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Mwenya, Mwenya

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## Universal Insurance and the Prospect Theory

Mwenya Mwenya

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Insurance is a big market as there are laws that make it a require, however, there really is no insurance policy that incorporates all policies. Barclays for instance offers health, home, student possessions, car, travel, student travel and life insurance policies.<sup>1</sup> In this case an opportunity for Barclays would be to repackage these and centre them around the target market e.g. a student may need student possessions and student travel this can be Student Universal Insurance etc. An example of this can be seen in the business insurance Barclays offers, namely; Complete Office, Complete Retailer, Complete Business, Complete Property Owner and Flatowner, Complete Motor Trade, Complete Contractor and Complete Homeworking.<sup>2</sup> These policies offer comprehensive cover to businesses covering most pitfall eventualities of business. Adopting such a package oriented approach in personal insurance can have positive effect.

To understand why such a package would benefit the institution it is essential to put oneself in the position of the customers. People do not generally enjoying spending money particularly on things that do not prima facie bring any sort of immediate enjoyment such as insurance. However prospect theory<sup>3</sup> says people feel more pain incurring loss compared to the amount of joy they derive from earning an equivalent amount. E.g. the average person would chose to gain £500, rather than gain £1000 then consequently lose £500. hence people chose to buy insurance to prevent the undesirable loss that accompanies not being insured.

This theory further elaborates on why having UI would be beneficial. They are two stages in deciding whether to get insurance or not according to the theory. Firstly is editing;<sup>4</sup> in this stage an individual weighs up their options i.e. costs of insurance, consequences of not being insured etc. In this stage the individual tries to simplify there options in order easier evaluate their options and come to a decision. Though buying insurance can not be viewed as having strictly positive and negative outcomes i.e. if you do not have insurance you will definitely lose more money than the insurance premiums you have to pay. An additional outcome is that you may buy the insurance but you never use it because the claim conditions never arise during the tenure of the policy. However, it can be assumed that a customer contemplating buying insurance would view it strictly positive and negative light, as for them to have begun to contemplate buying insurance they must have considered their circumstances and concluded that insurance is relevant to them only in a positive and negative sense.

After the editing phase is the evaluation phase<sup>5</sup> were the individual weighs up the minimum gain or loss if an insurance policy is taken and the risk of additional gain or loss at stake if a policy is

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1 Barclays (2013). Insurance Options available [online] at <http://www.barclays.co.uk/Insurance/P1242557963438> accessed [05/07/2013]

2 Barclays (2013). Business Insurance. Available [online] at <http://www.barclays.co.uk/Businessinsurance/P1242558528783> accessed [10/07/2013]

3 Daniel Kahneman and Amos Tversky, (1979). Prospect Theory: An Analysis of Decision under Risk. *Econometrica*, 47(2), pp. 263-291, March 1979.

4 Ibid

5 Ibid

not taken. It is at this juncture where UI can offer a sense of clarity. Throughout this whole process an individual if faced with a difficult task of having to weigh up complex information on what is the best insurance, a lay person will unlikely have the relevant knowledge or the expertise to make such a decision. UI would attempt to clarify this whole process by giving the customer the options available to them which would correspond with each phase of the theory. This would require a comprehensive and fair account of options available to the customer because a customer would conclude in favour of getting insurance because in most cases the law requires it. The evaluation stage wont be strictly necessary because the UI policy would have answered all the customers questions at the editing stage making evaluation a formality.

### **How will UI work in practice.**

The success of UI will lays in the fact it simplifies the process of selecting insurance and it is tailored to the needs of the customer. Simplification; in that it will answer all the customer questions at the editing stage of the theory. Question important to the customer at this stage are; do I need insurance? If so who are my providers? Who offers the best value deal? To ensure that a customer answers these questions in the positive it is important to to highlight the consequences of not having insurance support by perhaps real life cases to evidence the the consequences. It may be helpful to customers to perhaps have free workshops where customer can be invited to come and learn about the detailed facets of such products. It will also be important to demonstrate to the customer that UI offers the most convenient total package unique in the market.

Further high-street banks that offer insurance need to reassess the strategies they use when selling such products. Following the 2008<sup>6</sup> recession consumer confidence in banks has plummeted, further controversies with libor and euribor rates has exacerbated the situation.<sup>7</sup> Consumers have felt threatened or even alienated by banks. Selling products in this approach can make up for these insecurities. Because constructing such a UI policy will require the provider to stop and and really listen to the needs of the customer, rather than just offering the same standard packages and solutions that all the other providers offer. This will give that customer a reason to trust the provider because it is only by listening to the customer and cultivating a positive relationship that trust can be formed. This will also allow for customers to be reassured that the provider will not leave them exposed and it will also foster loyalty.

Thus UI has to be based on integrity, reliability, credibility and expertise. For customers to buy such a policy there has to be trust this forms the basis for integrity. It would be important to be blunt with the customer about the what UI offer and what it does not, however, this has to be communicated in an acceptable way that the customer will feel reassured by honesty. Reliability can be complemented by keeping the customer involved as much as practicable and having a "what goes wrong is down to us to what goes right is down to the customer" kind of mentality. Credibility can be built by emphasising the providers working methods and track record. The customers when buying UI will need to feel like the provider and them are developing the plot together and tailoring a path to better security.

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<sup>6</sup> Gore, Charles (2010). "The global recession of 2009 in a long-term development perspective". Journal of International Development (John Wiley & Sons, Ltd.) 22 (6).

<sup>7</sup> Treanor, Jill (June 27, 2012). "Barclays chief Bob Diamond gives up 2012 bonus over £290m fine".The Guardian. Available [online] at <http://www.guardian.co.uk/business/2012/jun/27/barclays-chief-bob-diamond-bonus-fine> accessed [06/07/2013]

By exploiting the prospect theory and answering the question a customer needs to know, selling such a product can be made easier. What UI offers is not just a repackaged insurance policy but rather completely unique way of selling insurance to customer; namely buy answering the question they most desire to know. UI offers a unique opportunity in that no other brokers offer such clear and hassle free policy. It also offers a chance to build better relationships with customer and encourage new custom.

## References

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