McKinsey&Company

Financial Services Practice

The Making of a Digital Insurer

The Path to Enhanced Profitability, Lower Costs and Stronger Customer Loyalty

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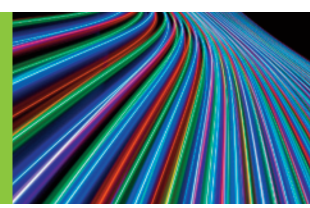

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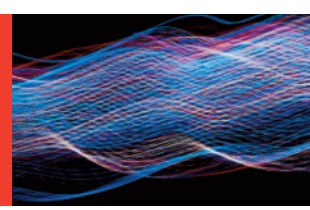

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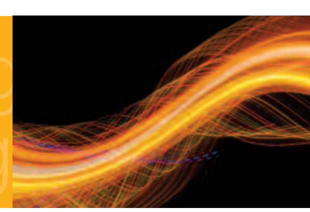
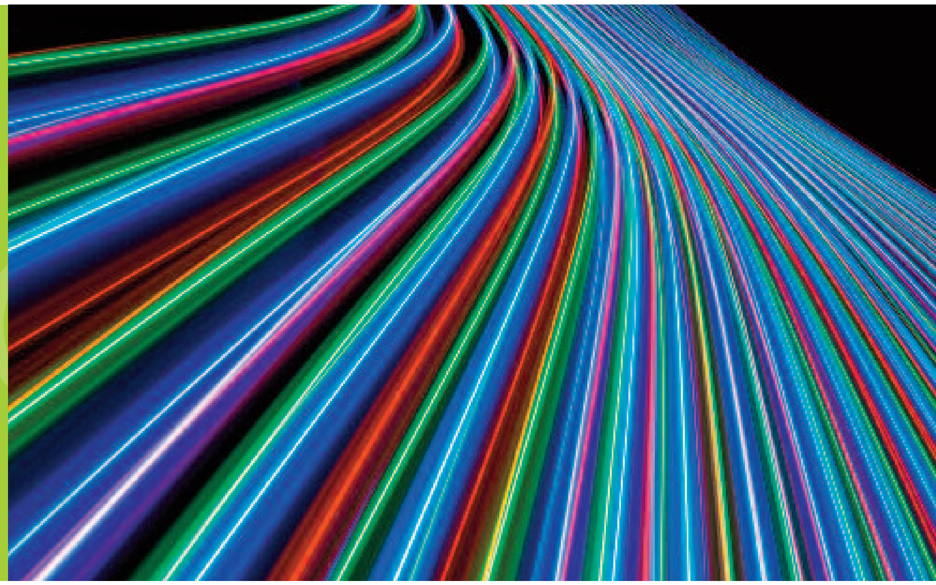




Introduction

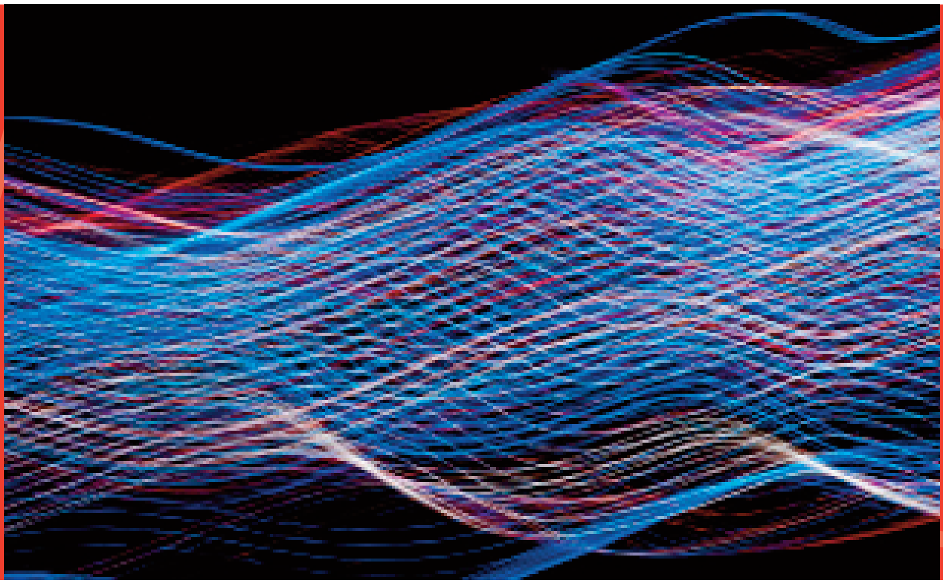
Insurers worldwide are increasingly creating value by using digital tools and technology in a number of innovative ways. However, much of the potential value—and the most significant opportunities for making digital a competitive advantage—remain untapped. To unlock this potential, insurers should follow the example of leaders in digitally advanced industries, which take an enterprise-wide approach to digital and understand that digital is more than the sum of individual initiatives. In short, to reap the full benefits of the digital era, insurers should aspire to become digital firms.

Digital firms leverage technologies such as mobile, social and cloud to make better decisions, automate processes, deepen their connection with customers, employees and intermediaries, and pursue profitable innovation, all at a rapid development pace. Furthermore, the most successful digital firms across all industries are distinguished by the degree to which digital is integrated at all levels and functions of the enterprise. Digital informs everything from strategy and organizational structure to day-to-day operations and workplace culture.

Today, insurance customers and clients' expectations have been shaped by their digital experiences with sophisticated companies in other sectors, such as Amazon and Uber. The digital bar for insurers is high and rising. Those companies that can meet this challenge will build greater customer loyalty, cut costs and improve profitability.

Based on work with carriers and research on the qualities that distinguish digital leaders across all industries, McKinsey has developed a perspective on how insurance management teams can set a course to attain digital excellence. By making progress in six key dimensions discussed in this report, insurers can both achieve significant immediate gains while paving the way for deeper, longer-term change. These dimensions are: strategy, customer-centricity, digitizing business processes, organization, technology, and analytics and decisionmaking. While the pace and magnitude of change depend on a carrier's present position and on their product focus, all insurers can derive significant near-term value from digital.

Importantly, the characteristics that have differentiated high-performing insurance carriers in the past—underwriting discipline, claims execution, investment management savvy—will continue to be fundamental to success. However, carriers that can combine these strengths while also leveraging the full power of digital tools and approaches will be in a position to lead the industry. This report concludes with a number of observations about how management teams can jumpstart this digital journey.



How Digital Firms Create Value

Insurers are already demonstrating the value that a digital approach can deliver through improved connectivity with clients and intermediaries, better decision-making, cost savings from automation, and as a springboard for business model innovation. The choice insurers face today is whether to simply invest in digital capabilities or become *digital insurers*. The best-performing carriers of tomorrow will choose the latter course. Based on work in the insurance industry and cross-sector research on the qualities digital leaders have in common,[1] McKinsey believes carriers should rethink their approach in six areas where digital can have the greatest impact: strategy, customer-centricity, business processes, organization, technology, and analytics and decision-making (Exhibit 1).

[1] **McKinsey Digital Quotient.** **See page 18 for description.**

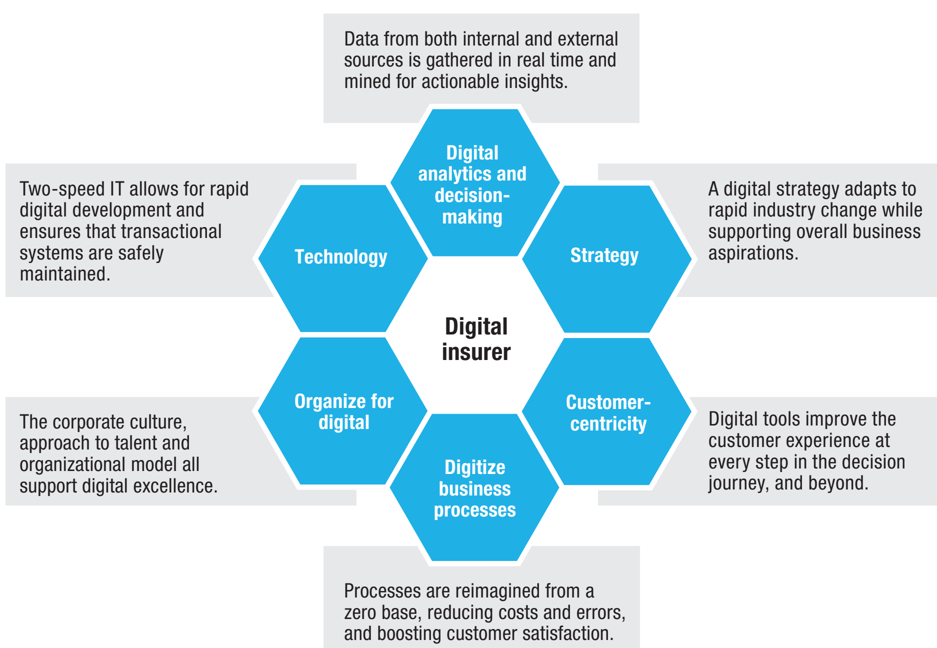
Strategy in the digital age

Insurers seeking digital excellence must develop a strategic approach that is nimble and flexible enough to adapt to rapid industry change. The risk of using a traditional long-term plan for digital strategy is that the industry context is likely to evolve by the time the strategy is fully implemented. The following questions can help management teams frame the discussion on digital strategy:

- What are the current needs of insurance customers and intermediaries? What are the pain points? How might they evolve?
- What digital opportunities can be captured—and what threats can be addressed—at each stage of the value chain? What is the nature and the magnitude of the value (cost, revenue, losses) at stake? How should we prioritize our approach to these opportunities?
- What is the gap between our current capabilities and our operating model? Are there areas where we can disrupt our own business? Places where we can test and learn, or adopt a follower mindset? In what areas should we build capabilities in-house, and where should we look for external partners?

Exhibit 1

To succeed in a digital era, insurers should rethink their approach in six areas



Source: McKinsey Insurance Practice

- Can we quickly and cost-effectively review our digital strategy and reallocate resources when change is required?

Overall, a digital strategy must be closely tied to or integrated into the overall business strategy; however, only one in six insurers in our research are doing this. Constructive management debate on these questions will help bring strategic challenges to the fore.

Insurers can use digital tools to develop a clear view of which customer interactions can be re-imagined through digital, which are frustrating for policyholders or insurance shoppers, and where an improved experience will have the most impact.

Customer-centricity

Insurance customers—including agents, brokers and corporate clients—have high expectations shaped by their digital experiences in other sectors with companies such as Amazon, Uber and Facebook. Meeting these expectations is both the challenge and the promise for insurance carriers in the digital era.

An effective approach to customer-centricity in insurance begins with the systematic examination of how digital can improve the customer experience at each step in the decision journey, whether the customer is a broker submitting an application for a global mining firm, a young couple seeking their first life insurance policies, a busy executive paying her multi-policy premium, or a policyholder filing a claim for glass damage. However, only one in 10 insurers in McKinsey research has aligned its digital strategy to maximize effectiveness across the full decision journey.

Insurers can use digital tools to develop a clear view of which customer interactions can be re-imagined through digital, which are frustrating for policyholders or insurance shoppers, and where an improved experience will have the most impact. Addressing bottlenecks or suboptimal performance in this way can lead to dramatic increases in growth (see sidebar, “A broader view of digital leads to rapid growth,” page 8).

As an example of how digital enables a new level of customer-centricity, consider a simple customer interaction: A car owner is checking the status of her financial accounts with an online financial services aggregator. A customized ad for a car insurance policy comes up, offering her an advantageous rate because she spends a relatively small amount on gas each month—indicating a below-average amount of driving. The moment is favorable to both the carrier, which can narrow its marketing approach to a degree unthinkable just a few years ago, and to the customer, who gets a money-saving offer she might never have known existed.

Carriers are also using digital to recast the customer relationship. In life insurance, where customer interactions are often limited to contract signing and payout, digital connectivity allows for far deeper engagement and opportunity. By tracking the "breadcrumbs" that policyholders leave across the social-media landscape, insurers can accurately—and selectively—connect with consumers at critical points in their lives (e.g., birth, wedding, new home) to offer relevant products, services and advice. One large U.S. life insurer used this approach to boost its agents' lead conversion rates by 20 percent. In commercial lines, a large carrier is differentiating itself from competitors by providing its global clients with unprecedented views of their worldwide coverage.

Digitizing processes

Digitizing business processes can deliver significant near-term gains in the form of reduced costs, lower error rates and increased customer satisfaction for carriers across the business line spectrum. Thus far, however, most carriers have not fully embraced the opportunity. Some expect their antiquated legacy IT systems to be an insurmountable obstacle, but the reality is that insurers can revamp many discrete processes without making changes to their underlying technology infrastructure.

Carriers are digitizing processes to achieve increases in both efficiency and customer satisfaction, often without major technology infrastructure upgrades, and in time frames measured in weeks or months, as opposed to years. Claims and servicing in particular are fruitful areas for the digitization of processes. One UK insurer eliminated around 20 million calls per year by introducing an app that allowed customers to make direct changes to their policies.

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 end-to-end processes (Exhibit 2, page 9). This is value hiding in plain sight. Furthermore, for many carriers, there are also numerous smaller-scale processes involving the needless pushing of paper and duplicative tasks that can be cost-effectively digitized over short time frames. (See sidebar, "Rapid process digitization," page 12.) Overall, McKinsey estimates that carriers can drive a minimum one- to four-point improvement in their overall expense ratios through rapid digitization.

Organizing for digital

Successful digital firms are distinguished by more than technical expertise. They invariably have a corporate culture, an approach to talent and an organizational model that create the conditions for digital excellence. These "digital champions" generate revenues that are about 10 percent higher than their industry average, are 20 to 30 percent more profitable than industry average, and score highly on a set

A broader view of digital leads to rapid growth

A U.S. insurer with an agent-centric culture and business model understood that it needed to adapt to changes in customer behavior—their own research predicted that 40 percent of new business in the next three to five years would come through online and mobile channels.

This was not the company's first attempt to build up the direct channel. A previous effort was positioned within the confines of the existing business model, with the same target segments, products and pricing. The results were mixed, at best: overall direct conversion was only half of what pure direct insurers achieved online.

This time, the insurer assembled a cross-functional digital team at the mid-management level and empowered them to make decisions within their functions (e.g., marketing, pricing, underwriting, customer experience). The team was built for speed; they removed legacy underwriting rules (tailored for the agency channel) from the online process in just one week.

Before digging into their analysis of the customer decision journey, the team aligned on metrics that reflected a cross-functional view (number of policies bound through online and mobile channels) as opposed to those that measured narrower functional success (e.g., traffic to website). They then built a fact base on sales-funnel performance and applied analytics to determine what elements played the most decisive role in converting shoppers to purchasers. One such element was marketing spend. The company discovered low marginal returns on digital marketing spend in states where agent density and price competition was high, which pointed to a clear opportunity for reallocating spend to regions where returns were higher.

In looking at personalization, the team turned back the clock on the start of the customer journey to two months before purchase, identifying key triggers such as a recent move or new home purchase that would point to an imminent insurance purchase. They then carved out macro-segments that would personalize journeys based on customer needs (e.g., protection versus price).

Taking a test-and-learn approach, the team designed pilots to rapidly increase their understanding of customer journey optimization (e.g., best time to call the customer who abandoned an online quote). They also embedded a two-speed IT architecture so they could act quickly and scale the resulting improvements.

The insurer expects to double the conversion rate with existing capabilities in about 12 to 18 months and is rolling out changes that will achieve the first 30 percent improvement in about six months. The number of tests per year has increased by a factor of 20. The carrier is also laying the foundation—with technology and data partnerships—to capture the additional impact over the longer term.

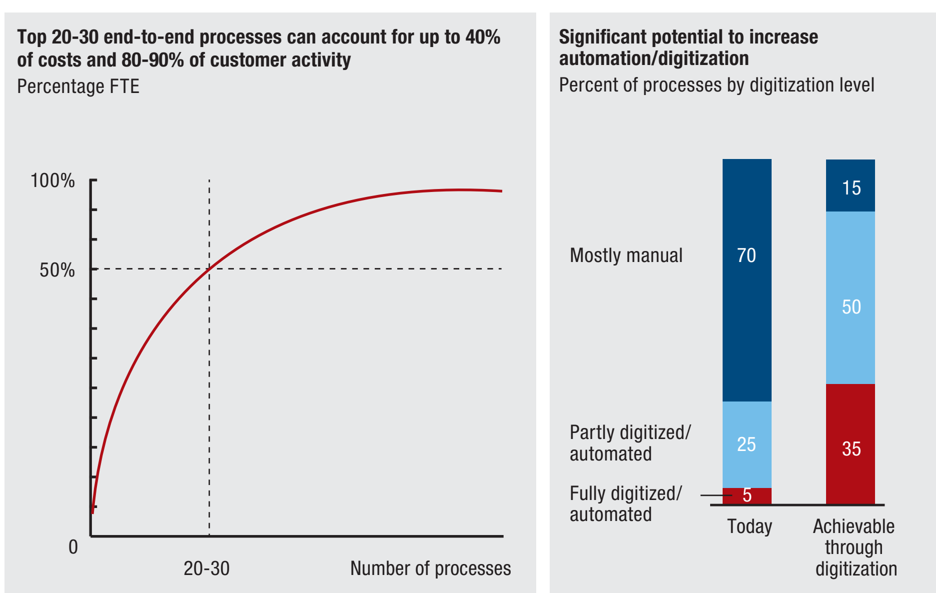
of best practices in three categories: culture, talent and organizational structure.

1. **Culture.** The cultural values that drive digital excellence include a higher risk tolerance, an acceptance of failure as part of innovation, and a test-and-learn approach. Other qualities common to digital leaders include quick decision-making, adaptive learning, internal collaboration and an external orientation (they know their strengths and are open to partnerships that can fix their weak spots). These qualities are highly indicative of success in digital, but some will appear antithetical to the culture of a traditional insurer. For instance, only 16 percent of U.S. insurers have an appetite for risk-taking and creativity that matches that of digital leaders across all industries. Cultural change is not an overnight project. It depends heavily on visible management buy-in and role modeling, and on rewarding and publicly celebrating examples of desired behaviors.

2. **Talent.** Top digital talent tends to be drawn to leading technology firms and start-ups. Traditional insurers must therefore build a strong talent value proposition to compete effectively. In some cases, an incubator or center of excellence can serve as a magnet for digital talent. Carriers must also overcome their traditional reluctance to hire from outside the industry, which often results in employees qualified from an insurance perspective getting plugged into digital roles for which they have no

Exhibit 2

Insurers can capture significant value by digitizing their largest processes



Source: McKinsey analysis

aptitude. Leading digital firms are sector agnostic when it comes to talent, frequently plucking hires from disparate sectors in the belief that digital competency matters more than industry knowledge.

3. **Organizational structure.** Changes in culture and talent practices, combined with a significant change in the technology operating model, inevitably put pressure on a carrier's organizational structure and processes. In responding to this challenge, insurers must choose the organizational model that best fits their company's current level of digital maturity. Successful companies in other industries follow a few archetypes. Some initiate digital innovation by creating separate venture capital incubators; others set up centers of excellence and appoint chief digital officers to lead them. Still others establish governing councils charged with thinking "big" and ensuring senior leadership buy-in. Notably, structures change as companies evolve. What might start out as a "new" competency to be incubated, such as social media, eventually matures and is integrated into the business.

Technology

Nine of ten carriers acknowledge that they are struggling to develop the technology infrastructure they need to support digitization. The size and complexity of their IT systems, many of which are based on dated legacy platforms, are a barrier to the rapid development that characterizes digital.

The best approach to this dilemma is to develop IT capabilities that run at two

The digital auto insurer

Among insurers, auto carriers have been ahead of the curve in digital innovation, offering policies with pricing based on usage and basing risk selection on actual driving behavior. What will distinguish a truly digital insurer from its more traditional peers?

It will proactively identify a customer based on observable behaviors (e.g., purchase of new car) or through partnerships with digital platforms (e.g., Amazon); offer a personalized quote without asking for any information from the customer; deliver advice virtually; enable policyholders to manage their policy through self-service platforms; manage seven of ten claims without human touches and in less than a week. This carrier will have a lower cost structure, and invest the savings in building its brand and in offering competitive prices and higher customer satisfaction. And because it will be a digital firm through and through, it will drive continuous improvement though mining of data and the running of tests in the market.

speeds: a foundational IT architecture centered on transaction systems, and a high-speed, agile IT model that focuses on customer engagement systems. This approach enables carriers to deliver rapidly on their digital projects, while ensuring the transaction systems of records are safe. A number of best practices can help ensure that the two-speed approach is successful. IT and businesses should be tightly knit and work to develop an in-depth understanding of the other side's processes, capabilities and challenges. Quickly delivering high-quality end products requires new ways of working, including agile development, rapid release cycles, automated testing and deployment. Notably, the most significant challenge here is usually not within IT, but rather in persuading the business to adopt this approach.

Digital leaders are highly skilled in gathering and analyzing data. Data fuels the insights and the innovation that set these companies apart.

The two-speed approach is not without complications. Processes in both tracks need to be carefully sequenced and coordinated so that underlying IT systems are prepared to support digital initiatives. Culturally, staff on the digital side (who tend to be creative) and those on the IT infrastructure side (generally more structured) have difficulty mixing, and yet their cooperation is a key to success. Insurers should acknowledge these talent challenges and take steps to address them (e.g., ensure that successes on both sides are celebrated with equal enthusiasm).

Digital analytics and decision-making

Digital leaders are highly skilled in gathering and analyzing data. Data fuels the insights and the innovation that set these companies apart. Data analysis has, of course, long been a core competency for insurers, who rely on their ability to make good decisions about pricing and risk. Insurers will need to build on these capabilities. The amount of data is exploding, the sources of that data are expanding and increasingly external, and the data is more unstructured, with insights more likely to come from changes in variables, rather than from static value.

For example, the exponential growth of data, combined with new analytics tools, is expanding the number of processes that can be digitized. Business processes that once relied on the judgment of trained employees can now be automated. One insurer is using IBM's Watson to answer questions from military personnel making the transition to civilian life.

Insurers are using digital data to develop insights that feed directly into value-driving initiatives. The insights that can be gleaned from digital footprints range across the full breadth of the insurance value chain, from optimizing digital campaigns to providing immediate, hassle-free quotes (e.g., by capturing external data associated with an address on driving licenses). Apps can now assess vehicle damage, allowing carriers to handle small claims with no human touches or to identify total losses and reduce cycle time. Monitoring social networks or applying voice analytics also helps carriers identify recurring fraud.

Insurers with strong data skills can quickly eliminate the costs required for market research. Instead of convening a focus group or launching a survey, carriers can test alternative designs and experiences live and in-market by splitting traffic on a site or app. The results of such testing are more accurate, and the testing is much easier and cheaper than traditional testing. Digital leaders run dozens of such A/B tests each week. One carrier saw a 500 percent increase in leads in response to changes to its website design directly informed by A/B testing.

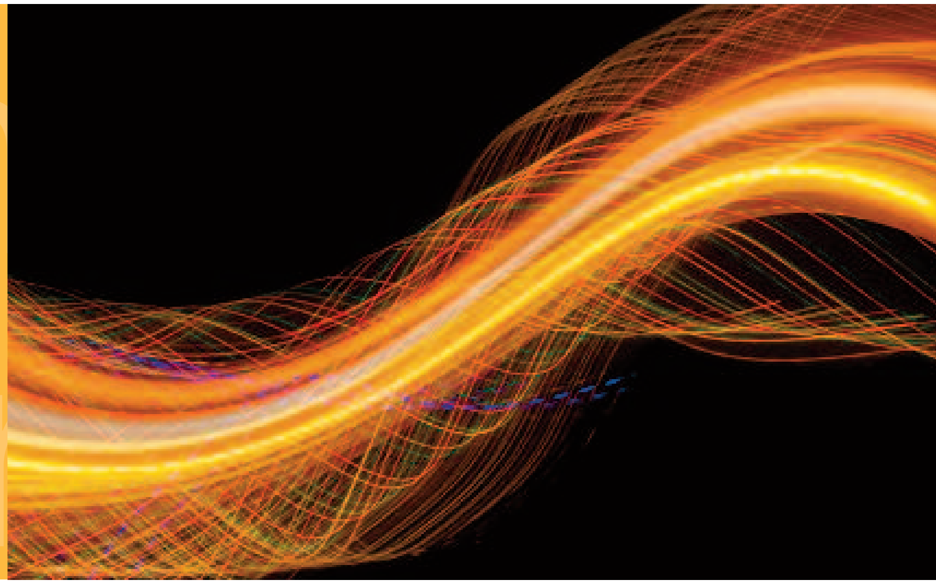
As insurers improve data capture and analytics, they should be sure to tie these efforts tightly to specific use cases, which must themselves be linked to overall strategy. Data is ubiquitous, which makes it easy for companies to be overwhelmed by choice. Effective digital firms focus on the data that drive value.

Rapid process digitization

An international insurer set out to review the 10 main customer journeys for its property and casualty and health and life businesses in one of its national markets. The review covered sign-up, contract amendment and claims management through a variety of channels including brokers, agencies and direct service.

By applying a rapid digitization approach, the insurer radically transformed the customer experience. International benchmarks were used to accelerate design and set ambitious targets for the project. Many of the carrier's policies can now be purchased online in just a few minutes, due to automatic algorithms that calculate premiums on the fly. A self-service portal allows some clients to review and amend their contracts without complication or the need to speak to a customer service representative. Certain claims can be reported using a mobile app and are processed automatically by an improved decision engine, and many high-frequency/low-severity claims can be automated. In some cases, fraud is detected automatically using big data and advanced analysis tools.

The insurer expects to cut non-commission operating costs by 30 to 50 percent, reduce compensation costs by one to three percent, and increase collected premiums by one to three percent.



Jumpstarting the Digital Journey: The Management Agenda

The digital transformation for insurers touches on all areas of the business, in what can seem to be a dauntingly complex undertaking. It would be a mistake, however, to insist on the perfect strategy and full organizational alignment before taking concrete short-term steps to drive value. The optimal approach combines quick wins with more measured, longer-term projects. In this way, early small-scale success can fuel the long-range digital transformation in a virtuous cycle. The following steps can help insurers jumpstart the digital transformation:

1. **Assess digital maturity.** There is a high degree of variance among U.S. insurers both in terms of their overall digital "maturity" and in specific digital strengths and weaknesses. Some score well on digital culture: they are comfortable with failing—and learning—as a pathway to success; they empower employees to take initiative; they promote a test-and-learn approach; they embrace cross-functional collaboration. Others are more advanced on capabilities: their technology infrastructure is strong, and they have made progress digitizing elements of the customer journey. It is critical for an insurer to have a clear view of where it stands so it can focus its efforts effectively.

A heat map of digital opportunities across all steps in the value chain, for every product and geography, is a fundamental tool in driving value. Opportunity rankings should incorporate both an assessment of business value and readiness for impact.

2. **Map the digital opportunity.** A heat map of digital opportunities across all steps in the value chain, for every product and geography, is a fundamental tool in driving value (Exhibit 3). Opportunity rankings should incorporate both an assessment of business value (e.g., financial impact, market analysis, nature of the opportunity) and readiness for impact—that is, address questions such as "Do we have the organizational and technical capabilities to address this opportunity?" "How complex are the regulatory and compliance issues?" With an explicit view of the value chain, leadership can prioritize the best opportunities and devise a roadmap for initial projects.

3. **Build a "fast-paced" core digital team.** Who are the people who make change happen? When putting together teams to take the first transformative steps for the organization, leaders need to bear several important points in mind. The team should be cross-functional and include members from all of the impacted areas of the business. Members must be empowered to make decisions on behalf of their business areas, and be encouraged to take risks. The team should work against unreasonable timelines and market-test its ideas. Once they succeed, these teams will be models for the rest of the company and should therefore demonstrate the risk tolerance and test-and-learn attitude that is so crucial for digital leadership.

4. **Run pilots.** The digital transformation should start with pilots on a few of the opportunities mapped earlier in the

process. Carriers should aim for quick wins in at least one core internal process (e.g., account underwriting) and one customer journey (e.g., claims submission). In the first pilot, the aim should be a 20-week process reinvention. For the customer journey, the team should start with the customer view of the process and develop an optimized experience—both from a cost and a customer perspective—over a short time frame.

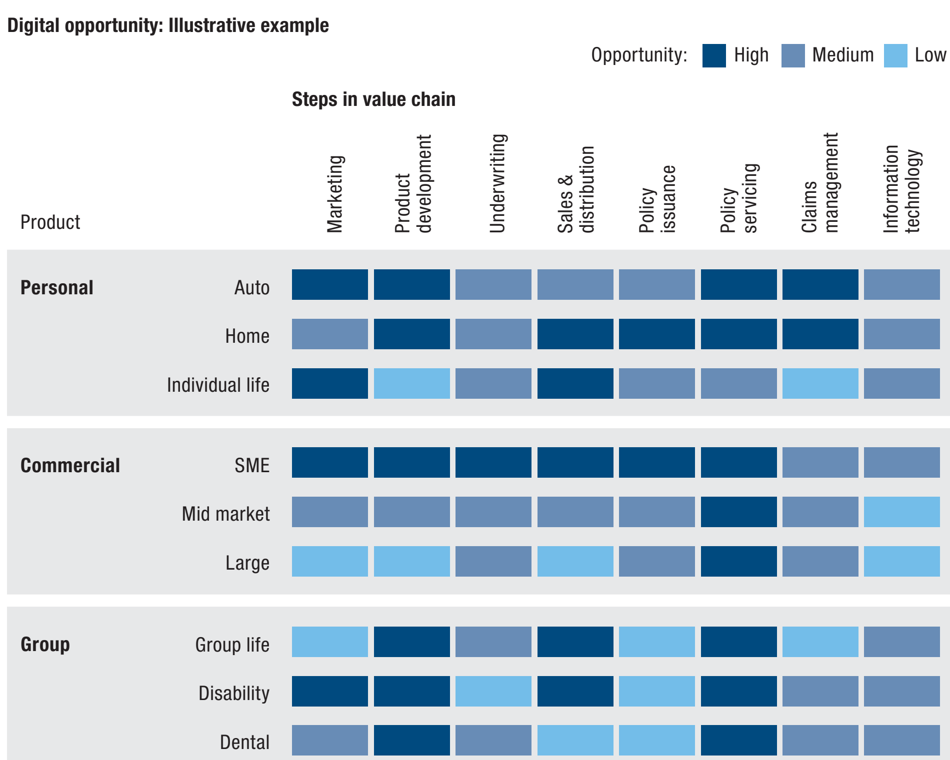
5. **Celebrate and build on success.** Leadership buy-in is critical in any major transformation. But in a digital transformation it is just as important for a culture to grow gradually out of repeated success stories. It is one thing for a company to make top-down pronouncements about the value of the test-and-learn approach; it is quite another when employees can see their colleagues take risks, fail and then succeed.

■ ■ ■

The fundamentals of the high-performing insurance carrier remain as relevant today as they have always been. However, the

Exhibit 3

A heat map can help prioritize digital opportunities across geographies, product lines and steps in the value chain



Opportunity ratings are based on assessment of both business impact and readiness or time-to-impact.

Source: McKinsey Insurance Practice

advent of the digital era adds another capability in which leading insurers will need to excel. The foundation of this success must be a holistic and organization-wide approach to leveraging digital. Insurers that commit to this approach will reap near-term rewards and, over the longer term, gain share, cut costs and losses, retain more customers, and set the pace for the industry for years to come.

Tanguy Catlin

Rob Hartman

Ido Segev

Ruxandra Tentis

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McKinsey Global Insurance Practice

REGIONAL LEADERS

Asia

Vivek Agrawal
Director, Tokyo
vivek_agrawal@mckinsey.com

North America

Devin McGranahan
Director, Pittsburgh
devin_mcgranahan@mckinsey.com

Europe

Stephan Binder
Director, Zurich
stephan_binder@mckinsey.com

INSURANCE DIGITAL LEADERS

Asia

Parker Shi
Director, Shanghai
parker_shi@mckinsey.com

Rae Chen
Associate Principal, Beijing
rae_chen@mckinsey.com

Violet Chung
Associate Principal, Hong Kong
violet_chung@mckinsey.com

North America

Pradip Patiath
Director, Chicago
pradip_patiath@mckinsey.com

Tanguy Catlin
Principal, Boston
tanguy_catlin@mckinsey.com

Rob Hartman
Principal, Pittsburgh
rob_hartman@mckinsey.com

Europe

Markus Löffler
Director, Stuttgart
markus_loeffler@mkcinsey.com

Jasper van Ouwerkerk
Director, Amsterdam
jasper_van_ouwerkerk@mckinsey.com

Johannes-Tobias Lorenz
Principal, Berlin
johannes-tobias_lorenz@mckinsey.com

About McKinsey Digital Quotient (DQ)

DQ is a quantitative measure of a company's digital maturity, based on specific management practices that are most correlated with positive digital and financial performance. DQ isolates the subset of management practices that most frequently contribute to financial and market success. It was developed based on the practices of leading digital organizations and "alpha tested" with more than 100 thought leaders and 200 companies worldwide. The framework is grounded on McKinsey's Organizational Health Index (OHI) program – a framework for assessing the key determinants of organizational performance. To learn more, please visit dq.mckinsey.com.

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