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Making digital strategy a reality in insurance

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Digital transformation is challenging in insurance, where change must happen without interrupting the flow of daily business. Here's how savvy leaders are taking on the challenge.

The nature of competition in property and casualty (P&C) insurance is shifting as new entrants, changing consumer behaviors, and technological innovations threaten to disrupt established business models. Though the traditional insurance business model has proved remarkably resilient, digital has the power to reshape this industry as it has many others. Innovations from mobile banking to video and audio streaming to e-books have upended value chains and redistributed value pools in industries as diverse as financial services, travel, film, music, and publishing. As new opportunities emerge, those insurers that evolve fast enough to keep up with them will gain enormous value; the laggards will fall further behind. To succeed in this new landscape, insurers need to take a structured approach to digital strategy, capabilities, culture, talent, organization, and their transformation road map.

Disruption at the gates

Though the P&C insurance business has long been insulated against disruption thanks to regulation, product complexity, in-force books, intermediated distribution networks, and large capital requirements, this is changing. Sources of disruption are emerging across the value chain to reshape:

- Products. Semiautonomous and autonomous vehicles from Google, Tesla, Volvo, and other companies are altering the nature of auto insurance; connected homes could transform home insurance; new risks such as cybersecurity and drones will create demand for new forms of coverage; and Uber, Airbnb, and other leaders in the sharing economy are changing the underlying need for insurance.

- Marketing. Evolving consumer behavior is threatening traditional growth levers such as TV advertising and necessitating a shift to personalized mobile and online channels.

- Pricing. The combination of rich customer data, telematics, and enhanced computing power is opening the door to usage- and behavior-based pricing that could reduce barriers to entry for attackers that lack the loss experience formerly needed for accurate pricing.

- Distribution. New consumer behaviors and entrants are threatening traditional distribution channels. Policyholders increasingly demand digital-first distribution models in personal and small commercial lines, while aggregators continue to pilot direct-to-consumer insurance sales. Armed with venture capital, start-ups like Lemonade—which raised $13 million in seed funding from well-known investors including Sequoia Capital—are exploring peer-to-peer insurance models.

- Service. Consumers expect personalized, self-directed interactions with companies via any device at any hour, much as they do with online retail leaders like Amazon.

Exhibit 1

Digital affects every part of the insurance value chain.

Example: Auto insurance

	Product	Marketing	Underwriting/ pricing	Distribution	Claims	Service
Trend	Product becomes more personalized and usage based	Digital drives more effective marketing via better target-ing and conversion	Availability of new data drives the next S-curve in pricing accuracy	Policies bound digitally become the norm (eg, 50% of auto policies)	Claims adjustment done digitally via integration with connected car sensors	Higher portion of service transactions completed digitally (online, mobile, social)
Examples from today	• Metromile insures ride-sharing drivers (eg, reaching ~150,000 Uber drivers)	• >65% of consumers get auto quotes online; 40% on mobile • 65% of European insurers plan to pro-fessionalize their online marketing	• Select carriers' programs have predict-ed rise in claims frequency and severity as car usage rose post-recession	• Direct channel growing at 2x rate of other channels • 70% of European insurers plan to install multiaccess training program for their physical sales channel	• Guidewire claims platform is becoming the industry standard	• +50% of service transactions completed digitally at leading carriers

McKinsey&Company | Source: McKinsey Global Institute analysis

- Claims. Automation, analytics, and consumer preferences are transforming claims processes, enabling insurers to improve fraud detection, cut loss-adjustment costs, and eliminate many human interactions. Connected technologies could allow policyholders and even smart cars and networked homes to diagnose their own problems and report incidents. Self-service claims reporting such as "estimate by photo" can create fast, seamless customer experiences. Drones can be used to assess damage quickly, safely, and cheaply after catastrophes.

All these disruptions are being driven and enabled by digital advances, as Exhibit 1 illustrates with examples from auto insurance. No single competitor or innovation poses a threat across the entire value chain, but taken together, they could lead to the proverbial death by a thousand cuts: many small disruptions combining to fell a giant.

Tremendous value at stake

The P&C industry lags in digital sophistication, so examples of the full benefits of digital are scarce. Our analysis suggests that the top 20 or 30 processes can account for up to 40 percent of costs and 80 to 90 percent of customer activity. Digitizing these processes can take out 30 to 50 percent of the human service costs while delivering a much better customer experience. And the benefits do not end there: Exhibit 2 shows how P&C insurers in the top quartile for digital performance are achieving twice the growth rate of their less digitally advanced peers and delivering better profitability at the same time.

A few carriers are experimenting with corporate venture capital, innovation labs, and other approaches as they explore untapped sources of value and new business models. Areas of early focus include connected cars and homes, the sharing economy, and the move from insurance as a product to protection as a service.

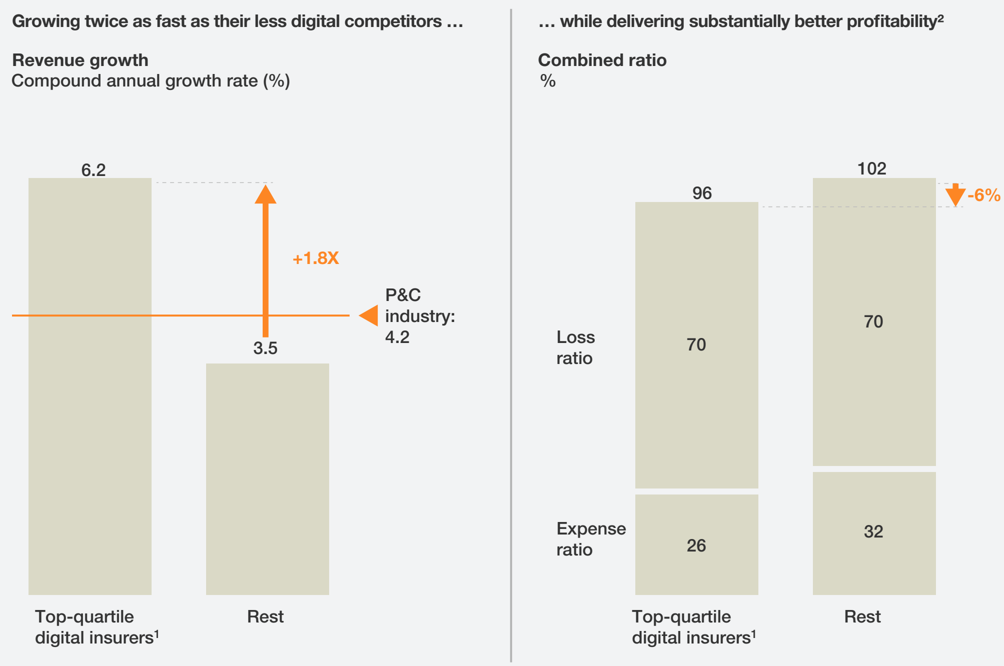
Many industry leaders are concerned about the costs and difficulty of transforming their business. To be sure, sizable investments are needed, but the penalty for doing nothing or moving too slowly could be far greater. Imagine the risk to incumbents if:

- Existing competitors slashed their costs and lowered their prices by half.
- Amazon or another digital giant with deep customer relationships moved into selling insurance, increasing price transparency and poaching the most profitable policyholders.
- A data aggregator drew on new sources of data to develop much more accurate underwriting and pricing models and partnered with a third-party investor to launch a new insurer that outperformed incumbents in profitable growth.

Exhibit 2

Top digital performers in P&C have outperformed the market.

2010–14



[1]P&C carriers in the top quartile of all North American companies (across sectors) by total digital quotient.
[2]Primarily through their lower expense ratios.

McKinsey&Company | Source: SNL; McKinsey Global Institute analysis

- A small commercial competitor offered cybersecurity insurance in a bundle with business-owner policies.
- A critical mass of autonomous vehicles eliminated many road accidents and injuries.

How would these disruptions affect premiums and profitability? How quickly would insurers feel the impact? How could they respond? And what other digital innovations lie in store (Exhibit 3)?

A structured approach to capturing value

Insurers are experimenting with many different approaches to digital, but all are grappling with the same challenge: deciding where and how to focus in order to establish or maintain

Exhibit 3

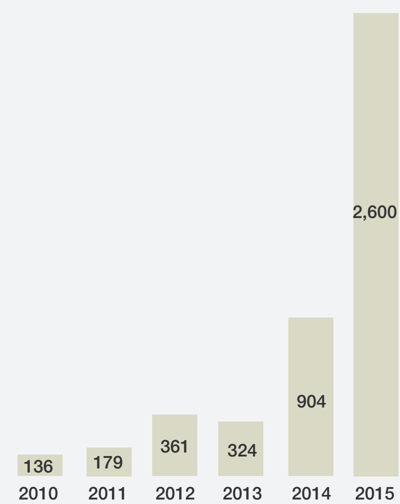
The next digital wave will transform insurance still further.

Digital trends transforming business models

Big data's next frontier	Growing ability to model ever larger and more complex datasets to derive nuanced insights from customer microsegmentation to genomics pattern recognition
Megarisk management	Basic risks are reduced as core products get safer (eg, self-driving cars), yet long-tail risks are growing (eg, natural catastrophe disrupting operations)
Telematics/ Industry 4.0	Cars and property are increasingly connected and able to communicate on a massive scale, enabling insurers to dynamically adjust insurance premiums based on risk
Digital-led growth in emerging markets	Emerging markets with 3 billion mobile owners using smartphones to search for, purchase, and pay for insurance
Personalization and ecosystems	As customers choose service providers to personalize their experience, service subscriptions become a greater share of revenues

Tech start-ups are disrupting the insurance industry and attracting record funding

Global investment in insurance-related start-up products[1]
$ million



[1]Including angel and venture-capital funding, private-equity investments, and funding from initial public offerings; rough estimates based on data available. Includes robo-advisory and insurance.

Source: CBInsights; Crunchbase; McKinsey Panorama; McKinsey Global Institute analysis

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a competitive edge. A successful digital transformation calls for a structured approach with action on five levels:

- Strategy. Align on a long-term vision to overhaul operations and generate new sources of value based on clearly articulated, shared priorities.
- Value capture. Build the mechanisms to execute the strategy by improving today's business and processes through digitization while simultaneously launching efforts to build tomorrow's digital business through innovation.

- Capabilities. Invest in the core technical competencies needed to support digitization and innovation, such as flexible modular IT architecture, deep data access and analytics, user-centric experience design, and digital operations.

- Culture, talent, and organization. Build agile test-and-learn capabilities at the front line to encourage experimentation and shift to a digital-first mind-set; recruit and develop new types of talent such as data scientists and design thinkers; and revise formal organization structures to encourage collaboration between functions and reflect the importance of digital.

- Road map. Build an integrated transformation road map that addresses all the elements above and takes into account the organization's digital maturity and readiness to embark on a multiyear digital journey as well as the value digital can bring to its specific markets and products.

To chart a successful path, it helps to understand common pitfalls. Digital strategies most frequently fall short when they lack a clear vision of the sources of value in digitization and digital innovation. To develop digital capabilities, insurers need to be prepared to commit adequate time and money. Lapses in digital culture, talent, and organization typically stem from insufficient investment in installing new types of talent and ways of working in the business, or a failure to adjust organization structures to reflect digital's importance. Some insurers struggle to go it alone as they strike out on their journey, when they might move faster or capture more value by partnering with third parties or buying them outright. Whether it is better to build, buy, or partner will depend on a company's starting point, aspirations, and time horizon.

What all successful digital transformations share is a sustained commitment from senior management, a shared long-term vision, a willingness to transform the culture and operating model, and the tenacity to persist through the difficulties that accompany any organizational effort of this magnitude.

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Undertaking a digital transformation is undoubtedly challenging, especially since insurers have to carry it out while managing their everyday business operations effectively as well. But the question is not "Do we have the appetite to undertake a digital transformation?" but "Can we afford not to?" □

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