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Tech-driven insurers: How to thrive in 2030

Insurance operating models are on the verge of a fundamental change. To thrive in 2030, insurers must commit to a specific role and take action now to secure the tech capabilities they need.

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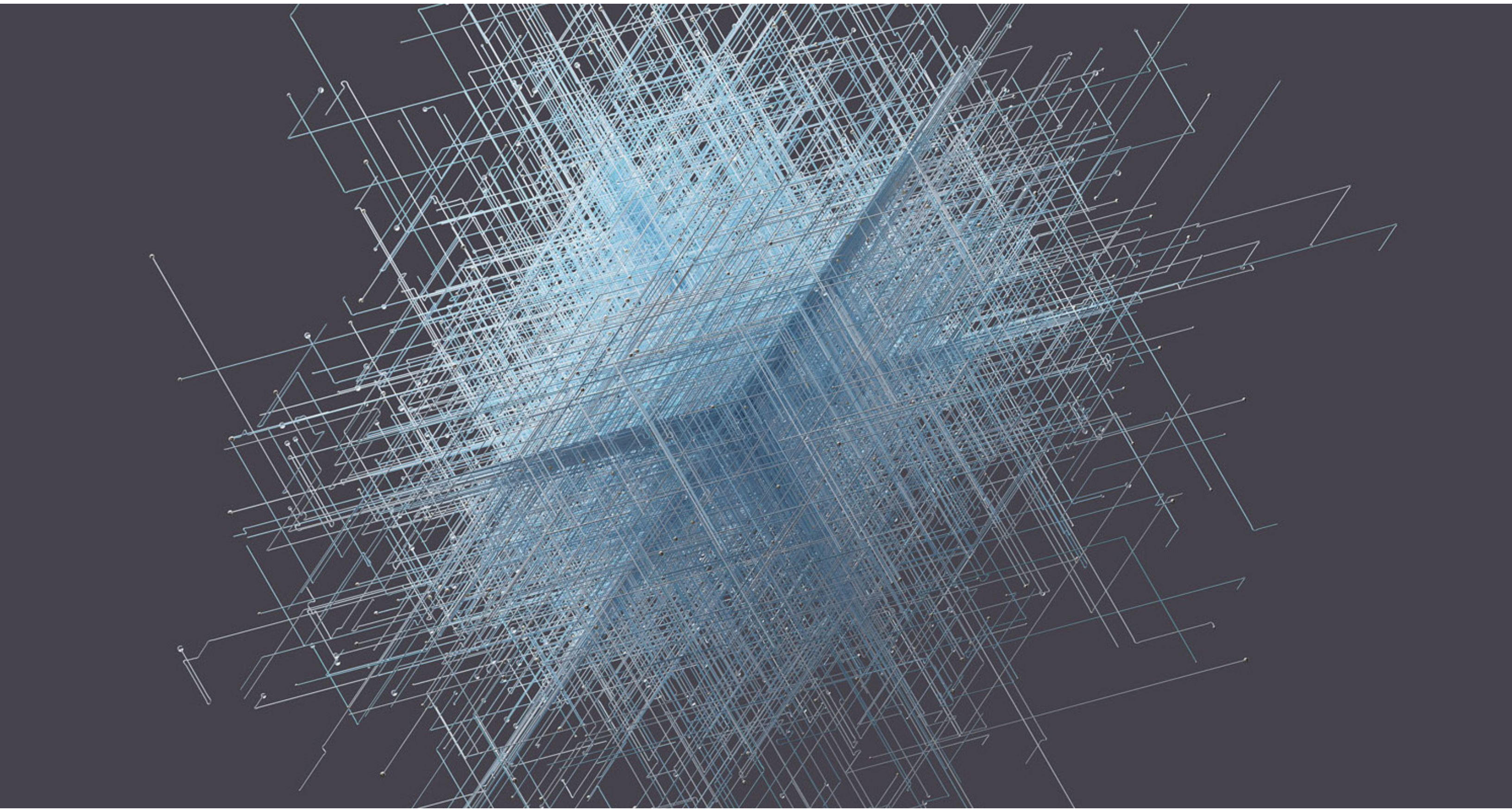

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The urgency for change is clear: Already, insurers with more sophisticated IT capabilities have an obvious advantage in terms of agility, growth, and cost ratios, and they are better able to match the increased need for digital offerings.[1] And insurers with market-leading analytics capabilities have a five-year revenue CAGR that's four times higher than that of competitors.[2]

If this is the reality now, what might 2030 look like?

Other industries may reveal the general direction in which things are headed. Incumbents are struggling to keep up with the significant shifts demanded by technology. New, pure digital players, such as PayPal and N26 in retail banking, have not only emerged but also achieved a significant market share in a short time—and even partially captured a market-shaping position. In telco and entertainment, a new set of tech-powered market leaders have gone a step further and fully reshaped the industry—leaving incumbents struggling with rapidly declining market shares or even forcing them to exit the market. And former value chains and operating models are all but obsolete as companies harness new opportunities from digitally enabled partnerships. Take mobility as an example: while traditional carmakers have had exclusive access to their customers, these customers are beginning to weigh purchase decisions based on various elements besides the vehicle's "hardware." Indeed, as cars are increasingly developed through partnerships, customers may soon purchase vehicles based solely on the software provider.

So what's the next move for insurers? After a history of incremental change in insurance, companies are facing an absolute imperative to adapt their traditional operating models. But no one insurer can tackle all the compounding changes. Succeeding in 2030 will require insurers to define where they can excel and where they can form partnerships—and leave the rest to others. And all insurers will need to rethink every aspect of how they operate, from their technology and structures to their processes and people.

Trends affecting insurers' operating models

Core trends suggest the insurance industry is not immune to the tech-based disruptions facing other industries—customer demands are changing, traditional operating models are under pressure, and new players are emerging.

— *Customer demands have substantially changed:* There's a growing push to create an "integrated customer experience," in which insurance is bought as an add-on to other services and goods. As such, it's important that insurers engage in digital ecosystems—and especially digital marketplaces focused on specific customer needs. Insurance services are increasingly purchased within such ecosystems, which are often owned by players from other industries, such as technology, media, and telecommunications and banking. The affinity market is similarly experiencing increasing revenues, for example, in automotive, retail, and more traditional bancassurance segments. Digitalization is a key component of this growth; our research shows that digital leaders increase revenue at five times the rate of other companies and total shareholder returns at twice the rate.[3]

  In addition to this shift toward integration, digital natives are causing customer expectations to rise significantly in terms of the quality and agility of insurers' digital offerings; many current insurers are not able to meet these expectations.

— *Classical operating models are increasingly under pressure:* At the same time that customer expectations are changing, there is continuing high market pressure on cost;

[1] Peter Braad Olesen, Krish Krishnakanthan, Jens Lansing, Björn Münstermann, and Ulrike Vogelgesang, "IT modernization in insurance: Three paths to transformation," November 4, 2019, McKinsey.com.
[2] Violet Chung, Dino Ho, Brad Mendelson, and Joe Zachariah, "How digital and advanced analytics can boost growth in Asian insurance," October 28, 2019, McKinsey.com.
[3] Ibid.

industry profits are flat at best. All the while, the gap between leaders and laggards is increasing—cost ratios for bottom-quartile players in our Insurance 360° sample are 200 percent higher in life and 45 percent higher in property-and-casualty insurance than for top-quartile players in our current sample.[4] One of the underlying drivers of this discrepancy is the increased cost advantage for large-scale players stemming from the high share of fixed costs for actions such as technological innovation or implementation of regulatory requirements, which is particularly visible in life insurance. And operations have been undergoing rapid change, especially with regard to claims and policy handling, due to digitalization and automation—a trend that has accelerated through the COVID-19 pandemic. One immediate effect of this trend is consolidation. In Germany, for example, the market share of the top five insurers by gross written premium increased by more than 25 percent in both life and property-and-casualty insurance between 2008 and 2018.

— *Outside tech-powered giants and dwarves are shaping the insurance market:* Outside players are taking advantage of the shifts as an opportunity to enter the insurance market, and the pandemic has encouraged them to move fast. These players tend to have significant customer-data insights, strong customer relationships, established digital-ecosystem competency, and cutting-edge technological skills—which allow them to harness data, integrate instantly, and quickly launch new products or ventures. And they're here to stay. Tesla, for example, has launched its own risk carrier. Amazon has not only established a comfortable B2B2C model in retail but also added to its growing financial-services products with a new small and medium-size enterprise (SME) insurance product for its growing base of SME sellers and affiliated online shops. IKEA has established tech-enabled B2B2C models with a distinctive customer experience and tailored insurance solutions, based on its understanding and projection of customer needs. And some of the largest tech companies are forming partnerships, as Google's sister company Verily did with Swiss Re to launch health-insurance subsidiary Granular Insurance.

— *Regulators are paying increasing attention to technical debt—with harsh consequences:* In banking, a substantial number of investigations are taking place on the pitfalls of fast-paced digitalization in IT landscapes that have not been fully cleared of technical debt. In the European Union, several leading European banking groups have been investigated and even sentenced for IT and data-related compliance breaches that originally stemmed from half-hearted use of technology, including a failure to comply with Know Your Customer guidelines, irregularities of digitalized processes, or performance and security issues with core systems. In several cases, these breaches have led not only to an abrupt end of individual C-level careers but also a rapid deterioration of the customer base due to trust and reputational issues, as well as value destruction of entire corporations to penny stocks. We are expecting to see a similar movement in insurance—given the growing number of new market entrants that regulators will want and need to discipline according to good practices in financial service, and also the growing need to protect against cyberrisk (for customers and the stability of the financial ecosystem). New regulations—such as the European Insurance and Occupational Pensions Authority guidelines for information and communication technology security and governance, and the Digital Operational Resilience Act—are already in the making.

[4] Alex D'Amico, Kweilin Ellingrud, Daniel Garza, and Nancy Szmolyan, "The productivity imperative for US life and annuities carriers," March 16, 2021, McKinsey.com.

These trends are creating a new market—one that will require insurers to make much more radical shifts to their operating models in order to operate successfully. While the full effect of these shifts will be visible only in 2030 or beyond, today three core changes already stand out. First, there is a significant increase in ecosystems and platform businesses that build on customer access. While this offers new opportunities for insurers at the core of such ecosystems, others are in danger of losing direct customer access. Second, utilities and services are increasingly provided across the industry. Given the benefits of scaling described above and a slow but continuous trend toward more standardization in the market, insurers and an increasing number of service providers are offering services across operations, IT, and support functions, in particular. And last, a new breed of highly integrated players, often very specialized and with agile and streamlined operating models, is entering the market—and those players are gaining scale (Exhibit 1).

The pillars of future business models

Amid all this upheaval, companies must think strategically about the role they're best suited to play and reconstruct their operating models accordingly.

Four roles for insurers

We see four major roles for insurers and other players within the insurance industry (Exhibit 2).

— *Ecosystem orchestrator:* The ecosystem aggregator owns the customer relationship and offers a broad range of ecosystem-driven services beyond insurance, such as mobility as a service and activity tracking. This role is for insurers that are already able to form and maintain partnerships. Current examples include Discovery, HUK Mobility, Ping An, and Pulse by Prudential.

— *B2B2C operator or product and back-office provider:* Players in this field provide comprehensive insurance services at scale. This model applies to insurers that run a highly efficient operating model built on large, internal scale efficiencies or market-leading levels of digitalization. These services can also be provided through a joint venture—for example, between reinsurers and service and tech providers. Current examples include

Exhibit 1

Major shifts in insurance operating models are under way.

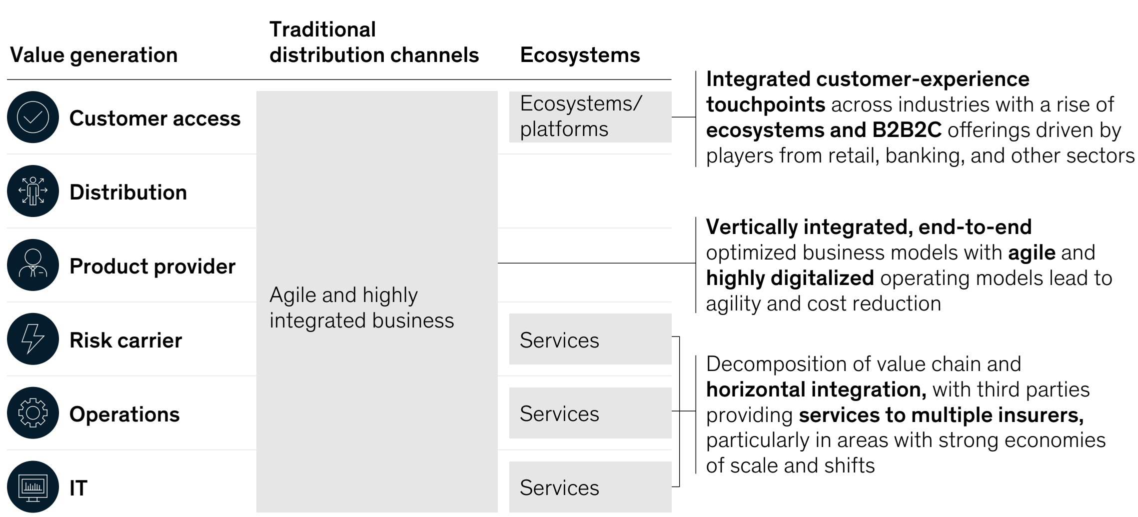
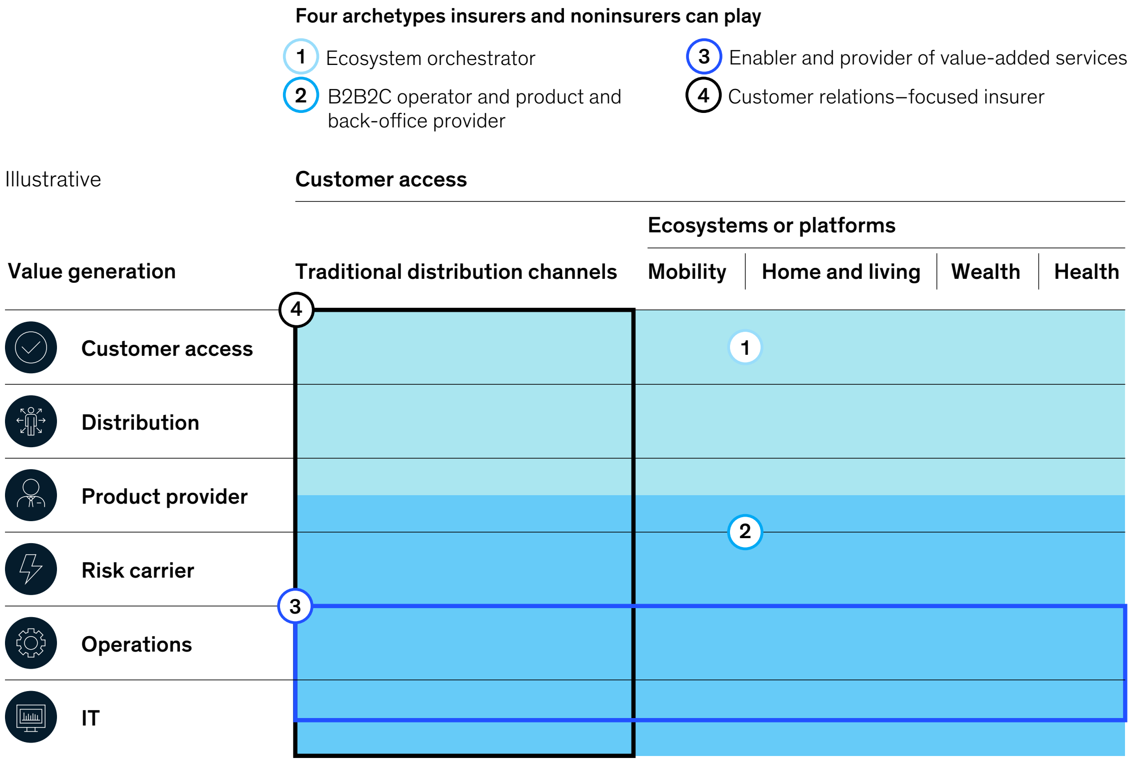


Exhibit 2

The new operating models push insurance-industry players into four archetypal roles.



players in the closed-book life insurance space—such as Phoenix Group, through its partnership with Tata Consultancy Services, and Viridium[5]—or insurance-as-a-service providers, such as Neodigital and iptiQ. Existing bancassurance players have the potential to grow by harnessing their B2B2C capabilities, particularly in combination with digital. While clearly an avenue of growth, this model often implies a loss of the direct customer relationship and a commoditization of services.

— *Enabler and provider of value-added services:* The enabler provides selected enablers and value-added services at scale. Examples include core-system providers (such as Guidewire and msg global solutions), large service and tech providers (such as Cognizant, HCL, and Infosys), insurers entering this space (such as Syncier), and specialists (for example, in sales or claims, such as ControlExpert).

— *Customer relation–focused insurer:* Carriers that continue to fully own the customer relationship include players specializing in niche segments (such as Petplan), as well as a small number of market-leading, large-scale players that can draw on their scale and technical and distributional excellence (such as Allianz or Geico). As a prerequisite,

[5] For more insights into the closed-book life insurance market, see *Running up on runoff: Strategic options for life closed books*, February 10, 2021, McKinsey.com.

their operating models are highly digitalized, efficient, and agile—and in many cases show a high level of vertical integration.

Compared with current industry structures, the biggest changes will come from the B2B2C, product-provider, and enabler roles—and these are also the groups we expect to grow the most. Companies in these roles may offer new business models or harness new opportunities to offer external services for others. Today, an estimated €25 billion in spending goes to these two archetypes in Europe. By 2030, we expect this amount to increase by about 70 percent to more than €40 billion. Most of this value is coming from IT services, followed by operations and support.

Opportunities by size

Insurers now have to ask themselves which strategic moves they should pursue. Depending on their size, they have the following (selected and not exhaustive) options.

Large insurers

Large insurers have opportunities to expand their business model by building on their scale and skill advantages to provide cross-industry services either as enablers (for example, Syncier) or as producers in B2B2C settings (for example, Swiss Re subsidiary iptiQ or Zurich's bancassurance collaboration with Deutsche Bank). To run this model successfully, capitalizing effectively on scale advantages is key. In particular, insurers should consider streamlining their offerings and operating models to reduce complexity.[6]

Small and midsize insurers

For small and midsize insurers, the strategic options are more nuanced. There are opportunities for these insurers to become producers or enablers similar to large-scale insurers in areas where they have a clearly distinctive capability. One recent example is Neodigital, which is building a cross-industry platform starting from a small customer base. However, these opportunities will be the exception rather than the norm.

Most small and midsize insurers need to review their current operating model and future-proof it. Many insurers can gain from harnessing an increasing set of options to overcome scale and skill disadvantages through cross-industry services or even white labeling.

Setting up for success in 2030

After players have identified the strategic moves that they're best suited to make, they must adjust their operating models accordingly across four dimensions: technology, structures, processes, and people. By getting technology adjustments right, insurers can lay the foundation for changes across the other dimensions.

— *Technology:* Increasingly, technology is a core means for insurers to differentiate themselves (see sidebar, "How insurers can use technology to differentiate themselves"). The technological backbone should include technical assets in both infrastructure and application landscapes, a reasonable level of technical debt,[7] and an architecture that fulfills future needs—for example, supporting external integration through application-programming interfaces.

— *Organizational and location structures:* Some leading insurers' IT organizations, for example, are moving their development teams to a product-centric organization—increasing business collaboration and agility.[8] Rethinking

[6] For more, see Nagendra Bommadevara, Björn Münstermann, Sanaya Nagpal, and Ulrike Vogelgesang, "Scale matters … to an extent: Playing the scale game in insurance," March 2, 2021, McKinsey.com.
[7] Vishal Dalal, Krish Krishnakanthan, Björn Münstermann, and Rob Patenge, "Tech debt: Reclaiming tech equity," October 6, 2020, McKinsey.com.
[8] For a broader perspective on agile operating-model structures, see Johannes-Tobias Lorenz, Deepak Mahadevan, Batu Oncul, and Mehmet Yenigun, "Scaling agility: A new operating model for insurers," September 14, 2020, McKinsey.com.

near- and offshoring options and developing a diversified footprint can dramatically improve efficiency and resiliency—and provide access to additional talent pools.

— *Streamlined, highly automated processes:* Within IT, leading insurers implement DevOps with highly automated testing and other internal processes. To streamline business processes, many insurers harness innovative low-code solutions, and they use automated reporting on targeted operational key performance indicators to achieve effective performance management.

— *People:* Leading insurance tech organizations cultivate engineering talent and build a diamond-shaped skill pool. They strengthen their teams through continuous training and development of state-of-the-art skills. And the most effective insurers tap a mix of in-house and sourced capabilities.

Tech-driven insurers: Getting started

Insurers must act now: getting tech capabilities to the needed state will take years, and the industry is approaching a tipping point in which structures will shift very quickly. A good approach follows four principles:

— *Understand your war game:* Know your (tech-related) lines of attack, and shape defensive and winning strategies with a tech-enabled or tech-backed unique selling proposition.

— *Take a value-centric approach to maximize business impact:* Take a step back to reassess the overall 2030 strategy and shape the tech transformation accordingly. Transformations should be a joint effort among business and technology teams, championed by business leaders, business development, the CEO, and the chief information officer.

How insurers can use technology to differentiate themselves

Opportunities to harness technology as a differentiator include the following:

— Bring user experience to the next level by shifting the technological focus to the front end. Increasingly, companies can modernize IT “front to back,” with an emphasis on customer experience and an ongoing hollowing out of the core instead of a full replacement.

— Rapidly digitalize workflows and improve time to market through automation, for both business processes and IT processes, such as testing. State-of-the-art tools such as no- or low-code platforms or robotic-process automation for business processes provide options for fast implementation and value capture.

— Accelerate time to market for new product lines or brands with only minimal integration into the existing landscape by harnessing software as a service or white labeling.

— Harness insurtech ecosystems from partners or platform and service providers for rapid access to state-of-the-art solutions along the full value chain. Strong integration platforms based on application-programming interfaces build the backbone.

— Build business intelligence and big data capabilities into any IT-modernization initiative, particularly those relating to core systems.

— *Balance quick wins and strategic initiatives:* Start with a clear vision of the desired end state and a road map for getting there. Implement high-impact levers that deliver tangible results in the near term as a proof of concept to gain buy-in and allow insurers to sustainably fund later projects. Then launch strategic initiatives in a second phase.

— *Focus on forming partnerships and building the technology muscle:* Build the people and governance model to be in sync with the technology platform to ensure that technology can scale beyond the pilot.

The anticipated disruptions in the industry are huge. While these will not happen overnight, many of these shifts are already starting, and there's a clear advantage for first movers. Insurers will benefit from clearly articulating their strategy and then adjusting their operating models accordingly. Shifts of such magnitude will take years, but by laying the groundwork now, insurers can enjoy a strong competitive advantage and brace for 2030.

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