BRANDED PRODUCTS AND INSURANCE

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For most insurance professionals, the most obvious aspect of branded products is the risk to the manufacturer and/or to the distributor of being sued in the courts for indemnity in respect of some loss or injury suffered by a user of the product. Employers' and environmental liability are among the risks attaching to the manufacture or preparation of the product, alongside all the hazards arising from the processes and materials involved. In looking at a completely different aspect of the relationship between branded products and insurance in this paper, I am in no way seeking to imply that these well-known insurance topics are less important. Indeed, a growing proportion of the price of any branded product relates to the costs of employing a risk manager and buying insurance, whether the financial risk is transferred to a professional insurer or retained by the manufacturer or trader in a captive insurance company.

Product valuation

Taking as given the importance of manufacturing, transport and liability risks in respect of any product, we can assume that the normal objective of manufacturers, transporters and traders is to sell the products to users. These may be human individuals or corporate entities, government agencies, charities or any one of a host of legal vehicles by which products can be owned. Even allowing for the fact that some consumers, such as charities and big corporations, can sometimes buy products more cheaply than can other consumers, it can be taken as a starting-point that the valuation of the product by its user-owner is linked to three factors:-

1. The price at purchase;
2. The time since the item was purchased, weighted by the perceived normal lifetime of the product and by the rate of inflation during the elapsed ownership period:

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3. The indemnity that the owner would expect to receive in the event of total loss of the item (if insured), giving allowance for the intensity of wear on the product per period of time.

The fashion of the past decade among insurers, to offer reinstatement cover to the owner of many branded products, has passed its peak. The idea that a person whose year-old designer shoes are water damaged could receive a new pair, at the expense of his insurer, can only be sustained at a very high rate of premium that is flexibly linked to an inflation index. Most insurance of products in use has been based on the older and more sustainable concept of indemnity. Inflation of costs and prices has continued in the nineteen nineties, on a world wide basis, regardless of the impact of recession on a succession of economies. The rate of inflation has differentially been mitigated, but the pressure has nowhere been removed. This has meant that underinsurance continues to be endemic: the total cover of the physical possessions of households and corporate bodies is less than the total replacement cost of those items each in their exact current state of usage and decay.

Danger of under insurance

In the event of an insured hazard befalling a single branded product that is in use to a single owner, whose cover for that class of property against that class of hazard is reasonably close to 100%, an insurer will normally provide full indemnity (including consequential aspects of the loss). However, it is becoming increasingly necessary, even in respect of a loss that represents only a fraction of 1% of an insured's property in the relevant category, to assess whether contribution should be invoked. This recognises that if 100% indemnity is provided on any total loss item to an insured who was in fact only 90% covered on their total insured property in that category, a dangerous precedent has been established. If a 1% loss gets 100% cover, without a 10% contribution being extracted, that can be seen as a useful investment in customer goodwill by the insurer (and, even more so, by any intermediary who may have been involved in any discussions that led to such a decision). But such a decision could lull the client into more positively deciding to under-insure in the ensuing periods. The insured can be under the impression that his insurer is willing to purchase his goodwill by conniving in underinsurance, and paying relatively small claims at 100%, rather than by engaging in more opaque competitive activities such as discounting or actually reducing the nominal premium payable. Then, when a more significant proportion of the total sum insured is sought in indemnity in respect of a major loss, the insurer's application of the principle of contribution may come as a severe shock (or even as an unsustainable cost) to the insured.

For these and many other reasons that are well known to insurance professionals, the institutionalisation of underinsurance, as an alternative to granting explicit concessions on premium rates, is not a sustainable strategy. This is particularly the case when the impact of reinsurers' requirements is taken into account: a cedent insurer whose portfolio of risks is systematically undervalued is unlikely to be able to treat effectively with reinsurers in a stiffening market.

Key factors of influence

Having thus engaged with some background considerations, we now turn to the principal concern of this article. How does an insured state an indemnity value for any partially consumed branded product that is in use; and how does an insurer confirm or reassess such a valuation? What are the factors that determine such a valuation? And (most importantly) how do these matters impinge on the economic development of the emergent "little tiger" economies?

As has already been stated, the factors that primarily influence such a valuation are:-

* purchase price;
* elapse of time from purchase;
* intensity of use per time period;
* normal rate of destruction of the product;
* inflation of the price of the product per time period;
* the insured's perception of these data, and related assumptions;
* the insurers' criteria for such assessments.

In every case, the starting point is the purchase price of the product. This article is concerned with **branded products**, those which bear a manufacturer's or distributor's label that carries with it an implication of a level of "pure" quality as well as a legally enforceable contractual obligation under product liability requirements and international community or national standards for product reliability. Some brand names, such as Rolls Royce, Christian Dior, Rolex and Johnson & Johnson, are instantly recognised all over the world by personal consumers. Others are equally universal in their acceptability to buyers of industrial machines, mining equipment, water treatment plant or any other category of industrial or extractive plant purchaser. These truly international brands can usually command authoritative acceptance by potential users of the products that bear the brands. This does not necessarily mean that their actual design, or their product liability insurance cover, is better than for a product made for the same purpose but by an "unknown" manufacturer located in Indonesia or in Taiwan.

The known vs. the not-so-well-known

A product from a well-known Italian distributor of leather handbags may be less stylish, less carefully stitched, and less well insured against the possibility that it could upset someone by discharging toxic fumes (due, say, to a new chemical compound used in the tanning process) than another bag that was made by an exporter who has just come on to the world market. But the bag that is sold under the big name may be priced at several dozen times the price of the alternative from an "unknown" manufacturer.

If a Japanese lady buys both the Italian bag (for special occasions) and the other bag (for more everyday use) and both are destroyed in a household fire, after the two bags have been in her ownership for 15 months, what level of indemnity is appropriate (assuming that the lady's estate is 100% insured)? Is indemnity due simply in respect of "two used leather handbags", at a few thousand yen each? Or does the loss of the bag with the world-renowned label command an indemnity that relates to a price differential that is based entirely on image? Both bags were lost in the fire: in the case of such a loss, the fact that the less-highly-valued bag had more extensive product liability and environmental damage liability cover does not significantly influence the quantum of indemnity. But if there had been no fire, and the lady had progressively become more dizzy as a result of inhaling fumes from the two bags, the higher probability of receiving damages for distress would be attached to the lower priced bag, which in these terms has the higher value. Economics has distinguished between value-in-use and value-in-exchange for some centuries; but economists have not accounted the potential to yield payments under product liability as one of the aspects of value-in-use. A "designer" handbag has a high value-in-exchange because of the image attaching to the designer label. The value-in-use of that product may not include access to any significant product liability insurance cover. When an insurer is called upon to accept his client's valuation of her possessions, it has generally been assumed that it is easiest to attribute to each item a maximum quantum of indemnity against the eventuality of total loss that is based on its market price when new weighted by age, wear and tear, or intensity of use, inflation, and such other factors as we judged to be appropriate to the class of property to which each particular item can be assigned. To take into account such considerations as the quality of a product's indemnity cover would tend to increase the total sum due to be paid to the insured in the case of physical destruction of that commodity (which deprives the owner of the possibility of subsequently activating that cover). However, the intelligent use of the concept that has now been introduced could help both the development of insurance in the tiger economies and the consolidation of export markets for manufacturers located in those economies.

Consumer conservatism

The maturely advanced industrial economies contain most of the companies that own the brand names that are instantly recognised internationally. It is going to be a very slow process to establish any new brand name alongside Omega or IBM, BMW or Dunhill. This is not due to the poor quality of Asian products, or to racialism among Europeans or North Americans, so much as it is due to consumer conservatism.

Young people instantly recognise new pop stars, and their fathers recognise new athletic record breakers or rugby stars, and their grandparents recognise instantly the latest drug or device that alleviates some medical condition to which they have become prone: these facts prove that new concepts, new packages, new products and even new brands can be accepted. Nissan, Sony and Panasonic have become recognised and accepted in over 150 countries since around the year 1970. A couple of established industrial giants in South Asia are obviously having more difficulty in gaining acceptance in some markets, and advertising of their products in Europe is still largely focused on introducing the companies and the pronunciation of the companies' names. Whilst the quality of some of the products offered from South Asian region may not be in question, their European or Latin American consumers would perhaps need to be convinced of the corporate strength that lies behind these brands.

Here, too, insurers have a crucial role to play. Insurance companies (influenced heavily by the reinsurers, and sometimes improperly by their governments) assign each model of car to an insurance class or category. Given that at least third party insurance cover is compulsory in developed countries, it follows that the marketability of a car is heavily influenced by the price of insurance cover for the vehicle, which is derived from the insurance class into which the model is placed.

Rationale behind expensive rating

Insurers have hitherto tended to assess cars purely on the basis of their market niche and their performance in the country where they are used (whenever the insurers are able to make such decisions free from political interference). Cars that are highly attractive to thieves, joy-riders and the immature adult children of the very rich must be charged the highest insurance rate, because the risks of theft, damage and liability claims are (pro rata) highest on such vehicles. The price scale moves down with attractiveness, engine size, reliability, rate of theft and the other factors that are well known to all insurers and brokers. An imported car from a lo wly-regarded manufacturer in another country will have low marks for attractiveness, but until proved otherwise (by years of usage) it will be awarded high marks for unreliability and for the hazard that might arise from potential faults that could appear in the operation of the vehicle (e.g. in conditions of snow and ice.) This negative market influence, producing an expensive insurance rating, combined with an "unimpressive" (yet) brand image, can be significantly modified if the manufacturer would be able to show that his motors are protected by unusually good product liability cover.

Inportance of trade liaison

Furthermore, if the motor manufacturer in one of the little tiger countries (for example) is able to liaise with his liability insurers in the design of his motor car, he may well be able to design it so that it matches the most advanced consumer preferences in the richest markets and ensure that all the hazards attached to such a sophisticated design are matched both by the most advanced engineering solutions and also by appropriate liability insurance. I am not aware of any case yet where this particular package of attributes attaching to any car (or any other product) has been assembled and then explained to the insurance community of an importer country. The potential market advantages of such a liaison between exporters' insurer and indigenous insurer are immense, from the point of view of a manufacturer who is trying to establish a **marque** or brand-image in the advanced consumer economies of Europe, North America and the Pacific Rim.

This short paper, in perhaps a discursive manner, has sought to introduce into the consideration of insurers in emergent industrial economies three key facts:-

a) the original market price of any manufactured product, sold in an advanced consumer economy, depends above all else on whether the product has a positive brand image. If so the price will be based on the image, **not** on cost of production, and the insured value of the product will shadow the image value-in-exchange;

b) a key factor in establishing a positive brand image for a "new" **marque** or brand-name is the strength of product liability cover that backs the product: in this way insurers in emergent industrial economies have a vital role to play in the development of export markets;

c) there has not yet been adequate dialogue between the insurers who cover consumer's possession of products in recipient countries (against both liability and loss hazards) and the insurers who cover product liability and related hazards in the country of manufacture.

The implications of these points could occupy the whole of this Journal through several issues, and if they are taken up properly in a positive spirit the issues that are explored will provide a fruitful field for consultancy in the development of insurance packages in emergent industrial economies.

Emergent role of Insurers in future world trade

An obvious constraint on the development that is envisioned here is the limit of the international reinsurance capacity that might be allocated to underpinning these classes of business. The effective use of captives, and the proper development of risk financing media to hedge currency fluctuations and other ancillary risks around the basic insurance packages, will enable reinsurers most effectively to focus their capacity on the key operational risks of product possession and liability arising during the period of possession.

The greatest issue in world economic development for the next couple of human generations will be how to consolidate demand for sophisticated consumer goods: supply produces no significant problem as there is at present a surplus of materials and of manufacturing plant relative to purchasing power for products. The role of insurance in resolving this problem, rather than merely acting as a facilitator of world trade, will come into focus quite sharply in the next few years. The importance of insurance to the markets will force manufacturers and traders to process the relevant perceptions through political channels as well as through market interactions. This will strengthen the political influence of the insurance sector, as its pervasive relevance both to imports and to exports is more clearly recognised. The trade-off that insurers can demand in exchange for patriotic underwriting must be tax concessions and other assistance by which insurers can afford to adapt their underwriting principles to serve macroeconomic objectives through the directed microeconomic processes of the market. The insurers' most often expressed need, for a better balance between taxation of their turnover and their requirement for adequate reserving, can be seen as part of the national economic interest in this context. Each country will make its own judgement as to the right balance in this area, and the successor to GATT will increasingly be influenced by these considerations.

Insurance has for too long been treated as merely a reactive component in the market and in the nexus of political economy. That is comfortable only to the extent that the pressures on insurers are seen in terms of market forces, most obviously the insurance cycle, and the heat of political controversy has rarely focused on insurance principles. That situation will change: insurance management will be much less comfortable but must become more interesting in the future. Whether or not it is more rewarding will depend on how far insurers can persuade both the political and the economic market places that their contribution imparts value-added strength to the progress of the market economy.