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Insurance Practice

Opportunities for insurers in a rapidly shifting insurtech market

After years of growth, the US insurtech market faces a sharp decline in valuations. How should established insurance carriers respond?

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For nearly a decade, insurtechs have experienced rapid growth and skyrocketing valuations. But in 2022, investors' optimism has been tempered by compounding pressure from inflation,[1] rising interest rates, and geopolitical and macroeconomic uncertainty. Investors are increasingly looking for a sustainable business model advantage—a far cry from the "growth at all costs" focus in recent years. As a result, major publicly listed insurtechs have seen their valuations plummet compared with their all-time highs. The exhibit shows the compression of valuation for ten publicly traded insurtechs that had previously enjoyed some of the largest funding rounds of the industry. This cooling has sent shock waves through the insurtech community and reminded players to balance their hunger for growth with scalable business performance.

At the same time, rising interest rates and hard markets are benefiting many insurance carriers. This stands in contrast to the previous decade, in which insurers struggled to earn their cost of capital.[2] This struggle persisted due to a prolonged period of premium growth below GDP growth and was compounded by the impact of sustained low interest rates on life and retirement carriers. There was also an influx of alternative capital and elevated catastrophe losses on property and casualty carriers. The market dynamics today, with insurtech players facing headwinds and incumbent insurers benefiting from certain tailwinds, have effectively "turned the tables" across the insurance landscape, putting traditional insurance companies in a much more advantageous position relative to insurtechs. In light of this, executives should consider the acute, strategic, and tactical opportunities now available to them.

Strategic implications for insurance carriers

The current environment has created new opportunities for carriers to raise their aspirations and move more quickly on their strategic priorities. To capture the opportunities, insurers will want to prioritize three strategic actions.

Make bold moves. During the 2007–08 financial crisis, a dichotomy emerged between the winners (what we call "resilients") and the losers. The subset of resilients not only widened the performance gap during and immediately after the crisis but also carried that outperformance into the next decade.[3] Across sectors, resilients differentiated themselves through similar actions: fast, decisive moves on productivity during the downturn to preserve growth capacity; M&A strategies characterized by proactive divestments and acquisitions to reshape the portfolio as needed; and the preservation of operational and financial options that allowed them not only to survive the crisis but also to accelerate through it. In the current economic landscape, bold strategic moves will be similarly essential.[4]

Raise the aspiration for strategic bets and business building. The current downturn in the insurtech market might seem to suggest that big digital bets are not worthwhile. But according to McKinsey's latest global business-building report, in insurance and financial services, every dollar of revenue from new businesses generates more than twice the enterprise value compared with every dollar of core business revenues.[5] Therefore, it is no surprise that eight in ten surveyed CEOs reported new-business building as a top five priority despite recent heightened economic volatility. In insurance, companies with capital to deploy may be able to significantly accelerate the growth of strategic bets by building new businesses and boosting the trajectory of nascent businesses in their portfolio.

Reevaluate build-buy decisions. Since their emergence, insurtechs have been continually transforming insurers' build-or-buy equations. Given the relative discount on existing solutions in the market and insurtechs' need for capital, now is the time to reevaluate those equations for both new and in-flight initiatives. As insurers raise the aspiration for strategic bets and business building, there likely will be substantially more opportunities

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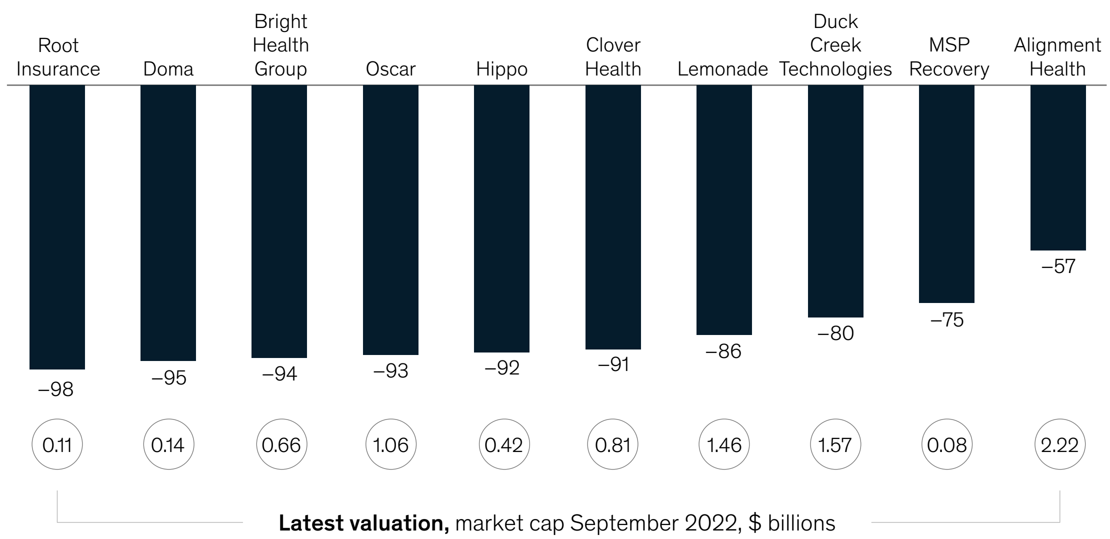
[1] Kia Javanmardian, Sebastian Kohls, Gavin McPhail, and Fritz Nauck, "Countering inflation: How US P&C insurers can build resilience," McKinsey, August 25, 2022.
[2] "Creating value, finding focus: Global Insurance Report 2022," McKinsey, February 15, 2022.
[3] "What can we learn from the 'resilients' of the last economic downturn," McKinsey, July 31, 2022.
[4] Alex D'Amico, Mei Dong, Kurt Strovink, and Zane Williams, "How to win in insurance: Climbing the power curve," McKinsey, June 18, 2019.
[5] "New-business building in 2022: Driving growth in volatile times," McKinsey, November 14, 2022.

Exhibit

As 2022 draws to a close, insurtech valuations are down.

Value loss relative to each US company's all-time high, %, as of September 2022



Source: Macrotrends

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to buy market access and capabilities now than at almost any time in the past decade.

Two tactics for traditional insurance carriers

Tactically, insurers can capitalize on the current valuation pressures on insurtechs in two ways.

Transform your talent structure. Compared with other industries, insurers have historically struggled to attract digital and analytical talent, even within financial services. As the initial disruption of insurtechs settles into and becomes part of the industry landscape, insurers could find themselves in closer proximity to the data scientists, machine-learning engineers, and other next-generation talent initially attracted to the industry by insurtechs. Especially amid fluctuations in the insurtech market, insurers can strengthen their digital talent through recruiting (as insurtechs are forced to downsize) or M&A (as an "acqui-hire" strategy becomes more viable with depressed valuations).

Be aggressive in procurement. Insurtechs have come to play a critical role in enabling the insurance value chain. In fact, according to McKinsey's Insurtech database, 63 percent of insurtechs enable the value chain and cooperate with insurers (as opposed to prioritizing industry disruption). Given that the current insurtech environment is characterized by a scarcity of capital and urgency to achieve profitability, insurers could have their strongest negotiating position in years with many of their current digital and technology vendors, as well as with vendors of platforms that they are considering as part of technology improvements and upgrades.

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