THE REAL RISK FOR PROPERTY AND CASUALTY INSURERS

IRRELEVANCE IN THE NEW DIGITAL WORLD

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Cyber risk, telematics, "digitalization," and related buzzwords dominate discussions about the future of property and casualty insurance. These are important topics, but they are only the visible manifestation of a deeper and more fundamental threat: namely, that in this new world, today's property and casualty insurers are becoming irrelevant to their customers.

This threat has been created by three profound changes in the insurance market.

THE TRIPLE THREAT

The first big change is around how *customers* behave – specifically, how they choose to interact with the people, objects, and companies in their lives. This is not merely a question of buying online. Increasingly, many of customers' most valued assets are virtual (their photos, their music); their business and social interactions are mediated digitally – and their physical possessions and surroundings are increasingly connected. This is a world where people's hopes, fears, and risks (and hence their insurance needs) are changing fundamentally.

The second transformational change concerns *information*. Vast floods of information about customers and their true behavior are becoming available. For example, a simple smartphone app can reveal more about how a customer really drives than any motor insurer has ever before known. It will be absolutely vital for insurers to work out how to gain access to these gushers of data, and how to convert them into insight.

The third change is in *competition*. Insurers are now coming face to face with new types of competitors with stronger brands, better customer relationships, more analytical firepower, and lower costs than the traditional insurer. These competitors are not only the well-known "big beasts" of the digital era, namely the likes of Google, Apple, and Facebook, but also retailers, utility providers, home servicers, and auto manufacturers. For example, the "my first Audi" concept in Germany bundles insurance into a single, low, monthly car rental cost.

DEVELOPING A COMPETITIVE ADVANTAGE

These developments mean that many of the competitive advantages that insurers have relied on in the past – brand, physical distribution networks, and scale – are losing their value. (See Exhibit 1.) At the same time, new business models are emerging that look very different from those followed by a traditional insurer.

There is, of course, no single recipe for success. But the winners to date seem to share a number of characteristics. They rely heavily on analytics and actively seek out new types of customer data and insight. They use this data to make decisions rapidly, and react quickly to changes in the competitive landscape – for example, updating prices to customers daily, rather than monthly, and updating underlying technical models monthly, not yearly.

They have an entrepreneurial or "trading" mentality, founded on a "test and learn" culture of finding out what works and what doesn't. This is true not only in setting prices and designing the digital customer journey, but also in areas such as lead generation, retention management, and outbound communications.

EXHIBIT 1: THE CHANGING SOURCES OF STRATEGIC CONTROL ADVANTAGE IN INSURANCE

WHAT DRIVES STRATEGIC CONTROL?		WHY DO INSURERS NO LONGER FIND IT EASY?	
OWNING A CRITICAL ASSET		Extensive branch and agent/broker networks...	...start looking like expensive liabilities if customers want to interact digitally.
A BETTER PRODUCT OR LOWER COST		Economies of scale from being the biggest insurer in the market...	...are undermined when new entrants have lower costs and better loss ratios.
BETTER ACCESS TO CUSTOMERS		Even the best-known insurance brands...	...turn out to be rather weak consumer brands.
BETTER KNOWLEDGE AND INSIGHT		Having the most policies in your portfolio...	...is no longer enough when new, far more insightful sources of data are available.
REACH AND NETWORK EFFECTS		Economies of scale and scope in operating claims networks...	...are undervalued by the end customer.

Source: Oliver Wyman analysis

They also have low operating costs, driven by a different approach to operations. They give primacy to digital interactions, customer self-service, automation, e-trading in underwriting (even in small commercial), and digital claims management.

The most successful new models have been built anew, rather than by cutting back an existing business. The best examples have achieved the operational holy grail of better customer outcomes, more satisfied staff, much lower operating costs, and better loss-ratio outcomes.

MAKING IT HAPPEN

These new types of business models are a long way away from where most insurers are today. Even if they accept the need for change, many large insurers will find it extraordinarily difficult to achieve it. They must struggle against legacy IT systems, resistance to change among staff, and skepticism created by the failure of previous cost-cutting initiatives.

The skills needed may require new talent, often from outside the insurance industry – which poses the challenge of how to attract and retain the type of commercially aware, entrepreneurial, digital-savvy employees who have not in the past seen insurance as their first choice.

Some large insurers have addressed this by taking a "skunk works" approach, piloting a new business model outside the constraints of the existing setup. This approach can pay dividends, not least by demonstrating what can be possible if today's constraints are relaxed. But it does not answer the question of how to transform the wider organization.

There is, of course, no easy answer to this question. Transforming large insurance firms will take tremendous effort from their management and leaders. Creating a sense of urgency and direction is the first step to motivating that effort. To do so, and to survive commercially while change is underway, we recommend the following six actions:

1. **Carry out an unsentimental analysis of the status quo.** Examine the drivers of change in the market and evaluate where your company will be allowed to make a profit five or 10 years from now.

2. **Think big when making strategic plans.** Staying competitive requires transforming a company's operations, culture, and talent model toward becoming genuinely agile, entrepreneurial, and low cost.

3. **Don't be paralyzed by the scale of change.** Avoid becoming distracted by the need to "run fast to stand still." Start with some small steps that deliver significant wins and demonstrate the art of the possible early on.

4. **Position yourself to capture value in a world with vastly more data**. Get to the forefront of analytical techniques and potential uses of new data by taking advantage of new approaches not just to analytics and IT infrastructure, but also by setting up the right organizational structures and hiring new and different talent. Avoid being out-innovated by startups or technology companies.

5. **Get fit for change to ease the transition.** Protect the back of book and actively look to take cost out. In our experience, cost reductions of 30 to 40 percent are achievable if the company takes a "blank page" view of what is now possible in a digital world.

6. **Make defensive plays to avoid being squeezed out by new competitors**. Find propositions that cannot easily be replicated by new entrants, such as bundling multiple products to offer unbeatable value. Insurers should also consider entering into strategic partnerships with potential competitors before the balance of power shifts too far.

CONCLUSION

Insurance markets are changing radically, and so are the sources of competitive advantage within it. Insurers need to think hard about the changes brought on by the digital revolution, or they risk becoming irrelevant to their customers.

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