CRAIN'S CHICAGO BUSINESS. Print Story Printed from ChicagoBusiness.com

State Farm's edge? It's private

By Joseph B. Cahill April 21, 2012

For a while now, I've been wondering why State Farm seems immune to the troubles plaguing Allstate.

After all, the nation's two biggest property-casualty insurers have a lot in common. Both were founded in the Midwest early in the last century. Both sell auto and homeowners' insurance to middle-class Americans through thousands of agents around the country. Both were slow to embrace direct sales over the telephone and Internet, the method favored by fast-growing competitors Geico and Progressive Corp.

Yet State Farm Mutual Automobile Insurance Co. holds its own against the direct sellers, while Allstate Corp. loses ground. State Farm expands—it's adding 900 agents—while Allstate's agent count dropped 13 percent last year.

What's the explanation? Ownership.

No. 1 State Farm, based in Bloomington, is a mutual company owned by the policy- holders who buy its insurance. No. 2 Allstate, based in Northbrook, is a stock company, owned by public shareholders. One answers to its customers, the other to Wall Street.

“The biggest difference is one is a public company and one is not,” says Paul Newsome, managing director at Sandler O'Neill & Partners L.P.

Anything State Farm does to please its customers also pleases its owners. Allstate, however, struggles to balance customers' demands for good pricing and service with stockholders' desire for profitable growth.

State Farm has more leeway to compete on price with the likes of Geico and Progressive, because its customer-owners benefit from any price cuts. On service and claims, State Farm can afford to be attentive and generous with the owners of the company.

“Because we are a mutual company, we don't have to have to sacrifice the long-term interest of our customers to accommodate the short-term interests of our stockholders,” a State Farm spokeswoman says.

It's a different story for Allstate, which declined an interview request. Every dime Allstate spends on claims or price cuts is one less dime for shareholders.

It stands to reason, then, that State Farm's scores were high and Allstate's average in the most recent customer-satisfaction survey conducted by J.D. Power & Associates.

State Farm's reputation for outstanding service makes a good selling point with customers. Geico and Progressive, meanwhile, distinguish themselves with low prices.

And what sets Allstate apart? Profitability. For all its growth woes, Allstate's margins exceed those of State Farm and most other insurers.

Catnip for investors, maybe, but not for customers. “Insure your car with Allstate—we're more profitable.” Now there's a catchy tagline.

An operating philosophy geared to investors puts Allstate at a competitive disadvantage. Its market share slipped more than a percentage point to about 10 percent over the past five years as premiums fell 6.7 percent, according to data from SNL Financial in Charlottesville, Va. Meantime, State Farm's market share edged up to 19 percent as premium growth of 9.8 percent outpaced the industry.

Allstate's predicament shows how public stock ownership sometimes deprives executives of the flexibility to respond to changing market conditions. Ironically, this eventually can prevent a company from meeting investors' other big demand: growth.

Doubts about Allstate's growth prospects depress its shares, which trade at about nine times projected earnings per share for 2012. Fast-growing Progressive, by comparison, trades at 15 times earnings.

Allstate shares have perked up lately on signs company brass is waking up to the growth worries. Allstate bought online insurer Esurance last year, and CEO Tom Wilson recently acknowledged the need to get more aggressive on pricing.

Barring an unlikely switch to private ownership, these moves look like Allstate's best bet. Giving up a few percentage points of profit margin won't plunge it into the red, and it will help Allstate compete for customers.

It's working for State Farm, anyway.