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Valuing future business: The concept of franchise value

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Franchise value is at the heart of the value creation cycle in insurance

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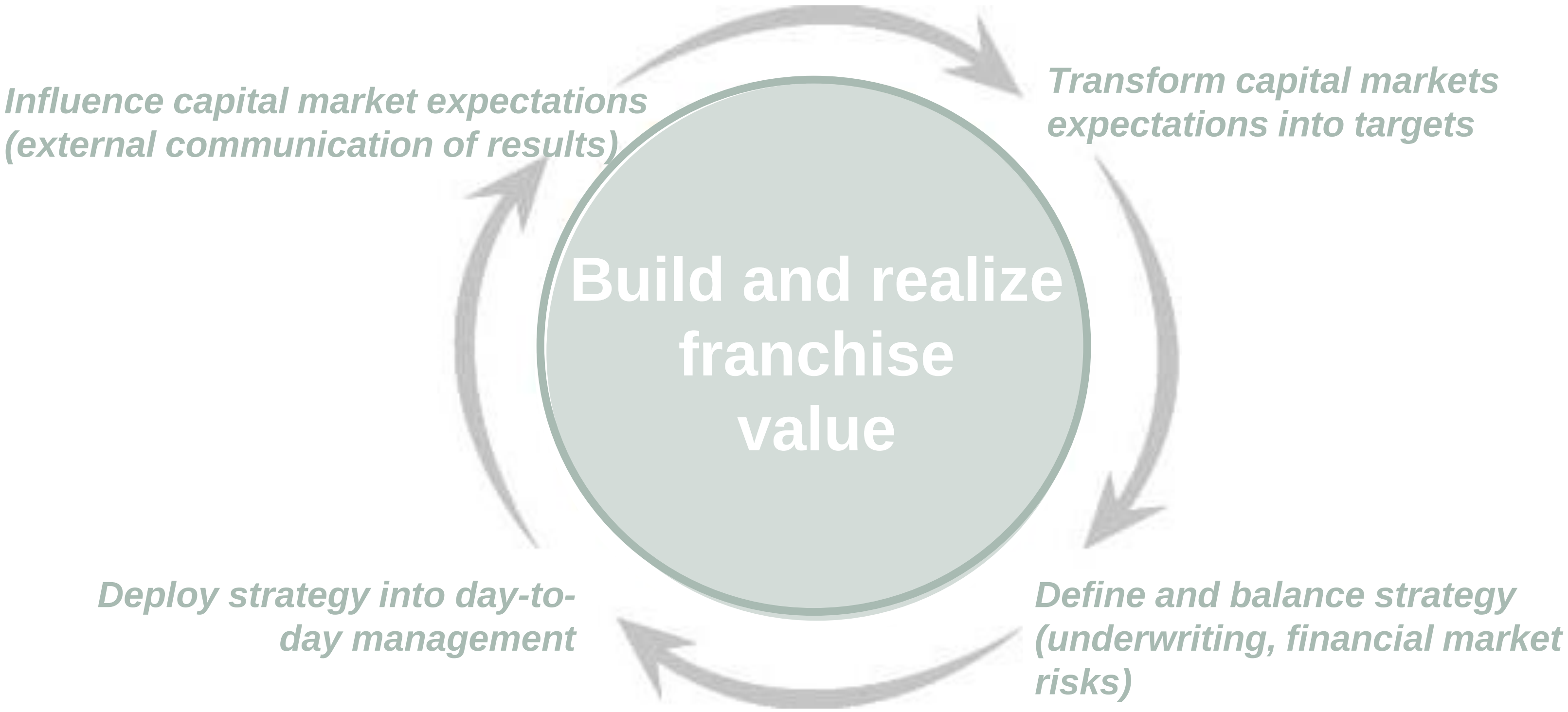
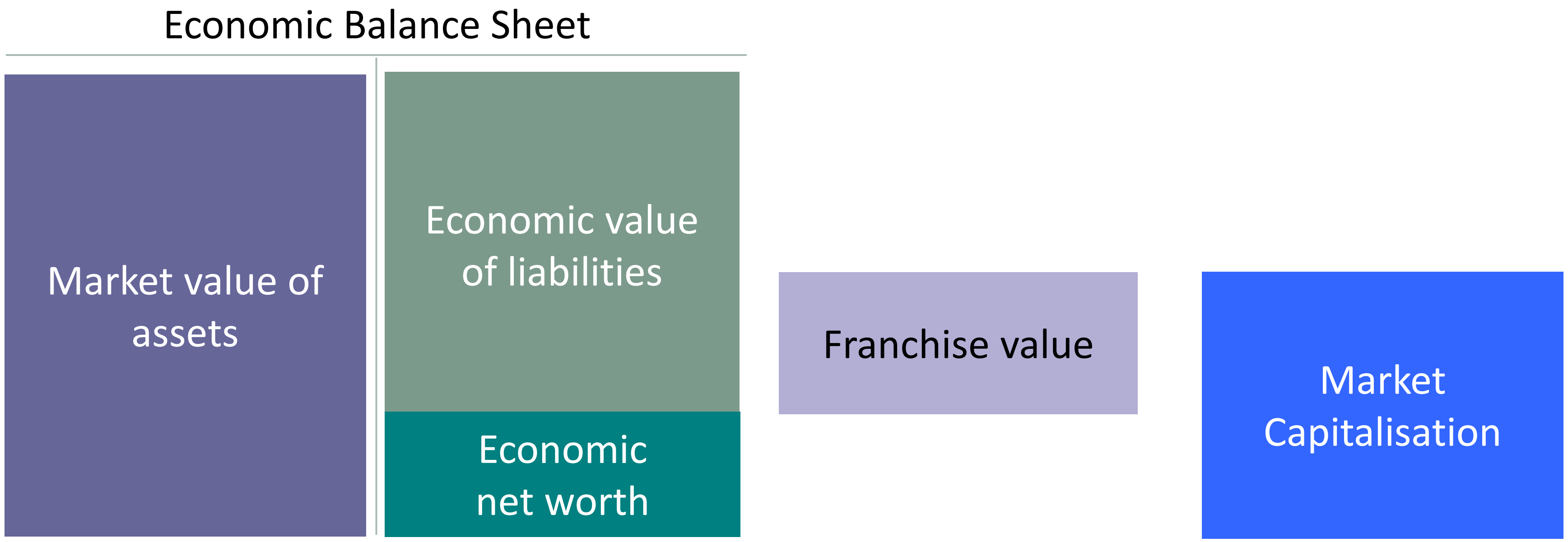
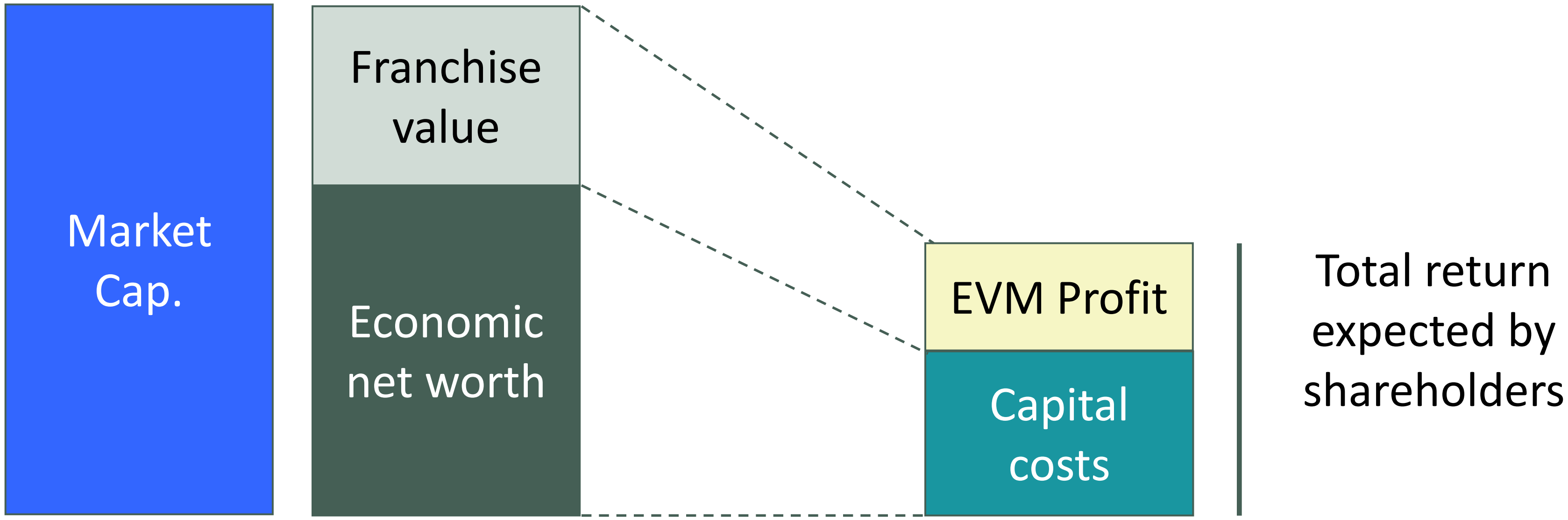


Capital in insurance: a shareholder perspective



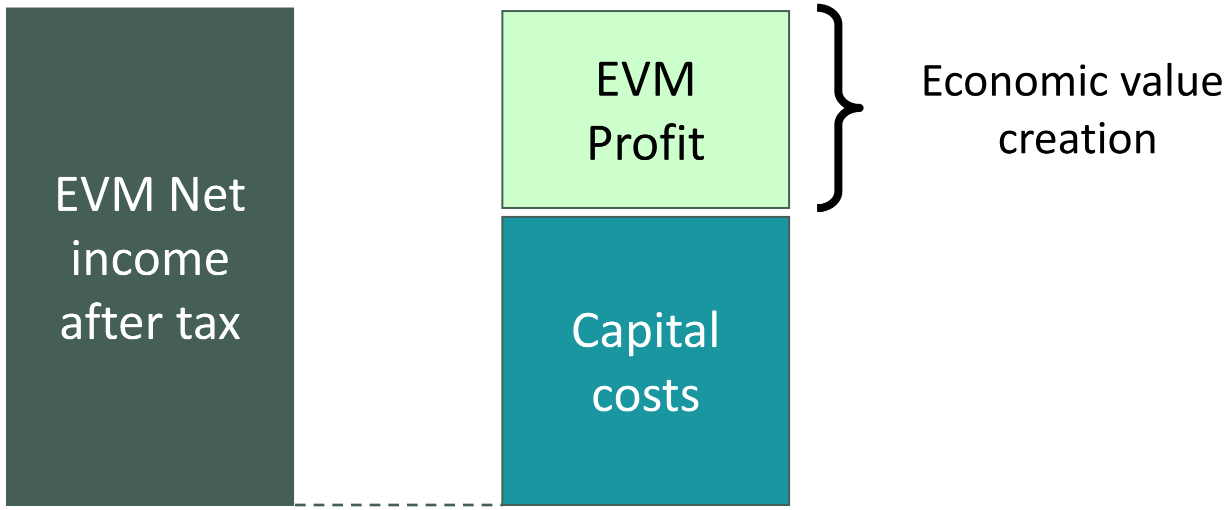
- Shareholders provide risk capital to support insurance business: *Economic Net Worth*
- But shareholders value the company at a higher value than economic net worth: *Franchise Value*

What shareholders expect: EVM profit



- Shareholders value companies at more than economic net worth because they expect future EVM profit to be positive, i.e. they expect management to create even more economic value
- How much economic value they expect is reflected in franchise value (market's assessment of insurer's ability to create EVM profit through future new business): *expected EVM profit*

Where economic value creation starts: Net income after tax



- *EVM Profit* is EVM net income after deducting taxes and capital costs (the cost of holding economic net worth)
- EVM profit measures economic value creation

Franchise value requires active management

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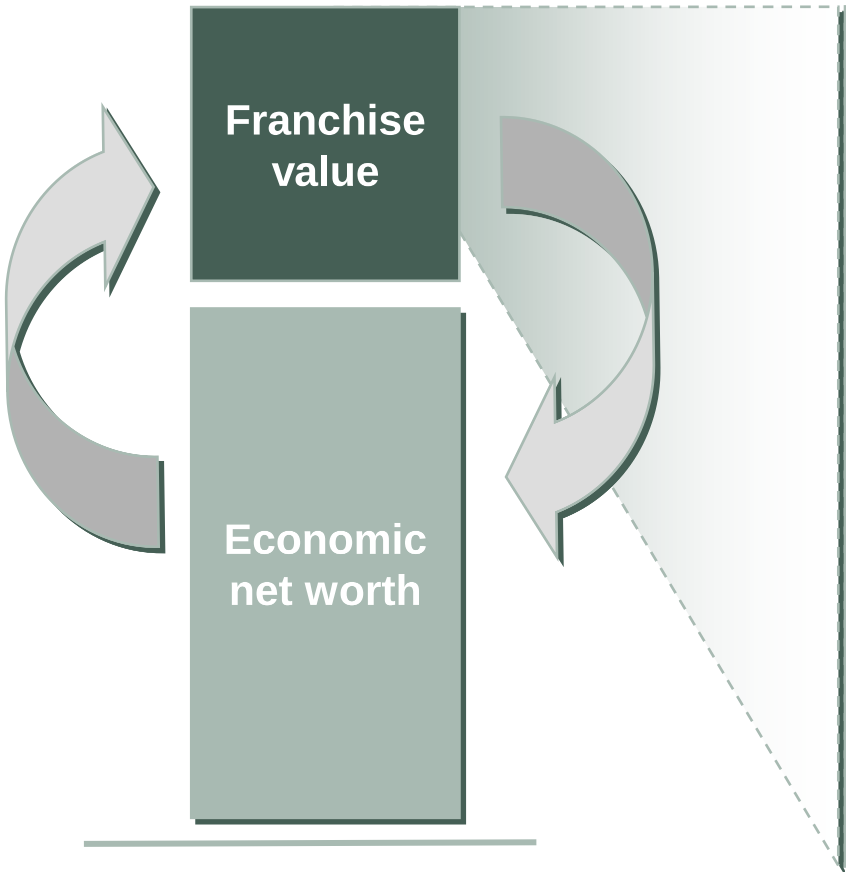

Innovation

- Acquisition of new clients/ development of new products
- Creation of strategic options

Implementation

- Operational implementation of created potentials and options
- Performance improvement

Communication

- Of both innovation and implementation

Translating targets into tangible measures

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Strategic planning

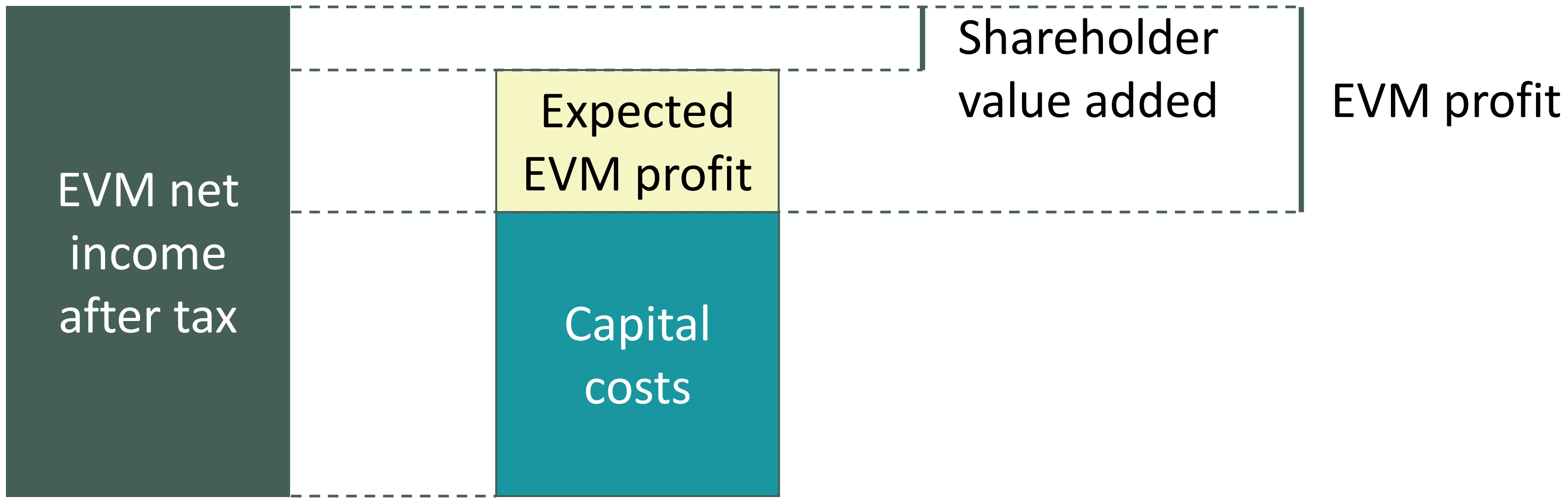
- Clear focus on value creation
- Link to external benchmarks
- Identification of and discussion about value gap between group level and operating entities/ business units

Rolling forecast

- Operational planning by rolling forecasts (bottom-up-process)
- Reduction of process duration by focusing on main value drivers
- Improve planning quality by de-linking forecast and compensation

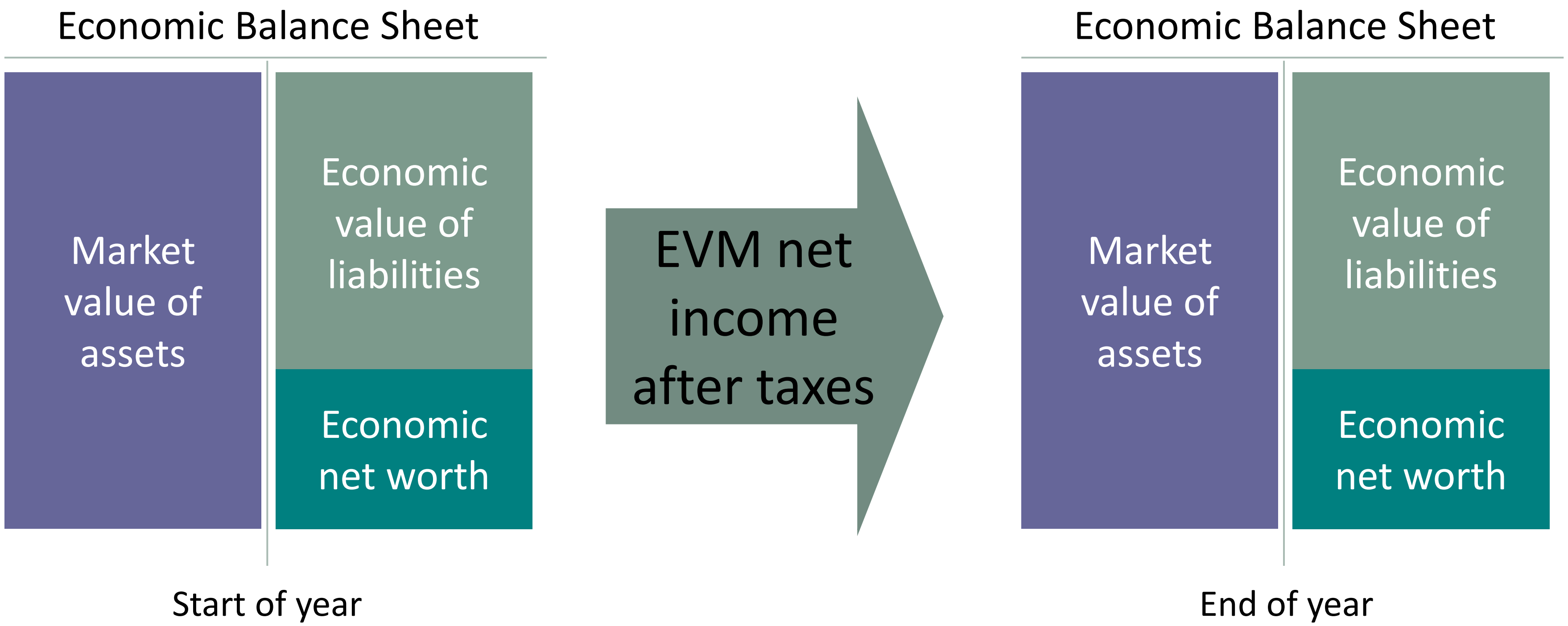
The value-oriented planning system results in a more flexible, more efficient and more market-oriented steering tool

Where shareholder value creation starts: expected EVM profit



- Only if **actual** EVM profit exceeds **expected** EVM profit will shareholder value be created (shareholders have already paid for what they expect!)
- For steering purposes overall EVM profit targets need to be higher than expected EVM profits

What shareholders get: EVM net income after tax



- EVM net income records the changes in economic net worth
  - net cash income
  - net changes in value of assets and liabilities
- Shareholders benefit from net income only after taxes!