

UNIVERSITY OF KWAZULU NATAL

**AN APPLICATION OF PORTER'S FIVE FORCES MODEL
TO DETERMINE THE ATTRACTIVENESS OF A THIRD
PARTY DISTRIBUTOR OF LIFE AND INVESTMENT
PRODUCTS.**

KIRUBALINGAM SINGARAM PADAYACHEE

STUDENT NUMBER : 200501128

Submitted in partial fulfillment of the requirements for the degree of
Master of Business Administration

Graduate School of Business, Faculty of Management,
University of KwaZulu – Natal

Supervisor : Mr Alec Bozas
Co-Supervisor : Mr Robin Martin Challenor

December 2006


2007 /12/31

TO WHOM IT MAY CONCERN

RE: CONFIDENTIALITY CLAUSE

Due to the strategic nature of this research it would be appreciated if the contents remains confidential and not be circulated for a period of five/ten years or other specified period.

Sincerely



K.S. Padayachee

DECLARATION

This research has not been previously accepted for any degree and is not being currently considered for any other degree at any other university.

I declare that this Dissertation contains my own work except where specifically acknowledged.

K.S.Padayachee 200501128

Signed 

Date.....~~08/01/2008~~.....

116093

ACKNOWLEDGEMENTS

“No undertaking of a project as intense as this study is possible without the contribution of many people. It is not possible to single out all those who offered support and encouragement during what at times seemed to be ‘a never ending journey’. However, there are individuals without whom this project would not have been completed, and to them go my special thanks and acknowledgement of their contributions.

Firstly, I am indebted to my supervisor, Mr. Alec Bozas who ensured that this project was completed and that all deadlines were met. I am deeply indebted to him for the uncompromising faith that he showed in the successful completion of this project.

Secondly, I want to thank my wife for the ongoing support and confidence that she gave me to bring this project to a successful end. I want to also thank her and my son Kumran for giving me all the time that I needed to work on this project. Thank you for your love and dedication.

Thirdly, to my parents for the inspiration that they give me to continually excel at all my tasks. Thank you for being part of my life in every thing that I do.

Finally, to the lord of my understanding for the quiet inspiration and strength that you showed me when the ‘going got tough’. I thank you and will always remain your loyal servant”.

AN APPLICATION OF PORTER'S FIVE FORCES MODEL TO DETERMINE THE ATTRACTIVENESS OF A THIRD PARTY DISTRIBUTOR OF LIFE AND INVESTMENT PRODUCTS.

ABSTRACT

The research centred around the fact that the existing methods of distributing life and investment products was inefficient and it was decided to research the issue to determine whether a more suitable cost effective method could be developed. Currently the distribution of life and investment products is very expensive and therefore an alternate method of distribution was being explored. This was also endorsed in a survey conducted by the Financial Services Board where it was found that in order for financial services company to survive and compete new models need to be developed to compete in this increasingly globalised industry.

Life assurance and investment products in South Africa and elsewhere in the world is sold by agents who are employed by the life assurance and investment companies. More recently other distribution channels have emerged and these include the internet, direct mail and call centres. The share of business that is obtained through these means is also an interesting feature to explore when investigating the methods used by new entrants to this multi billion rand industry.

The situation prevailing in the local industry is that independent brokers secure a contract with the life company's and this places the broker in a position to market the company's products through the use of business consultants. There are significant costs associated with the current model of distributing the companies' products. These are broker consultant salaries, car allowances and traveling expenses, entertainment expenses, overriding commission on the business sold by the broker they service, management and support staff expenses and related expenses.

The proposed model will have following characteristics.

- Have distribution contracts with all independent brokers.
- Using the franchise methods of training and recruiting business consultants.
- Variable costing methods in determining payments for service delivered.
- This method would also significantly reduce the cost of distribution by the new entrants into this multi billion rand industry.

In the final analysis it was shown that the third party distributor would make a difference to the manner in which life and investments products is distributed in this dynamically changing industry.

TABLE OF CONTENTS

| Description | Pages |
|------------------------|-------|
| Title page | i |
| Confidentiality Clause | ii |
| Declaration | iii |
| Acknowledgements | iv |
| Abstract | v |
| Table of Contents | vii |
| List of Tables | xii |
| List of Figures | xiii |

TABLE OF CONTENTS

| TITLE | PAGE |
|---------------------------------------|-----------|
| 1. Introduction | |
| 1.1 Introduction | 1 |
| 1.2 Value of Research | 8 |
| 1.3 Objective of the Research | 9 |
| 1.4 Limitation of the Study | 10 |
| 1.5 Research Methodology | 11 |
| 1.6 Structure of the Research | 12 |
| 1.7 Summary | 13 |
| 2. Literature Review | 14 |
| 2.1 Introduction | 14 |
| 2.2 Overview of the Five Forces Model | 14 |
| 2.3 The Five Forces Framework | 17 |
| 2.3.1 Threat of Entry | 18 |
| 2.3.2 Power of Suppliers | 21 |
| 2.3.3 Power of Buyers | 26 |
| 2.3.4 Threat of Substitutes | 31 |
| 2.3.5 Competitive Rivalry | 31 |
| 2.4 Summary | 33 |

| | | |
|-----------|-------------------------------------|-----------|
| 3. | Research Methodology | 34 |
| 3.1 | Introduction | 34 |
| 3.2 | Research Process | 34 |
| 3.3 | Pilot Study | 36 |
| 3.4 | Interviews | 37 |
| 3.5 | Ethical Issues | 38 |
| 3.6 | Problems Experienced | 38 |
| 3.7 | Positive Experiences | 39 |
| 3.8 | Conclusion | 40 |
| 4. | Data Collection and Analysis | 41 |
| 4.1 | Introduction | 41 |
| 4.2 | Industry Boundaries | 42 |
| 4.3 | Threat of Entry | 43 |
| 4.3.1 | Source of New Entry | 43 |
| 4.3.1.1 | Related Product Markets | 44 |
| 4.3.1.2 | Firms Up and Down the Value Chain | 47 |
| 4.3.1.3 | Firms with Related Competencies | 49 |
| 4.3.2.1 | Economies of Scale | 52 |
| 4.3.2.2 | Branding | 52 |
| 4.3.2.3 | Switching Costs | 53 |
| 4.3.2.4 | Access to Distribution | 54 |
| 4.3.2.5 | Expected Retaliation | 55 |

| | | |
|---------|--|----|
| 4.4 | Threat of Substitutes | 56 |
| 4.4.1 | Types of Substitutes | 56 |
| 4.4.1.1 | Product-for-Product Substitution | 57 |
| 4.4.1.2 | Substitution of the Need by a New Product or Service | 59 |
| 4.4.1.3 | Generic Substitution | 61 |
| 4.4.2 | Defending against the Threat | 61 |
| 4.4.2.1 | Relative Price- Performance of Substitutes | 62 |
| 4.2.2.2 | Switching Costs | 63 |
| 4.2.2.3 | Buyer Propensity to Substitute | 64 |
| 4.4.3 | Assessing the Extent of the Threat of Substitutes | 65 |
| 4.5 | Summary | 66 |
| 4.6 | Power of Suppliers | 67 |
| 4.6.1 | Characteristics of Supplier Power | 68 |
| 4.6.1.1 | Product Differentiation | 68 |
| 4.6.1.2 | Presence of Substitutes Inputs | 69 |
| 4.6.1.3 | Supplier Concentration | 70 |
| 4.6.1.4 | Importance of Volume to Supplier | 71 |
| 4.6.1.5 | Impact on Inputs | 72 |
| 4.6.1.6 | Threat of Forward Integration | 73 |
| 4.6.2 | Potential for Strategic Collaboration | 74 |
| 4.7 | Power of Buyers | 75 |
| 4.7.1 | Value Creation | 76 |

| | | |
|-----------|--|-----------|
| 4.7.2 | Characteristics of Buyers | 77 |
| 4.7.2.1 | Buyer Concentration vs. Firm Concentration | 77 |
| 4.7.2.2 | Buyer Volume | 77 |
| 4.7.2.3 | Buyer Switching Costs | 78 |
| 4.7.2.4 | Threat of Backward Integration | 79 |
| 4.7.2.5 | Presence of Substitute Products | 79 |
| 4.7.2.6 | Product Differentiation | 80 |
| 4.7.2.7 | Impact on Quality of Performance | 81 |
| 4.7.2.8 | Impact on Buyer Profits | 82 |
| 4.8 | Summary | 83 |
| 4.9 | Characteristics of Competitive Rivalry | 84 |
| 4.9.1 | Industry Growth | 84 |
| 4.9.2 | Fixed Costs | 85 |
| 4.9.3 | Product Differences | 86 |
| 4.9.4 | Diversity of Competitors | 87 |
| 4.9.5 | Exit Barriers | 88 |
| 4.10 | Summary | 89 |
| 5. | Conclusions and Recommendations | 90 |
| 5.1 | Introduction | 90 |
| 5.2 | Industry Boundaries | 92 |
| 5.2.1 | Research Issues | 92 |
| 5.3 | Threat of Entry | 94 |

| | | |
|-----------|---------------------------|------------|
| 5.3.1 | Findings | 95 |
| 5.4 | The Threat of Substitutes | 96 |
| 5.4.1 | Findings | 97 |
| 5.5 | Power of Suppliers | 97 |
| 5.5.1 | Findings | 99 |
| 5.6 | Power of Buyers | 99 |
| 5.6.1 | Findings | 100 |
| 5.7 | Competitive Rivalry | 101 |
| 5.8 | Conclusion | 102 |
| 5.9 | Shortcomings of the Study | 104 |
| 5.10 | Closing Comments | 106 |
| 6. | References | 107 |
| 7. | Appendices | 110 |

LIST OF TABLES

| TITLE | PAGE |
|-----------------------------------|-------------|
| 4.1 Survey of new entrant | 42 |
| 4.2 Survey of broker managers | 45 |
| 4.3 Survey of Independent Brokers | 50 |
| 4.4 Survey of Broker Managers | 51 |
| 4.5 Services that brokers value | 62 |
| 4.6 Buyer Switching Costs | 78 |

LIST OF FIGURES

| TITLE | | PAGE |
|---------|--|------|
| Fig 1.1 | Proposed model on Franchised Distributor | 5 |
| Fig 1.2 | Share of recurring premium | 6 |
| Fig 4.1 | Current Distribution Model | 43 |
| Fig 4.2 | Source of New Entrant | 44 |

CHAPTER 1

INTRODUCTION

1.1 INTRODUCTION

The researcher, who is employed in the investment industry, perceived that the existing methods of distributing life and investment products was inefficient and it was decided to research the issue to determine whether a more suitable cost effective method could be developed. Currently the distribution of life and investment products is very expensive and therefore an alternate method of distribution is being explored. This was also endorsed in a survey conducted by the Financial Services Board where it was found that in order for financial services company to survive and compete new models need to be developed to compete in this increasingly globalised industry.

Life assurance and investment products in South Africa and elsewhere in the world is sold by agents who are employed by the life assurance and investment companies. More recently other distribution channels have emerged and these include the internet, direct mail and call centres. The share of business that is obtained through these means is also an interesting feature to explore when investigating the methods used by new entrants to this multi billion rand industry.

The purpose of the study was to assess the potential of a firm seeking to operate as an independent distributor of life and investment products in South Africa by applying Porter's Five Forces Model and industry competitor analysis to the industry in order to see if the envisaged model on page (4) is appropriate for a company to adopt. The study

also sought to highlight those issues that the independent distributor should pay special attention to in its efforts to build a competitive business. The concept of a franchised distributor is an entirely new one to the South African market.

The research attempts to investigate the impact of the independent distributor in the life assurance industry and the new methods of distributing its products through cost effective methods and thereby increasing the market share of the company. These methods of distribution are examined by using Porter's Five Forces model.

The situation prevailing in the local industry is that independent brokers secure a contract with the life company's and this places the broker in a position to market the company's products through the use of business consultants. There are significant costs associated with the current model of distributing the companies' products. These broker consultant salaries, car allowances and travelling expenses, entertainment expenses, overriding commission on the business sold by the broker they service, management and support staff expenses and related expenses.

The business consultants are trained by the life companies on their products and various industry related issues.

The other method is the use of in house sales agents that are trained by the company for the sole distribution of its products. This method of distribution also helps the life company to earn revenue through a product-focused initiative.

For companies that use broker consultants and in house agents to distribute its product, the following costs are incurred:

- Management salaries and related costs.
- Support services.
- Consultant salaries, car allowances, office allowances.
- Training and development costs.
- Seminars and conventions.

The proposed model on page (4) can be used by new entrants into the life and investment industry. The new model will have following characteristics.

- Have distribution contracts with all independent brokers.
- Using the franchise methods of training and recruiting business consultants.
- Variable costing methods in determining payments for service delivered

This method would significantly reduce the cost of distribution by the new entrants into this multi billion rand industry. Companies that distribute their products through traditional methods incur the following costs:

- Medical aid pension and group life cover.
- Office rental, telephone and secretarial allowances.
- Commissions.
- Bonuses for achieving targets.
- Training and developing.

- Seminars and conventions.

Source: Stanlib Regional Manager (2006)

These large financial burdens have begun to threaten the future of established life assurance companies. Some insurers had to down scale their current operations in order to provide policyholder protection. The indications are that such methods of distribution have become too expensive to sustain, thus affecting the stability of the companies continued survival.

This being the case, new life assurance companies seized the opportunity to develop new products which they distributed through privately owned franchises on a fee for service basis. The results of this methodology have resulted in life assurance companies and investment companies' spending more time on research and development with more customer focused products that are more cost effective and provides greater coverage.

The study is intended to show the trends in the changing environment in customer-focused product developed as part of strategic management, using the theoretical evaluation methods in strategic management. The Five-Forces Model will also be used in evaluating the impact of the new entrants and the use of the new distribution methods. The diagram below was developed by the researcher.

The model below shows the current method of distribution that is used by the Life and Investment companies to market its products. By using this method agents and brokers that have distribution agreements with these companies are limited to selling only these

companies products. This method makes the distribution model more product focussed rather than it being client focused.

The proposed model of converting the distribution of Life and investment products to a independent distributor as high-lighted in the envisaged model below will become more client focussed rather than it being more product focussed. The agents and brokers will be aligned to the independent distributor will have secured contracts with all service providers in the Life and Investment industry giving them more options to choose appropriate product offerings to satisfy their clients objectives.

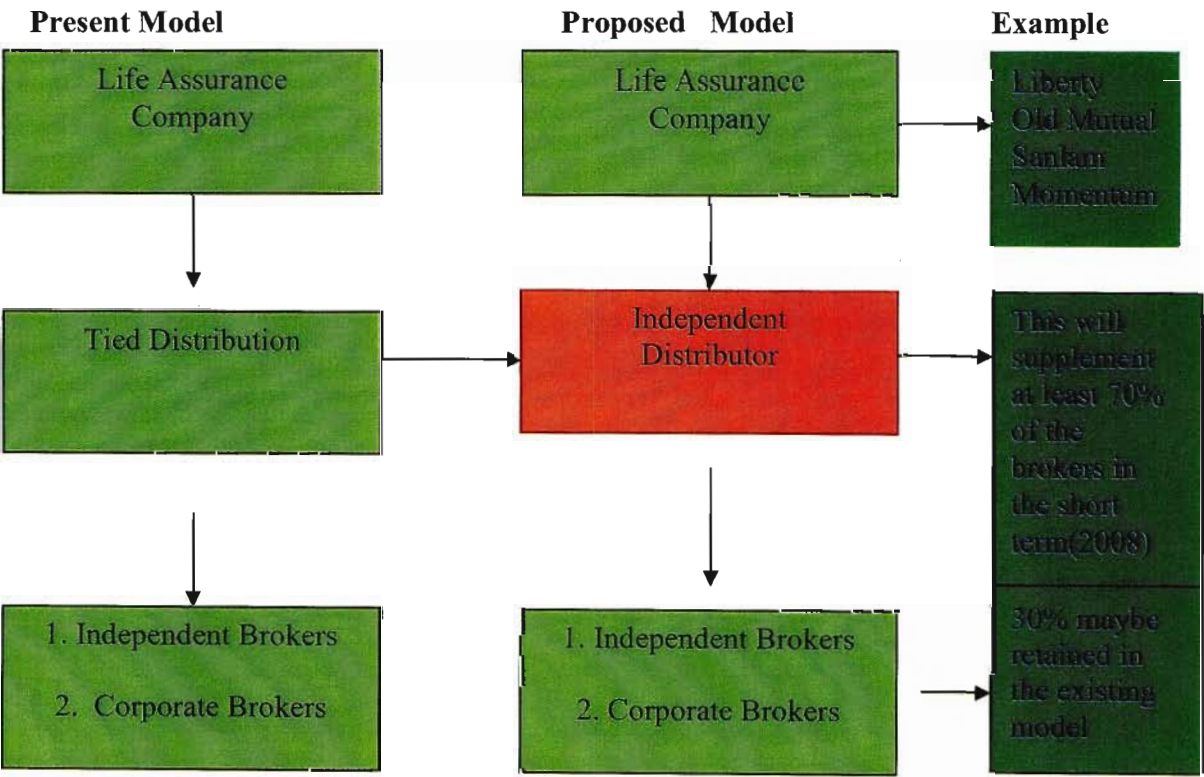


Figure 1.1. Proposed Model on Franchised Distributor (2006)

This research applies Michael Porters Five Forces Model of the industry and competitor analysis to firms seeking to operate as an independent third party distributor of life, investment and related products in South Africa. As can be seen from the above figure the focus of the study will be on the “Independent Distributor”. Porters Five Forces Model will be used to analysis the analyse the life and Investment industry in order that after the interview process, suitable recommendations can be made as to whether or not this proposed model is a suitable alternative to the existing Tied Distribution system.

As noted earlier that the marketing and distribution of life assurance and investment products are distributed by both agents employed by the life companies and independent brokers on a contract basis.

More recently other distribution channels have been established to access other markets in pursuance of increasing the market share of its premium income. The share of business sold by each channel is depicted below.

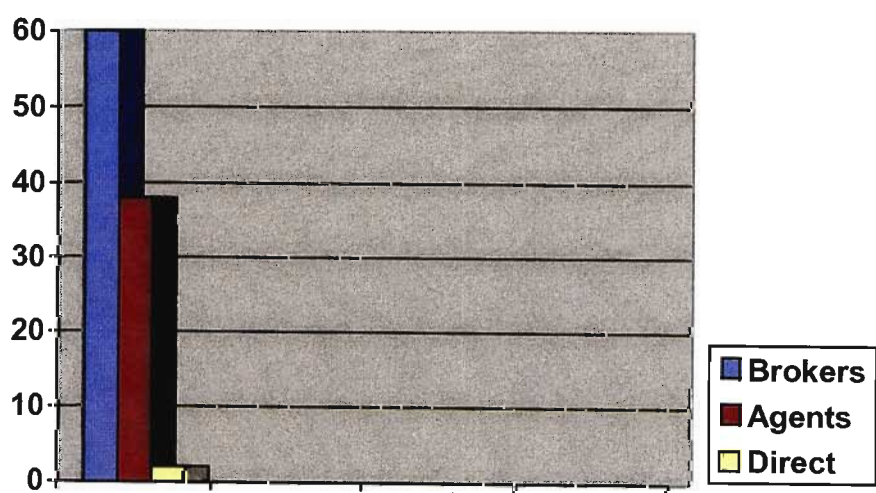


Figure 1.2. Share of recurring premium

Source: www.LOA.co.za (2006).

The total recurring business sold by these two channels is in the region of R6 billion. Recurring premium sold by other distribution channels is less than two percent of this huge market capitalization.

The current business model that is being used by most life and investment companies is proving to be very expensive and less profitable. There are significant cost associated with the established methods of distribution and these include basic salary, car allowances and travelling expenses, entertainment expenses, and overriding commissions on the business sold by brokers that they service, management and support staff salaries and related expenses, training, office space and related expenses, seminars for brokers.

The new model envisages a fee for service basis. This will remove the burden of traditional life and investment companies incurring large fixed expenses in securing its share of the market. The life and investment company will have distribution contracts with independently owned third party distributors. This new independent operation will focus on the distribution of the various companies' products through the broker consultants that are employed by it. The Life and Investment companies on the other hand will focus on product development in line with consumer needs. In this relationship the companies will become the franchisors and the independently owned franchises will become the franchisee.

The third party distributor would employ the broker consultants who would be trained and developed on the various companies' product range and also obtain the necessary

accreditations. Given the fact that this would significantly reduce the costs to the life and investment companies and the various cost mentioned earlier would be replaced by the fees paid to the independent distributor as their costs of distribution. This would greatly enhance the company's capabilities to focus on product development, risk management, asset management and other areas unrelated to distribution.

1.2 VALUE OF THE RESEARCH

This research is of value to life and investment companies or new entrants considering establishing a business model along the lines of the current proposition as it will be demonstrated that the proposed model is more efficient and it will increase profitability and focus more fully on product development. The consumer will be in a position to choose products that are more suitable for their needs. The second advantage to the consumer will be the pricing of the products that will become more favourable and client centric.

These savings and potentially improved profits through more effective sales should encourage the life and investment companies to seek to operate in an environment that will increase profitability and focus more fully on product development.

The research should provide others engaged in the distribution of life and investment products with additional insights into the distribution of its products and the competitive forces that shape it.

1.3 THE OBJECTIVE OF THE RESEARCH

The research will high-light areas that the Life assurers need to focus on, in order to build competitive, sustainable businesses. The core objective of this study is to explore the potential application of the Five Forces Model to the life and investment industry as far as a distributor is concerned, in the hope that by using the Five Forces model and by holding in-depth interviews with senior people in the industry, the independent distributor can become part of a company's distribution system to take it product to the consumer.

The Five Forces Model comprises the following with respect to the Life and Investment industry in South Africa-

- The entry of new competitors
- The bargaining power of suppliers
- The bargaining power of buyers
- The threat of substitutes
- Competitive rivalry

The proposed model as envisaged on page (5) will be considered using Porters Five Forces Model in the Life and Investment industry with respect to the objectives of the

study, namely to investigate a more effective and efficient means of distribution of products for the industry.

The objectives of the study are:

The core objective of this study is to investigate the independent distribution and sales of Life and Investment products, and to determine whether a more effective method and model can be developed.

The researcher was also considering the cost implication that companies incur concerning their sales force.

1.4 LIMITATIONS OF THE STUDY

Limitation one, was the reluctance of the life companies to fully disclose the actual costs incurred in operating traditional distribution systems versus a third party distribution. This information will be sourced to through broker managers and agency managers of life assurance companies.

Another limitation was the non-availability of current sources of information in the form of articles and studies on this topic in the last four to five years. The information that was used in the study was sourced from websites and journal articles. This is due to the fact that the industry players have been focussing on the regulatory issues.

A further limitation to the study is the fact that it confines itself to the Five Forces Model and competitor analysis, however it is through this framework that the future strategy for

the distribution of life and investment products could be developed. The proposed solutions will include an analysis of the political, economic, social and technological environments in financial services.

1.5 RESEARCH METHODOLOGY

To demonstrate the viability of the third party distribution of life and investment products as envisaged in the model on page (5), the research will seek to obtain the inputs of range key stakeholders in the life and investment industry. A questionnaire detailing the issues relating to the distribution of life and investment products will be discussed with independent brokers and broker managers across KwaZulu-Natal, Cape Town and Johannesburg. The interviews will be conducted on a face- to- face basis and the results of this will be used in conjunction with the theoretical framework as envisaged by Porter's Five Forces' Model. The brokers as well as broker managers that will be targeted will be spread across the spectrum of service providers within the KwaZulu-Natal, Cape Town and Johannesburg. The criteria in the target population will be those managers and brokers that have the Financial Planning Institute (FPI) accreditation and who have more than five years experience in the life and investment industry.

In addition to the above qualitative research, meetings will be held with FinanzPlan SA, a brokerage based in Cape who have commenced trading as a third party distributor of risk products. The methodology that they employ will be ascertained to corroborate the viability of a third party distributor in the life and investment industry. Their experiences

in the setup of their business and the securing of contracts with the many life and investment companies will be incorporated in this study.

The Independent Financial Adviser (IFA) network, which has commenced business with a limited offering in Johannesburg, will also be targeted to test the viability of an independent distributor in the life and investment industry. These discussions were used to assess the response of the life and investment companies to the new intervention in an industry that they have dominated for over 60 years.

1.6 STRUCTURE OF THE RESEARCH

- Chapter one is an outline of the research problem, the objectives and an overview of how the work will be undertaken.
- Chapter two consists of the literature review.
- Chapter three explains the research methodology and data from the fieldwork is contained in chapter four.
- The final chapter consists of the conclusions and recommendations together with a proposed model for the distribution of products for the life and investment industry. In addition recommendations are made for further research.

An overview of the Five Forces Model will be undertaken before discussing each in detail, with relevance to the life and investment industry. The results from the questionnaire will be applied to each component of the model and its attractiveness will be assessed.

1.7 SUMMARY

The industry method of selling policies has been shown, and the proposed franchise model of distributing life and investment products been shown. This method will be discussed in the subsequent chapters.

The research will first present a frame of the model itself, which will then be used in analyzing the financial data gathered during the research in order to arrive at the conclusion and recommendations.

This chapter has presented the problem and how it will be researched. The following chapter covers the review of the literature.

CHAPTER 2

LITERATURE REVIEW

2.1 INTRODUCTION

In this chapter an overview of the Five Forces Model and a discussion of how these competitive forces will shape the proposed strategy will follow. Some components of the Five Forces Model may be more applicable to other industries than others (Pearce and Robinson, 1997) and where appropriate, additional focus will be spent on those forces that are determined to be of greater importance to the industry under review.

2.2 OVERVIEW OF THE FIVE FORCES MODEL

Michael Porter (1985) states, “Competitive strategy is the search for a favourable competitive position in an industry, the fundamental arena in which competition occurs”. He further contends “competitive strategy aims to establish a profitable and sustainable position against the forces that determine industry competition”. Porter also alludes to the two central issues underpinning competitive strategy, the first of which is the industry attractiveness, in relation to which he comments “not all industries offer equal opportunities for sustained profitability”, whilst the second is the determinants of the relative competitive position within an industry, which he demonstrates by reflecting that some firms within an industry earn more profits than others. Porter emphasizes that both these issues are central in guiding a firm in its strategy formulation, as a firm that has not positioned itself well in an attractive industry is not likely to earn attractive profits.

Similarly, a well-positioned firm in an industry that is not very attractive or one that does not offer high profits may also be unable to generate attractive profits.

Given that industry attractiveness is the first fundamental decider of a firm's profitability (Porter, 1985), and that the ultimate aim of competitive strategy is to cope with and shape the rules that govern competition within and determine the attractiveness of the industry, it becomes critical to understand the forces in which such rules are embodied. The Five Forces Model is defined by Johnson and Scholes (2003) as the "means of identifying the forces which affect the level of competition in an industry, and which might thus help managers to identify bases of competitive strategy'.

Porter lists the following as the forces, whose collective strength determines the ability of the firms in an industry to earn on average, returns that exceed their cost of capital:

- The entry of new competitors
- The bargaining power of suppliers
- The bargaining power of buyers
- The threat of substitutes
- Competitive rivalry

Pearce and Robinson (2003) state, "the collective strength of these forces determines the ultimate profit potential of an industry." Pearce and Robinson (2003) suggest that in order to be profitability on a sustained basis, a firm must understand how these contending forces work in an industry, and how they affect the firm in its particular situation.

From the foregoing, it is evident that the model recognises that competition is manifested not only in the other firms within a particular industry, but has its roots in the underlying economics of the industry (Pearce and Robinson, 2003) or the industry structures (Porter, 1985). Therefore customers', suppliers, potential entrants and substitutes are all competitors in a sense, and some or all may contribute to the profitability of an industry, depending on the industry (Pearce and Robinson, 2003).

Porter argues that the five forces model determines industry profitability because they directly influence the elements of return on investment in an industry viz. Prices, cost, and capital investments. It will be seen, for example, that prices of the firm's offerings will be influenced by the power or constrained by the threat of substitute products. Similarly, the costs of the input materials will be influenced by the power of suppliers whilst the threat of new entrants to the market shapes the amount of the investment that is required (Porter, 1985).

Whilst it is true that the collective strength of the five forces model determine the profit potential of an industry (Porter, 1985; Pearce and Robinson, 1997), it bears reference that different forces take on varying degrees of importance in different industries (Porter, 1985) and hence, "the strongest competitive force or forces determine the profitability of an industry and so are of greatest importance in strategy formulation" (Pearce and Robinson, 1985).

Thus, the strategist wishing to position his firm effectively must understand the importance and underlying economic and technical characteristics of those forces shaping the competitive environment in his industry (Pearce and Robinson, 1985). However, it is of relevance that the firm is not necessarily a prisoner of its industry structure, and through the strategic choices that they make, firms can influence the five forces governing their industry and can accordingly alter an industry's attractiveness (Porter, 1985).

2.3 THE FIVE FORCES FRAMEWORK

Pearce and Robinson (2003) suggest that regardless of the collective strength of the five forces, the objective of the strategist remains that of finding a position in the industry, where his firm can best defend itself against these forces or influence them in its favour. They add further that in order to accomplish this, the strategist must go beyond what is immediately apparent, and analyse the sources of competition, or the underlying economic and technical characteristics of each force. A fuller discussion of each force becomes essential in order that the dynamics underlying that force be understood more intimately. Moreover, such understanding would allow the strategist to identify the relevance or strength of each force to his industry and would, accordingly, facilitate his desire to position his firm optimally.

It bears reference that "the Five Forces framework does not eliminate the need for creativity in finding new ways of competing in the industry. Instead, it directs managers' creative energies towards those aspects of industry structure that are most important to long-run profitability" (Porter, 1985). Indeed, in identifying and understanding those

forces that are critical to competition, the framework allows the strategist to identify those strategic innovations that would add the most to its firm's profitability.

Each force will now be discussed individually.

.

2.3.1 THREAT OF ENTRY

Porter (1985) suggests "the threat of entry determines the likelihood that new firms will enter an industry and compete away the value, either passing it on to buyers in the form of lower prices or dissipating it by raising the costs of competing."

A cursory understanding of basic microeconomics would generally be sufficient to demonstrate that in markets where firms make abnormal profits, new firms are likely to be attracted to and therefore enter that market, which in turn places pressure on prices and has the long term effect of reducing all firms in that industry to a level where they can only earn normal profits (in the long run). Such a theory does assume, of course, that firms operate under conditions of perfect competition.

Hence, it follows that, in the first instance, the threat of entry assumes conditions of perfect competition, whilst firms already within the industry and seeking to reduce such a threat, would wish to create *inter alia* conditions of imperfect competition, under which they may continue to earn abnormal profits in the long run.

Geroski (1999) offers two important lessons on the issue of new firms entering a market, the first of which is that successful market entry occurs due to product or process innovation, together with sound business planning, and the second that incumbent firms are frequently surprised by the onset of new entrants, because of their preoccupation with themselves and their activities.

Geroski (1999) also reasons that new entrants are likely to come from certain identifiable arrears, viz. firms operating in related product markets, firms that are either up or down the value chain and firms with related competencies.

Firms operating in related product markets are potential entrants largely as a result of their understanding of the needs of the same customers, given that they are present in the same markets (Geroski, 1999). Moreover, this presence also places them in a position where they are able to identify potential opportunities and finally, given that fact that they are already established in the same market, albeit with a different product, they already enjoy brand recognition and customer trust.

Firms that are either up or down the value chain are in a very similar position as those in related product markets in terms of understanding of customers, access to information, ability to spot opportunities and brand recognition, and hence, pose a similar threat of entry (Geroski, 1999).

Finally, firms with related competencies also present a threat of entry, largely as a result of their ability to use those competencies in different industries.

Given the understanding of where new entrants are likely to come from, Geroski (1999) also provides suggested ways of identifying probable or possible entrants. These include following the flow of valuable information outward from the market, which would assist in identifying those companies in nearby markets who may know or have an understanding of the same customers or be familiar with parts of the firm's value chain; considering firms with especially relevant capabilities and assessing whether these capabilities can be profitably applied in the industry concerned. Geroski (1999) also acknowledges that market entry as a result of a related competency is arguably the most difficult to anticipate, and suggests therefore that the analyst remain sensitive to this difficulty, in order that he not overlook it completely.

Geroski (1999) recommends further that answering the following questions would facilitate the identification of firms who are likely entrants:

- What are the key competencies that an entrant will need to enter the market?
- Who is likely to possess such competencies?
- What observable actions do they have to take as to assemble the skills and assets that they will need?

Assuming that the strategist is able to identify the potential entrants to the market, he would need to pursue some course of action that would allow the firm to defend itself against this threat. Porter (1985) lists the following underlying characteristics that increase or decrease the ease of entry into a market:

- Economics of scale;
- Proprietary product difference;
- Brand identity;
- Switching costs;
- Capital requirements;
- Access to distributions;
- Absolute cost advantages;
- Government policy;
- Expected retaliation

Firms within an industry seeking to reduce the threat of new entrants could essentially influence some or all of the above factors in a way that makes entry more difficult or less attractive to potential entrants.

2.3.2 POWER OF SUPPLIERS

This research shall cover the area of supplier power, with the traditional view of supplier power within the context of the Five Forces model, which essentially has as its objective, that of reducing or minimizing the bargaining power of suppliers' vis-à-vis the firm (Porter, 1985). This view is held essentially because of the very real possibility that

suppliers in a strong bargaining position, in determining the prices and quality of raw materials and other inputs, have the ability to restrict profitability in an industry (Porter, 1985). However, this research shall also visit the area of supplier collaboration, in order to determine whether such collaboration can have the effect of improving the structure of the industry, in which the firm operates, in order that the firm may consequently earn greater profits (Hamel, Doz and Prahalad, 1998). Pearce and Robinson (2003) suggest that suppliers are able to exert bargaining in a industry by raising prices or reducing the quality of their offerings, and through this are able to reduce the profitability of an industry that is unable to pass on these cost increases to their customers. They add further to the power of suppliers is a function of the various characteristics of the market situation.

Porter lists the following characteristics of supplier power:

- Differentiation of inputs;
- Switching costs of firms in an industry;
- Presence of substitute inputs;
- Supplier concentration;
- Importance of volume to suppliers;
- Cost relative to total purchases in the industry;
- Impact of inputs on costs or differentiation;

- Threat of forward integration relative to threat of backward integration by firms in the industry

McDonald (1999) also notes that the control of information and the control of strategically important technology are potential sources of power in supplier relationships.

Given the foregoing, it is evident that the relationship with suppliers is viewed, in the main, as an adversarial one, where firms in an industry would generally seek to minimise supplier power, in order that they (the firms) may earn greater profits (Dyer et al., 2002). This view cannot be criticized too severely as it would be difficult to argue against the notion that an industry where suppliers have very high bargaining power would generally be less attractive than one where suppliers do not hold much power, all other things being equal.

Nevertheless, the view expressed by Hamel et al., (1989) that “a strategic alliance can strengthen both companies against outsiders even as it weakens one partner vis-à-vis the other”, is one that warrants further exploration. Notwithstanding McDonald’s (1999) comment that “unequal power within partnerships can provide a serious obstacle to effective partnerships”, Dyer et al., (1998) confirm that there have been, over the past decade, an increasing emphasis on alliances, networks and supply chain management as vehicles through which firms could gain competitive advantages.

Indeed, research suggests that firms would be well advised to think more strategically about the role of suppliers as opposed to adopting a “one size fits all” approach (Dyer et al., 2002). They also recommended that each supplier be analysed strategically to determine the extent to which the supplier’s product or service contributes to the core competencies and competitive advantage of the buying firm and define a strategic partner as one who provides inputs that are typically of high value and is an important contributor to the differentiation of the firm’s final product. It is evident that these are the same attributes that add to the bargaining power of suppliers, as described above (Porter, 1985) and hence, reaffirms Dyer et al., (2002) suggest that firms do not adopt a “one size fits all” approach to supply chain management.

Hamel et al., (1988) draws a distinction very succinctly when they suggest that firms may engage in competitive collaboration to enhance internal skills and technology, but should ensure that competitive advantages are not transferred. Jarillo (1988) holds the view that co-operative relationships created and maintained by a firm can be source of its competitive advantage.

Notwithstanding the potential power that the supplier may hold vis-à-vis the firm, or vice versa, for collaboration to work on a sustainable basis to the mutual benefit of both parties, there needs to be *inter alia* a large amount of trust between the parties (Lorenzoni and Baden – Fuller, 1995). This is emphasized by Omar (2002) who suggests that when the two parties along the supply chain (in this instance, car manufactures and dealers) trust each other and engage in strategic collaboration, they serve customers better, reduce overhead and operation costs and generally increase profits. He adds within this context, that the collaboration leads to a greater “profit pie”, resulting in an increased profit for

both parties, who are accordingly both better off than before. Similarly, McDonald (1999) observes that a high degree of trust between partners acts as a safeguard against the dangers associated with an unequal distribution of power.

Dyer et al., (1998) quote the example of Japanese firms, whose close supplier relationships result in superior performance for various reasons, including inter alia more information is shared resulting in both firms improving their ability to co-ordinate interdependent tasks, firms are able to invest in dedicated or relation-specific assets which lower costs, improve quality and increases the pace of product development and the reliance on trust to govern relationships is efficient and minimizes transaction costs.

Given the experience with Japanese firms, Dyer et al., (1998) recommends that firms should maintain high levels of communication with strategic suppliers, provide managerial assistance where appropriate, exchange personnel, make relation-specific investments and to generally assist in ensuring that these suppliers have world-class capabilities.

Given the foregoing fairly opposing views, of reducing supplier power in order to increase industry attractiveness, versus that of engaging strategic suppliers in collaboration in order to increase profits for both parties (at the expense of those outside the alliance). Jarillo's (1998) view that co-operative and competitive behaviours of a firm are both compatible, complementary aspects of a unique reality is especially relevant. However, it is Dyer et al., (1998) words that are especially profound when they suggest that "a company's ability to strategically segment suppliers in such a way as to relies the benefits of both the arm's length (deliberately keep suppliers at arms length and avoid

any form of commitment) and the partner models (collaboration with strategic suppliers) provides the key to future competitive advantage in supply chain management

2.3.3 POWER OF BUYERS

“Management literature suggests that competitive advantage comes from unique resources that cannot be easily acquired, imitated or substituted for by others. It is difficult to argue with this concept, provided that the resources in question are used to produce something that customer’s value” (Chatterjee, 1978). Porter’s (1985) comments that the satisfaction of customer needs is a prerequisite to the viability of the industry are consistent with this view and he goes on to add that customers must be willing to pay a price for the offering that exceeds the firm’s cost of production for the firm to survive in the long run.

However, the critical question in determining profitability (and understanding competitive strategy) is whether firms can retain the value that they create for customers, or whether this value is competed away to others (Porter, 1985). Therefore, the power of buyers determines the extent to which buyers retain most of the value created for themselves, at the expense of firms in the industry (Porter, 1985).

Pearce and Robinson (2003) suggest that powerful buyers can reduce industry profits by forcing down prices, demanding higher quality or superior service levels and playing competitors off against each other. Porter (1985) lists the following characteristics that underlie the bargaining power of buyers:

- Buyer concentration versus firm concentration;

- Buyer volume;
- Buyer switching costs;
- Buyer information;
- Ability to integrate backwards;
- Substitute products
- Product differentiation;
- Brand
- Impact on quality or performance;
- Buyer profits;
- Decision maker's incentives

Johnson and Scholes (2003) suggest that the bargaining power of suppliers and buyers are forces that can be considered together, because they are linked and they can impose similar constraints on the industry vis-à-vis the margins that firms in that industry can earn. Hence, many of the considerations that applied to the power of suppliers are readily applicable to buyers, including whether or not collaboration can co-exist with competition vis-à-vis buyers. Johnson and Scholes (2003) add, in this regard, that collaboration between buyers and sellers is likely to be advantageous when such collaboration adds greater value to the firm, than that added when operating on its own,

and when the collaboration allows the firm to concentrate on and develop its own core competencies, whilst moving other non-core functions to specialists.

Central to the process of determining the bargaining power of buyers understands who the buyer is. Abell (1980) alludes to this when he argues that the first question to be asked when conceptualizing a market is which is being served, i.e. which particular customer group. Chan et al., (1999) suggest that competitors in most industries converge around a common definition of who the customer is, when the reality is often that there exists a chain of customers who are directly or indirectly involved in the buying decision. Moreover, given that customers whose own costs are driven by their purchases, are increasingly looking to purchasing as a way to increase their profits and therefore bring additional pressure to bear on prices, it is necessary for the firm wishing to persuade customers to focus on total costs, as opposed to acquisition price only, to have an accurate understanding of what its customers do and would value (Anderson and Narus, 1998).

Chan et al., (1999) also suggest that “challenging an industry’s conventional wisdom about which buyer group to target can lead to the discovery of new market space. By looking across buyers groups, companies can gain new insights into how to redesign their value curves to focus on a previously overlooked set of customers”. Chan et al., and Mauborgne (1999) advise, in a separate paper, that value innovation (which, through its emphasis on value, places the buyer, not competition at the centre of strategic thinking; and through its emphasis on innovation moves firms beyond incrementalism to completely new ways of doing things) makes competition irrelevant by offering new and superior buyer value. Moreover, this contributes to a reduction in

the bargaining power of buyers and is supported in this regard, by Michael Dell's view that a relationship with the customer provides valuable information, which in turn allows the firm to leverage its relationships with both buyers and suppliers (Magretta, 2004).

2.3.4 THREAT OF SUBSTITUTES

The threat of substitutes determines the extent to which some other product or service can meet the same buyer needs, thereby constraining the profit potential of an industry by effectively placing a ceiling on prices that firms in that industry may charge (Porter, 1985; Pearce and Robinson, 1997; Johnson and Scholes, 2003). Pearce and Robinson (1999) add that substitute products not only limit the profits of an industry in normal times, as described above, but also reduce the bonanza that an industry would otherwise enjoy in boom times.

Johnson and Scholes (1999) describe the different forms that substitution may take, which include product-for-product substitution, substitution of a need by a new product or service, generic substitution and doing without.

Chan Kim and Mauborgne (1999:84) agree "in the broadest sense, a company competes not only with the companies in its own industries but also with companies in those other industries that produce substitutes products or services." Hence, given that generic substitution is an accepted form of substitution (Johnson and Scholes, 2003), it is possible that light aircraft manufactures may find themselves in competition with yacht manufactures, or as in the case of Callaway Golf Clubs, golf club manufactures

with tennis racquet manufactures (Chan et al., 1999). Porter (1985) lists the following as characteristics underlying the threat of substitution:

- Relative price-performance of substitutes;
- Switching costs;
- Buyer propensity to substitute; Are subject to trends improving their price-performance trade-off with the industry's product

Pearce and Robinson (1999) advise that the substitute offerings that deserve the most attention are those that:

- Are produced by industries earning high profits

Johnson and Scholes (2003) suggest that the key questions to ask in assessing the extent of threat that substitutes pose, are:

- Does the substitute pose a threat of obsolescence to the industry's product, or does it provide a higher perceived value to customers?
- What switching costs would buyers incur in moving to the substitute?
- To what extent can built in switching costs reduce the risk of substitution?
- In understanding the characteristic put forward by Porter et al., (1999) suggests that although sellers rarely think consciously about how their customers make trade-offs across substitute industries, it is indeed, of critical importance in developing insights that would facilitate the firm overcoming this threat, that they

understand why buyers choose one substitute over another. They quote the notable examples of Home Depot and Quicken, in this regard, who were both able to revolutionize and expand their respective markets as a result *inter alia* of their understanding of the value that buyers attached to substitute products.

Chan et al., (1999) also argue, through the Quicken example, that in the instance where more than one substitute exists, it is generally beneficial to explore those with the greatest volumes in usage and monetary terms

2.3.5 COMPETITIVE RIVALRY

“A primary objective of competitor analysis is to understand and predict the rivalry, or interactive market behaviour, between firms in the quest for a competitive position in an industry” (Chen, 1996).

Chen (1996) defines competitors as “firms operating in the same industry, offering similar products and targeting similar customers”. Although this definition is not agreed with fully by the authors the broader definition offered by Chan et al., (1999) above which suggests that competitors may indeed, come from alternate industries, is perhaps more meaningful, the notion of “targeting similar customers” is an important one in understanding competitive rivalry. Indeed, one could suggest that the broadest definition of competitors is those firms that target similar competitors. Devlin (2002) suggests that competition occurs amongst firms’ offerings, rather than the firms themselves, which fits in neatly with the concepts of collaboration and competition existing side by side, discussed earlier. Devlin argues this view on the basis that customers choose amongst offerings, not companies.

Johnson and Scholes (2003) refer to competitive rivalry as the extent of direct rivalry between firms and their competitors. They add further that although the most competitive conditions are those where there is strong likelihood of entry, buyers and suppliers have much power and there is a strong threat of substitution, there are other inter-firm conditions, which also affect competition significantly. It bears reference, however, that firms in the same industry are not necessarily competitors and indeed, two firms will have little motivation to engage each other in competition if they have limited markets in common (Chen, 1996).

Porter (1985) suggests that the intensity of rivalry influences the prices that firm can charge, as well as the costs of competing, and causes firms to either compete away the value created by passing it on to buyers in the form of lower process or to dissipate the value through the increased costs of competing. He also offers the following characteristics, which underlie the notion of competitive rivalry:

- Industry growth;
- Fixed costs;
- Intermittent overcapacity;
- Product differences;
- Brand identity;
- Switching costs;
- Concentration and balance;

- Informational complexity;
- Diversity of competitors;
- Corporate stakes;
- Exit barriers

2.4 SUMMARY

This chapter provided an overview of the Five Forces model and discussed how competitive forces shape strategy, before discussing in detail, each dimension of the model and the issues relevant to that dimension or force. This was essential from the perspective of providing a framework for analysis of the information that is introduced in the chapters that follow. This includes the information obtained from the independent brokers, broker manager, internet 1 www.luasa.co.za, internet2 www.LOA.co.za, and the other industry players' e.g. independent distributors. Chapters 3 will cover these issues more detail.

The next chapter covers research methodology.

CHAPTER 3

RESEARCH METHODOLOGY

3.1 INTRODUCTION

This study was a qualitative study that canvassed the support of independent brokers, broker managers and provincial heads in the life and investment industry.

The research consisted of thirty five interviews with senior managers at nine life companies', thirty independent brokers and two new entrants in the field. This was augmented by a study documents of in house companies' and brokerages. All the data that was collected in the pursuance of this study will be applied to the third party distributor concept according to the dictates of the Five Forces framework.

3.2 RESEARCH PROCESS

The research process consisted of structured interviews with people in the life and investment industry, which were followed by an open discussion process. It was decided not to employ field workers and the researcher conducted all the fieldwork personally. The reason being that most of the people consulted are senior industry personnel and as the researcher as been in the industry for a long time he was able to make contact with them. To have sent fieldworkers would have involved a training process in terms of ethics, objectives of the research and aspects of the life and investment industry. In addition there was the risk that fieldworkers would not be granted interviews with senior managers. By having face to face contact with the respondents the researcher was able to obtain more detailed information and through

experience in the industry the researcher was able to structure the discussion in a manner which ensured answers to questions.

One must be mindful of the fact that the target industry is undergoing change.

To determine the viability of this new independent distributor model within the life and investment industry, the researcher had to obtain the views of experienced industry managers. To ensure a good balance in the study, people were targeted across the country. Some of the respondents were contacted and interviewed telephonically or by email and others were met by the researcher on a fixed appointment basis. This was done to secure greater representation from the different role players that shape this industry. Another positive effect of this methodology being that the chances of them not responding were reduced due to the direct and, or personalised contact being made. It would have been possible in some instances to have small groups of managers respond in a workshop situation. That approach was considered and rejected as it was essential to get personal opinions and direct answers and group sessions run the risk of a dominant personality or two controlling the responses which would have negated the value of the responses.

Though most respondents were interviewed on a face to face basis, in a few cases the interviews were telephonic and in one or two instances the respondents emailed the researcher their views. In all instances appointments were made for interviews.

In addition to the above respondents that were targeted were individuals who are committed to remain in an industry which meant that they would most likely offer better comments than would people intending to leave the industry. This was

ascertained by targeting those individuals that have obtained their Financial Planning Institute (FPI) accreditation. It is these people that will stay in the industry that will begin to offer new opportunities though this industry is in a mature phase. Some of the respondents were mere brokers whilst other were senior management, this spread of people across a spectrum ensured that good feedback was received from people across a large geographical area.

The study targeted people that held the recognised industry qualifications and the necessary accreditations as required that by the Financial Services Board. Due to the fact that some people were unavailable, the sample size was less than thirty five. In spite of this, the data collected was valuable and it was used in this qualitative study. By selecting qualified people it was hoped these people were more informed and thus contributed better quality inputs to the study. Based on the quality of replies it appears that, that was the case.

3.3 PILOT STUDY

A pilot study was conducted and based on that several changes were made to the interview schedule. The pilot study consisted of two (2) accredited brokers, two (2) senior managers, and one (1) provincial head. Initially a prompt sheet was used however it was revised to ensure an easier, more flowing interview session. Care was taken to explain that the nature of the research and the ethical issues to respondents before commencing with the interview process which covered the current industry system and the workings of the franchise model. The concise answers that came out of the pilot study was a good indicator of the responsiveness of the brokers, managers and senior managers

to costs effect means in distributing Life and Investment products in terms of global trends.

Another issue that was of concern was the role that broker consultants of the various Companies' would fill in the proposed model. Broker consultants have a role to play but the form and shape of duties will be in line with proposed model.

3.4 INTERVIEWS

The interviews that were conducted with two(2) senior executives at Finanzplan SA, a new broker distributor in the market, in Cape Town, Stanlib Regional management, small brokerages, independent brokers and tied agents working for life assurance companies. These interviews were conducted on a structured basis. The purpose of the interview was to establish the receptiveness of the life and investments companies to an entrant willing to take on the distribution of its products. This enabled the researcher to determine whether the companies are customer focussed or product focussed.

This research was exploratory in nature and canvassed a small percentage of key people in the industry as a such from a scientific point a of view it is not sound to propose that the model and the results of the interviews be proposed to be applied to the industry, until such stage this research is replicated in wider and possibly in a quantitative study.

The interview process utilized an interview schedule to extract the information that was required in order to fully discuss the franchise model (third party distributor) within the life and investment industry.

Interviews were conducted during and after working hours to suit the respondents. Respondents were chosen at random from a list of members of the Financial Planning Institute of South Africa and it was decided to target brokers in Cape Town, Johannesburg, and KwaZulu- Natal. This was done to establish whether such a business will appeal to the broader market of Life and Investment professionals.

3.5 ETHICAL ISSUES

All people interviewed were made aware that the research was for a dissertation in a Master's degree in Business Administration and that their participation was voluntary and that they were free to withdraw from the study if they wanted to. They were given the assurance that their name and details will not be given to any other person or organisation and they would not be named in the study. Respondents were informed that the records of the interview would be securely stored and that they would eventually be destroyed as per university policy at a point in the future.

This study was privately funded. There was no pressure from the industry to manipulate or adjust the findings of this research.

3.6 PROBLEMS EXPERIENCED

The intention was to interview a greater number of people in the industry, but due to the ongoing changes that the industry is facing and work pressures some agents and brokers withdrew from the interview. An attempt was also made to speak to the ombudsman of

the life assurance industry but due to work pressures the researcher was not able to conclude an interview.

In two to three instances a convenient alternative date and time could not be reached to conduct the interview that was initially set up. There were a small percentage of people who had agreed to an interview who could not make the interview due to unforeseen circumstances and who cancelled

3.7 POSITIVE EXPERIENCES

It must be recorded that Finanzplan SA, which is based in Cape Town, was very enthusiastic about the study. They are in the business of distributing life assurance products for a limited number of companies. They were very interested to know how a structured analysis of the industry would impact on the distribution segment of the life and investment business.

An abbreviated presentation of Porter's Five Force model together with a competitor analysis was made to FinanzPlan. They showed an interest in the value that was presented and the probability that the study could help Finanzplan SA structure their business with more focus giving them the edge when negotiating with life and investments companies to capture distribution.

In their opinion it is critical to have a sound framework to distribute the products of life or Investment Companies. They were of the belief that such a study will help their skills to become a market leader in the changing financial services environment.

3.8 CONCLUSION

This chapter discussed the research methodology employed. It also indicated how the fieldwork added value to the desk research carried out during the literature review phase. The approach that was adopted was suitable for a qualitative study of this nature. The chapters that follows will present the findings as found in the data from the research process

CHAPTER 4

DATA COLLECTION AND ANALYSIS

4.1 INTRODUCTION

In this chapter the data as interpreted from the interview process and the desktop research phase of this study is presented. The information gathered is used to support the argument for the third party distribution within this framework.

Since the researcher met and discussed the concept of the proposed independent distributor model with Finanzplan, the company has adopted it and have and tested it in the market place, which indicates that the model appears to be sound enough to warrant implementation, monitoring and assessment by a large company. The other new entrant in the market place is the Independent Financial Network (IFA). The IFA has less than 500 brokers in its network and the German based Finanzplan has far fewer brokers. Some international trends were examined to establish the viability of such an organization within the South African context. Norwich Life in the United Kingdom was the first company to begin rationalizing the sales in favour of independent financial adviser networks. This has resulted in life and investment companies becoming more client centric rather than product focussed.

4.2 INDUSTRY BOUNDARIES

In the context of the Five Forces model the industry is the arena in which the competition occurs (Porter, 1980; 1985). The attractiveness of the industry is another

important determinant of profitability, therefore it becomes important to establish the boundaries within which firms should operate.

The study refers to the independent distributors of life and investment products. The assurance and investment business may be divided into many segments. These segments are as follows, product development, asset management, risk management, premium administration, distribution (Knight and Morgan, 1995). The current study as undertaken by the researcher takes a view on the distribution of the products in the life and investment business in South Africa. The model that is illustrated in figure 1.1 of chapter1 shows the move from a tied distribution to an independent distribution.

The industry is made up of various players such as independent brokers, tied agents, consultants, managers, and direct sales. These channels compete not with other life and investment companies but with the sales channels within an organization, hence brokers will compete with agents regardless of the fact that the both may be competing for the same product provider. This is illustrated in figure 4.1. below.

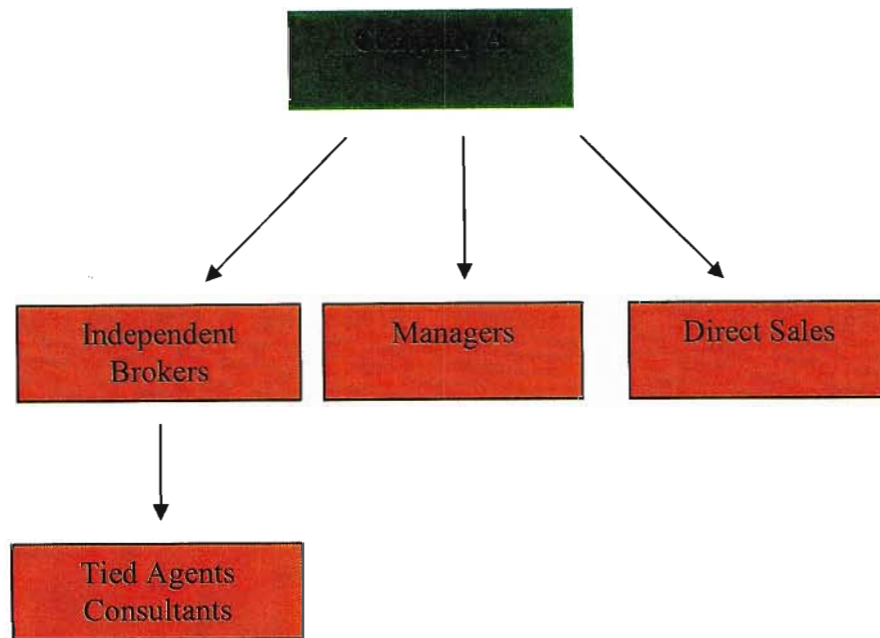


Figure 4.1 Current distributions by Life and Investment companies

THREAT OF ENTRY

This refers to the probability of a new firm entering an industry and as a result competes away the value created by that industry (Porter, 1980; 1985)

4.3.1 SOURCE OF NEW ENTRANT

It is suggested that new entrants are likely to come from the following areas (Geroski, 1999)

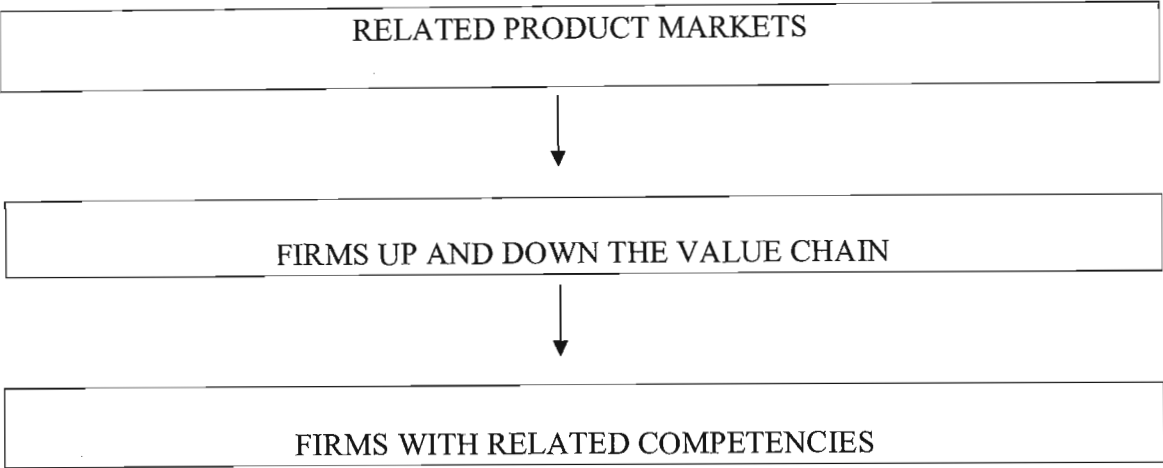


Fig.4.2. Source of New Entrant
Source: Porter (1985)

It would be logical to identify firms or players that fall into one or more of these categories

4.3.1.1 RELATED PRODUCT MARKETS

It is suggested by Geroski (1999) that related products are those goods and services that customers use together that are produced by firms in the same industry, in other words these may be complementary offerings. Stemming from this it would be useful to ascertain the goods and services that brokers will require with their contracts to sell life and investment products on behalf of service providers.

A discussion with independent brokers with reference to question one of the questionnaire, revealed that they require marketing information as a complementary service, while training also featured but more specifically brokers indicated that they required training in order to sell the products on behalf of the life or investment company. There was the requirement of technology products from the life and investment company. This they argued would complement the high level of service that is demanded of them from the various regulatory bodies that oversee the well being of the consumer in the current environment. In this case it is the Financial Services Board and the Life Offices Association.

This is consistent with the findings from question one of the questionnaire. managers at life assurances companies and investment firms that were surveyed, where 100% of these managers felt that marketing information and training were both necessary complementary services that enabled the brokers to sell the products and services of the life and investment companies. Technology services were also a high priority with the mangers that were surveyed with 77.8% of those surveyed attesting to this.

| | |
|-----------------------|-------|
| Marketing Information | 100% |
| Training | 100% |
| Technology Services | 77.8% |

Source: Table. 4.2 Survey of Broker Managers

Given the above, it is safe to conclude that the important complimentary services required by brokers with their contracts to a product providers offering is marketing material,

training and technology services. From this it can be reasonable deduced that a new entrant could come from any of these three areas.

The internal marketing divisions of the various product providers generally produce marketing information. In the general scheme of things this function does not present a huge opportunity to becoming a service provider to the related industry. This stems from that fact that people that lack industry knowledge and experience internally produce all marketing information.

Within the realms of training, development and technology major opportunities present themselves. Trainers and technologists require lots of industry experience in order to function optimally in the life and investment business. These two areas could present a significant threat of entry, as was the case with the “New Venture Academy” which was setup by former trainers of Liberty Life. They trained managers and recruits for Liberty Life franchises. These franchise are not outsourced distributions, they are merely off site operations in terms of Liberty’s growth strategy. They are still funded by the parent company and they must subscribe to the performance criteria as set by Liberty Life. The model being envisaged will operate independently from all Life and Investment companies. Its specific mandate will focus around the distribution of the various companies’ products.

By the same token providers of information technology could present a threat as evidenced by the advent of “Adivcenet”, an independent provider of financial planning

software to the life and investment industry. They have in excess of three thousand clients (3000) intermediaries as clients.

Therefore it may be concluded that the threat of entry posed by from related product markets emanate largely from training companies that provide a service to the life assurance and investment industry. The other impending threat is the developers of information technology systems for this industry.

4.3.1.2 FIRMS UP AND DOWN THE VALUE CHAIN

From the research it is clear that firms that are up the value chain are the product providers. These are the Life assurance companies, asset management companies, unit trust companies, and other risk providers. Given the size and large number of both service and product providers any new entrant will provide a threat to the suppliers. The manner in which life assurance is sold may pose a huge threat to a new entrant given the fact that these conglomerates will not want to lose control of their advantage through their distribution model.

Of significance however, chief executive officers of life assurance companies (LOA, website: 2004) in South Africa, 11.1% indicated that the distribution of products is not there core business, while 33.3% indicated that there is related to the kind of distribution model that they follow.

The study went on to further unpack this issue of distribution and the 66.7% of the chief executive officers confirmed that the core competences of their organization were related to distribution while 100% of them viewed distribution as being critical to their business. Currently the view on a new entrant seems to a balanced one. The new regulatory framework that is at play in its current form is the key deciding factor on the issue of a new entrant. Given the fact there are views of certainty on the one hand and uncertainty on the other hand, the threat of a new entrant from firms up the value chain may be considered to be high.

The other side of the value chain consists of independent brokers. The recognized governing bodies could not verify the exact number of independent brokers. All that could be ascertained was that there are in excess of 40000 intermediaries with the requisite minimum criteria to act as financial planners. These include tied agents and brokers with the Financial services Board of South Africa. Tied agents would also be potential customers and therefore may be potential entrants. Due to the similarities between tied agents and independent brokers, for the purposes of this study we will treat them as being independent brokers. From the numbers alone we can deduce that there exists a very real threat of entry from firms down the industry value chain. The firms may be faced with constraints and the largest one being the capital requirements to sustain and grow a viable distribution.

In term of general discussion held during the survey of brokers, at least 66% of the brokers are of the view that if broking was no longer an option, then they would seek opportunities in other business activities not related to life or investment sales. The other

33% did not indicate what alternatives they would pursue. This seems to be in line with the thinking of managers and chief executive officers mentioned earlier in this chapter. Given these findings, one could reasonably conclude that the brokers do not pose a threat of entry to the industry. As a result a threat of entry from firms down the value chain is minimal.

4.3.1.3 FIRMS WITH RELATED COMPETENCIES

Firms that have traditionally not operated in the financial sector, which have the requisite capabilities to compete may also serve as a potential entrant to the market (Geroski, 1999). From his observation it is evident that firms will find it difficult to identify this phenomenon. An example of this is the entry of supermarkets into the retail-banking environment. This has also been evidenced by the advent of risk provider that was previously dormant in short term insurance, eg Hollard Life Assurance.

It is essential to identify the competencies that would be necessary to compete in the life and investment industry. A survey of independent brokers revealed the following most important competencies.

| Competency | Percentage |
|-------------------------------|------------|
| 1. Interpersonal skills | 76.7 |
| 2. Ability to motive brokers | 53.3 |
| 3. Problem solving skills | 50.0 |
| 4.Ability to impart knowledge | 46.7 |
| 5. Technical knowledge | 40.0 |
| 6. Administrative skills | 36.7 |
| 7. Presentation skills | 33.3 |

Table 4.3 Survey of independent broker, 2006

Source: Independent Brokers, (2006).

Included in the same survey broker managers were also contacted to establish the competencies that are require to service the broker force, and the results of the that survey revealed the following;

| Competency | Percentage |
|--------------------------------|------------|
| 1. Interpersonal skills | 100.0 |
| 2. Ability to motive brokers | 100.0 |
| 3. Presentation skills | 100.0 |
| 4. Administration skills | 100.0 |
| 5. Ability to impart knowledge | 100.0 |
| 6. Technical knowledge | 89.00 |
| 7. Problem solving skills | 89.00 |

Table 4.4 Survey of Broker Managers 2006

Source: Brokers Managers (2004).

From the table above it is clear that broker managers felt that all these qualities are essential to be successful in the quest for broker business, but by comparison both independent brokers and managers displays some consistency in the servicing of brokers. The independent distributor will be able to accomplish these competencies, as the need to succeed will drive high service levels with professionally trained broker consultants.

In response to Geroski’s (1999) question of identifying potential entrants, this has been answered in the above (table 4.4 survey of broker managers). The second issue of identifying the competencies of such firm would be a onerous task due to the number of firms that are currently operating in South Africa (LOA website), bears testimony to the fact that Geroski’s (1999) observing and identifying potential entrants is most difficult. It

may be more useful to observe that the actions of new entrants that are starting such businesses. Some of the activities that such an organization will take are as follows;

- Contracting with product providers
- Attracting broker consultants
- Attracting brokers
- Office infrastructure
- Investment in technology

4.3.2.1 ECONOMIES OF SCALE

Distribution is one of the areas in which economies of scale apply and holds true in the life and investments industry. Initial investments are made in the areas of staff compensation, office infrastructure, technology and relationships with brokers. As more brokers contract to the firm the ratio of costs to premium income begins to reduce as a result of the firm becomes more profitable. In the case of a new entrant whose initial market penetration levels may not be as high as the more established firms will have to sustain financial losses until such time that they have critical mass with brokers. Finanzplan SA which is now establishing itself is in a position to attract some the leading brokerages in the country thereby giving it the first mover advantage in the independent broker market.

4.3.2.2 BRANDING

Brand loyalty is a significant factor in the life and investment business in South Africa. This was addressed in question thirteen (13) of the survey questionnaire. The independent

broker market places a large amount of business with long established life and investment companies. This was strongly supported in the survey conducted by the researcher. It revealed that 33.3% of the brokers surveyed placed business with certain life assurers as a result of the popularity of the brand. This was also reinforced by the broker manager survey in which it was show that broker placed business with certain life assurers because of the popularity of their brand.

Notwithstanding the above, industry statistics(www.LOA.co.za) shows that almost 85% of all new business continues to be placed with the 5 most popular companies . There was no disclosure of any material product or other differences among the competing companies. Therefore it may possible be that a lot of brokers maybe placing their business with certain companies as a result of the brands of those companies without understanding that to be the reason for it.

4.3.2.3 SWITCHING COSTS

This area may become significant in influencing or deterring a new entrant. It is the norm with industry players that should a client move from one company to another there would some cost implication to the client. Given the fact the firms have invested in the brokers business through the broker consultant in ensuring that the broker is trained, that the brokers' information systems are compatible and that brokers client base is managed and administered would make it difficult for the broker to move to a new firm without incurring any costs. The broker faces the risk of losing income through the potential loss of clients as a result of a change in the management of the brokers' client base.

The assumption that the building in of switching costs could act as a significant barrier to entry was tested in question eight (8) of the survey of both independent brokers and broker managers, where in the case of independent brokers, the major switching cost was perceived to be the need to establish a new relationship, with 53.3% of the respondents highlighting this. The need to promote the new company to clients and the loss of renewal income was also perceived to an important cost with 43.3% of the respondents suggesting that this would be so. This was followed by the possibility of losing the services of the existing company (40%) and the loss of client information (36.7%)

The broker manager survey showed that following to be the most significant switching cost that would be incurred: the need to establish a new relationship (77.8%), the need to promote the new company to their clients (77.8%) and the loss of service from the existing company (56.6%).

Given these as well as other significant switching costs that the firm could build in as a result of co-managing the broker's client base, it may be concluded that the firm would be able to build in high switching costs. This together with the low number of competent intermediaries in South Africa as evidenced by the low number certified financial planners (PFI website, 2005) does significantly reduce the threat of entry

4.3.2.4 ACCESS TO DISTRIBUTION

The firm distributes its products through brokers, of which there is a limited number. Moreover, it is evident from international trends, with the most recent examples being

that of the United Kingdom and Australia (www.IFA.co.za), that the number of brokers may decline due to the regulation in the industry and as a result reducing the number the of available distribution outlets. It would be prudent for the firm to gain a larger portion of the market as this will help in building a barrier to entry.

In the presentation with Finanzplan SA the importance of converting tied agents into independent brokers was also discussed. The view that the firm must to seek to build good quality relationships with suppliers who are the also the employers of these tied agents. Momentum Life moved away from the tied agency system of distribution to one of a broker distribution system. The main driver behind such a move was the enormous costs the company would in sustaining such a distribution network. This resulted in the conversion of agency contracts into broker contracts. Building a strong brand may also assist in ensuring that these agent, in the event they decide to become brokers, are attracted to the firm rather than to new entrants

4.3.2.5 EXPECTED RETALIATION

Retaliation to new entrant could take various forms and could be a deterrent to new entrants, but is not necessarily recommended. Such retaliation could include reducing the volumes of business of suppliers who offer their products via the new entrant, withdraw the services to the broker who enter into negotiations with the new entrant. Given the generally collaborative nature of both the buyer and the supplier relationship, these methods would not be recommended and the reliance should, therefore, be placed on the aforesaid characteristics to reduce the threat of new entrant to the market.

It bears reference to the fact that Finanzplan SA have indicated that they would observe but not take any other retaliatory action against new entrants, on the presumption that their high service levels and other switching costs would ensure their retention levels of brokers in the distribution networks. This was established in discussion with Finanzplan SA about its strategy to retain brokers that are contracted to them. They have decided to counteract pressure from other new entrants with excellent service and competitive product offerings.

4.4 THREAT OF SUBSTITUTES

The treat of substitutes determines the extent to which some other product or service can meet the same buyers needs, thereby constraining the profit potential of an industry by effectively placing a ceiling on prices that the firms in the an industry may charge (Porter, 1985; Pearce and Robinson, 1997; Johnson and Scholes, 2003).

4.4.1. TYPES OF SUBSTITUTION

The different forms that substitution may take were described by Johnson and Scholes (2003) were as follows. Product for product substitution, substitution of the need by a new product or service, generic substitution and doing without, and these are assessed more fully in order to determine inter alia what possible substitutes may exist within the context of this industry.

4.4.1.1 PRODUCT –FOR-PRODUCT SUBSTITUTION

This occurs where the product or service of an industry is directly substituted by an alternative offering, as in the example illustrated by Johnson and Scholes (2003) of email replacing the fax machine. Whilst one could debate the attributes of the alternative offering of product or service, and with all else being equal, the offering with more advantages is likely to be the one to prevail in the marketplace (as in the case of email over the fax machine). This also bears reference to the fact the pricing remains competitive in respect of the alternative offering. It is in this way that the product –for-product offering substitution places a ceiling on prices that may reasonably be charged for a product.

The offering in question is essentially the provision of a contract for independent brokers to place all their business with the different life and investment companies' via the independent distributor, and to receive service, training, motivation and other benefits from the independent distributor and its employees; the following may be identified as a product –for –product substitutes:

- Ordinary broker contracts held separately by the broker with each life assurer, where the broker places his business with those assurers with whom he holds contracts and receive service, training and motivation from them. Whilst the attributes of each alternative may be discussed at length, it is of significance that the presence of this substitute effectively means that the firm wishing to channel all the broker's business via itself, must pay the broker, rates of commission that

are, at least similar to that which he would receive if he placed the business directly with the life or investment company.

- Internet services to brokers where brokers hold separate contracts with life or investment company in the traditional sense, but are serviced on a more cost effective basis than currently, by the assurer serving them over the internet. Again, whilst the attributes of each may be discussed at length, it is of significance that the presence of this substitute effectively limits the margin that the firm may expect to earn from life assurers. It is of reference in terms of question thirteen, that 66.7% of the respondents in the survey of independent brokers indicated that they would not be willing to be serviced over the internet, whilst only 20.0% indicated that they would be willing to be serviced in this way. The remaining respondents were uncertain. Moreover, whilst 77.8% of the respondents in the survey of broker managers confirmed the Internet as a method of servicing brokers, 100% of them also indicated that the volume of business sold by brokers would decline in the event that broker consultants no longer serviced them. Hence, the Internet is not likely to present a formidable threat of substitution immediately. This may, however, change significantly with the increased use of the Internet by the South African broker fraternity.

Hence, the major product-for-product substitute would be the traditional or ordinary broker contract, whereby the broker transacts directly with the life and investment company. This is likely to remain an important substitute over an extended period of

time, as evidenced in the United States, for example, where despite the fact that independent third party distributors have been in existence for some time, 70.21% of the business concluded by independent brokers continues to be placed in the traditional way i.e. directly with the life or investment company (Dake and Mayo, 1996).

This was also evidenced in the low take on of brokers in the start up phase of Finanzplan SA and the Independent Financial Adviser network. After discussion with the marketing directors of both organizations, it was clear that a least 70% of the brokers canvassed by them were resistant to change relationships with companies.

4.4.1.2 SUBSTITUTION OF THE NEED BY A NEW PRODUCT OR SERVICE

This refers to the situation where a new product or service effectively renders the existing offering superfluous (Johnson and Scholes, 2003). In this instance, the product being discussed effectively renders the ordinary broker contract granted individually by life and investment houses; however, it is more difficult to identify those offerings that could effectively render this offering superfluous. Nevertheless, the following may serve as possibilities:

- Internet based selling may grow to the extent where end users buy increasingly through this medium, thereby bypassing the broker and rendering any contract that he may have superfluous. Although the internet may very well pose a threat of increasing importance in the future, it does not, at the present time, represent a significant distribution channel in terms of market share, as evidenced by the findings of Gopalan (2000), which suggests that only 7.69% of Asian life assurance companies currently use the internet as a distribution channel. The

United States experience is similar, where in terms of a submission by Dake and Mayo (1996), only 2% of share of market measure by new individual life premiums is attributable to direct sales, which includes the internet.

- Other forms of direct selling e.g. direct mail or telesales may, depending on its success also render the broker superfluous. Gopalan (2000) suggests that this method of distribution is more prevalent than the Internet, but remains significantly less important than intermediary based distribution, with 23.08% of the Asian life assurers using telemarketing and 51.28% using direct mail. This is in contrast to the to the 97.44% of the Asian life assurance companies that use intermediary distribution channels. As stated earlier that only 2% of the market share in the United States is attributable to direct response, and this includes telemarketing and direct mail.

The inability of these alternative distribution channels to make significant inroads into the industry may be attributed to the fact that most consumers prefer an intermediary to facilitate their purchase of life and investment related products and Glenn Morgan (1995) also alluded to the fact that life assurance is sold rather than This was supported by Knights and Glenn Morgan (1995) who stated “the market for (life assurance) product does not exist in advance of the personal selling encounters which constitute it.” Knight bought, and therefore requires the intervention of an intermediary to conclude the sale. It maybe concluded that the substitution of the need by a new product or service is at this stage very low.

4.4.1.3 GENERIC SUBSTITUTION

This occurs where products or services compete for need (Johnson and Scholes, 1999). The need that the product in question fulfils the creating of a creating a source of income for the broker, and hence any alternative sources of income that he may find would then satisfy the definition of generic substitution. A significant threat in this regard, especially amongst the less sophisticated brokers, is that of micro lending products where banks and other lending institution often use brokers to distribute their products to the mass market, in return for which the broker is paid a commission. However with the recent changes in the regulatory framework, this threat has been minimized.

The survey of independent of brokers also suggested that a large number of brokers could pursue alternative careers in other financial disciplines. However, the threat of generic substitution remains low, since these moves to alternative sources of income would occur largely under conditions where broking, for some reason, is no longer a career option for the individual, and therefore change is forced upon him.

4.4.2. DEFENDING AGAINST THE THREAT

It is important to discuss the characteristics that Porter (1980; 1985) identifies as having the ability to increase or decrease the threats of substitutes, within the context of whether the firm would be able to influence these in its favour, thereby making the industry and its competitive environment more attractive.

4.4.2.1 RELATIVE PRICE – PERFORMANCE OF SUBSTITUTES

This refers to the performance of the substitute product relative to its price. Essentially the lower or higher the performance of the substitute offering, the greater the likelihood of the customer choosing the substitute over the product of the firm. Hence, the firm may enhance position by continually improving its own price – performance trade off. This could be achieved by focusing on those areas that brokers perceived to be important to them, which was discovered in a study of independent brokers (refer to table 4.3)

| | |
|----------------------------------|-------|
| Personal contact | 22.1% |
| Assistance with solving problems | 17.4% |
| Advice on business | 15.1% |
| Motivation | 15.1% |
| Sales ideas | 11.6% |
| Training | 7.0% |
| Assistance with presentations | 7.0% |
| Counselling | 4.7% |

Table 4.5. Services that Brokers Value 2006
Source: Independent Brokers (2006)

Moreover, given that the most significant reason given by the independent brokers for placing their business with specific companies was better product and that the independent third party distributor would essentially provide access to the products of most of the life and investment companies, it would immediately offer higher perceived

value than those substitutes referred to. Its relative-performance may also be enhanced by focusing on the second most important area that brokers chose as their reason for placing business with specific companies. This was also corroborated by Finanzplan (2000), where it was established that the major reason for placing business with certain companies was “relationship with broker consultant”.

Hence, given all of the foregoing, it is evident that substitutes which pose the most serious threat viz. Traditional broker contacts which was discussed as a product-for-product substitute, clearly offers a relatively inferior price- performance trade-off than that which is available from the new firm. Whilst the new firm may use these factors to increase its market share, it may not remove the threat of substitution presented by the traditional broker contracts, as was evidenced in the United States.

4.4.2.2 SWITCHING COSTS

The building in of switching cost by a firm was viewed as important in reducing the threat of entry; it also becomes similarly important in reducing the threat of substitutes. The creation and the maintenance of strong relationships, training and development, compatible information systems and joint management of the broker’s client base, are likely to create significant barriers to the broker changing his service provider, thereby reducing the threat of substitutes. For switching to be relevant, the firm must in the first instance be able to attract the brokers, which may be difficult if the provider has built in switching costs.

4.4.2.3 BUYERS PROPENSITY TO SUBSTITUTE

It has transpired that 57% of brokers surveyed in terms of the questionnaire, would be willing to move their business from one company to another if they were offered a superior product or service, a small percentage indicated that they would not be willing to change. This represents a high propensity to substitute one contract for another. Broker managers on the other hand felt that there was a low propensity to change from one provider to another. The conclusion that may be draw from this is that there is no clear conclusion with regards to the broker's propensity to substitute.

The study also revealed that only 20% of the brokers were willing to switch from being serviced by broker consultants to the Internet. Notwithstanding the inability to draw clear conclusions as a result of this contradiction, the broker's propensity to substitute is also important from another perspective, which is in switching established brokers to the new firms offering in the first instance.

Brokers revealed that they are likely to switch their business under the following conditions;

- Breakdown in the relationship with Broker Consultant
- Better products
- Breakdown in the relationship with the company
- Better technology

Whilst the franchised distributor may not be in a position to influence the relationship between the brokers and his existing broker consultant, it would be in position to offer brokers the products of all life and investment companies, thus ensuring that they have greater choice and would always, have access to the best products. The franchised distributor should place itself in a position to cause the broker to switch from their current provider.

4.4.3 ASSESSING THE EXTENT OF THE THREAT OF SUBSTITUTES

Johnson and Scholes (2003) suggested the answering of certain key questions, which are designed to assist in the assessing the extent of the threat of substitutes, and these were discussed previously. The second and third questions relate to the issue of switching costs and have already been dealt with earlier, however, the first question which asks whether the substitutes poses the threat of obsolescence to the industry's product or does it provide higher perceived value, is important.

The substitutes that have been identified are traditional broker contracts where the broker contracts directly with the life assurer and is serviced by their employee/s, third party distributors who service brokers via the internet, direct sales which bypass the intermediary altogether.

The major players in the market are confident that an intermediary based distribution would still remain relevant, hence, it would appear that alternative distribution channels

e.g. internet and direct sales are unlikely to render franchised distributors or other forms of intermediary-based distribution obsolete.

It is not likely that traditional broker contracts would render the franchised distribution method of distribution obsolete; indeed, the threat would appear to be the reverse viz. A franchised distribution could potentially render traditional broker contracts obsolete. However, the international experience suggests that both models for servicing brokers shall remain relevant.

4.5. SUMMARY

In the above boundaries of the industry in which the franchised distributor will operate were defined. It then went on to identify the sources of new entrants, who were assumed to come from one of three areas viz. related product market, firms up and down the value chain or firms with related competencies. Individuals or organizations that are responsible for training intermediaries, providers of information technology services to the life and investment industry and finally, by the life and investment companies themselves presented the major threats of entry.

The above also looked at the factors that the firm could look at in reducing the threat of entry, and in this regard, economies of scale, brand, switching costs and access to distribution represented defences to entry. It is important to note that whilst these barriers to entry prove successful in defending against the threats posed by firms from related product markets, it does not provide a material deterrent to the life and investment companies, who continue, therefore to present a significant threat of entry.

The chapter then proceeded to define and assess the extent of the threat posed by the different forms of substitution, where it found that the threat of greatest significance came in the form of a product –for-product substitute and was the traditional broker contract, offered directly to brokers by life and investment companies. Although defences were identified, which firms could use in defending itself against the threat of substitution e.g. relative price-performance and switching costs, these are not considered to be significantly reducing this threat.

It may be concluded that life and investment companies present both major threats of entry and substitution to the industry. These companies are therefore of special significance and also act as suppliers to the firm, and their bargaining power will therefore be assessed.

4.6 POWER OF SUPPLIERS

Given their ability to determine prices and quality of raw material and other inputs, suppliers play a significant role in determining industry profitability (Porter, 1985). In this instance, the supplier's role is of critical importance since the role of firms in the industry in question is to distribute the product of these suppliers, in return for which the firm receives a margin on commission paid to brokers. Hence, in the absence of effective collaboration with these suppliers, the industry in question is effectively redundant

4.6.1 CHARACTERISTICS OF SUPPLIER POWER

Notwithstanding the fact that collaboration with suppliers is viewed as essential to the industry (to be discussed later), it is important to analyse the characteristics that influence the bargaining power of suppliers (Porter, 1985).

4.6.1.1 PRODUCT DIFFERENTIATION

Johnson and Scholes (1999) define differentiation as the provision of product or service that is perceived by the customer as being of a higher value than the offering provided by competitors. Pearce and Robinson (1997) are somewhat more emphatic in their assessment of differentiation, which they define as occurring when “businesses have sustainable advantages that allow it to provide buyers with something uniquely valuable to them”.

The life and investment companies that operate in the market currently are of the opinion that the products that they develop are differentiated in the market place. Broker consultants and broker managers in the life and investment industry also corroborated this view.

The fact that almost 85.14% of all business goes to the 5 major players in the life and investment industry according to the www.LOA.co.za, would suggest that there is no material difference between the product offerings between the companies.

It is further significant, that of all new business sold, 54.86% (www.LOA.co.za.) is sold by brokers is placed with these 5 companies thereby suggesting that the reasons for these five companies controlling such a large market share may lie outside of product differentiation and is more likely a function of their own distribution capabilities. It is not surprising that those companies with the largest market share also have large tied agency forces in the country.

Given the foregoing, it would appear fair to suggest that no clear conclusions may be drawn in respect of product differentiation of life and investment companies in South Africa.

4.6.1.2 PRESENCE OF SUBSTITUTES

This refers to whether the industry has alternative inputs to those provided by current suppliers (Johnson and Scholes, 1999). Hence, suppliers other than the registered life offices, which effectively constitute the life assurance industry in South Africa, need to consider.

As alluded to previously there are some 34 unit trust management companies and in excess of 30 registered offshore investment product providers currently in South Africa (FSB website, 2006), all of who develop products, which could effectively be viewed as substitute input for the firm to distribute. It is of significance that these product providers do not, in the main, have large established sales forces or other entrenched distribution channels and would therefore be more willing to enter into agreement with the firm.

However, the experience of Finanzplan SA would suggest that the products of these providers by themselves are insufficient to attract brokers. This organization holds contracts with a large number of the product providers, but has found that brokers, who derive a large amount of their commission from life assurance sales, were unwilling to contract to them on the basis of product alone. This bears reference to the fact the different life companies are effectively substitutes for those of the others, and the bargaining power of specific life assurers would be diluted therefore, if other life companies were willing to provide their products to the firm at favourable terms.

4.6.1.3 SUPPLIER CONCENTRATION

This is largely relative to the concentration of buyers i.e. supplier power is increased when the supplier group is more concentrated than the industry that it serves (Pearce and Robinson, 1997)

Moreover, given recent trends e.g. the acquisition of Sage life by Momentum life, Fedsure and Norwich life acquired by Capital Alliance, Charter Life by Liberty Life as well as the possible acquisition of Stanlib Asset Management by Liberty life, it is evident that further consolidation in financial services is highly likely and it would be fair to suggest, that there is a high concentration of suppliers.

However there is currently one independent distributor in South Africa viz Finanzplan SA. It must be borne in mind, that this channel is part of the larger industry distributors. This industry consists of approximately 40 000 intermediaries, numerous brokerage

firms, large numbers of broker consultants, etc. Hence, one can conclude that supplier concentration is greater than buyer concentration, and is indeed, likely to increase in the further consolidation in the financial services industry in South Africa.

4.6.1.4 IMPORTANCE OF VOLUME TO SUPPLIERS

Brokers have generated in excess of R2 billion rand in recurring premiums and in excess of R 15 billion in single premium new business. This constitutes 59% of all individual business and is therefore the most significant distribution channel in the financial services industry. While it is clear therefore, that the volume of sales by brokers is of enormous importance i.e. a supplier, the importance of the volumes of the franchised distributor would be determined by how much of the sales generated by brokers, it can cause to be placed via itself.

Moreover, it may increase its volume and therefore its importance, not merely by capturing a large market share of broker business, but by growing the overall volumes of business sold by brokers and therefore itself and the life assurance industry.

The International experience as per the United States model suggests that volumes of business placed via independent third party distribution is of great importance to suppliers and currently constitutes at least 30% of all new business sold by brokers (Dake and Mayo, 1996).

Hence, whilst there is insufficient information on the existing firms, to determine the importance of the firm's volumes to suppliers, it may be safely assumed, in view of the foregoing, that this volume will be of great importance to life and investment companies i.e. suppliers.

4.6.1.5. IMPACT OF INPUTS

This refers to how or whether the inputs provided by the supplier group impacts on the industry. Given that this industry acts as a distributor of products supplied by the life and investment industry, it would appear reasonable to conclude that the impact of the supplier inputs on the industry is extremely high. It is evident, for example, that the service levels of the supplier industry would directly affect the industry, their product development capabilities and legislation that affects them.

However, given the fact that other firms within the supplier group may be willing to provide superior quality service, the ability to switch suppliers does not exist, and hence, supplier power in this regard is reduced.

It was further ascertained from Finanzplan that brokers canvassed by them was not willing to change supplier though they held all the contracts with life and investment companies. This further reduces the bargaining power of individual suppliers as the firm is not likely to be under any undue pressure to maintain relationships with all life and investment companies, and is not likely to be unusually dependent on the inputs of any

particular company. However, given the number of life companies and the stage of maturity that they are in, that firm is likely to be able to obtain the inputs that it seeks.

Notwithstanding the foregoing, it is significant that 54.86% of all new business sold by brokers in South Africa is placed with the top FIVE life assurance companies (LOA website), which would suggest that these FIVE life assurers would wield more bargaining power than the other smaller less significant players. Therefore for the franchised distributor to become an established player and gain market share, it would need to have access to the FIVE major players.

Given the above it would be difficult to draw clear conclusions on the impact of inputs on the firm, however it would seem fair to suggest that suppliers would, as a result of this represent at least an average threat.

4.6.1.6 THREAT OF FORWARD INTEGRATION

Suppliers may be increased where there exists the possibility that it may integrate forward into the industry; if it does not obtain the margins that it seeks (Pearce and Robinson, 1997; Johnson and Scholes, 2003). Where this possibility exists, it places a constraint on the industries ability to improve the terms on which it purchases.

The major life and investment companies have large distribution channels consisting of both agency and broker networks, and a more recent development has been direct sales, hence it may be deduced that forward integration has already occurred, and the terms on

which the firm purchases from suppliers is already constrained by the cost that are associated with the various life and investment companies distribution channels. The life and investment firms may not want to enter into agreements with distributors due to the cost associated with distribution. From a recent report on the cost implications associated with distribution channels, 44% of the chief executives indicated that they will use any effective distribution channel, and hence, the presence of their existing channel will not be preclude them from entering into agreements with franchised distributors. This is further supported by the fact that reduced margins, legislative constraints and shrinking profit will force life and investment companies to seek optimal means of taking a product to the market, as opposed to relying on a single distribution channel to all markets. A survey conducted in 1993 found that customers benefit from the presence of multiple distribution channels.

In the study of chief executives mentioned earlier, the indications are that there would be willing to contract to such a firm if the concept proved successful. Hence the treat of forward integration remains high in this regard as well.

From the above it is clear that forward integration already exists in the broader sense and the threat thereof is very high, in terms of competing with the firm.

4.6.2 POTENTIAL FOR STRATEGIC COLLABORATION

The proviso set by Hamel et al.,(1989) suggests that that firms engaging in collaboration should seek to enhance the internal skills and technology, but must be careful not to transfer competitive advantage, and in this regard whilst the firm may seek to collaborate

with its suppliers for the purpose of mutual benefits in the area of offering advice with regards to new product development, providing information on the strength of the life and investment company brand, etc., it must ensure that it does not transfer its core distribution skills and should prevent direct relationship building between insurer and broker.

Similarly as discussed previously, the presence of a large degree of trust is central to sustainable collaboration (Lorenzoni and Baden-Fuller, 1995); hence, the franchised distributor should seek such relationship only with those companies with whom a degree of trust has been established.

As determined in the survey that not all brokers were concerned about the number of contracts that the firm held, hence, it may not be necessary to enter into a collaborative relationship with the supplier.

The potential for the collaboration with some suppliers, whilst yielding mutual benefits for both the firm and those suppliers with whom it wishes to collaborate, has the additional benefit for the firm of effectively reducing the bargaining power of the suppliers, since it would not be dependent on those suppliers in any significant manner.

4.7 POWER OF BUYERS

The bargaining powers of buyers determine the extent to which firms are able to retain the value that they create for customers, or whether most of this value is retained by the customer (Porter, 1980; 1985). Therefore within the distribution segment of life and

investment marketing, the bargaining power of buyers would refer to the extent to which the distributor is able to retain the value created or whether the value is increased by the broker by demanding high prices (higher commission) which would reduce the distributors margins. The other demand would be higher service levels at the same price, and this would increase the distributor costs and therefore reduce its profits.

4.7.1 VALUE CREATION

Central to this notion of who retains most of the value that is created, is the assumption that value is created by the industry in question. Being a new model in South Africa, its value has to test. The major benefits that brokers may derive from such a concept are as follows:

- Access to a large number of life companies
- Single point of service
- Not necessary to manage multiple relationships
- No need to meet the minimum requirements of all companies

Given the singular focus on brokers and its activities, it would seek to increase the volume of business sold by brokers; it becomes apparent that the firm would create more value than brokers would currently anticipate.

4.7.2 CHARACTERISTICS OF BUYER POWER

Porter (1980; 1985) identifies various characteristics that influence the bargaining power of buyers, and those that are of particular relevance to the industry in question are discussed further.

4.7.2.1 BUYER CONCENTRATION VS FIRM CONCENTRATION

This is largely relative to the concentration of suppliers i.e. a buyer power is increased when the buyer group is more concentrated than the industry which supplies it with inputs. One needs to assess whether the intermediaries in South Africa are more concentrated than the independent distribution firms that supply them, as well as other organizations that supply them with contracts e.g. life assurance companies themselves by way of traditional broker contracts.

As mentioned earlier that there are approximately 40 000 intermediaries according to the Financial Services board. Only a small percentage of these intermediaries belong to a recognised intermediary association (FPI website, LUASA website) and to a large extent they operate as individual entities. According to statistics released by Momentum Life (2005), the great percentages of these brokers are concentrated in the Johannesburg, Durban and Cape Town areas.

4.7.2.2 BUYER VOLUME

According to Pearce and Robinson, a buyer group is powerful if it purchases in volumes. Any broking house that contracts to and places its business with a firm, and sells a

significant volume of business, and where that constitutes a high percentage of the firm’s total volume of business, may place the firm in a strong bargaining position.

4.7.2.3 BUYER SWITCHING COSTS

This refers to the costs incurred by buyers in moving from one supplier to another, hence within the context of this industry, it refers to the costs incurred by the broker in moving from this firm to another firm or directly to the life or investment company.

According to a study conducted by Momentum Life (2004), the following switching costs were present:

| Cost | Percentage |
|---------------------------------------|------------|
| Need to establish new relationship | 53.3% |
| Need to promote new company to client | 43.35 |
| Loss of renewal commission | 43.3% |
| Loss of service from existing company | 40.0% |
| Loss of client information | 36.7% |

Table 4.6 Switching Costs
Source: Momentum Life (2004).

As discussed earlier that the firm would be able to build in significant switching costs in terms of the numerous benefits and services that it makes available to brokers including client management, ongoing training and development, etc. Therefore it may be

contended that the presence of switching costs may assist in reducing the bargaining power of buyers.

4.7.2.4 THREAT OF BACKWARD INTEGRATION

Buyer power is increased when there is the possibility that buyers may integrate backwards into the industry; if they do not obtain the margins that they seek. Hence, where this possibility exists, a constraint is placed on the industry's ability to improve the terms on which it sells to its customers.

As determined earlier that 60% of the brokers surveyed indicated that if broking were no longer an option, they would explore other activities unrelated to financial services. The remainder did not indicate what activities they would pursue.

Hence, it may be safe to conclude that the threat of backward integration in the industry by intermediaries is very low.

4.7.2.5 PRESENCE OF SUBSTITUTE PRODUCTS

This refers to whether buyers (Brokers) have alternative inputs to those provided by the firm, and clearly, there are significant substitute inputs including ordinary broker contracts held separately by the broker with each life and investment company, internet based services to brokers as well as other independent third party distributors.

As discussed in this chapter ordinary or traditional broker contracts offered by life and investment companies' brokers remain the most significant substitute to the firm's

offering and continues to account for an enormous amount of business concluded. This trend was especially significant in a similar experience in the United States.

It was concluded in earlier in this chapter that the Internet did not present a significant threat of substitution to the industry

It may be concluded that the presence of substitute products is significant, which enhances the bargaining power of brokers or buyers.

4.7.2.6 PRODUCT DIFFERENTIATION

Product differentiation, in general, refers to the provision of a product or service that is perceived by the customer as being of a higher value than offering provided by competitors (Pearce and Robinson, 1997). In this industry it would be the firms' ability to differentiate its offering in the eyes of the broker it serves.

In terms of differentiating itself from the traditional broker contract, the survey of independent brokers by Finanzplan (2005) revealed that brokers perceived the firm's offering as significant in that it offered access to a large number of companies, single point of sale, not necessary to manage multiple relationships and making it unnecessary to meet the minimum standards of all companies with whom the transacts business.

Since the focus of the franchised distributor would be on distribution, the firm would be able to offer superior service, and other benefits focused on the broker, which would increase the broker's volume of business.

Finanzplan SA seeks to differentiate itself on the basis of their sound administrative systems, which they claim is of significant benefit to the broker (Ms Kelly of Finanzplan SA, 2006).

Although the new franchised distributor would adopt a business model that is similar to that of Life and Investment companies', the differentiation would lie in the quality of people, and its ability to grow its market share not only by attracting brokers, and also increasing the volumes of business sold by those brokers.

4.7.2.7 IMPACT ON QUALITY OF PERFORMANCE

Currently broker consultants that are employed by the life and investment companies' service brokers. These broker consultants' recruit and service brokers with the intention of obtaining a greater market share of the brokers business. The consultant tries to build a sound relationship and offers superior service with the intention that such a relation will result in the broker placing a large portion of his business with that consultant. In this scenario the broker consultant is competing with consultants from other companies.

In the new scenario, the model changes to a single broker consultant, who is employed by the franchised distributor, who also recruits and services brokers, and in doing so, acts on behalf of the life and investment companies with whom the franchised distributor has contracts. Hence, the primary motive of the new distribution firm would be to increase the volume of business rather than maximizing market share.

This model aligns the brokers' objectives to that of the broker consultant i.e. the broker consultant will focus on increasing the brokers' volume of business rather than focusing on market share, which is the current scenario. This is likely to have a positive impact on the performance of its buyers i.e. brokers and that its activities would be tailored for this purpose i.e. as opposed to simply building sound relationships with and offering high levels of service to brokers.

The firm and its broker consultants will also benefit the brokers with problem solving, business advice, motivation, provision of sales ideas, training, assistance with presentation and counselling. In this manner, the firm would place itself in a strong bargaining position with its brokers or buyers.

4.7.2.8 IMPACT ON BUYER PROFIT

Where the firm positively impacts upon buyer profit, it increases its bargaining power. Given the foregoing discussion on how the firm would increase the broker's volume of business without increasing the broker's costs in any way, it is evident that the firm would have a material impact on buyer profit and in this way, enhances its bargaining power.

4.8 SUMMARY

Whilst various dimensions or characteristics of supplier power was studied, the concentration of suppliers in the distribution industry and the threat of forward

integration posed by the life and investment companies were found to be of great significance in enhancing their bargaining power.

Notwithstanding the foregoing, it was found that given the lack of material product differentiation, the presence of substitute inputs in the sense that the products of one life and investment company constituted a substitute for that of another and the low impact of inputs, given that the firm could obtain the inputs that it requires from alternative life and investment companies, strengthened the bargaining position of the firm.

This chapter then proceeded to assess the extent of the bargaining power of buyers, who are essentially the independent brokers served by the firm. It did this by researching the characteristics that influence buyer power, and once again found that the most significant threat posed emanated from life insurers, who essentially provided brokers with an effective substitute viz. the traditional broker contract.

Notwithstanding the presence of this substitute, the firm was in favourable bargaining position vis-à-vis buyers on the basis of the low buyer concentration, minimal importance of individual buyer volume, and the presence of significant buyer switching costs, the impact of the firm on the quality of the brokers' performance and the impact on the broker's profits.

The first four forces of the industry and competitor analysis have been considered, and the main threat was the life and investment companies. Outside of this the company remains fairly attractive and well positioned. The remaining force i.e. that of competitive rivalry will be considered.

4.9 CHARACTERISTICS OF COMPETITIVE RIVALRY

The framework referred to in part 2.3.5. Lists the characteristics that Porter (1985) identified as underlying the notion of competitive rivalry, and it is these which are now analysed within the context of the life and investment industry.

4.9.1 INDUSTRY GROWTH

The rate of market growth may have an impact on the industry of competitive rivalry in an industry and this is illustrated in situations of market growth. An organization may easily achieve its own growth as a result of general market growth; however, individual firms in a mature or stable market may only achieve growth at the expense of competing firms. Hence, mature and declining markets would generally increase the level of rivalry amongst firms in an industry.

Pearce and Robinson (2003) described the life and investment industry as a mature one, an assessment that is borne out by statistics released by the Life Offices Association (2005) and the Association of Collective Investments (2005), which reflected the industry only grew by 3.45% in the total recurring premium income, with many companies including the two largest viz. Old Mutual and Sanlam reporting negative growth in new business. The Financial Services Board of South Africa confirmed that the long-term industry is under pressure and that certain market segments are approaching saturation (FSB Annual Report, 2005).

Although the industry in question is not, as previously discussed, the life and investment industry, but rather the life and investment distribution industry, given that the life and investment distribution is largely a function of the life and investment industry, for purposes of this study, that its stage of market growth would be a function of that of the life and investment industry, and therefore may be taken as mature.

Hence, given a mature market stage, it may be deduced that the intensity of competitive rivalry would be very high.

4.9.2 FIXED COSTS

Although fixed costs will be present vis-à-vis establishing an office infrastructure, technology costs, staff expenses etc. these would be relatively lower than in most industries, and indeed, a significant portion of the costs i.e. broker consultants remuneration, would be variable in nature. This would also be true of other independent distributors.

However, life and investment companies with established internal divisions that service brokers are likely to have a relatively high exposure to fixed costs, especially as a result of the large number of people that they employ, together with their significant infrastructures and management structures. However, in the recent years, these companies have indicated a willingness to move away from these fixed costs where possible, as evidenced by the number of life offices that have downsized or curtailed their agency operations or introduced franchising options. Hence, it is likely that these organizations would also seek to reduce the fixed costs related to servicing brokers.

The relatively low fixed costs would suggest that competitive rivalry would be low.

4.9.3 PRODUCT DIFFERENCES

In an industry of low product differentiation, customers may switch easily between suppliers, thereby increasing competitive rivalry. However, Pearce and Robinson qualify this by claiming that customers may only move easily between suppliers in the absence of high switching costs

As alluded to earlier there are significant product differences between the traditional broker contract offered by life and investment companies and that offered by independent third party distributors, with little incentive or reason for brokers to switch from the third party distributors to life and investment companies.

However, given that there are little or no differences in the business models used by the different companies, brokers could switch from one to another if they so desired.

However, the potential for switching is adequately offset by the firm's differentiation vis-à-vis quality of staff and its ability to grow the broker's volume of business. Moreover, the presence of significant switching costs referred to earlier would also act as a barrier to brokers switching away from the firm.

Hence, given all of the foregoing, it would appear fair to conclude that the level of rivalry between those companies providing traditional broker contracts, these being the life and

investment companies themselves, on the basis of product differences, is very low whilst the rivalry between the firm and other independent third party distributors is low to average.

4.9.4 DIVERSITY OF COMPETITORS

Pearce and Robinson suggest that rivalry is heightened when competitors are diverse in “strategies, origins and personalities.” They deduce that this diversity causes them to develop very different ideas on how to compete in the industry, with the result that they continually “run head-on into each other”.

The main competitors in the industry are those companies that have traditional broker divisions that service brokers employ similar strategies in attempting to capture the maximum volume of business sold by brokers i.e. they employ broker consultants to recruit, build relationships with and service these brokers.

Although no tests were conducted to assess the diversity in personalities of competitors, it would appear reasonable to suggest that given the similarities in their backgrounds and the fact that they would have entered the life and investment industry, on average through similar recruitment and selection procedures, there is not likely to be significant variance in personalities. Hence, competitive rivalry as a result of diversity of competitors is assumed to be very low.

4.9.5 EXIT BARRIER

Industries in which there are high exit barrier generally experience a high intensity of rivalry, as a consequence of the likelihood of a persistence of excess capacity, and therefore increased competition (Johnson and Scholes, 1999).

The main competitors viz. Life and investment companies with broker divisions face different levels of exit barriers for various reasons.

Life and investment companies which offer traditional broker contracts generally have well established internal broker divisions which employ several hundred staff including broker consultants, managers and support staff, many of whom have been with these companies over extended periods of time. Hence, there would be significant exit barriers for these companies' vis-à-vis retrenchment costs or redeployment costs. The negative publicity that accompanies such retrenchments or redeployments may also impose significant costs on the company.

In addition to the actual staff costs, these companies would also have housed these employees in good quality offices and there is likelihood therefore, of costs associated with the early termination of leases.

An franchised distributor is unlikely to face similar exit barriers. They would not employ large numbers of staff and are unlikely therefore, to be faced with significant retrenchment expenses. Moreover, they tend to use less office space, concentrating on the main centres rather than being countrywide.

Given the foregoing, it may be concluded that the level of rivalry from the life and investment companies as a result of their high exit barriers is likely to be high, whilst that from other third distributors is likely to be low.

4.10. SUMMARY

As discussed in the other forces, the characteristics that underlie this force also assessed the intensity of competitive rivalry. The research suggested that although the industry is in a mature stage of growth and that high exit barriers were present in the case of the established life and investment industry, the intensity of rivalry was generally low. This was established by the low operating costs generally prevalent in the industry or where fixed costs were high, they were characterized by a willingness to reduce them, significant product difference between traditional broker contracts and the offering of a third party distributor and low diversity amongst competitors.

Although product similarities were observed between the new distributor and its more direct competitors i.e. Finanzplan SA, the presence of switching costs and other differentiating factors ensure that competitive rivalry remains low.

Having discussed all five forces within the context of life and investment distribution in South Africa. The next chapter will seek to draw conclusion and make recommendations where appropriate.

CHAPTER 5

RECOMMENDATIONS AND CONCLUSIONS

5.1 INTRODUCTION

The researcher, who is employed in the investment industry, perceived that the existing methods of distributing life and investment products was inefficient and it was decided to research the issue to determine whether a more suitable cost effective method could be developed.

The purpose of the study was to assess the attractiveness of an independent third party distributor of life and investment products in South Africa by applying Porter's Five Forces Model and industry competitor analysis the study sought to highlight those issues that the firm should pay special attention to in its efforts to build a competitive business. The model below was envisaged as the working framework for the research.

The frame work that was set at inception and as illustrated below sought to demonstrate that companies which spending large sums of money on the marketing of its products through its intermediaries may now have the option of moving the distribution to an independent distributor. This study sought to illustrate this through interviews and questionnaires that was target to the different stakeholders in the life and investment industry.

This saving that the life and investment companies will earn can be ploughed back into client centric product development. This view was endorsed by company executives who stated that the distribution of its products only formed about 11% of its total business.

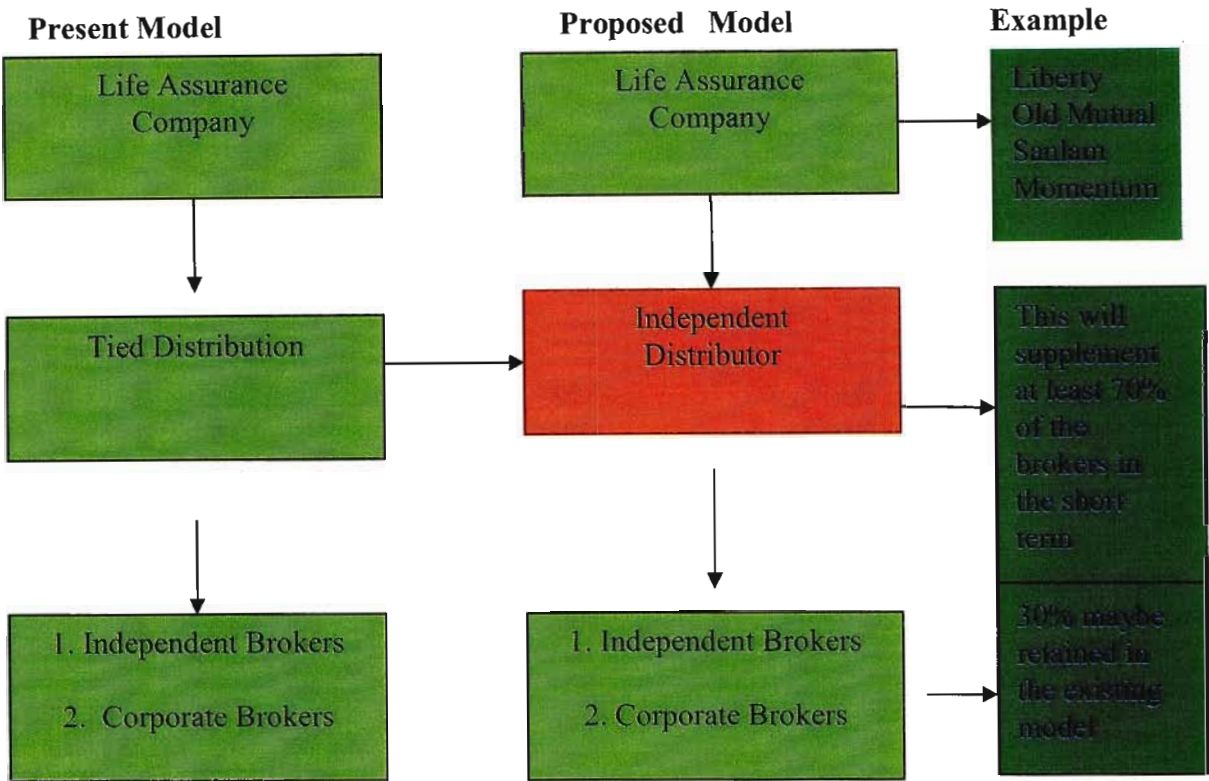


Figure 1.1. Proposed Model on Franchised Distributor (2006)

As discussed in chapter 1 of the study the distribution of life and investment products is through direct agents that are in the full time employment of life and investment companies’.

In chapter 4 the competencies required by the broker fraternity were examined, and it was shown that brokers required knowledgeable consultants that will help in increasing the

brokers business rather than becoming defensive towards the company they represent. This implies that firms need staff that know the range of products, know the laws governing their industry and sales practices and that they fully assess the needs of the prospective clients in order that they are able to sell him/her what he/she needs. Often in the past brokers sold policies that were less than ideal for the client but generated good income for the brokers

5.2 INDUSTRY BOUNDARIES

The industry in which the firm would operate was defined as being the distribution segment of the life and investment sector. The relevance of this is to understand who the major competitors are, and to separate the competitors (other brokers and agents) from the supplier (The Life Assurer), notwithstanding the fact that in some instances both competitor and supplier may belong to the same organization e.g. where a life company, which operates a broker division, agrees to the firm distributing its products via brokers, it follows that the life company would act as product provider on the one hand, whilst its broker division would be a direct competitor on the other hand.

5.2.1 RESEARCH ISSUE

The objective of the study was to apply the Five Force Model to a company seeking to enter the life and investment business as a new entrant specialising in the distribution segment only. This would ensure that the life and investment company would stick to its core competences rather than having internal competition.

The study also sought as its objective, that the distribution of the life and investment products could be outsourced with little or no impact on the companies' brand being affected in any way. The study was centred on the five key components of Porters Five Forces Model, which is as follows and the findings, conclusions and recommendation for each are discussed one by one and are based on the interview and literature research phases

- The entry of new competitors:
- The bargaining power of supplier:
- The bargaining power of buyers:
- The threat of substitutes:
- Competitive rivalry:

The study revealed that by outsourcing the distribution to an independent third party as envisaged, the profitability of the organization would improve; client retention and client management will improve. Most importantly, the company will be able to focus on product development to increase its market share.

Though volumes of sales has increased in recent year, it clear that the life and investment companies are struggling with increasing sales on the one hand and defending their products on the other hand. The confidence with which these products were sold in the past was agent centric. The retention of business was a secondary function to making high sales.

The study envisages a separation of the functions with life and investment companies' focusing on the development of customer focused, and the distribution of these products to independent brokers would be better dealt with by a specialist. In this instance it will be the third party distributor.

5.3 THE THREAT OF ENTRY

Having defined the threat of entry as the probability of new firms entering an industry and competing away the value created by the industry, the research went on to identify the sources of those new entrants, who were assumed to come from one of three areas viz related product markets, firms up and down the value chain of firms with related competencies.

It was concluded that those responsible for the training of intermediaries i.e. either employees of life and investment companies who specialize in training of intermediaries or those companies to which training of intermediaries is outsourced, as well as providers of information technology services to life and investment industry, presented a high treat of entry.

It was further concluded that the potential entrants would need to take certain observable actions in starting up their businesses and these included contracting with life and investment companies, attracting broker consultants into their employ, attracting brokers to contract with them, creating an office infrastructure and making investments in technology.

The reduction in the threat of entry was also considered, and it was found that the presence of economies of scale in the industry would ensure that firms that established themselves early would enjoy an advantage over the later entrants, which reduce the threat of entry. The new distribution firm would be advised to establish itself early to take advantage of the market conditions.

Branding was considered to be important, as well as switching costs was found to be important in defending against the threat of entry, as well as other threats, which was supported by both broker managers and independent brokers. It is recommended that the firm seeks to add value to the brokers business by building strong relationships with dedicated broker consultants, training and development, creating compatible information technology systems and taking over a large share of the brokers administration and client management, thereby creating very high switching costs. Access to distribution was also viewed, as an important factor in reducing the threat of entry in that once a fair share of brokers was contracted to the independent third party distributor and retained through high switching costs entry to the industry would appear unattractive.

5.3.1 FINDINGS

On the whole it may be concluded that whilst the various defences that the firm may raise is likely to have a significant impact in reducing the threat of entry posed by firms in related product market, the threat presented by firms up the value chain within the life and investment companies remains very high.

5.4 THE THREAT OF SUBSTITUTES

The threat was defined as the extent to which profit was constrained by the presence of other products or services that meet the same buyer needs, in assessing the extent of the threat, the different forms of substitution was considered.

The researcher also considered those factors that the firm could use to reduce the threat of substitution, bearing in mind that the major threat of substitution comes from the traditional broker contract offered to the broker by the life assurance and investment companies. The established life and investment companies will be able to sustain regulated rates of commission to the established inflows of new business.

The first factor that was relating to the price- performance of substitutes it was concluded that the firm offered a superior price performance trade off vis-à-vis possible substitutes including traditional broker contracts. However the international experience suggested that this in itself was not likely to significantly reduce the threat of substitution posed by traditional broker contracts.

Other factors that were discussed included switching costs, which, as with the entry, viewed as significant but assumed that the firm would be able to attract sufficient brokers in the first instance, since switching costs are only of relevance to those brokers who are already contracted to the firm. Hence, this also does not fully assist in curtailing the threat posed by traditional broker contracts, in that the main difficulty with this substitute is that

brokers, as result of holding existing contracts of this nature, do not join the firm in the first instance.

Although no clear conclusion could be drawn on the propensity of brokers to substitute, the conditions under which they would do so if the attractiveness of the new firm were greater than what they enjoyed currently, e.g. better products better technology.

5.4.1 FINDING

In summary the most significant threat of substitution is that posed by traditional broker contracts offered directly to brokers by life insurers and investment companies'. Whilst the presence of superior price performance trade off and switching cost may help to some extent, it is concluded that this did not reduce the threat sufficiently and hence the threat of substitution from traditional broker contracts remains high.

5.5 POWER OF SUPPLIERS

It has been stated that given the ability to determine prices and quality of inputs, suppliers play significant role in the determination of where value is distributed in an industry.

Although no clear conclusions could be drawn in respect of product differentiation of suppliers it was found that 85.14% of all new business sold in South Africa is placed with the 5 major companies' (LOA website), suggesting that there are differences between these and the other companies in the life and investment companies.

The presence of possible substitute inputs were considered and found not to be significant, or rather than alternative providers of retail financial services products e.g. Unit trust management companies. However a large number of life insurers ensured that supplier power was limited since the product of the different companies acted as substitutes for each other. This was entrenched by a survey conducted by FinanzPlan SA. (2003) of independent brokers where it was found that they would be willing to contract with the firm if it provided access to a limited number of life and investment offices.

Whilst there was clear evidence that the volume of business sold by brokers is of importance to the life insurance and investment industries and is likely to become of additional importance in the future, given the recent growth trends, the importance of the firm's volume to the life insurance and investment industries would be a function of its own effectiveness and essentially, what share of the total amount of business sold by brokers it can cause to be placed via itself. International experience does suggest that the firm will be able to generate volumes that are sufficient to cause it to become of importance to its suppliers.

However given the stage of maturity of the life insurance and investment industries currently finds itself, and the intensity of the competition between the firms in these industries, it is likely that even among the five most competitive companies, the third party distributors would be able to obtain the required input, thereby reducing the power of suppliers in this regard to no more than average.

The most significant threat posed by suppliers was found to be the threat of forward integration, an alternative that it may elect to exercise in the event that it does not obtain the margins that it seeks. Majority of life and investment offices already have established distribution channels and may therefore be treated as already having integrated into the industry, however, there is a high likelihood that they will also adopt the business model being espoused in this study.

5.5.1 FINDING

In summary suppliers hold significant bargaining power due to their greater concentration, which is likely to become further entrenched with the increased consolidation within the life assurance industry. However, if the firm is able to establish itself quickly and gain significant market share of the broker market this power may be significantly reduced.

5.6 POWER OF BUYERS

This threat exists due to buyers being in a strong bargaining position and being able to retain much of the value created by the third party distributor. The bargaining power buyers, who in this case would be brokers was assessed.

Brokers were found in the first instance to be less concentrated than the firms that supply them i.e. either life insurers or other suppliers of financial product. Hence, their bargaining power in this regard is very low.

Similarly it was concluded that individual buyers or buyer groups did not purchase in volumes that were especially significant, and therefore, buyer bargaining power in this regard is very low.

Buyer switching costs, as discussed earlier were found to be high and the firm is also encouraged to introduce other switching costs were appropriate, and this also serves to keep the bargaining power of buyers low.

The other significant factor that enhances the bargaining power of brokers was found to be the presence of substitute products viz. traditional broker contracts which discussed earlier, cannot be counted.

Product differentiation, its impact on the quality of the brokers' performance and its impact on the brokers' performance were all found to be favourable and therefore also reduced the bargaining power of buyers.

5.6.1 FINDINGS

In summary, whereas the firm enjoys relatively more bargaining power than buyers, the single area where buyer power is enhanced is especially significant, in that it is the threat of substitute products, these products being the traditional broker contracts offered by life assurance companies. It is also the one area that remains a threat consistently through the previous three factors.



5.7 COMPETITIVE RIVALRY

The intensity of rivalry within the industry was also assessed by looking at the characteristics of competitive rivalry.

It was found that the life assurance and investment companies' is in a mature stage of industry growth and although the industry being analysed, was defined as being only a segment of the total life assurance and investment industry, it was assumed that the distribution segment of the life assurance and investment sector would follow a similar stage of industry growth as the life assurance and investment industry itself, and hence may also be treated as mature. Given this mature market stage, the intensity of rivalry, on the basis of this alone, may be assumed to be very high.

Fixed costs were also seen to be a factor in assessing the intensity of rivalry in an industry and in this instance, given the relatively low fixed costs, and in the cause of the established life assurance and investment companies, their willingness of late to reduce their fixed cost exposure, caused this study to conclude that competitive rivalry, on the basis of this factor alone is low.

Product differences were assessed from both the perspective of the firm vis-à-vis traditional broker contracts and vis-à-vis other independent third party distributors.

Significant product differences were found to exist when comparisons are made to traditional broker contracts offered directly to the broker by life assurance and investment companies, and therefore rivalry as a result thereof is very low. Although there are few

116093

product differences between the insurance companies, the presence of high switching costs ensures that rivalry remains low to average.

Little or no diversity was found to exist among competitors, further contributing to a very low level of rivalry within the industry.

Finally, exit barriers were reviewed and found to be high in the case of established life offices and investment companies and low in the case of other independent third party distributors with the resultant conclusion that the level of rivalry that may be expected from life and investment companies is high, whilst that from other independent third party distributors is low.

Hence, the intensity of rivalry is increased by the mature stage of growth in the industry, otherwise it remains relatively low.

5.8 CONCLUSION

Given the foregoing, it is contended that whilst the independent distributor enjoys a favourable or attractive position vis-à-vis all five of the force model as envisaged by Porter, the threat posed by the established life and investment companies remains very significant from various perspectives.

It also appeared that there was little that the firm can do to reduce the threat posed by these companies. However, it may enhance its own position by the rapid accumulation of

market share, which would cause it to become a player of enormous importance to the life and investment companies, which in turn would lead to a more equitable bargaining position.

Given that fact that the independent distributor enjoys a favourable position, it is the conclusion of this study that the firm remains attractive and should proceed in establishing its business, but whilst remaining sensitive to the threats posed by life and investment companies and therefore, formulating strategies to reduce or cope such threats. Some of the actions that the independent distributor can take are as follows:

- Move early to take advantage of economies of scale and entrench itself in the market place, therefore also attracting the premier brokers within the industry;
- Build a strong brand;
- Introduce significant switching costs;
- Attracting the best broker consultants within the industry, including those with strong existing relationships with brokers, as these are likely to follow their consultants to the new company;
- Promote the superior price- performance trade-off of the firm;
- Enter into collaborate agreements with selected suppliers;

It is suggested that the successful implementation of these recommendations will enhance the new firm's position, thereby making its business more attractive and increasing its chances of success.

5.9 SHORTCOMING OF THE STUDY

The most important assumption of the model, and therefore the study, is found that the industry is the primary arena in which competition occurs and in addition to being questionable, the boundaries are being blurred. Notwithstanding this, the view of the industry as being central to competitive strategy remains one that is widely held and hence, a deliberate attempt was made to define the industry being analysed as accurately as possible.

Though not a short coming writers are critical of relevance of the Five Forces' as an analytical tool and its value to business is brought into question. These writers suggest that the framework works well in conditions of stability or where there is a fair amount of certainty but not in other situations. However, these writers do not offer any viable alternative for analysis and it is contended that the Five Forces Model can be successfully applied to the industry.

Another shortcoming, which Gordon (1997) recognizes and quotes Porter's acknowledgement, is that the Five Forces model does not recognize the role of government in shaping competition. This is a significant shortcoming; especially in the presence of the role that legislation is to play in redefining the life and investment industry in South Africa over the next few months. Such legislation will have a profound impact on the shape of the industry going into the next few months. Clearly though no business can operate without taking into account legislation and this is more so in the financial services sector. In the light of this it is argued that any well run company would

consider many factors more than the Five Force Model in its overall business strategy. This research focussed on the Five Forces Model in order to apply it to the marketing of life and investment products as it was believed and has been shown that the model could serve the industry and new entrants as well.

A further criticism, levelled not at the Five Forces' Model itself, but to the way in which it is used, is that using it assumes to some extent, that the new firm is creating value, with each force essentially determining how that value is then distributed. It is therefore, in the case of a new business, to conduct other analyses to determine the extent of the value being created and therefore, whether to invest in such a business. The argument to that view is that every firm has to incur some costs on getting products to the market and the costs of implementing a Five Forces Model should not be onerous at all.

As envisaged throughout this study the model is based on a new firm entering the market as distributor of life investment products for and on behalf of the established companies. It was also contended in this study that such a company would have cost benefits to the consumer and to other related parties.

This work is complete and it is contended that if the proposed model is to be implemented by the players in the industry there should be fewer problems and companies' would have better client retention strategies without the issues of concentrating on distribution.

5.10. CLOSING COMMENTS

Various aspects of the life and investment industry have been explored. The researcher explored the impact a third party distributor would have in this industry, within the context of Porter's Five Forces Model and suitable recommendations were made. It is suggested that where recommendations are implemented, benefits such as lower operating costs, increased client retention, greater focus on product development, increased profitability, and finally a strong brand will result due to goodwill being generated and the market share should increase.

In the light of the above this research has covered the ground it was designed to do, and as the problems have been explored and recommendations made, which if followed should be of benefit to new entrants to the market and in all probability would be a boon to existing firms in the market. It can thus safely be said that the research process is concluded.

This research has shown that there is a gap in the methods of distributing life and investment products. The fact FinanzPlan is testing the possibilities of a Franchised Distribution Network bears testament to the fact that there is problem with the manner in which companies distribute there products.

Further research into the distribution and marketing of Life and Investment products needs to be undertaken. In the researchers opinion further research needs to conducted with the pricing models on the distribution networks as a core activity of the life and investment business.

BIBLIOGRAPHY

Abell, D.F., 1980. Defining the Business: The Starting Point of Strategic Planning, Prentice Hall, New York

Ambrosini, V., 2002. Exploring Techniques of Analysis and Evaluation in Strategic Management, Prentice-Hall Europe, Hertfordshire.

Baden-Fuller, C and Stopford, J., 1992. The Firm Matter, Not the Industry, Rejuvenating the Mature Business, Routledge (13-34).

Benetton, N., 2002. Life Assurance: Improved Motivation with Lower Sales Costs - The Emergence Of Network Marketing in the Field of Financial Services, Insurance Times and Investments , Aug 2002 (20-22).

Chan Kim, W. and Mauborbnne,R., 1999. Creating New Market Space, Harvard Business Review , Jan-Feb 1999.

Chen, M.J., Competitive Analysis and Interfirm Rivalry: Towards a Theoretical Integration, The Academy of Management Review, Jan 1996 (100-134)

Dake, C.A. and Mayo, B.F., 1996. 1995 Premium Market Share by Distribution Systems in the United States, LIMRA, Hartford, CT.

Devlin, J.F., 1998. A Multivariate Analysis of Single Competitive Markets in a Services Environment, Journal of Strategic Management, (47 -63)

Dyer, J.H. Cho, D.S. and Chu, W. 1998 Strategic Supplier Segmentation: The Next “Best Practice” in Supply Chain Management, California Management Review, Winter 1998 (57 – 77)

Dollinger, M.J., 2002. Entrepreneurship strategies and Resources, Austen Press, Homewood.

FSB Annual Report, 2005, Pretoria.

Geroski, P.A., 1999. Early warnings of New Rivals, Sloan Management Review, Spring 1999 (107 – 115)

Gopalan, R., 2000. Asian Insurers also looking to implement Multiple Distribution Systems, LIMRA, Hartford, CT.

Hamel, G., Doz, Y. and Prahalad, C.K., 2001. Collaborate with your Competitors – and Win, Harvard Business Review, Jan-Feb 2001.

Lorenzoni, G. and Baden-Fuller, C., 1995. Creating a Strategic Centre to Manager a Web of Partners, California Management Review, Vol.37, No.3, Spring 1995

Magretta, J., 2004. The Power of Vertical Integration: An Interview with Dell Computer's Michael Dell, Harvard Business Review, Mar- April 2004.

Markides, C.C., 1999. A Dynamic View of strategy, Sloan Management Review, Spring 1999 (55-63).

McDonald, F. 1999. The Importance of Power in Partnership Relationships, Journal of Management Review, Vol. 25, No 1, Autumn 1999 (43 – 59)

Omar, O.E., 1998. Strategic Collaboration: A Beneficial Retail Marketing Strategy for Car Manufacturers and Dealers, Journal of Strategic Marketing , Vol. 6, No 1, March 1998 (65-78).

Pearce, J.A. and Robinson, R.B., 2003. Competitive Management: Formulation, Implementation and Control, Irwin McGraw-Hill, United States.

Porter, M.E., 1980. competitive advantage: Techniques for Analysing Industries and Competitors, Free Press, New York.

Porter, M.E., 1985. Competitive Advantage: Creating and Sustaining Superior Performance, Free Press, New York.

Van Aartrijk, P., 2000. Men are from Mars, Women from Venus , Independent Mercury, Insurance Journal (<http://www.insurancejournal.com>)

INTERNET SOURCES

Internet 1 <http://www.loa.co.za> Accessed on 3rd October 2006

Internet 2 <http://www.lusas.co.za> Accessed on 3rd October 2006

Internet 3 <http://www.fsb.co.za> Accessed on 5th October 2006

Internet 4 <http://www.ifa.co.za> Accessed on 8th November 2006

Internet 5 <http://www.INTERNATIONALINSURANCE.COM> Accessed on 28th September 2006

Internet 6 <http://www.fsb.co.za> Accessed on 5th October 2006

Jarillo, J.C., 1988. On Strategic Networks, Strategic Management Journal, June-July 1988.

Johnson, G and Scholes, K., 2003. Exploring Corporate Strategy, Prentice-Hall, Europe

Kotler, P ., 1997. Marketing Management: Analysis, Planning, Implementation and Control, 9th Ed., Prentice –Hall, New Jersey.

Leak,R and Van Der Merwe, S., 2004. Competitor Analysis: South African Investment Products, Metropolitan Life internal document, Cape Town.

Appendix 1

Re: Research dissertation in partial fulfillment for the degree of Master of Business

Administration

The attached questionnaire seeks to determine the role the brokers and broker managers play in securing and placing business with life and investments companies that are licensed as financial services providers in the Republic of South Africa.

Kindly answer the attached questionnaire in an unbiased manner, in order that we arrive at viable solution to the proposed model that is being envisaged in a study.

Your participation in this study will be treated strictly and your confidentiality will be maintained throughout.

The study seeks to apply Michael Porter's Five Forces Model of the Industry and competitor analysis to a firm seeking to operate as an independent third party distributor of life and investment products with the South African Financial Services framework.

Your participation in this will help in determining whether such a model will have the impact of changing the manner in which life and investment products will be distributed.

The study would also attempt to demonstrate the cost benefits that life and investment companies would enjoy, should such model become a reality.

Thank you for your participation in this study.

Kind Regards

Kiru Padayachee

Supervisor : Alec Bozas : Contact number:27823344477
Student : Kiru Padayachee : Contact number: 27823356661
Student number: 200501188
School : Graduate School of Business UKZN

1. 1.The competencies stated below, is a general list of the activities that a broker consultant perform in there daily duties. Kindly score the duties as follows: 25% being LOW; 50% being AVERAGE; 75% being HIGH; 100% being VERY HIGH.

| | |
|-----------------------------|--|
| Interpersonal Skills | |
| Ability to motivate brokers | |
| Problem Solving | |
| Ability to impart Knowledge | |
| Technical Knowledge | |
| Presentation Skills | |

2. After speaking to broker managers, they have stated that they view the list below as important, in order to service brokers. Do agree with these and kindly rate it as follows; 25% low; 50% average; 75% high; 100% very high.

| | |
|-----------------------------|--|
| Interpersonal Skills | |
| Ability to motive brokers | |
| Ability to impart knowledge | |

| | |
|-----------------------|--|
| Presentation skills | |
| Administrative skills | |
| Technical knowledge | |
| Problem solving | |

3. What are your views on a third distributor of life and investment products? Do you think that it would impact on your business negatively or positively?

Comment

| |
|--|
| |
| |
| |

4. Will the product or the level service being offered is the key determinant in deciding on whether to change supplier?

| |
|--|
| |
| |
| |

5. Do you thrive on the achievement of targets set by the different life and investment companies? If yes, kindly elaborate.

| |
|--|
| |
|--|

| |
|--|
| |
| |

| |
|--|
| |
|--|

6. Will a single exit distribution model be meaningful to your business? If yes,
kindly elaborate

| | |
|--|--|
| | |
| | |

7. Is loyalty to any life or investment company a deciding factor in deciding to
change supplier?

| |
|--|
| |
|--|

8. Will switching costs imposed by suppliers cause you to change suppliers? If
yes, kindly comment

| |
|--|
| |
|--|

| |
|--|
| |
| |

9. Is the knowledge of the broker consultant important in your ongoing
relationship with your product provider?

| |
|--|
| |
| |
| |

10. Is the product offering of company important to the level of support you given to a company? Give 2 reasons.

| |
|--|
| |
| |
| |

11. What percentage of business is given to the company that gives you the best service? Give one reason as to why this is the case.

| |
|--|
| |
| |

12. Kindly rate the following services as being important to your business. 25% low; 50% average; 75% high; 100% very high

| | |
|--------------------|--|
| Personal Contact | |
| Solving Problems | |
| Advice on Business | |
| Motivation | |
| Sales Ideas | |

| | |
|---------------|--|
| Training | |
| Presentations | |
| Counselling | |

13. Under which circumstance would you change company, if the need arose?

25% low; 50% average; 75% high; 100%very high.

| | |
|--|--|
| Breakdown in the relation with the BC | |
| Better Product | |
| Breakdown in relationship with Company | |
| Better Technology | |



UNIVERSITY OF
KWAZULU-NATAL

RESEARCH OFFICE (GOVAN MBEKI CENTRE)
WESTVILLE CAMPUS
TELEPHONE NO.: 031 – 2603587
EMAIL : ximbap@ukzn.ac.za

27 FEBRUARY 2007

MR. K. PADAYACHEE (200501128)
GRADUATE SCHOOL OF BUSINESS

Dear Mr. Padayachee

ETHICAL CLEARANCE APPROVAL NUMBER: HSS/0049/07D

I wish to confirm that ethical clearance has been granted for the following project:

“Porter’s Five Forcers model to determine the attractiveness of a third party distributor of life and investment products”

Yours faithfully

MS. PHUMELELE XIMBA
RESEARCH OFFICE

cc. Faculty Officer (Christel Haddon)
cc. Supervisor (Alec Bozas)