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Small Commercial Insurance: A Bright Spot In the U.S. Property-Casualty Market

Financial Services Practice

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Introduction

The U.S. small commercial insurance market is one of the few bright spots in the U.S. property-casualty insurance (P&C) sector and is thus the focus of intense competition that is likely to ramp up over the next few years. The market is both fragmented and profitable, a scenario that is drawing attention from carriers whose primary business lines are saturated and commoditized, as well as from attackers seeking fields that are open for innovation. Small commercial insurance is also one of the few U.S. P&C markets that has been growing in recent years.

The focus on the small commercial opportunity makes strong business sense, but there is a complication. Small business owners are increasingly using—or open to using—direct channels to shop for and purchase insurance coverage, which is altering the fundamentals that once defined success for carriers. So while the small commercial

market is a ripe opportunity, few traditional carriers are positioned to capitalize on it.

To stay ahead of agile attackers, carriers will need new capabilities. McKinsey research shows that small commercial customers can be grouped into need- and behavior-based segments that are far more accurate predictors of shopping and buying preferences than traditional business size and industry segmentation. As in personal lines, carriers will succeed by using these deeper insights to deliver tailored value propositions and messages, at the right moments, to satisfy the unique preferences of customers in each segment.

To illustrate the potential impact of this targeted approach, consider that when the direct revolution hit the personal auto insurance market, incumbent carriers spent hundreds of millions of dollars trying to hold onto customers that were not interested in what they had to offer. By sharpening their focus on the customers they know will be profitable, small commercial insurers can avoid this wasteful and scattershot approach.

The “consumerization” of small commercial insurance is likely to shift the balance of power in the sector. Carriers with customer-facing capabilities—particularly exclusive agent carriers with strong personal lines businesses and some small commercial presence—will have an advantage over those that distribute through independent agents. Independent agency carriers have deep industry experience and operational strengths, but will need to move quickly to develop marketing and customer-facing capabilities. And a third group is likely to make inroads: digital attackers unencumbered by legacy issues that can launch nimbler direct models.

This paper is based on proprietary McKinsey research that includes dozens of qualitative interviews with consumers and distributors, and a survey of a representative sample of over 1,500 small businesses in the U.S. ranging in size from one to 100 full-time employees, across a range of industries.

This report addresses a number of emerging issues in small commercial insurance, including how customer behavior is changing, what those changes mean for carriers already serving the market and for others considering a market entry, and how carriers can translate new insights regarding customer behavior and segmentation into superior performance.

A Dynamic, Growing Market

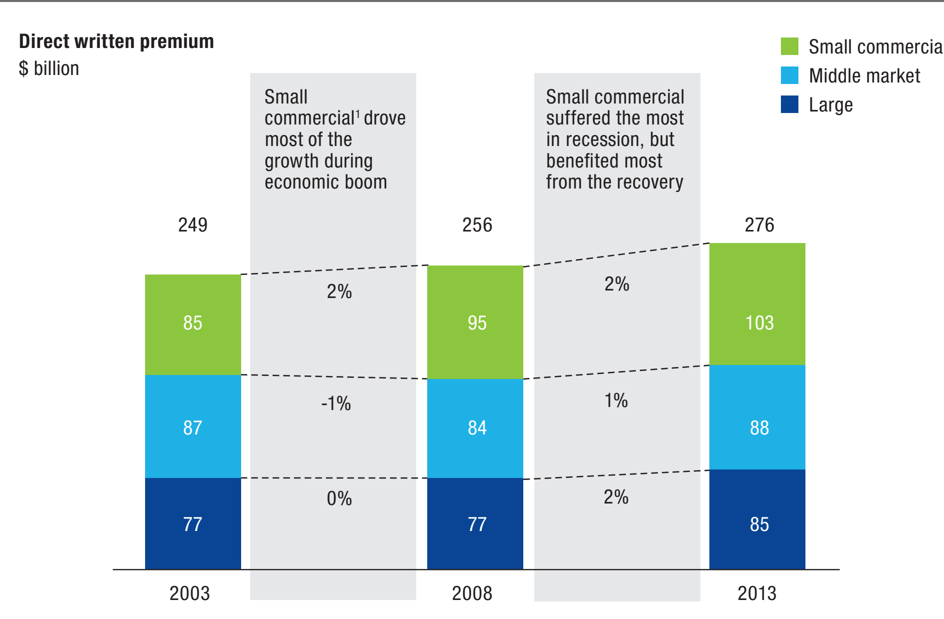
For P&C carriers, the U.S. small commercial insurance market has quietly become a sweet spot in a challenging industry landscape. On the one hand, the personal auto insurance market has become increasingly commoditized. In the mid-commercial segment, carriers are struggling to deliver the level of service clients demand at premiums they are willing to pay. And in large commercial lines, competition for a limited client base is fierce, with large brokers controlling access and taking the lion's share of revenue.

By contrast, the small commercial market, which serves businesses with up to 100 employees and $100,000 in annual premiums,[1] is more dynamic, with growth similar to personal lines auto and a fragmented competitive and geographic landscape.

[1] Median annual premium is $1,000 to $5,000.

Exhibit 1

Small commercial accounts for more than one-third of the U.S. commercial lines market, and is the fastest-growing commercial segment when the economy is expanding



[1] Defined as employers with 1 to 50 FTEs.
Source: AM Best; Conning

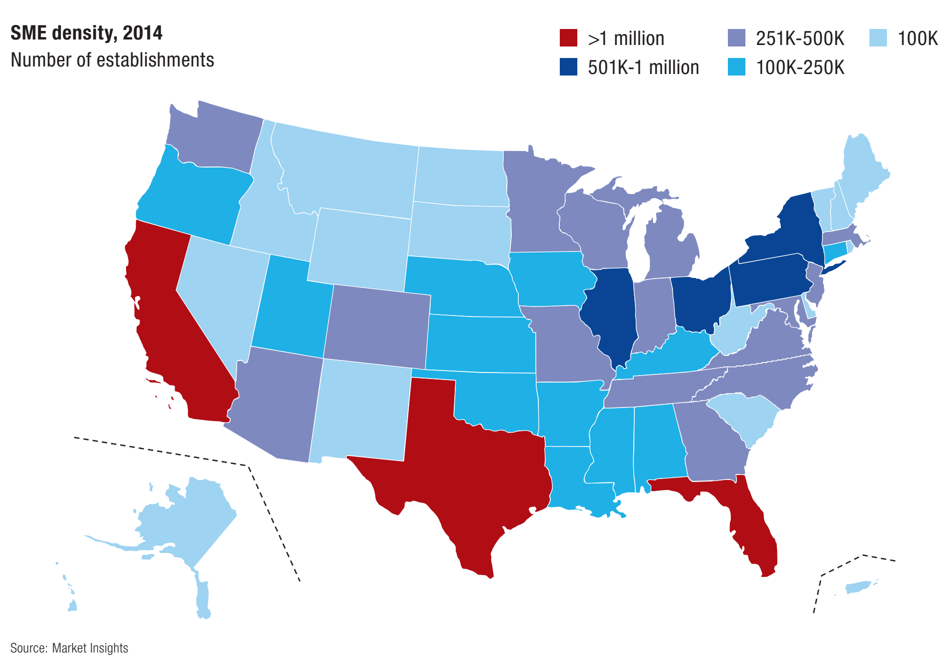
Direct written premiums were between $99 billion and $103 billion for 2013, up from $91 billion in 2011. This represents just over one-third of the broader commercial lines market (Exhibit 1) and includes about $6 billion in non-standard specialty lines premiums that are fairly evenly distributed across the U.S. (Exhibit 2, page 6).

Strikingly, almost 40 percent of sole proprietorships in the U.S. do not carry small commercial coverage and therefore did not qualify for McKinsey's survey. Some may be covered under home-based business owner policies or endorsements on their personal lines policies, but this finding still raises the possibility of unexpected room for growth in the smaller business market. (It may also indicate that some of the findings pertaining to smaller enterprises, such as propensity to buy direct, are even more significant than illustrated in this paper.)

The small commercial insurance market is divided among many carriers, with the largest accounting for only 6 percent of total premiums (Exhibit 3, page 6). Market share is particularly fragmented at the smaller end of the market (businesses with one to 29 employees). However, the largest carriers are moving quickly to secure their positions. In the past six years, the market share of carriers with over $2.5 billion in direct written premiums has increased by 12 percentage points, suggesting that scale is an important driver of growth.

Exhibit 2

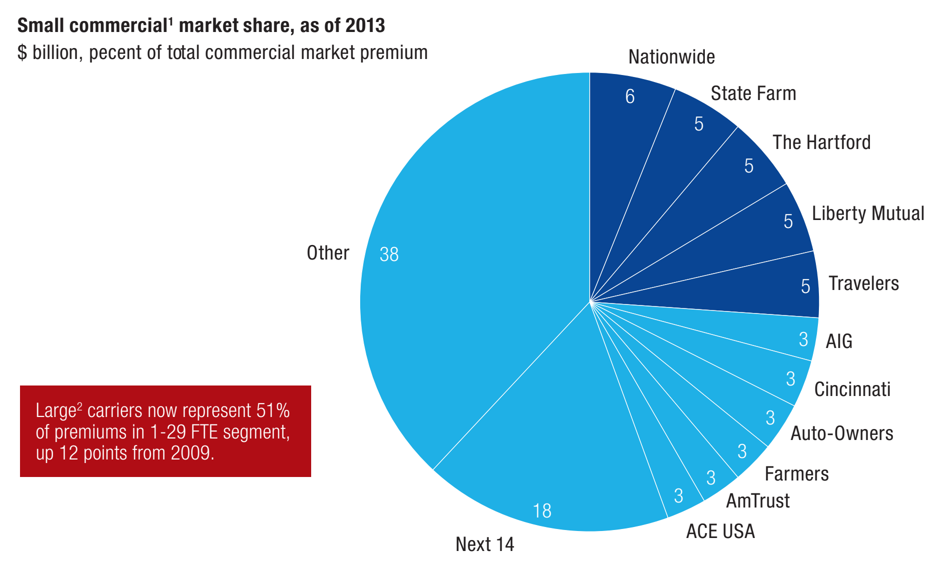
U.S. small businesses are geographically dispersed, creating a wide field for competition



Source: Market Insights

Exhibit 3

Carrier share in U.S. small commercial insurance is fragmented



[1] Presents the share for small commercial premiums for employers with 1-29 employees only

[2] Carriers with more than $2.5 billion in direct written premiums

Source: Insurer statutory and GAAP filings; public statements and presentations; Conning Research & Consulting analysis; McKinsey Small Commercial Insurance Buyer Survey, 2015

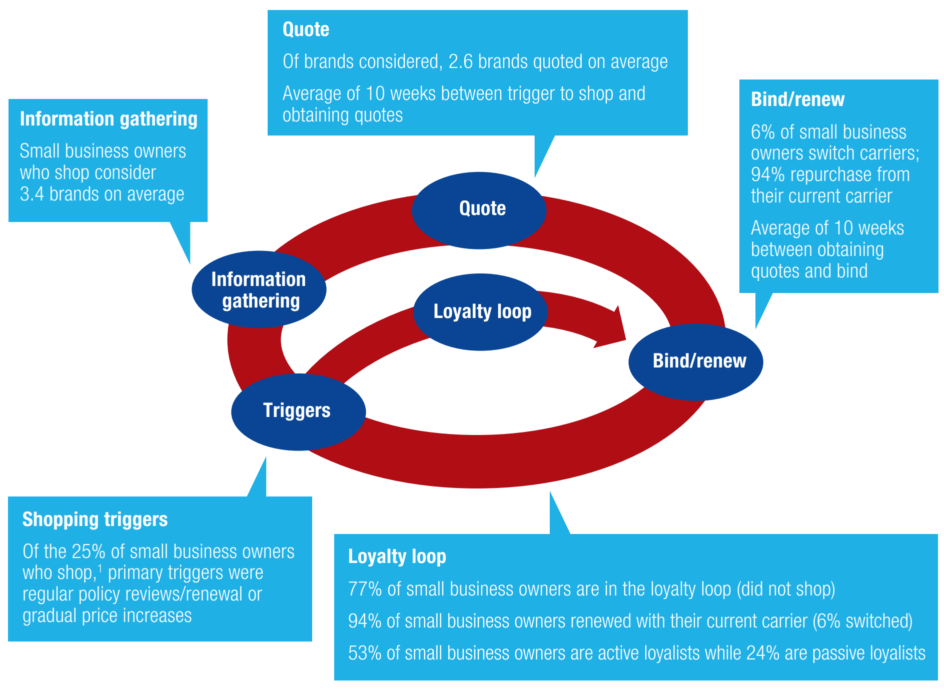
Disruption in Small Commercial Insurance

As the most favorable opportunity in U.S. P&C insurance, the small commercial sector is the focus of renewed attention from established carriers in other sectors, as well as digital-based attackers. As changing customer behavior upends traditional business models, carriers will need to improve in a number of areas: the ability to gauge the size and nature of the opportunity; targeting and reaching the right customers; and delivering value propositions that attract and retain them.

McKinsey's research revealed a number of actionable insights for carriers.

Exhibit 4

The decision journey in small commercial insurance



[1] "Shopping" is defined as consideration of carriers other than the current one

Source: McKinsey Small Commercial Insurance Buyer Survey, 2015

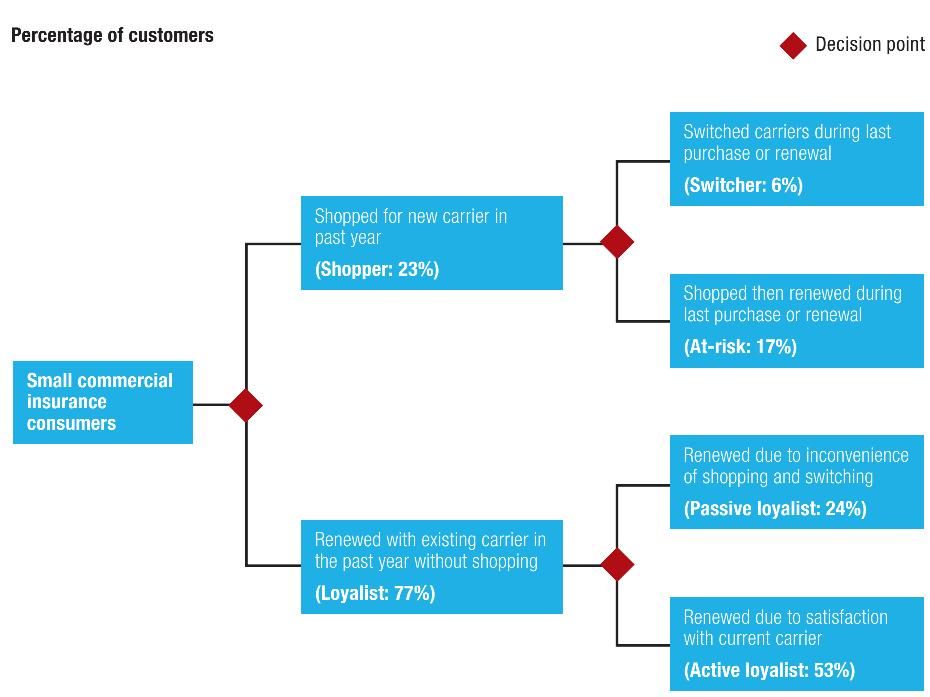
The universe of potential shoppers and switchers far exceeds the 6 percent who actually switch

The small commercial insurance customer decision journey (Exhibit 4) parallels the personal auto insurance journey in striking ways. Shopping and retention dynamics are roughly the same, and 6 percent of the customers surveyed switched carriers during their most recent purchase or renewal period, compared to 9 percent in our most recent personal auto research. Of the 94 percent who renewed with their existing carriers, 53 percent are "actively loyal," meaning they are willing to recommend their current carrier (Exhibit 5), in line with the 55 percent in personal auto.

The potential far exceeds the 6 percent who actually switched in the most recent annual shopping cycle, however. Considering the 17 percent who shopped around but renewed and the 24 percent who stuck with their carriers more out of inertia than true loyalty, the pool of potential switchers in any given renewal cycle represents almost 50 percent of the market. The challenge for carriers is to identify and reach those on-the-fence consumers and convince them to switch. Shopping and switching rates will also likely increase as innovators lower barriers to purchase, such as lack of transparency, cumbersome processes for comparing coverages and rates, complex forms, and multiple agent interactions.

Exhibit 5

94 percent of small commercial insureds renew, but only half are actively loyal



Source: McKinsey Small Commercial Insurance Buyer Survey, 2015

Customer needs and behaviors are nuanced and present untapped marketing potential

To reach the nearly 50 percent of small commercial consumers who are open to switching in every renewal cycle, carriers must harness new and more granular insights into customer behavior. Shoppers can be segmented based on their needs and behaviors, as we have seen in personal lines. There are seven distinct customer segments: independent agent loyalists; self-servicers; price seekers; local relationship/brand loyalists; high-touch, tailored protection seekers; uninvolved, reputation-centric; and industry-expertise shoppers (Exhibit 6, page 10). To get a sense of the shift that carriers will need to make to meet the demands of their customers, consider that small commercial carriers traditionally segmented clients by size or industry. Our research shows, however, that the two factors with the most polarizing impact on segmentation are *price sensitivity* and the extent and nature of customers' *reliance on agents*.

This insight opens new avenues for targeted approaches to marketing and acquisition, but also raises the bar for the kinds of capabilities that carriers will need to develop. Other preferences that vary widely by segment include binding channel, loyalty, service preferences, and the propensity to buy direct and to consolidate personal and commercial lines (Exhibit 7, page 11). For example, while *most* price-sensitive businesses, such

Exhibit 6

The seven small commercial insurance segments

1: Independent agent loyalists
- Rely heavily on agents (93% use agent)
- Tend to stay loyal with the chosen carrier
- Do not want to spend time researching on their own

2: Self-servicers
- Ability to manage policy online on their own is a must
- Need to be able to make the purchase quickly and easily
- Prefer purchasing online/on phone over customized

3: Price seekers
- Price is the most important factor
- Do not require much extra insurance coverage
- Do not require customized products or services

4: Local relationship/brand loyalists
- Access to local representatives is very important
- Prefers agents dedicated to one company (58% use exclusive agents)
- Tend to stay loyal with the chosen carrier

5: High-touch, tailored protection seekers
- Carrier must understand customer's industry
- Important to work with a local commercial agent
- Willing to pay more for extensive coverage

6: Uninvolved, reputation-centric
- Carrier reputation more important than that of the agent
- Least likely to work with an agent (53% direct from carrier)
- Basic coverage needs
- Lowest average premium ~$6,600

7: Industry-expertise shoppers
- Carrier must understand industry
- Willing to pay more for extensive coverage (avg. premium $26,200)
- Carrier reputation more important than that of the agent
- Most likely to shop

Legend:
- Relationship is important; cares about convenience
- Price-sensitive
- Relationship is paramount for protection and peace of mind
- Indifferent to price and relationship; focused on reputation and expertise

Source: McKinsey Small Commercial Insurance Buyer Survey, 2015

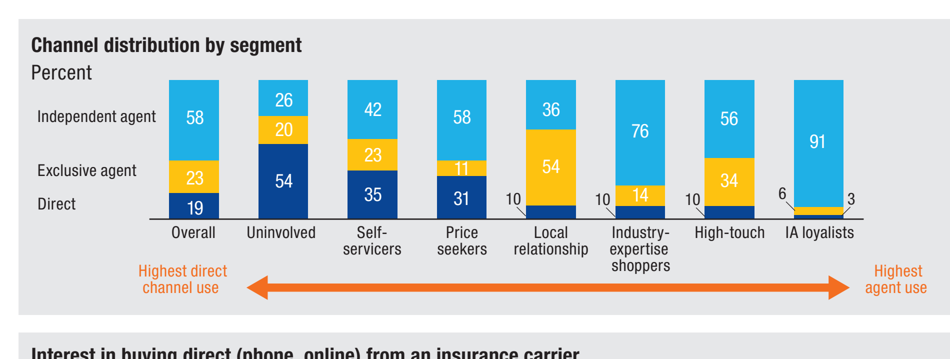
as service and retail companies, have simple, basic coverage needs and skew smaller (less than $250,000 in annual revenues), there are larger businesses across a broad range of industries that are highly price sensitive. Perhaps counterintuitively, insurance buyers at some larger, more complex small businesses (industry expertise shoppers) prefer to control decision-making and would do everything direct if they could; the same is true in some segments at the smaller end of the market (uninvolved, reputation-centric).

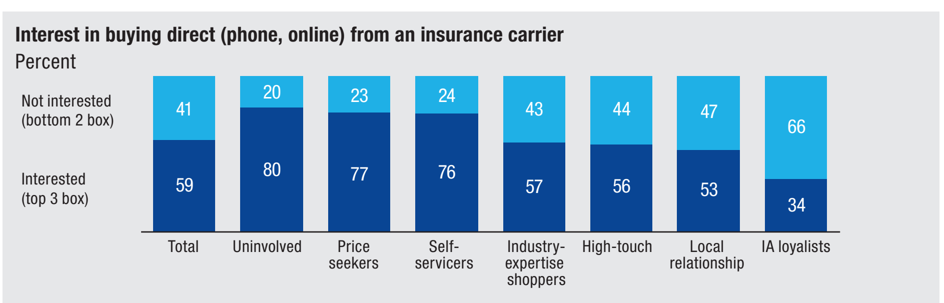
Segments that rely heavily on agents and brokers to help them navigate complex insurance needs do so for varying reasons. "Independent agent loyalists" and "self-servicers" value agents for convenience, for example, while "local relationship/brand loyalists" and "high-touch, tailored protection-seekers" rely on agents for peace of mind.

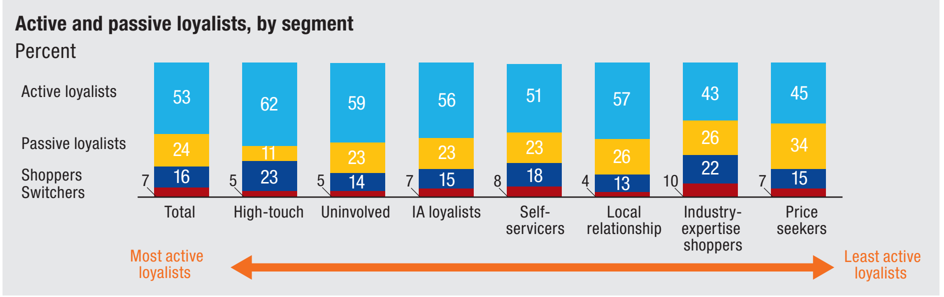
Claims needs also vary by segment, with some ranking speed over payment amount and others preferring high-touch, concierge-like service. The more granular carriers can get in recognizing distinct customer needs, the more success they will have at each step of the decision journey. Furthermore, this ability will serve small commercial insurers well in the event that direct models spark a war for market share like the one that took place in personal lines auto. The more information and insight that small commercial insurers can bring to segmenting their potential customers, the less they will need to spend on maintaining and gaining share.

Exhibit 7

Small commercial insurance segments display distinct binding behavior, proclivity for direct, and levels of loyalty







[1] Excludes all respondents who selected "Other" or "I don't know"

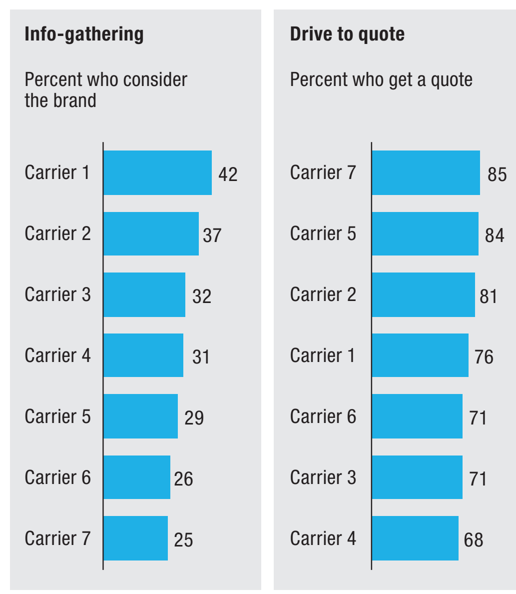
Source: McKinsey Small Commercial Insurance Buyer Survey, 2015

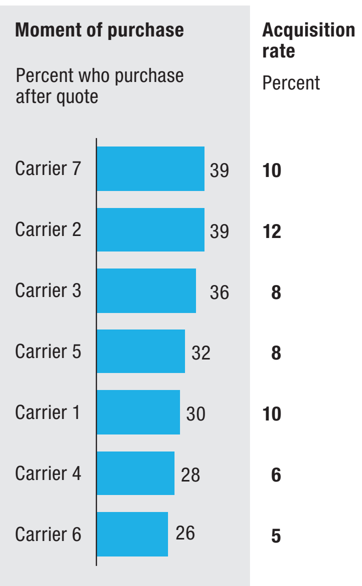
Carrier performance also varies widely in the *shopping* (Exhibit 8, page 12) and *loyalty* (Exhibit 9, page 12) phases of the decision journey. Carriers must learn more about the messages and marketing touch-points that influence customers' decisions and apply these insights to improve conversion rates along the journey.

In the *consideration* phase, for example, 42 percent of customers named the leading carrier while only 25 percent named the seventh-ranked carrier. This performance gap persists at the *quote* and *bind* phases. Comparing initial consideration rates with personal lines carriers is instructive. The highest-performing small commercial carrier scores 42 percent versus 60 percent for the top personal lines carrier. Among multiline carriers, there was a surprising correlation between the amount of spending on personal lines marketing and ranking in small commercial consideration; this implies that exclusive agency carriers in particular may be underinvesting in traditional marketing.

Exhibit 8

Small commercial insurance carrier performance is inconsistent across the shopping journey





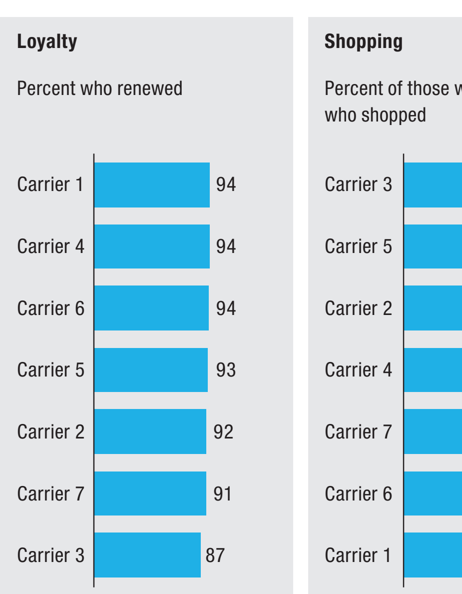
Acquisition rate
Percent

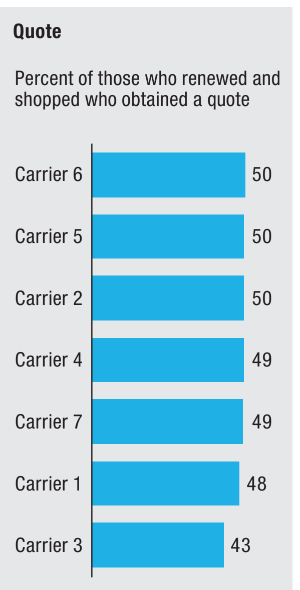
10
12
8
8
10
6
5

Source: McKinsey Small Commercial Insurance Buyer Survey, 2015

Exhibit 9

Small commercial insurance carriers perform very well in the loyalty loop, although 20-30% of any top carrier's loyal customers are shopping





Source: McKinsey Small Commercial Insurance Buyer Survey, 2015

No single carrier outperforms along the full shopping journey; the rankings change at each stage. For instance, one carrier that underperforms in information-gathering excels in quote and purchase. While it is unlikely that a single carrier could win at every step of the journey, a large carrier could gain share by improving performance in areas where it is lagging.

Small differences in performance at each stage of the decision journey lead to large gaps in overall acquisition rates.[2] The largest small commercial insurer has the lowest acquisition rate among the large carriers, whereas the large carrier with the highest acquisition rate does not rank among the top 10 in terms of premiums; the likely medium-term outcome of this disparity is, of course, a shift in market share.

A fresh look at the factors that determine which carriers become part of the customer consideration set undercuts the traditional "everything through the agent" strategy that most carriers employ. Agents represent about 30 percent of the influence on small commercial consumers' consideration and selection of a carrier; the remaining 70 percent is comprised of a combination of experience, word-of-mouth and marketing, including print, direct mail and sponsorships. Carriers will need to develop a broader toolkit of marketing tactics to raise their profiles with insurance buyers in a meaningful way. The carriers with the best performance at initial consideration are also among the top personal lines advertisers. Particularly at the small end of the market, this may argue for an increase in mass media advertising.

Retention is a powerful hidden lever

In their efforts to grow, carriers focus primarily on acquisition, but the vast majority of small companies make their decisions in the "loyalty loop": of the 94 percent who renew with their incumbent carriers, 82 percent (77 percent of all customers) do so without shopping. This means that investments in retention can deliver better returns than investments in acquisition. Existing customers tend to have better risk profiles, and their carriers have usually adjusted pricing to reflect the risks over time, rendering the accounts profitable. In addition, expensive marketing is not an integral part of retention dynamics.

Carrier performance on overall retention varies less than in shopping, but the percentage of customers who shop and then ultimately renew varies by as much as 12 points. Some carriers therefore face greater risk of attrition—possibly because their customers lean towards the "passive" end of the loyalty spectrum.

As noted, customers display two kinds of loyalty. Two-thirds of loyal customers are "actively loyal," meaning they renew without shopping, are willing to recommend their carriers and are harder for competitors to dislodge. More vulnerable are the 24 percent who are "passively loyal," staying the course out of inertia and not through any real attachment to their carriers. Many of these customers simply find shopping and switching inconvenient.

High levels of passive loyalty for a carrier are like an iceberg to an ocean liner—risk that is mostly hidden. In personal lines, direct carriers such as GEICO and Progressive grew mostly by attracting pas-

[2] Derived by taking the product of a carrier's conversion rate at each stage of the consumer decision journey.

sive loyalists from incumbents. Exclusive agency carriers were particularly hard-hit. A similar degree of disruption could easily be in store for small commercial carriers. By definition, passive loyalists do not shop; however, they are more open than active loyalists to effective marketing efforts from competing insurers—particularly if those insurers hit the sweet spot of dissatisfaction that prevents these customers from being actively loyal.

Carriers with higher levels of passive loyalty are vulnerable and may not be aware of it. Higher levels of active loyalty track closely to certain segments—local relationship/brand loyalists, for instance—and the drivers of active loyalty are unique to each customer segment. Along with a segment-specific targeting strategy, carriers need to understand what drives active loyalty for their target segments and tailor the customer experience to meet those needs.

It is widely understood that multi-product households are more likely to renew. Research reveals that 43 percent of small commercial consumers bundle personal and small commercial insurance with the same carrier, and that 64 percent of these customers lead with the personal lines policy. This means that roughly a quarter of small business customers place their commercial policies with their personal lines carrier.

In short, as competition intensifies in the small commercial insurance market, a winning strategy will be defined less by industry or business-size specialization and more by targeting specific customer segments, developing a compelling message through the full range of channels, and delivering a distinctive value proposition to acquire and retain customers.

Consumer demand for alternatives to agents exceeds supply

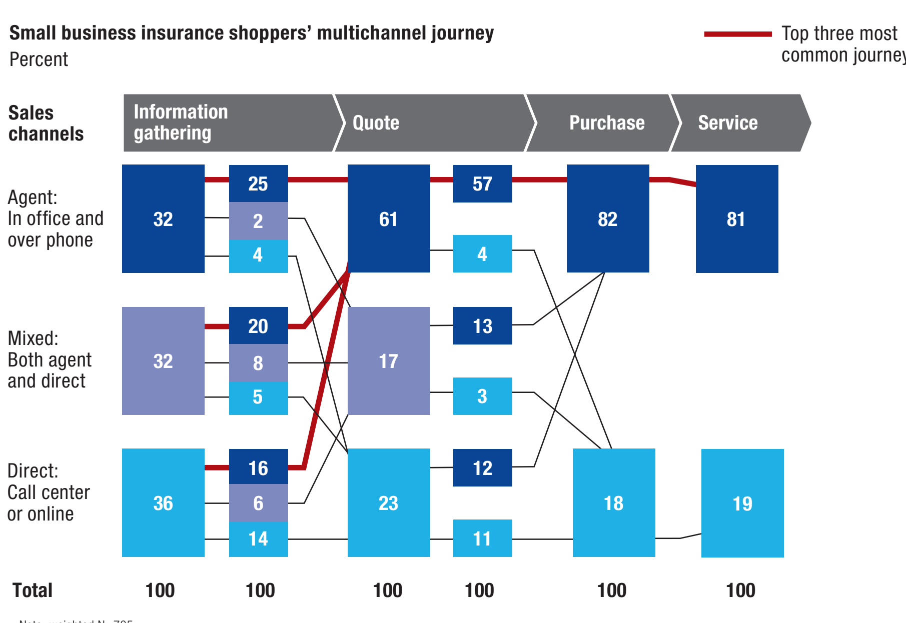
Small commercial insurance customers are taking more control in the early stages of their decision journeys. Almost 70 percent are gathering information through non-agent channels, including online, and almost half of these shoppers are using both agent and non-agent channels at this stage in the journey.

As they quote and bind, more people turn to agents. More than 60 percent quote exclusively through an agent, and 17 percent gather quotes on their own as well as from the agent. "Purchase" shifts even more heavily toward agents, with 82 percent of customers binding through the channel (Exhibit 10). Interestingly, 18 percent of consumers representing 10 percent of premiums say they are binding direct, and some are indeed binding with carriers such as Allstate-Esurance and USAA that have true online or call-center sales capabilities. But some of these customers may have misconceptions about what carriers mean by "direct" in this setting. For example, a customer may call an agent's office and consider that "direct." On the other hand, some consumers who actually did buy direct were surprised to be informed of the fact. Particularly in the smaller end of the market where the average buyer is less sophisticated, the distinction between channels is less clear-cut to customers than it is to carriers or industry observers.

Some customers will always value agents' advice and personal relationships and will continue to bind through that channel, even if access to and the convenience of direct quote and bind improves, but a significant number of

Exhibit 10

Nearly 70% of small businesses start the shopping journey using direct channels, while 18% purchase their policy direct



Note: weighted N=705

Source: McKinsey Small Commercial Insurance Buyer Survey, 2015

customers use agents simply because they are the most prominent and available channel, and would switch to direct if given the option.

About 60 percent of small commercial insurance customers surveyed would consider interacting directly with a commercial insurer, and 56 percent of these customers would consider binding direct (Exhibit 11, page 16). Almost half of respondents would be interested in interacting with a remote or virtual agent, a new model sometimes referred to as "pseudo direct," currently being pursued by Insureon, Bolt and other providers who have no local offices. Only 40 percent currently say they would be willing to bind through this channel.

A number of trends suggest an even greater potential for virtual and direct distribution in small commercial insurance.

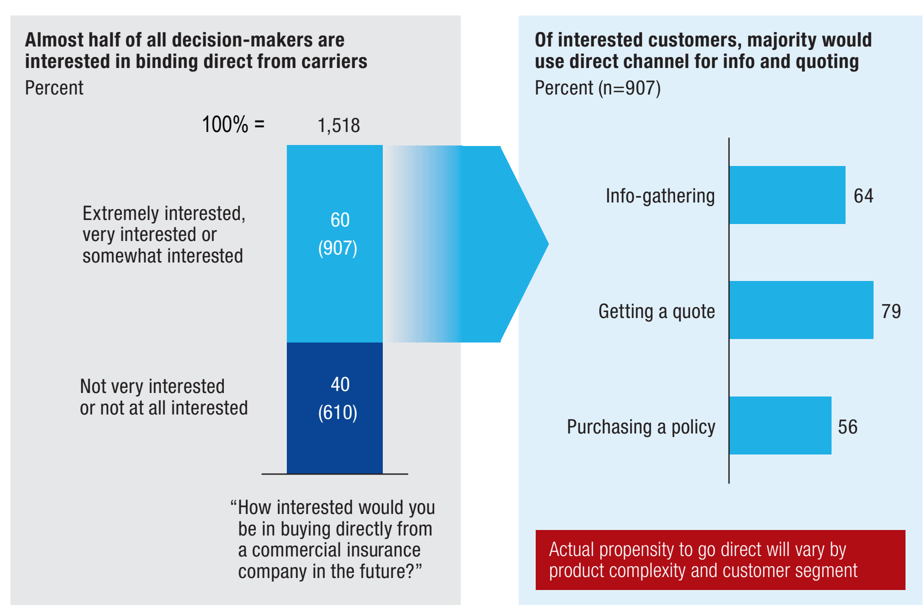
First, although 82 percent of consumers purchased through an agent, "top two box" satisfaction[3] with this channel was 51 percent. While online purchase is a far newer capability, customers who bought their commercial policy online report 49 percent top-two-box satisfaction, and cite convenience and comfort with conducting financial transactions online as the primary drivers. These factors will likely increase as carriers' direct quote-and-bind capabilities improve. Second, more than half of the interactions consumers have with their agents are by phone or e-mail, and most interact with their agents only one to three times per year. Over time, as in other industries, direct customers will likely promote their experiences to others, creating a ripple effect.

Online retail across most categories, including financial services, is nearly ubiquitous, which is why the shift to

[3] Total percent of respondents who responded "extremely" or "very" satisfied.

Exhibit 11

More than half of customers interested in direct show high propensity to bind in-channel



Source: McKinsey Small Commercial Insurance Buyer Survey, 2015

direct-to-carrier and virtual agency channels in small commercial insurance will likely occur at a faster clip than it did in personal auto. Direct and pseudo-direct channels could represent 20 to 25 percent of premiums and 30 to 40 percent of small businesses in five to 10 years. Customers choosing these new channels will likely be concentrated in certain needs-based customer segments, industries such as retail and mercantile, and standard, low-hazard lines. The only major constraint to growth will be carriers' ability to get direct and virtual quote, bind and service capabilities to market. McKinsey expects attackers to emerge with sharply defined direct approaches; consider how the UK's Direct Line upended the personal lines market with a simple direct model back in 1985.

McKinsey found significant overlap between customers interested in direct and those who are open to using a virtual agent to match them by phone with insurance professionals who are expert in their industry and can provide quick quotes from multiple carriers. Assuming that exclusive agency carriers will be more likely to pursue direct as a means to drive leads to their agents, while independent agents will prefer to partner with virtual agencies to avoid channel conflict, the result will be a battle for the 43 percent of consumers interested in both. Winners will likely be first-to-market with a higher quality customer experience across not only the direct and pseudo-direct channel but the entire multichannel environment.

The shift to direct distribution will have implications for underwriting. A separate analysis indicates that policies for small businesses in 20 to 40 percent of sub-standard industrial classification codes

can be underwritten with no-touch or one-touch underwriting. Yet, with notable exceptions including Travelers and The Hartford, carriers are struggling to extend straight-through-processing beyond the smallest, simplest risks.

Straight-through-processing capabilities are also becoming more important for carriers in their relationships with traditional brokers, such as Marsh & McLennan with MMA, who are experimenting with centralized, integrated models for small commercial. As these models advance, carriers who are unable to “connect” into these new systems will risk losing a major point of market access.

Consumers see products as overcomplicated and feel unprotected against emerging risks

Changing customer behaviors are a major driver of opportunity in small commercial, but carriers can also address trends in product satisfaction and emerging risks to win share. Many customers want to simplify the process for getting the right combination of products and coverages, and several stated that most of their interactions with agents involve constructing the optimal combination of lines, identifying and modifying the required coverages and then procuring the package at the most competitive rate. Carriers could offer simple packages tailored to the largest industries, and the major sub-classifications within them, to streamline this process. Lower-touch underwriting and lower agent commissions could have a material impact on expense ratios.

Among emerging risks, cyber risk is most troubling to small commercial decision-makers, with nearly one in three naming it as a top-of-mind concern and more than one in three reporting that they are not adequately covered. Other emerging risks include slander and liability via social media (20 percent feel exposed) and terrorism, where concern varies by industry. Businesses in construction, for example, are disproportionately concerned about terrorism. Another product-related insight from the research was that 40 to 50 percent of customers would be comfortable buying health insurance products from their P&C carrier or buying commercial P&C insurance on a healthcare exchange, contingent on the choice of carriers and quality of coverages.

Partner to fuel growth

Carriers may be missing significant opportunities for growth by not pursuing partnerships more vigorously. When asked about what kinds of companies they would consider as small commercial business partners, 44 percent of respondents to McKinsey’s survey stated that they would be open to purchasing branded P&C products from health exchanges. Separately, American Express was the individual company that decision-makers associate most with small business. While the execution may be complex, there are opportunities for carriers to drive growth through strategic partnerships outside the P&C insurance industry.

Success in the New Small Commercial Insurance Market

Experience in the pre-direct personal auto lines market can help shape a perspective on how the U.S. small commercial insurance market will develop over the next few years. In the mid-1990s, GEICO and Progressive started using direct distribution and, over the next two decades, grew at three times the rate of the industry, mostly at the expense of large incumbents. By the mid-2000s, the industry was spending about $6 billion on marketing every year as attackers pursued new customers and incumbents tried to hang onto them. GEICO's "15 minutes can save you 15 percent on car insurance"—as explicit a play for price-conscious shoppers as the industry has ever seen—forced incumbents to try to stem the attrition. The result

was massive value destruction. Premiums eroded and the perception of auto insurance as a commodity product was firmly established. It was not until this decade when personal auto insurers began to develop sophisticated marketing capabilities and to stake out differentiated value propositions that market shares finally started to stabilize.

As small commercial insurance heads down a similar path, incumbents must take action. Customer demand for digital information and education, quote and bind in small commercial is already well beyond the capacity of carriers to provide it, so the door is open for fast-moving and innovative attackers to disrupt the status quo. In other words, the small commercial version of GEICO is likely to emerge in the near term. Nimble new firms, such as Hiscox on the carrier side and Insureon in distribution, already have momentum.[4] In short, disruption is already afoot.

To meet the challenge, carriers will need to rethink their operating models on a number of fronts:

1. **Dedicated organization structure and leadership.** Carriers looking to step up performance in small commercial should take a page from leading carriers such as Travelers, where dedicated small commercial leadership teams report to overall commercial lines or P&C leadership. This structure, which makes responsibility for small commercial performance clear and explicit, has proven impact in terms of clarity of strategy and better economic outcomes.

2. **Better marketing in a rapidly consolidating competitive landscape.** As the "consumerization" of small commercial insurance gains steam, marketing will be an increasingly important factor in growth and retention, particularly at the smaller end of the market. Large personal lines carriers are already leveraging their advertising experience to win at initial consideration with smaller businesses. At the larger end of the market, where industry referrals and expertise carry more weight, word-of-mouth references, industry publications and mailings are more influential. As noted, customer segmentation in small commercial insurance will help carriers grow through differentiated strategies and value propositions. Multiline carriers may make advances by dedicating part of the broader corporate marketing team to improving small commercial acquisition and retention, or by hiring marketers to focus exclusively on small commercial. Other carriers may need to establish a new marketing function at a level that is senior enough to influence strategy. However the marketing function is structured, it will require capabilities in areas including marketing strategy, customer segment identification and targeting, customer insights, brand positioning, value proposition development, marketing touchpoint mix optimization, and digital and social media marketing, lead generation and retention.

3. **Channel diversity and integration.** Although around 70 percent of small commercial customers use direct channels for some combination of information-gathering, quoting and binding, few carriers offer consumer-friendly education content and tools on their Web sites, let alone direct quote and bind. They have work to

[4] Hiscox year-on-year growth rate between 2013 and 2014 was 39 percent. In recent press, Insureon CEO Ted Devine mentioned that Insureon's growth rate is around 40 percent.

do in terms of customer-facing Web features, but to deliver a pure direct experience, carriers will also need straight-through-underwriting for more than just basic risks. In another example of needs outstripping capabilities, 40 percent of small commercial customers are open to using a virtual agent but only a few carriers have partnered with firms that provide these services. A primary constraint is a lag in technological capabilities, such as screen-scraping and XML, that allow virtual agents to deliver on their promises of super-fast quotes. Independent healthcare exchanges could offer additional opportunities for increasing volume. In short, to succeed, small commercial carriers will need to offer broad, integrated multichannel distribution access (including a mix of direct and pseudo-direct), and develop strategic partnerships with small commercial-focused companies outside the insurance industry. Carriers paralyzed by the risk of channel conflict with traditional agents run the risk of being left behind.

> Carriers with high rates of shopping in their book (as high as 30 percent for some carriers), and a large share of "passive loyalists" among policyholders, will struggle to retain share.

4. **An analytics-based, iterative approach to retention.** Retention varies significantly by needs-based segment. Carriers should base their retention strategies on clear ideas about which segments are the core targets, develop a deep understanding of what drives "active loyalty" in these segments, and then tailor customer experiences accordingly. In the next few years, we expect carriers to refine their value propositions as the growth in direct and pseudo-direct channels improves price transparency and ease of shopping. Carriers with high rates of shopping in their book (as high as 30 percent for some carriers), and a large share of "passive loyalists" among policyholders, will struggle to retain share. All carriers should harness analytical models to predict and prevent churn and develop suites of tactics to reduce churn, increase engagement and promote active loyalty that can be iteratively tested with customers.

5. **More sophisticated analytics.** Predictive analytics already plays a prominent role in selecting and underwriting risks and processing claims, and this role will continue to grow.[5] In a recent McKinsey survey, 90 percent of respondents reported medium to high investment in data and analytics, and 30 percent called their investments "very significant." Many carriers have built "centers of excellence" with more than 50 data scientists, data engineers and other experts working on a broad portfolio of use cases. Despite these investments, however, significant untapped opportunities remain for analytics across the value chain, from acquisition to underwriting, pricing, retention, service and claims.

   Analytics can help sales teams type and target prospects in needs-based

[5] See "Transforming into an Analytics-Driven Insurance Carrier," McKinsey & Company, January 2016

segments, improving both acquisition and retention, since loyalty varies significantly by segment. In risk selection and underwriting, carriers have boosted profitability by up to 10 percent by using data to identify and price to primary loss drivers. And as in other retail industries, analytics can help predict and prevent churn to improve revenues and margins. Another important growth opportunity that analytics can help uncover is cross-selling. Given the number of customers bundling personal and commercial lines policies—and the fact that another 40 percent of the market is open to the idea—multiline carriers should pursue more cross-selling efforts. In certain industries, associations have significant influence. Strategic partnerships with these institutions could generate high-quality leads for carriers. Since these opportunities are limited, however, carriers should stake them out quickly.

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The U.S. small commercial insurance market will be a magnet for competition in the coming years, due to its robust growth prospects and relatively fragmented competitive landscape. As the keys to success change, some carriers will seek new insights, adapt and deliver the tools and services their customer segments demand. Those who move too slowly will falter; some will disappear.

Incumbent small commercial carriers will have company as they adjust to the new landscape. The big personal lines insurers—already a force in the market—are in some ways better positioned to succeed because they have already built capabilities to address "consumerization." Innovative new firms—carriers and intermediaries alike—are primed to leverage their digital sophistication and legacy-free models to tap into the market.

About McKinsey's Small Commercial Insurance Buyer Survey

McKinsey's Small Commercial Insurance Buyer Survey gathered responses to a 45-minute online survey from more than 1,500 U.S. small business decision-makers. Industries included services, finance, construction, retail, transportation, wholesale and manufacturing. Product mix included liability, property, workers' compensation, commercial auto and business interruption.

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