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Partnerships, scale, and speed: The hallmarks of a successful IoT strategy

The Internet of Things both promises to enhance and threatens to undermine insurers' business models. A three-pronged strategy is needed to secure its benefits.

Insurers have always offered "virtual" products and based their success on a data-driven business model. Information technology has thus been essential to their operations. Yet the industry has been slow to adopt digital technology and, in particular, to grasp the benefits arising from the Internet of Things (IoT). If it is to do so, it needs to put its foot firmly on the accelerator.

The soaring number of internet-connected devices that constitutes the IoT signals their influence. In 2010, there were 12.4 billion. By 2025, it is estimated there will be more than 50 billion. These devices, equipped with sensors and activators and attached to all manner of objects or worn by people, can convey vast amounts of data back to companies in real time and enable virtually immediate analysis and response, often without the need for human intervention. The way companies in many industries operate is changing because of them.

In the energy industry, for example, the IoT is being applied to the maintenance of wind turbines to improve their repair speed and reliability. In agriculture, sensors that monitor soil humidity and trigger irrigation are raising productivity. For insurers too, the IoT presents an array of opportunities, particularly in relation to the way they interact with customers—but it also poses a threat to existing business models. A winning IoT strategy will depend upon the partnerships and scale insurers can build, and the speed at which they do so.

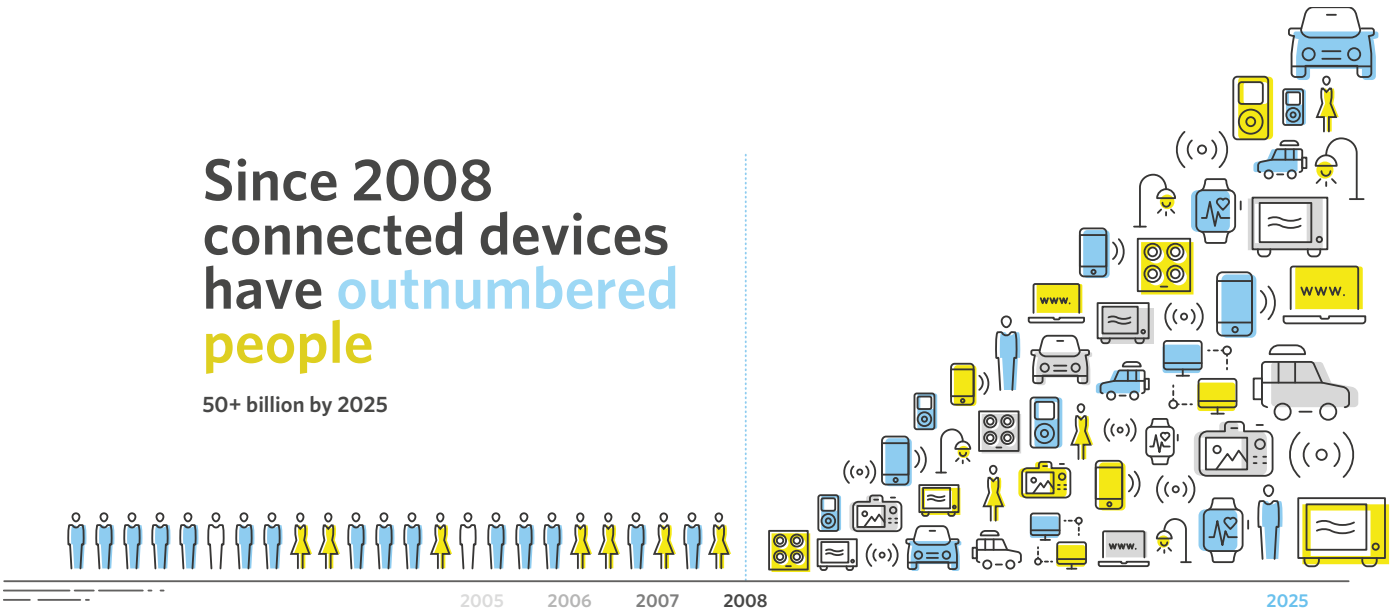
The emergence of ecosystems

At present, there are four primary areas for insurers considering an IoT strategy: connected cars,[1] connected health, connected homes, and IoT in commercial lines. The IoT can enhance existing business models in each and allow for more accurate risk assessment. For example, auto insurers used to price

1 For more detail, see "Shifting gears: Insurers adjust for connected-car ecosystems," May 2016, McKinsey.com.

Since 2008 connected devices have outnumbered people

50+ billion by 2025



Source: Statistisches Bundesamt, Deutsche Bundesbank, Prognos, Digital Sociey Study, Thomas Nipperdey, McKinsey.

policies on the basis of proxy variables such as the age, residence, and credit score of a driver. Today, they can price on the basis of real usage and driving behavior, such as how fast a vehicle is being driven and whether it is being driven at night. In a commercial setting, insurers can now know whether a business owner is following required safety and maintenance procedures.

While offering plenty of potential to enhance the business model, connected devices also challenge it.

On top of the core business of offering insurance policies, connected devices also give insurers the opportunity to interact more often with their customers and to offer new services on the basis of data collected—a step change in an industry where customer relationships are often delegated to an agent or broker, and customer touchpoints tend to be limited to annual renewals and occasional claims.

While offering plenty of potential to enhance the business model, however, connected devices also challenge it. The auto industry—the most mature sector in terms of its adoption of connected devices—illustrates the point. Cars are increasingly equipped with sensors that, besides monitoring a driver's behavior and vehicle usage, can collect other vehicle data such as oil temperature, brake wear, and tire pressure. A host of new applications are thus enabled that meet customer demands for convenience, safety, and security. And as their number grows, an ecosystem forms around the connected car, involving automakers, telecom companies, sensor and chip manufacturers, digital platform giants such as Uber, academic institutions and standards-making bodies, and, of course, insurers.

The emergence of this connected-car ecosystem changes the competitive landscape for all participants, but particularly for insurers. Connected cars have fewer accidents and breakdowns—the new technology increasingly prevents them. Hence, premiums fall. This downtick is potentially aggravated by significant changes in risk distribution. Connected devices can separate out the high-risk customers from the lower-risk ones, so the insurer's focus moves to predicting and managing individual risks rather than communities of risk and to developing new actuarial models. Moreover, careful drivers might expect significant discounts on their insurance premiums that will be difficult to balance with price increases for higher-risk drivers. These developments are expected to put pressure on hitherto stable revenue streams.

The loss of these risk-based revenues could well be offset by the emergence of

new, service-based revenues, however. Insurers could offer risk-prevention services, alerting drivers that their car needs a service, for example, or finding smart parking solutions. They could even offer proprietary data and analytics solutions to third parties, such as media agencies that focus on location-based advertisements.

Yet, notwithstanding assets such as proprietary data, long-established customer relationships, and analytical capabilities, insurers might not be in the best position to tap the IoT. To access the valuable data from sensors upon which new, hybrid insurance models depend, they will probably have to enter partnerships with the companies that own the data, such as auto manufacturers and health equipment producers—and these companies might have better contacts with their customers than insurers do. In that case, auto manufacturers that fit monitoring devices to every car as standard, or telecom companies that upgrade buildings with smart home sensors, could become gatekeepers to insurance customers. At the same time, companies outside the insurance industry are building risk-related data and analytics, alongside service capabilities. In other words, the IoT could undermine insurers' two hitherto critical competitive advantages—their underwriting skills and their customer access.

Becoming an attractive partner

What will it take for insurers to succeed in a connected world? Carriers should start by asking themselves three questions. Can I find the right partner? Can I build enough scale? And can I move quickly enough?

The question of finding the right partner is closely related to the question of building sufficient scale. Any partner will need to be sizeable. That is because very large amounts of sensor data will be required, on top of the proprietary data insurers already have, if meaningful insights are to be extracted from it, especially to get to sufficiently long claims histories in order to assess risks. At present, in respect of connected cars, for example, many sensor systems are of limited value because they have neither sufficient geographic coverage nor a link to data on actual claims frequency or severity.

Insurers need to make themselves attractive potential partners.

Insurers can enhance their chances of finding the right partner by considering carefully how they position themselves within an IoT ecosystem. For example, consumers are increasingly suspicious of companies collecting their data; thus insurers can present themselves as trusted and reliable collaborators. They can also highlight their capabilities in risk assessment. Yet ultimately, the most attractive insurers in the ecosystem will be those keen to build risk mitigation capabilities too, and to help provide services such as roadside assistance and medical assistance.

This leads to the third question: can I move quickly enough? Before long, the IoT will reach a tipping point where insurers not yet in the game could find themselves locked out. Unless they move fast, they might find it hard to secure a partner with the necessary mass of data and customer access. An auto manufacturer might need only one insurance partner, after all. Similarly, in the connected home market, those with the data are likely to be picky. In the end, this could be a winner-takes-all situation in which first movers shape the market and sustain a competitive advantage.

Insurers therefore need to make themselves attractive potential partners. That means defining a compelling value proposition and building the critical capabilities: next-generation IT that can interact with multiple external systems, advanced analytics that connect an insurer's data with insights from partners in the various ecosystems, the ability to integrate coverage and service solutions, and digitally native talent experienced in agile and test-and-learn modes of working.

The inevitable uncertainty that still surrounds the development of the IoT should not prevent insurers from taking bold, urgent action. The fast lane is the place to be. ▢

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