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The insurance switch: Technology will reshape operations

As insurance companies allocate more resources to technology functions, operations will need to reshape to make the most of their new tools.

by Krish Krishnakanthan, Björn Münstermann, and Karthi Purushothaman
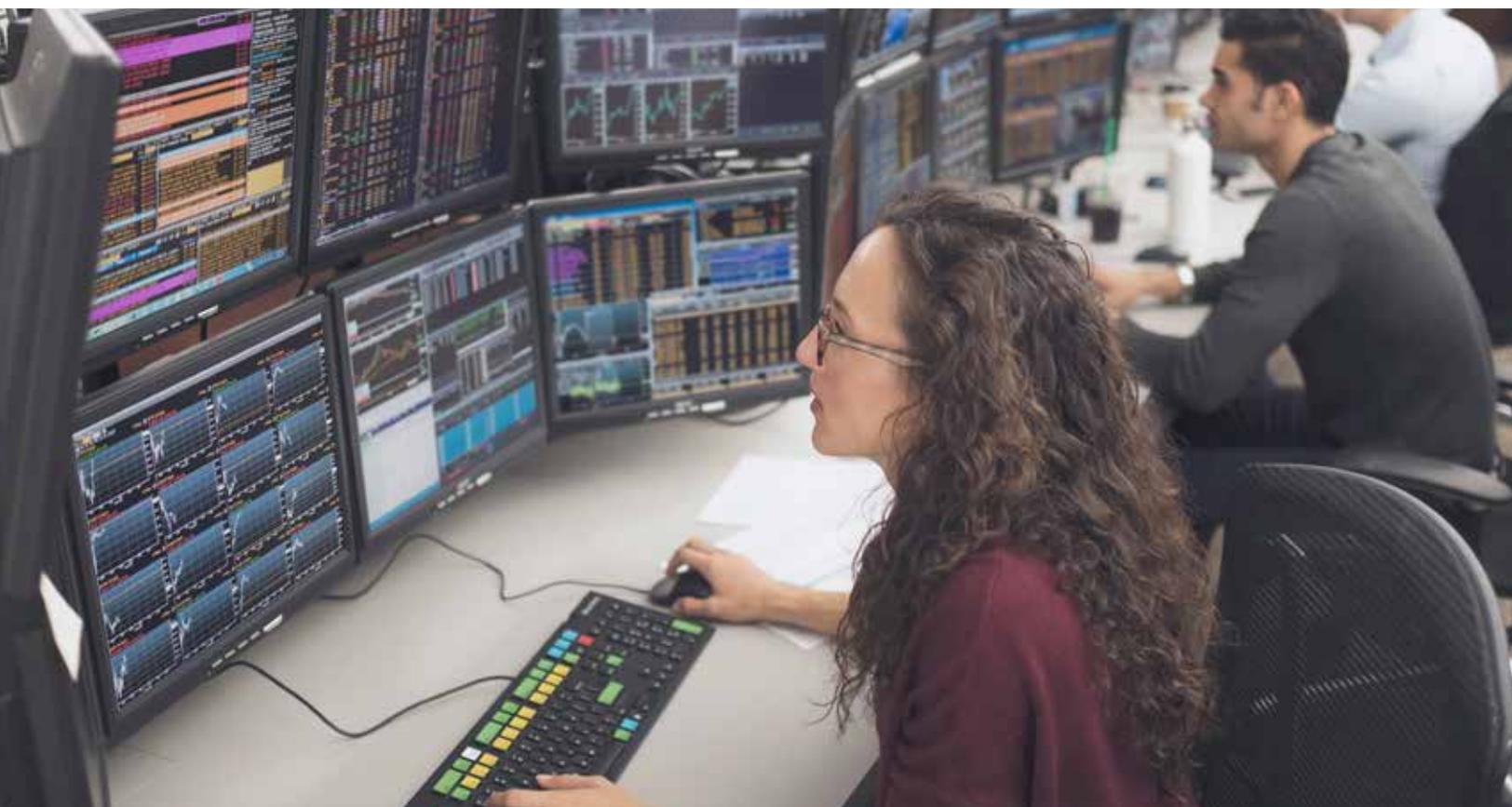
Insurance companies' technology and operations functions have traditionally operated independently. Technology facilitated the operations staff's work, but operations—underwriting, claims, and marketing—was the principal driver of corporate performance.

The relationship between the two functions is changing as insurers allocate more resources to technology functions without making similar investments in operational ones. Incumbents hope this shift will improve profitability and help them compete effectively on digital terrain—especially with insurtechs, which have technology-driven operations. Indeed, savvy insurers of all types are using new technologies to better serve customers. These tools will fundamentally alter the way insurers work, including with the automation of some of operations' traditional, manual tasks.

Our experience with insurers that want to leap into the digital era shows that as technologies evolve, these companies may end up automating 50 to 60 percent of traditional back-office operations. To prepare their operations organizations for these new ways of working, insurers should reshape themselves by forming interdisciplinary teams, formally integrating the technology and operations organizations, and assembling the tools that match customers' preferences. In addition, insurers should build capabilities to work regularly with external service providers,[1] hire talent literate in how to use the corresponding technology to enhance operations, and make sure their organizational cultures encourage and nurture experimentation.

Changing the way operations organizations work is a big undertaking requiring significant effort, but those that make this shift could see a significant drop in expense ratio and time to market; in turn, they may be able to make more investments, reduce prices, and improve profitability. Insurers that fail to change are likely to lose market share.

Technologies reshaping operations

Technology will eventually take over traditional operations. Indeed, property and casualty and life insurance lines are spending increasing amounts on technology. From 2012 to 2017, the average share of operating costs spent on IT increased four percentage points in property and casualty and three percentage points in life (exhibit).[2]

Where is this money going? To start, more insurance companies are sidestepping complex core IT systems by investing in software-as-a-service applications, which they use for distribution, operations, HR administration, and commission processing, among other tasks. The flexibility offered by these applications helps minimize or eliminate manual work arising from legacy processes.

Other technologies, such as automation, digital applications, and advanced-analytics engines, are further transforming operations. Depending on the line of coverage, these capabilities can streamline initial information gathering and document review, allowing customers to serve themselves during the underwriting, servicing, and claims processes. As such, these technologies are helping digital-first companies shrink their expense ratios to almost 40 percent lower than those of traditional property and casualty insurers.[3] Advances in artificial intelligence are also allowing incumbents to automate increasingly complicated tasks, including addressing all forms of customer queries.

For insurers with more mature technology capabilities, a suite of Internet of Things (IoT) technologies can help reduce manual interventions in claims and pricing. In coverage lines such as

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1. External service providers are outside organizations—often insurtechs or large-scale insurance-service providers—that supply capabilities to insurers on an as-needed basis.
2. For more, see Tonia Freysoldt, Sylvain Johansson, Christine Korwin-Szymanowska, Björn Münstermann, and Ulrike Vogelgesang, "Evolving insurance cost structures," April 2018, McKinsey.com.
3. The expense ratio is calculated by dividing the expenses associated with acquiring, underwriting, and servicing an insurer's premiums by the net premiums earned. The ratio is a measure of profitability, in which a company with a lower expense ratio is generally more profitable than one with a higher one.

Exhibit

The average cost of technology increased in property and casualty and life insurance from 2012 to 2017.

Average operating-cost breakdown by function, %

Value chain elements	P&C insurance 2012	P&C insurance 2017	Life insurance 2012	Life insurance 2017
Product development, marketing, and sales support	19	20	26	25
Operations	44	39	21	20
Other support functions	20	20	27	26
IT	17	21 (+4 p.p.[1])	26	29 (+3 p.p.)
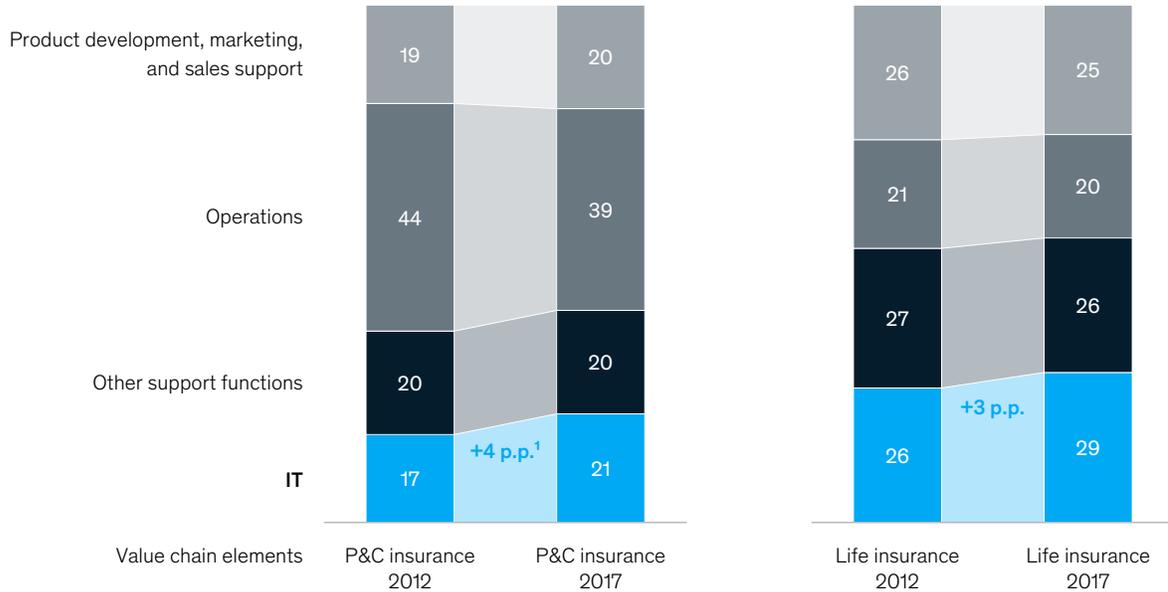
[1]Percentage point.

home insurance, for example, IoT building sensors can relay a steady stream of data regarding risk and damage and replace in-person visits from claims adjustors. Further applications of IoT technologies could prevent insurance losses on roadways, at work sites, and in homes and businesses by allowing insurers to perform dynamic risk assessments using updated data.

Building technology-driven operations functions

The insurers that thrive in an environment in which technology has transformed operations will be those that take six specific actions. They will build interdisciplinary teams that enhance decision making, integrate the technology and operations organizations, invest in tools to serve their customers, build playbooks to work with new external service providers, develop new talent strategies to update their organizations' capabilities, and create supportive cultures that challenge workers and encourage experimentation and learning.

Assemble interdisciplinary teams

Insurers are becoming more agile—that is, they are working and giving or receiving feedback in short sprints to better respond to frequently changing environments. As this shift occurs, technology and operations teams should begin to work in interdisciplinary pods that include product owners, technologists, data scientists, agile coaches, and operations and design experts.[4] The diversity of perspectives informing decision making and improving customer servicing gives these pods a

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[4] For more on agile organizations, see Wouter Aghina, Karin Ahlback, Aaron De Smet, Gerald Lackey, Michael Lurie, Monica Murarka, and Christopher Handscomb, "The five trademarks of agile organizations," January 2018, McKinsey.com.

distinct advantage. As new technology capabilities redefine customer interactions and operational workflows, these interdisciplinary pods should organize around complete customer journeys rather than individual transactions, which tend to cover only some customer needs.

For example, a team that can use its view of the entire intake-to-issue process to simplify the demands of customers is more likely to create a better customer experience than a team that focuses only on customer intake and curation.[5] As the organization's technology capabilities mature, the pods should evolve to incorporate more specialized technology roles. Doing so will enable them to build, scale, and manage automated systems specific to customer journeys.

One global insurer used interdisciplinary pods to fast-track the automation of operational processes. Within each pod, half of the staff are data engineers, visualization experts, and business-analytics experts; others are from the business and operations teams that helped design and operate the automated processes. The pods also solicit and receive periodic inputs from marketing, communications, legal, and regulatory stakeholders to formalize any changes needed to ensure that the new processes and innovations are adopted. The interdisciplinary pods designed and implemented the new process and systems in one-third of the time it usually takes a traditional team of specialists.

So far, the pods have automated almost 30 percent of the insurer's manual operations tasks. As a result, the company is operating more efficiently compared with the previous two years and has improved its satisfaction scores from customers.

Create integrated organizational structures
As interdisciplinary pods scale across the organization, changing mind-sets will be the

biggest challenge. For the pods to be effective, the organization should familiarize everyone (especially business, operational, and functional stakeholders) with the relevant roles and help them develop an appreciation for collaborating with technology specialists. Doing so may be best accomplished by integrating the core functions involved: operations and technology.

Banking and other financial services companies have a head start, given that in the past decade most of them have already become integrated organizations. Insurers must follow quickly in the next two to three years to take advantage of the changing relationship between technology and operations. To accomplish this, it will be important to establish clear training procedures, incentives, reporting structures, methods for managing performance, and career paths. For instance, one European bank eliminated organizational silos to improve its operations with technology. After such a transformation, a single person's responsibilities might touch on IT, operations, cost management, and end-to-end innovation management. Thanks in part to these organizational changes, the bank reduced its costs, brought in more technology offerings to smooth customer experiences, and can now execute on ideas more quickly.

Invest in technology tools that serve customer preferences
Customers increasingly prefer transparency and control in their interactions with all types of organizations. Insurers must adapt accordingly, offering technology experiences that are faster, more engaging, intuitive, and tailored to customer needs. For example, one American insurer offers a 24/7 chatbot service to help customers complete straightforward transactions, such as updating designated beneficiaries. The operations function, which has traditionally been responsible for providing this experience, will now have a big

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5   The intake-to-issue process covers the steps from learning about a new customer until an insurer issues a policy.

Insurers must offer technology experiences that are faster, more engaging, intuitive, and tailored to customer needs.

role in assuring these tools address the various customer and business use cases instead of directly addressing routine customer queries.

Adopt new service models
Insurers that want to transform to perform well in a technology-driven operations environment are often hampered by their legacy processes and technology stack. Many insurers are overcoming this challenge and setting up new service models quickly by partnering with insurtechs, technology companies, and even traditional business-process outsourcing companies. These new service models significantly reduce operational expenses while often also providing additional revenue streams in the form of recurring insurance-as-a-service offerings.

To ensure that these new service models enhance performance and improve the agent and customer experience, team members across different parts of the service model will need to work together to promptly address hurdles that may arise during the operational and technological transition.

Shift the approach to talent
As technology plays a bigger part in insurance organizations—to the point of replacing human operators in many routine operations tasks—

insurers must grow their talent pool to include individuals skilled at analytics, agile coaching, and customer-experience design. To facilitate this shift, leaders can upskill their employees who are most suitable for the organization's updated needs and shore up their external hiring capabilities. Organizations can even set up formal, at-scale training capabilities in partnerships with universities or online academies. For example, the Ritz-Carlton Leadership Center partners with faculty from leading academic and corporate institutions to promote customer-centric mind-sets in its senior executives, who can then infuse their organizations' cultures with those values.

HR will also need to devise ways to attract, engage, and retain this talent. Among the ways they can do this is to offer nonmanagement career tracks, initiate interactions (online and offline) with talent in the communities in which they already congregate, and have current technology employees act as evangelists for the organization.

Nurture a culture of learning
Even when organizations adopt practices such as sprints and zero-based design,[6] working with new technology will likely involve dead ends. To maintain an atmosphere of productive experimentation, insurers should cultivate an appetite

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[6] Zero-based design requires a "blank slate" that allows stakeholders to develop solutions tailored to specific goals without being influenced by previous models or preconceptions.

for experimentation and an acceptance of failure. This cultural adjustment will also make insurance companies better homes for the technologists they'll need, who tend to come from team cultures that encourage learning from failures.

Insurance leaders can create a culture of experimentation and learning by articulating their support, then demonstrating this commitment by modeling curiosity instead of punitiveness, even when technology initiatives fail. Regardless of the outcome, leaders should be responsible for making sure that their teams learn from experiments. Innovative incentive structures that mimic those of start-ups can also encourage experimentation and learning.

For example, one North American bank prides itself on a culture driven by data and analytics. Budgets allow for all employees, from the C-suite to line managers, to run experiments that could

seed future strategies. These budgets can sometimes yield less than 5 percent. One success story emerging from the bank's promotion of experimentation was the development of a system that automatically routes debt collection calls to the appropriate call-center operators—using analytics-guided designs—and provides customized scripts for them.

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Technological advancements are changing insurers from the inside out—and this reality is felt most in operations. While it's not yet clear how exactly technology and operations in the insurance industry will be transformed in the next few years, organizations will need to reshape themselves to make the most of the technology tools that will allow them to operate more efficiently and with a greater focus on customer experience.

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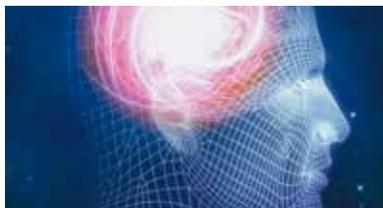
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