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NEWS

- ▶ Front Page
- ▶ Research
- ▶ Features
- ▶ Search News

USER LINKS

- ▶ Log In
- ▶ Log Off
- ▶ Register
- ▶ Subscribe
- ▶ Renew Subscription
- ▶ My Account

HELP & INFO

- ▶ About
- ▶ Privacy
- ▶ Contact



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The MSO Space: A Claims Leader's Perspective

by Jim Porcari

Multiple shop operations viewed through the lens of a former president of claims for a top ten insurer.

Jim Porcari, Principal at Insurance Resources recently completed a research project involving a review and analysis of the Multi-Shop Operation (MSO) segment of the collision repair industry. A summary of his observations and conclusions, viewed through the lens of a claims executive is outlined below.

As CollisionWeek readers know, the collision repair industry is huge, with estimated revenues of \$41 billion per year¹, split between more than 37,000 total repair locations comprised of single location operators, independent multi-shop operators (MSO) and dealer collision repair shop operations².

The industry is highly fragmented, and while it has consolidated considerably in the last five years, the remaining roughly 37,000 shops still represent an overpopulation of at least 15 percent³. The collision repair industry will continue its consolidation, with the existing independent MSO's continuing to grow and gain traction as they open new locations, buy smaller MSO groups and single location independent operators, combined with additional shops going out of business.

While still relatively early in the process, activity is accelerating, with announcements of acquisitions and organic new locations being announced every month by the MSO's. Even with all the growth activity by the MSO's, there are still less than 10 MSO's with more than 30 shops today⁴.

Multi-Shop Operators (MSO's)*			
	HEADQUARTERS	# OF STATES	LOCATIONS
Boyd	Winnipeg, Manitoba	14	176
ABRA Auto Body	Minneapolis, MN	12	118
Caliber Collision	Irvine, CA	4	102
Sterling Auto Body	Natick, MA	16	62
Service King	Dallas, TX	1	47
Collision Revision	Joliet, IL	3	27
Joe Hudson's Collision	Montgomery, AL	3	22
Cooks Collision	Walnut Creek, CA	1	21
Presision Collision	Bellevue, WA	1	18
Auto Body America	Antioch, TN	3	18

Sources: IRI Research, Boyd Group filings, BB&T Capital Markets, Industry publications

In addition to the general overpopulation and highly fragmented ownership of shops, additional catalysts and dynamics are in play that will further fuel this consolidation, to one degree or another, including:

- The constantly growing sophistication of skills required to effectively repair today's increasingly complex vehicles.
- The growing capital required to purchase and maintain the equipment needed to be able to efficiently and effectively repair today's increasingly sophisticated vehicles.
- A rapidly growing dependence on linked technology between shops, insurers and suppliers, which small shops cannot easily meet.
- A growing dependence by shops on Auto Insurers' direct repair programs (DRP) for a significant portion of their revenue.
- The eventual realization by OEM's that shops will have to be certified to repair and/or replace parts in technology-laden vehicles for warranties to remain in effect.

Some or all of these factors will prove to be insurmountable hurdles for many shops, further accelerating the consolidation in the collision repair space.

In addition to these variables and dynamics within the collision repair industry, there are trends and evolving biases in the insurance space that serve to support the growth opportunities for MSO's. These include:

- Growing acceptance of DRP networks as a foundational element of any good claims operation, in insurers of all sizes.
- Increased awareness in claims and procurement areas of insurers that a smaller number of vendors and more strategic partnerships with these vendors provide the insurer an opportunity reduce overall vendor support efforts and costs.
- The hurdles to become an insurer strategic partner.
 - "To become an insurer strategic partner requires capabilities in technology and process that only some level of revenue scale can support. Our best estimate is that a minimum annual revenue of \$2.0 million is required to support efficient and effective shop needs in tools and technology. This bodes well for well run, forward thinking MSO's and not so well for inefficient individual shops or small, inefficient and less well capitalized MSO's."
- Increased focus on customer satisfaction and the realization that the auto repair component of the claim can drive the success or failure of many downstream claims interactions. All of the top MSO's have a keen focus on and appreciation of customer satisfaction.
- Continued insurer focus on reducing loss-adjusting expense (LAE), which amounts to 10-13 percent of earned premium.

Pulling these threads together, it is clear that at this early stage of consolidation, there is significant additional opportunity for the current MSO's to gain size and share as this inevitable consolidation picks up speed. Given the right combination of base platform, a solid understanding of consumer, insurance and repair industry dynamics, coupled with the right vision and leadership, there is an outstanding window of opportunity for some MSO's to become clear leaders in the space.

There are only two (2) MSO's with more than 100 locations and only five (5) with more than 45 today. There is only one MSO that is public, The Boyd Group, based in Winnipeg, Manitoba, with 176 locations - 139 in the US (14 states) and 38 in Canada. Their growth has mostly been via acquisition of other MSO's, most recently True2Form (38 locations in 2010), Cars (28 locations in 2011) and Master Collision (8 shops, Jan. 2012), plus a limited number of single location additions.

There are only three MSO's with even close to a national presence;

Boyd with 137 locations in 16 states, ABRA with 114 locations in 12 states and Sterling, with 62 locations in 16 states. Even these organizations, the #1, #2 and #4 MSO's respectively, do not really have a nationwide footprint. Sterling, with a presence in 16 states is the closest to a true nationwide footprint. Caliber, the #3 MSO, with 102 locations, is only in four states, TX, CA, NV and AZ, with 94 of their locations (92 percent) in just two states, Texas and California. This indicates just how wide open the competitive landscape really is today.

Looking at the top 100 Metropolitan Statistical Areas (MSA's) and linking that to the market presence of the top 25 Personal Lines Insurance carriers, it is clear, the opportunity for a truly national MSO is in the 350 - 400 location range. At a scale efficient gross revenue goal of \$3.0 million per location, the gross revenue opportunity is at least \$1.05 billion to \$1.2 billion per year for an MSO of this scale.

Macro Level Collision Industry Dynamics

Our work on this project has helped us put a spotlight on the three key constituent groups that drive collision repair shop outcomes - Consumers, Insurers & Suppliers. While it is not news that collision repair shops have three core "customer" groups, the still unmet challenge is effectively working within each distinct area, while using common strategies and success measures across each constituent area.

The collision repair business is complex, with many moving parts and dynamics, some controllable, some not. Most MSO's have effective strategies and operating tactics within each of these three customer verticals. The critical execution issue is the lack of a comprehensive strategy and effective execution across these verticals.

Let's briefly look at each of the three main MSO customer verticals:

1. Consumers. The consumer vertical has many faces. The consumer may be insured, may be uninsured or may be a corporate fleet owner. Regardless of consumer type, the desired outcome is the same, the owner wants their vehicle back as quickly as possible, with a quality repair and don't want to be involved in supplier and insurer issues.

For the consumer, speed wins. The expectation is that they will be kept informed and there be as little friction as possible. Additional consumer expectations include:

- A flexible, easy to understand process - obtaining the estimate, getting into a rental, status updates (via text messages, or Internet based tools like AutoWatch), insurer communication and claims payment.
- Guaranteed work product - consumers, for the most part, don't want to get involved in OEM vs. aftermarket tug of war, they want quality parts with good fit and finish. If the shop (and insurer) guarantees the work, the consumer is satisfied.
- Transparency in process and billing - the ability to stay informed throughout the process, with key status updates proactively pushed to the consumer by the shop and/or insurer. This is an area where shops, suppliers and insurers have a lot of opportunity to work together providing this information, via mobile applications.

The consumer has high expectations of technology today. With many consumer facing businesses, mobile tools are a given, not an exception. The collision repair industry is at best a fast follower in developing and delivering consumer facing tools, particularly mobile applications.

2. Insurers. The insurer (auto, commercial, self-insured fleet) is also a customer of the MSO. While consumers may be relatively easily segmented into a few groups, insurers defy easy segmentation. What we can say with certainty is that there are a lot of them and they drive the vast majority of shop revenues.

In 2010, there were 259 carriers writing about \$163 billion in auto premium. The top 25 carriers wrote about \$132 billion (83 percent) of the total premiums. Here too, multiple dynamics are in play, some of which the insurers have more control over than others, including:

- Accident frequency - it will continue the downward trend of the last few years, driven by safer vehicles (anti-skid, anti-roll & other technologies), graduated licensing, higher impaired driver awareness, etc.
- Severity - will continue to rise, driven by a multitude of factors outside insurer control
- Fewer staff appraisers - driven by the growth and sophistication of DRP programs
- Tighter integration of estimating systems and claim systems

- Improved cooperation between insurers and shops to deliver a more seamless consumer experience
- Increasing use of analytics, by insurers, shops and suppliers to understand and manage the end to end process, help drive process improvement and develop service level agreements (SLA's)
- Third party quality certification - leading consumer product and service organizations have, for years, used independent third party organizations to certify quality and regulatory compliance. We would not be surprised to see insurers leaning towards shop operators that have this kind of third party "certification".
- Increasing use and innovation around mobile platforms - used by consumers and estimating tool providers

Insurance pays the vast majority of the dollars spent on collision repair. While it is tough to get specific agreement on the data, it is generally agreed that about 85-87 percent of all autos have insurance⁵, putting the insurer paid portion of the \$41 billion market at almost \$35 billion.

The claims dynamics associated with collision repair can be very complex, with deductibles, liability assessment, betterment, depreciation, excluded equipment, rental limitations, etc. That is why having MSO leadership that is knowledgeable on these issues, understands the basic internal dynamics of insurers and claims approaches to collision repair, and views the insurer as a customer, will be a distinct competitive advantage.

3. Suppliers. The supplier is the foundation of making the collision repair process work. There are too many suppliers to count, but they represent OEM part suppliers, AM part suppliers, repair equipment suppliers, estimating tool suppliers, paint suppliers, glass suppliers, shop & yard management system providers and many others.

This too is a very competitive space, with almost all the interaction being between the shops and the suppliers. The only place where insurers routinely get involved in the supplier space is in glass, where most insurers negotiate directly with the glass providers for windshield repair and replacement for "glass only" claims.

From a collision repair shop supplier perspective the dynamics in play include:

- Increasing or maintaining their market share in a world of lower repair volume and a shrinking pool of collision repair shops
- Intense pricing and discount competition - from suppliers of all types
- Ever improving and changing technology, requiring estimating system providers to constantly improve and update their offerings
- The need to integrate more tightly with insurer systems
- The demand for more data by all users in the supply chain

The supplier space is probably the least understood and appreciated by the insurance vertical. The insurer is concerned about the quality of repair, the effectiveness of the shop operations and the resulting efficiency of the repair process and subsequent customer satisfaction. The insurer does not get involved in the shop/supplier dynamics, which they shouldn't, but they should work to assure understanding of the dynamics involved.

Managing a Multi-Shop Operation - Today and for Tomorrow

In addition to managing the separate, yet interrelated dynamics of these three main customer groups, the MSO's have to stay abreast on changes in the macro environment around them and be as proactive as possible in preparing for these coming changes in the landscape.

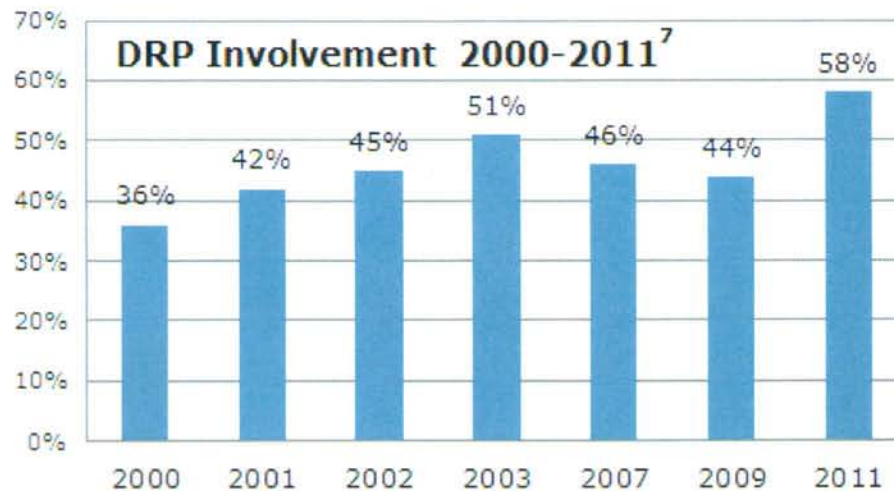
For example, not yet four full months into 2012 and both Infiniti and Chrysler have announced new "Certified Collision Repair Facility" Programs. The Infiniti program, which requires the shop to have an I-CAR Gold Class designation, will use DuPont Performance Coatings to assist in the implementation of the programs certification process.

The Chrysler program will use the certification services of the Assured Performance Network and will consist of more than 40 key business standards, including the I-CAR Gold Class designation, three dimensional structural straightening equipment and owning and utilizing squeeze type resistance spot welding equipment among others⁶. This trend will only grow and will be a factor (not the only one for sure) in the process insurers use to qualify shops and MSO's for inclusion in their direct repair programs.

While there are many opinions on the pros and cons of direct repair

programs, the clear trend among insurers is to increase their use as a tool in delivering a better overall consumer experience. The right shop partner is a DRP that helps provide a smoother process with overall reduced cycle time over the totality of the process.

Shops clearly recognize this, with almost 60 percent of shops being involved in a direct repair program in 2011.



The dynamics cited above, combined with the economic downturn that began in 2008 have accelerated this trend of DRP participation, with a 14 point increase in just the last two years⁷.

It is clear that tighter integration between insurer, shops and suppliers will be minimum requirements for an MSO to attract and retain insurance business. Estimating and parts suppliers will have to provide some of this platform. Shop management system suppliers will have to provide part of the solution. Insurance claim systems (both vendor supplied and internally developed) will have to provide part of the solution.

The core of the successful business model that will set the long term MSO winners apart from individual shops and other MSO's, is a triangulation of strategies for the three main customer groups in the insured collision event in a much more comprehensive way than any MSO does today. The successful MSO will overtly triangulate their strategy across all three areas by having a linked;

Consumer focused strategy and approach, and a
Insurer focused strategy and approach, and a
Supplier focused strategy and approach

All three of these groups are significant customers of the MSO. All three have unique issues and needs. All three depend on each

other, yet individual repair shops and MSO's generally view each customer group in a silo and to some extent play them off against each other.

The average MSO is in a tough spot, with their three customer groups also approaching this in a somewhat siloed manner. Insurers only focus on the consumer and shop verticals. Suppliers, generally only focus on the shop vertical, with some attention to insurers for limited products and in a few exceptions, like glass, looking directly at consumers, but with a focus on insured consumers for glass.

While this is unfortunate, the MSO has to focus on what they can control. MSO's deal with all three customer groups daily, but they generally tend to look at and approach them as verticals, with no overt horizontal or across strategy to weave all the threads together as tightly as possible with an overt goal of elimination of steps, touches, reduction of friction and end to end process efficiency.

The business model that does this, while at the same time leveraging people, capital & technology assets across all three constituent groups, will establish a significant competitive moat and be a successful survivor of the inevitable consolidation still to come.

Jim Porcari is a 30-year claims veteran of the Auto Insurance Industry. Jim is Principal of Insurance Resources International, LLC, a strategic advisor to insurers and companies in the insurance supply and support eco-system. Jim has more than 12 years of Chief Claims Officer experience, including more than seven years as President of Personal Lines Claims for a top 10 auto carrier. Jim has been a claims leader through five acquisitions and seven company integrations, as well as numerous due diligences, giving him unique insight into many alternative approaches to claims handling. You can e-mail Jim at Jim.Porcari@IRIpartners.com or visit www.IRIpartners.com.

¹ Source BB&T Capital Markets – *The Outlook for Multi-Shop Operators*, November 2011

² We obtained the industry, market and competitive position data used throughout this project from our own internal estimates and research, as well as from industry publications, studies and surveys conducted by third parties. While we believe our internal estimates and research are reliable, such estimates and research have not been verified by any independent source. Industry publications, studies and surveys generally state that they have been obtained from sources believed to be reliable, although they do not guarantee the accuracy or completeness of such information. While we believe that each of these publications, studies and surveys is reliable, we have not independently verified all of the industry, market and competitive position data from third-party sources.

³ IRI research, interviews & estimates

⁴ We do not include franchise operations such as CarStar, Macco & Fix Auto, due to the lack of direct control of day-to-day operations in the franchise locations and the resulting variability in process and tools that impact EBITDA and net results.

⁵ Insurance Research Council – *Recession Marked by Bump in Uninsured Motorists* – April 20, 2011