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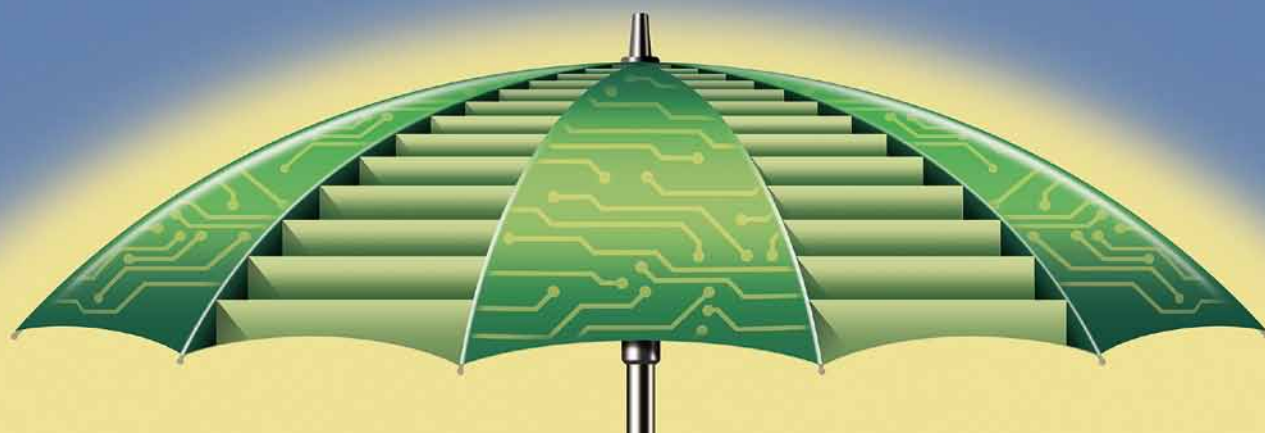
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An IT growth strategy for insurers

Emerging technologies could spark product innovations that change the way the industry serves customers. But insurers must match technologies with strategic goals.

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As the insurance industry emerges from recession, it faces a sea of challenges. The economic slow-down has intensified price competition, hitting margins at a time when market turmoil has depressed revenue streams from many insurance holdings. Similar difficulties in adjacent financial sectors have brought new competitors—for instance, joint ventures between banks and financial advisers—into the insurers' traditional terrain. Structural changes continue to shift global revenue pools to emerging markets, while customer behavior is shifting as more transactions move online.

In this environment, the industry must not only focus its strategic attention on areas from better

financial and risk-pool management to M&A but also develop innovative, growth-oriented products that can secure the loyalty of existing customers and attract new ones. Yet in the face of this challenge, insurers may be neglecting an important tool: technology. Across a number of industries, rapidly changing technologies have been changing the postrecession competitive dynamic. Web and communications technologies are spurring ways of creating products and reaching customers, as well as opening doors to more efficient and effective ways of delivering products and services. They are also giving rise to entirely new business models.

For two reasons, some insurers may find crafting a new approach to technology difficult. One is that

Takeaways

Emerging technologies will create business model disruptions as well as new opportunities for insurers.

Digital technologies will allow the industry to create highly customized products, develop new distribution challenges, and bring down costs with automated service delivery.

The very nature of risk sharing could change as social technologies allow the formation of affinity groups for insurance purchases.

A strategic approach to IT will require a clear view of technology goals, close collaboration between business and IT, and a more robust talent base.

they often see IT primarily as a cost center prone to overruns and a megaproject mentality; the industry spends 25 percent of its operating budget on IT, and executives often lament poor returns on the investment. Second, the industry is built on high levels of trust in product offerings and often on personal relationships between company representatives and customers. As a result, insurers fear to experiment with new technologies that could damage these fundamentals.

With costs and competition rising and growth facing limits, this is a good time for insurers to reexamine their IT options. Rapidly evolving technologies will probably change the industry's competitive patterns. Forward-looking companies are already taking steps to gain first-mover advantages through the intensive use of technology, which could facilitate new types of interactions with customers and company agents. In a growing number of areas, for example, IT may allow insurers to automate processes and cut costs without damaging service delivery. Customized products that rely on data and better risk analysis could provide new avenues for growth-boosting innovations. Finally, the combined effects of technology could change the nature of insured risk, leading to market disruptions that insurers will need to understand.

None of this is to say that the industry should pursue technology at the expense of core strengths, like empathy, service, and trust. Technology cannot replace the trust-based relationship between insurers and their clients but it can enhance it—offering better ways to understand and satisfy customer needs. (For more, see the video “Technology can’t replace trust: An interview with Generali Deutschland’s COO,” in this article on

mckinseyquarterly.com.) We believe that business and IT leaders together should begin examining technology at a level that matches their strategic goals and appetite for change.

Where technology matters

In four areas we have identified, technology could improve the operational performance of insurers, bolster their growth prospects, and perhaps even change current business models. The industry players in the following examples are technology leaders. Most insurers still have a sizable window of time to assess which technology path makes sense for them.

New interactive channels

Interactions with customers often rely on personal contacts and face-to-face meetings. But most consumers—indeed, most participants along the industry's value chain—are experienced users of the Web, “smart” devices, and social networks. Other industries, notably airlines, retailing, and telecommunications, have swiftly adopted such technologies to multiply internal and external interactions. Today, some insurers are exploring ways to link customers, agents, brokers, and back offices through these new channels.

Channel choice. For several years, insurers have been experimenting with new delivery channels for insurance purchases. South African Metropolitan Life, for example, has introduced a pilot life insurance plan named Cover2Go, which allows new customers to contract for short-term life insurance simply by sending an SMS.¹ Similar delivery modes are being explored in Asia, where the clients

¹ Short message service.

of AXA Thailand, for instance, can renew their motor policies via text messaging—and are encouraged to do so by a small gift as an incentive. Although these channel choices might not be applicable to all situations in all regions or policy types, they demonstrate the possibilities opened up by new technologies.

Convenient, cheap, ad hoc insurance. We know of one insurer that is drafting plans for low-cost, one-day ski insurance policies. The purchase process would be extremely simple: via cell phones, customers would send an instant message with a photo of an ad to a number displayed on it. Policy charges would then be added to their phone bills.

Information sharing. In a Facebook training initiative, 17,000 State Farm agents have created groups of “friends” to discuss new products or trade experiences about customer service and ways to handle claims more effectively. German insurer Generali Deutschland is using a social network to share information among its brokers.

Partner networks. The vehicle repair company Motorcare has created a wide-ranging digital network that connects insurers to its 800 garages in Germany. It has processed some 140,000 claims and reduced repair costs by up to 20 percent.

Product innovation: Flexible, customized policies

Insurance products most often come in standard packages with only a limited range of consumer options, such as the dollar amount of coverage and a few other basics—for instance, auto insurance that covers theft and ancillary

property damage as well as liability. Customers, meanwhile, are slotted into fixed risk categories.

Some insurers are now using their huge volumes of data on the needs, preferences, incomes, and lifestyles of consumers to roll out “mass-customized” policies, which combine many predefined options that adapt products to the needs of individuals. (Automobile manufacturers have done so successfully for some time.) The advantages are clear: customers get a bespoke product, while insurers apply the logic of mass production to lower their costs. One large insurer we know of plans to build continental-scale back-office factories with IT systems based on algorithms (also known as “rules engines”) that can adapt policies both to customers’ preferences and to specific market regulations. The idea is to combine the cost benefits of extreme scale with the flexibility needed to accommodate a wide range of products and services.

On another front, auto insurers are implementing dynamic coverage based on driving patterns and behavior. One leading carrier in the United States, for example, uses a tracking device to monitor drivers and applies discounts to policies as a reward for safe driving. Ultimately, sensors installed in customers’ vehicles could track other kinds of higher-risk activities (for instance, parking in high-theft areas). As technologies evolve, some of these features, delivered by GPS in mobile devices, may soon be commonplace. Similarly, health insurers are studying ways to track their customers’ activities, such as diet and exercise, to fashion insurance packages that reward healthy behavior with lower rates.

Elsewhere, insurers are encouraging customers to help cocreate new products. Allstate Insurance, for instance, has set up social-network forums to facilitate interactions among motorcycle customers and enthusiasts. It solicits suggestions and uses them to inspire new products and services.

Highly optimized, automated service delivery

The industry relies on labor-intensive, often paper-based processes for issuing and administering policies and for managing claims. IT can improve productivity by reducing the number of handoffs among agents, adjustors, and payment staff and by automating straightforward payment decisions through the use of expert software. New claims-management systems, for example, can automatically divide claims into clusters based on their complexity, their estimated value, and the risk of fraud. Some claims are paid automatically, others assigned to the appropriate adjustor. This approach improves cycle times, increases customer satisfaction, and reduces revenue leakage from fraud.

One large auto insurer has launched a prototype insurance project that combines a wide range of technologies. Deceleration sensors and GPS devices in vehicles can detect a collision, identify its location, and automatically notify the insurer. A tow truck is dispatched to the accident scene while additional sensor data help evaluate the damage remotely. Software programs determine the payments and automatically dispatch them, bypassing a range of adjustors and clerical staff. The insurer forecasts a 30 to 40 percent reduction in process costs thanks to this automated process. An increasing number of

players (including AXA, the UK-based company More Than, and Zurich) have already taken some initial steps along this path: iPhone applications that clients can use in car accidents or other emergencies. Policy-holders get in touch with the insurer's emergency assistance center, which uses GPS to note the accident's location. Customers can use their phones not only to highlight damaged areas by tapping images of their cars on their iPhone's screen but also to send the center photos of the accident to expedite claims handling.

The changing nature of insured risk

Leaders should know how technology could lead, over the longer term, to more disruptive change. Risk sharing, commonly known as mutualization, lies at the heart of the insurance business model. A growing ability to crunch data on customers will allow companies to segment them and risk pools much more finely. Competitors with such strengths could offer policies at favorable rates to consumers with more profitable risk profiles.

Social networks play a new role too. Beyond their value as tools, they could spawn novel, self-defining markets. Insurers should monitor the way affinity groups on Facebook or other social networks could, for example, coalesce into "minimutuals" that contract for coverage directly with reinsurers, bypassing traditional insurers. While still a novelty for the insurance industry, the idea of forming spontaneous, ad hoc groups of Internet users to negotiate preferential rates with providers of goods and services isn't new: Groupon, which specializes in precisely this type of deal cutting, has offered online discounts since 2008.

Capturing opportunities: A strategic approach

Technology is not a panacea for the industry's current challenges. Insurers face broadly differing competitive environments, and individual companies have different capacities for absorbing and deploying new technology. Nonetheless, insurers must develop a greater awareness of how to apply technologies meaningfully. Essentially, they must set a technology-adoption target aligned with their strategic goals, forge closer ties between IT and sometimes skeptical business leaders, and develop a cadre of IT leaders who can meet the new challenges. Our experience suggests that insurers could usefully consider the following approach.

Develop a clear picture of the target technology state

A key first step is to determine which strategic IT posture best fits the organization's business strategy. In our experience, most companies fit into one of three categories.

Opportunistic companies generally adopt IT innovations for defensive reasons, and only when technologies are mature and well established in the industry. This strategy best suits insurers with highly specialized businesses (for instance, maritime insurance), where success depends more on expert knowledge than on technology. Companies competing in markets or countries less open to competition also fit the opportunistic profile. Since such organizations see technological innovation as something of a necessary evil, their chief concern for IT investments is efficiency—adopting the lowest-cost

solution that delivers acceptable reliability rather than paying out large sums for something more ambitious.

Fast followers pick up selected technologies at a relatively early stage to gain competitive advantage—but only once it's clear they add value. Such companies are rarely early adopters; they wait for others to prove that a concept works and then rely on execution muscle to adopt it quickly and, where possible, to use it more successfully than first movers do. The key for fast followers is to create an “observation deck” so that the organization can spot potentially disruptive technologies early on.

Consider the UK wealth-management operations of a major insurer. In this market segment, an advanced advisory platform for high-net-worth clients is a differentiating feature. The insurer wasn't the first company to develop such a platform but was very alert to those launched by the competition and to the features that made them more (or less) popular with customers, and thus affected market share. The organization learned from others quite effectively, and its advisory platform, once launched, rapidly became one of the best on the market.

Digital insurers are aggressive, trendsetting, visionary companies—the “Apples” of the insurance industry—that have a well-developed capacity for IT innovation and believe that technology is *the* key to gaining and sustaining competitive advantage. Companies such as Admiral in the United Kingdom tend to be “greenfield” attackers, actively leveraging technology to access new markets and offer new services. Another leading carrier, in the United

States, allows prospective customers to tailor their auto coverage through an interactive application on the insurer's Web site.

Increasingly, we find that units within established major players are adopting this posture. The UK-based pay-as-you-drive car insurer Coverbox, for instance, offers discounted motor insurance to drivers who install a tracking system in their vehicles.

Align IT with the business

No matter which of these strategic postures an insurer chooses, successfully deploying innovative technologies requires the IT organization and business unit leaders to align closely. While this may seem self-evident, the interactions of business executives with IT are often patchy, tending to focus narrowly on efficiency or localized investment, not on defining a coherent, company-wide IT portfolio. It's not surprising that the industry's failed product launches often result from inadequate or even nonexistent collaboration between IT and business. Both sides should work to develop forums and decision-making bodies where fruitful interactions can take place.

In this vein, one global insurer with multiple business lines has overhauled its process for defining and investing in new IT projects. Divisional CEOs and senior executives of businesses must now meet regularly with the CIO and his direct reports in workshops that examine the relationship between key business initiatives and IT. The program, rolled out

to more than 50 countries in the group, has dramatically improved collaboration and the satisfaction of internal customers. Funding for "change the company" IT projects (as opposed to the usual "run the company" ones) has grown to 60 percent of all IT funding, from 40 percent, while IT's total cost has remained constant in the short term and is expected to decrease in the long term.

Strengthen IT talent

A strategic road map and collaborative leadership are essentials, of course. But they will be meaningless if an organization can't execute very well on both the IT and the business sides. That means efficient processes and strong talent. We see encouraging signs, within the industry, of recent efforts to improve IT management and of the more and more frequent use of "lean" methods. Many insurers are therefore benefiting from faster times to market, while productivity improvements in the 15 to 30 percent range are common. The business and IT skills needed to implement IT innovations are in short supply, however, so insurers must invest wisely in internal talent. And if a company is to apply technology successfully, the entire leadership team should have a thorough grounding in the latest trends in customer needs.

One global insurer has instilled more dynamism in its ranks by emphasizing meritocracy. The senior leadership has adopted a forced ranking of performance and created clear career paths that let high-potential staff members advance quickly while requiring them to rotate periodically

through various business lines. The goal: to develop well-trained, highly motivated IT executives who possess a broad understanding of the company's business and have created networks beyond IT that will give them an outsider's view of IT's performance.



For many insurers, IT innovation will require a major rethink of how the business is run and a transformation of IT management. To kick off

the thought process, it might be helpful to look beyond the insurance industry to spot promising opportunities offered by new technologies and by new business models that embrace those opportunities.

Insurance executives who set clear targets for a transformation, align the business with IT, and develop a strong talent base before beginning the journey can improve the chances that technology will become an important strategic lever in challenging times. ○