

# Ripple *Effect*

**What do free chocolate and coupons have to do with life insurance? For starters, they have the power to sway consumer perception and get sales moving.**

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**L**ast month's article explored some of the applications that behavioral economics offers our industry; this article will continue to expand upon that same theme. For the uninitiated, classic economics assumes that consumers are like Mr. Spock and make rational buying decisions based upon logic, while behavioral economics embraces the Homer Simpsons of the world and their irrational and emotional motivations. Behavioral economics has direct application to our industry because it explores the different way that consumers view risk related to losses compared to risks related to gains. For a comprehensive primer, download the 2005 LIMRA report *Behavioral Economics: Literature Review and Implications for Financial Services* by James Mitchell and Jim Holzworth.

One of the difficulties that behavioral economics identified was that people consider insurance premiums to be equivalent to "a definite loss" rather than an investment in a future gain. And people hate losses even more than they love gains. This unfortunate dichotomy understandably makes it even harder to convince people to buy an insurance policy. However, through an experiment conducted with something that everyone agrees is preferable to life insurance—free chocolate—there may be a creative and effective way to shift consumers' perceptions.

In his book *Predictably Irrational*, Dan Ariely reported on a revealing experiment that clearly captured the compelling influence of "free". He set up a table in a supermarket to sell two different types of chocolate: Hershey Kisses for a penny or very high-end Lindt truffles for a bargain 15 cents. Not

surprisingly, 73 percent of people chose the Lindt truffle. However, when they reduced the price on both items by one cent so that the Hershey Kiss was free and the truffle was 14 cents, suddenly 69 percent of people chose the Hershey Kiss over the truffle.

Undoubtedly, the Mr. Spocks of the world would clearly see that the Lindt truffle is a better bargain at 14 cents as well as at 15. However, like Homer Simpson salivating over—and subsequently gorging at—the all you can eat buffet, most consumers are helpless to resist the allure of “free”.

The psychological attraction of “free” has been exploited in numerous ways by a variety of different industries. In fact, in 2004, stores and manufacturers spent US\$ 2 billion on providing free samples. That’s why, although some people are known to “dine” at Costco on free food giveaways, it is estimated that in-store free samples can boost sales of those products by as much as 300 percent. In fact, 70 percent of shoppers will try a sample when asked and 37 percent will buy the product—not a bad closing ratio. It’s a pity that the insurance industry’s “free-look” provision isn’t as effective!

A slightly different means to leverage “free” in order to increase sales can be found at Amazon.com. A few years ago they experimented with offering free shipping on orders over a certain amount—with the “certain amount” strategically set to require the purchase of two books rather than one. Sales skyrocketed as people spent an additional US\$ 20 in an effort to save US\$ 3. Interestingly—and just as with free Hershey Kisses—the Amazon subsidiary in France decided to charge a single franc (about 20 cents) rather than “free” shipping and their sales didn’t increase at all—until they changed their promotion to match the rest of the company.

Amore devious version of “free” can be found in the world of home printers. Some manufacturers go so far as to offer free printers with the purchase of one of their computers. How can they justify such an extravagance? They make their profit from the extremely expensive and inefficient ink cartridges that are required for that particular model. In fact, informed consumers would do well to consider the cost of the ink cartridges

and their expected longevity in addition to the cost of the printer—just as with whole life and term insurance, sometimes the cheapest model to buy is the most expensive to own.

An extremely creative use of “free” comes from Eco-hangers, a start-up company that developed environmentally friendly clothes hangers made entirely from recycled paper. When additional strength is needed, a metal hook option made from recycled bottle caps is also available. Eco-hanger’s business model consists of giving their product away for free to dry cleaners across the country. What kind of a business model is that? How can a company possibly survive when they give their product away for free?

There are approximately 35,000 dry cleaners in the U.S. Their customers fit a very specific and clearly defined demographic and are easily identified geographically by zip code.

Eco-hangers generates revenue by selling advertising space on their hangers to savvy marketers who recognize that this is equivalent to strategically placing a billboard in every customer’s bedroom. What coffee manufacturer or cereal company wouldn’t want the opportunity to promote their products first thing every morning when their customers are getting dressed? What better location to advertise wrinkle free cotton shirts than on a dry cleaning hanger? And who doesn’t start thinking about diets and healthier food when their clothes stop fitting?

So how can the insurance industry

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exploit the psychological attraction of free in order to improve closing ratios, inspire increased sales, or as a means to deliver higher profit peripheral products?

One well established strategy involves offering free accidental death coverage. This capitalizes on consumers’ mistaken conception that a highly visible accidental death is more likely than death from illness and allows insurers to attract new prospects via a free offer of a highly valued yet minimal risk benefit. Another effective method involves waiving policy fees as an inducement to inspire sales on additional family members. Unfortunately, unlike with Amazon’s clever scheme, the disparity between the cost for an additional insurance policy and the savings from waiving a policy fee is not an especially attractive inducement. On the other hand, Canadian insurer Foresters came up with an innovative new rider on their BIG UL contract that provides up to double the death benefit for the first 15 years for free. This is a great way to provide enhanced protection for families when they need it most and simultaneously leverage the attraction of “free”.

Just as printer companies and Eco-hangers use their products as a sort of decoy to deliver alternative benefits, an effective use of “free” might entail leveraging life insurance to provide immediate benefits that consumers value more than the insurance itself. For example, in the modest income

market, it's very difficult for people to accumulate any savings. In fact, the sole savings vehicle of choice is the federal tax refund and many modest income consumers rely upon the forced savings element of their payroll taxes as the only means to save for large purchases. However, since the majority of small face life policies are funded through some form of systematic monthly withdrawal, it would be easy to leverage the same "forced savings" by allowing premium payers to round-up their payments to a higher amount and depositing the additional into an interest bearing savings account. Smart companies would promote the accumulated savings and resulting interest and encourage liquidity much like a "Christmas Club" account. Over the short term, the account could also be used to make up late payments and improve persistency. It wouldn't be difficult to promote this method as far superior and more efficient than simply overpaying taxes as a means to save money.

Another valuable marketing tool that is largely absent from the insurance industry is the use of coupons and rebates. At first glance, one might conclude that there is good reason why insurers don't employ these tactics. After all, our industry is highly regulated and prohibited from offering different prices to same classes of policyholders. In addition, margins on insurance products are uncertain enough without offering unnecessary premium discounts. However, the real benefits of coupons and rebates aren't the incentives they provide. Instead, they help manufacturers distinguish between "price sensitive" and "price insensitive" consumers.

For example, some consumers fervently scour coupons and are highly motivated to buy items at the most economic price (price sensitive). Other consumers place a higher value on their time and are willing to pay higher prices rather than take the time to search for bargains (price insensitive). Coupons allow manufacturers to satisfy both consumer groups in a cost effective manner by raising their normal prices slightly higher for sale to the price insensitive group, and discounting their price through coupons

in order to satisfy the price sensitive group. Some pre-need companies use similar techniques by offering sliding scales of commissions and interest rates to satisfy funeral homes with long-term versus short-term priorities.

One of the biggest challenges facing small face life companies is accurately predicting the ultimate mortality of their customers. Modest income prospects tend to have higher mortality than the general population due to a combination of factors. In fact, the link between demographics and preventable illness is so clear that the New York State Health Department created a Web site that tracks hospital admission rates for 12 preventable illnesses that read like a simplified issue life app and include hypertension, congestive heart failure, angina, diabetes, and COPD. In central New York where I live, hospitalization rates for preventable illnesses in lower income or rural areas can be as much as 50 to 75 percent higher than the state average.

Imagine how much mortality might improve if a final expense company were able to identify and attract those rare modest income consumers who were conscientious about maintaining their health? By offering \$50 coupons or rebates for routine annual physicals, insurers could both incent and attract customers who take a more proactive interest in their health. Alternatively, it wouldn't be inappropriate for an insurer to offer separate lower rates to consumers who could document periodic annual physicals. Regional carriers could explore partnerships with local public health clinics to both promote annual routine exams as well as the importance of life insurance.

One final aspect of the psychology of consumer behavior that has important and direct application to our industry comes from a study reported in *Predictably Irrational* on why people cheat. Disappointingly, it appears as if when given the opportunity, most honest people will cheat "just a little", and the risk of getting caught didn't seem to have much influence on whether people cheated or not. This is significant in the world of small face life insurance where simplified issue underwriting relies upon

an element of truthfulness on the part of agents and applicants. In fact, rescission ratios can be alarmingly high as the first opportunity to fully assess a risk occurs in the claims department with contestable claims. As a result, understanding the tendencies that influence misrepresentation is a critical aspect of a small face life program.

Life insurance is an intangible product that is difficult to sell because the expected benefits are long term and intended to benefit someone other than the purchaser. In addition, there are a number of psychological biases that make it difficult for consumers to understand—let alone value—our products. Fortunately, there are a number of positive biases that have been well documented and successfully leveraged by other industries. Whether it's capitalizing on the power of "free", employing "decoy" products to deliver alternative benefits, identifying consumer preferences through coupons and rebates, or utilizing psychology to influence consumer credibility, we need every edge we can get in order to deliver our products to the world.

Behavioral economics reminds us that there's a bit of Mr. Spock and Homer Simpson in all of us, but that both rational and irrational behavior can be predicted and influenced. Smart companies will continue to explore ways to exploit these tendencies until one day perhaps insurance agents will achieve closing ratios that will rival the free sample vendors at Costco. ■



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