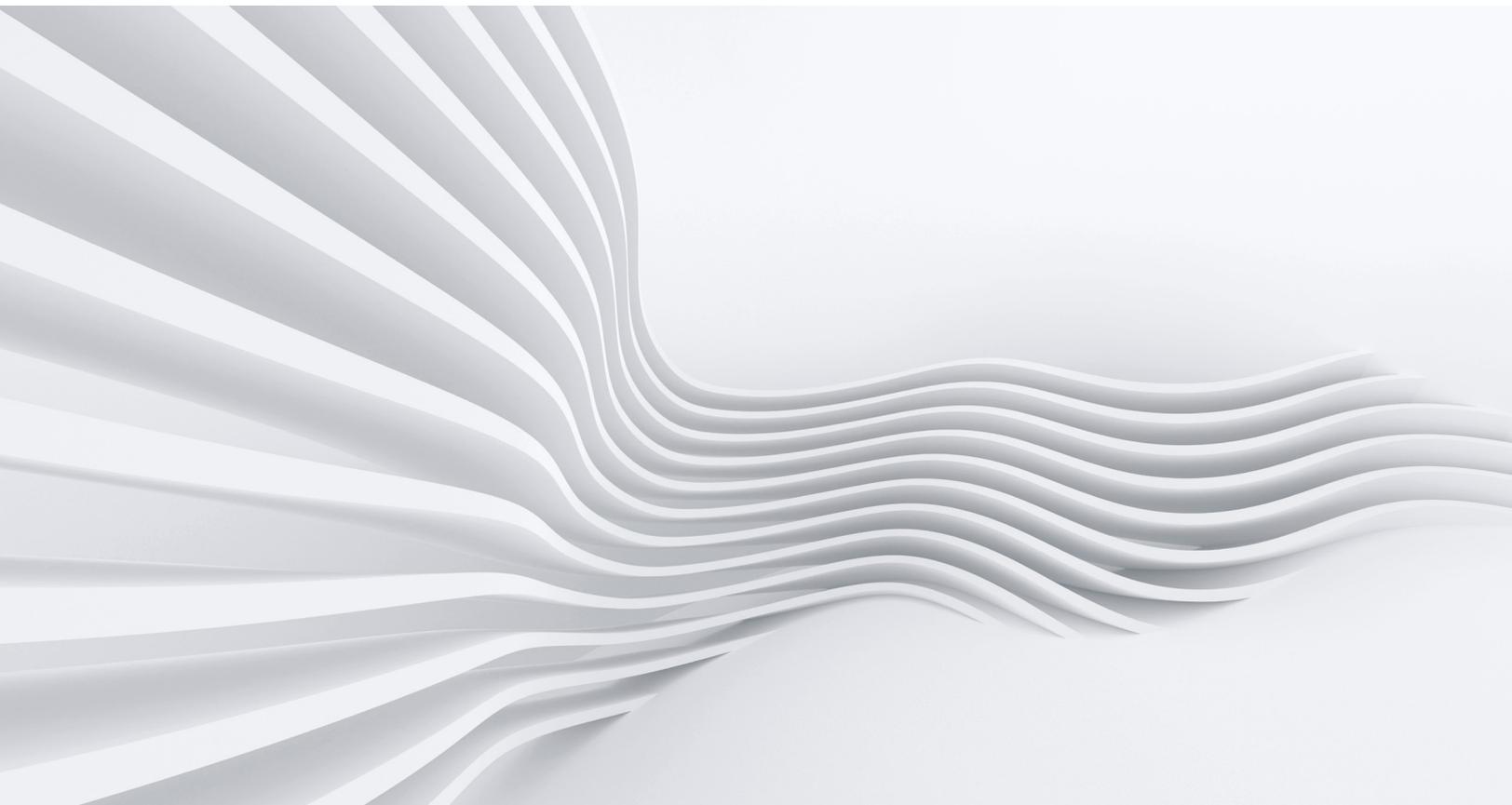


Insurance Practice

A better approach to M&A in North American insurance

Large deals are enticing but rare—and smaller ones create more value. Programmatic deal making would help.

This article was a collaborative effort by Cristian Boldan, Alex D'Amico, Jay Gelb, Steven Kauderer, Kurt Strovink, and Zane Williams, representing views from McKinsey's Insurance Practice.



It's easy to understand the allure of really large acquisitions: the best of them can be staggeringly successful. The right large acquisition, carefully mapped to an acquirer's strategy, can vault a company ahead of its peers into a position of global leadership. Those with well-defined synergies, flawless execution, and skillful integration can also earn enviable excess total shareholder returns (TSR).

But among North American life and property and casualty (P&C) insurers, such acquisitions are rare—and if higher shareholder returns are the objective, even many midsize deals fall short. In our analysis of approximately 250 transactions totaling more than \$200 billion in life and P&C carrier acquisitions since 2007, we found that the primary goal for six out of every ten transactions (representing 70 percent of

deal value) has been to increase scale. Presumably, the assumption is that the benefits of scale will show up in shareholder returns—but in fact, insurers in both the life and the P&C sectors generated superior excess TSR by focusing on smaller acquisitions and on goals other than building scale. This included, for example, efforts to diversify product offerings or add new capabilities (Exhibit 1).

Such a track record suggests that many insurers need a different approach to M&A, especially amid the COVID-19 crisis as factors such as sustained low interest rates drag down insurers' results. As the industry undertakes ongoing restructuring, making a series of small deals could be a bridge to a programmatic approach to acquisitions for P&C and life insurers,¹ increasing the odds of carriers'

¹ The definition of programmatic M&A is when a company makes more than two small or midsize deals in a year, with a meaningful target market capitalization acquired (median of 15 percent).

**Those with well-defined synergies,
flawless execution, and skillful
integration can also earn enviable
excess total shareholder returns.**

Exhibit 1

Smaller deals that add new products or capabilities help insurance M&A outperform the industry average.

Life insurance

Number of deals analyzed, 2007–present **76**

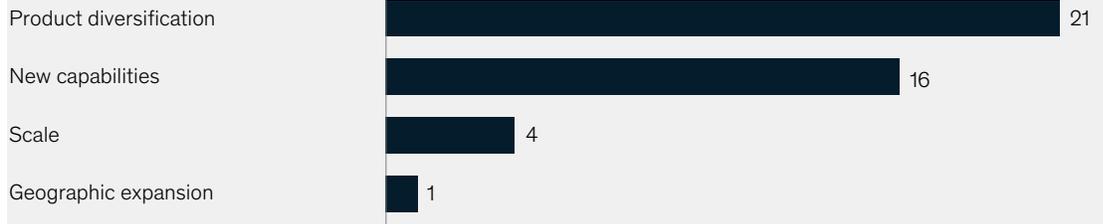
Combined deal value, \$ billion

77

Excess TSR¹ outperformance, %

Outperformance of small deals over large ones **7**

Outperformance by deal strategy



P&C insurance

Number of deals analyzed, 2007–present **173**

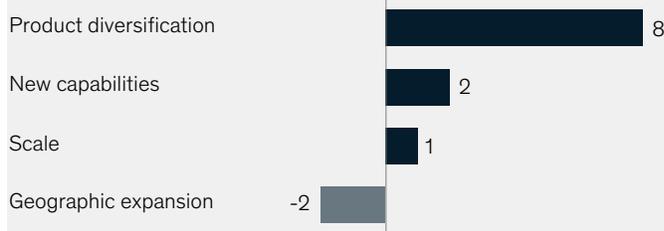
Combined deal value, \$ billion

136

Excess TSR¹ outperformance, %

Outperformance of small deals over large ones **3**

Outperformance by deal strategy



¹Excess total shareholder returns (TSR) defined as the change in acquirer TSR 30 days prior to two years after the announcement date in excess of the Dow Jones US Life Insurance Index and Dow Jones US P&C Insurance Index.
Source: Capital IQ; McKinsey analysis

success as well as their potential for long-term independence (Exhibit 2). Across industries, the most effective programmatic acquirers have built organizational infrastructures and established best practices across all stages of the M&A process—from strategy and sourcing to due diligence and integration planning to establishing the operating model.² With a brisk outlook ahead for all sorts of deals, the insurance industry has an opportunity to begin adapting those best practices for its own growth needs.

A bridge to programmatic M&A

The obvious advantage of smaller transactions is that they are less complex, usually making the acquirer's rationale clearer and more straightforward. Smaller deals that are core to an insurer's existing business often result in lower risk and greater excess TSR compared with large deals. And they are often more cost-effective to finance, whether through internally generated funds, bank loans, or newly issued debt.

An effective M&A process is key. The median TSR for insurance industry acquisitions obscures a striking difference between top- and bottom-quartile performance. For instance, insurers generating top-quartile results delivered excess TSR more than 40 percentage points above the bottom quartile, which suggests a substantial advantage for insurers with superior M&A capabilities (Exhibit 3). We also found that the insurers delivering top-quartile excess TSR tended to acquire businesses with high returns on invested capital and an improved growth profile as part of a new, larger organization.

Insurers with the most effective M&A processes often take a structured approach—more programmatic and central to a well-planned growth strategy than the approach that many insurers take. Indeed, despite the success achieved by companies in other industries that pursue M&A programmatically, North American life and P&C insurers tend to see acquisitions as one-off or episodic events, pursue large deals, acquire

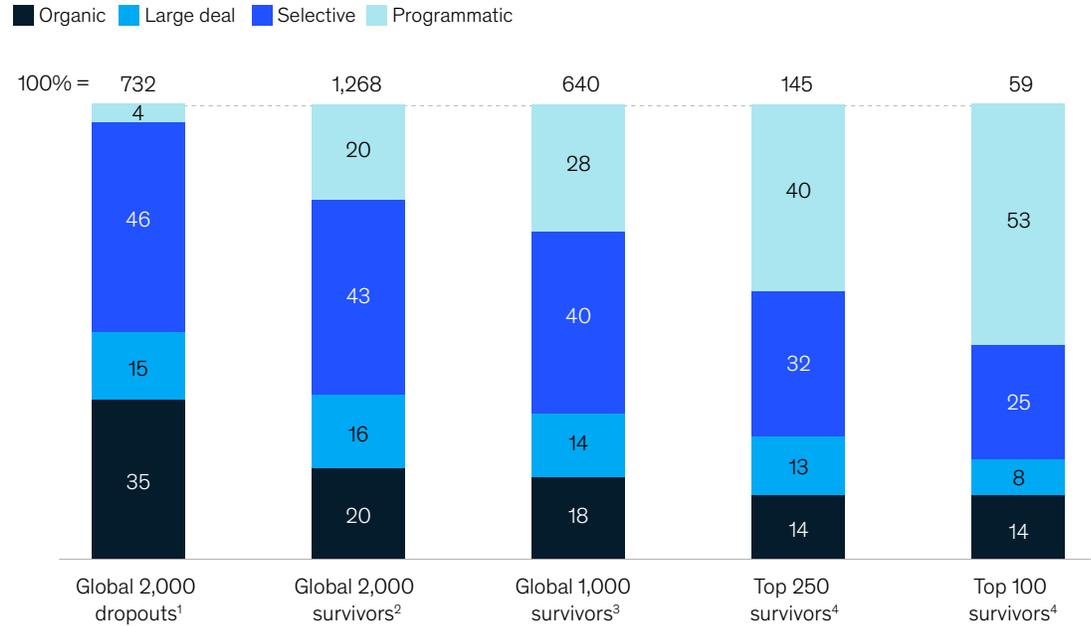
² Jeff Rudnicki, Kate Siegel, and Andy West, "How lots of small M&A deals add up to big value," *McKinsey Quarterly*, July 2019, McKinsey.com.

Smaller deals that are core to an insurer's existing business often result in lower risk and greater excess TSR compared with large deals.

Exhibit 2

Programmatic M&A strategy is critical for sustained, long-term success.

Distribution of Global 2,000 companies by M&A program, January 2010–December 2019, %

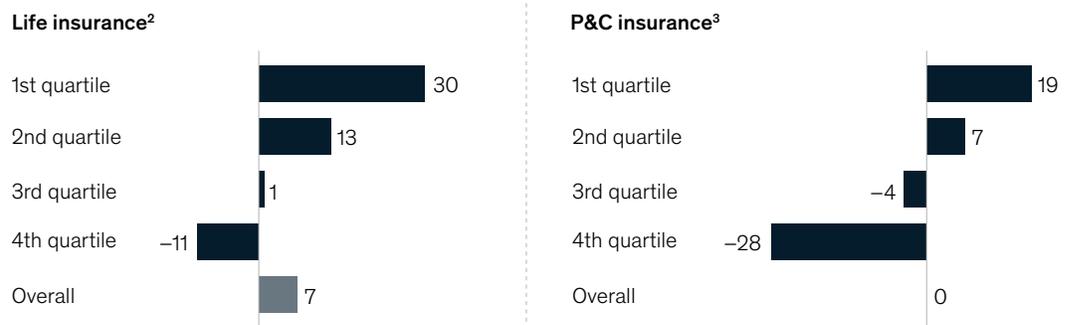


Note: Figures may not sum to 100%, because of rounding.
¹Global 2,000 dropouts were among the top 2,000 firms by market cap on December 31, 2009 (>\$2.0 billion) but were no longer in the top 2,000 by December 31, 2019 (<\$6.0 billion in market cap).
²Global 2,000 survivors were among the top 2,000 firms on both December 31, 2009 (>\$2.0 billion in market cap) and December 31, 2019 (>\$6.0 billion in market cap).
³Global 1,000 survivors were among the top 1,000 firms on both December 31, 2009 (>\$5.4 billion in market cap) and December 31, 2019 (>\$12.7 billion in market cap).
⁴Top 250 and top 100 survivors were among the top 250 or 100 firms, respectively, on both December 31, 2009 and December 31, 2019.
 Source: Capital IQ; Corporate Performance Analytics by McKinsey; Deal Patterns 2019

Exhibit 3

Median excess total shareholder returns does not tell the whole story—there is a wide gap between top- and bottom-quartile performance.

Performance based on quartile analysis, median excess TSR¹ %



¹Excess total shareholder returns (TSR) defined as the change in acquirer TSR 30 days prior to two years after the announcement date in excess of the Dow Jones US Life Insurance Index and Dow Jones US P&C Insurance Index.
²Number of announced life insurance deals with value >\$50 million: 42.
³Number of announced P&C deals with value >\$50 million: 104.
 Source: Capital IQ; S&P Global Market Intelligence; McKinsey analysis

selectively, or even forgo M&A to focus on organic growth (Exhibit 4).³ Such approaches carry higher risks than programmatic M&A and are less likely to generate excess TSR. And outperformance of the broader industry over a ten-year period is virtually impossible without a healthy inorganic strategy.

At its core, programmatic M&A means completing many small deals regularly over time rather than focusing on occasional large transactions. It also means divesting to refocus on growth in segments offering attractive returns. If done right, programmatic M&A can increase the odds of generating superior shareholder returns, as shown across multiple sectors (Exhibit 5).

Outlook for M&A among North American insurers

The overall pace of M&A activity among North American insurers is likely to increase, though we anticipate more activity among life insurers than P&C. For life insurers, industry consolidation is largely the result of macro challenges, including sustained low interest rates and challenges for many carriers in achieving an attractive, sustainable ROE. Meanwhile, P&C insurers also face headwinds from low interest rates, although less so than their life insurance counterparts, as well as an overabundance of carriers in many businesses resulting in downward pressure on ROE.

With restructuring under way, life and P&C insurers could focus on M&A in existing businesses, but they could also increase their presence in adjacent areas. For example, life insurers could expand in businesses related to asset and wealth management; P&C carriers could move into service-provider functions in personal, commercial, or specialty lines. However, concerns regarding whether carriers are holding adequate reserves could be a factor that keeps insurers on the sidelines. In both life and P&C insurance, we expect that M&A activity in North America will include acquirers from Europe and Japan seeking opportunistic transactions to expand their geographic presence.

Life insurance industry: Restructuring is under way

We expect increasing M&A activity, including divestitures, among life insurers based on industry challenges in achieving an attractive ROE in a low-interest-rate environment. Carriers are likely to continue targeting deals that increase scale, despite evidence that smaller transactions contribute more to TSR, especially transactions that will enhance product offerings or add new capabilities. Meanwhile, life insurers will seek to improve ROE profiles by divesting or reinsuring their legacy life and annuity blocks—an area where private equity will likely remain active.

Life insurance M&A would help many carriers boost their top-line growth and ROE. Still, we envision few whole-company mergers. This is because valuations for most publicly traded life insurers are already low. That leaves acquirers, many of which are wary of diluting earnings per share, to fund deals with existing excess capital or by issuing debt rather than by selling new shares.

It seems apparent that sustained low interest rates will lead life insurers to be more interested in selling than buying. At the same time, this situation could present a unique opportunity for mutual life insurers to engage in M&A based on their preference to diversify their business mix from rate-sensitive products and to deploy excess capital.

P&C industry: Both organic and inorganic growth opportunities

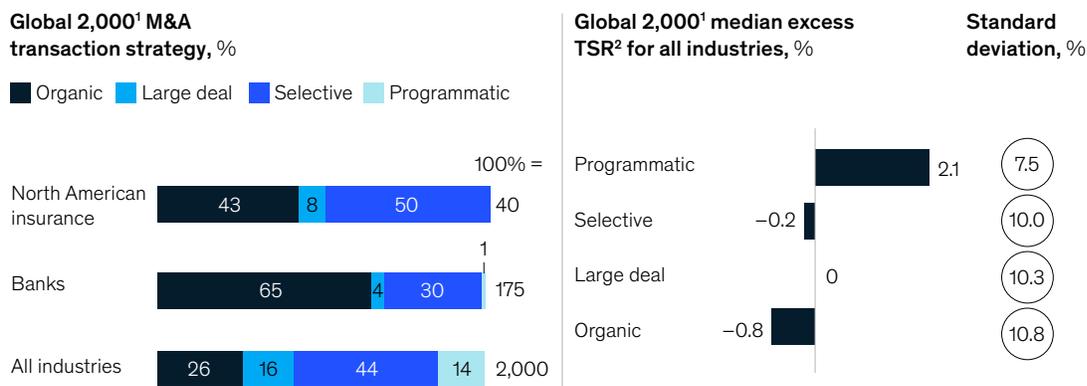
P&C carriers are likely to engage in modest overall M&A activity based on the industry's emerging organic growth opportunities. Even so, many P&C insurers would need to improve their growth and ROE profiles—and M&A could accelerate this process. We recommend insurers seek bolt-on transactions to expand product offerings and capabilities while valuations remain reasonable.

Our outlook partially reflects carriers' existing opportunities to redeploy capital in organic growth, largely reflecting robust commercial insurance and reinsurance pricing trends. We also anticipate that

³ In the large-deal approach, a company makes one deal or more per year, and the target's market capitalization is equal to or greater than 30 percent of the acquirer's market capitalization. In the selective approach, a company makes two or fewer deals per year, and the cumulative value of the deals is more than 2 percent of the acquirer's market capitalization. In the organic approach, a company makes one deal or fewer every three years, and the value of the deal is less than 2 percent of the acquirer's market capitalization.

Exhibit 4

North American insurers lack programmatic M&A, despite sustainable excess total shareholder returns in other industries.



Note: Figures may not sum to 100%, because of rounding.

¹Companies that were among the top 2,000 companies by market cap on December 31, 2009 (>\$2.0 billion) and were still trading as of December 31, 2019; excludes companies headquartered in Latin America and Africa.

²Excess total shareholder returns (TSR) defined as the change in acquirer TSR 30 days prior to two years after the announcement date in excess of the Dow Jones US Life Insurance Index and Dow Jones US P&C Insurance Index.

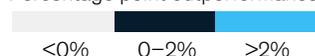
Source: Corporate Performance Analytics by McKinsey; Capital IQ; Deal Patterns 2019

Exhibit 5

Programmatic M&A leads to higher performance across most sectors.

Global 2,000¹ median excess TSR,² January 2010–December 2019

Percentage point outperformance



M&A program	Sector							
	Advanced industries	Travel, transportation, and logistics	Consumer packaged goods/Retail	Financials	Global energy and materials	Pharmaceuticals and medical products	Healthcare systems and services	Technology, media, and telecommunications
Programmatic	2.0	5.9	1.1	1.2	2.2	1.2	1.0	1.3
Selective	-0.5	0.0	-0.7	0.0	0.3	-0.3		-2.2
Large deal	-0.4	-1.9	-0.7	0.6	-0.1	-0.6	-1.3	1.7
Organic	-0.8	0.0	0.3	-0.1	1.7	0.9		-2.4

NOTE: Blank if sample size is less than five.

¹Companies that were among the top 2,000 companies by market cap on December 31, 2009 (>\$2.0 billion) and were still trading as of December 31, 2019; excludes companies headquartered in Latin America and Africa.

²Excess total shareholder returns (TSR) defined as the change in acquirer TSR 30 days prior to two years after the announcement date in excess of the Dow Jones US Life Insurance Index and Dow Jones US P&C Insurance Index.

Source: Capital IQ; Corporate Performance Analytics by McKinsey; Deal Patterns 2019

These deals are accelerating the trend toward market-share consolidation among the largest personal lines P&C carriers.

P&C insurers will allocate capital in support of organic premium volume growth once the global economy recovers, reflecting increased insured exposures.

A challenge to be addressed in whole-company commercial P&C acquisitions is the concern of potential buyers regarding the adequacy of commercial casualty loss reserves. The primary commercial P&C industry has been releasing loss reserves for more than a dozen years, which raises the question of whether reserve redundancies remain, especially if claims-inflation trends were to increase. This factor would clearly be taken into account in evaluating the attractiveness of potential carrier acquisitions.

However, personal auto and home carriers, which have mostly not seen cause for concern about their reserve adequacy, have been increasingly focused on acquisitions. There have been several recent transactions in which subscale insurers (those outside the ten largest in the United States) have been sold to larger carriers. These deals are accelerating the trend toward market-share consolidation among the largest personal lines P&C carriers.

Building more robust M&A capabilities

Many insurers need to enhance their M&A capabilities during the current phase of increased industry consolidation, particularly in the North American life insurance industry. The best are pursuing the following imperatives:

1. Make M&A a core plank of the overall strategy

The best acquirers embed M&A in their strategic planning process, often using an [M&A blueprint](#) to prompt business leaders to approach deal making more purposefully. Such blueprints require a thorough self-assessment to establish a baseline from which to identify gaps in corporate ambitions as well as the opportunities for acquisitions to fill these gaps. Blueprints also include a comprehensive market assessment that ties a company's M&A strategy to the most recent and relevant trends, accounts for potential disruptions, and acknowledges competitors' likely actions and reactions.

An M&A blueprint should also define any boundary conditions, or limits to the company's use of acquisitions. These conditions, which are typically imposed by the CFO or the board's investment committee with input from the CEO, provide an important reality check: they define the constraints of certain types or sizes of deals, thereby further narrowing the scope of potential targets. In setting these conditions, business leaders should account for preexisting financial hurdles. For instance, a rule that deals must increase earnings per share in the first year likely should not apply to deals targeting growth, because it could restrict a company's ability to acquire targets even with considerable longer-term prospects. Establishing these boundary conditions at the outset can add force to investment commitments and align everyone on negotiable and nonnegotiable terms.

The CEO's input is essential, especially in the midst of market disruptions such as COVID-19, when CEOs adapt their leadership in new ways.⁴ Indeed, McKinsey research has found that leadership in programmatic M&A is one of a handful of characteristics that distinguish successful CEOs in shaping long-term company performance.⁵ Bold moves overall, which include pursuing programmatic M&A, are vital; only one in 12 companies goes from being an average performer to a top-quintile performer over a ten-year period.⁶ CEOs must challenge their teams regarding the sufficiency of existing efforts, providing input into M&A to ensure their companies make bold, programmatic moves. As our research makes clear, the extent of those moves counts a great deal: materiality matters, not just directionality, and that's something CEOs are in a unique position to calibrate. It is, in fact, one of the most important aspects of their role.⁷

2. Cultivate top-priority M&A candidates

The best acquirers source and develop potential M&A candidates continuously and across all stages of the process. Programmatic acquirers often develop an extensive understanding of the relevant industries and build exhaustive rosters of potential targets that are consistent with their blueprint. They then begin systematic relationship-building efforts across the list even without a specific transaction

in mind, establishing their visibility as a potential partner and gaining basic familiarity with a broad range of firms. By doing so, these acquirers increase their chances of finding deals that otherwise might be overlooked while accelerating much of the early information gathering needed to build a first-pass view of a potential transaction.

To do this well, many insurers will need to shift the focus of their M&A teams from making one-off deals to building a more comprehensive view of their industry and its players across subsegments. They will also need to coordinate closely between the M&A team and the strategy team, as the overall strategic thrust of the company—and the role of acquisitions in pursuing that thrust—will shape the determination of which parts of the industry to focus on.

Increased canvassing of opportunities would allow acquirers to consider more deals and evaluate their attractiveness. Further professionalizing the M&A function can help. For example, companies need to make sure enough time is dedicated to canvassing for deals to maintain a pipeline of opportunities. They need to expand the number of executives paying attention to acquisition opportunities beyond the CEO, CFO, and head of M&A. Business-unit heads and the HR leader should also be included. Broader involvement in the

⁴ For more, see Carolyn Dewar, Scott Keller, Kevin Sneader, and Kurt Strovink, "The CEO moment: Leadership for a new era," *McKinsey Quarterly*, July 2020, McKinsey.com.

⁵ For more, see Michael Birshan, Thomas Meakin, and Kurt Strovink, "How new CEOs can boost their odds of success," *McKinsey Quarterly*, May 2016, McKinsey.com; Michael Birshan, Thomas Meakin, and Andy West, "A deal-making strategy for new CEOs," *McKinsey Quarterly*, April 2017, McKinsey.com.

⁶ For more, see Chris Bradley, Martin Hirt, and Sven Smit, "Strategy to beat the odds," *McKinsey Quarterly*, February 2018, McKinsey.com.

⁷ Alex D'Amico, Mei Dong, Kurt Strovink, and Zane Williams, "How to win in insurance: Climbing the power curve," June 2019, McKinsey.com.

Increased canvassing of opportunities would allow acquirers to consider more deals and evaluate their attractiveness.

process can help companies to fully understand, and potentially improve, their attributes and brand in the marketplace as an acquirer—a role in which the CEO should play a major part.

3. Assess the full spectrum of options, including partnerships, joint ventures, and alliances.

As companies in the insurance industry advance further into digitization and advanced analytics, they're likely to find partnerships, joint ventures, and alliances more relevant. This is especially likely among smaller insurers that lack the digital and fintech resources of their larger competitors. Many insurers will have to assess the full range of partnership opportunities, from full joint ventures (with or without equity) to strategic partnerships to contractual alliances, to find the right mix of opportunities and capabilities.

Across this range, insurers need clear strategic objectives and plans for their partnerships. They'll also need a methodology for evaluating each partner's contribution, a clear and aligned vision for the end state, a prelaunch partnership structure, and aligned governance arrangements that articulate clear management key performance indicators, transition- and operational-support agreements, and restructuring and exit provisions.

4. Never underestimate the value of a good divestiture.

McKinsey analysis of thousands of deals found that companies active in divesting, not just acquiring, earn 1.5 to 4.7 percent higher TSR than companies focused on acquisitions alone.

Successful insurers use forcing mechanisms like the budget process to review the landscape of potential assets to sell. They then proactively shape those assets for sale based on an understanding of their value to a more natural owner. Executives also pay special attention to stranded costs—such as outdated infrastructure, legacy supplier agreements, or depreciation and amortization costs—that can eat into the sale price of a divested business.

And once they decide whether to divest a business or carve it out, they pay at least as much attention to how to go about it. Three interrelated activities are key: defining which activities are to be included in the sale, determining the valuation story to communicate to potential buyers, and disentangling the divested assets.

In the North American insurance industry, big deals get a lot of attention—but smaller deals can create more value. With an outlook of increased M&A activity, companies have an opportunity to codify their M&A practices into a more structured program of frequent small deals.

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