OLIVER WYMAN

TEN IDEAS FROM OLIVER WYMAN

VOLUME 1

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TEN IDEAS
FROM OLIVER WYMAN

Oliver Wyman brings exceptional people together to create value by making lasting contributions to our clients, industries, and societies. We have a hunger for a deeper understanding of everything and love ideas.

In this collection of articles, we showcase 10 ideas from across our firm. Every idea contains concrete suggestions for how business leaders can improve and grow their businesses without taking on excessive risk.

We cover a wide range of issues – from the potential radical improvements in healthcare at lower costs to the increase in natural catastrophes to the threats and opportunities created by the vast amount of information available. Be it financial services, healthcare, consumer products, media, or in the auto industry, we provide ideas for companies to look beyond today's challenging environment and gain a long-term competitive advantage.

Scott McDonald

Scott McDonald
President, Oliver Wyman

1

WHEN RISKS COLLIDE

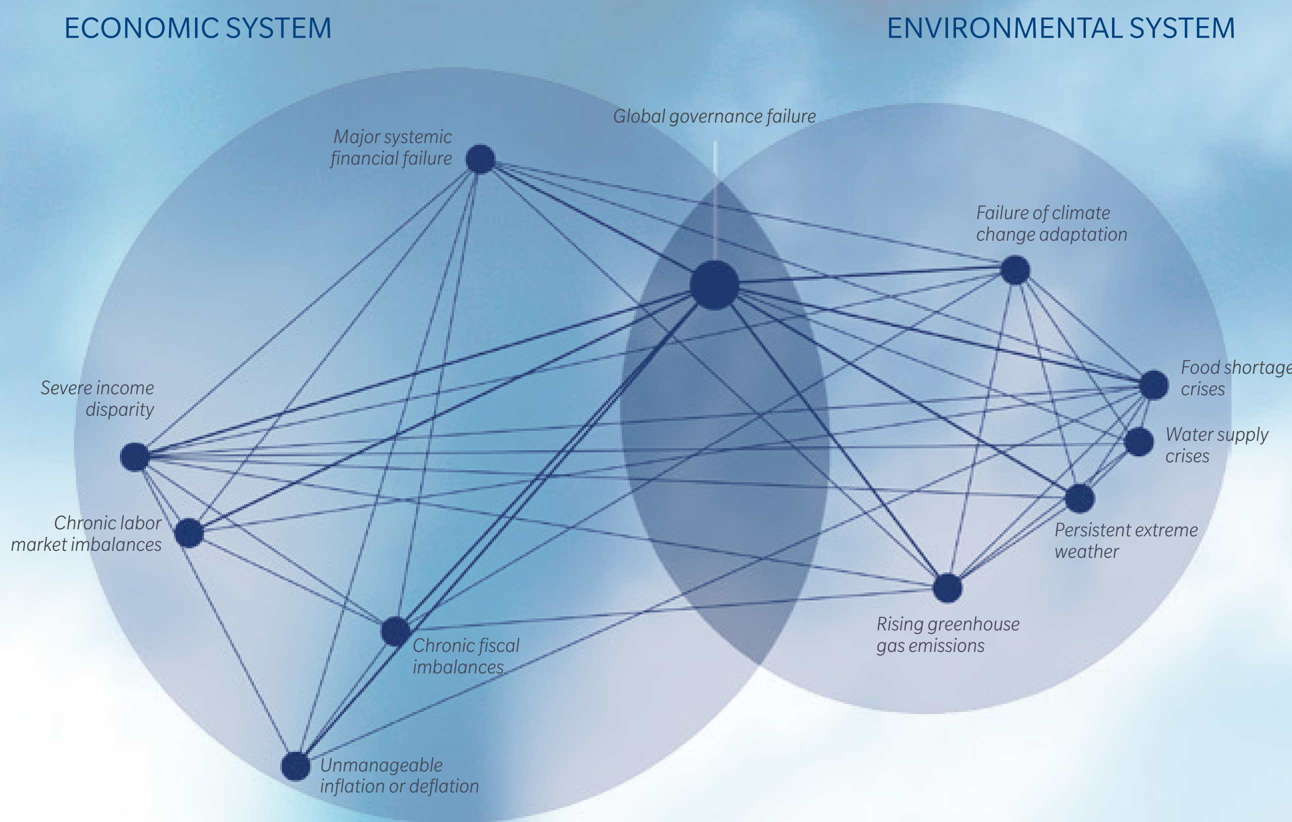
John Drzik

Two storms – environmental and economic – are on a collision course. The world's exposure to natural catastrophes is rising, but our ability to deal with these shocks is decreasing due to the weakened fiscal positions of many governments.

Economic losses from severe weather events worldwide have soared to $1.4 trillion in the last ten years, up from $387 billion in the 1980s, according to the World Economic Forum's *Global Risks 2013* report. More frequent " 100-year" storms due to climate change are one reason these costs are climbing. The migration of people to disaster-prone areas is compounding the problem. More than one billion people live in low-lying coastal areas, especially in Asia. In England, new construction in the Thames Gateway flood plain accounts for 11 percent of overall new build. In the United States, the population of hurricane-prone Florida has jumped six-fold in the last 60 years.

The portion of natural disaster relief costs shouldered by cash-strapped governments and international agencies has also been escalating. When Hurricane Diane struck New Jersey in 1955, government bore only six percent of the repair costs. By contrast, government picked up 69 percent of the aid required in 2008 when Hurricane Ike ripped through Louisiana to Florida, according to Wharton's Risk Management and Decision Processes Center. People increasingly expect governments to supply financial aid in an extreme weather event, creating a huge unfunded liability for society as more people migrate to disaster-prone areas.

Unfortunately, the weak fiscal position and significant debt burden of many countries means that they will be less and less able to respond to growing disaster relief costs, or to make the infrastructure investments needed to help mitigate environmental risks. There are many sources of pressure on government budgets. Each time our scarce financial resources are allocated to manage one set of pressures, our resilience for countering the next one is depleted – much like a weakened immune system. As a result, the fiscal weakness of the public sector is amplifying environmental risks as well as other vulnerabilities.



Source: *Global Risks 2013*, a report produced by the World Economic Forum, with support from Marsh & McLennan Companies, Oliver Wyman's parent company, and other partners

What can be done? Business leaders, together with political leaders and scientists, must make addressing climate change-related risks a priority. Here are three ideas for meeting the challenge:

1. *Create more sustainable public sector programs for disaster relief.* Governments underwrite the risk of natural catastrophes as much as insurance companies do. They should draw on the full set of tools available in the private sector to build a more disciplined approach to risk management and risk financing. Improved quantification of natural catastrophe risks would help governments to design targeted counter-incentives to discourage people from moving into disaster-prone areas and to determine whether they have allocated enough funds to match existing exposures.

   Disaster relief programs could become more sustainable by charging individuals accurate actuarial rates for government insurance or at least by making the budget implications of implicit disaster relief promises more transparent. The focus on long-term funding will also be likely to stimulate the creation of pooling mechanisms that better balance natural catastrophe risks between the government and the private insurance markets.

2. *Design public/private solutions for strategic infrastructure investment.* A lot of private sector money is sitting on the sidelines. For example, less than one percent of pension funds' $71 trillion in assets globally are allocated directly to infrastructure investments. Public and private stakeholders must collaborate on solutions that enable countries to marshal resources to build critical infrastructure to respond to disasters before they strike, and to mobilize coordinated assistance quickly to the point of shock by better sharing the risks involved. A recent Marsh & McLennan Companies survey of senior infrastructure industry leaders showed that 60 percent believe there is sufficient cash available to invest in environmentally-sound infrastructure. The trouble: There is a lack of transparent models to guide sustainable infrastructure financing and development.
3. *Sharpen private sector focus on the broader risks of extreme weather events.* Most companies use insurance to dampen the cost of property damage caused by natural catastrophes. They should also consider the wider strategic and operational implications of more frequent natural catastrophes – for example, the benefits from supply chain diversification. Many players in the global technology industry are still reeling from the massive cutbacks in semiconductor production after the hurricane and earthquakes in Japan and Thailand. Locations for major operational centers should be carefully considered to balance the cost savings from concentrating operations with the benefits from limiting the risk of business interuption by spreading operations across geographic regions.

As with any health issue, the sooner colliding risks are addressed, the easier and less expensive it is to prevent their dangerous repercussions. We should get started now.

John Drzik is CEO of the Oliver Wyman Group, a subsidiary of Marsh and McLennan Companies, which contributed to the writing of the World Economic Forum's *Global Risks 2013* report.

2

GIVE BILLIONS OF PEOPLE BETTER MEDICAL CARE

TERRY STONE

Remember when computers were huge – when they occupied whole buildings and cost tens of millions of dollars and required constant attendance by highly trained specialists – and when, really, they didn't do all that much or do it all that well?

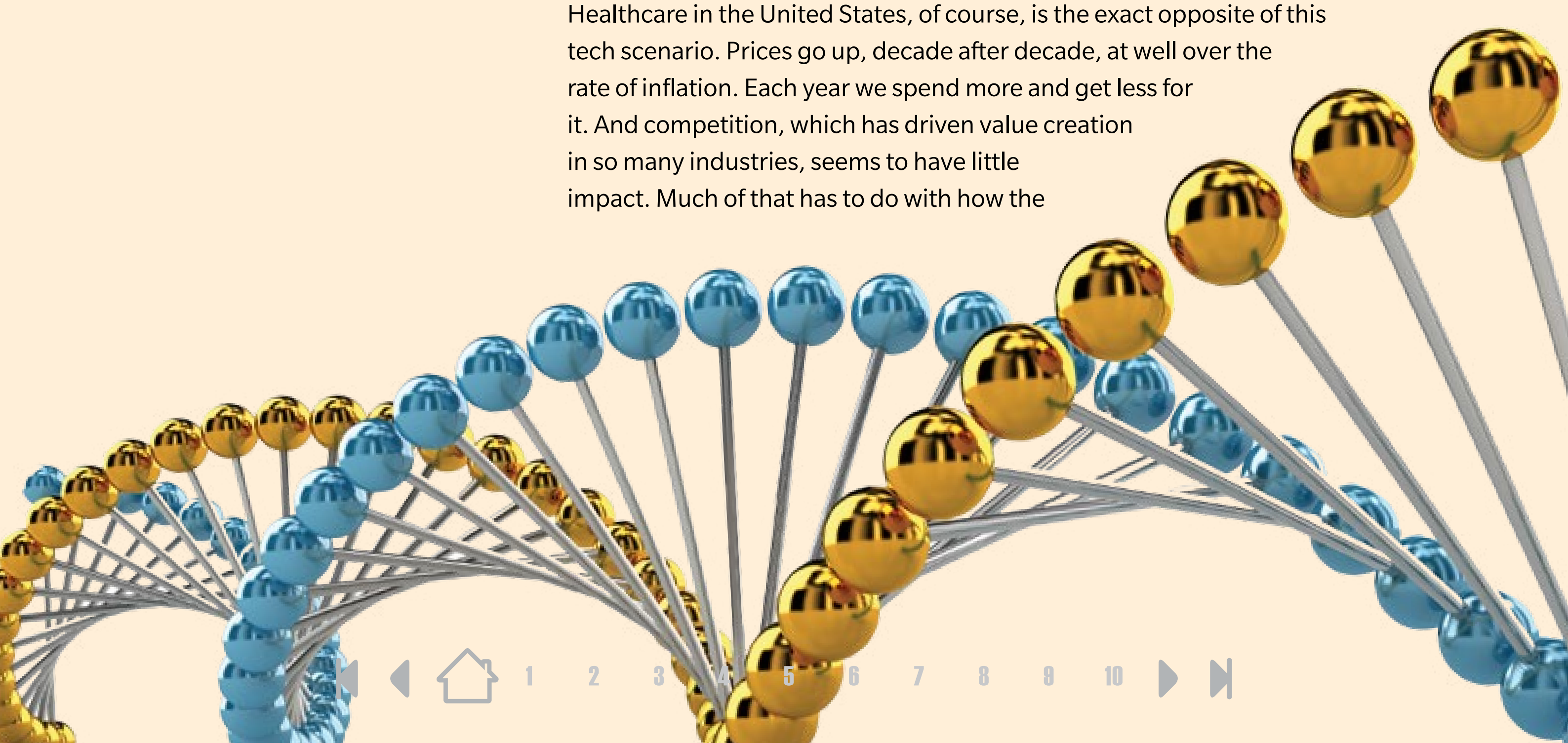
But computers evolved: They got smaller and faster and cheaper and better, until there was one on every desktop – then in every college kid's backpack. Instead of tens of millions, they cost a few hundred bucks and, especially once we connected them all to the Internet, they did everything – played us music and movies, sent our messages, kept our records, served as typewriter and filing cabinet, post office and toy.

And then, as companies like Apple and Google stepped in, blurring the lines between media companies, telecom providers, and consumer electronics manufacturers, there was a jolt of new value. It was hard to tell exactly what an iPhone was – part communications device, part media player, part Internet, part store – but the experience was compelling and the perceived value off the charts.

Falling prices. Rising value. Products and services that are more and do more: That's what innovative industries are supposed to provide.

So what's wrong with healthcare, and how do we fix it?

Healthcare in the United States, of course, is the exact opposite of this tech scenario. Prices go up, decade after decade, at well over the rate of inflation. Each year we spend more and get less for it. And competition, which has driven value creation in so many industries, seems to have little impact. Much of that has to do with how the



industry is structured. Patients with health insurance don't care about costs – and mostly don't even know what they are. The doctors and hospitals that make the decisions about what care patients receive are paid on a per-service basis. It's a blueprint for runaway costs.

What if healthcare companies were rewarded for achieving great results for the lowest possible costs? It turns out that with better economic incentives, creative companies can come up with ingenious ways of keeping patients well – some of which truly expand the definition of healthcare.

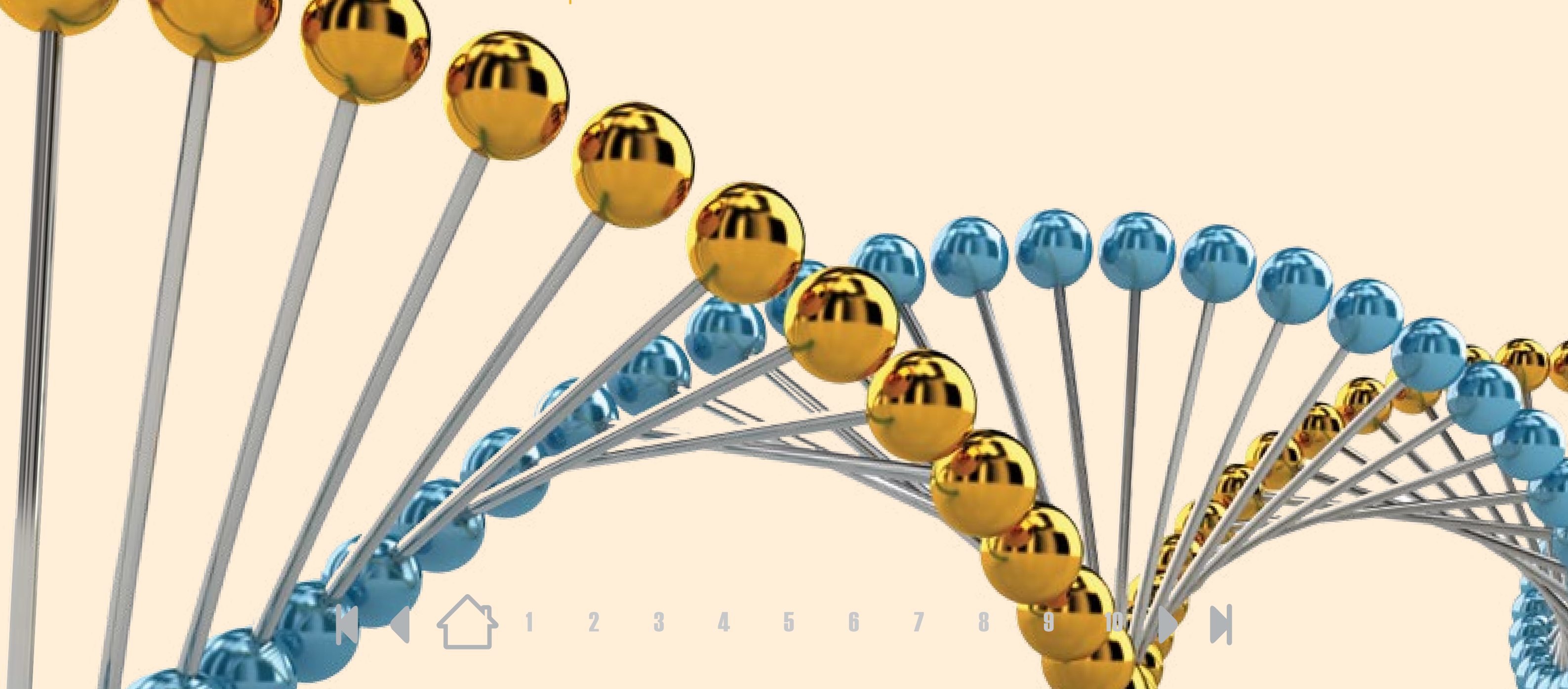
For example, elder-care specialist CareMore has discovered that you can break the back of medical inflation by keeping your highest-risk patients well and out of the hospital. Hip surgery is a big driver of costs among the elderly; CareMore keeps them on their feet by fall-proofing homes and clipping their toenails. Congestive heart failure sends large numbers of the elderly to the hospital; CareMore detects it early, when it can be treated on an outpatient basis, by giving patients wireless bathroom scales that report unexpected weight changes to doctors.

CareMore's patients are frail and old, but the targeted approach works just as well with more mainstream populations. At Boeing, for instance, a pilot program with targeted care for the at-risk reduced healthcare costs by 20 percent – and sent absenteeism plunging by more than half.

Other employers need to follow Boeing's lead, and soon. For them, the rewards will be lower costs and healthier employees. For the rest of us, the payoff will be a vibrant healthcare marketplace, where traditional providers and new entrants from retail, tech, and other fields compete to provide more value year after year.

Or to put it another way, remember what happened to tech. Now imagine it happening in healthcare. It's a truly great idea.

Terry Stone is the managing partner of Oliver Wyman's Health & Life Sciences practice. She is based in Dallas.



3

LAUNCH A NEW FINANCIAL INFORMATION INDUSTRY

AARON FINE

In 1984, then-CEO of Citibank, Walter Wriston, said that "information about money has become almost as important as money itself."

Citibank's early forays into the business of information failed. Nevertheless, Wriston was right. Information businesses within financial services will soon be worth more than the rest of the industry. At current growth rates, independent payment networks, credit bureaus, rating agencies, exchanges, data providers, and other information companies linked to American banking will have a higher market value than American banks by 2020.

This need not be a cause for despair at traditional banks and insurers. Despite their sluggish response to the "information revolution," they remain producers of some of the most valuable information in the global economy. And, because they are risk-based businesses, where good decision making drives returns, they can readily convert information into profit.

CONSUMER PAYMENTS AND DEPOSITS DATA

CONSUMER BANKING

Offers (where they shop, what they need)
Pricing (elasticity, drivers of flow)
Cross-sell (other financial services providers, size of wallet)
Underwriting/risk management (financial health, cash flow)

COMMERCIAL BANKING

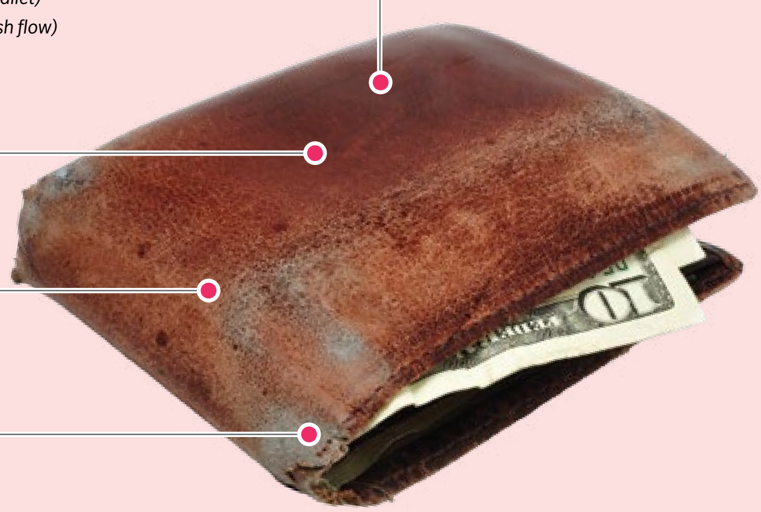
Loan targeting, underwriting, monitoring (change in market share, financial health of customers)

INSURANCE

Targeting and underwriting (indicators of riskiness, changes in coverage needs)

OPERATIONS

Branch value (travel patterns, usage)



Source: Oliver Wyman analysis

Financial firms have been slow to embrace information because the rewards for making better use of it have traditionally been modest. When the information revolution took off in the late 90s, leverage was high, interest rates delivered strong deposit and treasury profits, and lending was growing rapidly. Reliance on cash, checks, and paper forms made branches important to customers. Poor access to financial information also made them dependent on advisors. They paid for both through higher interest rates, higher premiums, and lower yields.

Fast forward to today, and the situation is reversed. Economic uncertainty and stagnant collateral values have increased risk and, therefore, the cost of inaccurate decision making. Ultra-low interest rates have destroyed deposit margins. At the same time, increased access to information is giving customers new preferences, favoring price, speed, and digital access over easy access to branches. Wriston's "money business" is in trouble. Financial firms need an information strategy.

Financial firms' myriad transactions with households and businesses provide not merely revenue but information. An electronic transfer between a client and another financial institution indicates who the client's other providers are. Wires can reveal a business client's suppliers, customers, needs, and exposures. Transactions on a current account are windows into a client's spending habits and financial health.

The competitive edge financial firms can derive from such information is limited mostly by their imaginations. Consider just one source of data, the transactions and balances on consumers' current accounts. As the exhibit shows, this can be used to improve returns well beyond consumer banking in large part because the data can be used to improve decision making.

By the same token, misuse of information can destroy banks' business models. Consider equity research. Historically, trading desks charged clients a fee for trades that covered not only the cost of execution but also other "value-added" services, including research by the banks' analysts. Without credible equity analysts outside of banks or readily available "execution only" services, customers had little alternative to paying for the bundled proposition.

In recent years, however, the digitalization of trading has created desks that sell trade execution without the extra cost of research. And many analysts have left sell-side firms to become independents, creating real competition in research. In short, the information revolution has destroyed banks' advantages in selling equity research.

These are but two examples, but the message has broad applications. Financial firms will succeed only where they enjoy a sustainable informational lead, and only provided they develop the ability to exploit that advantage. Identifying these areas and diverting resources to them should be a strategic priority.

Aaron Fine is a New York-based partner in Oliver Wyman's Financial Services practice. This article is adapted from the 16th edition of *The State of the Financial Services Industry* report.

TURN VOLATILE COMMODITY PRICES TO YOUR ADVANTAGE

Roland Rechtsteiner • Ernst Frankl

Ready or not, industries are being reshaped by volatile commodity prices. In response, developing a deep understanding of a company's exposure to unpredictable raw material prices and revamping procurement processes to mitigate their potential impact is not just a good idea. It's now a must.

Commodity price swings are the second-largest driver of earnings uncertainty at publicly-traded companies, following macroeconomic factors. Nearly one quarter (23 percent) of senior financial professionals consider commodities to be the primary driver of their earnings variability, according to a survey conducted by the Association for Financial Professionals (AFP) with Oliver Wyman's Global Risk Center. Take consumer product companies. Their margins are squeezed as the prices of commodities ranging from aluminum to milk rise faster than their revenues. Raw materials are their biggest expense, accounting for about half of their costs. Yet most consumer product players try to stabilize their profits – unsuccessfully – by cutting production costs, reformulating products, and investing in their brand.

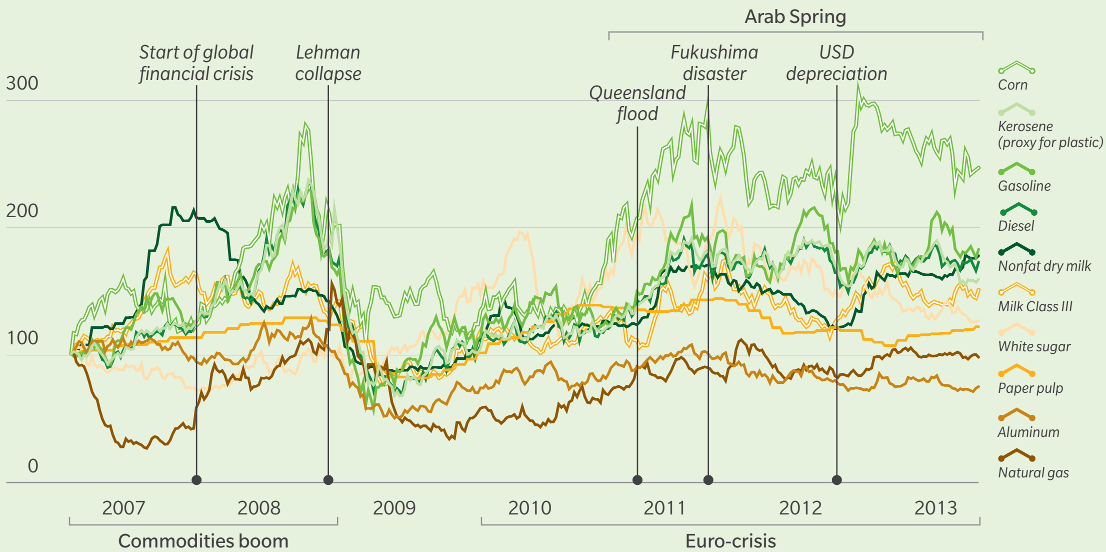
There is a better approach. Savvy managers are reducing their earnings' volatility caused by commodities by about 10 percent by shifting their procurement mind-set from securing supplies toward price risk management. They are developing a significant advantage over their competitors by taking three steps:

STEP 1: *Create transparency.* Consumer product companies have recently experienced some rude surprises – announcing quarterly losses due to price spikes in the raw materials used in their products. Procurement teams need to develop a comprehensive understanding for the underlying cost and price drivers of the full breadth of commodities sourced globally. This includes their indirect exposure to commodities such as the grain eaten by the chickens that provide the eggs for their goods. Procurement teams should also look at historical volatilities in combination with a forward-looking risk exposure model.

STEP 2: *Optimize risk-return.* Procurement teams need to think more like traders. By this, we mean they should consider trade-offs involved in buying decisions and evaluate if risks tied to more uncertain commodity prices are worth the received discount. In increasingly volatile markets, it might make sense for a company to pay more for a commodity if there is price certainty. It's also important for companies to be able to pounce when commodity prices suddenly surge or plunge not just in one business – but across an entire business portfolio.

COMMODITY PRICES†

RELATIVE CHANGE (2006 = 100%), 2006-2013 YTD



Source: Datastream, Oliver Wyman analysis

† Commodity classes grouped and proxied by single prices: Kerosene (plastics, flexibles), Natural gas (Energy), Nonfat dry milk (Milk ingredients), Corn (protein), Paper pulp (cardboard), Sugar (sweetener, health ingredients and fruit preparation), Aluminium (other packaging material) and Diesel, Gasoline (Transportation)

STEP 3: *Share risk.* Companies can improve their capability to share the rising risks they face from unpredictable commodity prices by developing contracts that assign these risks more equitably between buyer and supplier. One way to encourage this is to follow the example of New Zealand-based food service company Fonterra: It has started to auction a significant portion of its dairy production for future delivery. The price transparency resulting from these auctions has created more price certainty not only for Fonterra's contracts, but also for the dairy industry as a whole.

It's tempting to think volatile commodity prices are temporary. They're not. They are the new normal. Procurement managers must clear their heads and adapt to this new environment. They must become expert commodity price risk managers.

Roland Rechtsteiner is a Zurich-based partner at Oliver Wyman and head of the Global Risk & Trading practice. **Ernst Frankl** is a Frankfurt-based associate partner in Oliver Wyman's Global Risk & Trading practice.

5

TREAT DATA AS A COMPETITIVE WEAPON

PAUL BESWICK

Information technology systems are the beating heart of any enterprise, and the key to ensuring business runs smoothly from one day to the next. They can also confer a real competitive advantage. Businesses like Amazon built their success on superior systems and use of information. What's perhaps less obvious is the fact that any enterprise that gets the right data into the hands of decision makers can make thousands of daily decisions just a little bit better. This can add up to a huge gain in profitability and rapidly transform overall performance.

There's been plenty of hype about "big data." But what we have in mind is subtly different: finding ways of helping decision makers cut through complexity, making their lives easier. Rather than "making use of that mountain of data on your server," it's about enabling what one of our clients once called "business – fast and simple." The key to pulling this off is to develop an explicit, differentiated strategy for IT investment across your business, focusing on those areas where agile systems can deliver an edge.

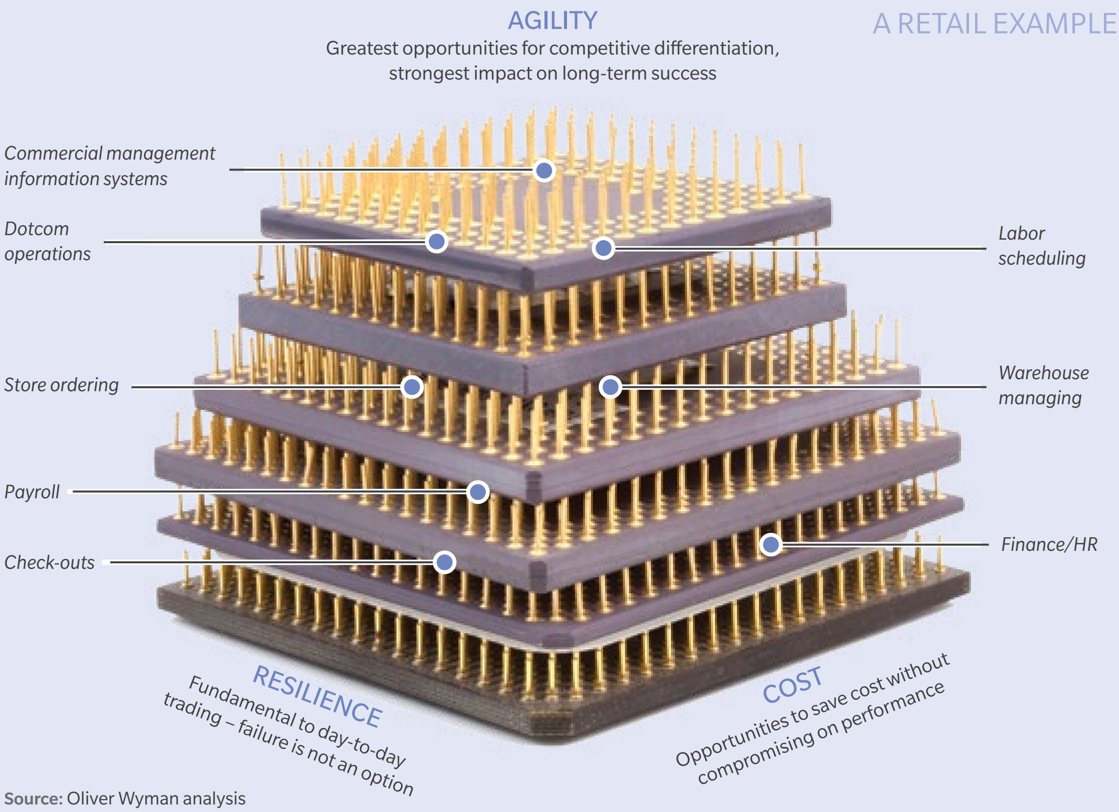
It's nice to have the latest system, but it's also expensive. As with any other investment, spending on information technology needs to be targeted where it delivers the greatest returns. This tends to be in areas in which better management of information means better (and faster) decisions about things that really matter.

Where these opportunities lie is rarely obvious from the outset. But it's something senior executives are well-placed to figure out. To identify the areas with greatest potential, ask the following:

- For each of the key levers in my business, how good are my decision-making capabilities? And how far, and in what ways, do they rely on high-quality management of information?
- Do I know how my capabilities and my rate of innovation compare to my competitors? Do I believe I'm driving more value from my IT projects annually than they are?

Answering these questions allows you to build a development plan that can deliver real value to the business – a nuanced investment strategy in which you deliberately choose to lag your competitors in some areas, and forge ahead only where it's worthwhile. This is in stark contrast to many IT procurement strategies, which can often be caricatured as being either "it's vital that we stay on the leading edge" or "if it ain't broke…" – usually with little assessment of how much value is at stake either way.

DIFFERENT IT SYSTEMS HAVE DIFFERENT PRIORITIES



Source: Oliver Wyman analysis

In our experience, there are three competing needs when setting IT development strategy: resilience, agility, and cost. For many systems, robustness and reliability are everything; the business risk is just too high otherwise. But this isn't always the case, and often the areas where resilience matters most have limited scope for innovation, while the areas where improving capabilities can drive real financial returns often have lower reliability needs.

This allows a more flexible approach to IT development, and gives room to tailor the strategy to meet different priorities. The exhibit gives a schematic picture of how they tend to vary across different areas of IT – in this case focusing on retail.

Most businesses have opportunities to reallocate their IT resources toward a much more agile, value-focused agenda that can improve their overall commercial success. The right approach can accelerate the pace of innovation, shorten time-to-value, and greatly improve the productivity of IT investments. In any data-rich, slim margin industry, *"business – fast and simple"* is critical.

Paul Beswick is a Boston-based partner at Oliver Wyman and leader of the North American Retail practice.

6 GO GREEN, BOOST PROFITS

Michael Lierow

Developing a sustainable business is not just good for the planet. It's also good for business. Done right, a company can gain a significant and lasting competitive advantage by developing a more environmentally-sensitive business model. That's because it will enable a company to pursue new avenues of growth and avoid soaring resource costs, consumer desertion, and unending regulatory pressure.

Our research shows that companies in countries that are members of the Organisation of Economic Co-operation and Development can boost their annual profits by at least $765 billion and reduce their carbon emissions by 2.5 billion tons if they implement selective measures such as reducing material input and waste or improving their supply chain operations. The time to take these actions is now.

Michael Lierow is a Munich-based partner at Oliver Wyman and head of the firm's Sustainability Center.

TRANSPORTATION & LOGISTICS
$314 BILLION in cost savings
1.3 BILLION tons of CO_2 saved

ENERGY
$294 BILLION in cost savings
872 MILLION tons of CO_2 saved

Source: US Census, EIA study on the rail sector, US Department of Transportation annual report, 7th framework program for research and development (Eureapa), Oliver Wyman analysis

Note: OECD countries only, potential impacts of selected sustainability levers. Tons are metric tons. Profit and cost-saving calculations do not reflect necessary additional investments

RETAIL

$92 BILLION additional profit

62 MILLION tons of CO_2 saved

WASTE MANAGEMENT

$8 BILLION in cost savings

26 BILLION tons of CO_2 saved

INTEGRATED MANUFACTURING

$57 BILLION in cost savings

257 BILLION tons of CO_2 saved

FINANCIAL SERVICES

$924 BILLION investment opportunity

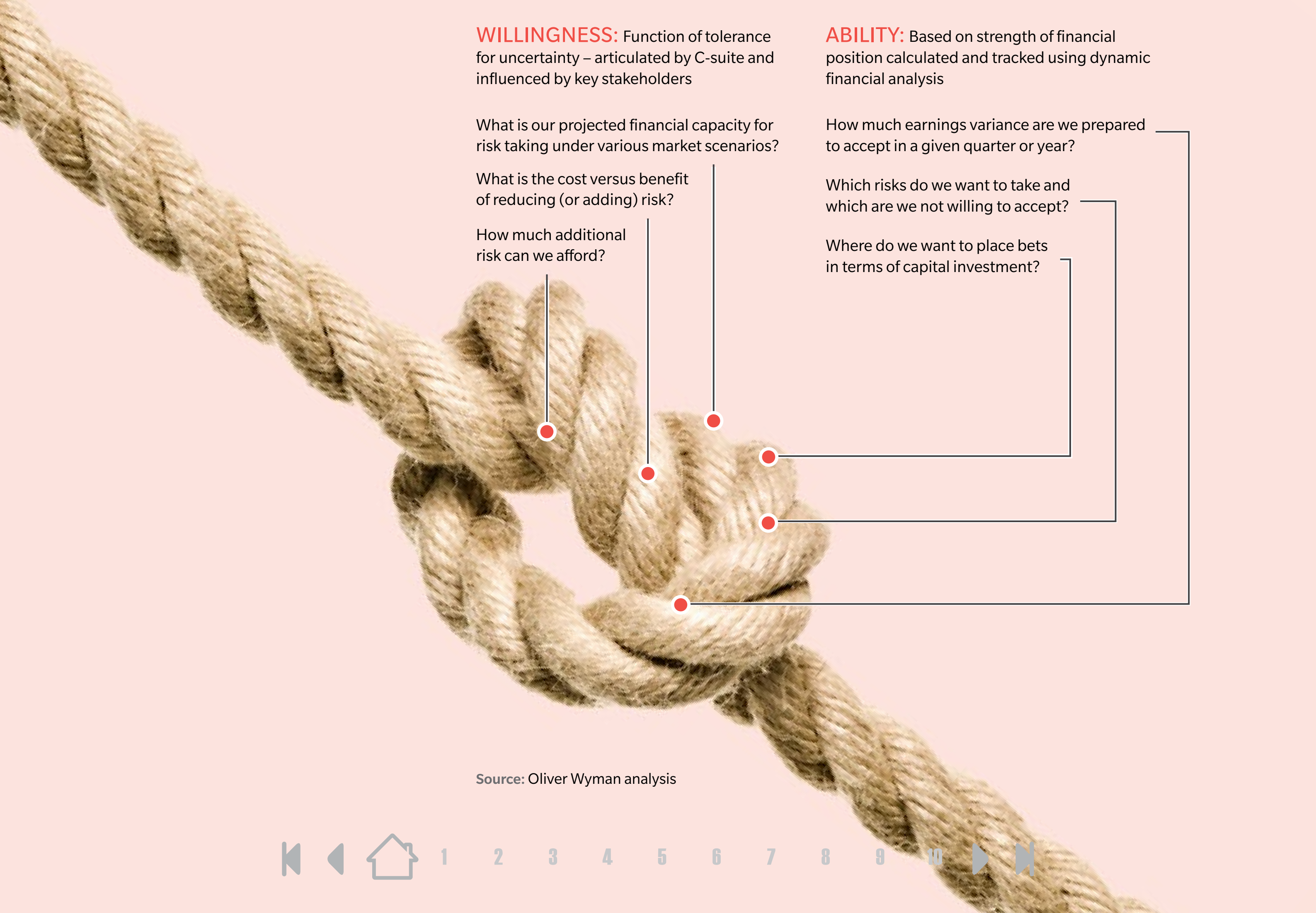
INCREASE THE RETURNS ON THE RISKS YOU TAKE

ALEX WITTENBERG • MARK PELLERIN

Most boards of directors recognize that a well-defined risk appetite is crucial to withstanding shocks and creating sustainable value. But nearly 70 percent of board members think that their companies have room for improvement in this area, according to a recent survey by the National Association of Corporate Directors.

Boards and senior management teams must develop risk appetite frameworks that can support risk governance, performance management, and major decisions on an ongoing basis. A clear risk appetite framework

DEVELOPING A HOLISTIC VIEW OF COMPANY TOLERANCES



Source: Oliver Wyman analysis

encourages companies to be more resilient and to invest wisely, balancing potential returns with associated risks. It is essential for firms considering an ambitious growth strategy or undergoing significant organizational change. The framework is also critical for firms that are facing market or operational vulnerabilities or that are under pressure to turn around financial performance.

In our experience, a risk appetite framework should possess three characteristics to be effective:

- A quantitative and qualitative foundation based on a comprehensive, strategic view of the key drivers of value creation and value destruction in the firm. This includes issues as diverse as the company's geographic footprint, customer relationships, operational capabilities, capital structure, liquidity, and human capital.
- Relevance to a broad swath of stakeholders at different levels in the organization. The board will use the core provisions of the statement as a governance tool to ensure its risk priorities are adequately monitored and that strategic ambitions are aligned with shareholder interests. Senior management will use it as a lens for considering major strategic decisions and ongoing performance management. Financial Planning & Analysis and Treasury teams will look at the underlying metrics to obtain a more detailed perspective on earnings volatility and rating-dependent metrics.
- A connection to key decision making processes across the firm. The framework needs to increase the value derived from enterprise risk management by applying greater rigor and accuracy to forecasts and strategies. Thus, the risk function is able to act as a true partner of the commercial and finance teams in risk-return management.

Fundamentally, a risk appetite framework helps senior management to align a company's willingness to take risks with its ability to do so, exposing and resolving any tensions between the two. It consists of two parts: a crisp statement with clear tolerance thresholds and a financial model that supports the analysis of risk-bearing capacity.

By bringing together the performance of the corporation and its commercial operations in a single framework, a risk appetite statement triggers discussion about key financial drivers and associated risks. Consisting of only a few pages, the statement guides senior management teams toward a consensus with respect to their tolerance for variance and acceptable levels of risk taking. Equally important, it helps management and the board focus on high-level, meaningful targets at the intersection of risk, strategy, and performance.

The statement informs, and is underpinned by, an analytical tool. This is the framework's engine. It supports reports on critical metrics and models particular scenarios as well as stresses – such as a downturn in revenues, a change in capital structure, or the impact of an acquisition.

For many companies without risk appetite frameworks, taking risks will remain an uncoordinated, sprawling collection of activities. For these boards of directors and management teams, making critical, strategic decisions will continue to be a source of frustration.

For business leaders, however, developing a firm sense of their company's appetite for risk can represent a critical driver of growth. By quickly assessing if potential opportunities, adverse events, or a combination of both, are in line with a company's appetite for risk, these senior management teams will outmaneuver competitors in rapidly shifting competitive landscapes and optimize their companies' returns.

Alex Wittenberg is a New York-based partner in Oliver Wyman's Global Risk & Trading practice and head of the firm's Global Risk Center. **Mark Pellerin** is a New York-based associate partner in Oliver Wyman's Global Risk & Trading practice.

8

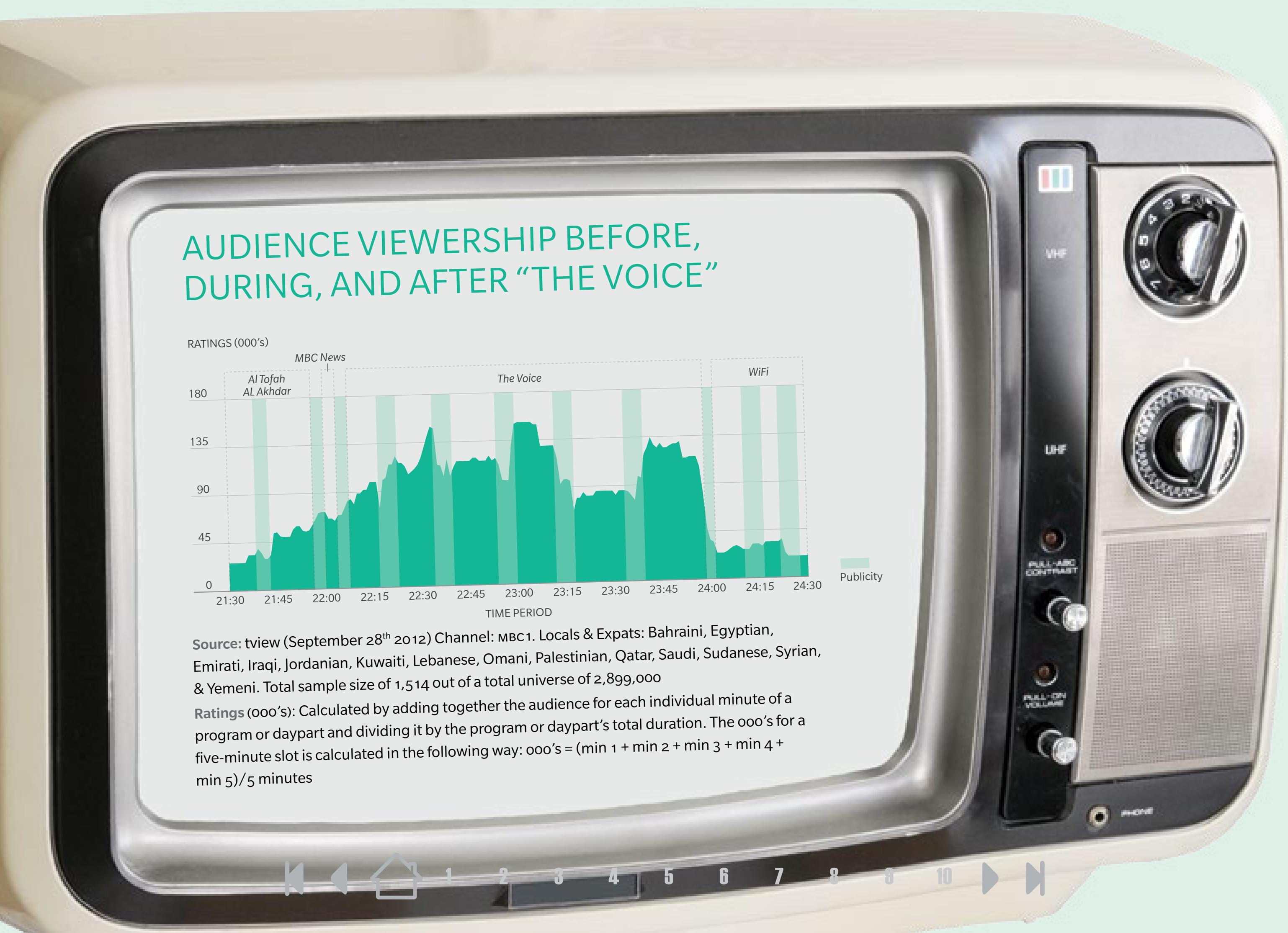
REMAKE MEDIA METRICS IN THE MIDDLE EAST

JEFF YOUSSEF

If Oliver Wyman were a TV station, by the time you finished reading this sentence, we would know what you thought about us.

In mature advertising markets, reliable, granular, and almost real-time one-minute ratings captured through automatic TV Audience Measurement (TAM) systems with "People-meters" allow broadcasters and other content owners to measure the success of their content production and packaging. They indicate which content is well-monetized to media business units, ad representatives, and advertisers.

By improving the knowledge of their customers and providing metrics with systems like People-meters, TV broadcasters and other content owners have



sparked a flourishing business in advanced TV markets. With reliable audience measurement systems that track and report viewership on each registered channel on a minute-by-minute basis, market players can identify and reward the quality and creativity of content production and realize the economic opportunities offered by network advertising. That's because getting the right data about TV viewers' choices, and understanding the data to make better decisions, results in more efficient and effective programming and advertising spend determinations.

Developing this capability can dramatically expand the size of TV industries and other businesses, especially in less developed markets. Our analysis suggests that the less than $2 billion TV ad market in Middle East and North African countries (MENA) could nearly double in size if networks adopted reliable audience measurement systems, for example. At present, we estimate that the MENA TV ad market is at about 30 percent of "fair" estimates, considering its regional gross domestic product.

But Oliver Wyman analysis of data drawn from the People-meter systems recently introduced in the United Arab Emirates (tview) indicates that ad spend allocation, program selection, and content creation decisions driven by real metrics could usher in a paradigm shift in the TV industry by renewing the interest of international investors and increasing advertisers' budget allocations to other ad channels, such as print.

A critical mass of market players will need to recognize the benefits of People-meters before the industry can be reshaped. Coordinated endorsement from the MENA governments, especially in the Gulf Cooperation Council, is important. It is also crucial that advertisers, media agencies, and broadcasters embrace such a paradigm shift in the media business and invest in capabilities to use the data.

This capability will provide never-before-seen insights into the value of individual programs. Because advertisers will be able to drill deeper than the average viewership of channels, they'll adopt a new mind-set, and be forced to develop a new skill set for commercial operations.

Data, currently relegated to a marginal role, will become the most important element for successful negotiations and transactions of media content, converting commercial decisions from art into science.

This shift will impact the media sales force, too, which will need to professionalize, much as the MENA pharmaceutical business has done. Training on how to request, interpret, and present People-meter data for commercial purposes will be crucial for media salespeople to maximize revenue potential, especially for "long-tail" programs.

In our experience, the companies that can address both strategy and people issues will be best positioned to seize a wide range of new opportunities.

Jeff Youssef is a Dubai-based associate partner at Oliver Wyman. He leads the firm's Media practice in the Middle East and North Africa.

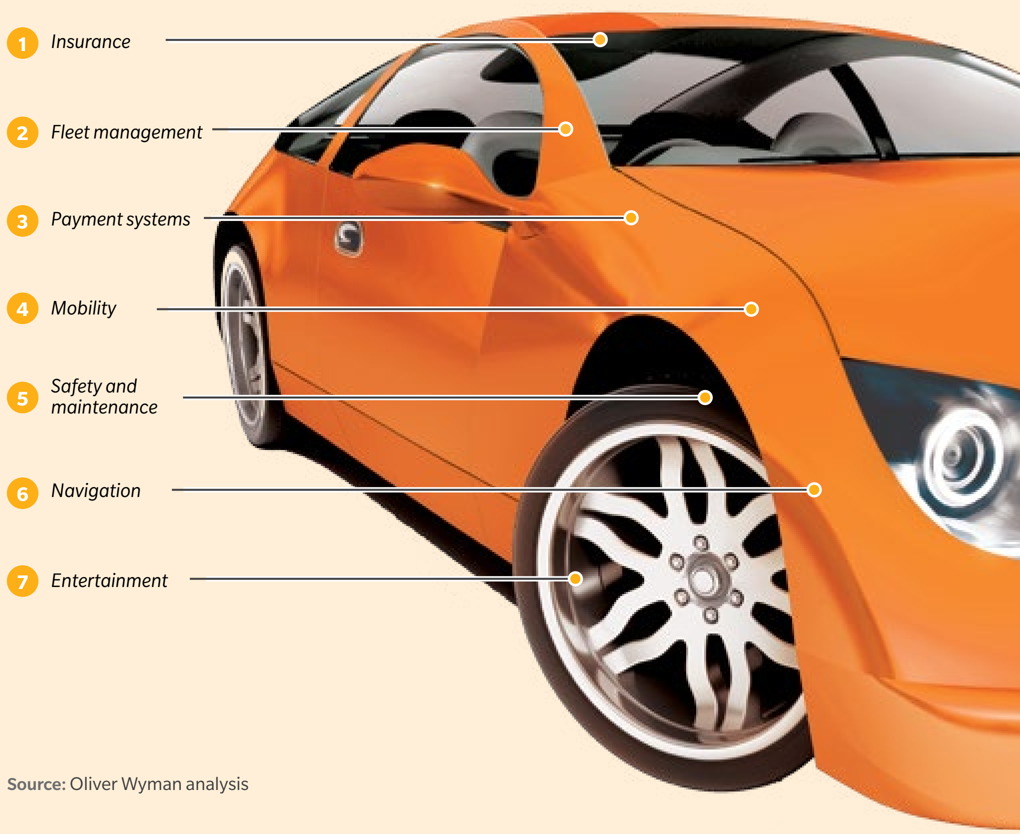
9 DRIVE NEW BUSINESS MODELS

Matthias Bentenrieder • Juergen Reiner

By 2016, half of the world's vehicles will be able to navigate roads, provide automatic maintenance reminders, and download popular movies and songs from the Internet. By 2033, all of the vehicles in Japan, North America, and Western Europe will have these capabilities – and more.

The global economy is stalling. But a transformation under way in the auto industry to "connected cars" is creating a golden opportunity for auto makers – and many other service providers – to boost their earnings by billions of dollars. Already, millions of European customers are willing to pay about $130 per year for Internet music streaming. We estimate that Internet-savvy premium car drivers may soon spend five times this amount once subscription business models are introduced that offer bundles of connected services in seven areas.

CONNECT CARS TO SERVICES



Source: Oliver Wyman analysis

Driven largely by the mandatory installation of the eCall system in all new vehicles sold in the European Union from 2015, demand for emergency and security services will boom. Remote diagnosis and aftersales services such as maintenance reminders or automatic notification to a repair shop if key parts start to wear down will also become increasingly popular.

Fleet management systems, already in use, will penetrate the mass market and standard platforms. They will become the norm in smaller fleets. The volume of these systems is projected to grow at 20 percent per year to reach 5.7 million units by 2016.

Mobile payment systems are still at a nascent stage but are gaining momentum. In the insurance industry, for example, new region-specific possibilities for product development are taking shape, as well as for customer and accident management.

Operating connected car services will also give rise to new payment models. Today, many services are offered to end-users free of charge in an attempt to gain valuable user data. For example, WAZE, a provider of free social global positioning system and navigation services, has launched advertising platforms and promotes B2B activities. Google and eBay also are combining free location-based search services with advertising, shopping, and commerce services.

In the years to come, premium auto makers' primary goal should be to transition from systems integrators to service integrators. Audi, BMW, Mercedes, and Volkswagen need to concentrate on their own strengths in the service segment, by focusing on vehicle-related services such as safety and aftersales services.

It makes little sense, however, for premium auto makers themselves to provide weather and navigation data or music streaming. To offer these services, they must find new partners, or expand existing alliances. For this reason, Daimler and Deutsche Telekom recently announced their future collaboration in online services and web applications. Their joint offering includes real-time traffic information, mobility services, personal radio, and access to social networks. Mass auto manufacturers will need to partner with systems integrators to create comprehensive service bundles. For example, Renault and Atos, the French information technology service provider, have entered into a strategic partnership to sell connected car services. In this venture, Renault uses Atos's IT infrastructure, which integrates a large variety of content providers and also offers an app store and a payment function. The deal allows Renault to pay Atos on a transaction basis.

Add it all up, and it's clear the auto industry has entered a period of historic flux — and opportunity. Watch for the auto makers that concentrate on their core competencies, target a specific position with the right services, and thus, offer an attractive and comprehensive bundle of services, to emerge as the industry's next generation of leaders.

Matthias Bentenrieder and **Juergen Reiner** are
Munich-based partners in Oliver Wyman's Automotive practice.

10

SELL INSURANCE ON DEMAND

BERNHARD KOTANKO

Life is complex, and so are the risks we all face. But buying insurance needn't be.

Every individual, household, or business faces a great variety of risks. Insurers have typically responded to this fact by offering comprehensive coverage. This makes insurance policies complex, with many inclusions and exclusions. It makes them expensive to sell, because a specialized advisor must walk the client through all the permutations. And it makes them difficult to sell, because consumers tend to become aware of particular risks at particular times – such as the risk of injury when they buy a motorbike. There is no occasion at which someone is concerned about all the risks he will face in his life or business.

So it is not surprising that the standard insurance model, of a dedicated sales force pushing comprehensive solutions to businesses or individuals, is struggling to deliver growth in mature economies. For the past five years, premium income has grown more slowly than GDP.

And marginal costs continue to rise due to complexity and regulatory demands. Yet there are exceptions, and they point the way to a brighter future for insurers. For example, people now often buy travel insurance online, immediately after they have bought a holiday or flight. Similarly, when people buy cars, they are usually buying an insurance policy embedded in the warranty.

These policies cover narrowly defined risks and are sold at the time and place where the consumer becomes aware of them, usually through a partnership with the supplier of the insured good or a closely-related client access point. This "on demand" model thereby avoids the problems of the standard "push" model – the complexity, the cost, and the consumer indifference.

Insurers are beginning to adopt this model, for example, when providing coverage for special travel or accidents or when marketing at specific occasions such as birth or marriage. But this only scratches the surface of the potential for on-demand insurance. Insurers could offer new types of protection for everything from biometric risks when a new child is born to cash flow protection when a person changes his or her job.

By doing so, the on-demand model would give insurers significant opportunities for increasing sales while reducing costs – rewriting the rules for the entire industry.

Bernhard Kotanko is a Zurich-based partner at Oliver Wyman and head of the European Insurance practice.

OFFERING PROTECTION WHEN IT MATTERS

Extend family protection against biometric risk when a child is born, in partnership with healthcare providers

Embed home insurance in real estate services, in partnership with developers and brokers

Supply cash flow coverage for salary freezes, in partnership with employers and trade unions

Provide accident coverage at ATMS at vacation spots, in partnership with banks and tourist agencies

Make wedding insurance available, in partnership with wedding planners and wedding venues

Source: Oliver Wyman analysis

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