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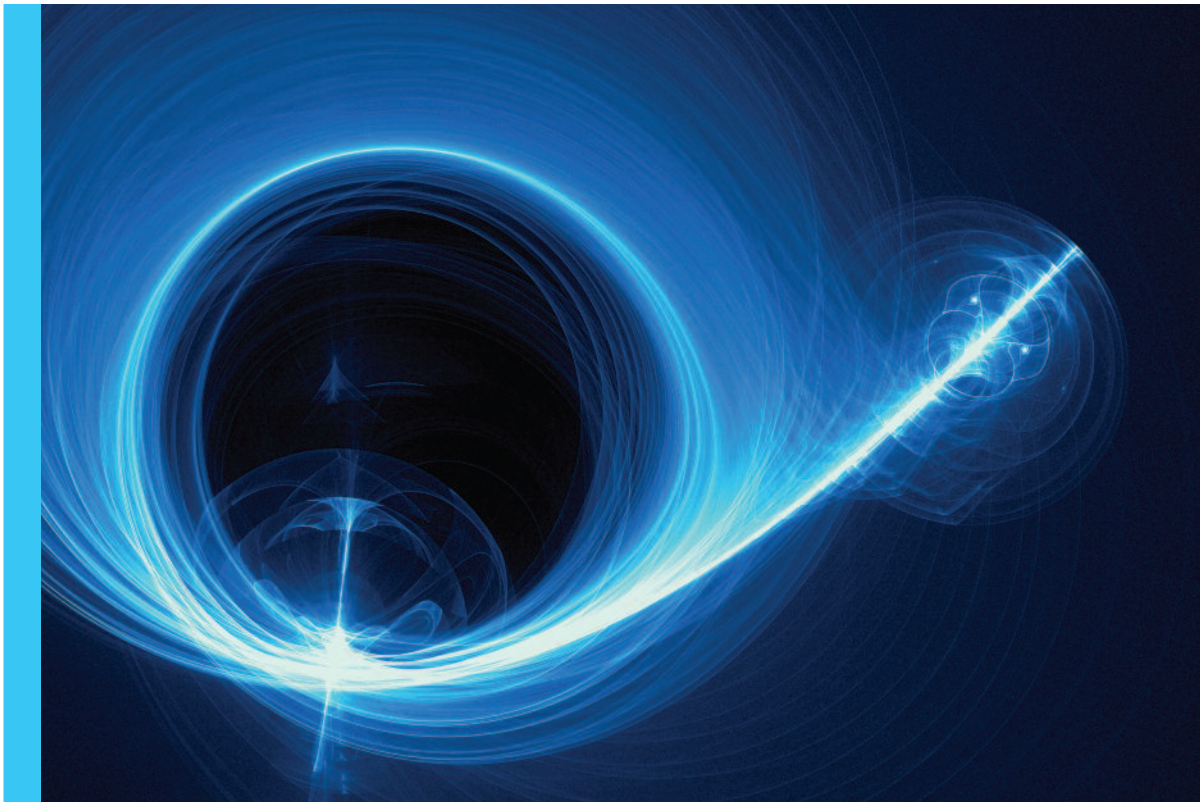
The Hallmarks of Digital Leadership in P&C Insurance



Financial Services Practice

The Hallmarks of Digital Leadership in P&C Insurance

Introduction

When it comes to sustaining strong performance, certain digital capabilities and practices matter more than others. McKinsey research finds that the property-casualty (P&C) carriers that generate the strongest financial results do a handful of things especially well. They articulate an ambitious digital strategy. They use analytics and automation to enable more responsive and accurate decision-making. They instill a culture that obsesses over customer needs, and they build collaborative and agile organizations capable of continual innovation.

Over the last three years, McKinsey has measured the Digital Quotient® of 44 insurers around the world by evaluating the 18 management practices related to digital strategy, capabilities, culture and organization that correlate most strongly with growth and profitability. Top insurers, those that score 50 and higher (on a 100-point scale), are growing revenue 1.5 times as fast as the rest of the field and are operating with a combined ratio that is four percentage points lower.

By contrast, the average DQ score for the rest of the insurance sector is just 33—putting traditional insurers well below the average digital maturity of businesses across industries. Among the issues, the data finds that the average insurer is not adapting to the changed channel environment. They're not targeting customer pain points effectively. They're struggling to reduce process complexity, and not delighting customers at a time when entrepreneurs with limited resources can marshal digital technologies to develop competing offerings in a matter of weeks.

These findings reveal that the new bar for P&C carriers is not simply to invest in technology, but to focus on the practices most correlated with strong financial and customer performance and build the digital DNA of the organization.

The Practices that Lead to Outperformance

Compared to sectors like retail, the insurance industry is still early in its digital transformation. Only a handful of the P&C insurers in the DQ database earned scores of 50 or higher that put them into the Established Leader category. In North America, for example, which accounted for just over half of the insurers in our benchmark, insurance ranked third from the bottom of the 10 industries studied, ahead of only transport and logistics and private equity (Exhibit 1).

The divide matters since DQ scores are highly correlated with financial performance. Based on five-year compound annual growth rates (CAGR), the highest-scoring leaders in insurance and across industries generate revenues and shareholder returns that are 11 and 5 percentage points higher than laggards, respectively.

But while the insurance sector is still maturing with respect to digital—especially in areas like organization and culture—outperformers are employing digital to reshape their business, operational and organizational models. Within the insurance sector, top-quartile DQ performers are generating a CAGR of 6 percent compared to 3.9 percent for the average player and substantially higher profitability (Exhibit 2, page 6). They commit to a clear digital strategy, invest in essential technological capabilities, work toward a collaborative mindset, and align their organizational structures, talent development, funding and performance indicators with the digital strategies they have chosen.

Indeed, the DQ research shows that specific management practices related to digital strategy, culture, capabilities and organization have an outsize impact on performance.

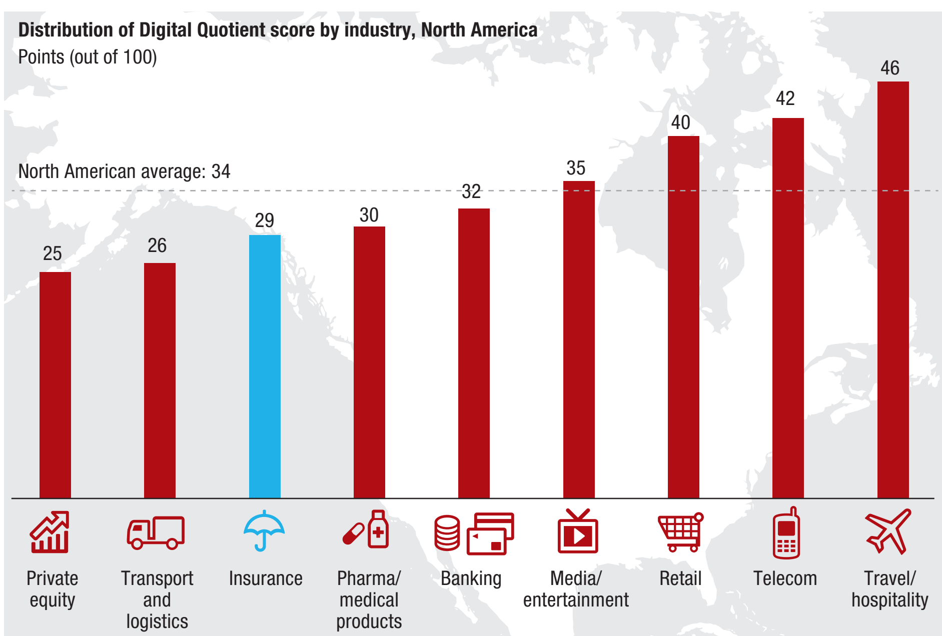
1. **Strategy:** One digital area where the insurance sector shines is strategy. Top-performing insurers earned an average score of 73 for the effectiveness of their digital strategy compared to an average score of 40 for all other sectors and geographies. That strong performance was driven by three management practices. Leading insurers create a bold, long-term vision, based on a clear and shared articulation of customer priorities. They build strong senior leadership consensus around that vision, and they set robust targets around such areas as growth, market share, customer satisfaction, expense ratio and return on surplus. What's more, they

center that strategy around digitally enabled customer journeys and look for ways to sustain innovation, efficiency and satisfaction.

Boldness is especially important. Leaders focus on changing the nature of the experience. They recognize that incremental improvements are not enough to stay ahead of digital advances. To hang onto a customer base that had become increasingly frustrated with long branch queues, limited window hours and one-size-fits all service, for example, ActivoBank became the first Portuguese financial institution to adopt a digital-first model. Under the operating mantra that "each customer receives only what they need and pays only for what they use," the bank created a digital strategy focused on the lifecycle needs of different customer segments, from those just beginning their careers to those starting a family, and so on. The product, sales and service model was tailored accordingly, with the aim of triggering relevant offers in under six minutes. Upgraded websites and apps provided a retail look and feel with intuitive touchscreens and simple non-banking language. The relationship manager approach was overhauled similarly. High-value customers are now automatically directed to concierge-style relationship managers and lower-value customers receive efficient digital self-service. These changes transformed the institution's brand. In the six years since the initiative launched, ActivoBank has increased CAGR by 35 percent, and customer retention, revenue per customer and overall loyalty are among the highest of any competing institution in that country.

Exhibit 1

North American insurers lag other sectors in digital maturity



Source: McKinsey Digital Quotient

Unlike the typical three to five year business plan, the strongest digital strategies are continually refreshed and realigned. Importantly, those strategies look beyond the pressures of the next earnings report and take into account where the insurer can use digital technologies to attack, defend and partner in the near-term as well as further out. Progressive, for instance, invested heavily in telematics, even though it recognized that the payoff might be years away. But they took a long-term view and the investment delivered: Progressive's telematics leadership has helped the company keep losses and costs down even as the frequency of accidents across industry rose. Similarly, USAA saw an opportunity to expand from servicing just one part of the automobile purchasing decision journey—insuring a new car—to facilitating the entire chain from test drive to title. The company's AutoCircle program allows members to conduct the complete auto-buying process over their iPhone or iPad. They can search for a new car, arrange financing, and secure insurance quickly and at competitive rates. The strategy has allowed USAA

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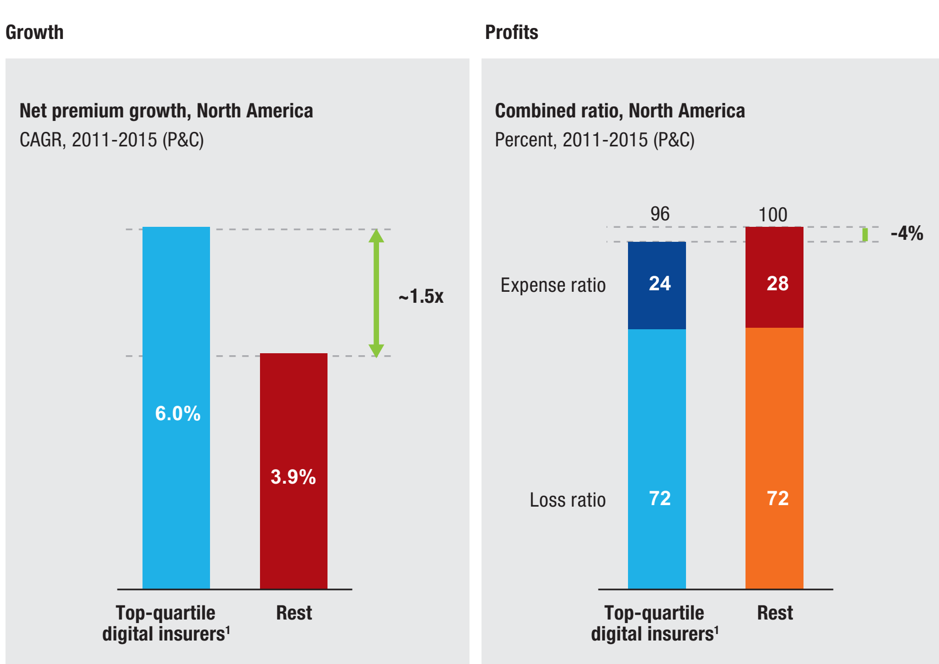
Exhibit 2

Digital leaders in P&C are also market leaders



[1] P&C carriers in the top quartile of all North American companies (across sectors) by total Digital Quotient

Source: SNL; McKinsey Digital Quotient

to diversify its base and provide its members with superior convenience and value.

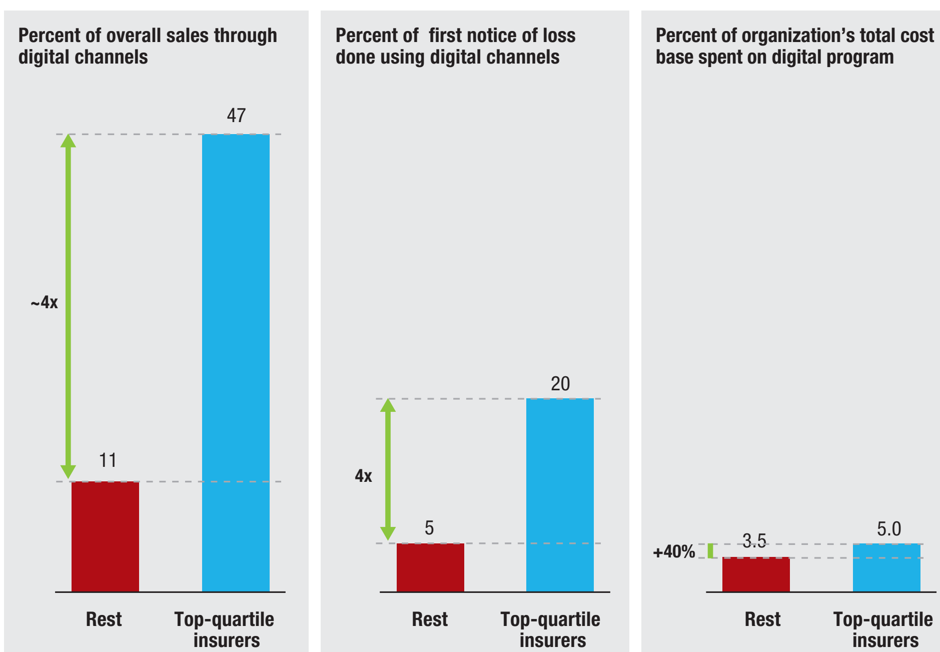
2. **Capabilities:** Insurance leaders are particularly strong in areas like marketing, automation, channel connectivity and digital content creation. They generate one-third more sales over digital channels than the average insurer and they make it easier for customers to file claims and execute other routine services online (Exhibit 3).

   But the sector as a whole lags in the three areas most correlated with strong financial performance, namely data-driven decision-making, flexible technology infrastructure, and digitizing the customer experience. These are advanced capabilities, however, and rather than embrace a suite of complex changes at once, many DQ insurance leaders are pushing process automation and digital marketing first—relatively quick and simple steps that can deliver both cost savings and a boost in helping insurers acquire new customers efficiently. As insurers' digital capabilities mature, they should focus on the following steps:

Digitizing the customer experience: Digital leaders don't just take a process like quote and bind and digitize the existing steps. They reimagine how that process fits into the broader customer decision-making journey and then they redesign it to deliver a more satisfying and differentiating experience. Lloyds Bank, for example, is in the midst of a major digital transformation effort, investing £1 billion between 2015 and 2017 in redesigning and digitizing key

Exhibit 3

Digital leaders automate more customer-facing processes



Source: SNL; McKinsey Digital Quotient

end-to-end customer journeys in their retail and commercial banking and insurance businesses. The goal is to provide a seamless, omnichannel experience, with more self-service, increased automation, and a reduction in manual work for both employees and customers. The digital effort is part of a broader simplification project aimed at delivering £1 billion in annual savings. As of June, 2016, the bank reported more than 12 million active online customers (including 7 million active mobile customers).

Digital leaders in insurance are adept at creating a more flexible and responsive IT environment and working around traditional legacy IT constraints.

Data-driven decision-making: Among top performers, better and more integrated data analytics allow carriers to enhance productivity and performance, curate higher-quality leads, raise their cross-selling rate, and improve straight-through-processing. At Progressive, for example, policy holders can participate in Snapshot, the telematics-enabled personalized rate-setting program mentioned earlier, in which a diagnostic device records a driver's road habits over a period of 30 days, capturing such things as the number of miles driven, the number of times the driver hits the brakes and how hard, the amount of driving done at night and so on. At the end of the trial, customers receive an adjusted rate based on their driving behavior. Good drivers can receive discounted premiums of as much as 30 percent and Progressive uses its analytics insights to implement more frequent and smaller rate increases. In 2015, for example, Progressive was the first major insurer in North America to identify an increase in claims frequency and adjust its pricing accordingly—a direct reflection of the company's ability to use smart underwriting practices to draw in profitable policies.

Agile technology infrastructure: Top insurers are adept at creating a more flexible and responsive IT environment and working around traditional legacy IT constraints. Allianz, for example, embraced a "two-speed IT" model to gain a more modular IT architecture, allowing it to decouple customer-facing capabilities that are designed to be iterated and released quickly from legacy systems that have higher stability requirements and slower release cycles. The tech architecture is a critical enabler of the insurer's overall digital transformation, which includes targeted productivity gains worth at least €1 billion annually.

3. **Culture:** McKinsey's DQ research reveals that a handful of cultural attributes separate outperformers from the rest of the pack. DQ leaders across industry have a greater risk appetite with respect to digital initiatives; they embrace an agile "test-and-learn" mindset; they look outward for inspiration and they enforce cross-disciplinary collaboration. However, insurers, even those in the top quintile, trail the rest of the market in fostering this kind of cultural environment. The top quintile averages only 26 on the DQ table with the

rest of the pool averaging a relatively lackluster 19. Still, a number of P&C carriers are looking to close that divide, especially with respect to promoting agile work practices.

To help their organizations model the kind of collaborative innovation that is intrinsic to pure-play digital companies, some insurers are hosting digital “hackathons” that bring diverse teams together to brainstorm new products and journey elements that overhaul a key aspect of the customer experience.

A large North American insurer, for example, employed agile development techniques to support continuous learning, rapid prototyping and testing. Since introducing agile, time-to-market has fallen from over 150 days to 30. Today, 95 percent of employees are involved in agile deployment across the business.

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4. **Organization:** Most carriers, even those among the top quartile, struggle with adapting the way they work. While backing digital initiatives with needed investment is important, DQ analysis shows that governance, talent practices and well-aligned roles and responsibilities are especially correlated with market success. For insurers, however, the average DQ score on organizational practices is 22 compared to 37 across industries.

   Raising their digital game will require insurers to adapt how they recruit, develop and retain talent. Insurers also need to be thoughtful in figuring out where and how to deploy their digital hires. Many of these individuals come from less formal, collegial startup environments. Surrounding these highly sought-after hires with a cohort of like-minded peers and sufficiently stimulating projects will be important to keep digital talent challenged and engaged.

   Insurers must also work to close organizational divides by bringing people together in agile teams based on skills rather than their functional background. Done well, agile teaming offers a unifying language and structure that cuts through organizational silos and stimulates cooperation. In practice, that means delegating decisions downward and giving the front lines greater empowerment to act on behalf of the customer. It also means iterating and parallel problem-solving rather than sequencing requirements, development and testing as has been the traditional way.

At ING, for instance, employees are broken into cross-functional groups from small “squads,” to larger “chapters,” “guilds” and “tribes,” and given end-to-end responsibility for customer functionality. Employees from marketing, product development and IT work in co-located teams to foster collaboration and accelerate testing and development. To keep progress aligned with the overall business and customer strategy, ING introduced a new performance measurement and tracking system with regular reporting. That system gives management easy insight into team performance and allows them to make quick course corrections as needed. Since embracing agile teaming, ING has improved time-to-market by 35 percent and efficiency by 20 percent.

Putting Digitization on the Fast Track

Personal lines insurers, commercial lines insurers and others all have different paths to value. But no matter where insurers sit in terms of their positioning and business goals, to compete toe-to-toe with fast-moving peers and aggressive insurance technology start-ups, insurers must adopt a digital-first mindset. That takes a sustained commitment from senior management, a long-term vision and a willingness to fundamentally change how they work.

For this shift to happen, corporate culture must change. The insurers that succeed in raising their DQ scores and financial performance most quickly take a two-pronged approach to implementing their vision.

They digitize in the near-term: McKinsey estimates that P&C and life insurance carriers have as much as 30 to 40 percent of their expenses locked up in their top 20 to 30 core processes. Digitizing those processes end-to-end, through automation, integration and straight-through-processing can yield major improvement in operating profit margins.

In parallel, insurers must explore the innovations that will power tomorrow's business models. In doing so, they must prioritize a handful of customer journeys, those most aligned with their strategy, and then redesign them in full.

They innovate for the long-term: To support that transformation, organizations need to build agile test-and-learn cultures and empower the front lines. They need to rethink their offerings and value propositions in the context of broader innovation ecosystems like mobility, the connected home, robotics, cybersecurity and other digitally enabled applications. That requires sustained investment in three areas: analytics, technology and design thinking. Insurers must fund the core technical competencies required to support digitization and innovation, such as flexible modular IT architecture, deep data access and analytics and user-centric experience design.

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Digitization is reshaping insurance markets and business models faster than most carriers have been able to respond. But while carriers know they need to adjust quickly, the best realize that calibration is also critical. The top-performing insurers will be those that move strategically to embrace the digital practices proven to be most correlated with strong financial and customer returns.

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For information about McKinsey's Digital Quotient, visit www.mckinsey.com/dq or email digital_quotient@mckinsey.com.

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