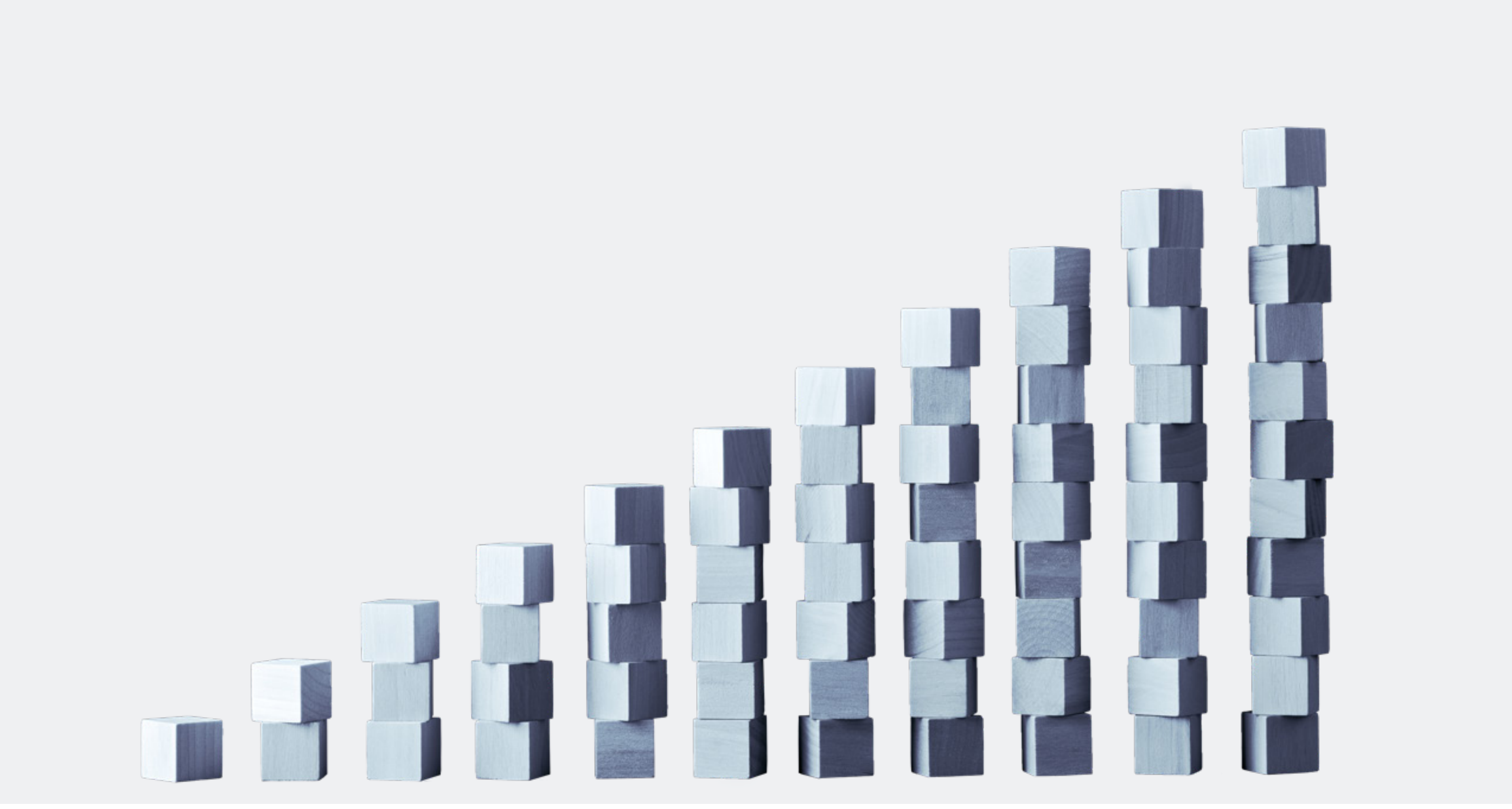
Insurance Practice

Building new digital businesses in insurance

More incumbent insurers are considering building digital businesses. Three McKinsey experts discuss what to do—and with whom.



June 2021

In this episode of our *McKinsey on Insurance* podcast series, we discuss how to approach building digital insurance businesses and what insurers can learn from their counterparts, both within and outside the insurance industry.

An edited transcript of the conversation follows. For more conversations from *McKinsey on Insurance*, our podcast series about the trends, disruptions, and strategies that are reshaping the insurance industry today, subscribe to the series on Apple Podcasts or Spotify.

Ari Libarikian: Welcome, everyone, to *McKinsey on Insurance.* I'm your host, Ari Libarikian, a senior partner in McKinsey's Insurance Practice and global leader of Leap by McKinsey, which works with established companies to imagine, build, and scale new businesses. Today we'll be discussing how insurers can better compete against digital players by launching new businesses of their own. Joining me is Pia Schlüter, a partner in McKinsey's Düsseldorf office, who works with European insurers on business building as well as digital-and-analytics transformations.

Along with us is James Bilefield, who's an expert in digital strategy and transformations and has built a range of businesses within financial services and across industries—technology, media, and so on. He serves on a number of public, private, and nonprofit boards and has worked on a broad set of growth and change initiatives. He's also an active investor in technology and a senior adviser to McKinsey. Thank you both for being here.

Traditional insurers are seeing growing competition from digital players. The pandemic and customer-behavior changes are pushing the industry to become digital much more quickly, and one of the big levers is building their own businesses. First let's consider why and when a traditional insurer—both life and P&C [property and casualty]—should build a new business. James, maybe we start with you.

James Bilefield: Of course, insurance is one of the oldest intermediate industries in the world, right? Lloyd's insurance market has been around, I think, since the 17th century and has been remarkably resilient to disruption over the years of all sorts of new technology and, frankly, has been dominated for decades by just a handful of pretty well-established players with relatively few new entrances versus other industries.

But I think the world's now changing pretty fast for the sector, driven largely by new technology and data, making it possible to transform not just the core underwriting part of the industry but also how policies are distributed, how claims are managed, and how you serve clients and customers in new ways that could lower risk, increase engagement, and lower your cost to serve.

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A good measure of that is the investor community. They’re getting pretty excited about insurtech, a little bit of a variation on fintech. I saw some numbers from Willis Towers Watson that said in 2020 annual insurtech funding reached an all-time high of just over $7 billion US across 377 deals. So that’s the highest dollar amount, I think, in any year ever. And I think incumbents—which are facing into these headwinds—the key question for them is how quickly they adapt to what seems to be inexorable market changes, and really to decide what size of share their organizations will have in the next generation of the insurance industry.

Pia Schlüter: Adding to what James said, I think it’s exactly these market changes—changing customer behavior or the increasing availability of data and also technology—that is the reason why insurers are increasingly building new businesses. It’s a way for them to protect themselves from disruption to their core business. It’s a way to meet these shifts in customer behavior and expectations. Most importantly, it’s also a way for them to open up completely new revenue streams.

We’ve done a bit of research and found that opening up new revenue streams was actually a key reason in over 60 percent of all business builds. Insurance also knows that if they don’t start building these new digital businesses themselves, there will be one highly funded insurtech somewhere that will do it, and that will eventually take away their customers and eat up their profit pools.

Ari Libarikian: Yeah, great points. I always find it interesting when incumbent organizations aspire to build new businesses. The very first question is typically “What assets do we have as a mature, established company that we can use in this new business? How can we win?” And in the case of insurance, the whole industry is based on having data and running analytics on it to try to calculate risk and create value propositions for customers. One of the things I’m seeing insurers explore is entering more capital-light industries—building analytics platforms and data platforms leveraging all the data they have. Not just using the data to price a policy and provide insurance, but pooling the data and running analytics to get smarter to help customers in different ways. It’s quite an innovative use of a very old asset.

When people think about new-business building for incumbents, the first thing that comes to mind is always digital attackers: “Let’s build a digital business. Let’s get digital distribution and it’s much easier, faster, cheaper, more seamless, et cetera.” Is that the only archetype for business building in insurance, or are there other models that we’re seeing?

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Pia Schlüter: It’s definitely not the only model. In fact, I think we see four different models today in insurance of new digital businesses. The first one is what you call it, a digital attacker—basically a direct-to-consumer, or some also call it a direct 2.0 insurer. That’s mainly selling online or via aggregators.

A second model that we increasingly see is digital omnichannel insurers. In addition to online and aggregator sales, they also serve brokers or the bancassurance channel or even tied agents.

And then a third model: we increasingly see insurance businesses being built by noninsurers. So think of, for instance, several carmakers that are now offering or building their own auto insurance to sell jointly with the car.

And then finally we also see platform—or let’s say ecosystem—plays, which integrate insurance with other broader services. And sometimes these ecosystem or platform plays even focus only on one individual element of the insurance value chain like distribution.

James Bilefield: I think that’s interesting, Pia. I see competition coming from many sides to incumbent insurance players, and the digital attackers tend to get the headlines and maybe a lot of the investment dollars. But don’t underestimate the power of big tech. The existing big tech platforms within this competitive space have very deep, data-rich customer relationships, and a number of them have already moved into financial services and are either looking to—or are already starting to—expand that footprint into the world of insurance.

Pia mentioned some of the car companies building into this market that helps them build an ongoing relationship with customers, moving away from a more transactional purchase of a vehicle into more of a lifelong, almost SaaS-type relationship, which is quite attractive from a valuation perspective. But it’s not just carmakers: some home builders, realtors, other players are also extending capability into insurance.

And amongst the digital attackers themselves, I think we should differentiate a little bit. Some are simply focused on established market segments, basically using new technology to innovate just a part of that value proposition. Some are betting on segments that are entirely new—for example, gig workers. Some others innovate mostly on the distribution side rather than the product side; others build components to help incumbent insurance with their own tech stack around data collection, claims, handling fraud detection, et cetera, which can be a big unlock of optimized performance for a large existing organization. So there are many different flavors among the digital attackers, and I think it’s important to differentiate between them as you start to think about the right strategy for your organization.

Ari Libarikian: I love both of your points. This is actually a very nuanced space. We always say the reason to build these new businesses is to serve a strategy, right? It’s not something that’s fun to do or an innovation experiment or something digital just because you want to do digital. One of the strategic shifts I've seen in the industry in the last decade or so is moving from what I call repair and replace to predict and prevent: getting a lot smarter and providing a more holistic set of experiences for the customer beyond just paying a claim.

It's becoming more and more clear that the industry is using digital business building to help fulfill that goal. The bad news is it's really hard to build these things. I think our research has shown something like an 8 to 10 percent success rate for new businesses to scale with a satisfied management team. The majority of these don't get there. And so maybe we can get into that a little bit. What are some of the challenges? Why is it hard, and what are the challenges we've seen in building new businesses?

James Bilefield: I would say that it's important to keep a flexible mind on actually what you choose to build versus where you partner smartly, and also what you're able to buy in the market—either renting capabilities, which you need just for a period of time, or to buy for a longer period, or forever.

I would highlight the power of partnerships for incumbents, which allow them to integrate great new technologies, which they've struggled to build themselves. Those technologies can also help add functionality quickly to serving customers and potentially broaden a range of products—and sometimes also geographies as well.

They can also then leverage the kind of incumbent advantages around data and analytics, and they also can leverage their access to capital—and customers—often under a really trusted brand. Frankly, those are often assets that digital attackers don't bring usually to the table.

We've seen some really good examples of smart partnerships between digital attackers and incumbent financial-services businesses elsewhere in the kind of wider financial-services sector. And we've even seen some of the digital attackers use partnership effectively to broaden their range of products at speed. They're partnering with other digital attackers to grow faster. And so it's not just the incumbents who are partnering with these folks; they partner with each other to gain scale and escape velocity, which they need to succeed.

Pia Schlüter: I would fully agree with this. For digital attackers or digital businesses, making the right decision on where to build something and where to buy or partner on something is really crucial because it not only allows them to speed up and lower their investments, but it also allows them to improve their value proposition. I think this is especially relevant in the types of ecosystems or platform plays that we are increasingly seeing.

Ari, to your question, I think in addition to this is leveraging the best technology, using agile ways of working, and putting a superstrong emphasis on customer acquisition. I would see three critical success factors for incumbents trying to build digital businesses. And that, for me, would be number one: talent and resources. Number two, data and analytics. And number three, thinking about how to transfer some of the learnings, or assets they are building in the digital business, to their core business.

Ari Libarikian: The word that comes to mind for me, when I think about challenges, is "culture." So on top of all the great points you made about building new businesses, culture—and building a culture that is more test and learn—is really hard. How do you create something that looks and feels like a start-up, pivots quickly, is agile, makes decisions based on the customer, adapts—how do you do that in a company that in many cases is decades or even centuries old? It requires speed, and it requires these large, mature companies to be much more nimble. So establishing this culture of agility and the talent you need for it—like you said, Pia—is pretty critical. It's something I see a lot struggle with. And those that figure it out bring the best of the core—the incumbent advantage—and combine it with the speed of a start-up.

James, are there other industries that insurance can learn from here? Because everyone's dealing with a similar set of challenges. There are probably some other industries that have vaulted ahead faster than the insurance industry has. Any learnings and examples there?

James Bilefield: That's a great point. I think there are absolutely lessons to learn from industries which are a little bit further along the disruption curve than perhaps insurance has been. Some of the traditional news-broadcast groups have built pretty significant and profitable digital businesses, which are now often larger than their traditional analog businesses. Some large retailers—CPG [consumer-packaged-goods] brands, luxury-market players—have also done a good job. And they've been able to compete effectively against digital attackers using that incumbent—or set of incumbent advantages—they naturally have.

Also in financial services, certainly in the consumer financial-services space around the world, in China, the US, and elsewhere, there are some really good examples of new digital businesses developed by incumbent organizations that are really taking on the digital attackers and winning.

I pull out a few lessons from those successes. To your point, Ari, I'm starting with culture—and just understanding that the kind of fundamental change required is really difficult. I worked with a media company some years ago where the kind of scale of digital business which was required to be built was the biggest change this organization has seen in over a century. And it didn't just impact the build of the new digital business, but ultimately all parts of the organization. Every single employee within it was affected by the impact of this change, both directly in their work, but also culturally in ways of working and how capital was allocated around the organization. I think you really need to ensure you have full alignment around the board table and the executive committee table around the strategy that's needed, the boldness of the approach you plan to take.

Budgets tend to need to be pretty significant, certainly multiyear. And teams also need to be agile and iterate along the way. This is never a straight road, and you need to hold your nerve sometimes when you're 12 to 18 months in, and you're in that valley, I suppose, where you've started out, you've started to spend some significant money, but you're not yet seeing the fruits of some of those quick wins come through quite as quickly as you'd hoped. You need to hold your nerve linked to that. I think this needs to be an initiative absolutely owned by the chief executive of the organization. It's not something you can successfully delegate within the organization. And a CEO needs to ensure they've got the right mix of those new and existing talent around them in the right positions, with the correct incentives. You need to get the diversity of all dimensions correct. And also align on that kind of level of ambition to make sure that everybody's singing from the same set of lyrics.

Something which I think is not unique to successful digital businesses, but certainly I think is accentuated by digital businesses, is that obsessive focus on the end user, and involving the end user as early as you possibly dare with your plans. So that's typically sharing with them beta versions of your new service—frankly, ideally before you're comfortable, because you'll learn so much from real insight with that end customer—and building around that customer rather than around your own internal processes or just automating existing systems and approaches, which is unlikely to give you the breakthrough change that you need to succeed against the pure-play businesses.

Finally and importantly, I think you need to build privacy and security into the new business by design. Trust is so critical across financial services; of course, insurance is no different. And to succeed with the new business, privacy security and related aspects need to be front-and-center built into what's being developed. And trust is something which is slow to build and can easily be lost.

Ari Libarikian: Great. It's a long list of learnings, but rightfully so, because as we established, this is a very hard thing to pull off. So let's talk about getting started. It's nice to talk about the theory of big digital ideas and new businesses, but very practically, as a company, whether an insurance company—or, as Pia said, a company outside the industry that's looking to enter with a new business build—what are some practical ideas companies can do to get started?

James Bilefield: I think you need a little something of a burning platform. It's helpful to focus the minds of the organization and the board around this topic. So I think rolling forward three or five years and imagining that one of the deep-pocketed big tech companies had moved into your market. How would they do that? What could you do to prepare for that day? How are you thinking around your customer journeys? How are you digitizing those? What across your organization are you able to automate today, tomorrow, or never? Where do you best deploy the amazing human capital you have in the organization? How are you using data in your organization? How are you using it to make better decisions and to innovate? And to what extent are you shifting your use of data from kind of looking in the rearview mirror to starting to understand and to use live data, and then using that live data to make some smarter decisions? Put that against the fact that the world of technology will not stand still in the next three years. So are those plans still fit for purpose with accelerating trends of technology disruption that we see around the world and the billions of dollars being invested in insurtech that I referenced earlier? And if not, what as an organization do you need to build, and how fast?

Pia Schlüter: I absolutely agree. And Ari, to be very practical, I think you need to identify the one area where you want to build a new business. Is it reinventing the way you do insurance, or is it building something broader, or a platform, or an ecosystem play? Is it in the area of motor, or mobility, or is it in the area of home, or in something completely different? And then once you've decided on this, put together a small but high-performing team. Give them—or have them dedicate—a hundred percent of their time for a few weeks to come up with a very concrete, and ideally customer-tested, idea in what we would typically call the breakout phase. And then once you have this idea, you can further detail it and start building it.

Ari Libarikian: I like to say you take one big risk in building a new business, which is the decision to build the business. And then every step thereafter is about derisking. And the way you derisk is exactly like you said: you anchor it in business value, you get to the customer quickly, you create an iterative approach, you stage-gate, and then you roll it out.

One of the challenges we typically see, especially in the early days, is how to measure the progress and success of the business. Two or three years in, it's pretty clear. You're looking for P&L [profit and loss], you're looking for value with customers—you can measure that. How do you measure that a month in, three months in, six months in, even 12 months in? What separates the companies that are on the right path in the early stages from the ones that are not? Have you gotten customer feedback? Do you have a path to getting data and insights? Do you have a successful minimum viable product? Those are some of the things we might look for in the early days. I find that it's a very common challenge, especially for management teams with established companies.

One more question: sustainability is a big theme nowadays, and it's quite important for corporations

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to have impact broadly, not just shareholder impact. Any observations on what insurance-industry executives and teams can do from a sustainability perspective in building new businesses?

James Bilefield: I think sustainability has shifted in the minds of more forward-thinking business leaders from a topic which is about risk and is now about license to operate. And it's shifting to a posture where it's actually about potential competitive advantage in the future alongside doing the right thing and bringing the organization and other stakeholders with you as you lead. I think the pandemic has highlighted the powerful role of business in solving some of the wider ESG [environmental, social, and corporate governance] topics. And sustainability for any forward-looking business plan over the next three to five years needs to incorporate, frankly, not just sustainability, but also some of the social-equity and other goals, which are now, I think, becoming, frankly, table stakes for organizations generally. And I think if you're trying to leap forward and do something more exciting and significant with a new-business build, embedding those values and those principles into the core, alongside security, seems like really smart business.

Ari Libarikian: Thank you so much, James. Thank you, Pia.

It's clear that changes in customer behavior, new competitive threats—and, frankly, a brave new world for all of us—presents an opportunity, but also a burning platform for insurers to build new businesses and scale them. I hope everyone's enjoyed the discussion on building businesses for incumbents. On behalf of myself and my colleagues, Pia and James, thank you for listening.

James Bilefield is a senior adviser in McKinsey's London office; **Ari Libarikian** is a senior partner in the New York office; and **Pia Schlüter** is a partner in the Düsseldorf office.

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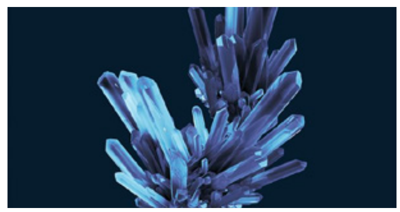

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