.

Looking at the existing customers, the Insurance Group has a high ratio of
wealthy customers, especially in the Bavarian region. This has to do with the
fact that the Insurance Group has many elderly customers and a
proportionally small share of younger clients. This is partly because its
image attracts elderly customers and partly due to their loyalty. As customers
do not change insurers, the customers have been growing old with the
insurer. This is not necessary bad, looking at demographic developments and
the fact that the elderly clients have more money to invest in insurance
products and a rather low non-life claims rate. The Insurance Group
therefore even introduced a 55+-customer strategy to attract elderly clients in
2008. However, the Insurance Group also sees the need to reach younger
clients in the future. As stated by a board member “The customers grow old
with us. This is a problem as long as the Insurance Group cannot win
younger customers.” In order to reach this customer group some new ways
are needed, like the implemented Internet sales channel, younger sales
personnel and specially developed products for this target group. The
Insurance Group has started this by developing special offers for “young
adults”. It was generally expected, however, that it takes time to change the
dominance of elderly clients.

4.2.3.3 Insurance Products and their Development

Product development departments were introduced in 1996. Each insurance
line has its own product development entities. Although the insurance lines
are responsible for product development, they need to cooperate with the
common sales and IT functions. Due to the fact that the insurance lines have
the responsibility, the products are developed from the insurance line
position, looking at the competitors and at their own existing product
portfolio. Inside-out pricing is used based on claims forecasts, existing
administrative fees and commissions as well as required margin goals. In
order to ensure an overall view, the insurer introduced a new product
development process in 2010 where all product ideas from all insurance lines
are analysed in detail considering customer, sales, profit and IT. The aim is
to ensure that the products are market oriented and at the same time easy to
implement. This change with a central process and product board96 was not
seen as purely positive from the insurance line point of view, as the new
process limited their flexibility. As a board member responsible for non-life

96 The product board and committee will be discussed in more detail in “4.2.6.2 Formal
Structure”.

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insurance stated: “The new product development process enables an overall customer picture. However there is still a need to clarify the responsibilities of the product board and committee versus the insurance-line manager’s responsibility for revenue and profit.”

With the introduction of common IT systems, many of the regional product development tasks were centralised into the Munich departments. There is a common belief among the centralised functions in Munich that the product requirements should not differ between the regions. The regional insurers in the Group however find it important that regional know-how is integrated into the centralised product development in order also to fulfil regional requirements. The new product development process introduced in 2010 has the aim of supporting the coordination of all functional and regional aspects.

During the interviews it was highlighted multiple times that insurance is about risk transfer. It is an old business just like agriculture. Insurance as a product is generally considered not in need of further development, and in that respect similar to an automobile. Insurance offerings are commodities, and the products offered by the Insurance Group are seen to be interchangeable with those of their competitors. The Insurance Group is not an innovative trendsetter, rather a “me-too” product developer. This is not seen as a problem, however, as market share is not believed to be won by innovative products, but with strong sales channels. Currently the time to market is considered rather long, making it difficult to introduce innovative and unique products. With the new product development process the aim is to be able to introduce new products within twelve months. With this goal it is believed that the Insurance Group would reach a level that is average for its market. The goal to reach market average is seen as a challenge. In order to react quickly to market changes, fast decisions are needed. The approval committee supporting the product development process only meets three times per year, however.

4.2.3.4 Summary of the Insurer’s Market Position

The position of an insurance company, like all other companies, in the German insurance market is generally a question of revenue and profit. After deregulation an insurer needed to be successful in these areas. This is becoming increasingly important due to the fact that the market is growing increasingly unstable and unpredictable. The insurer has been successful in general. Looking into the market position in more detail, using the parameters discussed in the theory chapter, the picture is more differentiated as illustrated in Table 4.2.

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97 In 2006/2007 the insurance companies in Berlin-Brandenburg started using the Munich IT systems. Due to multiple postponements the Saarland insurance companies are still not fully migrated.
### Table 4.2: Market position of the Insurance Group

<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td><strong>Market characteristics - Insurance Group’s interpretation</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Market development</td>
<td>Growth market with increasing price competition due to deregulation.</td>
<td>Mature market with limited growth has led to increased competition.</td>
</tr>
<tr>
<td></td>
<td>Limited cost orientation due to the high capital return on investments.</td>
<td>As a result of the reduced capital return on investments the industry is very cost oriented since 2000.</td>
</tr>
<tr>
<td></td>
<td>More stable risk situation.</td>
<td>Volatility has been increasing due to terrorism, more frequent elementary occurrences and political uncertainties.</td>
</tr>
<tr>
<td>Consolidation</td>
<td>Consolidation of the actors in the insurance industry.</td>
<td>Increased interest in consolidation (public insurers) as a substitute for market growth and in order to ensure cost synergies.</td>
</tr>
<tr>
<td>Predictability</td>
<td>Stable market with a high level of predictability.</td>
<td>The market is getting more unstable and unpredictable.</td>
</tr>
<tr>
<td><strong>Financial/Quantitative performance of the Insurance Group</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Profitability</td>
<td>Profitable, exceeding market average, mainly due to capital return on investments.</td>
<td>Profitable, slightly exceeding market average, also due to positive underwriting results (however declining since 2008).</td>
</tr>
<tr>
<td>Capital return on investments</td>
<td>Average market level (which was generally high during this time).</td>
<td>Average market level (which has been decreasing) due to conservative investment policy.</td>
</tr>
<tr>
<td>Market share</td>
<td>2.8%</td>
<td>Increased to 4.0% mainly due to the main acquisitions in 2002 and 2004.</td>
</tr>
<tr>
<td><strong>Non-financial/Qualitative performance of the Insurance Group</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Customer satisfaction</td>
<td>Below market – seen as a governmental agency.</td>
<td>Increasing to average market level due to high scores for image and solid company – however below market in service quality.</td>
</tr>
<tr>
<td>Sales channel satisfaction</td>
<td>Stable on a low level.</td>
<td>Stable on a low level, however with decreasing rates in 2009 after a short improvement in 2006, as treaty administration got low ratings after the re-organisation of the service production.</td>
</tr>
</tbody>
</table>

### 4.2.4 Corporate Strategy

In this section the corporate strategy will be discussed. This includes the global goals that are seen as corporate strategy within the Insurance Group, the existing resources and capabilities and their development, the acquisitions and the corporate strategy process.
4.2.4.1 Global Goals as Corporate Strategy

In 1998, the insurance company identified some global goals upon which the annual planning is based. These goals are applicable to all insurance lines and insurance companies within the Insurance Group. After the acquisitions of the regional insurers, the global goals were supplemented by more insurance-group-oriented goals, like market position in the regions and the regional insurance model. Although the global goals have not changed over the years, the description of them has been altered. In 2008 the goals were renamed corporate strategy, which was presented to and approved by the Supervisory Boards. In 2010 a communication programme was started for the employees. The programme received positive feedback, as “the employees, due to the long-lasting crises, are very interested to know and pleased to hear how the company sees its market position and its strategic goals” according to the CEO. The global goals and their descriptions are presented in Table 4.3.

The set of global goals, or the so-called corporate strategy, is a mixture of goals and important aspects that need to be considered in order to reach the goals. They constitute “a rather broad set of variables to fulfil” as stated by a marketing manager, providing limited guidance about what to do and what not to do. After the acquisitions, the corporate goals were also introduced in the regional insurance companies. Expected growth and cost position were formulated as short-term and long-term financial goals. How to reach these goals was delegated to the regional companies. In order to acquire a better understanding of the real relevance of the global goals and their influence on strategy, they were intensively discussed in the interviews.

The Insurance Group positions itself as a price-competitive, multi-channel service insurer offering all customers all insurance products that they need. This positioning is followed in all regions and by all insurance lines. Consultation and services are offered through the sales channels, which therefore need to be supported adequately. The Insurance Group did not always prioritise high service to the sales channels, but this has changed over the years. The change was due to some initiatives concerning “customer orientation” and to the fact that the sales and marketing division is getting more involved in decisions at an earlier stage.

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98 The “customer orientation” initiative was started during the second half of 1999. All employees were involved in the development of quality standards for their own departments. The suggestions at the department level were consolidated into company-level guidelines for reliability, reachability, affability, complaint behaviour and transparency.
Table 4.3: Global goals as baseline for the corporate strategy

<table>
<thead>
<tr>
<th>Global Goals</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profitability (since 1998)</td>
<td>The goal is to ensure increasing profitability in all insurance lines and all insurance companies within the Insurance Group. Profitability should be based on underwriting results as well as on return on investments. Until 2006 it was explicitly stated that the Munich based Board of Directors set up the profitability goal for all companies in the Insurance Group. In 2007 the importance of an appropriate risk management was added to this goal.</td>
</tr>
<tr>
<td>Customer and sales orientation (since 1998)</td>
<td>The global goal is to achieve top values for customer and sales orientation. It is seen as a guideline for sales as well as administrative and supporting functions. The customer and sales partner satisfaction surveys are used as a measure for continuous improvement. In 2009 the goal was supplemented by a group wide customer view. Based on this view, the insurer together with its sales partners should offer customers superior service, competence and commitment.</td>
</tr>
<tr>
<td>Cost position (since 1998)</td>
<td>The goal is to maintain a cost-leadership position among service insurers. In the annual planning, premium growth must exceed cost growth at the corporate, insurance-line and company levels. Until 2006, Corporate Control had the task of monitoring cost development. In 2006 the centralisation of tasks in regions with a low cost level was added to the corporate goal. In 2009 the goal was supplemented by the importance of standardisation and superior quality in order to reach a good cost position.</td>
</tr>
<tr>
<td>Market position (introduced after the acquisitions – 2004)</td>
<td>The aim is to attain a leading market position in all regions by exceeding average market growth. This growth is to be enabled by offering customers market-oriented and profitable products and also through acquisitions, mainly in Germany. Since 2009 the importance of keeping the inherited profitable insurance portfolio is a part of the market-position goal.</td>
</tr>
<tr>
<td>Regional insurance (introduced after the acquisitions – 2004)</td>
<td>The insurance company follows a regional business model in which individual regional insurance companies operate with their own brands in serving their local markets. By highlighting the region, the insurer seeks to differentiate itself from national competitors and to stress proximity to customers and local sales partners. By being local the regional companies can offer insurance products that meet local demands. In 2009 this global goal was supplemented by a sentence highlighting the corporate role and the benefit of sharing central functions.</td>
</tr>
</tbody>
</table>

Although the Insurance Group is positioned as a service insurer, considerable energy is put into monitoring costs. During the years of high growth, the cost situation received little focus. However, since market growth stagnated almost to zero, the cost situation has been getting more attention. The pressure for cost savings has also been continuously increasing since 1999/2000, as a result of the volatile capital market. As a consequence of this volatility, insurers in general can no longer assume that capital return on investments can compensate for increasing costs. The
mounting cost pressure within the Insurance Group is also due to the general aim of the German insurance market to lower its cost level. This pressure to lower costs has caused reluctance to invest in quality-enhancing projects that bring long-term benefits. “Costs are evaluated in figures whereas market-orientation projects are about hope.”99 It has therefore become increasingly difficult to get top management commitment for a project based on hope for a better future.

The Insurance Group has not changed the global goals since they were formulated, and it plans to keep them as long as they “function”. It was highlighted that being a regional market leader, offering multiple insurance lines, does not allow much change. Throughout the interviews, there was a clear consensus that the main corporate goal has long been, and still is, to achieve growth. Even after the financial crises the commitment to grow more than the market average was kept. This was motivated with the belief that lost market share would mean that a company is no longer competitive. Growth is also considered necessary in order to control cost rates and to ensure more assets under management, but also as sales channels are motivated by growth. The bottom line is that growth is needed to finance the group’s large and complex structure. Long-term growth is said to be valued more highly than short-term return on capital. At the same time, long-term investments are evaluated against short-term cost-savings targets since strict cost-savings targets were introduced in response to the financial crises.

The insurer differentiates itself as a regional insurer. Being near the customers and understanding the customer is seen as a differentiation compared to global or even German-wide insurance companies. The regional business model, however, also “leaves some issues open as it is broadly formulated and can be interpreted in many different ways concerning regional responsibility versus central coordination in order to attain synergies”100. The concept is considered to lack clarity in regard to responsibilities, interfaces and rules of cooperation among regional insurance companies. One important aspect mentioned was how to coordinate the benefits of corporate resources and capabilities among the insurance lines and regions.

4.2.4.2 Corporate Resources and Capabilities

The Insurance Group inherited certain valuable resources at its foundation. The Savings Banks were already established as a sales channel, especially for life insurance. Based on this experience, the Insurance Group has been able to build up multiple strong sales channels in addition to the Savings Banks. The multiple sales channels are seen as true assets, also outside of the

99 Comment by a manager responsible for evaluation of project ideas.
100 Statement from a manager working for the Berlin/Brandenburg-based insurance companies.
sales division, “as insurance is a question of sales”\textsuperscript{101}. Especially the Savings Banks, with high market shares in their home regions (e.g. 60\% in Bavaria and Palatinate and in Saarland and almost a monopoly position in Brandenburg), offer huge potential for sales. Additionally, after a long history as a regional caretaker in case of fire, the corporation started their business with an excellent image of trust. The image is regarded as especially precious “as trust has immense value in insurance, more so than price, product features and service orientation”\textsuperscript{102}. This caretaker role is still visible through engagements with regional fire fighters and in climate protection. The group’s former caretaker role and current engagements, combined with the fact that the Insurance Group is not viewed as profit-oriented by its customers, as it is not registered on the stock market, is a valuable advantage over multinational competitors. The last financial crisis strengthened the importance of this image even more, “as people value security even higher as an effect of the financial crisis”\textsuperscript{103}.

The Insurance Group was allowed to take over the monopoly fire insurance portfolio from the Federal State. Since the start, the Insurance Group has been able to keep the majority of these contracts. This vast portfolio provides a good balance of risks that enables the Insurer to offer favourably priced coverage to clients. As this profitable portfolio is managed directly, without any expensive sales intermediaries, it also strengthens the company’s cost position. Additionally, thanks to its historical role in fire insurance, the Insurance Group has an expertise in the area that is broadly recognised, also by competitors.

Aside from the sales channel, the image of trust and the fire insurance know-how mentioned above, the interviewees from the regional insurance companies in Saarland and Berlin-Brandenburg mention regional presence as an important competitive advantage. With a regional presence, the insurers are close to regional sales channels and customers. Additionally, with their regional responsibility, they can respond quickly to regional demands. During the period under study, however, responsiveness to local demands was considered to be decreasing because of the centralisation of resources at the group level that started in 2006.

The Savings Banks as a sales channel, the image, and the enormous inherited fire insurance portfolio and the know-how in fire insurance are valuable resources arising from the history of the Insurance Group. These resources continue to aid the Insurance Group in gaining a strong market position. The common opinion among persons interviewed, however, was that the Insurance Group was not taking full advantage of this potential

\textsuperscript{101} Was highlighted in multiple interviews with informant from different areas and different levels.
\textsuperscript{102} Stated by board members as well as the manager responsible for corporate business development.
\textsuperscript{103} Highlighted in an interview conducted in 2010 based on the fact that the owners, the Savings Banks, were not strongly affected by the subprime crisis.
source of support. The high potential of the sales channels, especially the Saving Banks compared to other bank assurance operations, is not viewed as being fully utilised. The image of responsible caretaker is considered in the marketing but not in the service processes. Also, for a long time the former monopoly fire insurance portfolio was not managed actively or seen as offering excellent potential for cross selling. Although the lack of use and further exploitation of existing resources was highlighted and considered as potential for developing the business and strengthening the company’s market position, little real development occurred. Initiatives in new areas have been taken, but because of the strong emphasis on existing business models and goals, these endeavours were backed only by limited investments and commitment. However, a company can also be successful by sharing the existing advantages with new companies brought into the group. This will be discussed in the next part.

4.2.4.3 Acquisitions

The Insurance Group belongs to the association of insurance companies under public law. They are regionally organised and do not compete in each other’s regions. The acquired companies are also insurance companies under public law. With the acquisitions, the Insurance Group has been able to broaden its geographic footprint and has strengthened its leading role within the association of insurance companies under public law. Due to the common background, no real analysis of business model was considered necessary during the acquisitions. Whereas the acquisition in Berlin-Brandenburg brought access to a growth region, the acquisition in Saarland brought only access to synergy potential. Although the acquisitions were conducted with a long-term perspective, a break-even in the future is considered very important. That is, in the long run some cost synergies should be gained from the acquisitions. With the decision to migrate the IT systems of the regional insurers, a baseline for gaining group wide synergies was implemented. However, although it was recognised that in order to really yield a benefit the processes between the regional insurance companies also need to be harmonised, it was not ensured. Besides the shared IT systems, management competence, products and insurance know-how as well as the knowledge how to support and develop sales channels, especially the Savings Banks, were mentioned as valuable resources with which the insurance corporation could support the acquired insurances. Generally, as all companies act in insurance, the common knowledge is seen valuable.

Although the owners, the Savings Banks, stress cooperation more than consolidation, the management of the Insurance Group is convinced that the consolidation of the public insurance will sooner or later continue. The goal of the Insurance Group is to ensure that the consolidated public insurance company will be seated in Munich. In order to ensure this, the insurer needs to continue to be active in the consolidation process among the public
insurers. However, although the Insurance Group is the biggest insurance company under public law, it has only a limited influence over this consolidation process, as it is managed via the Savings Banks. Therefore, in order to achieve the growth goal, the Insurance Group is also interested in acquiring insurance companies outside public law. Acquisition outside the common background of insurance companies under public law is considered to require a deeper analysis of the business models in order to ensure a fit. However, according to a manager involved in business development, the insurer sees “acquisition more as a question of timing and finding a candidate at the right moment than fitting business models”. Until the right candidate is identified the corporate strategy process is seen as a vehicle for attaining the growth goal.

4.2.4.4 The Corporate Strategy Process

Until 2007 the Insurance Group did not have a strategy process, but it had a very well-functioning planning process with goals on the corporate level and action plans prepared by the insurance companies describing how to reach these goals. In 2007 the insurance lines and supporting functions were given the task of developing their business or functional strategies based on the corporate strategic goals. The aim was to ensure that the insurance lines and supporting functions were aiming in the same direction. The strategies were finalised in 2009. The resulting business and functional strategies are still closely connected with the planning process, as the strategies developed are viewed primarily as an aid for identification of growth areas and fields for cost saving. Although the Insurance Group has intensified strategy-related activities with the introduction of the annual strategy process, on-going strategic development is still not considered a primary task of the Board of Directors. Given this lack of top management engagement, differing interpretations of the global goals and their priorities are common in the business lines and the insurance companies. Despite the lack of a common interpretation, top management is of the opinion that the company is not badly positioned compared to other insurance companies in regard to its strategic activities.

During the interviews it was emphasised that thanks to stable corporate management, with few changes among the board members, the company has been acting consistently during its fifteen years on the market. It was also pointed out, however, that stable management might not be enough to deal with the changing environment. There was a perception, especially among mid-management, that activities needed to be better coordinated in the company’s changing environment. The limited extent of coordination has already led to some difficulties. As stated by a board member, “Before we were lucky, nowadays we are veering from one error to the next”, owing to the lack of strategic coordination and clarification of global goals among the board members. As the corporate global goals are difficult to combine because of their contradictions, and as they allow a wide range of
interpretation, clearer guidance is sought, mainly by lower and mid-level management, for coordination among the insurance lines as well as supporting functions. Coordination has increased during the study’s timeframe, however, as new boards and commissions have been introduced.\footnote{104} Additionally, the investments are discussed more intensively and prioritised based on the global goals. The global goals give guidance but sometimes also stop important long-term investments. For example, as stated by a board member “although the Insurance Group could afford to invest more in IT, the investments are often postponed in order to reach the corporate goal of limiting the cost ratio on an annual basis”.

The Insurance Group provides the connected insurance companies a high amount of freedom, as long as the corporate global goals are followed and the annual targets are fulfilled. With the high pressure to reach these goals, especially for growth, companies tend to react opportunistically rather than strategically. This is seen critically, as it is especially important to have clear strategic guidelines in a growth situation. This could be ensured by group level involvement on business and functional strategy development. However, the corporate level is not involved in the strategy formulation and implementation on these levels, although they initiated strategy development in 2007. Nonetheless, sometimes decisions taken on the group level have consequences for the insurance lines, especially as the insurance lines since 2006 have been increasingly dependent on the common resources and supporting functions centralised on the corporate level. These aspects are discussed in the section “4.2.6 Group Organisational Structure” and the strategy parts of the insurance line sub-chapters.

4.2.4.5 Summary of the Corporate Strategy

Right from the start, the corporate strategy has been one of portfolio management, where the units have been managed according to strict goals derived from the global corporate goals. Over the years the main global goal of growth has remained, though the complementary goal of profitability has been gaining importance, especially since the financial crises. The corporate level is not deeply involved in the strategies of the individual insurers and supporting functions. However, since 2006 the level of coordination has been increasing, as resources were concentrated to central units acting for multiple insurance lines and regions. This increased coordination is challenging, as the corporate goals are not easy to combine and allow a wide range of interpretation. Therefore many in the insurance line as well as the supporting functions wish for clearer guidance for their coordination.

\footnote{104} This will be discussed in more detail in “4.2.6.2 Formal Structure”. 

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Table 4.4: Aspects of corporate strategy

<table>
<thead>
<tr>
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<tbody>
<tr>
<td>Corporate goals</td>
<td>Growth</td>
<td>Growth combined with cost effectiveness (since 1999) due to general market development.</td>
</tr>
<tr>
<td>Synergies between business units</td>
<td>Limited synergies – as all companies had their own supporting functions.</td>
<td>Increasing since 2006 due to centralised resources and supporting functions.</td>
</tr>
<tr>
<td>Coordination strategy of the business units/insurance lines</td>
<td>Management through goals (portfolio management strategy).</td>
<td>Management through goals (portfolio management strategy).</td>
</tr>
<tr>
<td></td>
<td>Limited need for coordination, as the founding insurers were individual companies with own supporting functions.</td>
<td>More resource- and activity-sharing activities have been started (as supporting resources have been centralised) which require an increased amount of coordination.</td>
</tr>
<tr>
<td></td>
<td>No strategy process – only a planning process with action plans.</td>
<td>Although insurance lines and supporting functions were given the task to develop strategies in 2007 based on the corporate goals, still common priorities are missing.</td>
</tr>
<tr>
<td>Valuable resources/capabilities on corporate level</td>
<td>Multiple and inherited at the foundation of the Insurance Group.</td>
<td>Valuable resources are increasingly being discussed. They are however not actively developed further nor explicitly connected to strategic development.</td>
</tr>
<tr>
<td>Market position (generally mapped with business strategy level but was mentioned on the corporate level in the interviews)</td>
<td>State-owned monopoly insurer of the region without a clear market position.</td>
<td>Price competitive regional service insurer (however still not a cost leader due to the large and complex and thereby expensive structure) where service is offered over the sales channels.</td>
</tr>
<tr>
<td></td>
<td>Caretaker of the region.</td>
<td>Image differentiator (trust based on the former regional caretaker position) used in marketing.</td>
</tr>
</tbody>
</table>

The Insurance Group position itself as a service insurer. The image of trusted caretaker is used to differentiate it from the competitors. One board member summarised this as follows: “The insurance companies are not really innovative, nor are they cost leaders, nor do they offer better service than their competitors. Being near our customers [as a regional insurer] and having the image of caring is the competitive strength. The customers
believe they are important to us.” The image, however, is not reinforced by any activities. Instead, operations have been concentrated on cost saving, especially since market growth has slowed after the financial crises. The image is one of the valuable resources that the insurer inherited with its foundation. Due to these resources, it has been and still is well positioned in the market and has great potential to act successfully also in the future. However, utilizing and further developing existing resources should be intensified, according to many interviewees. Nonetheless, these valuable resources have not been further developed since the company’s foundation, except for the extension of market channels.

The strategy aspects on the corporate level are summarised in Table 4.4.

4.2.5 Control on the Corporate Level

This section starts with a description of the control system on the corporate level. Thereafter the planning process and the reporting structure will be discussed, before the section is summarised by mapping the information with the theory aspects identified in the previous chapter.

4.2.5.1 Corporate Control System Characteristics

Corporate level exercises tight financial control of the insurance lines and the regional insurance companies through the annual planning process and monthly reports. The corporate level shows little interest in how business units plan to reach their own goals as long as corporate global goals (as defined in the previous part) are met. This approach to management control is seen as consistent with the regionally oriented business model that highlights the responsibility of the regional Board of Directors.

The management control system is focused on collecting information for corporate management. With growth being the primary goal for so many years, management control is very revenue oriented. Additionally, the corporate goal that costs should increase less than revenue has led to very detailed cost control over the last few years. Since the start of corporate control in 1996 the measurements booked premiums, number of contracts, costs of claims and benefits, lapse rate, headcount, administration costs, acquisition costs, as well as the results from asset under management have been used. In 2004 the sales targets were additionally set per sales channel and controlled for the first time on the group level. The target achievements are presented in a monthly report including some consolidated measurements like claims ratio, combined ratio and lapse ratio. As new measurements have been continually introduced, too much information is available within the corporate control system according to corporate control. However, as a consequence of the financial crises, with increasing pressure to reach
positive underwriting results, the control system has actually been broadened in scope. With the decreasing capital results from investments, more attention is currently paid to underwriting results on the product level. It was previously acceptable for one insurance product to offset the underperformance of another. This is changing. Since 2008 each insurance product is planned, followed up and evaluated individually for the purpose of eliminating products with negative results.

Generally, little attention is given to service production control on the corporate level. The more operational issues are managed and controlled by regional Boards of Directors and the governing boards. The only regular measurement reported to the corporate level is the backlog situation. It is seen as an indicator not only of productivity but also of quality, as a managed backlog ensures short response times for customers. Although other operational measurements are not consolidated on the Group level, projects within operational control are started and conducted at this level. One principal project, managed by Corporate Control, was the cost benchmark project, conducted during 2005/2006. Based on the benchmark results, it was decided on the corporate level that the cost saving potential identified should be reached within four years. The task of devising steps to achieve the potential identified was delegated to the operational level. As a consequence the planned cost levels were reduced without considering the achievement of the identified potential.

In addition to the monetary measurements, customer and sales-channel satisfaction surveys are conducted for the whole group on a regular basis. Even though the surveys are closely connected to the global goal “customer and sales orientation”, they only receive limited top management attention. “The customer and sales channel surveys are taken as information, but not really reflected in the management control”.

In 2007 as well as 2008 there were discussions on integrating these measurements into the management control system, but both times this idea was abandoned. Instead the analysis of the outcome of the surveys was delegated to the insurance lines and to the department management level. Managers at this level are responsible for the development of action plans and the implementation of the actions planned. Fulfilment of these plans is not given the highest priority when resources are needed for other operations. Therefore as stated by a manager in sales and marketing “the results of Customer and Sales Partner Satisfaction Surveys during the years have not shown any development in any specific direction”. Due to this, although the service orientation is slowly increasing, there is still potential for improvement. As pointed out by one marketing manager, “if the

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105 The capital return on investments has traditionally compensated for the small contribution or even the losses from the insurance business. This changed with the financial crisis in 2008, as the investment market became more volatile.

106 The governing boards will be discussed in more detail in “4.2.6.2 Formal Structure”.

107 Stated by a Munich-based board member.
company paid as much attention to the satisfaction survey action plans as it does to cost control, it would be a service leader in the insurance market”.

The Insurance Group, with its target oriented management control, is less centralised than the other insurance companies under public law. Except the corporate control unit, there are two specialised group-wide control units, one for project control and one for asset management control. Aside from the central units there are consolidating control units for each insurance line and for sales. These consolidating control units are responsible for consolidating the information from the regional control entities. The regional control entities have a rather complex coordination structure as they report to all the consolidating control units and need to fulfil the regional requirements as well. This is further discussed in the next part, the corporate control process.

4.2.5.2 Corporate Control Process

The corporate control process was established in 1996/1997. Before that each company had its own control processes. Until 2006 the goals were mainly defined top-down by the corporate board. Since then the goals get defined top-down and confirmed bottom-up. Each year plans for the following three years are developed. The on-going plan is used as a basis for the next year’s planning process after it is verified against market development. In the beginning the business units did not engage in the planning and were not really interested in preparing a bottom-up plan. They just accepted the goals coming from the corporate level without questioning them too much. The engagement has continually been increasing, and with that, the planning has been becoming more stable, with decreasing differences between plan and actual outcome. Most important, according to the corporate CEO is that the planning process has been accepted and achieving targets is taken seriously.

The planning process starts with a kick-off meeting where the top-down goals, derived from the global goals and the market development, are discussed and agreed upon. All the members of the corporate and the regional Boards of Directors attend the kick-off meeting. Targets are defined for revenue, profit and cost ratio on corporate, insurance line and regional company level. No non-monetary targets are included. After the top-down goals are defined, the bottom-up planning starts. The bottom-up plans are more detailed. They are prepared and coordinated among the persons responsible for the insurance lines, claims management, sales channels and the cost centres. Parallel to the monetary plans, actions supporting the target achievement are also identified. The actions can be cost, revenue, headcount, claims and sales oriented. As the actions involve multiple organisational entities and bind resources, corporate control verifies the cost-benefit calculations of the individual actions as of 2008.

Until 2003 all planning parameters like sales, revenue, claims and costs were planned and controlled separately. Starting in 2003 the different plans have been integrated into a profit and loss report on corporate level by
corporate control. In 2005, due to the acquisitions, the controlling and planning process was consolidated on the insurance line level. This means that the plans from all companies within one insurance line are consolidated into one profit and loss statement for the insurance line. Before the plans are presented at the corporate level they are discussed regionally and in the governing boards per insurance line. Due to the iterative process the plans are usually discussed multiple times on different levels before the final approval by the Boards of Directors. Although the targets are mainly set top-down, a great deal of energy is still put into discussing whether the targets are really achievable. The iterations and the multiple levels of coordination and approval take much time and are resource intensive.

During the corporate planning process the project portfolio is also planned for the Insurance Group. The project commission, which was established shortly after foundation, is responsible for the planning and the prioritisation of the projects. The commission, where all the insurance lines are represented, gets a top-down defined budget for all projects. The task of the commission is to allocate the available budget to the most important projects. After the prioritisation is finalised by the project commission, the project portfolio is presented to the Board of Directors for approval.

The achievement of targets is monitored monthly. All the members of all the Boards of Directors receive a monthly report where current values are compared to plan. In this report the premium income, sales performance, claims and benefits, cost, headcount, investment results and project costs as well as the backlog are reported. Target achievement is reported on individual insurance, insurance line and corporate level as of 2005. In 2006 the monthly report was updated with a “traffic light system” symbolising the risk of not being able to achieve the target. In the Munich Board of Directors meetings the monthly reports have been presented and discussed since 2008. During these presentations Corporate Control highlights the most important issues. In case of major deviations the analysis and the development of an action plan is delegated to a responsible board member and discussed at the following board meeting. After the report is discussed at the Board of Directors meeting it is distributed to the main department managers, who are responsible for communicating the results further. However, there is no official process for the communication of the targets and achievements to the employees. Therefore, although the information is supposed to be communicated further, the targets and their achievement are not really transparent to all employees. Occasionally some information is included in employee newsletters or in the seldom-occurring company meetings.

In addition to the monthly reports, the fulfilment of the action plans is controlled on the corporate level as of 2008. Although the implementation of the actions is within the responsibility of the insurance lines or supporting functions, the action plans, from the cost point of view as well as their results, are measured and regularly reported to the corporate level. This reporting ensures that the actions receive more attention and are managed in
a more professional manner. The actions are generally planned once per year. If additional actions are needed during the year these actions are discussed in the governing boards per insurance line. If a budget is available for these actions the governing boards can decide upon the implementation. If no budget is available, there is a need for approval from the regional Board of Directors based on a business case. Due to the stricter planning, there is less available budget for unplanned actions without a dedicated board approval.

Just like the planning, the reporting has become more sophisticated and more emphasised over the years. This is pushed from the corporate side. The preparation of the reports on a monthly basis therefore binds a considerable amount of management capacity. The financial crises have led to increased pressure concerning underwriting results and cost efficiency. Although the pressure has been increasing, the control processes have not been changed, only tightened. A regional board member summarised the change as: “The awareness of keeping the set targets has been increasing. Controlling is therefore getting more attention and the results are discussed more intensively.” Generally, according to the managers interviewed, the Insurance Group has a more complex control structure than the other top ten insurance companies in Germany. The reason is that the insurance lines and the regional insurance companies are given a high level of freedom in conducting their business. This freedom is not only seen as a sign of trust and giving the insurance companies a free hand. It is also viewed as a result of limited coordination of strategic questions on the corporate level. Instead the detailed management control enables the corporate level to get a sense of coordination and control over the units.

During the year the plan achievement is forecasted twice. All the parameters – sales, premiums, claims and costs – are forecasted. Also, the action plans are monitored and updated if necessary. The forecasts are discussed in a similar iterative process as the original plans before the Board of Directors approves them. In the beginning, after the introduction of the planning process in 1996/1997, the plans were not really taken seriously and were more seen as a form of soft direction. This has been changing over the years. Especially since the subprime crisis the pressure to stick to the plan is severe, and a negative forecast is hardly accepted without strong arguments. “There is a pressure to deliver the numbers” among the insurance line managers.

4.2.5.3 Summary of Control on the Corporate Level

Corporate control uses a strict control system that mainly measures revenue and costs. This financial control is used to manage the insurance lines, supporting functions and regional insurance companies. The planning and reporting process is managed by the Corporate Control department and is top-down oriented, with the targets derived from the corporate global goals and market development. Against the centrally set top-down targets, bottom-
up decentralised planning is conducted. Due to the fact that only fixed targets are set from the corporate level without detailed guidelines, the planning process builds on negotiations between the different insurance lines and supporting functions. The aspects discussed concerning corporate control are summarised in Table 4.5.

Additionally to the corporate control system, control and management issues are discussed in the boards and commissions implemented for the coordination of the corporate resources and activities. This type of control will be discussed in the next section.

Table 4.5: The development of the corporate control between 1995 and 2010

<table>
<thead>
<tr>
<th>Aspect of Control System</th>
<th>Insurance Group Around 1995</th>
<th>Insurance Group Towards 2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate control system</td>
<td>Corporate control of business units through financial control.</td>
<td>Corporate control of business units through financial control.</td>
</tr>
<tr>
<td>Corporate performance measurements</td>
<td>Narrow scope of monetary measurements based on internal goals focusing on growth.</td>
<td>Broad scope of monetary measurements based on internal information goals on growth and cost efficiency.</td>
</tr>
<tr>
<td></td>
<td>Although the customer satisfaction surveys were started in 1998 and the sales-partner satisfaction survey in 2000, no actions were derived from them during the first few years.</td>
<td>Customer and sales-partner satisfaction surveys are conducted, but the actions derived from them get limited top management attention.</td>
</tr>
<tr>
<td>Control process characteristics</td>
<td>Tight control with frequent and detailed monitoring of fixed targets.</td>
<td>Tight control, enabling corporate level a control and coordination over the units, with frequent and detailed monitoring of fixed targets.</td>
</tr>
<tr>
<td>Long-term perspective</td>
<td>Tendency towards more short-term orientation.</td>
<td></td>
</tr>
<tr>
<td>Rigid and formal process with top-down targets – with little involvement from the business units.</td>
<td>Rigid and formal process with top-down targets – increasing engagement from business units (since 2006).</td>
<td></td>
</tr>
<tr>
<td>Limited integration and coordination of the different plans and reports.</td>
<td>Increased integration and coordination of the plans and reports (since 2003).</td>
<td></td>
</tr>
<tr>
<td>Diagnostic controls where actual results are compared to plan.</td>
<td>Mainly diagnostic controls where actual reports are compared to plan, but also some interactive control by major deviations.</td>
<td></td>
</tr>
</tbody>
</table>
4.2.6 Group Organisational Structure

In this section the organisational structure of the Insurance Group is presented. The first two parts deal with the corporate organisation by looking into corporate functions and the formal structure used for the coordination of company-wide tasks. Thereafter the informal structure is discussed. The last two parts, before the summary, deal with more operational issues like the role of technology and the work organisation structure in the introduced customer and sales partner service centre.

4.2.6.1 Corporate Functions

In 1995 when the Insurance Group was founded almost no corporate functions were set up. Between 1995 and 1997 the supporting functions like sales support and marketing, human resource management, finance, IT and facility management were reorganised and consolidated into the supporting entities for all Munich-based companies. Since 2006, after the main acquisitions in 2002 and 2004, the aim is that the supporting functions in Munich increasingly take over a service provider function for the regional insurers. “The centralisation of the supporting functions was not just a question of economies of scale but also about gaining more central control” according to the CEO. The level of centralisation of the functions is illustrated in Figure 4.22.

The centralisation is dependent on the IT systems, which were implemented in Berlin 2006/2007 but still not in Saarland\textsuperscript{109}, and it is also dependent on political decisions. Since the acquisition of the companies, multiple projects were started with the goal of identifying functions, which should be centralised on the insurance line and group levels. Due to the different interests within the regions and insurance lines, even the implementation of decisions taken has been rather difficult. However, as a result of the increasing cost pressure, this has been changing. In 2010, for example, the

\textsuperscript{109} The planned migration has been postponed due to other priorities on group level.
majority of the supporting functions in Berlin were consolidated, with the Munich supporting entities in order to gain cost benefits and fulfil the cost targets defined on the corporate level. As the Saarland Insurances fulfil their cost targets they have not yet been fully integrated into the corporate functions. Centralisation is still a trade-off from the regional point of view, however, as the local flexibility becomes limited when synergies are reached on the group level. In order to protect regional flexibility, some regional managers have been compensating the centralisation by building up their own “hidden” support staff – although this offsets the cost-saving goal. There is a paradox concerning the corporate management of the regional insurers as pointed out by a regional board of director: “The Insurance Group uses financial control as a management strategy where they limit the control to financial targets. However, through the migration to the common IT systems and the centralisation of functions the strategic alternatives, which are available for the regional insurers, become limited. With well-functioning service provider processes and the understanding of all players this paradox could be solved. This is an issue that is under development, but as it is a question of cultural change it needs much attention and time before all parties have developed a common understanding.” The coordination of the central entities is fulfilled with the established governing boards and commissions as discussed in the next part.

The centralisation of the supporting functions is seen as only the first step among corporate management. Within the next four to five years multiple members of top management in both Munich and the regions believe there will be group-wide consolidation of functions in treaty and claims administration in order to reach future cost targets. In the long term all functions except local underwriting, sales support, and control units are aimed to be consolidated on the corporate level.

**4.2.6.2 Formal Structure**

The coordination between the entities has been getting increasingly important due to the centralisation of functions and resources. Except for the formal control process, control and management issues are discussed in the boards and commissions set up for coordination of corporate resources and activities. At the end of the period under study, one corporate holding company, one insurance-line holding company, three insurance-line governing boards, and seven supporting commissions were used for group-wide coordination (see Figure 4.23).

The principal institutions, the Life and the Non-Life Insurance Governing Boards, were introduced in 2005. These governing boards are responsible for coordinating business beyond the borders of the autonomous insurance companies and regions. The regional Board of Directors as well as the Corporate (Munich-based) Board of Directors, which are responsible for the specific insurance line, are members of the governing boards. The board members of the supporting divisions also attend the meetings. In these
boards product development, IT development, market campaigns and insurance-line-specific operational issues are discussed, and investments are prioritised. Owing to the dominance of the Munich-based companies, the meetings mainly discuss issues of high importance in Munich. This was commented as follows by a Munich-based board member: “Not all regional requirements are discussed in the governing boards. This would not be possible due to the diversity of the items. It would burst the frames of the meetings.” As the governing boards cannot take any company-overlapping decisions, issues regarding the whole group need to be approved by all regional Boards of Directors. The Health Insurance Holding manages health insurance issues for all regions. However, as supporting functions are not represented in the Health Insurance Holding, a Health Insurance Governing Board was added in 2010 in order to ensure coordination between the health insurance line and the supporting functions.

The Product Board and the Commissions coordinate the operations of the centralised supporting functions. The Project Commission was established shortly after the foundation of the Insurance Group and the Capital Investment Commission in 2003/2004. The others have been implemented during the last few years. The Risk Commission was established in 2007 and the Sales and Marketing Commission in 2008. The Product Board and Commission were introduced in 2010. Like the governing boards, the Product Board and the Commissions are not authorized to take any decisions. The recommendations and prioritisations made by them need to be confirmed by official decisions taken by the regional Boards of Directors.

**Figure 4.23: Boards and commissions coordinating the business beyond the borders of the autonomous insurance companies and regions**
Although the volume of commissions and boards is increasing, they are regarded as very beneficial for the organisation. Their coordination is of major importance, however. Two major challenges concerning the coordination were mentioned in the interviews: one is the absence of alignment of coordinating entities with regional responsibility; the second is coordination among the coordinating committees and boards.

As mentioned in the global goals, the Insurance Group follows a regional business model with regional responsibility for profit, revenue, market development and operations. However, the regional insurances are, as mentioned, dependent on centralised functions. Therefore there is a need to consider the requirements from the regional insurance companies in an appropriate manner. In 2010 one Munich-based manager however still confirmed that “the activities of the centralised functions are still Munich-oriented”. This is due to the fact that the prioritisation of regional requirements is not yet fully regulated. “Given the differences in size, prioritisation cannot be based only on monetary value. There is also a political aspect that needs to be considered. Decisions relating to political aspects are often coordinated outside of the official prioritisation rules of the boards and commissions.”

This limits the coordinating power of the governing boards and the commissions by decreasing the decision transparency.

The second challenge mentioned is coordination among the coordinating entities. One mechanism of coordination is that decisions are not taken by commissions and boards but by the regional Boards of Directors. Additionally, the same persons are members of the three most important commissions and boards: the Product Board, the Governing Boards of the insurance lines and the Sales Commission. Nevertheless, as pointed out by the corporate CEO, “the increasing number of commissions and boards makes coordination a challenge”. Although, the benefits of the boards and commissions are apparent to corporate management at present, at the same time their existence is planned to be evaluated in the future in view of the challenge of coordinating them.

4.2.6.3 Informal Structure

As a group of independent insurance companies were consolidated into the Insurance Group in 1995 all of them had their own sub-cultures and informal structures. Many years after the foundation these remain very obvious. Even an open rivalry between the Munich companies was mentioned in the interviews. This was getting better thanks to new members among the Munich Board of Directors. Also, the normal management and employee rotation has supported the development of a common culture. In spite of the changes, the Insurance Group was still described as a “bundle of entrepreneurs with their own networks, protecting their own areas” by a

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110 Statement from a regional board member.
Munich-based board member. This state of affairs is considered to be strengthened by the fact that the entities are not being formally coordinated towards clearly defined common goals.

In order to understand the culture and the informal structure, there is a need to look at the historical background. The insurers belonging to the Insurance Group used to differentiate themselves from other companies through the discreet and balanced acting based on the state-owned background. Some interviewees even called it conservative and bounded dynamic behaviour. The stability of the company over decades has enabled the building of personal networks among the managers, beyond the formal structure. These networks have been very convenient as they ensured that critical issues were coordinated faster than through the vertical hierarchy. A couple of years ago the aim of the networks changed, as a reaction to the increased cost orientation and the fact that work was getting more performance oriented. The networks still exist but are used in a more political manner. As pointed out by a human resource manager, “the company is in danger of developing into a political organisation, where employees have limited trust in the employer and the formal structure of the organisation”.

This development can also be seen in the communication among managers. In 1995 when the Insurance Group was founded, some structural rules were settled concerning hierarchical levels and reporting structure. All the insurance companies integrated have a flat structure with only three hierarchical levels (Board of Directors, main department managers and department managers). Due to the flattened structure, the management style changed. Before it was less hierarchical and a main department manager could discuss issues with the department managers on the same level. Today there are clearer rules of control and stricter lines between the hierarchical levels. This development was unexpected, as a flat structure was supposed to encourage a more flexible structure.

In general, the informal structure has remained in place over the years; however, it has changed from being beneficial for the coordination and task fulfilment to being more of a political vehicle. Although middle management highlighted this development, it was not seen as a major issue by top management. Before summarising this section two work organisation topics, applicable for all insurance lines will be discussed: the aim of IT investments and the effects of the implemented customer and sales partner service centre.

**4.2.6.4 Aim and Effects of the Technology Investments**

For the last ten years the insurer has been in the middle of replacing the old treaty systems. The life and health insurance systems were migrated in early 2010, and the last retail non-life insurance products were migrated in mid 2010. Additionally, some common systems were introduced to all insurance lines. The goal of the new treaty systems was to be flexible, both concerning automation of operations and implementation of new products. In the
beginning flexibility was more important than productivity. However, during the implementation time the importance of productivity increased. In order to enable a productivity increase, the level of automation needs to be increased. This depends on the product structure. In order to be able to standardise and thereby increase productivity, products need to be simplified. This criterion is not yet fulfilled, however. Although the desired level of automation is not yet reached, both coordination needs and operations have already changed due to the IT implementation. The following general developments were mentioned:

- The employees require less expertise as know-how has been integrated into the systems. Before the treaty/claims administrator needed to look into different guidelines, draw his/her own conclusions and then document the decision in the system. Now the data just needs to be typed in, and the system draws the conclusion and suggests a decision. The employee does not need to and is actually not even entitled to draw her/his own conclusions anymore. The treaty administration can therefore to a high degree be performed by less skilled employees or even directly at the point of sales.

- The decision to develop some common systems for all the insurance lines has increased coordination workload, as the structure has not been changed accordingly. Neither an insurance line nor a regional insurer can any longer decide any changes alone but needs to get an agreement from all involved parties. This is very time consuming.

The clear goal is to increase automation and thereby productivity. When the level of automation increases fewer employees will be needed. Handling this is expected to be a challenge, especially as the employees regard their workplaces to be secure due to the long stable history of the Insurance Group. However, the secure role of the employer has already been challenged, when the customer and sales partner service centre was introduced.

4.2.6.5 Customer and Sales Partner Service Centre

The insurance corporation decided in 2004 to re-organise service production by providing a customer and sales partner service centre for all insurance lines. The aim was to establish a centre with highly competent staff offering personal contact with customers and sales partners. Implementation of the centre was intended to support the global goal of customer and sales-channel orientation. Generally the intention was to increase quality of service and at the same time to decrease costs. Short turn-around times, high capacity utilisation and competence-based routing of incoming calls and

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111 Although the name indicates that only one service centre was established, nearly all service production functions were re-organised into service centres. Only some special underwriting entities were not integrated into the service centre model.
paper transactions were expected to increase productivity and thereby improve the cost situation. The basic idea of the concept was that production processes should be organised similarly in all insurance lines, thus facilitating a region-wide customer view. Additionally, the service production of the different insurance lines should be comparable through the use of common transparent measurements. All service centre employees should be able to handle and fulfil a wide range of requests, and customers and sales partners should be guaranteed a high level of accessibility. This would lead to prompt answers to enquiries that would strengthen the competitive position of the insurer.

In June 2008 the customer and sales partner service centre was launched. It was a major reorganisation of service production. Previously service production employees were highly specialised, and could generally administer contracts for only one type of insurance, or sometimes even just for special types of transactions within one type of insurance. In the preparations the plan was to ensure that every employee would be assigned a position appropriate to her/his know-how and wishes. In the end, however, employees could only choose whether they preferred to work in a telephone or correspondence entity. The employees of the telephone entities received training on all products offered as well as telephone training, whereas the correspondence entities received only limited training, if any. Employees with experience from different types of insurance were seated in groups. The idea was that they could learn from each other and thereby broaden their skills. As one aim was to decrease costs through increased productivity, manpower had already been reduced when the centre began to operate. This, combined with the low level of skills and the on-going training, had major effects on service levels in the beginning. Because of backlog problems, it was decided to suspend the training, leaving employees to administer the types of requests with which they were already familiar. Additionally, the fact that the different types of insurance are managed in different systems makes all-round administration difficult. The planned development of a common front-end tool was postponed in order to save on costs. With the limited technical support, the work is very stressful, especially in the phone entities, as employees need to switch between systems in order to obtain an overview of the customers’ transactions.

Morale among employees at the customer and sales partner service centre was low from the very beginning. Employees are required to work in open-plan offices, and their working hours are not as flexible as they used to be. Employees feel that they do not have any privacy and are subjected to increasing external pressure to perform as their work is automatically routed

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112 The service level agreements are the same for all entities of the customer and sales channel service centre: 90% accessibility for sales partners and 80% for customers in the telephone entities. In correspondence a response to a new application should be returned within 3 days and for modification transactions within 8 days.
to their individual electronic in-boxes. They feel unable to influence their situation because of the high level of formalisation and standardisation. Moreover, they find that their whole job situation is moving towards industrial-type production. Although the insurer introduced a change management programme to smooth the introduction of these changes, turnover rates remain high.

Two years after introduction, the specified productivity-based service levels were reached. The quality problems remain, however, as a result of the high turnover rates at the service centre and the postponed implementation of the new systems. When the service centre was introduced, a high level of service was promised to the sales channels. This raised expectations that are still only partially being met. Therefore, the introduction of the service centre has not improved the quality of service. In the sales partner satisfaction survey of 2009 30% of all sales partners answered that they were dissatisfied. The customer and sales partner service centre was given a particularly negative rating. The criticism was directed primarily at the quality of information and the long response times. Although accessibility has been improving, sales partners do not rate it as an element of service quality. The content and quality of the answers received was not considered satisfactory. It was pointed out that when a sales partner calls multiple times she/he gets differing answers.

Top management has been acknowledging the importance of stabilising service production and increasing the quality of the service offered. Production was stabilised by assigning overtime and extra resources to the customer and sales partner service centres. More long-term actions have been initiated, such as qualification and training, enhanced operating control including load balancing and transparency, communication with sales channels and steps to improve employee motivation. The first turbulent months of the service centre showed that a service-oriented production model can only be combined with a productivity increase if the employees receive an adequate level of training and if the necessary IT-based tools are in place.

Although it took two years to reach the first level of stability, all parties at the top management level are convinced that the customer and sales partner service centre is the right model for service production. With the common measurements the performance is transparent. Due to the better-organised production the service production model has already achieved increased productivity (as illustrated in Figure 4.24 the productivity increased considerably since the introduction in 2008) and accessibility as well as

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113 The transactions are routed to employees based on these service level agreements. The arrangement is a kind of FIFO (first-in first-out), though also dependent on the application’s deadline flag. Department managers can overrule this routing for special types of transactions or even for a specific transaction request. The service production employees themselves, however, are supposed to handle transactions in the order in which they are routed to their mailboxes.
shorter processing times. According to a responsible board member the next step is “to control costs more strictly and to improve the efficiency of service production”, although the managers responsible for the service production highlighted the need to invest in increasing the quality. “Nowadays we only talk about lowering the costs, although the main goal at the beginning of the customer service centre project was to increase the quality.”

![Graph: Productivity per employee in the Insurance Group based on premium per employee](image)

### 4.2.6.6 Summary of the Corporate Structure

The organisational structure of the Insurance Group has been becoming more complex over the years due to coordination of the acquisitions and the centralisation of resources. Boards and commissions have been established to coordinate the activities of the increasingly centralised functions. The current challenge is to coordinate the coordinating entities and to prioritise the demands of the different regions. Although operational issues are discussed and agreed upon by the boards and commissions, decisions are taken centrally by the regional Boards of Directors. This leads to vertical coordination rather than the desired horizontal coordination intended when the multiple boards were set up.

**Table 4.6: Aspects of organisation structure mapped to corporate and business strategy**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate functions</td>
<td>None or very limited</td>
<td>Increasing centralisation of</td>
</tr>
<tr>
<td></td>
<td>(centralised in a region),</td>
<td>functions and common resources for all regions since 2006.</td>
</tr>
<tr>
<td></td>
<td>as the companies integrated into the Insurance Group had their own resources.</td>
<td></td>
</tr>
</tbody>
</table>

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114 Statement of a mid-level manager of a supporting entity.
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Centralised experts and standards</td>
<td>Decentral expert functions lead to limited level of standardisation.</td>
<td>Development towards standardisation over centralised expert functions since 2009.</td>
</tr>
<tr>
<td>Decision making</td>
<td>Decentralised power and limited coordination.</td>
<td>Centralised power and vertical coordination, as the conclusions drawn in commissions and boards need to be approved by the Boards of Directors.</td>
</tr>
<tr>
<td>Integration / Coordination</td>
<td>No formal coordination until the establishment of the governing boards in 2005.</td>
<td>High coordination requirements due to centralised resources has been solved by introducing multiple commissions and governing boards with the challenge of coordinating these coordinating entities.</td>
</tr>
<tr>
<td>Informal structure</td>
<td>Strong coordinative informal networks.</td>
<td>Strong informal networks increasingly used for internal politics and protection of own interest areas.</td>
</tr>
<tr>
<td>Aims of technology</td>
<td>Document the decision taken.</td>
<td>Increase productivity through standardisation and automation.</td>
</tr>
<tr>
<td>Work organisation within service production</td>
<td>Within their area of expertise, service employees have a high level of functional power to take decisions concerning customer issues and their own work processes.</td>
<td>Since 2008: The extent of functional power is strictly limited. Employees feel viewed only as production resources without flexibility to react to individual customer needs.</td>
</tr>
<tr>
<td></td>
<td>Low level of formalisation, including flexible work conditions with less transparency of outcome.</td>
<td>Since 2008: High level of formalisation with strictly organised work hours and work processes in a transparent work environment.</td>
</tr>
<tr>
<td></td>
<td>Service production employees are experts within a limited area.</td>
<td>Since 2008: Aim for production employees to have broad know-how enabling them to take care of multiple tasks. Work is however still routed to employees based on their existing knowledge profiles.</td>
</tr>
<tr>
<td></td>
<td>Caretaker role (quality) is given priority in service production.</td>
<td>Productivity control is given priority in service production.</td>
</tr>
</tbody>
</table>

Although the corporation is stressing employee and organisational development, the rigid and hierarchical management culture based on command and control still dominates among the managers. The informal
structures that have always existed have started to be used in a more political manner protecting the status quo, rather than to clarify tasks in an informal and fast way.

Developments in work organisation and IT on the corporate level support standardisation, and automation and productivity are increasing. This could also be observed as a result of the introduction of the customer and sales partner service centre.

The aspects discussed concerning organisational structure are summarised in Table 4.6.

### 4.2.7 Summary of the Insurance Group Level

The Insurance Group has been involved in a more or less continuous change process since 1995. Looking at the on-going internal activities as well as the development of the external environment the changes probably are going to continue the next few years.

Although multiple boards and commissions have been founded and strategies based on global goals have been created, the activities are still managed through centralised decisions taken by the Board of Directors. From the corporate point of view the activities are thereby integrated and coordinated, although problematic issues were highlighted in some interviews. In the next sub-chapters insurance-line- oriented views will be presented.

### 4.3 The Life Insurance Line

In this sub-chapter the life insurance line of the Insurance Group studied is presented. This sub-chapter is based on information received from the case study company. The information received in the interviews is complemented with public and internal documents.\(^\text{115}\)

Life insurance companies are situated in all regions, as illustrated in Figure 4.25. All the regional life insurance companies offer private life insurance as well as occupational pension solutions. Additionally, a sales organisation for occupational pension solutions (PMG) was founded in 2002. Except the regional business, Bavarian Life Insurance is acting as a nationwide provider for occupational pension solutions for all public insurance companies, and also conducts cross-border sales of annuity life insurance in Iceland. The timeline of the integration of the different life insurance companies is also illustrated in Figure 4.25.

\(^{115}\) The internal references per section are listed in Appendix C.2.
As illustrated in Figure 4.26 Bavarian Life Insurance, with 90% of the booked premiums in 2010 dominates the life insurance business within the Insurance Group. Their part of the annual premium was even slightly higher in 2004, directly after the integration of Berlin-Brandenburg Life Insurance. Until the merger with the Insurance Group life insurance was not seen as an important business area in Berlin-Brandenburg. Since the merger in 2004 the life insurance in Berlin-Brandenburg has increased their life premium income by over 150%.

Figure 4.25: The German life insurance entities within the Insurance Group and the timeline of their integration

Figure 4.26: Share of annual premium of the life insurers belonging to the Insurance Group
Life insurance is the insurance line with the highest amount of premium income in the Insurance Group. However, looking at the profit before consolidation and taxes, life insurance, together with health insurance, contributes far less than non-life insurance does. Before looking that the market position of the life insurance market the case company’s interpretation of the life insurance market will be presented.

4.3.1 The Insurance Group’s Interpretation of the Life Insurance Market

The aim of this section is to highlight the most important changes from the case company’s point of view, not to give an objective picture of market developments.

Life insurance is still seen as a growth market mainly due to the changes in the state-owned retirement system. Especially the state subsidised life insurance products are booming. However, due to their low savings amount, there is a need to increase the efficiency in the administration of these products in order to be able to keep a low cost ratio. Additionally the occupational pension offerings are increasingly important as they are connected to tax incentives and as every employee is entitled to an occupational pension offering as of 2004.

Due to the new pension reform in 2004, the life insurance industry changed character. Life insurance has since then developed away from the capital-market-based endowment product to an annuity insurance offering a monthly lifelong pension. The Insurance Group faced some problems due to the decrease in the endowment products, as the Savings Banks, as the main sales channel, mainly sold endowment products up to then.

Since 2005 the market has been changing towards single premium payments. As the single payments business needs to be won each year, it makes the annual premium volume more volatile. The single premium payments are very important for the life insurance companies, however, as they have been ensuring a good growth rate during the last years. Also due to the subprime crisis the single payment business within life insurance has been increasing. In low interest times the insurance industry can offer the clients better conditions than other investments due to the long lifetime of the total portfolio. In order to stabilise the business and to limit the short-term interest hunters the life insurance market is regulating short-term policies.

There are some substitute products available, like funds offering more flexible and more individual solutions, which are threatening the market share of life insurance solutions. However, after the financial crisis in 2008 the fund-based market has been decreasing. Additionally, life insurance products offer an insurance against longevity and offers guaranteed outcomes that are advantageous compared to funds.
Overall, the life-insurance market is getting more turbulent due to the changing legal and tax regulations. Additionally, the customers are better informed; they read more and follow the ratings more thoroughly. The life insurance line has some difficulty achieving high ratings in some of the comparisons due to its conservative long-term asset management policy. This has been changing with the latest subprime crisis. The customers have been attracted by safety again since 2008. This has been beneficial for the life-insurance market, and to the Insurance Group studied, as they offer a stable, continuous growth of capital. In the next section, the changing market position of the life insurance line on the Germany life insurance market during the study’s timeframe will be discussed.

4.3.2 Position in the Life Insurance Market

The German market was well protected until deregulation in 1994. As the life insurance companies belonging to the Insurance Group were founded as early as 1922, 1947 and 1951, they have benefitted from the protected era. The Insurance Group has an average position on the life insurance market, altering between ninth and tenth place among some 100 life insurers in Germany during the study time frame, with a market share of between 2.5% and 3.4%. In the region of Bavaria-Palatinate, the insurer has the second largest regional market share, at over 11%. In the other regions the market share is lower. Saarland Life Insurance has a market share of approximately 10% whereas Berlin-Brandenburg has only a very limited market share of approximately 3%. Between 1995 and 2010 the life insurance part of the Insurance Group grew over 157% whereas the German market during the same time frame grew by 100%. The premium income developments and the market share of the life insurance part are illustrated in Figure 4.27.

![Figure 4.27: Life Insurance premium and market share development](image-url)
Comparing the growth ratio among the three life insurance companies since 2004, the growth rate in Berlin-Brandenburg exceeded that of the other two regions (except for 2009 due to a special effect of exceptionally high cancellation). However, Saarland Life Insurance has also exceeded market growth since the integration into the Insurance Group. Whereas the other regions have been exceeding market growth with a good margin, Bavarian Life has only exceeded market growth by three percentage points during the same time frame with the exception of 2009 and 2010. The growth rates between 2004 and 2010 are illustrated in Figure 4.28.

![Graph showing growth rate comparison](image)

*Figure 4.28: Life Insurance premium growth compared to total German life insurance growth*

The growth exceeding market average during the last year is mainly due to a very high share of single premium sales (as illustrated in Figure 4.29). Since 2005 the single premium share of new business is 15–20% higher than market average. This is due to the fact that the bank sales channel feels comfortable selling these products. As the single premium sales need to be won on a yearly basis the high share leads to very volatile premium growth. Additionally, as the single payment products are partly used as short-term investments, the cancellation rate is expected to increase when the market recovers from the financial crisis and offers higher yields elsewhere. In order to limit this volatility the Insurance Group in mid 2010 decided to limit their short-term single premium portfolio and only to offer solutions with a minimum duration of five years.
Comparing the cost position with the German life insurance market, it can be concluded that the administration cost ratio\textsuperscript{116} and the acquisition cost ratio\textsuperscript{117} have been below the market average during the studied time frame (illustrated in Figure 4.30).

\textsuperscript{116} The administration cost ratio is the percentage of expenses for management of the insurance portfolio to the premiums written.  
\textsuperscript{117} The acquisition cost ratio for new business includes the expenses for acquiring new insurance contracts and places them in relation to the total premiums paid from new policies.
Although there is a big interval between Bavarian Life Insurance and the other regional life insurers, all companies within the Insurance Group can show an administration cost rate below the German market average, as illustrated in Figure 4.31 (left). Insurance companies need to inform their customers about their acquisition cost rate as of 2008. It is an advantage if the rate is far below market level, like at Bavarian Life. Also the acquisitions cost rates for both Saarland Life Insurance and Berlin-Brandenburg Life Insurance have been decreasing and have been below the German life insurance average the last few years (right-hand side of Figure 4.31).

The lapse ratio\(^{119}\) is also an important indication of the position of a life insurer. As illustrated in Figure 4.32 (left-hand side), the Insurance Group had a very much lower lapse rate than the market average until 2009. This is seen as a measurement of the sales consultation quality. A low lapse rate shows that the customers are offered solutions fitting their needs. The last two years the market average has been decreasing and thereby reached the Insurance Group average.

The last component influencing the profit of a life insurance company is the capital return on investments. Generally, capital return on investments has been more important than the cost ratio in life insurance. The Insurance Group has followed a conservative investment strategy, which has enabled the group to reach a market-level interest rate on investments as illustrated in Figure 4.32 (right). Although following the market standard, there is a risk of

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\(^{118}\) The low acquisition cost rate in Berlin-Brandenburg in 2008 was due to a special effect with cancelled contracts.  
\(^{119}\) The lapse ratio refers to premature contract cancellation as a percentage of the average annual portfolio.
not reaching the minimum guaranteed yields in life insurance due to the difficult investment premises, as the average yield has been decreasing from around 7% to 4%.

**Figure 4.32:** Comparison of the lapse rate of Insurance Group (left) as well as a comparison of the interest on investments with the average German life insurance market (right)

Now after looking at the parts that influence the profit of an insurance company, it is time to compare the underwriting results of the individual life insurance companies in the Insurance Group. This is illustrated in Figure 4.33. Apart from the special capital reserve effects of 2008 at Berlin-Brandenburg Life Insurance all companies shows an underwriting contribution. This is especially important during times of low yield.

**Figure 4.33:** Comparison of the underwriting profitability between the life insurance companies within the Insurance Group
The life insurance line, as all the other insurance lines, participates in a customer satisfaction survey on a regular basis. As illustrated in Figure 4.34 (left-hand side) for many years the life insurance line was rated much lower than German insurance market and the overall Insurance Group. Since 2005 the life insurance line has been catching up with the group average and since 2007 with the market average. However in 2009 the satisfaction index decreased again. The reason for the decrease in 2009 was the service, which was rated lower again after receiving a higher rating in 2007 (as illustrated in Figure 4.34 right side). The customers of the life insurance companies especially find the treaty administration service unsatisfactory.

Generally, the life insurance companies are doing better than the market concerning growth and cost ratios. The volatility of the premiums due to the high amount of single payments is a threat to long-term stable growth. The low customer satisfaction rate for life insurance, although it has been improving, could develop into an additional long-term threat. Before looking into how the life insurance companies deal with these challenges, life insurance specifics within sales-channels, customer structure and products are presented.

![Figure 4.34: Life insurance overall customer satisfaction rate development (left) and treaty administration satisfaction rate (right) compared German Insurance Market and the Insurance Group customer satisfaction rates (% of customers who are satisfied or very satisfied with service and offerings)](image)

### 4.3.2.1 Sales-Channels of the Life Insurance Line

Banks and brokers are becoming increasingly important as sales channels in life insurance in Germany. As mentioned on the corporate level, the Insurance Group, especially in life insurance, is well represented in bank sales, especially in Bavaria, Palatinate and Saarland. In Berlin-Brandenburg cooperation is currently being strengthened. The Savings Banks are traditionally strong in selling capital-based endowment products and new
single payment life insurance solutions due to their investment orientation. However, they are not as strong in selling annuity insurance solutions, which, due to state substitutions, are gaining in importance.

The Insurance Group has not yet established insurance brokers as a major sales channel in life insurance. Insurance brokers have gained importance in the German life insurance market, however. The Insurance Group therefore needs to strengthen the broker sales channel in the future in order to take advantage of this growth potential. This is a challenge due to the regional business model, as brokers seldom limit their business to a region. Additionally, the insurer does not pay as high a commission as expected by brokers. Generally the insurer is interested in ensuring that the ratio among the sales channels is well balanced. This is not the case in life insurance, where the Savings Banks are dominating, bringing in more than two thirds of the total new life insurance business.

4.3.2.2 Customer Structure of the Life Insurance Line
The Insurance Group in its main region Bavaria-Palatinate has a high share of well-earning clientele. They have especially identified wealthy 50/55-plus inhabitants as an important target group in life insurance. This clientele uses the single-payment model as a tax-planning instrument. This is one reason for the high share in this business in the region of Bavaria-Palatinate. In the other regions the clientele looks different. Especially in Berlin-Brandenburg the customer structure is socially weak with a high immigrant background and many state employees. This is especially apparent in life insurance. The Berlin-Brandenburg Life Insurance has the lowest monthly premiums in Germany. Saarland Life Insurance, like Bavaria-Palatinate, has elderly customers. This is connected to the fact that Saarland Life Insurance employed sales agents are of the same age as their elderly clients. Although the elderly clients, especially the wealthy 55–65-year olds, are interesting as a customer group in life insurance, Saarland Life Insurance tries also to reach younger clients via the Savings Bank sales channel. As the Saving Bank customers are generally very loyal, the goal is to bind the young customers in an early stage and then to accompany them over their lifetime. In order to do this, the product portfolio also needs to offer appropriate solutions over the lifetime of the clients.

4.3.2.3 Life Insurance Products and their Development
Although life-insurance product development has been changing, the products are standardised to a high degree. After deregulation, the Insurance Group, as well as the market, has grown more innovative, introducing more innovative products within a shorter timeframe. New products are introduced on a yearly basis. The product changes are often driven by legal changes. Much product and system development capacity needs to be allocated to product alterations due to legal changes. During the last years the Insurance Group has therefore been able to invest only very limited capacities in “real”
innovation. Although offering a wide product range, the life insurers in the Insurance Group do not see themselves as innovative. The product development rather follows a competitor-oriented “me-too” strategy. This lack of innovation is not believed to be a problem, as market share is not believed to be won by innovative products but by trust.

Product development was centralised during the study time frame (starting in 2006). However, the regions have some special regional demands. The fulfilment of these regional demands is very important for the regional insurers, as their competitive advantage is to be and act as a local service provider. A step towards ensuring this is the new product development process introduced in 2010, which was discussed in “4.2.3.3. Insurance Products and their Development”. New products can be introduced within three–six months when everything is running smoothly. This is within the market’s average introduction time. However, as pointed out by some interviewees, things are not always running smoothly. In these cases the introduction of a new product can take up to one year.

4.3.2.4 Summary of the Life Insurance Market Position

The life insurance line within the Insurance Group has an average position on the life insurance market. The life insurance part has been exceeding average market growth, lately due to the high share of single premium payment sales. This makes premium growth volatile. This, together with dominance of the Savings Bank sales channel, the elderly customer groups and the standardised products, makes the future challenging for the life insurance line. The aspects discussed in this section are summarised in Table 4.7.

*Table 4.7: Life insurance market development*

<table>
<thead>
<tr>
<th>Aspect of Market</th>
<th>Life Insurance Line Around 1995</th>
<th>Life Insurance Line Towards 2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost situation</td>
<td>Cost gained limited interest due to high capital return on investments.</td>
<td>High emphasis on increasing efficiency and decreasing cost rates due to ratings and low capital return on investments.</td>
</tr>
<tr>
<td>Product</td>
<td>Market based on products ensuring a long-term stable return.</td>
<td>High-yield volatile products gained in importance (at least until the financial crisis in 2008); this led to increased competition from substitute investment products.</td>
</tr>
<tr>
<td>Regulation</td>
<td>Stable legal and tax regulations.</td>
<td>Changing legal and tax regulations.</td>
</tr>
<tr>
<td>Aspect of Market</td>
<td>Life Insurance Line Around 1995</td>
<td>Life Insurance Line Towards 2010</td>
</tr>
<tr>
<td>------------------</td>
<td>---------------------------------</td>
<td>---------------------------------</td>
</tr>
<tr>
<td>Predictability</td>
<td>High predictability.</td>
<td>Due to more turbulent market decreasing predictability.</td>
</tr>
</tbody>
</table>

### Financial/Quantitative performance of the life insurance line

| Profitability of life insurance business | Higher than market due to much lower acquisition and administration costs. | Higher than market, due to lower cost level, although market is catching up. |
| Capital return on investments | Slightly lower than average market level (around 7%). | Average market level (which has been decreasing to 4%). |
| Market share | 2.6% | Has been increasing to 3.4% in 2010, however mainly due to increasing sales within short-term single premium products. |

### Non-financial/Qualitative performance of the life insurance line

| Customer satisfaction | Although the lapse rate is lower than market (symbolises that the customers are offered adequate solutions) the customer satisfaction index is far below average German insurance market index. | Lapse rate is around the decreased market average. At the same time the customer satisfaction index has constantly been improving since 1998. Market average was reached in 2007 (average market ratio decreased at the same time). In treaty administration a satisfaction ratio above the German average was reached in 2007, which decreased again in 2009. |

4.3.3 **Strategy of the Life Insurance Line**

In this section the life insurance strategy within the Insurance Group is presented. The presentation will start with the business strategy of the life insurance line. Thereafter the service production strategy will be presented. The section will be summarised using the strategy aspects identified in the theory chapter.

4.3.3.1 **Business Strategy of the Life Insurance Line**

The group level competitive strengths of image and brand as well as the strong sales channels are very valuable to the life insurance line. Especially the corporate image and the trusted brand are important for the life insurance line. It enables the life insurers a rare and non-imitable position. This position has been increasing in importance since the subprime crisis due to the increased trust in both the Insurance Group and in the Savings Banks. The strategy of life insurance is based on the corporate global goals and the Insurance Group market position. The group positions itself as a service insurer, and so does the life insurance line. Service is, in the life insurance line, defined as being accessible and providing good customer care. However, this customer care is not provided by the insurer itself, but by the
sales channels. In other words, the life insurance line needs to ensure that the sales channels are able to provide this service to its customers. During the interviews the service offered to the sales channels and their needs were discussed. Many of the managers involved in operations thought that the level of commission paid is the main or even the only criterion for the sales channels. Few managers reflected how the service provided was influencing the sales channels satisfaction ratings.

Although the different insurance lines do not position themselves individually on the market, the Munich-based life insurance division in 2006/7, as a part of the corporate strategy process, actively discussed their market positioning and strategy. The conclusion from the discussion was that the awareness of the life insurance solutions needed to be increased through marketing and press. The increased awareness is not just targeted towards end consumers but also the sales channels. One very important vehicle to ensure awareness on the market is to handle the ratings in a professional manner. For the ratings the interest rate offered to the customers (which is based on the achieved capital return on investments) and the cost ratio are important. As the investments are handled on the corporate level, the life insurance line can only influence the cost ratio. Its goal was to lower the administration cost ratio to 1.6% (the Bavarian life insurer reached this in 2010). Each regional life insurance company within the Insurance Group develops their own positioning strategy based on the global goals and the regional market situation. Although the positioning is a regional responsibility, there is a common basis, due to the consolidation of supporting functions like product development and IT support.

Life insurance like all other insurance lines within the Insurance Group has as a target that its growth should exceed the market level. Some managers questioned the comparison with the overall market. They pointed out that a more peer-group-oriented comparison would be more meaningful. This would sort out companies who have been losing market share constantly since 1995, and it would make the goal more challenging. However, during the time frame studied, the insurance line had to fight during some years to even keep up with the average market growth. This was mainly due to the product shift from endowment to annuity products. In order to reach the growth goals during these years, some investment-oriented products, with very narrow profit spans, were offered as single-payment transactions. Additionally, especially in the region of Berlin/Brandenburg, growth was strengthened through widening the sales channels.

Until the introduction of the corporate strategy process in 2007, where all the insurance lines were requested to develop their business strategy, the market position of the life insurance line was hardly discussed. Annual strategy meetings were held before as well, but they were more connected to the annual planning process and how to fulfil the corporate top-down targets.
4.3.3.2 Production Strategy of the Life Insurance Line

Until 2006/2007 service production was organised after the sales channels. This led to non-standardised sales-channel-specific processes with a high level of flexibility. The service production employees could make own decisions within set frames with the aim of supporting the sales channel. However, as mentioned in the business strategy, the life insurance in Munich 2006/7 formulated the goal to lower the administration cost ratio to a level substantially below the market average. Therefore the service production units were organised with the aim of supporting efficient administration. Product development had the goal of developing standardised products that can easily be administered, or even better, to develop products for which the administration can be automated. With this change, life insurance service production in Munich became more equipment focused, with the expertise implemented into the systems. Sales channels were enabled to get information directly from the systems and to enter new customer applications directly into them, where the processing in most cases is automated. Only special cases still require a manual risk assessment.

Until 2008 treaty administrators had contact with both end customers and sales intermediaries. The contact paths were kept rather short, and a fast medium like telephone is preferred. With the implementation of the customer and sales partner service centre in Munich in 2008, service production was divided between front-end administration taking care of the standardised requests and back-end administration taking care of the complex requests. The transparent service production introduced was seen to support the goal of achieving a low administration costs ratio.

Service production is slightly differently positioned in Berlin, as they do not have the same service structure, although they do use the same treaty system. In Berlin the goal is to increase the service to the sales channels by ensuring “transparent operations”. This means that it must be transparent to everybody who does what, also to the sales partners. Unlike in Munich, paper-based contacts are preferred instead of telephone as it enables the balancing of workload.

Saarland Life Insurance, like Berlin-Brandenburg, encourages intensive contacts between sales channels and service production employees. This requires flexibility and broad skills among the service employees. To increase the number of cross-trained employees is therefore a goal in service production. In order to increase efficiency at the same time, longer customers contacts are not desirable. Automation is also implemented in order to increase productivity (the main part of the applications are handled automatically). A sales tool in Saarland also enables the sales channels to make some changes to existing treaties. The sales person can see all details concerning their own intermediated policies and high-level information about additional contracts of the customer.

During the business strategy development process, service was defined as being accessible and providing good customer service. However, in service
production this was not highlighted. No overall service production strategy process exists. Instead single issues are analysed and solved by inter-functional task forces or projects, almost always with the aim of increasing the efficiency and productivity in service production. An exception is encouraging direct contact between the service employees and the sales channels in Berlin and in Saarland. This aimed to increase the level of service rather than efficiency. Also, due to the limited size of these insurers, they both pursued the aim of decreasing the vulnerability by cross-training employees.

### 4.3.3.3 Summary of the Life Insurance Line Strategy

The life insurance strategy follows the corporate global goals and the group positioning as service insurance. The life insurance line benefits from the competitive strengths that exist on the group level. No specific market advantages were mentioned coming from life insurance side. Service production is oriented towards productivity and efficiency. The level of automation and standardisation has been increasing. This fits well with the cost level reduction goal, but is not optimal for the overall positioning as a service insurer.

<table>
<thead>
<tr>
<th>Table 4.8: Strategic aspects of life insurance and production strategy</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Aspect of Strategy</strong></td>
</tr>
<tr>
<td>Goals of the life insurance line</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Competitive market position of the life insurance line</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Valuable resources/capabilities in life insurance</td>
</tr>
<tr>
<td>Production strategy / Characteristics of the production</td>
</tr>
</tbody>
</table>
Following the corporate strategy process, a business strategy for life insurance was developed. However, the service production part was not included. The aspects of business and service production strategy in life insurance lines are summarised in Table 4.8.

4.3.4 Control in the Life Insurance Line

In this section the control processes and systems used in the life insurance line are presented. The mechanisms already described from the corporate control point of view will be complemented with the life insurance perspective. In the first section the management and the production control implemented in life insurance lines are described. Thereafter the planning process and the reporting structure will be discussed before the section is summarised.

4.3.4.1 Management and Production Control in the Life Insurance Line

Management control in the life insurance line follows the corporate management control. The measurements reported to Corporate Control are also used in life insurance. In life insurance, additionally, the sales performance and development are followed up and managed. This includes revenue from new business but also cancelled business per sales channel and product or product line. Product control has also been enhanced in life insurance in order to ensure transparency concerning the contribution from each product. To control product profitability in life insurance is difficult, however, due to the longevity of the products. Product profitability changes over time, depending on the average age of the insured persons and capital market developments. However, as product control is aligned to product ratings, it is gaining in importance. As a result of the increasing volume of short-term single premium business, liquidity planning has also been
introduced in the life insurance management control system. Management control has been becoming more complex due to the financial crises, especially after the subprime crisis in 2008 and due to the implementation of the mandatory risk-management processes. Risk management has been receiving even more attention since 2008 due to volatile capital market developments.

Since 2006 there has been plans to develop life insurance management control further by implementing a balanced scorecard. The idea was to integrate more non-monetary measurements into management control. Due to other priorities, the implementation has not been finalised. However, some non-financial aspects have been introduced in 2007, like risk assessment as well as the follow-up of action fields set up for the annual plan and the implementation of the life insurance strategy.

During the interviews it turned out that management and production control are strongly interconnected for the insurance line level, as insurance line management was deeply involved in both. In production control some group level guidelines are also followed by life insurance. Backlog, for example, is measured and reported to the corporate level. Other measurements, like development of over-time, accessibility via the telephone, amount of incoming post, transaction processing time, the oldest open treaty transaction as well as the error rate based on manual ad hoc check-points follow corporate guidelines but are not reported regularly to the corporate level. The corporate guidelines define the frames for the production control targets. However, the real targets are set by regional management, taking into consideration local conditions and the requirements from the regional sales channels.

The main measurement for life insurance production is productivity, measured as number of treaties administered per employee and day. Although productivity was seen as the main measurement in production control, for many years no target was set for it in life insurance operations. Moreover, productivity was only indirectly measured by calculating incoming requests and backlog. Some main department managers complained that these measurements were inaccurate. They even argued that they trusted their experience more than the measurements when managing the production entities. Aligned with the introduction of the customer and sales partner service centre in 2008, a standardised production control was introduced. The agreed service level agreements: transaction processing time and telephone accessibility are measured. Both measurements are oriented towards productivity. Although quality is measured by additional measurements like the oldest open transaction and spot tests of the outgoing mail, the quality measurements are still under development. The service quality is indirectly measured via the customer and sales-channel satisfaction surveys conducted on the group level. The results from the surveys are not compared to any specific quality targets, however, and are more used as general input for quality improvements.
As capacity is the basis for both productivity and service quality, capacity planning and adjustment is a main mechanism in production control. Life insurance plans their capacity somewhere between peak and average. Life-insurance business is highly seasonal, with a peak at the end of the year. Although the annual demand cycle is well known, the calm periods are not managed in an adequate manner. During the calm periods the over-time hours could be reduced even further and training could be conducted. This does not happen, however. Instead, there is a general belief among the managers that the employees are entitled to have some calm periods between the peaks. Capacity is managed by monitoring the weekly backlog statistics. When a certain limit is reached, the situation is analysed. It is determined whether the backlog is due to an extraordinarily high rate of absence among the employees or if there is a real capacity problem. Changes in capacity are managed by using the flexible work-hour regulation that was implemented in 1998 for the whole Insurance Group. If the internal work-hour regulation including Saturday work is not sufficient, temporary staff is engaged. A permanent capacity increase beyond plan needs to be approved by the Board of Directors. Due to the cost saving initiative it is seldom approved, instead the level of automation is expected to resolve the capacity issues in the long run.

4.3.4.2 Planning and Reporting Process in the Life Insurance Line

From the life insurance line’s point of view the planning is a top-down process. The targets are defined top-down for the whole life insurance line. Against these top-down targets, bottom-up planning is conducted. Each life insurer conducts the planning independently of the other life insurers in the Insurance Group. As preparation for planning, regional meetings are arranged where the goals for the life insurer are discussed based on the corporate top-down goals, market developments and the available sales channels. Also, concrete action plans to reach the set goals are developed and agreed upon internally at these meetings. Many functions and divisions are involved in the planning process, as there are several interdependencies when life insurance business is planned. The main interdependency has to do with the growth target. Growth needs to be coordinated with the sales plan. As life insurance shares sales capacity with the other insurance lines, life insurance sales targets and capacity for planned actions need to be negotiated with the Sales Directors who are responsible for the sales channels.

The results of the regional planning and forecast process are discussed and approved in the Life Insurance Governing Board before they are handed over to Corporate Control and presented to the Boards of Directors for

120 The year-end peak within life insurance is not really based on any dependency. It is more a question of culture. The sales channels are more sales driven at the end of the year as they want to reach their goals. Although this could be changed, it is generally accepted. It was pointed out that “to try to change this might lead to the sales persons selling other insurance products.”
approval. Although the life insurance plan is consolidated and discussed for all life insurance companies in the group, there are no common goals for all life insurance companies within the group. This would not fit in with the regional responsibility assigned to the Boards of Directors.

As already discussed, the plans are followed-up and reported to the corporate level on a monthly basis. The production control measurements, apart from backlog, are not reported to corporate control. However, they are included in the monthly report, which is provided to the Life Insurance Governing Board. Although plan differences are discussed in the Life Insurance Governing Board, the active control process is a regional issue. To develop and implement action plans is therefore a regional responsibility. The actions identified and the results of their implementation are presented in the Life Insurance Governing Board, however.

Control has been changing due to the financial crises and especially after the subprime crisis. The life insurance line is, according to a life insurance board member, right now “in the middle of a low-yield period, which it needs to survive”. As the capital return on investment has stabilised on a low level there is pressure to keep the underwriting result and the cost ratios. The control process has not changed, but the awareness has been increasing. Control is receiving more attention, and the results are discussed more intensively among the management.

4.3.4.3 Summary of Control in the Life Insurance Line
The life insurance control systems and processes are aligned with the corporate processes. Some few additional aspects are included in the life insurance line control, like product and liquidity plans. In production control, the measurements have been becoming transparent and well defined in connection with the introduction of the customer and sales partner service centre. The aspects discussed in life insurance control systems are summarised in Table 4.9.
<table>
<thead>
<tr>
<th>Aspect of Control System</th>
<th>Life Insurance Line Around 1995</th>
<th>Life Insurance Line Towards 2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Control processes</td>
<td>Top-down oriented processes.</td>
<td>Tight control with frequent and</td>
</tr>
<tr>
<td>characteristics</td>
<td>Limited involvement in the</td>
<td>detailed monitoring of fixed</td>
</tr>
<tr>
<td>in the life insurance</td>
<td>top-down oriented planning</td>
<td>targets set top-down.</td>
</tr>
<tr>
<td>line</td>
<td>process.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Limited involvement in the</td>
<td>Full regional bottom-up</td>
</tr>
<tr>
<td></td>
<td>top-down oriented planning</td>
<td>involvement since 2006 including</td>
</tr>
<tr>
<td></td>
<td>process.</td>
<td>coordination with supporting</td>
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<td>premium products with</td>
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<td>Informal process with</td>
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<td>limited involvement</td>
<td>processes with integrated</td>
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<td>from life insurance part.</td>
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<td>actual results are compared to</td>
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<td>plan.</td>
<td>plan are receiving more attention</td>
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<td>Performance</td>
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<td>control and liquidity planning.</td>
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<td>Production control</td>
<td>Additionally the risk control</td>
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<td>in the life insurance line</td>
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<td>production control.</td>
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<td>peak and average demand.</td>
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<td>Temporary workers engaged to</td>
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<td>support operations during</td>
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<td>year-end peak.</td>
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<td>Production control concept</td>
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<td>based on indirect</td>
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<td>measurements and management</td>
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<td>experience.</td>
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<td></td>
<td>Performance</td>
<td>Productivity measurement was</td>
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<td>measurements used in</td>
<td>introduced without any target</td>
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<td></td>
<td>production control</td>
<td>and a clear definition in 2006.</td>
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<td>Mainly backlog measurement.</td>
<td>Extended quantitative performance</td>
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<td>measured based on service level</td>
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<td></td>
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<td>agreements since 2008.</td>
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4.3.5 Organisational Structure of the Life Insurance Line

In this section the organisational structure of life insurance is discussed. The first section deals with the formal structure including the coordination in life insurance whereas the last section is dedicated to the work organisation.

4.3.5.1 Formal Structure of the Life Insurance Line

In 2005 Bavarian Life Insurance was reorganised with the aim of establishing a clear responsibility assignment based on clear principal–agent relationships. Supporting functions were consolidated into main departments. One of these supporting functions, life insurance product development, received the group-wide role in 2006. Until the introduction of the customer and sales partner service centre structure mid 2008 in Munich, service production was organised according to the sales channels. This enabled some kind of benchmark between the entities. In the beginning the life insurance customer and sales partner service centre had one telephone and four equal correspondence departments. The aim was to ensure comparability among the entities. However, after a while the correspondence unit was reorganised based on available expertise. Now all new applications are routed into one department. Another department specialises in indemnification. The remaining two departments taking care of change transactions are somehow comparable.

The importance of coordination across the insurance lines and regions is increasing, due to common sales channels as well as common systems. The coordination structure is rather complex, including functional and regional coordination. When looking at the life insurance line, two dimensions of coordination need to be considered: coordination among the functions within one regional life insurer and coordination between the regional life insurer and the centralised functions.

In the regions there are monthly meetings with all main department managers acting in life insurance. All main department managers in turn have regular meetings with their department managers, which in turn have regular meetings with their employees. In this way all the issues in the regional life insurance can be coordinated. Also, coordination across the main department borders is needed. Thanks to the clear responsibility assignments established in 2005, this coordination is claimed to run smoothly in Munich. The main department responsible for the topic is always responsible for coordinating issues with the other main departments. Before the clear assignments of responsibility, this coordination was done in an ad-hoc manner, as nobody was dedicated to ensuring that the tasks were coordinated and addressed. In Berlin and Saarland this coordination has always been easier due to the smaller size.

The coordination of tasks and the prioritisation of common developments is discussed and decided upon by the Life Insurance Governing Board, where all insurance companies and the centralised supporting functions are
represented. Mostly the discussion among the members leads to a consensus although the roles and responsibilities between the centralised supporting functions and the regional insurers are not yet clearly defined. Due to this lack of clarity the regional insurers feel threatened by too much centralisation.

4.3.5.2 Work Organisation Structure of the Life Insurance Line

As discussed in the operations strategy section, the operations are oriented towards productivity and efficiency. In this section the work organisation structure supporting the service production will be discussed in more detail.

With the implementation of the customer and sales partner service centre in 2008, the work organisation structure in Munich was changed from the sales-channel-oriented structure to a structure dividing between standardised and complex administration. Although there were some difficulties with the implementation, the life insurance line is convinced that it is the right organisation form for life insurance service production. Despite the problems, the work is considered to be better structured and organised than before the implementation of the centre. Additionally transparency concerning service production has increased. The next step, according to life insurance line management, is to control costs.

Before the implementation of the customer and sales partner service centre, the procedures were sometimes explicitly developed for each sales channel. In order to act flexibly the employees could exercise some discretion within set limits, but only for issues that were not yet regulated. With these sales-channel-specific procedures the life insurance line wanted to increase the service offered to the sales channels. After the implementation of the centre, operations are no longer organised according to the sales channels. Instead common procedures have been implemented across all sales channels. With the new structure the aim is to standardise in order to increase efficiency. However, the transactions are still not fully standardised between the centre’s departments. Some work-arounds are still needed in the new systems implemented in 2009/2010 and the planned process optimisation and automation was postponed. A project looking at standardisation, automation and optimisation is started and is slated to run until the end of 2010.

In order to increase flexibility in production the goal in life insurance production has long been to develop employees to perform multiple tasks. This goal was never fulfilled. Although the departments used to handle all kind of treaty administration incl. indemnification, the employees were specialised within the departments. With the new customer and sales partner service centre structure there is a goal that all employees should be able to handle 80% of all basic transactions. Due to the migration to the new systems in 2009/2010, the employees still do not have these skills. Most employees have received training, but they have not been practicing their new skills since the training. As the new treaty systems supports the
transaction process with some guidance the new system is slower compared to the old one. The increased capacity for automation is believed to counterbalance this productivity decrease. The automation level has been successively increased and in 2010 80% of all new applications were automatically contracted by the system.

Due to the automatic routing of basic transactions, there are some identification and motivation issues among the employees working in the customer and sales partner service centre. The employees who used to work for a specific sales channel were said to identify with that specific sales channel. They worked extra hard to manage the transactions connected to “their” specific sales channel. Now this connection no longer exists. They only get a certain number of transactions transferred to their mailbox that need to be finalised during that day. This lack of connection is seen as frustrating especially as the freedom to decide and manage the work independently is absent.

Additionally, very few examples were given of employee involvement. The common opinion among management was that although employees are asked to get involved, they do not really bring so many ideas. This might have to do with the hierarchical culture. Communication runs hierarchically from the Board of Directors, to main department manager and from them to the department managers, who inform the employees. No path for communication exists from employees to top management. However, there are exceptions. One main department manager mentioned workshops held with the employees, where optimisation of the processes was discussed. In these workshops the employees themselves proposed organisational changes, which were implemented.

Due to the smaller size of Berlin-Brandenburg and Saarland, employees are encouraged to perform multiple tasks in production, in order to ensure that all transactions can be performed also during holiday seasons. Before the implementation of the new systems in Berlin, the employees had a higher degree of independent decision making, as expert logic was not built into the old systems. Also, the rules and processes were not strictly documented at that time, leaving the employees some room for their own decisions. This has been changing with the implementation of the group wide systems. However, although service production also in Berlin is getting more standardised and equipment focused, with only a limited amount of discretion for administrators, the service employees organise their work themselves and sort out the transactions they are able to take care of.

The treaty administration in Berlin-Brandenburg and Saarland is not divided between standard and complex administration. Both locations have a call centre taking care of some incoming calls, although the call centre rather takes notes of the issues and sends them to the treaty administration entities. No organisation similar to the customer and sales partner service centre is planned, due to size limitations. Berlin is nevertheless interested in consolidation of the treaty administration functions in a group-wide
customer and sales partner service centre. As Saarland Life Insurance still has its own IT systems, no common treaty administration is being discussed. Instead Saarland insurance is planning to introduce a more qualified telephone entity handling all insurance lines including claims. The aim is to increase accessibility and thereby to increase the quality of service production.

4.3.5.3 Summary of the Life Insurance Line Organisation Structure

The organisational structure, and especially the coordination of tasks, is rather complex in the life insurance line. The group model with regional individual insurers and centralised supporting functions in Munich increases the complexity, as all individual interests of the regional insurance companies need to be coordinated. This is done via the Life Insurance Governing Board, but still some agreed roles and rules are needed in order to optimise coordination.

The work organisation is increasingly being trimmed towards productivity and efficiency. This development is supported by automation and standardisation of the work processes. Transparency concerning productivity and service measurements is being introduced in order to receive feedback concerning the structure and the organisation of the operations.

The changes in the aspects discussed in this section are summarised in Table 4.10.

Table 4.10: Aspects of organisational structure mapped to corporate and business strategy

<table>
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<tbody>
<tr>
<td><strong>Formal structure</strong></td>
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<tr>
<td>Life insurance structure</td>
<td>The organisation of operations and supporting functions was based on sales channels.</td>
<td>In 2005 a centralisation of life insurance supporting functions was started and in 2006 they took over a group-wide supporting role.</td>
</tr>
<tr>
<td>Integration / Coordination</td>
<td>Hierarchical chains of command.</td>
<td>Hierarchical chains of command combined with an agent-principle organisation and coordination over Life Insurance Governing Board – however with clear roles and rules lacking.</td>
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<tr>
<td><strong>Work organisation</strong></td>
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<tr>
<td>Functional power given to production employees</td>
<td>Sales-channel-specific with some level of employee discretion. Service production employees managed their work themselves.</td>
<td>The extent of functional power strictly limited due to standardised and automated processes. Some discretion allowed in case the tasks are not yet formalised and standardised.</td>
</tr>
<tr>
<td>Level of standardisation/formalisation</td>
<td>Until 2007 sales-partner-specific processes with a low level of formalisation.</td>
<td>High level of formalisation and standardisation.</td>
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<td></td>
<td>Flexible work conditions with less transparency of outcome.</td>
<td>Strictly organised work hours and work processes in a transparent work environment.</td>
</tr>
<tr>
<td>Specialisation of production employees</td>
<td>High level of specialisation within the departments.</td>
<td>Broader knowledge is aimed for (especially within the smaller insurers) but due to productivity priority and introduction of new systems the aim is not fulfilled.</td>
</tr>
<tr>
<td>Human resource policies</td>
<td>Employees identified with the sales channels they supported.</td>
<td>Employees are increasingly seen as a production resource trimmed for efficiency. Employee productivity is controlled via automated workload balancing.</td>
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<td></td>
<td>Limited employee involvement due to hierarchical organisation.</td>
<td>Limited employee involvement due to hierarchical culture (only top-down communication is foreseen).</td>
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<tr>
<td>Aims of technology</td>
<td>Technology is used for documenting decisions.</td>
<td>Technology is used for automation and productivity increase.</td>
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<tr>
<td></td>
<td>Expertise logic is programmed into the system limiting the decision flexibility of the treaty administrators.</td>
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4.3.6 Summary of the Life Insurance Line
The life insurance line is strongly connected to the corporate processes concerning strategy, control and organisations of tasks. This is mainly because the corporate resources like the image of a trusted caretaker and the Savings Banks sales channel are valuable to the life insurance and as many functions have been centralised over the years on the corporate level. Although the image is a valued resource, the main aim is to achieve a low cost ratio and thereby a good rating. Therefore cost orientation and productive service production are seen as the main goals in the life insurance line in Munich. The regional life insurance companies in Saarland and
Berlin-Brandenburg are less cost oriented and see more benefit in ensuring close cooperation between service production and sales channels.

In the next sub-chapter the health insurance line’s view will be presented.

4.4 The Health Insurance Line

This sub-chapter presents the health insurance line of the Insurance Group and is based on information received from the case study company: interviews and public as well as internal documents.\footnote{The internal references per section are listed in Appendix C.2.}

Unlike the other insurance lines, all three health insurance companies within the Insurance Group are consolidated into a sub-holding structure. The Insurance Group offers full coverage and supplementary health insurances as well as travel insurances in Germany. One health insurance is active only in the Bavaria-Palatinate region, whereas the Saarland Health Insurance and the Travel Insurance are acting as nationwide health insurance for all public insurance companies in Germany. In addition to the private health insurance offerings, Bavarian Health Insurance offers governmental aid health insurance solutions within Bavaria-Palatinate.\footnote{Civil servants get a part (70-80\%) of their health bills paid by their employers. This risk can be “outsourced” to an insurance company. This outsourcing is called the Government aid health insurance.} The health insurance part has some sales organisations of its own. In 2001 a Broker Service was founded to support brokers in selling health insurance products. In 2005 a direct sales organisation, Health Insurance Services, was founded. Finally, in 2006 a sales support organisation was founded, with the aim of strengthening the health insurance sales of the public insurance companies.

The timeline of the integration of the different health insurance companies into the Insurance Group is illustrated in Figure 4.35. The main acquisition was the Saarland Health Insurance. There were two major reasons for the acquisition. The Insurance Group wanted to encourage cooperation between the different public insurance companies in Germany by offering a common nationwide health insurance. Secondly, it provided growth potential in health insurance as Bavarian Health Insurance had reached its growth limits due to the fact that its business is limited to the Bavarian-Palatinate region.

The Bavarian Health Insurance and the Saarland Health Insurance entities act officially together over the Health Insurance Holding. There are no plans to merge these companies. They still have their own sales channels and products, although there is a tendency towards more cooperation.
As illustrated in Figure 4.36a the Saarland Health Insurance has increased its share of the total health insurance business by 4% since the merger in 2000. When looking at the share of insured persons, as illustrated in Figure 4.36b, Saarland Health Insurance has a proportionally larger share of insured persons than premium income. This has to do with their high share of supplementary insurance coverage. The supplementary insurance coverage entails lower premiums than full-coverage health insurance.

**Figure 4.35: The health insurance entities within the Insurance Group and the timeline of their integration**

**Figure 4.36a: Share of the annual premium of the health insurers belonging to the Insurance group**
Developments in insurance types between 2000 and 2010, as illustrated in Figure 4.37, show that the trend is going from full-coverage insurance to supplementary health insurance. Nevertheless, full-coverage health insurance, due to the high premiums, is still the most important product in health insurance.

The health insurance line brings in around one third of the premium income for the Insurance Group. The insurance line has until 2007 brought a constant annual profit from around 50 Million Euros before consolidation and taxes. In 2008-9 the claims ratio and the acquisition costs entail a minimal profit. The increased costs were a consequence of the temporary
deregulation of full-coverage health insurance in 2009. In 2010 the profit again grew to over 50 Million Euros. Before the market position of the health insurance line is investigated, the Insurance Group’s interpretation of the health insurance market will be presented.

4.4.1 The Insurance Group’s Interpretation of the Health Insurance Market

In this section the external environment of the health insurance line will be discussed. The aim is to highlight the most important changes from the insurer’s point of view, not to give an objective picture of market developments.

Private health insurance is very dependent upon legislation and politics. Due to the on-going changes and discussions about the future of private health insurance for almost a decade, this dependency has been increasing. The health insurance market is however still a growth market, not only due to the adjustment of the premiums. Thanks to the health reform discussion health insurance has high news coverage, which increases the awareness of private health insurance among the citizens.

Since the beginning of this decade private health insurers had been preparing for the new legal regulations implemented in 2009. For a period of six months health insurance clients could switch their insurance suppliers and take parts of their age reserves with them. This forced the market into stiff competition, although it was restricted in time. As a preparation, customer service was newly defined in health insurance. The insurance companies wanted to bind their existing customers to limit change incentives, and at the same time be attractive for new customers. As the clients are entitled to move a part of the reserves as of 2009, they are expected to switch their insurers more often in the future. This will increase the uncertainty and price-sensitivity. As the competition gets tougher, new and cheaper products are being introduced with decreasing levels of benefits.

The health insurance line, like all insurance lines, has been affected by the financial crisis since 2008. As the capital return on investments is decreasing, the pressure in underwriting and general cost saving is increasing. Private health insurers have reacted by increasing premiums and by cutbacks in claims payments. The low capital return on investments is especially critical in private health insurance, as there is a legal requirement to ensure at least 3.5% of return on the old ageing reserves. If the asset management cannot deliver this level, reserves need to be used to cover the

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123 An insurance company is not allowed to cancel a health insurance policy. They are however entitled to adjust the premium if the ageing reserves cannot cover the increasing expenses. The increasing expensive medications and the increasing average age of the policy holders may trigger a need for an adjustment. As an adjustment leads to higher lapse rate, it is avoided as long as possible. Independent trustees monitor the calculations and can actually even force a health insurance company to adjust their premiums.
difference. Except for 2008, the health insurance line of the Insurance Group has been able to ensure this minimal level (as illustrated in Figure 4.38), but if the capital market is not developing positively it will be tight in the future. There has also been a trend towards more cautious behaviour among consumers since 2008/9. They reflect more on what coverage they really need. This is especially evident in the market for supplementary health insurance.

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<th>Return on Assets</th>
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<tr>
<td>2.0%</td>
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<td>3.0%</td>
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<td>9.0%</td>
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- **Insurance Group Health Insurance**
- **German Health Insurance**

*Figure 4.38: Developments in return on investment in the Insurance Group health insurance line and the average German private health insurance market*

The increasing political risk, due to the changing governmental health care reforms, demographic developments with an ageing clientele, as well as increasing price-sensitivity have been changing and are believed to continue to change the private health insurance business. In the next section the insurer’s position and how it has been influenced by the market changes will be discussed.

### 4.4.2 Position in the Health Insurance Market

The Insurance Group is in seventh place on the German market for health insurance, with a market share of around 6% since the integration of Saarland Health Insurance (see illustration in Figure 4.39). However, due to the large number of insured persons with supplementary insurance solutions, the Insurance Group is in fourth place if the number of contracts is counted. Bavarian Health Insurance, with a 16% market share, is the market leader in its region. Saarland Health Insurance, acting throughout Germany, has a smaller market share. The Insurance Group is actually fighting to keep its position on the market. Based on premiums it has moved from position five in 2000 to position seven in 2008. The growth strategy has not developed as expected. The insurance companies under public law have a market share of
more than 10% in life and non-life insurance products. In health, the insurance companies under public law do not reach this level of market share.

Figure 4.39: Health insurance market share development based on premium income and number of contracts

Figure 4.40: Comparison of the administration cost ratio (left) and acquisition cost ratio (right) of the health insurers within the Insurance Group and the average German health insurance market

Comparing the cost position with the average German health insurance market (illustrated in Figure 4.40), it can be concluded that Bavarian Health Insurance has been below the market average considering both the administration cost ratio \(^{124}\) and acquisition cost ratio \(^{125}\) although the

\(^{124}\) The administration cost ratio is the percentage of expenses for management of the insurance portfolio in relation to the premiums written.

\(^{125}\) The acquisition cost ratio for new business includes the expenses for acquiring new insurance contracts and places them in relation to the total premiums paid from new policies.
acquisition costs have increased during the last few years. With its integration into the Insurance Group, Saarland Health Insurance had higher administration cost ratios than the market. They decreased to a level below the market average in 2005. However, although the acquisition costs of Saarland Health Insurance decreased between 2000 and 2005, they never reached the market average and even increased again in 2008. The higher acquisition cost ratio at the Saarland Health Insurance is explainable, as they pay commissions to the public insurers as well as their sales channels.

In addition to the cost for administration and sales, the claims ratio is important to compare. The health insurance claims ratio shows the extent to which income from premiums flows directly into insurance benefits and ageing reserves. As illustrated in Figure 4.41, Saarland Health Insurance has a much lower claims rate than the market average, whereas Bavarian Health Insurance has been constantly higher than the market level. This is due to the fact that Saarland Health Insurance, which was established in 1979, has a younger clientele than Bavarian Health Insurance, which was established in 1926. When analysing the claims ratio, the included refinancing ratio also needs to be compared. As illustrated in Figure 4.41 right side, both insurers belonging to the Insurance Group allocate less to the reserves than the market. This is partly explainable by the age structure of the Bavarian part, as companies with old and even ageing clientele generally reserve less than companies with younger clientele.

**Figure 4.41:** Comparison of the claims ratio of the health insurers within the Insurance Group and the average German health insurance market on the left and the refinancing ratio on the right

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126 The refinancing (RfB) ratio expresses the scope to which companies have additional funds for providing relief on contribution levels at a future date. The higher the rate, the more reserves are allocated to the old ageing reserves. The rate is calculated as the amount of allocated reserves in relation to premium income.
Taking all the components together shows that although the health insurers belonging to the Insurance Group have shown positive results from their insurance business activity\(^\text{127}\), they have only partially been able to outperform the market average for some years (see Figure 4.42).

![Results Ratio from Insurance Business Activity](image)

*Figure 4.42: The results ratio from insurance business activity of the health insurers within the Insurance Group and the average German health insurance market*

As the capital return on investments (as illustrated in Figure 4.38) also does not over-perform the market average, it can be concluded that the Insurance Group is not an over-performer in the German health insurance market. However, the health insurance line still contributes to the Insurance Group profit and also bears parts of the corporate costs, so it is seen to be an important part of the Insurance Group.

The health insurance line, just like all insurance lines in the Insurance Group, is included in the regularly conducted customer satisfaction surveys. As illustrated in Figure 4.43, both health insurers exceeded the Insurance Group average values during all studies, except in 2007. Both health insurers have actually had a declining trend between 2005 and 2007. In the last customer satisfaction survey the customer satisfaction values have been increasing again. At Bavarian Health Insurance the decline was mapped with the cost cuts and long response times in claims handling but also product limitations. At Saarland Health Insurance the decline was mapped with product limitations but also with the overall customer service. The introduction of stricter claims management to keep down the claims costs was also considered to be a reason for the decreasing customer satisfaction.

\(^{127}\) The results ratio from insurance business activity is derived from the ratio of insurance business financial results to earned gross revenues. This indicates how much of the annual revenue from contributions is left after deduction of all expenditure items (PKV Annual Report 2009).
Generally, the health insurance companies have been profitable over the years although they have not always been able to keep the market average. Although both companies are well established on the market, the market changes during the last years as well as the coming years can be seen as major challenges for the health insurance line. Before looking into internal mechanisms used for handling these challenges, the health insurance specifics within sales channels, customer structure and products are presented.

4.4.2.1 Sales Channels of the Health Insurance Line

In addition to the regular sales channels of the Insurance Group, health insurance has, established its own additional sales channels: three sales companies, one for broker service, one for supporting the public insurance companies health insurance sales and one direct sales channel serving Germany nationwide. All these sales channels have dedicated know-how within health insurance. Additionally, the health insurers offer supplementary health insurance solutions through cooperation with a statutory health insurance. In governmental aid health insurance the holding has its own small sales force acting in Bavaria.

Although they are a valuable nationwide sales channel for health insurance sales, there is an impression that the Savings Banks could improve as a sales channel, especially within the region of Bavaria and Palatinate. The interest in selling insurance, and especially health insurance, is not established in all Savings Banks. The fact that the Savings Banks actually consist of individually managed and organised banks does not make it easier to establish insurance sales as a main business in the banks. However, in
spite of their declining share of new business, the Saving Banks are considered important due to their broad market access in all regions. The proprietary health insurance direct sales organisation is the second biggest sales channel. Since foundation it has continually been increasing in importance. Also, sales through brokers have been developing well, especially after the foundation of the dedicated broker sales support organisation. In general health insurance has a broad sales channel mix, offering access to multiple customer groups.

4.4.2.2 Customer Structure of the Health Insurance Line
The health insurance customers of the Insurance Group are in general rather conservative, earn good money and they drive nice cars. This should mean that they are not very price sensitive. The health insurance line has identified some customer segments like entrepreneurs, medical doctors and health-conscious persons for whom special full-coverage health insurance products have been developed. The customer structure of the supplementary insurance products is different, with a more price sensitive and younger clientele. The different requirements from these client groups make service differentiation difficult to implement, especially as all customer groups are supported through a common service production entity.

The health insurance line has classified their customers as A, B, C and D customers. The customer classification is based on the level of claims. A customers have a high plus account, that is, they have paid in more fees than they have received in indemnification. The insurer would like to bind these profitable customers by offering them a very high level of service. This kind of classification is only used by the health insurance line within the Insurance Group.

4.4.2.3 Health Insurance Products and their Development
In health insurance the products are standardised and regulated as the health insurance products are a part of the social security system. Although the products are not customised, they are modular and can be combined in order to fulfil a client’s individual need. The products are valued as exchangeable on the market. The products are offered at average market price. As the average price is decreasing, cheaper and leaner products, not including all the benefits of the older products, are being increasingly offered.

Generally, product cycles are getting shorter, and there is a trend towards more variation in products and their coverage. Due to CRP, the automatic receipt handling system implemented, the insurance line is able to offer more flexible products in more variations. The CRP system automatically compares the terms and conditions with the claims application. For example, it checks if only generic medicament is covered before approving a medicine bill. Before the implementation of the CRP system, the administration of these types of products variations was impossible.
The customer satisfaction surveys show that approximately 40% of customers are satisfied with the health insurance products offered. With this value the health insurance products are rated high within the Insurance Group. They are however rated low compared to the market average, especially concerning product flexibility. These results confirm the health insurer’s own view, highlighted by all interviewees, that they do not differentiate themselves with their product offerings, as they are valued as exchangeable on the market.

4.4.2.4 Summary of the Health Insurance Market Position

The health insurance line has an average position on the health insurance market. The insurers have been keeping up with market developments, although in the last few years they have lost their cost advantage. Due to this and the high acquisition and claims ratio they have been facing some challenges. The aspects discussed in this section are summarised in Table 4.11.

Table 4.11: Health Insurance market development

<table>
<thead>
<tr>
<th>Aspect of Market</th>
<th>Health Insurance Line Around 1995</th>
<th>Health Insurance Line Towards 2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market development</td>
<td>Growth market.</td>
<td>Limited growth market.</td>
</tr>
<tr>
<td>Product</td>
<td>Full coverage product.</td>
<td>Change from full coverage towards supplementary products with lower premium.</td>
</tr>
<tr>
<td>Regulations</td>
<td>High regulation based on stable legal frame.</td>
<td>New regulations challenge the private health insurance market.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Aspect of Market</th>
<th>Health Insurance Line Around 1995</th>
<th>Health Insurance Line Towards 2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profitability of health insurance business</td>
<td>Higher than market until 2003 (Bavarian Health Insurance) and 2008 (Saarland Health Insurance).</td>
<td>Lower than market since 2009, but still positive.</td>
</tr>
<tr>
<td>Capital return on investments</td>
<td>Slightly below market level (around 7%).</td>
<td>Average market level (decreasing to 4%).</td>
</tr>
<tr>
<td>Market share</td>
<td>4.6%</td>
<td>Has increased to 6.2%, although stable since consolidation with Saarland Health Insurance in 2000.</td>
</tr>
</tbody>
</table>
### 4.4.3 Strategy of the Health Insurance Line

In this section, the health insurance strategy is presented. The presentation will start with the business strategy of the health insurance line. Thereafter, the service production strategy will be presented. The section will be summarised using the strategy aspects identified in the theory chapter.

#### 4.4.3.1 Business Strategy of the Health Insurance Line

The health insurance line also has its goals aligned with the corporate global goals, that is, growth over the market and a growth rate higher than cost rate increase. The long-term goal is to get a 10% market share or to be among the top three health insurance companies in Germany. This means that growth, organic as well as enabled through acquisitions, is the main priority. Organic growth is to be achieved by strengthening the sales channels. This is done by developing easy-to-sell products, by increasing the sales of supplementary health insurance products through cooperation with statutory health insurance funds, and by supporting full-coverage health insurance sales by training and educating the sales forces. Although the cornerstones for growth are identified, an overall implementation plan has not been developed. Nevertheless, the trend from full coverage to supplementary health insurance line is an opportunity for the Insurance Group, due to its access to the nationwide Savings Banks sales channel. Health insurance has been developing the goals and the cornerstones in an on-going process, where market positioning has been discussed at each board meeting and presented for discussion to the management team twice per year.

The health insurance line does not compete with price, although price is becoming increasingly important. According to the interviewees, the insurers position themselves as service insurers, where service is provided through the sales channels. They therefore mainly concentrate on taking care of the sales channels and not the customers. Consequently, sales-channel orientation is important in both sales support and insurance production. This means that excellent training and incentives are offered but also that transactions are handled in an efficient and transparent manner. Since 2007, also service towards customers has been highlighted. However, the health insurers are
not market leaders in service, as the customer and sales-channel handling is not considered flexible enough.

Additionally, corporate management stresses the importance of cost efficiency. The corporate message is that the cost factor needs to be kept low in order to be competitive on the market. For a long time the health insurance line differed from the other insurance lines. In health insurance there was, until some years ago, a willingness from management to invest in new innovative ideas. This was seen as leading to a competitive advantage. If an investment was backed up by a good business plan, the management used to approve the investment. However, due to the cost orientation pushed from the corporate side, the willingness to conduct long-term investments has been decreasing.

The two health insurers act differently on the market. Bavarian Health Insurance is an active market participant in its dedicated but limited region of Bavaria and Palatinate. Saarland Health Insurance does not have its own brand, however, and sells health insurance only indirectly through the other regional insurance companies under public law. The health insurance solutions outside Bavaria and Palatinate are sold under the label of the regional companies under public law. Saarland Health Insurance is thereby dependent on the market positions of the regional insurances under public law. Within Bavaria and Palatinate, Bavarian Health Insurance can differentiate itself through its inherited image. The down-to-earth and native sales channels in the region strengthen this image.

Saarland Health Insurance had a different strategy before the merger. It was founded in 1979 as a common health insurance of the regional insurance companies under public law. The main aim was to grow. Technology was not used to gain cost benefits but to improve processes and customer orientation. For example, as early as 2000 they offered an online Internet portal for their customers where they could verify their contract information and conduct some transactions. Since the merger Saarland Health Insurance is still growing but at a lower rate. There are mainly two reasons for this. Firstly, Saarland Health Insurance was seen as a common health insurance among the insurance companies under public law. Now it is seen as a part of the Insurance Group. The insurance companies under public law are nowadays only minority owners. This has decreased the priority of health insurance sales among them. Secondly, product innovation was stopped, as product development was moved to Munich. On the other side, the Saarland Health Insurance, as an independent company would probably have had problems in the long run when the growth rate declined. The whole organisation was organised for growth. In the long run Saarland Health Insurance is therefore believed to have gained a stable platform enabling them to manage market changes through the integration into the Insurance Group.
4.4.3.2 Production Strategy of the Health Insurance Line

Health insurance service production can be characterised as standardised mass service production. Due to customer relationship management it could be called flexible mass production in some cases. Since the merger in 2000, the goal of production is to ensure high productivity and cost efficiency. Costs can be saved in indemnification or claims handling as well as in administration. The insurers have been actively managing the indemnification process since 2000. This led to declining claims ratios until the health reform campaign was started in 2009. The goal is to continuously lower both the claims and the administration ratio. A low administration cost ratio is ensured by high productivity. The health insurers have therefore been increasing the productivity goal with 3-4% annually for years. After years of increase the goal is no longer reachable without changed processes and increased automation. IT is consequently gaining in importance, both in indemnification and treaty administration.

Production is supported by guidelines. All products and tariffs have their specific rules and regulations. Therefore a broad portfolio of products increases the complexity of service production. Especially in claims handling there are over 6,000 guidelines registered in a database. The introduction of an automatic scanning and verifying tool, CRP, in September 2006 led to major changes in production. CRP automatically evaluates the claims requests against these guidelines. Due to the automatic evaluation more products and more flexible products can be offered. With the introduction of CRP the discretion of the employees decreased. The indemnification administrator only needs to get involved when the CRP system does not find any clear rules. In these cases employees are allowed to decide within their fixed ranges. Only management is entitled to take decisions outside of the ranges. If a client complains, the service production employee can check the classification of the client. If it is an A client the administrator has an extended permit to alter the decision.

The automatic scanning and verifying tool, with its aim to cut costs, led to a decrease in customer satisfaction in 2007. However due to a soft set of rules used (only 4,000 of the 16,000 available rules were used), the insurance line received fewer customer complaints than expected after the introduction of CRP. The sales channels, who have contact with customers in first place, have complained, however. The challenge is to explain the cuts imposed due to incorrect billing to the customers in an adequate manner. This is actually a common challenge among all the health insurers, as nine of the top ten health insurers have similar systems implemented. Generally, these companies saved at least one percent of the indemnification costs through the CRP system. This is an enormous cost saving for the health insurance companies. For the Insurance Group it was a savings of ten million Euros in the first year, even with the soft set of rules used in the beginning. With all the rules implemented the cost savings may reach thirty million Euro (which equals...
around 3% of indemnification costs). Companies that do not have a system implemented face a severe challenge, as such amounts of money cannot be saved via administration costs. Also, productivity has been increasing in indemnification administration due to the introduction of CRP. The indemnification administrators actually still, to a certain degree, check the verification provided by the system, as they do not trust the system completely. Without this checking productivity would increase even more. Productivity developments for both companies are illustrated in Figure 4.44. The premium per employee is higher in the Bavarian Health insurance due to their higher ratio of full-coverage insurances with considerably higher premiums.

![Premium per Employee in MEUR](image)

*Figure 4.44: Productivity of the health insurers within the Insurance Group, measured as premium per employee*

The service orientation discussed in the business strategy of the health insurance line (see previous section), is not really supported by the chosen production strategy, however. The implementation of CRP, which has led to indemnification cuts, is a service challenge. Although as yet only a soft set of rules has been used, it has led to a conflict with clients and sales partners. In order to improve service, the insurer offers full-coverage clients a telephone hotline for health consultation where questions about doctors and hospitals, as well as medicine are also answered. However, this is not a service differentiation as all health insurance companies offer their customers similar hotlines.

### 4.4.3.3 Summary of the Health Insurance Line Strategy

The health insurance line’s business strategy is oriented towards the Insurance Group positioning and the global goals. The health insurance line benefits from the competitive strength on the group level, like the sales
channels and the size of the organisation. Additionally, health insurance has an advantage from its own specialised sales channels.

Saarland Health Insurance, due to their nationwide activities, is dependent on the positioning of the regional public insurers, whereas the Bavarian Health Insurance benefits from the image of the Insurance Group. The interviewees refer to the health insurance line as a service insurer, with service provided via the sales channels. However, the corporate pressure on cost orientation is guiding the priorities in production. Service production is oriented towards productivity and cost cutting. This accords well with the cost level reduction goal, but has very little to do with the overall positioning of a service insurer. However, the question is how important the service positioning is on the market. One of the persons interviewed pointed out that “as the health insurance market competes on price it fits with the operational goals”. The business and service production strategy in health insurance lines is summarised in Table 4.12

Table 4.12: Strategic aspects of health insurance and production strategy (if the aspects differ between the health insurers this is indicated in the table; if no indication, the statement is valid for both health insurers)

<table>
<thead>
<tr>
<th>Aspect of Strategy</th>
<th>Health Insurance Line Around 1995</th>
<th>Health Insurance Line Towards 2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Goal of health insurance line</td>
<td>Bavarian Health Insurance: Growth goal as stressed on the corporate level.</td>
<td>Growth combined with increased cost orientation due to decreasing capital return on investments since 2002.</td>
</tr>
<tr>
<td></td>
<td>Saarland Health Insurance: Before the merger it was organised towards fast growth.</td>
<td>Service insurer however service is seen to be provided via the sales channels. Bavarian Health Insurance: Marketing differentiation through corporate image.</td>
</tr>
<tr>
<td>Competitive market position of the health insurance line</td>
<td>Bavarian Health Insurance: Stable health insurer.</td>
<td>Service insurer however service is seen to be provided via the sales channels. Bavarian Health Insurance: Marketing differentiation through corporate image.</td>
</tr>
<tr>
<td></td>
<td>Saarland Health Insurance: Growing innovative health insurer.</td>
<td>Bavarian Health Insurance: The inherited image of being a trusted partner.</td>
</tr>
<tr>
<td>Valuable resources/capabilities in health insurance</td>
<td>Bavarian Health Insurance: Savings banks as a strong sales channel.</td>
<td>Effective sales channel mix. Bavarian Health Insurance: The inherited image of being a trusted partner.</td>
</tr>
<tr>
<td></td>
<td>Saarland Health Insurance: Management openness to support investments in innovative areas.</td>
<td>Bavarian Health Insurance: The inherited image of being a trusted partner.</td>
</tr>
</tbody>
</table>
4.4.4 Control in the Health Insurance Line

In this section the control processes and systems used within the health insurance line are presented. The mechanisms already described from the corporate control point of view will be complemented with the health insurance perspective. First the management and the production control implemented within the health insurance line are described. Thereafter the planning process and the reporting structure will be discussed before the section is summarised.

4.4.4.1 Management and Production Control in the Health Insurance Line

The health insurance line is managed by the use of tight financial controls. The corporate level takes little interest in the strategic planning. The management control on the corporate level is mainly based on financial measurements concerning revenue, claims, cancellation rate, backlog, costs and headcount. In addition to the corporate management control system, the health insurance line controls the profit and loss for the different products. Sales results are also monitored by measuring premium from new business and number of tariffs sold. Additionally, investments like the introduction of new products or the implementation of a new system are checked against business plans. Since the merger into the Insurance Group, management control is strictly oriented towards clear goals, which are set on the corporate level, for example cost targets. This was not the case at Saarland Health Insurance before the merger. During that time targets were seen more as guidelines. Also, the emphasis on cost and headcount planning has been
growing in importance and complexity since the integration into the Insurance Group.

Customer satisfaction rates are not explicitly used, although surveys are available. The results of the measurements are used neither to set targets nor for preparing explicit action plans. For the Insurance Group-wide customer satisfaction survey, however, the health insurance line, like every other insurance line, is integrated into the corporate process. This includes the preparation and presentation of action plans to increase customer satisfaction.

Lapse rate is measured and managed by a task force. Until 2008 the lapse rate was not managed, as the new treaty rate was so high. The business was only controlled via premiums from new sales, not taking the lapse rate into consideration. For a couple of years the new treaty rate has been stagnating, whereas lapse rate is increasing, albeit marginally. The idea behind the lapse rate task force is to find measures against a high lapse rate at an early stage.

Production control is oriented towards cost efficiency, which is measured through productivity, backlog and indemnification cut rate. The Health Insurance Board of Directors sets targets for these. There are no clear quality targets due to the orientation towards efficiency. Before the merger, more production measurements were used at Saarland Health Insurance, like customer retention and some employee statistics, like employee turnover, level of education and training-days per employee. These measurements are not used any more due to the clear emphasis on cost efficiency.

Capacity is the basis for both productivity and service quality, therefore capacity planning and adjustment is a main mechanism in production control. The health insurance line has a rather sophisticated tool supporting headcount capacity planning. The capacity is planned on a yearly basis based on average capacity. The health insurance control department prepares a forecast of transaction volumes on a monthly basis based on experience from the last few years. Based on this forecast, vacations are planned to fit with forecasted demand fluctuations. Major backlogs that occur during peaks are accepted, as capacity is set to manage average demand and not peaks. Increasing backlog is used as a measurement for capacity problems. Due to increasing automation and the cost-saving activities, usually no extra capacity is approved, except temporary employees with contracts that are limited in time.

### 4.4.4.2 Planning and Reporting Process in the Health Insurance Line

The control department for health insurance is divided into two parts, a strategic and an operational department. The strategic department is responsible for the planning process, in coordination with sales and corporate control. They also conduct market analysis and coordinate benchmark studies in the private health insurance association. The operational department takes care of statistics used for production planning. They control premium and claims/indemnification development as well as
the input and output of the departments. They also control the level of indemnification cuts. Beyond that they control the business plans and costs. Additionally, due to the implementation of the automatic scanning and verifying tool, CRP, in September 2006 a new department was founded. This new department is responsible for the statistics of this system.

The corporate planning process is followed. The plans are prepared bottom-up and thereafter negotiated against the top-down goals. The aggregated plans and the resulting profit and loss calculation are discussed in the Health Insurance Board of Directors before being sent for approval to the corporate level. The process is iterative until the set targets are fulfilled.\textsuperscript{128} Forecasts are prepared twice per year as an indication of the probability to meet plans. However, due to the pressure to stick to the plans, no negative deviations are accepted. If there is a gap to plan, it is the task of the control units to highlight that and also, with the support of the manager responsible, to explain the reasons for the gap. In these cases action plans are developed with the aim of ensuring that the plan is fulfilled.

The actual results against the plans are followed-up on a monthly basis. The control department of the health insurance line consolidates the reports for the health insurance line including costs, premiums, claims/indemnifications, headcount and backlog and sends them to corporate control. The Health Insurance Board of Directors receives additional information, like productivity and sales-channel performance. The monthly reports have grown and become more complicated as new requests were included over time. There is a need to simplify them again. However, since the financial crisis in 2008, the control process has instead been intensified. The target achievements are communicated hierarchically. The board members communicate them to their main department managers who in turn communicate them to their department managers. The employees only rarely receive any information concerning the targets and their achievement.

4.4.4.3 Summary of Control in the Health Insurance Line

The health insurance control system and processes are aligned with the corporate processes. Some few additional aspects are included in the health insurance control, like profit and loss per product type as well as sales-channel performance. The health insurance line also monitors investments against approved business cases. In production control, the health insurance line has long been implementing efficiency-based measurements, like productivity, backlog and indemnification cut rate. The aspects discussed in health insurance control systems are summarised in Table 4.13.

\textsuperscript{128} One example is the preparation of the plans for 2008. The bottom-up prepared plans did not meet the corporate targets. After three trials corporate management simply declared that no exceeding of limits is acceptable. Thereafter the plans were finally adjusted. This clearly shows that the target is fixed on the corporate level.
Table 4.13: The development of health insurance control system between 1995 and 2010 (in case the aspects differ between the health insurers this is indicated in the table, in cases where statement is valid for both health insurers)

<table>
<thead>
<tr>
<th>Aspect of Control System</th>
<th>Health insurance around 1995</th>
<th>Health Insurance Towards 2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Control process</td>
<td>Top-down oriented process where targets were more seen as guidelines (especially at Saarland Health).</td>
<td>Top-down control process with tight frequent, detailed monitoring of fixed targets. Full bottom-up involvement – however with the goal to stick to the top-down target. Intensified control process since subprime crisis.</td>
</tr>
<tr>
<td>characteristics in the health insurance line</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Top-down oriented process where targets were more seen as guidelines (especially at Saarland Health).</td>
<td>Top-down control process with tight frequent, detailed monitoring of fixed targets. Full bottom-up involvement – however with the goal to stick to the top-down target. Intensified control process since subprime crisis.</td>
<td></td>
</tr>
<tr>
<td>Long-term investments were granted for positive business cases.</td>
<td>Shorter term cost orientation leads to less space for investments based on a long-term business case.</td>
<td></td>
</tr>
<tr>
<td>Informal process that received limited attention.</td>
<td>Rigid and formal processes with increasingly integrated decision-making.</td>
<td></td>
</tr>
<tr>
<td>Diagnostic control where actual results are compared to plan.</td>
<td>Diagnostic controls where actual results are compared to plan, although combined in health insurance with interactive controls via dedicated task forces.</td>
<td></td>
</tr>
<tr>
<td>Performance measurements used in management control</td>
<td>Bavarian Health: Aligned with the corporate monetary performance measurements. Saarland Health: Before integration into the Insurance Group more quality-based measurements were used.</td>
<td>Broad scope of monetary-based internal information focusing on growth and cost efficiency.</td>
</tr>
<tr>
<td>Production control in the health insurance line</td>
<td>Priority towards efficiency with annual productivity increase foreseen.</td>
<td>Efficiency and cost orientation based on IT-enabled productivity increase.</td>
</tr>
<tr>
<td>Capacity set at average demand accepting increasing backlogs during peaks.</td>
<td>Capacity set at average demand with actions taken to limit backlogs by predictable demand fluctuation and by increased level of automation.</td>
<td></td>
</tr>
<tr>
<td>Production control concept based on output control supported by a sophisticated production control.</td>
<td>Production control concept based on strict output control supported by the production control system.</td>
<td></td>
</tr>
<tr>
<td>Performance measurements used in production control</td>
<td>Some service and employee oriented performance measurements were combined with monetary-based measurements.</td>
<td>Fixed monetary-based performance targets and measurements focusing on production and resource utilisation.</td>
</tr>
</tbody>
</table>
4.4.5 Organisational Structure of the Health Insurance Line

In this section the organisational structure of health insurance is discussed. The first section describes the formal structure including the coordination in health insurance whereas the last section is dedicated to the organisation of work.

4.4.5.1 Formal Structure of the Health Insurance Line

The health insurance line, like the rest of the Insurance Group, has a flat organisational structure with only two management levels below the Board of Directors level. The organisation is functionally structured, that is, the treaty administration and the indemnification administration are divided into different main departments. The treaty administration departments are organised according to the sales channels due to sales-channel-specific demands. The indemnification departments are organised by region. The assumption is that the indemnification requests are administered the same way for all customers, independent of sales channel. After the introduction of the automatic verification system, CRP, in 2006, front-end departments that scan and check the scanned receipts and bills were introduced. Although the tasks in these front-end departments require limited or no health insurance skills, some qualified indemnification administrators were transferred to the new departments. Additionally, a health management main department has been established to support indemnification administration to validate medical treatments in special and more complicated cases.

The integration of Bavarian and Saarland Health Insurance was not smooth at first. The integration was to a certain extent a question of showing power. The benefits and competencies of Saarland Health Insurance were not considered during integration. Also the decision to manage the merger in a soft manner led to decisions being postponed, which in turn increased the insecurity both internally and on the market. The integration was established in two steps. In the first reorganisation project supporting functions were consolidated, whereas the treaty and the indemnification administration were reorganised and a call centre for all inbound calls was introduced in the second project. Since then minor adjustments, like centralisation of functions on corporate level, have been implemented in order to ensure cost-efficient operations.

According to the managers interviewed the health insurance line has, maybe due to the background of Saarland Health Insurance, a somewhat different culture from the life and non-life insurance lines. It was described as being more open and communicative, starting from the Board of Directors level. The Board of Directors was said to promote a transparent culture with fast decisions and transparent follow-up of set goals. But due to increasing integration into the Insurance Group this health-insurance-specific open and transparent culture is slowly diminishing.
The work in the health insurance line is coordinated mainly on the main department manager level. The health insurance line has many inter-department work forces where main department managers discuss issues like indemnification, underwriting, lapse rate, sales and product development. It was mentioned that there is only limited coordination with the other insurance lines. One example mentioned is customer classification. There is a potential for mismatch in customer classification between the insurance lines. A not so important D customer from a health insurance point of view might be an A customer from the non-life insurance point of view. Due to the Sales, Marketing and Product Board and Commissions introduced in 2008 and 2009 these activities are coordinated among all insurance lines. In 2010 a Health Insurance Governing Board was also implemented in order to coordinate the health insurance issues better with the centralised supporting functions. This was needed, as the health insurance line over the years has become more dependent on the centralised supporting functions.

4.4.5.2 Work Organisation Structure of the Health Insurance Line

Health insurance is a mass production environment. Treaty administration and indemnification are strictly separated from each other. They also use different systems. Therefore the employees are specialised. They work in either treaty administration or indemnification. In indemnification and treaty administration multiple tasks are encouraged, however.

In the standardised health insurance operations the goal is to get standardised transactions closed in the most efficient manner. The health insurance line established a common call centre in 2001/2002 to deal with all calls from clients. As the call centre has access to all information, they can take care of all types of transactions from the sales channels as well as from customers, with a completion rate of 80–90%. It took three years to reach this completion rate. It also took three years to educate the customers and sales channels to use the phone instead of sending letters to make enquiries. Although there is a goal to standardise processes and decisions in service production, this is not fully supported by the treaty administration system. Although some automation was introduced as early as 2002, other parts of the system do not have any strict workflow, enabling the administrators to find their own best way to complete a treaty. Standardisation is instead enforced through written instructions. This is not considered efficient in a mass production environment.

The indemnification departments were specialised earlier. Some of them needed to check the bills and question disbursements aggressively, whereas others needed to be highly productive and close as many indemnification requests as possible. This has been changing due to the introduction of CRP, the automatic verification system. Now all departments need to question disbursements with the support of the automatic system verification. This was a new way to work for the units that did not examine the bills in detail as they were trimmed on productivity in the past. Nowadays indemnification
requests are automatically checked against the guidelines by the CRP system. Therefore the role of indemnification administration has changed from applying rules to quality assurance of the implemented rules within the CRP-system. The administrators, however, still need to be well trained, as they need to address decisions that are not automatically taken by the CRP system. In these cases the employees need to follow guidelines. As it is important to treat all clients alike, explicit procedures exist, and there is a strong emphasis that they are followed. Generally only management is allowed to make decisions outside of the guidelines.

Before the merger, the goal at Saarland Health Insurance was innovation and increasing quality through process optimisation and increased customer orientation. During that time the employees were seen as an important resource, and their skill development was measured. Nowadays, due to the productivity orientation, the employees are more seen as a production resource that should be trimmed for efficiency.

4.4.5.3 Summary of the Health Insurance Line Organisation Structure

The organisational structure in health insurance is less complex than the other insurance lines at the Insurance Group, thanks to the common holding structure. However, as more functions are centralised and coordinated on corporate level, the need for coordination beyond the health insurance line is increasing. The trend since the merger is towards more centralisation of the functions and integration into the Insurance Group. Also, the work organisation is changing in health insurance. It is increasingly trimmed towards productivity and efficiency with the support of standardisation and automation. The changes within the aspects discussed in this section are summarised in Table 4.14.

Table 4.14: Aspects of organisational structure mapped to corporate and business strategy (in cases where the aspects differ between the health insurers this is indicated in the table; if there is no indication the statement is valid for both health insurers)

<table>
<thead>
<tr>
<th>Aspect of Organisation Structure</th>
<th>Health Insurance Line Around 1995</th>
<th>Health Insurance Line Towards 2010</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Formal structure</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Health insurance structure</td>
<td>Centralisation of supporting functions in health insurance after merger.</td>
<td>Centralisation of supporting functions on the corporate level.</td>
</tr>
<tr>
<td></td>
<td>Functional structure where the treaty administration entities are organised by sales channel.</td>
<td>Functional structure with a common service centre.</td>
</tr>
<tr>
<td></td>
<td>Fast decisions due to the high level of autonomy.</td>
<td>Decisions need to be coordinated on group-level.</td>
</tr>
<tr>
<td>Aspect of Organisation Structure</td>
<td>Health Insurance Line Around 1995</td>
<td>Health Insurance Line Towards 2010</td>
</tr>
<tr>
<td>---------------------------------</td>
<td>----------------------------------</td>
<td>----------------------------------</td>
</tr>
<tr>
<td>Integration / Coordination</td>
<td>Hierarchical chains of command in Bavaria and open communication in Saarland.</td>
<td>Hierarchical chains of command. Coordination via task forces.</td>
</tr>
<tr>
<td></td>
<td>Limited coordination outside the health insurance line.</td>
<td>Coordination outside health insurance lines via group-level commissions and the Health Insurance Governing Board.</td>
</tr>
</tbody>
</table>

**Work organisation**

<table>
<thead>
<tr>
<th>Functional power given to production employees</th>
<th>Position based, however skills were also measured and documented.</th>
<th>Increasingly position based, know-how and skills are not measured or documented.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Level of standardisation/formalisation</td>
<td>Employee discretion allowed within set guidelines although the level of discretion was limited.</td>
<td>Standardised and automated processes where employees verify system suggestions. Non-automated tasks are solved following guidelines, and management solves exceptions. Based on client classification some discretion within set limits is allowed.</td>
</tr>
<tr>
<td>Specialisation of production employees</td>
<td>Specialised, especially in indemnification.</td>
<td>Jobs divided between low-skill jobs (scanning) and expertise jobs (assessment of automated rules).</td>
</tr>
<tr>
<td>Human resource policies</td>
<td>Especially in Saarland: Employees were seen as important resources.</td>
<td>Employees are increasingly seen as a production resource trimmed for efficiency.</td>
</tr>
<tr>
<td>Aims of technology</td>
<td>Saarland Health Insurance: Technology was used for innovation and enhancing service quality.</td>
<td>Technology is used for automation and productivity increase.</td>
</tr>
</tbody>
</table>

4.4.6 Summary of the Health Insurance Line

Although it is more independent than the other insurance lines due to the different background of the Saarland Health Insurance, the health insurance line is connected to the corporate processes concerning strategy, control and organisation of tasks. The insurance line is also more independent from the rest of the organisation due to its nationwide orientation. However, due to growing centralisation, the level of dependency and coordination has been increasing over the years. In the next sub-chapter the last insurance line, non-life insurance will be presented.
4.5 The Non-Life Insurance Line

In this sub-chapter the non-life insurance line of the Insurance Group studied is presented. This sub-chapter, like the previous ones, is based on information received from the case study company. The information received in the interviews is complemented with public internal documents.\textsuperscript{129}

In the non-life insurance line, the Insurance Group offers its clients all major insurance classes. The Insurance Group has non-life insurance companies situated in all its regions, as illustrated in Figure 4.45. All the regional insurance companies offer private and commercial non-life insurance solutions. As industrial insurance is not limited to a specific region, and as the smaller regional non-life insurance companies cannot cover higher risks themselves, industry insurance underwriting is provided nationwide through a joint venture.\textsuperscript{130} In addition to the strict regionally acting non-life insurance companies, the Internet Insurer operates all over Germany. The timeline of the integration of the different insurance companies is also illustrated in Figure 4.45.

\textsuperscript{129} The internal references per section are listed in Appendix C.2
\textsuperscript{130} The underwriting joint venture and the travel insurance are not included in the analysis as they are managed outside of the Insurance Group main structure.
As illustrated in Figure 4.46 the Bavarian non-life insurances, with 83-85% of booked premiums, dominates the non-life insurance line within the Insurance Group. As illustrated in the charts, the growth rates in all regions have not differed very much, although Berlin-Brandenburg lost some weight compared to the Bavarian Non-Life insurers.

![Figure 4.46: Share of the non-life annual premium of the non-life insurers belonging to the Insurance Group](image)

The non-life insurance line brings 28% of the premium income of the Insurance Group. In 1995 the share was much higher (37%), but due to slow growth in non-life insurance in general this share has been declining over the years. However, looking at the profit before consolidation and taxes, non-life insurance is still the most profitable insurance line. The claims costs due to natural hazards notably decreased profits in 2002, 2004 and 2007 (see illustration in Figure 4.18). Before looking at the market position of the non-life insurance line the case company’s interpretation of the non-life insurance market will be presented.

### 4.5.1 The Insurance Group’s Interpretation of the Non-Life Insurance Market

The non-life insurance industry has constantly yielded a good return. However, it is mature, with no real potential for growth. Due to this stagnation, it has developed into a replacement market with competition concentrating on price. With the German Insurance Contract Act implemented in 2008, treaty periods have shortened and switching insurers has been simplified. Additionally, with the new act, insurance costs, both for administration and acquisition, are becoming more transparent. All these regulations have increased price sensitivity in the market. This in turn has led to an increasing focus on cost efficiency among non-life insurers.
The trend towards decreasing retention and increasing cost-sensitiveness is not seen as reversible. This will lead to decreasing margins also in non-life insurance. In order to keep the non-life insurance business stable, there is a need for long-term increased cost-efficient solutions through automation and simplification of the products and processes. The low capital return on investments since the subprime crisis in 2008 has increased the pressure even more on profitable underwriting and cost saving.

4.5.2 Position in the Non-Life Insurance Market

The non-life insurance part of the Insurance Group had a good start in 1995. In Bavaria the non-life insurance companies were able to take over the monopoly portfolio of building insurances. Additionally, as the main non-life insurance companies were founded as early as 1781, 1881, 1921 and 1951, they have been benefitting for a long time from the protected market before deregulation in 1994. This start has enabled the Insurance Group to grow to a medium-sized non-life insurer, with a German market share of around 3.6%. The Insurance Group has occupied ninth place among non-life insurance companies in Germany since 2004. In its major region Bavaria-Palatinate the Insurance Group is the market leader, with a customer share of 37-38%. The high customer share is grounded in the building insurance. The Insurance Group insures around 85% of all residential buildings in Bavaria and Palatinate. Although the Insurance Group is not the market leader in Bavaria and Palatinate in the other non-life insurance classes, the insurer and its employees have a standing and act as if they were market leaders in all insurance classes. Saarland Non-Life Insurance is also the market leader in its region. The non-life insurer, acting in Berlin and Brandenburg, has only 7% of the regional non-life insurance market.

The non-life insurance line of the Insurance Group has been increasing its market share constantly since 1995, as illustrated in Figure 4.47, left-hand side. Premium growth is developing slightly better than the German premium growth average, except the peaks in 2002 and 2004, when Saarland Non-Life Insurance and Berlin-Brandenburg Non-Life Insurance were consolidated into the Insurance Group (illustrated in Figure 4.47, right-hand side). Partly due to the acquisitions, the Insurance Group has been growing much more vigorously than the market between 1995 and 2010 (+70% compared to +11% market growth).
Although the total growth rates have exceeded market growth, only the Bavarian Non-Life Insurers show a steady rise, as illustrated in Figure 4.48.

Whereas the mature regions of Bavaria-Palatinate and Saarland have more or less followed the German market trend, the growth region Berlin-Brandenburg has a more individual curve due to stiffer competition among the actors in that region (even losing the market share they gained 2006-8 again in 2009-10).\footnote{Half of the decrease in 2010 is due to the decision to cut back the re-insurance business.}

\footnote{131}
Comparing the cost position of the non-life insurance line with the German non-life insurance market, it can be concluded that the average cost ratio, including both the administration and the acquisition costs, is below the market average (illustrated in Figure 4.49). One major reason for the low cost level in Bavaria is the former monopoly insurance portfolio, where no commission is paid.

Although the average is below the market cost average, the regional non-life insurers in Saarland, for many years, and Berlin-Brandenburg, consistently, have cost ratios above the market level (also illustrated in Figure 4.49). The goal is for the Berlin-Brandenburg and Saarland region to reach the cost ratio level of the Bavarian Non-Life Insurers. Whereas Saarland Non-Life Insurance has been decreasing its cost ratio, the trend in Berlin-Brandenburg looks rather unstable. Dividing the cost ratio into administration and acquisition cost ratio, it can be concluded that Berlin-Brandenburg has been decreasing its administration cost ratio (except in 2010 due to the decreasing portfolio), although not to the ratio of Bavaria and Saarland. However, during the acquisition cost ratio has been increasing.

The combined ratio, where the claims ratio\(^{132}\) is added to the cost ratio, shows the profitability of the insurance business. As illustrated in Figure 4.50, the Insurance Group has a combined ratio around the market average. Whereas the Bavarian Non-Life Insurers are below the market average the other regions exceed the average combined ratio. This is mainly due to higher claims expenses in these regions.

\(^{132}\) The claims ratio refers to the costs for claims incurred for the accounting year as % of earned premiums.
The last component influencing the profit of a non-life insurance company is the capital return on investments. Generally, the capital return has been compensating for a high combined ratio in all insurance lines. As illustrated in Figure 4.51 the Insurance Group interest on investments remains somewhat below the German market average.
Now after looking at the parts that influence the profit of a non-life insurance company, it is time to take a look at the profit of this insurance line. The profit of an insurance company partly comes from the underwriting results (insurance-technical results) and the non-underwriting results (capital return on investments and special effects). As illustrated in Figure 4.52 the non-life insurance line has been contributing positively to the Insurance Group results (profit before taxes) since 1995. The contribution does not mainly come from the underwriting results but from the non-underwriting results, however.

*Figure 4.52: Development of non-life underwriting results*

After discussing the current results it is time to look at aspects that determine future results. Like all the other insurance lines, the non-life insurance line participates in a regularly conducted customer satisfaction survey. As illustrated in Figure 4.53 the non-life insurance line has been following the ratings of the Insurance Group. Since 2007 both the Insurance Group and the non-life insurance line has been catching up with market average. The non-life insurance line in 2009 even reached the market average level in treaty administration service rate as illustrated in Figure 4.54.
Figure 4.53: Non-life insurance customer satisfaction rate development compared to the German Insurance Market and the Insurance Group customer satisfaction rates (% of customers who are satisfied or very satisfied with the service and offerings)

Figure 4.54: Treaty administration service index of non-life insurance line compared to German Insurance Market and the Insurance Group rates (% of customers who are satisfied or very satisfied with the treaty administration)

Generally, the non-life insurance line has exceeded market growth and at the same time has been able to keep a cost ratio below the market average. As the capital return on investments more or less follow the market average, all these indicators confirm the stable position of the Insurance Group in the German non-life insurance market. The insurance companies in Bavaria-Palatinate have some regional advantages, as the Bavarian market is more stable than the rest of Germany. Additionally, in this region the Insurance Group was able to take over the former monopoly portfolio of two million real estate insurance contracts. Although the strict monopoly situation has
been deregulated since 1995, the customers have still not reacted to deregulation. The lapse rate has been very low. The market share in real estate insurance has only decreased from 98% in 1995 to 85% in 2010. This is partly due to the good reputation of the Insurance Group and partly due to the rather complicated procedure for switching real estate insurance coverage. It will be a challenge for the insurer to keep and develop these two million real estate insurance contracts, especially as the procedure to change the real estate insurance is being simplified. Although Saarland Non-Life Insurance inherited a monopoly building insurance portfolio long before the Second World War, it still has a market share of 30% in building insurance. This shows the loyalty of building insurance clients.

In Berlin-Brandenburg building insurance does not have any relevance, as the policies from the state-owned time were transferred to free agents during the union of eastern and western Germany. Here the situation is not developing as well as in the other regions. Due to high competition in the region, growth from 2006-2008 was lost again in 2010. This together with high acquisition costs and small operations does not enable the insurance to attain a stable position. The situation for Saarland Non-Life Insurance is more stable. They have exceeded the market growth rate, although the region is actually declining. At the same time Saarland Non-Life Insurance has been able to lower the cost ratio and keep the claims more or less on the market average level. This has enabled them to earn a small profit over the years. The Bavarian Non-Life Insurers are the main contributors of profit, however. In order to get a more detailed picture of the non-life insurers market position, the sales channels, the customer structure and products will be discussed next.

4.5.2.1 Sales Channels of the Non-Life Insurance Line

The non-life insurance line uses all sales channels available in the Insurance Group. In the region of Bavaria-Palatinate as well as in Saarland, agents are the main sales channel, although the Savings Banks are becoming increasingly important. In Bavaria the branch offices, which mainly take care of the building insurance customers from the monopoly inheritance, have been developed into a main sales channel since 2005. The aim is also to increase the cross-selling ratio of the more than two million real estate insurance customers. However, the branch offices still need to be further developed concerning their sales culture, and an effective customer relationship concept needs to be developed. One step in this direction was their integration into the sales division in 2009. In Berlin, insurance brokers are the main sales channel in non-life insurance. This is an expensive and limitedly loyal sales channel. As stated by a non-life manager in Berlin, “the business comes fast if good conditions are offered, but it also disappears fast if somebody else offers better conditions for the sales channel”.

In non-life insurance new sales channels like retail sales channels (i.e. motor insurance via car dealers) and Internet sales are gaining market share.
These price-competitive sales channels are threatening the service insurers as adequate service is offered through these sales channels as well. The Insurance Group started its own Non-Life Internet Insurance in 2008. The idea is not to push this sales channel with marketing activities but to offer active clients an Internet channel. Very few existing insurance customers (1-2%) cancelled their contracts in favour of a cheaper insurance policy with less coverage via Internet Insurance. Therefore, the Insurance Group does not see any risk of cannibalising their other sales by offering cost-optimised Internet based non-life insurance solutions.

4.5.2.2 Customer Structure of the Non-Life Insurance Line
The Insurance Group has just recently started to gather data in order to be able to evaluate their customer structure. There is a general belief that the customer structure has not changed since 1995. However, at the same time, as with the life insurance line there is a strong feeling among some of the managers interviewed that the customers are getting older. In non-life insurance the average customers are 40+ and one third of the customers are between 45 and 65 years old. The consequence of the ageing clients is interpreted in different ways. On the one hand it is seen as an issue, as the insurance company is not attracting younger customers. On the other hand it is seen as an advantage, as elderly clientele have a solid claims profile and are very loyal. Maybe partly due to their age, the customers in Bavaria-Palatinate are wealthier than the average German population. Derived from the huge real estate insurance portfolio, the average client also owns a house. However, due to the insurer’s passive role, these clients usually do not have an additional insurance policy at the insurer.

In contrast to Bavaria and Palatinate the customer structure in Berlin-Brandenburg is socially weak. Therefore, price sensiveness is higher in Berlin-Brandenburg than in the other regions. Saarland Non-Life Insurance also has mainly elderly customers. However, this is not mainly due to building insurance but rather to elderly sales agents. Saarland Non-Life Insurance is therefore trying to reach younger clients through the Savings Bank sales channel.

The Insurance Group, just like its main sales channel, the Savings Banks, does not target any specific customers groups. Both institutions aim to reach everybody in the region. In order to ensure insurance offerings for all groups, the retail customers have been divided into age groups for a couple of years. Additionally, the insurer has been developing special insurance concepts for two main age groups; active 50+ and young adults. This is due to the existing customer structure and the aim of attracting a younger clientele. Although a special concept was developed, no obvious change among the younger clientele has been registered among the managers.
4.5.2.3 Non-Life Insurance Products and their Development

Speed in introducing new products is gaining in importance. The insurer can introduce new products faster than the market, but still not as fast as their peer group (the top 5 non-life insurers on the German market). The main reason is the complexity of coordination due to multiple interfaces and functions being involved in the product development. Responsibilities are centralised in Munich for all non-life insurance companies. All product issues, that is, new product development as well as alterations of existing products, are discussed in the Non-Life Insurance Governing Board. The corporate process introduced in 2010 and the multiple responsibilities in the non-life insurance division introduced in 2008 make product development rather complex. The responsibilities of the Corporate Product Board and Committee versus the Board of Directors responsible for the revenue and profit of the insurance line are still not fully settled. With gained experience concerning the roles and responsibilities, the corporate process is expected to run more smoothly.

The insurer does not have innovative or special products. Product development in non-life insurance line follows a “me-too” product strategy. The insurer offers two classes of standardised insurance products – compact and optimal. The compact is developed with the goal of winning and keeping clients that are price sensitive, whereas the optimal is offered to the service-oriented clients, including add-ons like assistance services. With the compact and the optimal versions offered, the insurer is keeping up with the rest of the market. The innovation is not seen as the major challenge in product development, but IT is. The IT systems were not flexible enough to support innovative products before IT migration. In 2010, due to the increased capabilities offered by the new IT systems, the insurance company decided to move away from the optimal and compact product structure towards a more component-oriented product structure.

Saarland Non-Life Insurance has successfully been offering standardised bundled products for their retail customers since 2005. With these simple offers multiple risks can be covered with one contract and with one signature. Berlin-Brandenburg Non-Life Insurance followed the idea and introduced a private bundled product in 2008. Also in Berlin-Brandenburg the bundled product is very successful. Retail bundles have not yet been introduced in Munich. This is partly due to the fact that the old treaty systems could not support them and partly due to the fact that Munich has not seen the benefits of offering bundled products to retail customers. Due to the success in the regions and due to the fact that the new systems introduced in Munich could support the bundle structure, the bundled products is being analysed also in Munich in 2010. In all cases it is becoming increasingly important to develop simple products. The sales channels are requesting simple products, and the administration of simple products is more efficient.
The non-life insurance line therefore started a project in 2010 analysing the products with the aim of reducing the exceptions allowed.

The customer satisfaction survey has shown that product satisfaction has increased to approximately 35% of the customers being satisfied with the non-life insurance products offered. This is due to the increasing flexibility and scope of the products. The price is not seen as advantageous to the insurer. Although product satisfaction is increasing among the customers, it is still lower than the market average. These results confirm the insurer’s own position that they do not differentiate themselves with their product offerings.

4.5.2.4 Summary of the Non-Life Insurance Market Position

The non-life insurance line has an average position on the German market. As one first line manager pointed out, the insurer, at least in Munich, has the optimal size: “it is big enough to be able to carry the costs and small enough to be able to react to market dynamics”. The non-life insurance line has exceeded average market growth, mainly due to acquisitions, and has also been able to keep the cost ratio below the market average.

Table 4.15: Non-life Insurance market development

<table>
<thead>
<tr>
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<tbody>
<tr>
<td>Non-life insurance market characteristics - Insurance Group’s interpretation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Market development</td>
<td>Limited growth market.</td>
<td>Stagnating market constantly yielding a good return.</td>
</tr>
<tr>
<td>Cost orientation</td>
<td>Limited cost orientation</td>
<td>Increased cost orientation due to stagnating growth and decreasing capital return on investments.</td>
</tr>
<tr>
<td></td>
<td>due to high capital return on investments.</td>
<td>The new insurance act has led to increased cost transparency.</td>
</tr>
<tr>
<td>Predictability</td>
<td>Highly predictable market</td>
<td>More unstable and unpredictable market due to shortened contract periods and increased competition.</td>
</tr>
<tr>
<td></td>
<td>with loyal clients.</td>
<td></td>
</tr>
<tr>
<td>Financial/Quantitative performance of the non-life insurance line</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Profitability of non-life insurance business</td>
<td>Higher than market.</td>
<td>Higher than market – however market is catching up due to increasing cost levels in the non-life insurance line of the Insurance Group.</td>
</tr>
<tr>
<td>Capital return on investments</td>
<td>Stable around 7%.</td>
<td>Decreasing just like the average market level to 4%.</td>
</tr>
<tr>
<td>Market share</td>
<td>2.5%</td>
<td>Has increased to 3.6%, albeit due to the acquisitions of Saarland and the Berlin-Brandenburg Non-Life Insurance.</td>
</tr>
<tr>
<td>Non-financial/Qualitative performance of the non-life insurance line</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Customer satisfaction</td>
<td>Below the average German insurance market.</td>
<td>Reached German average in 2007, partly due to a decreasing market trend concerning customer satisfaction.</td>
</tr>
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</table>
The real estate insurance portfolio inherited from the state at its foundation in 1995 entitles the insurer a good base from which to develop the market position further. This, however, requires that the insurer is taking an active role. In the next sub-chapter the strategy for handling this market development will be discussed. Before looking at the strategy of the non-life insurance line, the aspects discussed in this section are summarised in Table 4.15

4.5.3 Strategy of the Non-Life Insurance Line

In this section the non-life insurance strategy in the Insurance Group is presented. Just as with the other insurance lines, the presentation will start with the business strategy of the non-life insurance line. Thereafter the production strategy will be presented. The section will be summarised by mapping the data collected to the strategy aspects identified in the theory chapter.

4.5.3.1 Business Strategy of the Non-Life Insurance Line

The non-life insurance strategy project that started in 2007, as a part of the corporate strategy initiative, concluded that the non-life insurers in Bavaria until that point had a reactive business strategy. The aim of the project was to change that and at the same time keep the framework given by the corporate global goals. The non-life insurance line benefits from the group-level competitive strengths of being a solid insurance provider with an image of being a trusted caretaker. Additionally, the well-known brand and the expertise in fire and building insurance and the strong sales channels are very beneficial for the non-life insurance line. These competitive strengths, which were mainly built up in the past, are implicitly reflected in the business strategy developed in non-life insurance. The resulting business strategy was documented as follows in an internal strategy paper: “Ensure growth based on know-how and long history, especially building on the excellence in the fire and municipality business, customer and sales-channel orientation, speed and quality, target-group-oriented offerings, and if necessary sales-channel-oriented offerings. Internally growth is supported by a communicative management.” In addition to interpreting how the global goals are to be understood in the non-life insurance line, the task of the strategy project was to identify market potential in defined customer segments. The results of this part, which was rather quantitative, were used in the annual planning process. The internal strategy paper, just like the corporate global goals, provides the potential to develop ideas in many directions. As pointed out by an insurance line manager, “it does not give guidance concerning what to do and what not to do”. The main benefit of the strategy project was therefore a picture of the market growth potential, according to both top and middle management.
All the insurance lines within the Insurance Group have a growth target upon which the business strategy needs to be based. Although growth is the main goal, stabilisation of the huge real estate insurance portfolio is also an important goal in the non-life insurance line. Cross selling to this huge customer base is seen as a potential way to reach the growth goal. During the last years the cross-selling ratio has increased somewhat; however, this has also led to increasing acquisition costs, as growth in a stable market is expensive. In the past the non-life insurance line has grown more than the market mainly due to its external acquisitions. Additionally, an insurance company can easily increase its revenue by accepting risks that are questionable and that are avoided by competitors. Consequently, there is a need to balance growth with profit. This has especially been highlighted since the subprime crisis in 2008.

The non-life insurance line does not have its own positioning on the market, but follows the Insurance Group’s positioning as a price competitive, multi-channel service insurer offering all customers all insurance products they need. Although a group-wide high-level strategy paper was developed for the non-life insurance line, each region still develops its own strategy based on the global goals reflecting the regional market situation. All the insurers are pretty well positioned as trusted caretakers providing basic insurance solutions. This is strengthened by marketing campaigns where the insurer is positioned as an insurance company that looks after the customer issues as if they were its own insurance issues and by ensuring fast and fair claim adjustments.

A service insurer is defined in non-life insurance as an insurance company offering the customer to take care of the details and the decisions for them. This is done by offering the clients consultation. The sales channels are very important in this positioning, as the service and the consultation to the customers is provided through the sales channels and not directly from the insurance companies. Although it is improving, the service to the sales channels still has some obstacles that need to be surmounted, such as the postponed technical implementation of a direct information channel to the sales channels concerning the status of their clients’ applications. Although the insurer is not competing aggressively based on price, it aims to combine the service positioning with lower prices than its main competitors. According to middle management, the price level is not always transparent, however. The insurance company is not perceived, sometimes actually not even among the colleagues, as offering a good price even though the offering is very competitive.

The goals and strategy have not really changed since 1995. They have often been discussed but not really altered. As stated by a manager involved in the strategy project: “The insurer has just been doing business without thinking about strategic things like market positioning. Due to the success, there has not been any pressure to change things, and no strategic decisions have been taken. The pressure from the market is increasing, however.”
pressure has not led to any strategic decision-making but to more cost-oriented behaviour since 1999/2000. Many of the middle managers interviewed state that costs are currently saved without having a framework to guide the prioritisation of themes and projects. This makes savings less transparent to the employees and actually also to the middle management. The potential in the other direction, that is, to find areas were the customers are willing to pay a premium price are starting to get some attention due to the non-life strategy project, although they currently have lower priority than cost saving. Multiple interviewees expressed the increasing importance of strategic thinking as the competition for the building clients has increased. Other insurers have their eyes on this group, as real estate owners are wealthy customers. The old monopoly portfolio is therefore probably going to be more unstable in the future and needs to be counterbalanced with more active strategies. Since the strategy project, an annual strategy process has been established. Although the strategy is discussed annually, it is again positioned as preparation for the starting meeting of the corporate planning process. As a non-life board member stated, although not answering the market position question, “the strategy has enabled the non-life insurance line in Munich to develop a clear picture supporting the planning”.

4.5.3.2 Production Strategy of the Non-Life Insurance Line
The sales channels are seen as the customers of service production. Although the insurer positions itself as a service insurer, there is potential for enhancement. Service production is still very internally oriented. “The insurer is in the middle of a paradigm change from an internally oriented organisation to a customer-process-oriented organisation. The culture needs to be reshaped towards service and customer orientation.” However, the change needs to be supported with customer-oriented process structure and customer-oriented systems. As pointed out from a board member, “Service orientation means that also the internal supporting functions and processes need to be customer oriented. However, today productivity is the main goal when processes are evaluated.” A project ensuring customer-oriented processes was planned to start in 2008 but was postponed until 2010. At the same time, in order to ensure a cost ratio below the market average, the goal is to make the service production faultless and efficient. This can be done through automation. Automation is seen as a win-win-solution. The customer, alternatively the sales person, can see the transaction status, and the insurance company has no media disruptions. At the end of 2010 the insurer was able to implement automation in all major retail non-life insurance lines in Munich and in Berlin. In claims, quick claims handling tends to increase the service level and minimise costs. Therefore the insurer has implemented a fast claims management with a “clean desk” policy. That is, the incoming claims should be handled the same day they are received.

133 Statement from one non-life insurance board member.
Additionally, in order to increase speed, some claims are directly regulated over the phone.

Treaty administration and normal claims handing has been developing from expertise-oriented service production to a standardised mass service supported by IT systems. This development is especially visible after the introduction of the customer and sales partner service centre in July 2008.

In Berlin, service in production is defined as friendly, competent and fast administration. In order to be able to ensure this flexibility, it is important that the employees are able to take care of multiple transactions and insurance classes. This is not the case right now, especially as the different insurance classes are supported by different treaty systems. However, at the same time the systems support automation and easier administration, as the decisions are programmed into the systems. This supports cost efficiency in operations.

Although a board member pointed out that the challenge in service production is a question of finding “a mixture of being able to work cost efficiently and ensuring satisfied customers”, Saarland Non-Life Insurance also has the goal of increasing the cost efficiency. This is to be achieved by increasing the level of automation. The early implementation in 2002 was seen as a competitive advantage. Besides the high level of automation, service production could be organised better, ensuring all-round treaty administration. This would be especially beneficial due to the critical size of Saarland Non-Life Insurance. Actually, as Saarland Non-Life Insurance has been able to lower their administration costs since the merger into the Insurance Group, the aim is to keep the low cost level and to increase the quality in the treaty administration. Issues like increasing telephone accessibility and shrinking the backlog and the throughput time are therefore increasingly receiving management attention.

The insurer does not have any special positioning in service production. The new customer and sales partner service centre is seen by many of the managers in non-life insurance as independent of the market positioning. “It is ‘just’ a service unit which should keep the service level agreements set up.” The production strategy issues are therefore not discussed in an explicit process. Some aspects, like the capacity needed to ensure agreed service levels, are integrated into the annual planning process. Additionally, production issues are discussed in regular meetings among the main department and department managers as well as in inter-functional work groups. With the implementation of the customer and sales partner service centre, production issues have been receiving increased attention. In the non-life insurance strategy paper the customer and sales partner service centre was positioned to support mainly the cost position goal, by increasing productivity and thereby continually reducing the headcount. This has some effects as stated by one manager responsible for the service centre: “At the end of 2009 the non-life customer and sales channel service centre was actually keeping the service level agreements more or less. In 2010 they are
not being maintained anymore. This is due need to reduce the headcount in order to reach the cost-saving targets”.

The regional non-life insurers in Berlin-Brandenburg and in Saarland highlighted that the intense interaction between point of sales and production employees, was seen to have strengthened the market position. However, they have also altered the goals towards productivity and efficiency in the last few years.

4.5.3.3 Summary of the Non-Life Insurance Line Strategy

The non-life insurance line follows the corporate global goals and the group positioning as service insurance. The starting position and the inherited competitive strengths are reflecting the good position of the non-life insurance line. Although the non-life insurance line started a strategy process in 2007, there is a need for a framework that can support an overall prioritisation of themes and investments. The corporate image of a trusted caretaker is strengthened by marketing campaigns and by ensuring fast and fair claims adjustment. Service production, which receives little attention, has been developing towards productivity and efficiency with an increasing level of standardisation and automation. The aspects of business and operations strategy in non-life insurance lines are summarised in Table 4.16.

Table 4.16: Strategic aspects of non-life insurance and production strategy (in cases where the aspects differ between the non-life insurers this is indicated in the table; if there is no indication the statement is valid for all the non-life insurers)

<table>
<thead>
<tr>
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<tbody>
<tr>
<td>Goals of non-life insurance line</td>
<td>Growth goal stressed on corporate level.</td>
<td>Based on the corporate goals, the non-life goals are oriented towards growth combined with ensuring profitability. In non-life the stabilisation of the huge real estate portfolio is seen as a baseline for growth.</td>
</tr>
<tr>
<td>Competitive market position of the non-life insurance line</td>
<td>Stable and trusted fire insurer with a reactive role on the market.</td>
<td>Market leader in fire insurance in the region. Marketing differentiation based on the trusted caretaker image, but combined with cost-centred orientation.</td>
</tr>
<tr>
<td>Valuable resources/capabilities in non-life insurance line</td>
<td>Know-how in fire insurance. Image of a caretaker. Cost benefits from the inherited monopoly portfolio.</td>
<td>The inherited valuable resources. The sales channel of own branches.</td>
</tr>
<tr>
<td>Non-life insurance line production strategy / Characteristics of the production</td>
<td>Little attentions given to production. Strict hierarchical decision rights.</td>
<td>Mass production supported with automation and IT since 2008.</td>
</tr>
</tbody>
</table>
### 4.5.4 Control in the Non-Life Insurance Line

In this section the control processes and systems used in the non-life insurance line are presented. The mechanisms already described from the corporate control point of view will be complemented by the non-life insurance perspective. In the first part the management and the production control implemented in non-life insurance lines are described. Thereafter the planning process and the reporting structure will be discussed before the section is summarised.

#### 4.5.4.1 Management and Production Control in the Non-Life Insurance Line

The Insurance Group use tight financial controls over the business units but take little interest in their strategic planning. The group-level management control is mainly concentrated on the planning and reporting process. Some standard tools and projects are additionally coordinated on the group level, like benchmarks used for the assessment of headcounts and cost levels. The control process has been getting more centralised over the years. In the past the insurance line control units were able to act more independently from Corporate Control. The non-life insurance line reporting is now following the measurements and the formats coming from the corporate level during the planning and control processes. In addition to the corporate measurements, the insurance technical results and the combined ratio is measured per product on the non-life insurance line level. Product profitability is also compared with the sales targets per product in order to ensure that sales support or adequate commissions push the profitable products. However, in order to enable correct and timely control on the product level there is a need for an IT-enabled approach where product portfolio information can easily be gathered and analysed. For this purpose a
A data warehouse was developed in Munich during the study time frame 2005-2010. Saarland Non-Life Insurance had already developed tools that support the business responsible managers when they analyse claims on the contract level, contracts on the sales-partner level and profit on the product level.

In 2002 implementation of a comprehensive management control in non-life insurance line was started. Meetings were held in order to evaluate which method and tool to use. Balanced scorecard was chosen for implementation. This implementation was initiated from the former CEO and was conducted together with McKinsey. Just the financial dimension of the balanced scorecard was used. It was only implemented on a very high level and was therefore not really useful as a management control tool on the non-life insurance line level. Therefore it was abandoned after a couple of years. A board member in the non-life insurance line stated that the current management control systems and process of the Insurance Group are nearer to practice. It is a non-complex system, based on the annual plan. It is easily understood compared to e.g. the EVA-method used by other insurance groups. This increases the usability of the management control system.

In production control the backlog is consolidated into the monthly report on the corporate level. Due to the limited focus on production in general, for a long time very little was done in production control. In 2003 some internal benchmarks were implemented between the units. The aim of production control was and still is to ensure that a transaction is finalised efficiently and error-free. It is also important to be accessible for the customers and the sales channels. The production control measurements are aligned with these requirements. Until the advent of cost orientation, which started around year 2000, quality and customer-orientation was more important than productivity and efficiency. Nowadays it is the other way around. Efficiency is measured by using quantitative targets like number of transactions, backlog, turnaround times and the oldest open transaction. Until the introduction of the customer and sales partner service centre in 2008, ad hoc indirect and manual measurements or even rules of thumb were partly used, as the IT systems did not deliver objective statistics that could be used for production control. As a result, comparability between the entities was difficult and production control was rather opaque.

With the implementation of the customer and sales partner service centre, specialist functions for production control were introduced. They monitor the workload of the different departments and prepare reports based on service level agreements of production time and accessibility. Although some ad hoc measurements are used to check the quality of the calls and outgoing correspondence, the control systems introduced so far are rather productivity oriented. This accords with the aim of trimming the organisation towards efficiency. However, based on the results of the sales channel satisfaction survey conducted in 2009, action plans have been prepared to increase the level of quality in the customer and sales partner service centre. Still no more quality-based operational measurements were implemented as a part of the
regular production control. Generally in production control, the cultural sides of engagement and motivation of the employees receive very little attention; instead the work is evaluated and controlled via quantitative measurements. However, production control is not only a matter of the measurements used. It is a mixture between measurements, meetings, and dialogue between different hierarchical levels. During meetings operational issues like feedback from the sales channels, complaints, capacity, cost issues, backlog, forecast for the next 2-3 weeks and action plans to reach the planned goals are discussed. These meetings were introduced as a reaction to the low service level after the introduction of the customer and sales partner service centre.

As non-life insurance has many insurance classes with different demand peaks, capacity could be adjusted in the insurance line. The main issue is the skills of the administrators. In order to be able to adjust the capacities, the administrators need to be trained in multiple insurance classes. This is not implemented in all areas. Therefore, there are still some peaks. Holidays are planned taking the annually recurring peaks into consideration. Major accidents or elementary incidents of course cannot by planned. When an incident occurs it occurs. In these cases an external call centre can be engaged to take care of the phone calls and register the claim applications. The call centre does not administrate the transactions, however. They only keep the customers away so that the administrators can work without being disturbed. This is not efficient but is seen as a compromise to the cost efficient average capacity.

In the non-life customer and sales partner service centre the telephone is more highly prioritised than correspondence in the event of peaks. The telephone departments have capacities to handle average demand. In case of higher levels of demand the correspondence departments support the telephone departments. During peaks, when the transactions cannot be managed during normal work hours, employees are asked to work overtime. If the capacity management actions are not enough to manage the situation, there is no other choice than to let the work fall behind. This conforms with the market and is also accepted at the insurance company, although backlog targets are strictly monitored. The empty table policy\textsuperscript{134} followed in claims handling is also a way to handle volume differences, as people that are used to the empty table policy work with the speed needed to ensure that they do not get a backlog. Generally, with increased automation changes in the volume will cause less trouble in service production.

\subsection*{4.5.4.2 Planning and Reporting in the Non-Life Insurance Line}
Since 1997, the non-life insurance companies are integrated into the corporate planning process. With the introduction of the Non-Life Insurance Governing Board in 2005, planning and control was additionally

\textsuperscript{134} The daily claims applications should be handled during the same day.
consolidated on the insurance line level. In the non-life insurance line a couple of regional meetings are conducted annually, where the planning and action plans are discussed based on market developments as well as internal priorities. At these meetings the priorities within the non-life insurance line are agreed upon per region.

The planning process from the non-life insurance line level starts with the preparation of the corporate start meeting. Although target setting is a top-down process, the non-life insurance line control department supports the process. In the start meeting the strategic insurance lines and insurance classes to be pushed via the corporate sales channels are approved. This is a critical decision for the insurance lines as the sales capacity is limited. Therefore the support for the preparation of the start meeting from the insurance line side is considered essential. It ensures that the market know-how available in the non-life insurance line is adequately taken into consideration during the target setting process. After the top-down targets per region are approved a bottom-up planning processes is started. Since 2005 all the plans in the non-life insurance line are integrated into the profit and loss plan. The prepared plans per regions are discussed in the Non-Life Insurance Governing Board before they are sent to Corporate Control and presented to the Board of Directors for approval.

The planning process is coordinated and verified on the group, insurance line, insurance company, insurance class, sales-channel and department levels. The planning process therefore takes considerable time and binds many resources. Especially the discussions about priorities between the insurance classes bind much management capacity. Some more decisions from the corporate level concerning priorities would limit all these discussions.

The approved plans are managed and coordinated on the regional level, and the results are regularly reported in the Non-Life Insurance Governing Board. Monthly reports are also prepared for Corporate Control. In these reports market developments and the fulfilment of the action plans are also included. In addition to the management control measurements, the backlog situation is also reported monthly to the corporate level. In the monthly reports traffic light logic is included. All red and yellow issues as well as major success issues are discussed at the regional Board of Director meetings. Additionally, current developments compared to plan as well as action plans and production control are discussed in the Non-Life Insurance Governing Board each month. Although discussed on the insurance line level in the governing board, the control of the results is a regional responsibility. In the event of a plan difference the regional Board of Director is responsible for setting up an action plan.

Control has been changing due to the subprime crisis starting in 2008. As the capital return on investments is limited, there is more pressure to maintain the underwriting/claims ratio and cost ratio. The control process has not changed, but the awareness of maintaining the ratios has increased.
Before the crisis the managers were not really sensitive concerning targets. As control is receiving more attention, the results are discussed more intensively among management.

### 4.5.4.3 Summary of Control in the Non-Life Insurance Line

The non-life insurance management control systems and processes are aligned with the corporate processes. Some few additional aspects like insurance technical results and combined ratio per product have been included in the non-life insurance line control. Production control is still not as sophisticated and does not get the same attention as management control. This was said to be not only due to lack of interest; it was also interpreted to be a sign of trust that production is well managed. Comparability and transparency in production control was said to have increased after the introduction of the customer and sales partner service centre. Overall, the control system has been changing towards centralised coordination over the years. As one main department manager points out this has also been changing the culture of the company. “We are changing from wanting to do everything right for the customers towards wanting to make everything transparent”. The aspects discussed in non-life insurance control systems are summarised in Table 4.17.

*Table 4.17: The developments of non-life insurance control system between 1995 and 2010*

<table>
<thead>
<tr>
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<tbody>
<tr>
<td>Control processes</td>
<td>Top-down oriented processes, with</td>
<td>Tight control with frequent</td>
</tr>
<tr>
<td>characteristics in the</td>
<td>limited bottom-up involvement,</td>
<td>and detailed monitoring of fixed</td>
</tr>
<tr>
<td>non-life insurance line</td>
<td>where targets were more seen as</td>
<td>targets set top-down.</td>
</tr>
<tr>
<td></td>
<td>guidelines.</td>
<td>Full regional bottom-up involvement.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>The awareness about maintaining</td>
</tr>
<tr>
<td></td>
<td></td>
<td>targets only changed due to the</td>
</tr>
<tr>
<td></td>
<td>Informal processes with limited</td>
<td>Rigid and formal processes</td>
</tr>
<tr>
<td></td>
<td>attention from non-life insurance</td>
<td>with integrated reporting on the</td>
</tr>
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<td></td>
<td>line side.</td>
<td>non-life insurance line level.</td>
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<td></td>
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<td></td>
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<tr>
<td></td>
<td>Diagnostic controls where actual</td>
<td>Diagnostic controls where actual</td>
</tr>
<tr>
<td></td>
<td>results are compared to plan.</td>
<td>results are compared to plan.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Due to financial crisis in 2008</td>
</tr>
<tr>
<td></td>
<td></td>
<td>more interactive control.</td>
</tr>
</tbody>
</table>
### 4.5.5 Organisational Structure of the Non-Life Insurance Line

In this section the organisational structure of non-life insurance is discussed. The first part deals with the formal structure including the coordination in non-life insurance whereas the last part is dedicated to the non-life insurance work organisation.

#### 4.5.5.1 Formal Structure of the Non-Life Insurance Line

Due to the multiple insurance classes and customer groups the organisational structure is more complex in this insurance line than in the life and health insurance lines. In order to manage this complexity the following organisational structural changes have been implemented.

During consolidation the non-life insurance line in Bavaria-Palatinate was organised by customer group. Each customer group handled multiple functions like sales, consulting, underwriting, treaty administration and claims. The aim of the organisation structure was to ensure continuity in
customer contacts and client expertise and thereby to strengthen the customer orientation instead of highlighting the insurance classes. However, the structure also led to an increased need for coordination among the units concerning the insurance classes. The customer and sales partner service centre introduced in July 2008 led to structural changes in the whole non-life insurance organisation. With the implementation the standardised service operations and the specialists were divided into different organisational entities. With the new structure the insurance classes were highlighted instead of the customer groups within the specialist entities. The role of insurance class manager was even positioned as a group-wide role and not limited only to the Bavarian region. In order to ensure that the interests of the customer groups are still maintained, managers for the customer groups were also implemented. Additionally, in order to coordinate the interface with sales and marketing, sales-channel managers for all the sales channels were implemented in the non-life insurance organisation. With this re-organisation a matrix organisation was introduced.

Although the aim with the new organisations was to ensure an efficient and clear structure with clear definitions of roles and responsibilities, the implementation of the matrix organisation in July 2008 led to some confusion concerning responsibilities. As the responsibilities were not clearly defined, many conflicts had to be solved. This led to an immense coordination effort in the beginning. A manager summarised the situation with the following sentence: “A matrix is difficult to live if there are no common goals and if the persons are not willing to take active responsibility”. Although all the issues are not yet resolved, a non-life insurance board member finds the matrix structure beneficial, as it supports the process of “making issues explicit that in the past were implicit”. Due to the Munich-based clarification process, the insurance line managers have not yet expended their responsibility area outside the Bavarian region.

Claims handling has also been reorganised since consolidation. In 1995 there was only one centre for claims handling, with nearly 300 employees. Disciplinary and expertise responsibilities were divided during that time. However, this organisation structure led to low transparency in the claims centre concerning tasks and responsibilities, decreasing productivity and low work morale. In order to solve these problems eleven claims units were introduced. In 2001/2 these claims units were re-organised into three regional centres. Within the three claims centres quick claims and more complex claims are handled. They are organised by region and insurance class. Some 60-70% of the employees deal with phone-calls, where claims are reported, and they also finalise the claims handling when the written claims information arrives. In addition to the three claims centres, the administration of major claims is centralised in a separate entity. In 2008 a project was started with the aim of reorganising claims handling and developing a new claims system. The implementation of the new structure and the deployment of the new system is planned to be finalised in 2011.
The new structure will follow the organisational guidelines of the customer and sales partner service centre, that is, the work will be divided into standard and expertise claims administration. The goal is to have an organisational structure across all regions. This includes consolidation of task and load balancing among all German regions where the non-life insurers are active.

Over the years the level of coordination has increased between the insurance lines and regions, due to common systems, sales channels and centralised functions. In the non-life insurance line two dimensions of coordination need to be considered; coordination between insurance classes and functions in one regional non-life insurer, and coordination between the non-life insurance line and the centralised functions.

The previous customer-oriented structure led to a high degree of coordination in the insurance line. The structure also resulted in complex business processes and systems due to the multiple requirements coming from the different customer groups. The new matrix-oriented structure did not reduce the complexity or the conflict in the organisation. However, it ensures that different points of view are considered at common meetings. Due to dual responsibilities, many functions need to be involved in decision-making, which, especially during the first months after implementation, has led to long discussions before decisions could be taken.

Coordination between the non-life insurance line and the centralised supporting functions is also rather complex. This coordination is managed via the interface of responsible roles in Munich. For example, the sales channel managers coordinate all sales issues and the system engineering all issues concerning IT-systems. However, the common sales channels and the common systems among all insurance lines are making coordination very complex, and the changes are becoming almost unmanageable. “Especially as the barrier between sales and the insurance lines seems to be cultivated.”

The coordination of tasks and the prioritisation of common developments among all regions are discussed and decided upon by the Non-Life Insurance Governing Board, where all insurance companies and the centralised supporting functions are represented. However, as stated by a mid-level manager supporting the governing board: “Due to the lack of strategic discussions, there are no clear rules supporting the prioritisation of the different regional requirements. Due to this lack the decisions are based on the power-situation of the requester.”

In Berlin-Brandenburg and Saarland the companies are much smaller. This enables easier and faster coordination with the regional sales organisation as well with IT. Also, the fact that the responsibility in these regions is centralised among very few managers makes coordination and consensus-finding very much easier.

135 Stated by a member of the board responsible for the non-life insurance line.
4.5.5.2 Work Organisation Structure of the Non-Life Insurance Line

The work organisation structure was adjusted when the customer and sales partner service centre was introduced in Munich. The standardised and the more complex requests were divided from each other. The aim was to decrease the turn-around times by continually increasing the number of standardised tasks. The employees in service production follow explicit written procedures. The line managers settle issues that are not standardised and explicitly documented. In the service centre, as in the old work organisation structure, the department managers manage the work. They sort out important transactions and divide the work among the available employees. In the service centre, they are supported by a knowledge-based routing system. With the system the tasks an employee is supposed to handle during that day are pushed into the employee’s inbox. Based on the finalised transactions the department managers can control the daily number of transactions conducted per employee. This gives little room for empowerment, or at least perceived empowerment among employees. In fact, most top managers do not encourage the empowerment of the employees.

Whereas inbound telephone tasks require broad know-how, correspondence is more specialised and standardised. In this role the know-how of the employees does not need to be wide, as the different transaction can be routed to the persons capable of taking care of them. Although there is a general goal, especially in the customer and sales partner service centre, that employees should be able to administer multiple insurance products, there is no incentive in the current structure for the employees to learn multiple insurance products. Normally, on the job training is used to develop the employees towards a broader know-how. Most of the training is based on initiatives among the employees. One administrator prepares a theme, which is then presented and discussed.

Although the tasks are not divided between front and back offices in Berlin-Brandenburg and in Saarland the work is organised is a similar manner. Service production is strictly regulated, and only line management is entitled to take decisions about exceptions. However, due to the difference in size there is a greater need for employees to be able to handle more insurance products and different transaction types. Saarland Insurance is planning to introduce a more qualified call centre for inbound calls and simple transactions in 2010. The aim is to increase accessibility to both customers and sales partners. A similar call centre has already been implemented in Berlin. Berlin, however, as they use the same IT-systems as Munich, is more interested in a common service organisation where the operational functions could be consolidated among all non-life insurance companies belonging to the Insurance Group.

The work organisation is very much oriented towards efficiency and standardised tasks with a limited amount of employee discretion. Although
there is a generally belief that productivity is gained through increased motivation, the involvement of the service employees is nevertheless rather limited. For example, no balancing of the workload among the employees themselves is foreseen. Due to the hierarchical organisation, with strict top-down communication, the interest on getting involved is rather limited from the employees’ side as well. As long as the systems support efficiency through increased automation, this lack of involvement is not seen as a major issue at the Insurance Group.

**4.5.5.3 Summary of the Non-Life Insurance Line Organisation Structure**

The organisational structure, and especially the coordination of tasks in the insurance line, is very complex in the non-life insurance line. Due to the new structure in Munich, it is ensured that all dimensions, that is, customer group, insurance class and sales channel, have their representatives. Although this ensures that all aspects are considered, it does not support easy and fast decision-making. The group structure, with regional individual insurers and centralised supporting functions in Munich, increases the complexity, as all individual interests of the regional insurance companies need to be coordinated. This is done through the Non-Life Insurance Governing Board. Agreed roles and rules are still needed however in order to optimise this coordination.

The work organisation in non-life insurance is trimmed towards productivity and efficiency. This development is supported by automation and standardisation of work processes. The work organisation does not seek to highlight empowerment or to involve the employees in the further development of the organisation. The employees are more seen as production resources. The changes in the aspects discussed in this section are summarised in Table 4.18.

*Table 4.18: Aspects of organisational structure mapped to corporate and business strategy*

<table>
<thead>
<tr>
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<tbody>
<tr>
<td><strong>Formal structure</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Non-life insurance structure</td>
<td>Functional structure based on customer groups.</td>
<td>Matrix structure since 2008 where the insurance class, customer groups and the sales channels are represented.</td>
</tr>
<tr>
<td>Integration / Coordination</td>
<td>Hierarchical chains of command.</td>
<td>Hierarchical chains of command.</td>
</tr>
<tr>
<td></td>
<td>High coordination effort to consolidation the requirements on the insurance-class level.</td>
<td>The matrix organisation in Munich has led to increased coordination efforts due to unclear responsibilities and priorities.</td>
</tr>
<tr>
<td>---------------------------------</td>
<td>-------------------------------------</td>
<td>-------------------------------------</td>
</tr>
<tr>
<td>Integration / Coordination</td>
<td>Limited coordination with other insurance companies belonging to the Insurance Group.</td>
<td>Coordination among the regional non-life insurers over the Non-Life Insurance Governing Board. Due to the lack of clear roles and rules coordination is not yet optimal.</td>
</tr>
</tbody>
</table>

**Work organisation**

| Functional power given to production employees | Some functional power, exceptions are however mainly handled via management. | The extent of functional power is strictly limited. |
| Level of standardisation/formalisation         | Standardised and formalised processes with limited uncertainty and employee discretion. | Standardised and automated processes. Non-automated tasks are solved following guidelines. |
| Specialisation of production employees         | Specialised | Although the goal is to broaden the know-how, the employees are still rather specialised. |
| Human resource policies                         | Production employees received limited attention. | Employees are increasingly seen as a production resource with a low level of empowerment and involvement. |
| Aim of technology                               | Technology is used for documenting decisions taken outside the system. | Technology is used for automation and productivity increase with the aim to substitute employees. |

4.5.6 Summary of the Non-Life Insurance Line

The non-life insurance line, like the life and non-life insurance lines, is aligned with the corporate processes concerning strategy, control and organisations of tasks. This is mainly because the corporate resources are valuable for the non-life insurance and because many functions have been centralised over the years. Due to the multiple insurance classes with their own interests, the coordination and the structure in non-life insurance is more complex, however.

With this sub-chapter all the insurance lines of the Insurance Group have been presented. In the next chapter the case study material presented in this chapter will be analysed concerning strategic congruence, integrated control and coherent organisational structure.
5 Analysis

In this chapter, the collected data presented in the previous chapter will be analysed based on the framework presented in the theory chapter. The objective is to match the empirical patterns of the different insurance lines with each other and with the theoretical patterns concerning strategy, control and organisational structure and their relation to competitive advantage.

The first four sub-chapters analyse the different dimensions starting with the environment, followed with strategy, control and organisational structure. In these sub-chapters the interaction between corporate, insurance line and insurance production on the functional level is discussed as well as the interaction between these dimensions. The alignments among the dimensions are summarised in the fifth sub-chapter before the performance of the Insurance Group is discussed. In the last sub-chapter the analysis is summarised.

5.1 Developments in the German Insurance Industry

The European and thereby the German Insurance market was regulated until 1994. Deregulation did not change the competitiveness of the market to the extent expected. Very few new insurers have entered the market. This is partly due to the limited available sales channels for new entrants and partly due to the increased competition among the existing insurers. The competition for market share among existing insurers has increased the market uncertainty, however. Also, customer behaviour has been changing. The customers are increasingly better informed about alternatives, which has also increased their price awareness. This price sensitivity combined with the financial crisis in 2001/2, which decreased the capital return on investments, has increased the cost awareness of the insurance companies. All these effects as well as the decreasing growth rate have decreased the predictability and thereby increased the uncertainty.

Even if the insurance market has been getting more dynamic and unpredictable over the years, the effects of the long-term regulation that allowed the existing insurers to build reserve capital and the long-term character of their insurance business have been moderating the effects. As a result, the market, though de-regulated, is still to a certain extent a protected market. However, the latest financial crisis, the subprime crisis, has altered
the competitive situation considerably. The market has therefore been changing more rapidly since 2008.

The increasingly dynamic and thereby more unpredictable market influences the management of insurance companies. The former market characteristics, which had offered the companies a relatively quiet and stable position and thereby gave management time to react (cf. Ilinitch et al. 1996), are disappearing. As early as 1990 Diacon pointed out that deregulations in general offer both opportunities and threats. The outcome depends on the ability of a company to respond to the resulting pressure to react to the changing competitive situation, to reduce costs, or to operate in an innovative manner (cf. Hitt et al. 1998 and Ennew et al. in 1990). Also, in the insurance industry market developments have increased the importance of strategic thinking.

Table 5.1: Market and environment between 1995 and 2010

<table>
<thead>
<tr>
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<tbody>
<tr>
<td>Market characteristics</td>
<td>Growth market with increasing price competition due to deregulation.</td>
<td>Mature market with limited growth has led to increased competition. The market is however still generating a constant profit. As a result of the limited growth and reduced capital return on investments the industry is very cost oriented.</td>
</tr>
<tr>
<td>Level of predictability</td>
<td>One year after deregulation the market was still stable and predictable.</td>
<td>The level of predictability has decreased due to legislative changes, increased competition among existing insurers, better-informed price-sensitive and less loyal customers and the increasing power of sales channels. Although it is now de-regulated, the long-term regulation of the market still to a certain extent protects the long-time actors.</td>
</tr>
</tbody>
</table>

As the management reactions are based on the perceived market developments, their interpretation of the environmental changes was also discussed. The management of the Insurance Group highlighted the constantly increasing competition in the German insurance market since 1995, as well as a development towards cost orientation as a reaction of decreasing growth and the decreasing capital return on investments. Additionally, the increasing uncertainty due to natural disasters and legislative changes was highlighted. All these developments were said to have been leading to volatility and a more unpredictable market. The persons
interviewed thereby confirmed the general market statement about the environment becoming less predictable. This opinion concerning the trend towards more uncertainty was common to all insurance lines. The perceived market developments, as discussed in the case study chapter, are presented in Table 5.1. In the next sub-chapter the strategic actions taken by the Insurance Group due on the changing market will be analysed.

5.2 Strategic Congruence

In this sub-chapter the strategic congruence among corporate, insurance line and service production levels is analysed. In the analysis, environmental developments are also taken into consideration. This is especially important as the environment limits the number of strategic choices available to a company. However, as pointed out by Hrebiniak and Joyce (1985) regardless in which environment it acts, a company always has a great deal of choice in terms of means or methods of competition. As the valuable resources are seen as a baseline for the strategic positioning in the theoretical framework, the sub-chapter starts with an analysis of the inherited resources and their development. Thereafter the alignment of the strategic choices is analysed before the strategic framework is discussed.

5.2.1 Valuable Resources of the Insurance Group

The Insurance Group inherited multiple valuable resources thanks to its background as a state agency regulating fire damage for two hundred years. Due to this unique history it has gained a high level of customer trust. Although trust in itself is not a source of competitive advantage in all market situations (Barney and Hansen 1994), it is very important in the insurance industry. As trust emerges from the long-term values, principles, and standards of a company, trust is only available to a few firms (Peteraf 1993). It is thereby a real source of competitive advantage for the Insurance Group. However, as Barney and Hansen (1994) point out, the fact that a firm once had a culture that encouraged trustworthy behaviour does not mean that it will always have these attributes. Cultures evolve and control mechanisms change, leading to less emphasis on attributes encouraging trustworthy behaviour towards clients (Whitener et al. 1998, Barney and Hansen 1994). In this case study it was highlighted multiple times that due to changing behavioural patterns the emphasis on trustworthy behaviour was decreasing. The reason given for this was the increasing emphasis on productivity and cost saving. Whitener et al. (1998) conclude similarly from their study that high-control organisations, with a high degree of centralisation and with a primary focus on efficiency, constrain or impede the development of trustworthy behaviour.
Besides the trust based on the long history, the Insurance Group has a competitive advantage in sales. The Savings Banks as owners are also a broad, stable and long-term sales channel for the Insurance Group. Diacon (1990) analysed the strategic implications of insurance companies. He concluded that an insurance company being linked to a bank has multiple advantages, due to the cross-selling opportunities with the bank products and due to the access to the bank's customers. The Insurance Group enjoys these advantages and also actively strengthens this valuable resource by supporting the Savings Banks with annual sales and marketing plans to encourage sales and strengthen this cooperation. The Insurance Group has used this know-how to extend their sales channels also beyond the Savings Banks, for example when rebuilding the branches to a sales channel.

Alongside trust and the unique cooperation with the Savings Banks, some other valuable resources, like unique know-how in building insurance and the monopoly portfolio leading to cost advantages, were mentioned by the interview partners. Although the valuable resources were known and widely accepted, the Insurance Group did rather little to move them forward, with the exception of the strong cooperation and support of the Savings Banks. They did not actively try to develop new valuable resources or capabilities based on the existing inherited ones. Bengtsson and Kalling (2007) conclude from their studies of corporate development that companies avoiding active development of their competences (including both resources and capabilities) tend to lose their competitive advantage. Instead, an unreflected passive specialisation occurs without clear decisions around products and competencies. Bengtsson and Kalling explain this development with the dominant logic of the decision takers. It is nearly connected to single-loop-learning (Argyris 1976), exploitation (March 1991), rigidity (Leonard-Barton 1992) and path dependency (Teece et al. 1997). This kind of development is successful in a stable and rigid market. In a more dynamic market, active management is seen as more beneficial, supporting the development of new complementary competencies that enhance the company's offerings or lead to new offerings. At the studied Insurance Group no active development of new resources and capabilities based on the existing ones was recorded, although the recognition of the existing ones was increasing. This behaviour is seen to be beneficial in a stable market like the insurance market has been for many years. The market is changing, however, albeit slowly, into a more dynamic market, where more active management is seen as preferable.

The insurance lines gain advantages from the corporate valuable resources and capabilities. Especially in life insurance trust is believed to be even more valuable following the financial crises and especially the subprime crisis. Only health insurance mentioned valuable resources that they had developed independently from the inherited ones on the group level. They highlighted their management being open for investments in new areas and their broad sales-supporting organisation. However, the openness
to invest in new areas was decreasing due to the corporate pressure on cost saving over the years.

In service production no real unique valuable resources were identified. Although some beneficial developments were mentioned, like the transparency towards sales channels leading to intensive interaction between sales and service production as well as the IT-systems supporting automation and productivity, they were nevertheless not seen as something rare in the insurance industry. This could be due to the limited attention that was given to service production in the Insurance Group.

It can be concluded that the Insurance Group has access to inherited valuable resources. These resources have not been further developed since the company’s foundation, except for the extension and the strong support of the sales channels. Still, the valuable resources seem to have retained their value for the Insurance Group. This is especially true regarding the image of trust. The development of the valuable resources as discussed in the case study chapter is summarised in Table 5.2

Table 5.2: Valuable resources and their development between 1995 and 2010

<table>
<thead>
<tr>
<th>Aspects</th>
<th>Valuable Resources/Capabilities Around 1995</th>
<th>Valuable Resources/Capabilities Towards 2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valuable resources/capabilities on the corporate level</td>
<td>Multiple and inherited at the foundation of the Insurance Group (image of trust, Savings Banks as sales channel, competence in fire insurance and fire-insurance monopoly portfolio).</td>
<td>Valuable resources are increasingly discussed although they are not actively developed further or explicitly connected to strategic development.</td>
</tr>
<tr>
<td>Valuable resources/capabilities on the insurance-line level</td>
<td>Group level competitive strengths are ensuring a nonimitable position for the insurance lines.</td>
<td>Benefits from the inherited resources and capabilities. Where the group-level resource of trust is even more valuable since the financial crises (especially in life insurance).</td>
</tr>
<tr>
<td></td>
<td>Management openness to support investments in innovative areas (mainly Saarland Health Insurance).</td>
<td></td>
</tr>
<tr>
<td>Valuable resources/capabilities on the production level</td>
<td>No specific valuable resources enabling a market unique position were mentioned.</td>
<td>No specific resources were mentioned.</td>
</tr>
</tbody>
</table>
5.2.2 Alignment of the Strategies on the Corporate, Insurance Line and Service Production Levels

The corporate strategy is based on global goals reflecting multiple aspects like growth, costs, sales and customer orientation as well as the regional insurance business model. As stated by a manager involved in the strategy project: “The Insurance Group does not really have a corporate strategy. It has global goals but they are rather broad and do not give any guidance how to position the business units.” The global goals have emphasised growth since foundation in 1995. The complementary goal of profitability has gained in importance since the financial crises.

The Insurance Group uses the global goals as strict targets and delegates their achievement to the management of the insurance lines and the regional insurance companies. The Insurance Group started to centralise supporting functions in 2006 as a part of their cost-saving activity. Although centralisation limits the alternatives available to the individual insurance lines and the regional companies for reaching their goals, the Insurance Group has not changed its corporate strategy used to coordinate the insurance lines. They still use portfolio management based on defined annual targets.

The insurance lines differ somewhat from each other concerning how to reach the main target of growth. Due to the increased transparency concerning cost ratios on the life insurance market, the life insurance line has started to look more at efficiency in order to lower the cost ratios. They also offer some investment-based single premium products with narrow profit spans in order to fulfil the growth target. The non-life insurance line, which enjoys a positive cost effect based on the monopoly insurance portfolio, is less concerned about cost ratios and more about maintaining the advantage of the inherited huge monopoly portfolio. The health insurance line has accepted higher acquisition costs in order to achieve growth. In order to improve the overall cost ratio, they have increased their cost control in claims by introducing an automatic receipt control system. Despite this, the health insurance line is the only insurance line that has not managed to grow and to maintain its profitability in recent years.

Like the corporate level, the insurance lines have not chosen a clear market position. The insurance lines see themselves as regional service insurers, offering service via their sales channels. This position is combined with a differentiator strategy based on the unique image of a trusted caretaker used in marketing. The common market position has to do with the fact that all business lines offer insurance solutions and that they all benefit from the same inherited corporate valuable resources, leaving little room for different positioning. Although the unique image of a trusted caretaker, enabling the insurance lines a position as a marketing differentiator (like defined by Miller 1988 and 1986) is acknowledged, there are no current activities strengthening this position other than the marketing message “we
insure you as we would insure ourselves”. Employee behaviour is very important for a service company aiming for marketing differentiation. In order to fulfil the positioning of a caretaker – the employees need to act like that too. An example mentioned is to ask if they can do something else for the customer when the original issue has been resolved. Employee behaviour is not taken into consideration at the Insurance Group, however. Marketing is positioning this, but they do not have any authority to implement any changes in service production in the Insurance Group. Instead, costs-saving activities dominate daily business since the financial crisis in 2001/2.

The emphasis on the image of a caretaker and cost efficiency at the same time is difficult to fulfil especially in service production (cf. Rhee and Mehra 2006). One top manager even questioned whether service orientation is even needed with the following statement: “The fact that the customers are not satisfied is not a problem, as winning customer is a question of trust and not service. The customers buy insurance solutions from companies that they trust, not the most friendly and service-oriented companies.”

The Insurance Group conducted some changes in service production during the studied time frame. The orientation towards product development rather than process development over the years had been resulting in a complex product portfolio and time-consuming treaty administration. A broad product range generally implies a high level of complexity, which in turn generates uncertainty in production (Nilsson and Rapp 1999, Gupta 1987). In order to minimise this complexity and to increase productivity, IT developments were started with the aim of standardising and automating processes. Additionally, in 2008, service production was divided into standardised transactions and complex specialised transactions when the sales partner and customer service centre was introduced. This reorganisation had the aim of increasing the quality of service and decreasing costs. However, during the preparation of the new service production structure, very little effort was put into identifying what is meant by customer and sales partner service. As Johnston (1989b) points out, in order to be able to identify what it is, it is necessary to understand the market position that is aimed for and the range of expectations derived from that position. This lack of a clear market position and priority between the quality and cost-saving targets may be the reason why many of the interviewees perceived uncertainty with the newly founded sales partner and customer service centre.

Over time, however, the main emphasis in the German insurance industry on cost reduction was seen as the main priority in service production. Due to the orientation towards productivity and costs, over the years service production has developed towards mass service production. As Miller (1988

136 Although the name indicates that only one service centre was established, nearly all service production was re-organised into service centres. Only some special underwriting entities were not integrated into the service centre model.
and 1986) pointed out, the main activities in a marketing differentiation are to increase loyalty through marketing but also through high-quality customer relationship management in production. Production functions, supported by IT systems providing information and enabling automation, could be positioned, especially in the service industry, as a primary marketing tool for an organisation stressing quality of service and a high level of responsiveness (Prajago and McDermott 2008, Peters 1987). At the Insurance Group, however, production is aligned towards the internal target of cost efficiency instead of high level of quality. Rhee and Mehra (2006) point out that a market positioning that is supported by the service production priorities is critical to organisational performance in the service industry. The decreasing customer and sales partner satisfaction of the Insurance Group since the introduction of the customer and sales partner service centre in 2008 is an indication of misalignment between the chosen service production priorities and the marketing differentiation position based on loyalty and well-functioning customer/sales partner relationship management. In the health insurance line some activities that strengthen customer loyalty were noticed, however, like customer classification enabling service production employees to alter their decisions based on the customers’ payment balance rating. The aim is to increase the loyalty of profitable customers with low claims ratios.

To conclude, the strategic development of the Insurance Group seems to have resulted in some misalignments. Firstly the strict portfolio management on the corporate level combined with the centralisation of supporting functions might lead to disadvantages, as the insurance lines and insurance companies are supposed to fulfil the set targets, but at the same time the group is increasingly controlling the resources needed to meet the targets. Secondly, productivity-oriented mass-service production is not consistent with the service insurer position combined with the trusted caretaker image. The standardised mass service production does, however, support the cost-saving orientation of the Insurance Group. The strategic development of the insurance group discussed in the case study chapter is summarised in Table 5.3.
Table 5.3: Strategy development of the Insurance Group between 1995 and 2010 (in cases where the aspects differ between the insurance lines or insurance companies this is indicated in the table; if there is no indication the statement is valid for all the insurance lines and insurance companies)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate goals</td>
<td>Growth symbolising strength of the insurance group towards customers and sales partners.</td>
<td>Growth combined with profitability due to the decreasing capital reserves since the first financial crisis in 2001/2 and even more since the subprime crisis in 2008.</td>
</tr>
<tr>
<td>Corporate strategy for the coordination of the business units/insurance lines</td>
<td>Portfolio management strategy: Management through overall goals during the annual planning process.</td>
<td>Portfolio management strategy: Management through overall goals.</td>
</tr>
<tr>
<td>Main goals of the insurance lines</td>
<td>Growth goal as stressed on the corporate level.</td>
<td>Growth goal combined with cost efficiency as stressed on the corporate level. Life: Ensure growth through investment-oriented single payment products with very narrow profit spans. Non-life: Stabilisation of the real estate portfolio for growth.</td>
</tr>
<tr>
<td>Competitive strategy/Market position of the insurance lines</td>
<td>Minor attention paid to the topic due to the history of being a state-owned stable monopoly insurer of the region. Reactive strategy: Actions were taken based on growth alternatives available at the moment. Limited to Saarland Health: Growing innovative health insurer (before integration into the Insurance Group).</td>
<td>Service insurer providing good service through the sales channels combined with marketing differentiation based on trusted caretaker image. Life: Increase awareness through marketing and good product ratings (by lowering the cost ratio). Health: Applications/Inquiries are to be handled in an efficient and transparent way – keep market average. Non-life: Market leader in fire insurance in the main regions.</td>
</tr>
</tbody>
</table>
When comparing the strategic development with the analysis framework used in this study, it can be concluded that around 1995 as well as towards 2010 the insurance group was not ensuring strategic congruence on all levels through their activities. In 1995 the misalignment could be explained by the limited interest in strategic issues due to the company’s background as a monopoly insurer. Towards 2010 the misalignment can be explained by the cost orientation of the insurer, which does not support the marketing differentiation strategy based on a trusted caretaker image. The consequences of this misalignment will be discussed in more detail in sub-chapter “5.5 Summary of Strategic Congruence, Integrated Control and Coherent Organisational Structure”.

5.2.3 Strategic Framework

Before this sub-chapter is summarised the strategic framework, or more the lack thereof, at the Insurance Group will briefly be discussed. At the Insurance Group strategy was mainly defined in terms of objectives to be achieved rather than means or methods of competition. Generally, the German insurance industry does not have a strong emphasis on strategy

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137 Corporate strategy, market positioning or business strategy and service production strategy.

138 “The main problem at the Insurance Group is that there is no strategy that is clear enough that it can be used as a framework for ensuring that decisions taken are coordinated into one direction” was stated by a manager in a supporting function. Many similar statements were made in the interviews.
formulation and implementation. Looking back at the time after deregulation, generally all German insurers formulated mission statements of a general nature documenting strategic goals. Additionally these formulated strategic goals often contradict each other (Oletzky 1998: p. 4). Case studies have shown that firms with clear goals and methods for achieving the goals perform better than firms that try to emphasize converse goals and methods simultaneously (Rust et al. 2002). This indicates that if one insurer differs from general market developments and defines clear goals and methods, they could gain a competitive advantage. Concerning this point, the Insurance Group does not differ from the other market participants. Its global goals, also seen as the corporate strategy, are partly contradictory and therefore can be used only to a very limited extent as a guideline for strategic action and operational decision-making.

Growth has been the main goal of the Insurance Group during the whole study period, although increasingly connected with profitability over the years. This emphasis could be one explanation why the Insurance Group never stressed the importance of developing a clear framework. In an interview, Porter (Hodgetts 1999) points out that a lack of strategic framework is common among companies aiming for growth. As managers push to grow on all fronts, they tend to move away from a clear competitive position (Porter 1996). However, by clearly choosing to compete in one way and not another, top management could ensure clear priorities for the organisation. Companies that try to keep many fronts open, risk confusion among the employees attempting to make day-to-day operating decisions without a clear framework (Porter 1996). This confusion was present in the studied Insurance Group, especially among mid-management. Although a strategy initiative was started from the corporate level in 2007 with the aim of defining strategies for all insurance lines, the situation did not change. Even though the aim was to abandon the reactive position, no clear strategy supporting decisions and setting clear priorities was developed.

When the environment is relatively static, where the need to take decisions deviating from experience is very modest, an unclear strategy does not need to lead to confusion (Inkpen and Choudhury 1995). In these situations planning could make a great contribution to organisational alignment (Gage 1982). The long history of stability could therefore be a further reason that the top management of the Insurance Group showed limited interest in strategy (cf. Miller and Graham 1981). Strategy was actually even defined in multiple interviews as something academic, with little operational relevance. Instead the planning process is considered to be an applicable tool for coordination and high-level alignment of the activities. However, the question is whether planning is sufficient as a baseline for the coordination of decisions and activities as the market becomes more unpredictable. In a more dynamic environment, strategy is supposed to give guidance how to handle changes (Stalk et al. 1992: p. 62). This clear positioning was lacking at the studied Insurance Group. As stated by a
manager and confirmed in multiple interviews, there is a belief that “if the Insurance Group does not position itself properly on the market, it will be tough the next few years”.

To conclude, a strategic framework could be used as a vehicle that supports strategic congruence, by supporting fit among a company's activities (Berggren and Bernstejn 2007, Mankins and Steele 2005, Porter 1996) and to ensure optimal resource management (Nilsson et al. 2011: p. 133). By linking the activities to an overall system a company can achieve a real competitive advantage that is difficult to replicate by a competitor. This is especially important in a service industry, like insurance, where the service in intangible (D'Aveni 2007) and can easily be copied (Gustafsson and Johnson 2003). Rhee and Mehra (2006), based on their study of the retail banking industry, emphasize that strategic frameworks coordinating activities, and especially linking positioning and service production priorities with each other is a must for the success of service businesses. Therefore, in the service industry a strategic framework, as a vehicle supporting strategic congruence, seems to be very beneficial in order to ensure a guideline for employees’ own decisions when interacting with customers during service production (cf. Dougherty 2004). Therefore there is a high probability that the lack of a strategic framework could harm the competitive position of the Insurance Group, as it is generally impossible to make a number of random choices that all turn out to be consistent if they lack a strategic framework (i.e. Inkpen and Choudhury 1995).

5.2.4 Conclusion Strategic Congruence

The Insurance Group has a long history of success in a stable, regulated and growing market. As discussed above, studies of successful companies acting in a more dynamic environment, however, show that more active management in strategy might be necessary. A strategic framework could support strategic decisions, leading to strategic congruence and identification of new competencies that need to be developed. However, the insurance company studied has rarely adjusted its strategic efforts due to environmental changes. This can to some extent be explained by the general stability of the insurance market compared to other markets. Although the environment has become less predictable over the years, and competition has been increasing, the effects of the long regulation of the market are still visible.

Setting up a strategic framework, at its core, involves choices and trade-offs that are often viewed as risky, because the company must set itself apart from industry rivals. The choice to follow the institutional forces (Bengtsson and Kalling 2007), that is, the trends in the industry, on the other hand, is a rather easy and safe one. Just to try to follow the market trends and to improve on best practices is not a strategy, however (Hammonds 2001), and therefore very seldom leads to strategic congruence and a long-term
competitive market position. The insurer studied has been and still is a successful company. However, there is a risk that they might fall victim to a fatal flaw of pursuing a competitive advantage that is based on historical valuable resources (cf. Porter 1991b). They are not developing new resources or capabilities in order to ensure the competitive advantage of the future. Due to the growth goals, they seem to have chosen to compromise on a strategy in order to grow faster. Thereby they risk being “stuck in the middle” (Porter 1980). The lack of effort invested in strategic questions could lead the Insurance Group into severe trouble, as the insurance market is, although rather slowly, developing into a more competitive market.

5.3 Integrated Control

In this sub-chapter the main developments in the control system, control process and production control will be analysed. Thereby the interaction between the different control mechanisms and the implemented strategy will also be reflected.

5.3.1 Alignment of the Insurance Group Control System

The Insurance Group has implemented a corporate control of its insurance lines based on monetary goals, which are frequently and tightly monitored. Over the years the number of performance measurements used has increased. Although increasing in scope they are still monetary, mainly measuring growth and cost developments. The performance measurements have become more short-term oriented, although the top management has indicated multiple times that the long history of the company obliges them to think about and assess investments taking long-term development into account.

Besides the monetary measurements, the Insurance Group regularly conducts sales partner and customer satisfaction surveys. The results of these surveys are not used to set targets, however, and receive only very limited top-management attention. Although the creation of action plans is centrally coordinated by the marketing department, they are not given high priority. The responsibility for their implementation is delegated to the operational level and their fulfilment is not monitored on the corporate level. As one manager pointed out, if the customer and sales partner satisfaction surveys were to get as much attention as cost control, the Insurance Group would be the market leader in service. The marketing differentiation strategy of a trusted caretaker would benefit from more service-quality-oriented targets. However, although highlighted multiple times by controlling departments and in many interviews, the monetary goals measuring growth and costs still get almost all the management attention.
The insurance-line and the regional control systems follow the corporate reporting system. The main difference is that regional and insurance-line measurements are somewhat more detailed. The Saarland part of the health insurance line used to include quality measurements in their management control system, but due to pressure from the Insurance Group concerning monetary goals, they have been abandoned over the time.

The corporate control based on tight financial targets fits with the portfolio management strategy chosen on the corporate level. However, as the insurance lines and regional insurers are becoming increasingly dependent on centralised supporting functions, this might lead to a misalignment. Currently corporate level is not giving much guidance as to how to solve priorities among insurance lines and supporting functions. This has led to long discussions and negotiations among the entities. A more interactive corporate role giving guidance to the entities during strategic planning would probably be beneficial in the future.

Table 5.4: The development of the control system between 1995 and 2010 (in cases where the aspects differ between the insurance lines or insurance companies this is indicated in the table; if there is no indication the statement is valid for all the insurance lines and insurance companies)

<table>
<thead>
<tr>
<th>Aspect of Control System</th>
<th>Insurance Group Around 1995</th>
<th>Insurance Group Towards 2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate control system</td>
<td>Corporate control of business units through financial control.</td>
<td>Corporate control of business units through financial control.</td>
</tr>
<tr>
<td>Corporate performance measurements</td>
<td>Narrow scope of monetary measurements based on the growth goal.</td>
<td>Broad scope of monetary measurements based on the growth and cost- efficiency goals.</td>
</tr>
<tr>
<td></td>
<td>Backlog is the only production control measurement reported on the corporate level.</td>
<td>Backlog is the only production control measurement reported on the corporate level.</td>
</tr>
<tr>
<td></td>
<td>Customer and sales-partner satisfaction surveys were not yet introduced.</td>
<td>Customer and sales-partner satisfaction surveys have been conducted since 1998, but the measurements derived from them still receive limited top-management attention.</td>
</tr>
<tr>
<td>Insurance line performance measurements</td>
<td>Aligned with the corporate monetary performance measurements. Limited to Saarland Health Insurer (before integration into the Insurance Group): Quality-based measurements were used in addition to the monetary measurements.</td>
<td>The corporate monetary performance measurements focusing on growth and cost efficiency are supplemented with product control.</td>
</tr>
</tbody>
</table>
The focus on revenue and cost-based measurements is quite consistent with the corporate aim of growth and cost reduction. However, the fact that quality of service is measured in surveys but is not given high priority by top management does not fit well with the marketing differentiation based on image. The image is based mainly on the inherited caretaker role. The development of the image is not covered by the control system, however. As Morgan and Rao (2002) highlight, the main measurements align the behaviours and actions of the various parts of a firm. This is especially powerful in service companies, as they unify the actions of disparate organisational functions and levels. In the case of the Insurance Group the actions are aligned towards growth and cost-efficiency and not towards the caretaker image that is used to differentiate the Insurance Group from its competitors.

The aspects of the control system as presented in the case study chapter are summarised in Table 5.4. In the next section the control process, which is an important complementary vehicle to the control system in aligning the company’s activities, will be analysed.

5.3.2 Alignment of the Insurance Group Control Process

The Insurance Group has a very rigid and formal planning process. The process is managed and coordinated from the corporate level and based on top-down goals. The insurance lines are allowed to suggest their own targets for growth and cost ratios since 2006, but if they do not fit with the corporate global goals, they are generally not accepted on the corporate level. The corporate level delegates the coordination between the insurance lines and the supporting functions during the planning process. Due to a lack of guidelines concerning priorities, this coordination is a question of negotiation skills. The insurance line with the strongest argumentation power and informal network gets more capacity commitments from the supporting functions. During the year diagnostic control is used based on monthly reports. Only when the deviations are egregious is a more interactive control process introduced in form from action plans prepared by the responsible managers, which are discussed at the Board of Directors meetings. Studying the minutes of meetings, it could be seen that the issues were intensively discussed bi-weekly and feedback was given to the managers responsible for correcting the deviation. The question remains, however, whether bi-weekly discussions can be classified as interactive control.

It is easy to see what Otley (1999) refers to when pointing out that the real challenge in management control is the transition from following up measurements to real management, when analysing the activities of corporate management of the Insurance Group. A supporting management is very important, however, as studies (e.g. Grant 2003) show that strategic decisions are increasingly made outside the plan in response to upcoming opportunities and threats and are subsequently incorporated into the plan.
Therefore a dialogue is important in a changing environment. As the environment of the insurer is becoming more unstable and unpredictable, this capability seems to be increasingly important for the competitive advantage.

A tight control process fits with the cost orientation of the company. It does not align well with the chosen differentiation strategy, however. This misalignment has been partly mitigated by the rather stable insurance market and the very stable inherited valuable resources. With the changing environment it will be increasingly important to react to market changes. Thereby a loose control process including an interactive dialogue would be more beneficial. The aspects of the control process presented in the case study chapter are summarised in Table 5.5. In the next section the production control will be analysed, before the integrated control system part is summarised.

### Table 5.5: The development of the control process between 1995 and 2010

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Control orientation</td>
<td>Top-down oriented processes, with limited bottom-up involvement.</td>
<td>Top-down oriented processes, with full bottom-up involvement including negotiations with supporting functions.</td>
</tr>
<tr>
<td></td>
<td>Targets are seen as guidelines.</td>
<td>Awareness of keeping targets changed due to the subprime crisis in 2008.</td>
</tr>
<tr>
<td>Time-perspective</td>
<td>Long-term perspective.</td>
<td>Tendency towards more short-term orientation.</td>
</tr>
<tr>
<td>Process characteristics</td>
<td>Informal process with limited integration and coordination of the different plans and reports.</td>
<td>Rigid and formal process with increased integration and coordination of the different plans and reports.</td>
</tr>
<tr>
<td>Follow-up</td>
<td>Diagnostic controls where actual results are compared to plan.</td>
<td>Diagnostic controls where actual results are compared to plan. Interactive control for major deviations.</td>
</tr>
<tr>
<td>Control character</td>
<td>Tight control with frequent and detailed monitoring of fixed targets.</td>
<td>Tight control with frequent and detailed monitoring of fixed targets that enable the corporate level to exert control and coordination across the units.</td>
</tr>
</tbody>
</table>

### 5.3.3 Alignment of the Insurance Group Production Control

In the Insurance Group production and production control receive limited management attention. Backlog is the only production control measurement reported to the corporate level. It is included into the monthly reports and
some general guidelines are set on the corporate level concerning acceptable backlog levels. The backlog measurement ensures standardised information (cf. Mouritsen and Hansen 2005, Ahrens and Chapman 2004) on the corporate level, which is used as a baseline for discussions concerning production and capacity levels. During peaks it is commonly accepted that backlog levels cannot be maintained. The backlog measurement is also seen as a measurement of quality, as both sales partners and customers are believed to expect fast production. Ensuring reliable performance does not improve loyalty behaviours beyond a certain point, however. Research shows that after fulfilling basic expectations, a firm must meet expectations related to customer orientation to enhance loyalty (Schneider and Bowen 1999). The Insurance Group has not developed their production control into this area, however. Also, after the introduction of customer and sales partner service centre only productivity and accessibility measurements were introduced, with strictly set targets.

Production control, based on productivity and measurements of output, is well aligned with the system of tight management control. It also fits with the mass service production that has been introduced. However, it does not strengthen the caretaker image, as service quality and flexibility are given lower priority than efficiency and productivity. The chosen production priority actually runs counter to achieving customer satisfaction (cf. Miller et al. 2000, Lovelock 1992). Therefore quality-based measurements could be beneficial to include into the production control system of the Insurance Group (cf. Zahorik et al. 2000). This is especially important as Banker et al. 2000 conclude from their study that managers often do not recognise the true benefit of allocating more effort and resources to improving customer satisfaction unless the production control and their own reward system focuses their attention on improving customer satisfaction. This conclusion is applicable for the Insurance Group as well. As the sales partner and customer satisfaction only receive very limited management attention on the corporate level, they are also not highlighted on the production control level. The aspects of production control system as presented in the case study chapter are summarised in Table 5.6
Table 5.6: The development of production control between 1995 and 2010 (in cases where the aspects differ between the insurance lines this is indicated in the table; if there is no indication the statement is valid for all the insurance lines)

<table>
<thead>
<tr>
<th>Aspect of Production System</th>
<th>Insurance Group Around 1995</th>
<th>Insurance Group Towards 2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Production priority</td>
<td>Sales-channel orientation with some differences among the insurance lines. Life: Priority towards sales-channel-specific needs. Health: Priority towards efficiency with annual productivity increase. Non-Life: Priority towards quality that was changed to efficiency around 2000.</td>
<td>Productivity and cost orientation enabling comparison between entities.</td>
</tr>
<tr>
<td>Capacity</td>
<td>Capacity set between peak and average demand. Increasing backlogs accepted during peaks.</td>
<td>Capacity set towards average demand. Peaks are increasingly handled through increased level of automation.</td>
</tr>
<tr>
<td>Control concept</td>
<td>Life and Non-Life: Production control concept based on indirect measurements and management experience. Health: Sophisticated production control concept based on output control.</td>
<td>Production control concept based on output control.</td>
</tr>
</tbody>
</table>

5.3.4 Conclusion Integrated Control System

As Otley (2005: p. 304) points out there is a need to connect control systems design and use with issues of strategy, both espoused and emergent. Control systems need to reflect the aims of an organisation and the plans that have been developed to achieve the aims. Furthermore, by linking corporate strategic imperatives with service production measurements, a corporation can translate and drive strategy by ensuring that production is aligned with the vision of the board (Busco et al. 2007). The Insurance Group does not
seem to have an overall well-integrated control system. Although supporting the cost orientation of the insurer, the control system does not support the marketing differentiation strategy highlighting the trusted caretaker image.

The connection between strategy and the control system is not only a challenge for the insurance group studied, but is also a challenge facing many German insurers. Only few insurers have established a control system connected to their strategy (Oletzky 1998: p. 11). Not only deregulation in 1994 but also the decreasing trend in the stock market has led to altered behaviour in the insurance industry. The current decreasing return from state bonds, in which the insurers invest most of their assets, is making this problem even more pressing. The high capital return on investments that used to compensate the high combined ratios\(^{139}\) (Johne 1993) has ceased to exist. As a result, many insurers have been implementing transparent cost structures with feedback mechanisms. This general market trend has probably strengthened the cost orientation of the control system at the Insurance Group under study.

5.4 Coherent Organisational Structure

Organisational structure is an additional aspect of internal control supporting a company’s strategic choices. Due to the mergers and acquisitions that followed deregulation, the organisation structures of the insurance companies grew bigger and more complex. This is also the case for the Insurance Group that was founded in 1995 from four independent insurance companies. In order to reduce complexity and to achieve high cost-efficiency by enhancing economies of scope, the insurance organisations started centralising the back-office work into departments specialising in underwriting, processing policies and claims handling. This has led to a rather rigid organisation. At the same time the market situation is becoming more dynamic and unpredictable, albeit not rapidly. The rigid organisation does not seem to be optimal in a more dynamic environment. Ennew et al. (1990) concluded from their study of financial service companies after a deregulation\(^{140}\), that in order to react to market changes the companies would benefit from a more flexible organisational structure.

The conclusions drawn by Ennew et al. (1990) have been confirmed by organisational studies (i.e. Kathuria et al. 2007) that have identified organisational alignment as a clear performance indicator. This is especially important in markets where the offerings are more or less standardised (Bhimani 2005), as in the insurance market. Achieving this alignment is not trivial, however, as stated by Fonville and Carr. “Getting functions or

\(^{139}\) Combined ratio = Net premium written – incurred losses – loss adjustment expenses – underwriting expenses (Fiegenbaum et al. 2001).

\(^{140}\) The majority of the companies studied were banks that were partly deregulated as early as 1986 in the UK, that is earlier than the deregulation of the insurance industry in Germany.
business units aligned with the overall strategy is however often problematic. Many organisations are made up of fiefdoms, unwilling to share power, resources, information, or ideas in the interests of the greater good. Trapped in their own ‘stovepipes’, business units or functions may find it difficult to see how actions at their level can lead to greater achievement for the total organization” (Fonvielle and Carr 2001: p. 8). How the Insurance Group has handled the organisational challenges over the years is analysed in this subchapter. First the organisational structure, and thereafter the work organisation, is analysed before the overall organisational alignment with the strategy is summarised.

5.4.1 Organisational Structure

The Insurance Group was founded in 1995 through a consolidation of four independent insurance companies under a holding structure. In order to increase group coordination, all the members of the board of directors were given shared responsibility for all insurance companies belonging to the group. This is still the case for all insurance companies in one region, that is, the Munich board members jointly represent all the Munich companies, the Berlin board members the Berlin-based insurance companies and the Saarland board members the Saarland insurance companies. However, although the board members are formally jointly responsible for all the insurance lines and the supporting functions, each board member has her/his own specific area of operational responsibility. During the interviews it became very clear that the interest of the board members in their own areas is much stronger than their interest in the overall Insurance Group. Comments like “automation is the responsibility of the system-engineering department within the sales division” and “the cross-selling target is not an issue of the insurance line but the sales organisation” symbolise the clear boundaries that exist also among top managers.

One reason for this attitude might be the centralisation of supporting functions. Since foundation, activities have been undertaken to promote centralisation. During the first few years the centralisation of functions was limited to the region, but since 2006 the support functions are being centralised on the corporate level. The main aim of centralisation is to save costs. At the same time, centralisation decreases the flexibility to react quickly to market requirements and increases the coordination efforts among all entities representing their specific interest areas.

In order to coordinate centralised resources, a rather complex structure of boards and commissions has been introduced. However, the fact that all the boards and commissions only formulate recommendations that need to be approved by the boards of directors limits any real horizontal coordination. The centralised vertical decision power not only limits the effective coordination but also makes the benefits of the coordinating entities less transparent. An additional challenge facing the Insurance Group is that of
coordinating the coordinating entities. The fact that the Insurance Group does not have a well-defined strategic framework (as discussed in the strategy sub-chapter) upon which decisions can be taken decreases the transparency and the harmonisation of the recommendations formulated. Due to the lack of clear guidance, coordination via informal networks outside the official boards and commissions is strong in the Insurance Group. As these informal networks have changed their characteristics to optimise themselves, the actions and agreements taken by them are not always optimal for the whole organisation.

Table 5.7: The development of the organisational structure between 1995 and 2010

<table>
<thead>
<tr>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>Corporate functions</td>
<td>None or very limited (centralised in a region), as the companies integrated into the Insurance Group had their own resources.</td>
<td>Increasing centralisation due to cost saving intention in the supporting functions (started in 2006).</td>
</tr>
<tr>
<td>Decision-making</td>
<td>Decentralised power on the insurance company level.</td>
<td>Formalised and centralised decision-making power and vertical coordination as the conclusions drawn in commissions and boards need to be approved by the boards of directors.</td>
</tr>
<tr>
<td></td>
<td>Due to the high level of autonomy, decisions can be taken quickly.</td>
<td>Long decision cycles as the issues are discussed in the coordinating entities before decisions are taken on the board level.</td>
</tr>
<tr>
<td></td>
<td>Hierarchical chains of command with the exception of Saarland Health Insurer, where a culture of open communication is established.</td>
<td>Hierarchical chains of command.</td>
</tr>
<tr>
<td>Integration / Coordination</td>
<td>No formal coordination until the establishment of the governing boards in 2005.</td>
<td>High coordination requirements due to centralised resources. The coordination binds management capacity and makes the organisation rather internally oriented.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Multiple commissions and governing boards established since 2008.</td>
</tr>
<tr>
<td>Informal structure</td>
<td>Strong coordinative informal networks.</td>
<td>Strong informal networks increasingly used for internal politics.</td>
</tr>
</tbody>
</table>
The Insurance Group on the corporate level, due to the centralisation of supporting functions, enforces resource sharing between the insurance lines and the regional insurers. Its control and coordinative arrangements, on the other hand, remain quite hierarchical. The coordination within an insurance line and between the insurance lines and the supporting functions takes time, binding management capacity. This has made the organisation rather internally oriented and leaves little management capacity free for market-oriented adaptation. The hierarchically managed organisation accords well with the cost orientation of the Insurance Group. As the insurance market, although becoming more dynamic, is still rather stable, the structure of the Insurance Group seems to fit both the main priorities and the market. The corporate financial control and the centralisation of the supporting functions is a contradiction, as the centralisation actually limits the alternatives of the insurance companies to fulfil the set targets. This contradiction could be solved in the long run by establishing clear responsibilities concerning the supporting functions and the insurance companies as their customers (cf. Goold et al. 1994) or by corporate management taking a more active role in the strategic planning and thereby setting clear priorities. In 2010 this was still lacking, however. The aspects of the organisational issues discussed in the case study chapter are summarised in Table 5.7.

5.4.2 Work Organisation

The Insurance Group re-organised its service production in 2008. The aim was to increase both the service quality and the decrease the costs of production by ensuring a high level of formalisation and standardisation. The implementation was not as successful as originally planned. After multiple task forces, increased resources and top-management attention, the situation stabilised. The changed conditions of the employees in the new organisation have not yet been accepted, however. The turnover rate is high, as the employees apply for vacant positions in the “back-office” departments. The low acceptance among employees can be traced to multiple reasons, the main one having been identified is decreasing self-organisation. This has a major consequence for the service quality, as more decentralisation in decision-making has been connected to greater commitment to, and responsibility for, service production (Nilsson and Rapp 1999 draw similar conclusions for product manufacturing). In the new work organisation structure employees are involved in optimisation initiatives only to a limited extent. During the interviews very few examples were given where the employees were involved in resolving quality or productivity issues. Employees that provided unsolicited ideas were not appreciated. Although employee involvement was not encouraged before the new work organisation either, employees were previously granted some functional power and self-organisation.
The new work organisation was supported by new IT systems. Multiple studies point out that IT investments are intended either to reduce cost or to improve product and service capabilities (Brynjolfsson and Hitt 2000, Hammer 1990). These different goals lead to differing requirements that must be matched by the information technology. IT can be used to support flexibility by providing the employees a broader information base (Hitt and Brynjolfsson 1997) or it can be used for increasing efficiency through the automation of “rule based” system (Lee 1984). The Insurance Group aimed to achieve both increased service quality and productivity with the new IT systems. After implementation, however, the productivity increase was highlighted more than the increase in service quality. IT is seen as a vehicle to replace employees and to ensure that the rules are applied more consistently in risk and claims assessment. In other words, IT is used for industrialising the service operations.

Overall it can be said that the insurance company, with the introduction of the customer and sales partner service centre, introduced a mass service production environment with the purported aim of increasing the efficiency of service production. The service production organisation introduced is quite consistent with the cost-saving ambition of the insurer, though not with the closeness to customers sought by a marketing differentiator based on a unique image of a trusted caretaker. The aspects of work organisation discussed in the case study chapter are summarised in Table 5.8

Table 5.8: The development of the work organisation between 1995 and 2010 (in cases where the aspects differ between the insurance lines or insurance companies this is indicated in the table; if there is no indication the statement is valid for all the insurance lines and insurance companies)

<table>
<thead>
<tr>
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<tbody>
<tr>
<td>Functional power given to production employees</td>
<td>In their area of expertise, service employees have a high level of functional power to take decisions concerning customer issues and their own work processes.</td>
<td>The extent of functional power is strictly limited. Employees feel they are viewed as mere production resources without flexibility to react to individual customer needs. Health: Based on client classification, some discretion is allowed by the service employees.</td>
</tr>
<tr>
<td>Level of standardisation / formalisation</td>
<td>Low level of formalisation and standardisation, including flexible work conditions with less transparency of outcome.</td>
<td>High level of formalisation with standardised and automated processes.</td>
</tr>
<tr>
<td></td>
<td>Self-organisation is allowed concerning working hours and work preferences.</td>
<td>Low level of self-organisation with strictly organised work hours and work processes in a transparent work environment where employees are controlled via automated workload balancing.</td>
</tr>
<tr>
<td>Specialisation of production employees</td>
<td>Service production employees are specialised within a limited area.</td>
<td>Broader knowledge is aimed for (especially in the smaller insurers), but due to productivity priority and introduction of new systems, the aim is not yet fulfilled.</td>
</tr>
<tr>
<td>----------------------------------------</td>
<td>---------------------------------------------------------------</td>
<td>-------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Human resource policies</td>
<td>Caretaker role (quality) is given priority in service production.</td>
<td>Productivity control is given priority and employees are increasingly seen as a production resource trimmed for efficiency.</td>
</tr>
<tr>
<td></td>
<td>Low level of empowerment – however with a certain level of self-control over the work process. Saarland Health: Employees were seen as important resources and their skills were measured and documented.</td>
<td>Low level of empowerment and employee involvement due to hierarchical culture (only top-down communication is foreseen).</td>
</tr>
<tr>
<td>Aims of technology</td>
<td>Technology is used for documenting decisions. Saarland Health: Technology is used for innovation and increasing service quality.</td>
<td>Technology is used for automation and productivity increase and to substitute for employees. Additionally, expertise logic is built into the system limiting the functional power of the service employee.</td>
</tr>
</tbody>
</table>

5.4.3 Conclusion Coherent Organisational Structure

As long as the Insurance Group can optimise efficiency through standardisation the strict and hierarchical organisation structure and the chosen work organisation can be considered adequate (cf. Eisenhardt and Sull 2001). However, a positioning that requires more flexibility and service quality exceeding the market level might be a challenge with the chosen organisational structure. As the insurance industry is only slowly developing towards a more open and competitive environment, the efficiency-based structure, although not fitting with the customer-oriented caretaker image, can be seen to adequately support the Insurance Group.

Only the coordination of the centralised supporting functions is not well balanced with the financial control chosen by the corporate level. Due to the lack of guidelines concerning priorities, the negotiations among all entities involved are very time consuming and bind management capacity. In a more unpredictable environment decision-making might be delayed under these circumstances. Fortunately, as stated above, the insurance environment is changing only slowly towards more uncertainty, giving time for the Insurance Group to enhance and simplify the coordination of the centralised supporting functions.
5.5 Summary of Strategic Congruence, Integrated Control and Coherent Organisational Structure

After discussing all the dimensions individually, the overall situation of alignment is analysed in this sub-chapter based on the theoretical framework. The situation around 1995 and towards 2010 will be discussed, as well as the changes leading to the situation in 2010.

The corporate strategy has been and is based on common goals with the primary emphasis on growth. These goals are applicable to all insurance lines and regional insurance companies belonging to the group. Corporate management has followed a portfolio management strategy since 1995, combined with financial control. Goal achievement is delegated to the management of the insurance lines and the regional insurance companies. Around 1995, the decentralised supporting functions required limited coordination via corporate management. Since 2006, however, more supporting functions are being centralised. In order to coordinate centralised resources, a rather complex structure of multiple boards and commissions has been introduced. Still, the coordination of the centralised resources is not optimally organised due to a lack of rules concerning priorities and responsibilities. The centralisation thus limits the alternatives available to the individual insurance lines and the regional companies to reach their goals. This is not well aligned with the portfolio management strategy combined with financial control based on strict targets. Due to the increasing amount of centralised supporting functions, increased involvement of corporate management in the strategic planning by setting priorities concerning the common resources would be beneficial. Clear communication concerning priorities and how they affect the strategic planning of the insurance lines would enhance the common understanding and direction of the corporation.

The Insurance Group, including all its insurance lines, is positioned as a service insurer, not competing on price but nevertheless offering good prices. The market positioning as a customer-oriented caretaker (marketing differentiation strategy) is based on the inherited image. There are no current activities strengthening this position other than the marketing message “we insure you as we would insure ourselves”. Instead, cost-saving activities have dominated daily business since the financial crisis 2001/2. With the introduction of the customer and sales partner service centre in 2008, mass service production was established with the principal aim of increasing productivity and decreasing costs. During introduction, the service quality declined. This attracted some top-management attention and led to investments in additional resources. It was underscored by operational management that in order to achieve a sustainable increase in service quality, more training and supporting IT systems would be needed. After stabilisation, however, the main goal of top management is to increase the efficiency of service production, rather than to invest in improving the service quality. This feature is not consistent with the marketing
differentiation strategy based on the caretaker image, but it does fit with the cost-saving orientation of the insurer.

A company following a marketing differentiation strategy must in the long run ensure that the service production fulfils the market promise. Failure to fulfil the promise can harm the firm’s relationship with its consumers and thereby decrease their loyalty. Around 1995 service production was better aligned with the market promise, due to its more customer- and sales-partner-oriented professional service production. As early as 2001/2, due to the cost orientation, production control was changed from service quality towards productivity and efficiency. The control priority, however, did not fit well with the work organisation until the introduction of mass service production in 2008.

Overall it can be concluded that the insurance group under study, around 1995 as well as towards 2010, was not ensuring strategic congruence through their activities. In 1995 the misalignment could be explained by the limited interest in strategic issues due to the company’s background as a monopoly insurer. Towards 2010 the misalignment can be explained by the cost-centred orientation of the insurer, which does not support a marketing differentiation strategy based on a caretaker image. Also, in 2010 the interest in strategic issues was rather limited, as decisions concerning priorities and a clear strategic framework was not on the agenda of the top management. In 1995 due to the stable environment with low level of uncertainty and high capital reserves from the deregulated time, this lack was not as problematic as it is towards 2010. The more uncertain environment and the critical developments in the capital return on investment increase the need to align the organisation in a common direction and thereby to ensure that the activities of the different levels support each other.

Since foundation, management control has been based on financial measurements concentrating on revenue and later cost control. Around 1995 this did not align well with the limited attention towards strict targets on the insurance-line level. With the increased attention given to control aspects on the insurance-line level, the alignment towards the corporate financial control has increased over the years. Generally the financial control fits the principal target of growth and the cost reduction initiative taken since the financial crisis in 2001/2 and the market tendency toward lower costs. Although service quality is measured over customer and sales partner satisfaction in common market surveys, they do not receive much top-management attention. The activities resulting from the surveys are not given high priority, and responsibility for their implementation is delegated to the operational level. It was claimed that if the insurer paid as much attention to service quality as to cost control, it could be the market leader in service and thus strengthen the marketing differentiation strategy of a trusted caretaker. Instead the organisation is being trimmed in order to control and reduce costs. This change was summarised by an insurance line manager as
“we are changing from wanting to do everything right for the customers to wanting to have everything transparent via control”.

Production control, based on productivity and measurements of output since 2001/2, is well aligned with the system of tight management control. It also fits in with the mass service production introduced in 2008, which is based on formalised and standardised processes with very limited functional power delegated to service production employees. However, the production control and work organisations do not strengthen the caretaker image, as quality and flexibility are given lower priority than efficiency. Therefore, although management control and production control are well aligned with each other, the insurance company does not have an integrated control system. Even though both levels of the control system support the cost orientation of the insurer, they do not support the marketing differentiation strategy.

Since 2005 the Insurance Group has been installing multiple boards and commissions to coordinate the activities of the centralised supporting functions. Although these multiple entities have been implemented to increase horizontal coordination, coordination is still vertical owing to the limited decision-making powers of these entities. This centralised power and the vertical coordination would be in line with a stable environment where no fast decisions are needed. During the last few years the market has been developing towards more uncertainty, however. As issues need to be discussed in the established boards and committees before decisions are taken on the board of directors level, the Insurance Group cannot react quickly to environmental changes. Due to this limitation informal networks are used for informal decision-making outside the official coordination channel. This lowers the transparency of decisions and priorities taken within the whole organisation. Therefore, it can be summarised that although the work organisation is well aligned with mass service production, the Insurance Group has not achieved an overall coherent organisational structure. The above-discussed development is illustrated in Figure 5.1 and Figure 5.2. The arrows symbolise the misalignments discussed. While looking at the illustrations it can be concluded that the Insurance Group due to the environmental changes and the decisions taken by the management increased the level of mismatch towards 2010.

Two developments could be identified as the main reasons for this misalignment. Firstly, the cost orientation that was established in 2001/2 without taking the marketing differentiator position into account. From that point on the organisation was optimised taking only costs into consideration. Although the internal priorities in service production as well as management and production control were not supporting customer and sales partner satisfaction, upon which the caretaker marketing differentiation is based, the image has remained rather stable. This supports the importance of considering valuable rare resources when looking at a company’s market position and competitive advantage. The valuable resources seem to
counterbalance misalignment within strategic congruence, integrated control and coherent organisational structure, to a certain extent.

The second reason for the new misalignments, also linked to the cost-saving initiative, is the portfolio management position of the corporation. This management position has been retained even though supporting functions have been centralised due to cost saving since 2006. Instead of engaging itself in setting priorities and supporting the insurance companies in their strategic planning, the corporate level limits itself to setting top-down goals that need to be fulfilled. Coordination has instead been delegated to multiple newly established boards and committees. However, these boards and committees do not have any guidelines like a strategic framework upon which they could take decisions nor do they have any real decision-making power. Therefore decisions are remitted back to the board level. As a result, decision-making in the Insurance Group is centralised, and implementation is based on vertical chains of control. This is not an optimal choice for a company with centralised resources acting in an environment developing towards more uncertainty.

According to the theoretical patterns, the increased level of misalignment should lead to a decreasing competitive advantage and thereby declining performance over the years. This will be discussed in the next sub-chapter.
5.6 Performance

It is one thing to analyse the factors shaping change episodes, and quite another, much bigger and more intractable problem to produce convincing evidence that a pattern of change initiatives contributes to organisational performance (Pettigrew et al. 2001). Nevertheless, the competitive advantage of the insurance company will be analysed in this part by examining its performance. In the discussion on competitive advantage, both quantitative financial measurements and long-term qualitative measurements of performance are included. In this way both a competitor-centred assessment and a sales-partner/customer-focused assessment of competitive advantage can be achieved (cf. Day and Wensley 1988).

Ever since the insurer’s establishment in 1995, profitability has been satisfactory in all insurance lines. The principal reasons for this success have been the favourable capital return on investments, especially in the initial years, and the low acquisition cost due to the inherited monopoly portfolio and the Savings Bank sales channel, which requires lower commissions than other sales channels. Thanks to the conservative asset management strategy, the insurer has achieved acceptable levels of return on investments even during the recent years of turbulence. For these reasons management has been able to focus more on growth than on profitability. Growth has mainly been achieved through acquisitions. Since the latest major acquisition in
2004, the insurer has been struggling to achieve organic growth exceeding the market average. Although the Insurance Group has exceeded the average level of market growth over the years, some interview partners actually stated that in comparison with its peer groups the corporation’s growth has not always been so evidentiary. Overall it can be concluded, however, that from a financial point of view the insurer is still performing well on the German insurance market, as it has exceeded the market average for revenue growth and profitability.

As for qualitative measurements of performance, on the other hand, the picture is somewhat different. Customer satisfaction surveys show that the company’s wealthy elderly clientele appreciates the regional insurance model, with consulting sales channels. But the surveys also show that the insurer is having problems in attracting younger clientele. Younger clients are more price-sensitive and tend not to consult with the sales channels but to search for insurance offerings on their own. This trend suggests that the insurer is facing a challenge in attracting younger clientele on a long-term basis. Nevertheless, when looking at existing customers, the insurer has been achieving increased customer satisfaction, according to a Germany-wide insurance survey. In 2007 the insurer reached the average German level, though that was also due to a decreasing German average. Generally it can be concluded that the insurer still has a strong and loyal elderly customer group but has not yet found the right strategy to attract new customer groups.

In insurance, sales channels are vital. The insurer is very strongly tied to its main sales channel, the Savings Banks, as they are not only a sales channel but also the owners of the insurance group. In addition, over the years the insurer has broadened its sales channels in order to reach customers outside the Savings Banks group. More independent sales channels, however, require more sales support. Generally, sales-partner satisfaction has been low. In 2009, shortly after the introduction of the customer and sales partner service centres, it dropped dramatically following years of positive development. Despite the low level of sales channel satisfaction, the surveys are more seen as “a reminder of the long-term weaknesses” instead of alerts for change as one board member commented. In summary, the insurer is benefitting from the loyal Savings Bank sales channel but is still searching for the optimal way to support the new independent and more demanding sales channels.

It can be concluded that the insurer is currently competitive. Ever since its foundation, it has exceeded average market performance in growth and profitability. The difference in relation to the market has been diminishing in the last few years, however, and in some parts it has even disappeared totally. The performance aspects are summarised in Table 5.9.

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141 The insurer launched a price-sensitive Internet insurance in 2008 in order to attract younger clientele.
### Table 5.9: The development of the market position of the Insurance Group between 1995 and 2010

<table>
<thead>
<tr>
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<tbody>
<tr>
<td><strong>Financial/Quantitative performance measurements</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Profitability</td>
<td>Profitable, exceeding market average, mainly due to capital return on investments and lower acquisition costs.</td>
<td>Profitable, slightly exceeding market average, also due to positive underwriting results (although they are declining since 2008). A lower than market profitability since 2009 in health insurance.</td>
</tr>
<tr>
<td>Capital return on investments</td>
<td>Average market level (which was generally high during this time).</td>
<td>Average market level (which has been decreasing).</td>
</tr>
<tr>
<td>Market share</td>
<td>2.8%</td>
<td>Increased to 4.0% although mainly due to acquisitions and short-term single premium product sales in life insurance.</td>
</tr>
<tr>
<td><strong>Non-financial/Qualitative performance measurements</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Customer satisfaction</td>
<td>Below market level– seen as a governmental agency. Saarland Health Insurance was above the market average before the merger with the Insurance Group.</td>
<td>Increased to average market level (also as the German insurance market has a decreasing market trend since 2003) due to high scores for image and solid company – although below market in service quality.</td>
</tr>
<tr>
<td>Sales channel satisfaction</td>
<td>Stable on a low level.</td>
<td>Stable on a low level. Decreasing rates in 2009 (after a brief improvement in 2006) due to low rates in treaty administration after the reorganisation of service production.</td>
</tr>
</tbody>
</table>

Because of the long-term nature of the insurance business, especially in life and health insurance, the financial effects shown by the current mediocre qualitative performance indicators will have a long time lag (cf. Oletzky 1998). Nevertheless, as Pettigrew and Whipp (1991) conclude from their study of de-regulated markets, including life insurance, long-term success is based on reactions, change and decision-making. They found that the high performers were distinguished by the way in which they conducted environmental assessments, linked strategic and operational activities with the environmental development, managed their human resources as assets and liabilities, and managed coherence in the overall process of competition. The analysis in the previous sub-chapter showed that the studied Insurance Group has not managed all these activities in a comprehensive manner.

### 5.7 Summary of the Analysis

Since its foundation, the Insurance Group has been exceeding the market
average performance concerning growth and profitability. Although the difference to market has been declining in the last few years, management still seems not to be alerted. The market in general seems to react slowly. This is explained by the fact that the insurance business was regulated and thereby protected until 1994. During this time insurance companies could build up capital reserves. This, together with the long-term nature of the business, especially in life and health insurance, can lead to an impression that there is no need to change quickly and to react to all environmental changes (cf. Chandler 1962). This could explain why the Insurance Group has not reacted comprehensively to the changing competitive environment, leading to declining performance.

Only when organisations continue acting out strategies long after they have outlived their usefulness does the situation become problematic. In the case of the Insurance Group, the current way of business is only partly misaligned. At the same time, as highlighted above, change in the German insurance market is slow. This slow change and the continuous high value of the inherited unique resources seem to enable the Insurance Group to partially keep its competitive advantage although the level of alignment of its activities has been decreasing.
6 Conclusions and Implications

In this chapter the conclusions of this study are presented. This is done in the first sub-chapter. In the second sub-chapter the conclusion drawn from this research case are compared with conclusions drawn from the other research cases belonging to the same research programme. Thereafter the business implications from the research conclusions are discussed before the chapter and this thesis is closed with a discussion of ideas for further research.

6.1 Conclusions from the Research Case

The aim of this study is to increase the understanding of competitive advantage. According to the service industry framework for competitive advantage (as illustrated in Figure 3.6), a company with a fit between its external position and its internal activities will achieve a competitive advantage in its market. Put another way, a company with a strategy aligned with its competitive arena, with strategic congruence between different strategic levels, with an integrated control system and with a coherent organisational structure is foreseen to have a competitive advantage over other companies in the same industry.

According to the analysis the Insurance Group is not ensuring an overall coordination of the activities, although there is a fit among some of the dimensions. Therefore, as discussed in the sub-chapter “5.5 Summary of Strategic Congruence, Integrated Control and Coherent Organisational Structure” some aspects of alignment as well as some misalignments could be identified at the insurance group studied. The level of misalignment increased over the time frame studied, based on changes in the environment but also due to less than consistent decisions taken by management. Although the Insurance Group has been successful in regard to market share and profitability since its foundation in 1995, its competitive advantage, measured as performance compared to the market average, has decreased. The declining performance combined with the increasing level of misalignment supports the assumed importance of achieving a consistent positioning among strategy, control and organisational structure. It can therefore be presumed that strategic congruence, integrated control as well as coherent organisational structure influence a company’s competitive advantage.
This case study supports the use of a broad model when analysing competitive advantage. This is in line with earlier conclusions stating that neither the environment, strategy, control system nor organisation structure is sufficient alone to explain the company’s performance (cf. Olson et al. 2005, Lenz 1980). In order to achieve a long-term competitive edge, there is a need to coordinate different elements within a corporation (Surowiecki 1999, Porter 1996) and to find a strategy, a control system and a structure with a high degree of internal complementarity (cf. Miller 1996). Meeting this gives a company a sense of mission and direction, and it is harder for a rival to match an array of interlocked elements and activities than merely to imitate a particular activity or to replicate a service offered (Porter 1996: p. 73). Based on the case study analysis, some complementary aspects influencing the level of alignment needed were identified, however. In this study the inherited valuable and unique resources and the semi-protected environment seem to smooth over the effects of the misalignment and the declining competitive advantage.

The Insurance Group inherited multiple valuable and unique resources at its foundation, as discussed in “5.2.1 Valuable Resources of the Insurance Group”. The most valuable of these resources is the unique image. During the time frame studied the Insurance Group did not develop any strategies for utilising its unique inherited image of a trusted caretaker to strengthen its differentiation from the competitors. Still the Insurance Group has in fact been able to maintain this unique image. Therefore it seems that the value of resources appears to remain stable in an environment that changes only very slowly. The strength of the image-based market position and its apparently stable value has been ensuring the Insurance Group a competitive advantage, although no activities have been undertaken to strengthen or even just to retain the image of a trusted caretaker. It can therefore be concluded that valuable resources should be included as a complementary point of view when competitive advantage is studied.

The characteristics of the insurance industry as discussed in sub-chapter “5.1 Developments in the German Insurance Industry” seem also to influence the effects of the misalignments. Due to the slow frequency and speed of change it appears that quick reaction is not as relevant in the insurance industry as in industries acting in an even more competitive environment. Although the valuable and unique resources were not further developed or strengthened and multiple areas of mismatch were identified in the analysis, the competitive situation of the insurance company is only slowly weakening. Even if a semi-protected environment gives management more time for reflection, the deteriorating competitive situation of the Insurance Group indicates that a company still needs to react to changing conditions. In conclusion, although the model for competitive advantage stressing internal and external alignment may not seem to be so important for the Insurance Group at present due to the semi-protected environment, this
situation will probably change as the market is increasingly affected by deregulation.

After discussing the general influence of strategic congruence, integrated control and coherent organisational structure on a company’s competitive advantage, and presenting the identified complementary aspects of inherited valuable resources and the semi-protected environment influencing the level competitive advantage, the theoretical definitions incorporated into the framework will be reviewed based on the case study material.

As discussed in section “5.2.2 Alignment of the Strategies on the Corporate, Insurance Line and Service Production Levels”, the lack of strategic congruence led to an uncertainty in the Insurance Group concerning the right means to reach the set goals. The fact that the corporate strategy was not changed away from portfolio management through corporate goals although resources were centralised led to uncertainty among the insurance lines concerning how to prioritise the common resources. A more interactive role for corporate management in strategic planning was requested, including setting priorities concerning how to utilise the centralised resources. This requested change towards an activity-sharing strategy supports the theoretical definition that foresees a more interactive corporate strategy in case of activity or resource sharing among the business units.

Despite this uncertainty, the fact that the marketing differentiation strategy did not align well with the cost orientation did not lead to any high level of ambiguity. This could be explained by the cost and productivity orientation of the management and production control systems. As only monetary measurements were used in the reporting, the emphasis on service quality and customer loyalty decreased. Although questioned by some interview partners, the general opinion was that the unique image of trusted caretaker was only seen as an external marketing issue that did not need to be reflected in the internal activities. Comments like “winning a customer is a question of trust and not service” indicate that the inherited trust was taken for granted and not connected to the service currently delivered to customers. Although the image enabling the company to enjoy its market differentiation was paid limited attention, it remained stable. The stability of the image indicates that, although Porter (1996) sees differentiation through marketing only as a temporary phenomenon, which can only be observed before the customers have learned to evaluate the offerings, marketing differentiation appears to be a valid and stable market position in the service industry.

The mass service production that was introduced is an example of optimising the internal activities differently from the external market position. It aligns well with cost orientation but less well with customer loyalty enhancement. Although the assumed theoretical definition of strategic congruence between the business and production strategy could not be found in the insurance group studied, a perceived strategic congruence could be identified between the business and production strategy based on cost orientation. Still this misalignment between the caretaker image and the
Productivity-oriented mass service production should not be ignored, especially as studies have pointed out the importance of ensuring that there is no gap between the external image and the actions taken in service production (Davies et al. 2010, Nielsen et al. 2000) as a company’s image is largely dependent on the impression employees create during their customer contacts (Sekhon et al. 2013, Anaza and Rutherford 2012, Andreassen and Langseng 2010). As the Insurance Group studied differentiates itself from its competitors based on its image and not by offering cost-optimised solutions, this could develop to a critical misalignment, although the caretaker image currently seems to be rather stable.

The mechanisms theoretically predicted to enhance each other on the management and production control level were confirmed in the insurance group studied. The choices made in the control system were well aligned with the cost oriented activities of the Insurance Group. However, the tight control with short-term monetary measurements on management control level and the productivity-oriented output control of production did not support the marketing differentiation position based on the image of caretaker as quality, and customer-oriented measurements receive only very limited management attention. However, as discussed above, this could be due to the fact that the image of a trusted caretaker was seen only as an external marketing issue. Management control provides a framework for management and employees that influence them and supports their activities towards a shared view of the organisation’s direction (Nilsson et al. 2011: p. 278). It can therefore be concluded that the control mechanisms used in the studied insurance group on the management and service-production levels were guiding the activities towards the perceived strategic orientation of cost optimisation.

The choices made concerning the organisational structure on the corporate level were not perceived to be optimal in theory or in practice, whereas the efficiency-oriented workgroup organisation accorded well with mass service production.

Although multiple boards and committees were introduced on the corporate level to coordinate the centralised resources, the decisions were taken on the board level. This hindered the intended horizontal coordination. Informal networks were instead used to enforce decisions concerning the allocation of centralised resources. However, these decisions were not optimised for the whole organisation but for the special interest areas of the informal network. Based on the case material it can therefore be concluded that the theoretical ideas of the coherent organisational structure were confirmed in the case study. The uncertainty concerning the coordination of the centralised resources on the corporate and business-unit levels indicates that the organisational choices did not support the strategic choices made. In order to support the allocation of the centralised resources a more interactive corporate role would have been beneficial, combined with decentralised...
power and horizontal coordination of activities. This, however, would also require clear strategic priorities, which were lacking in the Insurance Group.

On the other hand, the workgroup organisation with a high level of standardisation and a low level of functional power aligned well with the productivity-oriented mass service production strategy. On the other hand, it did not support the customer-orientation aspects important for the chosen marketing differentiation strategy based on the caretaker image. More empowerment and flexibility to fulfil customer specific requests would be needed in order to support a marketing differentiation business strategy based on a caretaker image (cf. Nielsen et al. 2000).

Overall it can be concluded that the cost orientation was given more attention than strategic positioning when aligning the internal control mechanisms in the Insurance Group. Therefore the misalignment concerning marketing differentiation did not lead to any high level of uncertainty in the Insurance Group studied. The lack of support from the control system and organisational structure for the allocation of the centralised resources was seen critical at the Insurance Group, however. This misalignment could develop into a critical aspect, as many studies have indicated performance decreases due to trade-offs between synergies and the coordination costs arising from complex interdependencies between business lines (Zhou 2011, Rawley 2010) especially in rigid organisations like the Insurance Group under study (cf. Rawley 2010).

The results of this study support that strategic congruence, integrated control as well as coherent organisational structure influence a company’s competitive advantage. Due to the semi-protected environment the effects were nonetheless weaker than they probably would have been in a more competitive and unpredictable market. Moreover, the study supports the strength of an image-based marketing position as a valid differentiation strategy. This strength seems to be supported by the apparent stability of valuable and unique resources. This supports the integrated approach of competitive advantage where both the positioning framework and valuable resources are used as complementarities when competitive advantage is studied (as illustrated in Figure 3.4). Furthermore the theoretical combinations of strategic congruence, integrated control and coherent organisational structure were confirmed in practice, although the choices made by the Insurance Group did not always follow the theoretically foreseen combinations. Overall, the main contribution of this study is the integrated approach of the framework and its ability to increase the understanding of the interaction of factors influencing competitive advantage in the service industry.
6.2 Conclusion based on the Research Programme

As was discussed in section “2.4.4 External Validity”, this study is a part of a research programme where case studies have been conducted using the same tentative model as basis with the aim to understand how strategic congruence and integrated control are connected to competitive advantage. The aim of the research programme is not to develop a common framework for all the studies, but to increase the understanding by analysing and explaining the common conclusions as well as the specialities within each case.

The results of four studies in this programme have been published. Ahlström (2008) looked into what constitutes strategic congruence and integrated control for organisations in the service-intensive senior-housing market pursuing a differentiation strategy. His study supports the hypothesis that successful market players have a high degree of consistency between strategy and control systems. Anjou (2008) looked at Scania, a successful manufacturer of busses, trucks and industrial engines. She concluded that the tentative model could be used as an analysis framework identifying the level of strategic congruence and integrated control. Scania, based on the framework, had achieved strategic congruence and integrated control while following a combination of differentiation and cost leadership. The strategic congruence and integrated control seem to have influenced the level of success the manufacturer achieved on its chosen markets. Sundberg (2009) studied Atlas Copco, a manufacturer of compressors, construction and mining equipment, power tools and assembly systems. Sundberg’s analysis of the different dimensions shows that Atlas Copco over the years has been achieving strategic congruence and integrated control by mutual adjustments. Moreover, as performance has been improving, Sundberg connects the development towards strategic congruence and integrated control to an increased level of competitive advantage, although he highlights the need for deeper analysis of this link. Nilsson (2010) studied Saab, a conglomerate in the airplane and defence industry. His study also confirms the hypothesis that the level of strategic congruence and integrated control influences a company’s competitive advantage. Nilsson also identifies some deviations from the theoretical fits, which he, as in this study, explains by the industry characteristics.

The four previously published studies and this study highlight the importance of aligning the strategy with the internal control mechanisms. They have also shown that the level of alignment seems to influence the competitive advantage of the companies studied and thereby their performance compared to their competitors acting in the same industry and market. However, the studies have also found some industry-specific aspects influencing the alignment and the competitive advantage. It can therefore be

142 The deeper analysis will be included into his dissertation, which will be published in 2014.
concluded that strategic congruence, integrated control and coherent organisational structure are important aspects that influence competitive advantage, but that there are also other industry-specific factors influencing both the level of fit needed to be achieved and the resulting competitive advantage.

6.3 Business Implications

A further objective was to conduct a research study with relevance to practice and thereby to provide support for practitioners. As the environment of the insurance industry has been changing over the last decade after being a stable, regulated and at the same time growing market, an increased understanding of competitive advantage should be beneficial for insurance managers. In this study some aspects influencing competitive advantage have been discussed, taking the common trend among German insurance companies into consideration.

Although the results of the study are not broad and clear enough to suggest a normative model for competitive advantage based on strategic congruence, integrated control as well as coherent organisational structure, it highlights the need to consider multiple aspects in an overall framework. The discussion concerning the interaction of the different dimensions should be beneficial for management in the insurance industry or even the service industry. Especially the importance of aligning service production and its control mechanisms with the desired market position provides unique aspects as service production in financial services and especially the insurance industry has received limited management attention (Hatzakis et al. 2010). Service production well aligned with the business strategy could therefore be a way to achieve a competitive advantage in the insurance market (cf. Prajago and McDermott 2008). Moreover, the framework offers an opportunity for an insurance company to differentiate its activities from the general market trend towards cost orientation. By using the competitive framework an insurance company could choose an alternative market position and align its internal activities accordingly. This would enable a unique position that could lead to a competitive advantage.

The conclusion concerning the long lasting value of valuable and unique resources should also be of interest to managers in the service industry, as these resources could ensure a company a position that is not as easy to copy as service products and processes. Strategies and internal control mechanisms around valuable resources, including their further development, could enable a company a long-term competitive advantage (cf. Nilsson et al. 2011). Especially the valuable resource of trust seems to provide a long-lasting potential to differentiate the company from its competitors. Therefore a service company aligning the internal activities and marketing message
accordingly could achieve a strong and long-lasting competitive position based on trust.

Furthermore, the uncertainty in the studied Insurance Group due to the lack of a consistent framework leads to a practically oriented conclusion available to all companies, with or without any valuable resources. A communicated strategic framework with defined goals and means for achieving the set goals provides a company with a clear sense of direction and well-organised resource management (Nilsson et al. 2011). This sense of direction empowers fast decision-making and coordination of activities without long negotiations concerning priorities. This seems to be increasingly important in the insurance market, based on its development towards uncertainty.

The aim of this study is to increase the understanding of competitive advantage and how strategic congruence, integrated control and coherent organisational structure influence a company’s competitive advantage. Although this study was conducted 15 years after Oletzky (1998) stated that these topics receive only limited management attention in the German insurance industry, very little seems to have changed during this time. Maybe now the market situation has changed enough to capture the interest of insurance managers regarding these topics. At least the analysis and the conclusions of this case study support the idea that a strategic framework including service production priorities could support an insurance company in achieving a competitive advantage.

6.4 Further Research

Although this study was a part of a research programme, which enables some comparison of the conclusions concerning competitive advantage, further studies would enable a deeper understanding of competitive advantage and its mechanisms especially in the service industry. As this study was limited to one insurance group acting in Germany, it would be interesting to replicate the study for other insurance companies acting in the same environment in order to be able to compare their level of alignment and competitive advantage with the Insurance Group studied. This would deepen the understanding of how strategic congruence, integrated control and coherent organisational structure influence an insurance company’s competitive advantage, and it would increase the external validity of the conclusions drawn in this study. Additionally, in order to enhance our knowledge of service management, comparative studies of other service organisations outside the insurance industry would be beneficial. Furthermore, in order to enhance the understanding of semi-protected markets, a comparative study of a service company acting in another deregulated market would be valuable. In addition, in order to deepen our understanding of the alignment of a company pursuing a marketing
differentiation strategy, a comparative study of another service organisation pursuing a strategy based on image would be interesting. It would extend the first interpretation based on the studied Insurance Group concerning the separation of internal choices and external market position.

Beyond the idea of comparative studies, many interesting areas for further research were identified during this study. For example, it would be interesting to analyse the change process when a company following a different strategy than the rest of the companies becomes integrated into a corporation. In this study, due to its broad scope, the change process of the Saarland Health Insurance, which followed a different strategy until the acquisition, could not be analysed comprehensively. The resistance in the beginning and then the process of gradual alignment would have been interesting to follow in more detail. It would also be interesting to deepen the analysis of change. In the Insurance Group there were many signals of change during the time frame studied. Yet top management was hesitant to take a clear position on the future priorities of the Insurance Group. Due to this hesitation this case study could be regarded as an example that organisations are rarely rational systems that are internally consistent (cf. Bhimani and Langfield-Smith 2007, Archer and Otley 1991). The management processes and choices concerning strategy, control system and organisational structure on different organisational levels seem to have been influenced by a diversity of contextual, organisational, political and environmental factors (cf. Langfield-Smith 1997, Lord 1996, Dent 1991). It would be interesting to delve further into these factors influencing change in a deeper case study including real-time observation of the change process.

This study increases our understanding of competitive advantage and resulted in some general conclusions concerning strategic congruence, integrated control and coherent organisational structure, but at the same time it identified multiple further research ideas. Although I am curious about the outcome of the further research ideas, at the same time I am pleased to finalise this research project.
References


Appendix A: Interview Guide

**The Role of the Respondent** (All respondents)

Could you briefly describe your role and area of responsibility? How has your role been changing since 1995?

Is your role more operational or market oriented?

In which ways are you involved in the strategy, control and organisational structure?

Wrap up question: Can you describe your management style?

How is your success controlled and measured?

**Environment**

**Industry** (CEO, CFO, Sales, Business Development)

How would you characterise the insurance industry (stabile/turbulent, growth/decline, fast or slow changes)?

What does the competition in market and from outside of the market (alternative products) look like?

Does the business follow the general business cycles? Does it have its own cycles? Were would you say that you are right now? How long is the current cycle? Have the characteristics of the cycles changed lately?

How has this been changing the since 1995? Have these changes led to changes in the way the business is performed in the industry?

How has the financial crises changed the insurance market?

How has the company handled this change (strategy, control or organisational structure or market positioning)?

Do you expect any changes in the industry in the future?

**Market (Regions)** (All members of the Board of Directors, Business Development)

On which markets (region/product) do you compete?
How does your market look like compared to the industry as such (stable/turbulent, growth/decline, change rate)?

Does the market situation differ between the business units acting on separate markets and selling different insurance products? How?

What does your competitive situation look like compared to your competitors? Do your different business units have different competitive positions?

What is influencing the market from outside (legislation, politics, and market structure)? Can you alter this influence?

Which substitute products do you see as competitive to your products?

How is your bargaining power compared to your customers and your market channels (banks and insurance agents)?

Is it easy for new entrants to establish in your market?

How do you gather information about the market? Who is responsible for this task?

Who in your organisation creates new products, distribution of these products and their pricing? Which information do they need in their decision process?

In 2009 a new product development process was introduced? Has this project led to a better integration of sales and IT in the process? Are the regional insurance companies better integrated? Are the insurance lines developing more integrated products now?

Does the new process lead to a faster introduction of new products? Are the customers increasingly involved during the development?

Are the changes in your offerings been of a minor or major nature?

Has your customer structure changed since 1995?

How has the situation been changing since 1995?

Do you expect any changes in the market in the future?

**Strategy**

**Corporate Strategy** (CEO, CFO, Sales, Business Development)

Could you describe the corporate goals and strategies? How do they get updated?

Which criteria are important when acquiring new business units? Are you seeking synergies (products, market, know-how, economies of scale) between your business units?
What are your competitive strengths? How are they reflected in the strategy process? How are they confirmed? Are they confirmed by an external source?

Which are your key success factors? How are they measured?

Could you describe the corporate strategy process, formulation and implementation? Who is involved? How often is the strategy discussed/altered? What is serving you as an input? Is there any connection between the performance measuring and strategy formulation? Do you at the same time formulate the business strategies? Is the corporate strategy used as an input for the business and operational strategy?

How do you differentiate from other corporations? Is your strategy process more or less centralised compared to others? Do you co-ordinate the activities more or less compared to others?

Regional presence versus synergies through centralization: How is this developing?

Are the functions that were defined to be centralized as in the common work group well as in the central functions project been developed forward?

How have the strategy, the competitive strengths, the key success factors and the strategy process altered since 1995?

Which decisions taken in the past are still reflected in today’s corporate strategy?

Do you plan any changes in the corporate strategy in the future?

**Business Strategy** (All members of the Board of Directors)

Could you describe the goals and strategy of the business unit?

What are your competitive advantages? (Price, diversity/wide product range, quality, fast delivery, short product development time, creativity/innovation, close customer relationship, sales-channels, know-how, after-sales service, customisation, flexibility)

How are they reflected in the strategy process? How are they confirmed? Are they confirmed from an external source?

What are your key success factors? How are they measured?

What does your competitive situation look like (market leader in a segment?)?

How are you differentiating yourself from other companies?

**A. Differentiation variables:**

- Insurance product/service differentiation
- New product development

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- Product quality / Product rating
  - Differentiation through marketing and image/brand?
  - Differentiation through better customer service? Quality?
  - Differentiation through more experienced/better trained personnel?
  - Differentiation through better sales channels?

B. Cost Leadership Variables:
   Price difference enabled through:
   - Operational efficiency
   - Vertical integration
   - Newness of plant and equipment
   - Capacity utilisation
   - Relative direct costs
   - Process R&D

Is the business more operational or market oriented?

Could you describe the business strategy process, formulation and implementation? Who is involved? How often is the strategy discussed/altered? What is serving you as an input? Is there any connection between the performance measuring and strategy formulation? Is the corporate strategy reflected in the business strategy? Do you at the same time formulate the operations strategy?

How have the strategy, the competitive strengths, the key success factors and the strategy process altered since 1995?

Which decisions taken in the past are still reflected in today’s corporate strategy?

Do you plan/foresee any changes in the business strategy in the future?

Operations Strategy (Business Leaders)

Could you describe the goals and strategy of the operations unit / service production unit?

What are your competitive strengths in service production? How are they reflected in the strategy process? How are they confirmed? Are they confirmed by an external source?

What are your key success factors? How are the measured?

What are the characteristics in your production (mass service or professional services)? How does your operation differentiate you from your competitors?

- Equipment/people focus (the core element in the service delivery is provided primarily by equipment of people). Which kind of technical support
is available? Why are you investing in equipment? Productivity (automation) or flexibility?

- Length of customer contact per transaction. What is wished (short/long, media)?
- Extent of customisation of the products? Customised, standard with options or standard? Is the process also standardised? How? Documented processes or through a tool? What portion of your turnover comes from non-standard products?
- Degree of employee discretion – extent to which customer contact personnel exercise judgement in meeting individual needs. Who can take decisions?
- Source of value added, front or back office or the proportion of customer contact staff to the total staff requirements. Do you divide between back and front office?
- Production priority: Cost or service?
- Production process focus: Customer or production-orientation?

How do you handle changes in production (volume and product mix)?

How do you react to demand of new products? Can you introduce them faster than the market? Include time for product development as well as time until you are able to integrate a new product in the operations (including the systems)?

Could you describe the operational strategy process, formulation and implementation? Who is involved? How often is the strategy discussed/ altered? What is serving you as an input? Is there any connection between the performance measuring and strategy formulation? Is the corporate and/or business strategy reflected in the business strategy?

How have the strategy, the competitive strengths, the key success factors and the strategy process changing since 1995?

Which decisions taken in the past are still reflected in today’s strategy?

How has the Customer and Sales Channel Service Centre changed the service production? Or the sales channel support?

Have you seen any change in quality or productivity? Which? What is the goal?

After what premise is the centre organized? Specialist, all-rounder?

How is the work organized? How is the work managed and controlled?

How do you plan to continue the development of the Customer and Sales Channel Service Centre?
Are the customer calls still outsourced and not dealt with by the Customer and Sales Channel Service Centre? Is a change planned here?

According to the rating presentation 2008 – the customer and sales partner service centre started in non-life private correspondence part with a red and a sales telephone green. At the same time the life started with a yellow telephone and a green correspondence. Where the priorities differently set. In non-life the correspondence took over the phones by need.

Do you plan/foresee any changes in the functional strategy in the future (equipment/people focus, length of customer contact per transaction, extent of customisation of the products, degree of employee discretion, front or back office orientation, product/process focus)?

Control

Management Control (All members of the Board of Directors, Business Development, Central Controlling)

General Questions
Describe in short terms the overall management control:
Which performance measurements are used? How are they chosen?
Which standards are set from corporate to business unit and operations level? How are the reports consolidated? Which reports do you get and which do your unit prepare additionally?
Who sets the targets? Corporate, business or functional level (Top-down or Bottom-up)? Is it an iterative process?
Is the achievement of targets connected to a bonus system?
How are the targets and the achievements communicated? To whom, by whom and when?
Which reports do the owners request?
How are the business unit controlled?

- Strategic planning companies whose centres have a high degree of influence over business unit planning, but use flexible controls
- Financial control companies which use tight financial controls over business units but take little interest in their strategic planning
- Strategic control companies which have low influence over business unit planning but tightly control the implementation of the business unit's chosen strategy
- Centralised, one-business companies that determine business unit strategy at the centre and apply tight operational controls.
How do you differentiate from other corporations? Is your controlling more or less centralised compared to others?

**Planning and Follow-Up**

Who and which roles are involved? Which parts are decentralised and which centralised? Number of employees involved?

Which tools are used? Budget, forecasts, updated forecasts?

How are the different planning tools integrated? Sales, costs, employee, revenue

Which time horizon is used? Short/Long, amount of years?

How much freedom do the business units and functions have in this process? How are the plans developed, consolidated and approved?

With which frequency do you follow-up your plans?

How are differences to plan treated? Tight or loose control – are goals changed – under which circumstances? When and in which situations can plans be updated? Who is taken the decision?

**Integration**

Is there a feedback loop from control to strategy? Are the control systems connected to the strategies? Are the performance measurements developed and chosen with the strategy and goal in mind?

Are the control systems integrated? Corporate to business unit, business unit to operations?

**Vision and Longitudinal Impacts**

Which pros and cons do you see with the current system?

Which changes has occurred since 1995? What was the reason for the change? From which part of the organisation did the change request come? Pros and Cons with the change?

What decisions taken in the past are still important in today’s management control?

What does management control look like for the future? Do you plan/foresee any changes in the management control in the future

**Operations Control** (Business Leaders, Business Controllers)

**General Questions**
Describe in short terms the overall operations control:

What do you control operationally? What dimensions? Costs, Capacity, Quality, productivity? What performance measurements are used? How are they chosen?

Which standards are set from corporate to business unit and operations level? How are the reports consolidated? Which reports do you get and which do your unit prepare additionally?

Who sets the targets? Corporate, business or functional level? Is it an iterative process?

Is the achievement of targets connected to a bonus system?

How are the targets and the achievements communicated? To whom, by whom and when?

**Planning and Follow-Up**

Who and what roles are involved? Which parts are decentralised and which centralised? Number of employees involved?

What tools are used? Budget, forecasts, updated forecasts?

How are the different planning tools integrated? Sales, costs, employee, revenue

What time horizon is used? Short/Long, amount of years?

How much freedom do the functions have in this process? How are the plans developed, consolidated and approved?

With what frequency do you follow-up your plans?

How do you treat the plans? Like a soft direction or are they signed in blood? When and in which situations can plans be updated? Who decides?

**Capacity/Demand**

How do you plan/forecast your capacity (average or peak)? Long-term or short-term? Where do you get your input? How do you plan your capacity for demand fluctuations? Do you analyse historical data?

How do you manage capacity? (Part-time employees, flexible temporaries, cross-train employees, sharing capacity with other firms, let work fall behind, focus employee efforts on bottlenecks)

When do you react on capacity problems? What are your early warning signals that capacity and demand are not in balance?
How do you handle slack supply (hire extra workers, overtime, increase staff, time away customers, subcontract work to other firms, rescheduling other operations, cross-train employees to perform a variety of duties)?

How do you handle over supply (training, layoff employees, take on subcontracting jobs, give employees leave time, perform non-vital tasks)?

Are you doing something to manage the demand (incentives for the sales to smooth out demand)?

**Quality/Productivity**

Do you have clear quality targets? Who and how are they defined?

Do you measure the service quality (in terms of customer satisfaction, that is, the degree of fit between customers' expectation and perceptions of service and employee satisfaction)?

How is service quality measured (hard/soft measurements, Internal/external sources)?

Are the external data used for internal decision-making or to set up internal measurements?

Who is involved in the measurement/target decision?

Do you have productivity measures? How are they measured? Who is involved?

When do you react to productivity/quality problems? How?

What suffers in service quality when services run out of capacity? Is this measured?

Is there an upper and/or lower utilisation level where service quality is affected for the worse?

**Integration**

Is there a feedback loop from control to strategy? Are the control systems connected to the strategies? Are the performance measurements developed and chosen with the strategy and goal in mind?

Are the control systems integrated? Corporate to business unit, business unit to operations?

**Vision and Longitudinal Impacts**

What pros and cons do you see with the current system?
What changes have occurred since 1995? What was the reason for the change? From what part of the organisation did the change request come? Pros and Cons with the change?

What decisions taken in the past are still important in today’s operational control?

What does operational control look like for the future? Do you plan/foresee any changes in the operations control in the future?

**Organisational structure** (All with different aspects)

**Structure, management and culture**

Describe how your organisation is structured (How many hierarchical levels? Rigid or Relationship between the hierarchy levels? Classical pyramid or flat?)

How are departments structured? Functional (where responsibilities are divided by function e.g. marketing, production) or by customer structure?

Are the tasks divided between front and back office? What is the ratio between front and back office?

How often is the organisational structure evaluated? Who is involved in developing and deciding upon a new structure?

To what extent is there a need to co-ordinate the work of the production department with other departments (e.g. sales, marketing, and product development)?

How often are regular meeting held between departments?

Are you using inter-departmental task forces? For what?

What are the main tasks of the management (control or development)?

Is compensation linked to performance for the employees (at which levels)?

How would you describe our corporate culture? How do you communicate it (internal marketing)?

**Role and qualification of employees**

Qualification of the employees? Know-how and training of the employees? How long training is needed in order to be able to perform the tasks (Standardised job tasks enabling relatively unskilled, inexpensive workers who require only limited training to perform highly standardised tasks or more broadly tasks where long training is involved?)

Are the employee skill/knowledge levels measured? Is the improvement measured?
Are you encouraging your employees to be able to perform multiple tasks in the production process?

How do you develop your employees? Are employees rewarded for learning new skills? How? Development paths?

Do you have explicit procedures and role descriptions? Is there a strong emphasis that they are followed?

How is the grade of empowerment or employee involvement (the degree of participation that workers at all levels in the company have in decision making that affects their particular jobs)?

How is the level of compensation compared to your competitors?

How do you motivate your employees?

Do you conduct surveys of employee satisfaction/attitudes?

How is your turnover rate compared to your competitors? What strategy do you follow?

**Technology and environment**

Are technology investments made in order to save on employee costs or to support qualitative increases?

What is considered by the design of service environments? (How are customer and/or employee needs considered?)

**Changes**

What changes have occurred since 1995? What was the reason for the change? From what part of the organisation did the change request come? Pros and Cons of the change?

What decisions taken in the past are still important in today’s structure?

Do you plan/foresee any changes in the structure in the future
Appendix B: Time-Line Used to Identify Critical Events During the Interviews
Appendix C: Interviewees

## C.1 Interview Dates

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<th>2006</th>
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**Number of Interviews**

| 26 | 35 | 9 | 21 |

**Total number of interviews:** 91  
**Total number of interview partners:** 49

BoD = Member of the Boards of Directors  
2<sup>nd</sup> level = Main department manager reporting to a member of the Board of Directors  
3<sup>rd</sup> level = Department manager reporting to a 2<sup>nd</sup> level manager
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Appendix D: List of Document types

External Information Provided by the Case Company:
- Kundenmonitoring Assekuranz 2007
- Icon Added Value Survey 2007

Information Provided by the Case Company (externally available):
- Annual Reports of all Insurance Companies belonging to the Group, 1995-2010
- Company Presentations 2005-2009
- Portrait of the Insurance Group, August 2009, Downloaded from their Website on 12.10.2010
- Rating Presentations 2006-2009

Customer & Sales Partner Information Received from Insurance Group:
- Commercial Customer Satisfaction Survey 2006
- Customer Survey concerning cancellations 2004
- Results from the customer orientation initiative 2001

Internal Information:
- Minutes of Meetings from all Board Meetings in 2009
- Minutes from Strategic Off-Site Meetings of the Boards in 1997-2009
- Presentation of the Global Goals 2008, 2009
- Strategy Papers from Non-Life and Life Insurance 2007, 2009
- Presentation from the planning start meetings 2007, 2009
- Monthly corporate control reports 2008
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DISSERTATIONS FROM THE SWEDISH RESEARCH SCHOOL OF MANAGEMENT AND INFORMATION TECHNOLOGY

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44. Röndell, Jimmie (2012), *From Marketing to, to Marketing with Consumers*, Department of Business Studies, Uppsala University, Doctoral Thesis No. 155.

45. Lippert, Marcus (2013), *Communities in the Digital Age: Towards a Theoretical Model of Communities of Practice and Information Technology*, Department of Business Studies, Uppsala University, Doctoral Thesis No. 156.


