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The Changing Face of Indian Insurance

In Pursuit of Profitable and Sustainable Growth

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FOREWORD

We are pleased to present this joint publication from Federation of Indian Chambers of Commerce and Industry (FICCI) and The Boston Consulting Group on **"The Changing Face of Indian Insurance: In Pursuit of Profitable and Sustainable Growth"**.

This publication is a summary of the 14 point action agenda for the Indian insurers to get profitable and drive sustainable growth, along with a global collection of BCG perspectives from insurance and other industries on key relevant topics.

The Indian insurance sector is poised for growth in the coming years having navigated through a period of immense regulatory action & bringing appropriated changes to prevalent business models. We hope this publication will be helpful in providing some inspiration and actionable insights to all stakeholders for the next exciting phase of the Indian insurance sector.

We are thankful to all the authors of the perspectives, along with FICCI and BCG teams for their contributions.

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THE CHANGING FACE OF INDIAN INSURANCE

BY ALPESH SHAH AND AJIT ROCHLANI

IT HAS BEEN 15 years since the privatization of the Indian insurance industry. The objective of privatization was to create awareness and increase insurance penetration in the country. The story over the past 15 years has been that of the glass half-full and half-empty. The number of insurers has grown from around five in the year 2000 to over fifty today. Over the same time, penetration for life insurance increased from 1.5 percent in FY 2000 to 2.6 percent in FY 2015 and was as high as 4.5 percent in FY 2010, while in non-life insurance it increased from 0.5 percent to 0.7 percent. At the same time, there have been significant changes in the product portfolio as well as the channel mix. The industry has, during this period witnessed several dramatic shifts, including emergence of bancassurance, de-tariffing, regulatory activism, explosion of health insurance as well as the emergence of large government insurance schemes. These transformative changes project the story of the glass half-full.

But, the half empty side of the glass is also visible. The last few years from 2008 have been really tight for life insurance. The tight economic situation in 2008-09 changed consumer behaviour and there were multiple regulatory changes on products and channel commissions as well as TP pool. The channel economics have been really tight with a challenged agency model, banks taking a lot of the value in bancassurance and the poor perception of insurers in the market. All in all, the outcome of all the elements above has been the fact that profitability of insurers has been really hurting. To put out some numbers, the private non-life insurers had cumulative losses of ~Rs 2,200 crore from FY 2008 to FY 2013. Interestingly, they have had a much better run post this period and in fact have delivered a cumulative profit of ~Rs 4,000 crore from FY 2013 to FY 2015. Similarly, life insurers had cumulative losses of ~Rs 17,600 crore from the start till FY 2010, they too have fared a lot better over the last few years with cumulative profits or ~Rs 23,400 crore post from FY 2011 to FY 2015. Lastly, standalone health insurers (SAHIs) have posted cumulative losses of ~Rs 1800 crore over the past few years.

In the above context, ***the key challenge for the insurance industry is to drive profitable and sustainable growth.***

If this does not sound challenging enough, imagine having to do this in an ever changing and evolving world. The world-at-large is transforming rapidly. Some of the key trends that are expected to impact the sector in its next phase include:

- ***The digital imperative***: The connected world, the mobile revolution, digitization of everything, Internet of things (IoT) and big data are some of the key elements of the digital imperative.
- ***Changing consumer needs and behavior***: Changing lifestyles, increased awareness, diverse needs and the emergence of the increasingly more demanding consumer are some of the key changes in consumer behavior.
- ***Ageing***: The 21st century is expected to witness more ageing than ever before. The segment over 60 is the fastest growing age segment across the globe and comes with all the linked implications of retirement products, different needs, etc.
- ***Economic puzzle***: Rate hike uncertainties in the US and the uncertainties in Europe and China are impacting the global economy, including India.
- ***Regulatory activism***: This is a large trend globally as well as in India and is expected to continue.

Digital is likely the most important trend amongst all of the above. As industries are disrupted by bold digital business models from non-traditional attackers, more and more traditional companies are at risk of extinction. BCG's rating for potential digital disruption shows that both life and non-life insurance are high on the scale of potential disruption as shown in the Exhibit 1.

Music, retail, media and travel are far along on this path, but we are also seeing similar patterns in more traditional industries, such as banking, healthcare, industrial goods, manufacturing etc. The Insurance industry is not untouched either, with many non-traditional participants in the insurance

Exhibit 1: Insurance Getting Severely Impacted by the Advent of Digital

New digital attackers are changing the rules and disrupting traditional value chains

Grade 4

Total digital substitution risk

- Music
- Media (press, magazine)
- Insurance Non-Life

Grade 3

Digital-native models new competitors requiring adaptation

- Advertising
- Insurance Life
- Travel distribution
- Retail chains
- Retail banking

Grade 2

Hybrid Digital-Physical customer experience

- Airlines
- Automotive
- Consumer products
- Education
- Health
- Hotels & restaurants
- Manufacturing
- Telecom
- Transportation & Logistics

Grade 1

Operations & costs impact of digital disruptions

- Construction
- Mining
- Oil & Gas
- Utilities
- Pharmaceuticals

space—from retailers to automobile companies to airlines to start-ups, to name a few. In addition, digital is not a standalone trend; it affects multiple factors such as processes, changing customer expectations, increasing awareness etc.

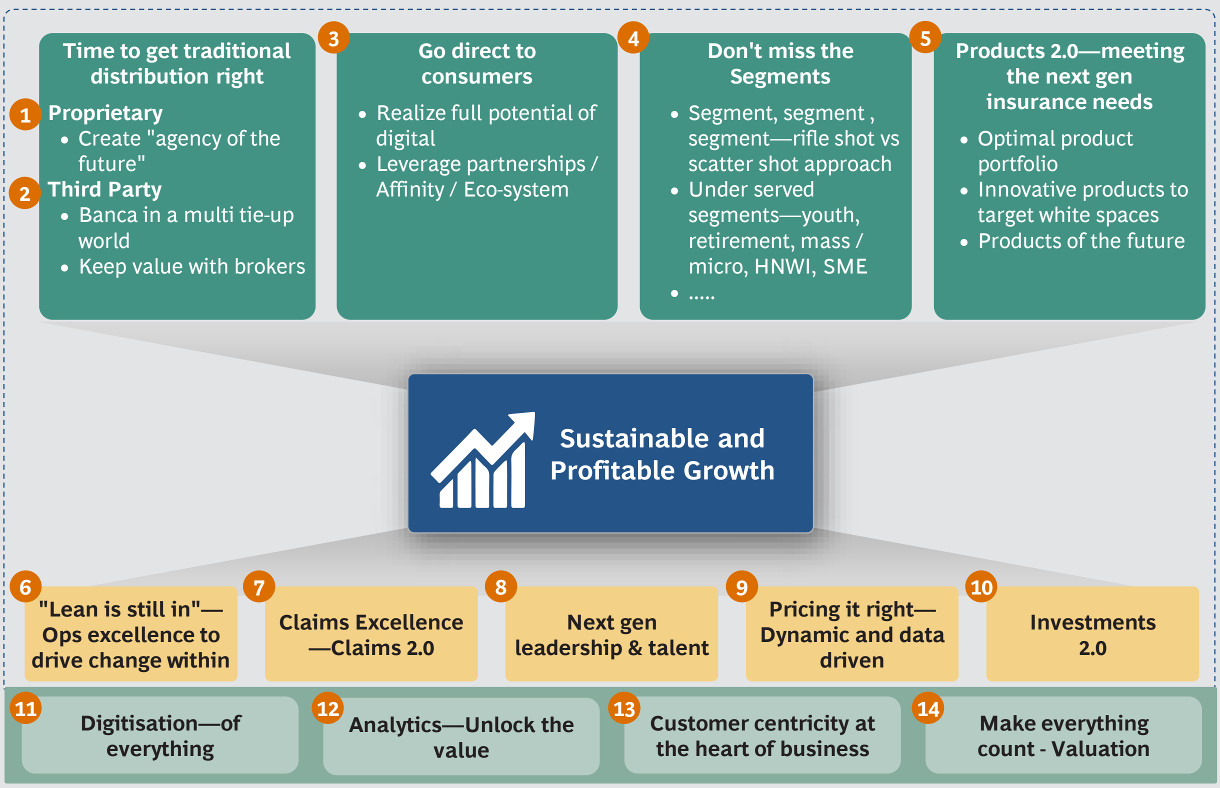
In the above context, as the insurance industry focuses on its biggest challenge—that of driving profitable and sustainable growth, the question is, 'what is the roadmap for addressing this challenge?' While it could be considered foolhardy to generalize and define an agenda for insurance, we have taken a bold step and defined a 14 point action agenda for Indian insurers that could lead to this target. (Refer Exhibit 2)

1. ***Create 'agency of the future'***: What has been disappointing in the last few years is to see most of the Indian insurers struggling with traditional distribution channels, be it proprietary or third party channels. A robust proprietary channel is necessary for sustained growth at an industry level. While multi-partnership banca architecture will open up opportunities for insurers, the health of the agency channel cannot be neglected. Currently, agency channel economics are difficult to sustain for most insurers. India is likely the only large country in the world with a fixed cost agency channel. A fixed cost for agency management with an active agency span of control of 2-3 is a recipe for disaster. Add to that the fact that there is increasing dissatisfaction with agents amongst the Indian insurance consumers, specifically the younger segment. When we speak with the insurers, almost all of them agree that with changing consumer expectations and the impact of digital, the role of agents will undergo significant changes in the future. However, not enough insurers have truly attempted to design the agency of the future and hence this is an opportunity to innovate and take the lead in this space.

   Building the agency of the future will require:

   - ***An uncompromising focus on sales management***: There can be no substitute for laser-like focus on the right

Exhibit 2: 14 Point Action Agenda for the Indian Insurers



inputs to achieve target outputs. This means higher volume of commercial activity (customer visits, recruitment activity) aligned with focus on the right segments with the right products supported by better quality client discussions driving higher conversions.

- ***Enablers geared to drive optimal sales management***: Whether it is training which is not just product based but also with sufficient focus on selling skills (sales teams have a stronger need to learn how to prospect and how to sell rather than just what to sell), or harnessing the power of technology to optimally manage the sales funnel, facilitate better quality client discussions and make it easier to monitor the unit's performance, it is important to strike the right balance between production, quality and team build-up through performance management and incentives.
- ***A segmented approach***: A 'one size fits all' approach towards agents or agency managers is sub-optimal. It is crucial to have a simple and actionable activity-based segmentation which categorizes agents or agency managers into a few (not many) prototypes.
- ***Enhanced customer engagement***: Leveraging best practices from the consumer industry as well as technology to make the connect.
- ***A sales culture cascaded from the top*** which asks the right questions, focuses on the right metrics, resists the temptation for short-term boosts (driven by high cost contests) to build the right behavior for the medium-term.

The journey towards building a robust agency channel of the future will not be a quick one. It will require 'seemingly obvious' actions which unfortunately have not been institutionalized, taking unglamorous and small but necessary steps to stay on the course to fundamental on-ground behavioral change.

2. ***Realize the full value of third party channels***: Banca has gained share and is already the largest channel for private life insurers but is still significantly under-penetrated, especially in the case of many PSU banks. IRDAI has already come out with new regulations that allow banks and other corporate agents to tie-up with maximum three insurers in each of the life, non-life and health categories. The regulation was finalized after years of deliberation, but we are yet to see any multi tie-ups. The industry should look at bancassurance models around the world and learn from the experiences with other open architecture models. Globally, in similar situations, we have seen models of a wide variety, ranging from 1:1 dedicated partnerships as well as open partnerships. In the case of multiple insurer partnerships, again we have seen banks follow a model of full direct competition with multiple insurers, or segmented offerings to insurers by geography (urban vs rural, metro vs tier I/II/II); by products; by customer segments (mass vs HNWI vs SME) or even by channels (direct vs branch vs …), based on the strengths and capabilities of the various insurers.

   Insurers have been struggling to keep value with brokers and intermediaries and the discomfort of insurers has been the biggest reason for the restricted growth of this channel. Insurers and brokers need to work together to share value and explore ways to create a strong third party arm of distribution that can reach customers in a customer friendly way just as any other proprietary channels.

3. ***Go direct to consumers***: Going directly to customers creates a lot of value for insurers. The single largest reason for this is the fact that an insurer can collect more and better data from customers directly rather than through intermediaries. This can be used to enhance the engagement with customers and increase cross-sell/up-sell to get more value from the same customers.

   Global experience shows that in the case of digitally advanced countries, life insurance has reached 5-7 percent of sales online, while retail non-life is seen as high as 35-40 percent. India is clearly at the early stages of the same journey. The percentage of consumers buying insurance online is only about 2 percent and this has gone up from 1 percent in January 2012 to 2 percent in January 2015. Based on a survey of over 20,000 Indian consumers that BCG's Centre for Customer Insights conducts every year covering over 100 product categories including insurance, we believe that the Indian consumer is ready for online purchase of insurance amongst multiple other products. Survey results over the last few years have shown an encouraging trend in terms of the expansion of the digital footprint (percentage of insurance consumers having access to the Internet increased from 30 percent in January 2012 to 51 percent in January 2015), and even more importantly, in digital influence (percentage of insurance consumers doing one of 10 commercial activities such as comparison, research etc. online) moving up from 10 percent in January 2012 to 17 percent in January 2015. So, while online digital purchase is as low as 2 percent, the potential is already nine times the current value and is on the rise.

Insurers will also need to build other direct channels for reaching out to retail customers. There is scope for innovation here and opportunity to create a new market. Partnerships will play a key role in the growth of direct channels going forward. Although insurers should look to reach out to potential customers directly, the right set of partnerships can help in a big way by enabling insurers capture the mind space of potential customers at the right time. For example, MetLife's partnership with Gerber in the US to use the Gerber Mom network to sell child products has been hugely successful.

Thirdly, innovations in an ecosystem could evolve to create a comprehensive offering for a targeted group, where the services address an integrated set of customer needs, including insurance. A good example is 'Vitality' by Discovery, an integrated wellness program that incentivizes its 5.5 million members to pursue healthy behavior. Vitality has over 20+ data provider partners such as healthcare providers, fitness clubs and wellness programs, wearable devices (Polar, Garmin, Fitbit), telcos (CellC) and retailers (Clicks, Pick n Pay, Woolworths) to offer a comprehensive health services menu to its customers that goes beyond just health insurance. To read more about the role of ecosystems in Insurance, we encourage you to read our full report '***Insurance and Technology—The Emerging Role of Ecosystems in Insurance***'.

4. ***Don't miss the segments***: There are two parts to this—the first is to segment customers and the second is to address under-served segments. So far, most insurers have done only the most rudimentary segmentation. The time has come for insurers to change their approach from scatter shot to rifle shot.

   In addition, a significant part of future growth can come from covering the under-penetrated segments. There are quite a few segments that are still significantly under-penetrated. For example, the HNWI segment is significantly under- penetrated when it comes to insurance. This is a segment that is rich on money and poor on time, and so Indian insurers will have to create tailored solutions to cater to this segment. There are several such segments that present large opportunities but which will require a tailored approach to serve them, prime amongst them being retirement, mass market, youth, SMEs etc.

5. ***Products 2.0—Meeting the next gen insurance needs***: In this rapidly evolving world, it is becoming increasingly important to look at end-to-end solutions rather than just insurance products. And this is true for health, life and non-life insurers.

   The next gen insurance needs will be very different, and companies driving innovation have sweeping visions of an ever-more-connected world, more digital, more mobile, with wearable, new-age industrial, an-app-for-just-about-everything future. If smart-phones are the tech industry's defining device of the past five years, many feel that "wearables" will define the next five. Today, there is low data collection and interaction between insurers and consumers, but in future there will be frequent interaction and continuous data collection because there will be connected phones, connected cars, connected homes and connected human beings. So the key challenge is about what insurers can do with this data to create the products of the future.

6. ***Lean is still in—operational excellence to drive the change within***: 'Lean is in' has become a old time cliché, but for Indian insurers it is still very much the trend. Insurers know that lean can help achieve operational efficiency, cost benefits and can also make for satisfied customers. Yet, most insurers struggle with how to create lean processes. With 'lean' being a hot topic in the Indian insurance circuit, it is no surprise that almost all insurance companies have launched process optimization programs under various headings—'Lean', 'Customer Centricity', 'Ops Improvement' in recent years, but the time may be right to review the degree of success achieved.

   Operating expenses to total premium ratio for the private life insurance industry is around 17 percent in India, while it is single digits in the more evolved markets in countries like the UK, Germany and France. Only LIC has an operating expenses to total premium ratio of below 10 percent in India. Indian insurers need a holistic lean approach, with the multiple objectives of enhancing customer centricity, lowering opex costs while at the same time increasing employee satisfaction. The BCG perspective on lean, ***'Less is More: Lean 2.0 Programs in the Global Insurance Industry'*** shared in this publication covers five practical ideas for lean programs.

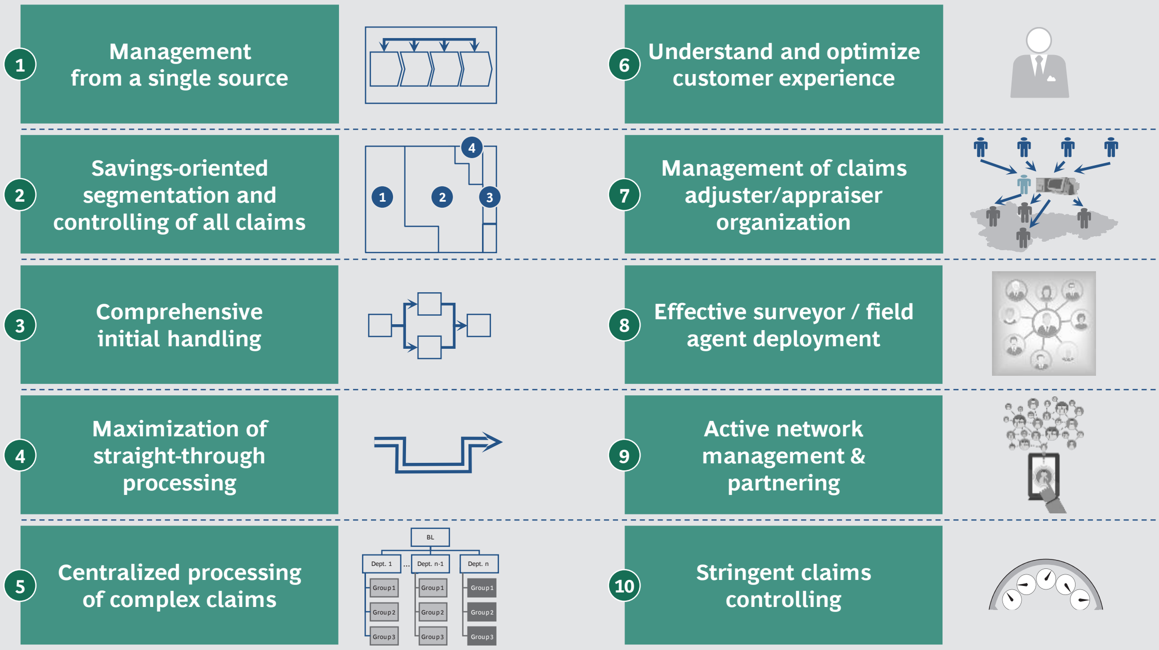
7. ***Claims excellence—Claims 2.0***: Claims cost is the single largest cost head for non-life insurers. Hence, we have excluded the claims process from the other processes in topic 6 above. This topic is more relevant for non-life and health insurers and less for life insurers. A quick benchmarking of the claims processes being followed by Indian insurers against that of global best practices shows that Indian insurers need to drastically simplify their claims processes from their current state by making more efficient use of technology. The key challenge in optimizing claims processes is to get the balance right across the three axes of processing costs, pay out costs as well as customer satisfaction. Listed below are ten success factors for achieving 'best in class' claims management (Refer Exhibit 3).

In this report we have shared a case study on ***'How AIG Moved Towards Evidence Based Decision Making'.***

8. ***Next gen leadership and talent***: Globally, top executives consistently rank leadership and talent management at the top of their agenda, but express frustration with the return on their investments in this area. Companies with strong capabilities in leadership and talent management outperform those with weaker capabilities. The companies that excel at leadership and talent management have figured out how to involve their leaders, and not just the HR team, meaningfully and regularly in people development. In fact, leaders in high-performing companies can spend more than 25 days a year on leadership and talent management activities. This is a topic relevant for all corporates, but even more for insurers in India, since the industry is faced with multiple challenges and, because of its perception, has not always been able to attract the best talent easily.

   In this publication, we have shared our report ***'The Global Leadership and Talent Index—The Smart Way to Improve***

Exhibit 3: Ten Success Factors for Claims Management Identified



Source: BCG analysis.

Capabilities and Create Value'. The BCG Global Leadership and Talent Index (GLTI) is the first tool to quantify precisely a company's leadership and talent management capabilities. The power of the GLTI lies in its simplicity. It is a 20-question survey that places a company at one of six leadership and talent management capability levels and suggests ways to move systematically from one level to the next. It quantifies the revenue and profit gains that companies can expect from moving up the index.

9. ***Pricing it right—dynamic & data driven***: Pricing as a lever for growth and profitability is often underestimated, but there are several reasons such as increased competition, cost, price sensitive customers, regulations etc. that make the aspect of pricing extremely crucial. Pricing calculations of insurers are mainly based on an actuarial/cost view, but the customer and competitor perspectives are also very important. Factors like the customer's willingness to pay, product differentiation, segmentation, market position, and focus on growth vs profitability, all need to be weighed in. Digital innovation allows dynamic and real time pricing, but insurers need to leverage 'big data' to be able to do that.

   In our perspective ***'The Six Steps to Pricing Power in Insurance'***, we talk about building a sturdy pricing process and how insurers can enhance their pricing capabilities by acting on the six steps.

10. ***Investments 2.0***: In the last 15 years, India has given better investment returns than most other markets, but the difference between average and optimal investment returns can often be the difference between making losses and profits. Investment management strategies will need to be adapted to the changing market environment, while also meeting regulatory criteria. The challenge for the CIOs of insurance companies is that they have to always manage their investment portfolio under new constraints and regulations.

India is still far from facing the low interest rate environment challenge that insurers in the west are facing, but in order to learn from the experience of global insurers it might be helpful to look at how they are managing this challenge. Insurers are looking at diversification and hedging strategies to optimize their financial position, to be able to achieve increased diversification in asset allocation. European insurers are also looking at emerging markets' debt and equity.

11. ***Digitization—of everything***: Insurers around the world are increasingly digitizing front end sales processes as well as back end processes in an effort to achieve higher productivity, operational efficiency and cost benefits. As most Indian insurers are just embarking on the digitization journey, it is important to prioritize processes, build supporting capabilities and define strategies for implementing and driving adoption. Digitization benefits all key stakeholders: on the ground sales force, managers, back end teams as well as customers. In order to realize the full potential of digitization, insurers need to re-imagine their operating model completely and look at how digitization can make the dream state possible. With the progress of technology, almost every insurance process can be digitized, but Indian insurers need to individually evaluate their starting position and prioritize processes and initiatives that can deliver maximum value and also have a long term digitization roadmap.

    Our perspective '***A Roadmap for Winning as Insurance Goes Digital***' will help in coming up with a roadmap for digitization: where to start, what to change, how much to invest and how to make it all happen.

12. ***Analytics—unlock the value***: Analytics can help insurers open a lot more opportunities and can also help in extracting maximum value from the existing initiatives. The value of good data and what companies can do with it is often underestimated. Insurers need to identify innovative value creating opportunities to use data for generating new insights, achieving process improvements, including claims and fraud management and come up with new more efficient operating models. To be able to unlock the full value of data and analytics, insurers need to develop processes and capabilities which enable ongoing appropriate data capture, storage and management as well as advanced analytics. As insurers look to build data and analytics capabilities, it is also important to build the right processes to ensure compliance. Lastly, it is extremely important to maintain the trust of customers and not to go overboard with what you can do with customer data.

    In our perspective ***'Bringing Big Data to Life: Four Opportunities for Insurers'***, we have shared four ways in which life insurers can profit from big data and analytics.

13. ***Customer centricity at the heart of business***: The next phase of the Indian insurance sector will likely not be driven by the insurers, but by the consumers themselves. Consumers today are more aware and more demanding than ever before. Insurers will have to keep customer expectations and customer experience in mind while going about their business.

    CEOs need to lead this charge themselves in order for their teams to follow suit. For example, A.G. Lafley, former CEO of Procter and Gamble, often used the famous quote "The customer is the boss" to communicate the importance of customer engagement. He in fact changed the vocabulary of the organization. In business reviews, his first question to all businesses was, "How is my customer doing?" and not "What are your numbers?" In addition, every quarter he would spend a day in customers' homes to get a feel for what customers want.

    Analytics are great, but analytics can

never be as useful as asking customers what they want. Focusing on what really matters to the customers is the base for creating a truly customer centric organization.

We have shared our perspective '***Customer Centricity in Financial Services goes Digital***', that talks about how rapidly evolving digital capabilities, particularly mobile, social-media and big-data offer financial services companies entirely new opportunities for understanding, serving and engaging customers.

14. ***Making everything count—valuation***: Insurers need to look beyond just the actuarial valuations and focus on how to create a truly valuable company that can provide sustainable returns to shareholders and also continue to create value. IRDAI has allowed insurers to get publically listed. However, there are a number of factors that insurers need to consider before deciding whether they need to go for an IPO. An IPO only makes sense as an integrated part of a strategic plan. Insurers should first set a valuation target, define an appropriate strategy and make decisions accordingly. It is also important to understand that a company's value-creation strategy is only as strong as its value-management capability, which drives a company's processes and organizational culture.

In closing, each of the insurers will need to define their own agenda based on the 14 point agenda defined above. The journey to developing a sustainable and profitable model will not be a quick and easy one. It will require insurers to take multiple actions along many of the 14 dimensions identified above.

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For Further Reading

In the following section of the report, we have shared global BCG perspectives from Insurance and others industries on key relevant topics.

THE FUNDAMENTAL TRENDS RESHAPING LIFE INSURANCE

BY BARTLOMIEJ MACIAGA, ALPESH SHAH, ACHIM SCHWETLICK AND ASTRID STANGE

SIX YEARS AFTER THE global financial crisis, the reshaped contours of the market for the life insurance industry are coming into focus. As with any other turn of events, threats and opportunities abound.

The threats—notably low interest rates, regulatory scrutiny, customer concerns, and rising competition from banks, mutual funds, and other asset managers—should not obscure the sizable and growing opportunities.

Demographics and technology are all friendly forces for the industry. Insurers are well poised to help older people manage their assets in mature markets, especially as the government's role in providing retirement income shrinks. In emerging markets, insurers can cater to the desire of the expanding middle class to save and plan for the future. Digital and mobile technologies are opening new, low-cost channels to consumers in all markets. (See Exhibit 1.)

This new environment will produce winners and losers. To understand what will separate the winners from the pack, we recently concluded a comprehensive global study of the life insurance industry. As part of our research, we interviewed senior executives in the 16 markets that generate 80 percent of global life-insurance premiums.

We detected five trends that will drive success in the future. Two of them describe how the design of products can improve profitability:

- Creating savings products without guarantees
- Tailoring protection products to untapped segments

Three trends respond to shifting consumer needs and behavior and changing distribution capabilities:

- Simplifying products and sales approaches for the mass market
- Customizing, without complicating, products for the affluent market

EXHIBIT 1 | The Opportunities and Threats for Life Insurers

Opportunities

Aging population
- Rising need for retirement products
- Greater awareness of changing needs because of increasing longevity

Reduced support by governments and employers
- Lower government pensions
- Rising need for individual retirement products

Digitalization
- Access to new customer segments
- Need to reformulate personal advice

Future customers
- Emerging middle class
- Demand for simple savings and protection

Threats

Low interest rates
- Increasing pressure on profitability and costs
- Worsening value proposition of insurers

Increasing regulatory scrutiny
- Strengthening new rules for capital
- Greater regulation of sales and conduct

Growing customer concerns
- Selling scandals and loss of trust
- Increasing demand for transparency

Competition from alternative providers
- Banks with more flexible forms of savings
- Asset managers offering retirement products

Implications for life insurers
- Driver of profitability and growth
- Shift in response to changing customer and distribution requirements

Source: BCG analysis.

- Tapping the workplace as a new distribution channel

These global trends have not taken hold equally in the 16 markets we studied, but they will blossom throughout most of the global insurance marketplace in the coming years. (See Exhibit 2.) The insurers that understand these trends and act quickly to develop products that respond to them will be able to overcome the well-publicized threats facing their industry and surf on the waves of opportunities that demographics and technology provide.

Creating Savings Products Without Guarantees

For decades, insurers relied on guaranteed savings products that offered high, stable returns, which appealed to customers looking for good yields and security upon retirement. Those days are dwindling. Falling interest rates and rising capital requirements prevent insurers from offering generous guarantees and are forcing them to rethink the savings proposition.

Asset management remains one of the most important strengths of insurers, but they now need to engineer financial solutions that provide assurances—rather than guarantees—of solid, steady, long-term performance. In this new environment, insurers still have two strong advantages over traditional asset managers and banks: their reputation and their distribution networks, both of which they can use to promote new offers to retail customers.

The Standard Life Investments Global Absolute Return Strategies Fund is an example of this type of solution. From 2008 through 2013, the UK fund exceeded its target return of 5 percentage points over the six-month London Interbank Offered Rate by 3.6 percent annually. This performance, coupled with low volatility, has attracted investors. Assets have increased from £1 billion in 2008 to £20 billion in 2013, despite annual fees exceeding 1.5 percent for retail investors and no guarantee of returns. The fund takes both long and short positions globally and invests judiciously in derivatives to generate returns and minimize risk.

Swiss Life Premium Immo, another successful product without explicit guarantees, invests in commercial real estate in Switzerland and expects to earn around 4 percent annual returns after fees. Investors view the fund as an attractive alternative to

EXHIBIT 2 | How the Trends for Driving Success in the Life Insurance Industry Are Taking Hold

		Profitability and growth drivers		Changing customer and distribution requirements		
		Creating savings products without guarantees	Tailoring protection products to untapped segments	Simplifying products and sales approaches for the mass market	Customizing, without complicating, products for the affluent market	Tapping the workplace as a new distribution channel
Europe	Austria	Established trend	Established trend	Developing trend		
	Belgium	Established trend	Developing trend	Developing trend	Developing trend	Developing trend
	France	Established trend	Established trend	Developing trend	Developing trend	Developing trend
	Germany	Established trend	Established trend	Developing trend	Developing trend	Developing trend
	Italy	Established trend	Developing trend	Developing trend	Developing trend	
	Netherlands		Established trend	Developing trend		Developing trend
	Poland	Developing trend	Established trend	Developing trend		Established trend
	Switzerland	Established trend	Established trend	Developing trend	Developing trend	Developing trend
	United Kingdom	Established trend	Established trend	Established trend	Established trend	Developing trend
U.S.	United States	Developing trend	Developing trend	Established trend	Established trend	Established trend
Mature markets in Asia-Pacific	Australia		Established trend	Established trend	Developing trend	Established trend
	Japan	Established trend	Established trend	Developing trend	Developing trend	
	South Korea	Established trend	Established trend	Developing trend	Developing trend	
Emerging markets in Asia	China	Developing trend	Established trend	Developing trend	Developing trend	
	India	Developing trend	Established trend	Established trend	Developing trend	
	Indonesia	Developing trend	Established trend		Developing trend	

Maturity of trend: Established trend; Developing trend

Source: BCG analysis.

purely financial products. Founded in 1857, Swiss Life, the nation's largest and oldest life insurer, is able to draw on the strength of its brand to introduce new product lines.

Moving into a world without guarantees has challenges. The new products will be similar to those offered by mutual funds and banks, and insurers will have to learn how to compete against these institutions. In addition to drawing on their brand and distribution capabilities, insurers will need to deploy sophisticated asset-management tools, such as dynamic portfolio rebalancing and hedging. Explaining these techniques to their sales forces, independent financial advisors, and customers may be challenging. Communication, marketing, and clear product descriptions will become more important than ever.

Tailoring Protection Products to Untapped Segments

As margins deteriorate for traditional savings products, protection products—such as term life insurance, disability insurance, and annuities—are becoming relatively more attractive to insurers. They provide new sources of income, generate steady margins, and diversify risks. Under new capital standards, such as the European Union's Solvency II directive, this diversification can help minimize capital requirements.

These products appeal to two large sources of relatively untapped demand: emerging markets and the low-income segments of mature markets. In emerging markets, the middle class has a growing appetite for protection products, while the low end in mature markets has historically been underserved. In all markets with an aging population, consumers are recognizing the value of products that offer steady retirement income and other services in old age. To broaden their offerings and increase margins, insurers increasingly embed additional services in protection products.

In China, for example, Taikang Life has created an innovative annuity that provides retirees with an apartment for life and optional medical care and other features. The product is aimed at older affluent consumers who are able to pay a large, single-contribution premium. The company plans to sell about 50,000 policies over ten years; 2,000 were sold in the first six months.

This new product enables Taikang Life to build a new revenue source and compete against banks. Other insurers are preparing to offer similar products. The winners will successfully pull together marketing, sales force training, and real estate expertise into an attractive package.

In South Korea, Hyundai Life responded to many consumers' perceptions that life insurance products are too expensive and confusing by offering an à la carte health-protection policy called Hyundai Life Zero. Customers can pick the particular risks, such as cancer, that they want to cover at a fraction of the cost of comprehensive, long-term health-care policies. And the benefits of the plan are so simple to understand that it is offered online and by phone in addition to traditional channels. The insurer sold 15,000 policies in the product's first six months.

Despite their appeal, however, such products take insurers out of their comfort zone. Insurers do not have deep experience in many of these segments, so risk assessment and pricing—as well as developing low-cost sales channels—will be crucial. Since many of these products will offer coverage that is less than comprehensive, insurers must make sure that communications about coverage are clear and be prepared to manage risk and litigation.

Simplifying Products and Sales Approaches for the Mass Market

Several forces are combining to encourage product simplification and streamlining. First, regulatory moves, such as the European Union's Insurance Mediation Directive, will impose greater expense, liability, and oversight on traditional products. Those products sold without the need for advice from an agent or sales executive will escape these burdens.

Second, declining returns have reduced insurers' ability to finance expensive channels with high management fees, especially for savings products.

Finally, consumers' buying preferences have changed, too, shifting toward online and direct channels. While such routes are less costly and widen the access of insurers to consumers, new products offered through these channels must be sufficiently simple to be sold without advice.

Insurers need to do more than simply strip away features from existing products. They need to build products that appeal to specific customer segments and that can be sold through direct sales channels. Online marketing material will also need to be simple, transparent, and interactive and be designed to appeal to specific segments.

The online channel will explode with innovation over the next several years. One likely avenue of experimentation will be automated and algorithmic advice that directs potential customers to specific products depending on those individuals' answers to questions.

Scottish Friendly, for example, has created a suite of tax-advantaged individual savings accounts that appeal to specific consumer segments. Each account offers varying levels of choice and financial risk tailored to the sophistication of the customer.

Online marketing material for each account is based on simple graphics, checklists, and descriptions. Telephone support is also available. These accounts helped to double Scottish Friendly's sales in 2013, the first year that they were offered.

Metropolitan Life, the largest U.S. insurer, is pursuing the mass market by offering term life insurance in a box through Wal-Mart stores. Snoopy, the lovable dog in the Peanuts comic strip, is featured prominently in the in-store marketing material. The policies are available with coverage as low as $10,000, opening the low-income market to insurance products. Customers activate the policies by calling a toll-free phone number and answering simple eligibility and health questions.

For an industry known for complex products, the trend toward simplification presents several challenges. Insurers will need to sharpen their skills in consumer insight to identify the most attractive features and benefits for specific segments. The new products will also need to be successfully integrated into insurers' distribution networks without alienating the existing sales forces.

Insurers must address the hybrid needs of more savvy consumers, who often seek streamlined, simple products and services for a specific need—such as life or accident insurance or savings—but still require some support during sales and service. Such a multichannel approach could combine the best of worlds by leveraging simplicity and personalization.

Customizing, Without Complicating, Products for the Affluent Market

Simplification is a smart strategy for new and low-end insurance customers, but it is generally unsuitable for the affluent segment. These customers have the means and the desire to pay for advice, customization, and more advanced financial-savings products. Despite changes in the industry, the best financial advisors still have a role to play and can actually increase their earnings by focusing on affluent customers and sophisticated products.

Italy's Assicurazioni Generali designed a three-phase product for German consumers in their fifties who want to maintain flexibility at the start of their policy and receive protection and benefits as they enter retirement. During the first two years, the policies are fully liquid. In the second phase through retirement, withdrawals are still allowed. In the third phase, the product converts to an annuity. Long-term care and critical-illness riders are available. The product was so successful at launch, taking in €1.5 billion in premiums in 2011 and 2012, that Generali had to impose sales and production measures to manage capital.

Insurers should not go crazy with customization, or they will land in an economic trap. Instead, they should rely on stringent economic calculation and rigorous customer segmentation to provide varying levels of customization. For example, the mindset and expectations of a customer whose net worth is $500,000 may be similar to those of a customer whose net worth is $10 million—but they have very different financial needs. Insurers will also need to allow agents to customize without creating unnecessary complexity—or risk overwhelming both agents and customers.

Tapping the Workplace as a New Distribution Channel

In many markets, consumers have grown frustrated with the increasing complexity of life insurance products and the lack of transparency and questionable sales practices of insurers themselves. These consumers have gravitated toward other savings products, such as bank accounts, mutual funds, and employers' savings plans. Meanwhile, regulators have encouraged employees to save for retirement by supporting auto enrollment in their companies' plans and providing tax benefits that promote participation.

These trends have helped raise the importance of using the workplace as a sales channel. Insurers may now integrate several insurance and savings offers into one customer-friendly package that carries the employer's stamp of approval. Insurers have offered basic life and disability insurance through the workplace for a long time already. But they now offer a much wider range of products and services and developing an integrated workplace-marketing machine that combines industry-specific expertise with scale and technology.

Insurers are able to leverage their expertise in relevant industries and product areas, such as income protection; provide products aimed at specific occupational groups; and offer other services. In the UK, Unum, a specialist in financial protection products, offers a suite of products through the workplace. These include income protection insurance, which provides a rehabilitation program to help employees return to work, and a program called Unum Life-Works, which provides legal, lifestyle, and fitness assistance for employees.

Insurers can also leverage their long-term relationships with employers to position themselves in the role of orchestrator, providing employees with a range of products and services from several insurers. Aon Hewitt, a benefits advisor, has created an insurance marketplace for employees at large U.S. corporations, allowing them to shop from a range of products offered by several insurers. Life insurers are also well positioned to organize private marketplaces in the workplace.

Conventional wisdom is wrong. There is growth potential in the life insurance business. So long as people are averse to risk, demand for insurance will remain. However, insurers will not be able to grow in the same way they have in the past, positioning themselves as pure financial organizations and relying on asset returns to solve all their problems. They will have to challenge both their business models and the way they operate in order to ride the waves created by these five trends.

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IMPROVE P&C PROFITABILITY AND PREMIUM GROWTH

SIX STEPS

BY TIM HOYING, JAMES PLATT, MICHAEL BONGARTZ AND YASUSHI SASAKI

THE GLOBAL NONLIFE-INSURANCE MARKET is likely to remain challenging over the coming decade. Greater price sensitivity, a lack of differentiation among carriers, and record-low interest rates have constrained top-line growth for most insurers. The uncertain pricing environment has added to these woes, squeezing margins and contributing to low equity returns. On top of that, a spate of catastrophic events has elevated loss ratios in recent years.

With growth in developed markets expected to remain sluggish, some insurers have turned to rapidly developing economies (RDEs), but this approach has proved no panacea. Although RDEs post much higher growth rates—averaging 16.2 percent since 2003—strict regulations and strong domestic competition have made the barrier to entry both high and costly in favored destinations such as China and India.

Despite these challenges, property and casualty (P&C) insurers can carve out premium growth and greater profitability. But they need to have a clear strategy, and they need to take action now. In our view, P&C insurers that adopt all or most of the following six initiatives can lift return on equity by 4 to 8 percentage points by 2022.

Get out of the commodity business. P&C products have become commodity like, with low customer engagement and high price sensitivity. The opportunities for meaningful customer exchanges, the kind likely to inspire loyalty, are, in most cases, limited to low-frequency events such as when customers are shopping around for a new policy or they are renewing coverage. From the customer's perspective, claims and other activities that involve more interaction seem transactional, making for a relatively bland experience. That may explain why a recent survey conducted by The Boston Consulting Group shows that consumers are far less loyal to their P&C providers than to their other financial-services partners. For instance, consumers are about twice as likely to search for cheaper auto- and home-insurance options during the course of a year than they are to switch bank accounts or investment advisors.

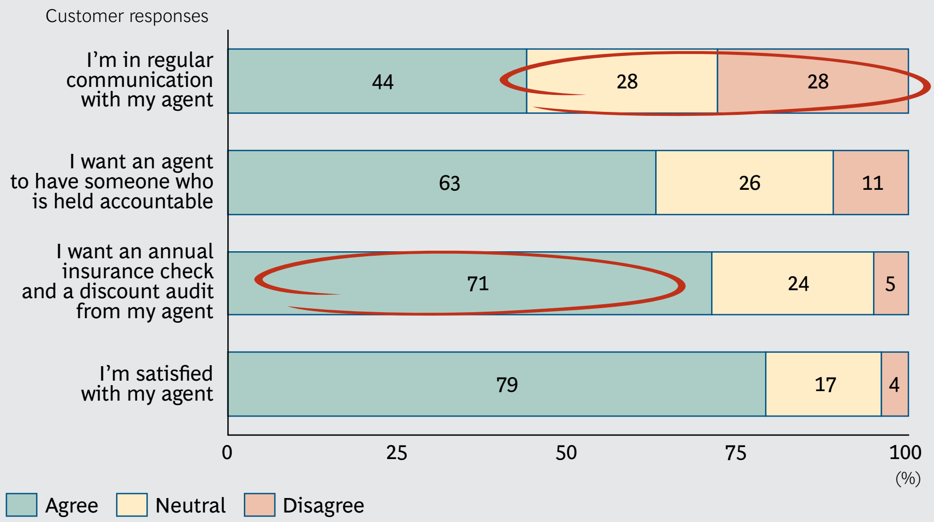
To change that dynamic, P&C carriers could take a page from other, formerly commoditized, sectors. A few decades ago, for example, very little distinguished the coffee brands sold on store shelves or poured in the corner shop. Coffee was coffee, a commoditized product and the victim of price wars. Then, Starbucks entered the fray and changed the perceived value, sourcing high-quality coffees, implementing strict standards, and customizing both the product and the in-store experience. The results revitalized a once-stagnant market and allowed Starbucks to command a price premium three times that of its competitors.

Some insurers, such as State Farm Mutual Automobile Insurance and Admiral, have begun to experiment with similar aproaches. State Farm has made the customer-agent relationship a key point of differentiation. The company has also launched a high-concept offering in Chicago in the form of the Next Door café—a no-pressure environment from which it dispenses free advice on insurance and other financial products. Admiral has found success by creating brands that target specific segments. Its Diamond brand, for instance, is directed at women and offers add-on coverage for such items as handbags and car seats, and its Bell brand focuses on the needs of young drivers, with offerings such as telemetry-based auto insurance. Such differentiation has helped both State Farm and Admiral outperform their peers.

Increase customer engagement through the agent channel. BCG survey data reveal a strong correlation between high agent interaction and high customer satisfaction. (See Exhibit 1.) This finding shows that it is especially problematic that most customers do not have regular contact with their insurance agent.

To improve the quality and frequency of agent-customer interaction, insurers should arm their agents with tools and resources that can help personalize their outreach. Those tools can include a breakdown of the most common customer needs and analytics that detail when to reach out to a customer and how to tailor the offering. Increasing the number of agent touch points also goes a long way. These touch points can range from relatively simple strategies, such as customized year-end reviews and

Exhibit 1 | Most Customers Don't Hear Regularly from Their Agents, but They Want Annual Check-Ins



Source: BCG Next Generation of P&C Insurance Consumers survey, January 2011.
Note: Results are based on responses of consumers who were asked to "indicate whether you agree or disagree with the following statements related to your local agent" and "indicate whether you agree or disagree with the following statements about insurance in general." Data are from U.S. consumers but are also representative of Canadian and Japanese respondents. N = 1,003.

satisfaction surveys, to more complex and innovative offerings, such as cafés and storefronts that add new sources of value.

BCG analysis shows that by improving the customer experience, an average-size U.S. insurer can improve gross written premium growth by as much as $75 million to $150 million per year.

Go direct with small commercial-enterprise customers. Insurers have the potential to take some of their small- and midsize-enterprise (SME) business direct—an approach that could shave costs, broaden the customer base, and create more opportunities for customer engagement. Furthermore, it's a move that SME customers seem willing to embrace. A recent BCG study found that, depending on their location, 20 to 30 percent of SMEs would consider buying directly from their commercial insurer.

Tapping into this market, however, will require changes to the existing direct-to-consumer sales model. Although small commercial-auto policies, for instance, are similar to standard personal-auto policies and include many common prepackaged coverage options, SME customers have more complex requirements and need more assistance in selecting the appropriate coverage level. For the direct-to-SME model to work, therefore, carriers will need to supplement the approach with dedicated advisors. To avoid channel conflicts, carriers will need to sell through a different brand in markets where they already have agent distribution. Those factors notwithstanding, going direct has the potential to be a far more cost-effective distribution model than selling through brokers and agents. And from the customer's point of view, the direct model can, in many cases, be much faster as well. We have seen application-to-bind cycle times that once lasted a week being reduced to less than a day.

Some insurers have already begun to test the waters. We anticipate that others will follow and that the direct commercial SME market could reach $25 billion by 2022.

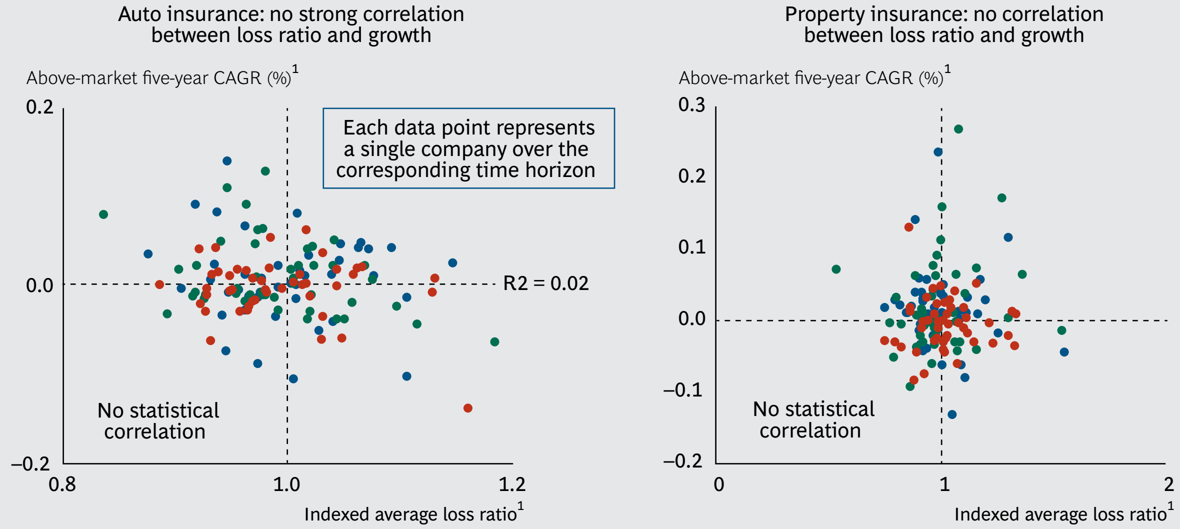
Make smarter RDE bets. Not all RDE opportunities are created equal. Although many see China as the first port of call for multinationals seeking to gain a toehold in Asia and other high-growth markets, extensive regulation, strong domestic competition, a complex local-distribution structure, and the need for on-the-ground expertise can dampen the cost benefit and make it hard for multinationals to gain traction. In fact, China, India, Russia, and Thailand have proved less favorable markets for insurers to enter because of restrictive regulations, challenging combined ratios, and entrenched domestic players.

But opportunities remain in underpenetrated RDEs. Of these, Brazil, Mexico, Turkey, and Malaysia are especially attractive: they offer less regulation, fewer restrictions on foreign ownership, previous multinational success, and high premium and profit potential. We expect RDEs to add more than $400 billion in incremental premium revenues through 2020, with these four countries contributing nearly one-quarter of that total. By factoring in all the soft and hard costs, P&C insurers can determine which locations offer the greatest ROI potential.

Use analytics to drive down loss ratios and improve pricing advantage. Global loss ratios have inched up more than 2 percent over the past 15 years, a period that also saw an explosion in data analytics capabilities and raw computing horsepower—precisely the sorts of tools that can help insurers improve their ability to calibrate pricing, underwrite, and detect fraud. Nonetheless, insurers have been slow to adapt to these technologies, owing in part to a lingering misperception that low loss ratios come at the expense of growth. Our research, however, shows little to no correlation between loss ratios and growth performance in either the auto or personal sector, suggesting that customers don't think that quality and service have suffered as a result of loss ratio improvements. (See Exhibit 2.)

To bring their loss ratios down, market leaders are applying big-data analytics to do everything from targeting low-risk customers to developing highly granular pricing schemes and more intensely data-driven underwrit-

EXHIBIT 2 | Running Low Loss Ratios Does Not Harm Growth Prospects



Customers do not penalize companies for managing loss ratios closely through pricing, underwriting, or fraud avoidance

• 1996–2000 • 2001–2005 • 2006–2011

Sources: SNL Financial; Hoppenstedt; BCG analysis.
[1]Market average = 1 for all markets.

ing. Using analytics in this way can help insurers sustain their loss-ratio improvements despite changing market conditions.

Downsize operating and claims costs to stay ahead of the accelerating cost curve. Expense ratios in developed countries are on a downward trend. BCG expects the global average to fall to 20 to 25 percent in developed markets over the next decade, driven by, for example, technology improvements and consolidation. That reduction represents a 300- to 500-basis-point improvement for the average insurer. That high bar (the equivalent of roughly $450 million for an average-size insurer) means that laggards will find themselves at a competitive disadvantage.

To keep up with the field, insurers should focus on scale and efficiency—the characteristics that define all top cost performers in the P&C sector. The cost-lowering initiatives that offer the greatest ROI potential include modernizing policy administration and claims systems and standardizing operating procedures with specialized roles for complex tasks. Insurers should also consider establishing shared-services centers for standard operations such as underwriting, claims, and policy administration, and they should look for opportunities to improve active-claim management.

Some of these changes don't require massive investments. A number of insurers have centralized their support functions without adding to their expense base simply by streamlining processes and making better use of existing systems. Because efficiency solutions cut across functions, however, putting these solutions in place has as much to do with organizational behavior as with technology. In light of that, insurers need to align key performance indicators with incentive systems to drive companywide improvements and put more focus on executing the changes required.

Although the global P&C market will continue to exert pressure on margins, the six initiatives presented here could, by 2022, be worth $250 million to $575 million in underwriting profits for the average top-20 insurer. Moreover, they lay the foundation for a more sustainable business model.

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INSURANCE AND TECHNOLOGY: EVOLUTION AND REVOLUTION IN A DIGITAL WORLD

BY BCG & MORGAN STANLEY

BCG AUTHORS: UGO COTRONEO, JEAN-CHRISTOPHE GARD, MICHAËL NIDDAM AND NICHOLAS BARSLEY

THE INSURANCE INDUSTRY IS on the brink of major technology-driven changes, according to "Evolution and Revolution: How Insurers Stay Relevant in a Digital Future," a new report by The Boston Consulting Group and Morgan Stanley Research. To better understand both the changes and the opportunities they will create for insurers that embrace them, we jointly conducted a global study that included 50 interviews with senior executives of insurers and technology providers and a proprietary survey of insurance consumers in 12 countries.

The survey findings point to the need for insurers to completely rethink their customer engagement model. Consumers' overall digital experience with insurers lags that of other industries—particularly when it comes to "moments of truth" such as paying claims. As consumers continue to integrate digital experiences into their everyday lives, they expect these experiences, as well as their relationship with insurers, to become more direct, simple, seamless, and intuitive. Consumers also expressed strong interest in seeing insurers develop innovative products that apply technology-driven capabilities and are deployed close to the source of their needs. Because "digital native" insurers are well positioned to address these consumer expectations and can operate much more efficiently, they present a significant threat to incumbents.

The study identified many technology-driven opportunities for insurers. For example, the research found a significant number of applications in insurance for the connected sensors and devices that comprise the Internet of Things. Insurers will be able to collect new data sets and assess risk in completely different ways, which has the potential to radically reshape product propositions and reduce the size of global risk pools. Property and casualty insurance is likely to see the biggest long-run impact from technology disruptions as it moves from actuarial risk assessment using statistical techniques to structural risk modeling based on real-time observations. Similar changes are likely to be seen over time in health insurance and life protection. Insurers that seize these opportunities are likely to become the industry's leaders, while those that do not could find themselves disadvantaged as the industry evolves.

Ecosystems, in which multiple players collaborate, are likely to become increasingly important in the insurance industry. Insurers will need to form partnerships with technology providers that can supply and service connected devices. They will also need to form broader partnerships to secure early access to customers and valuable data sets. The rising importance of ecosystems entails the risk that new players will enter the insurance industry at different points of the value chain or take control of these ecosystems—potentially leveraging far more detailed customer insights than are currently available to insurers. The long-term result could be lower returns for insurers if they lose control of customer relationships and become more marginalized providers of capital.

To defend their markets, insurers must aggressively build new business models that focus on meeting consumers' expectations for digital interactions. They must also apply the capabilities of new technologies to improve the ways they assess risk and operate their businesses. The biggest winners will be insurers with the foresight to identify new game-changing technology that may not be ready for immediate commercialization but could have a significant long-term impact on the industry.

This is a joint publication by BCG and Morgan Stanley, to read the full report and disclosures, please use the below link or scan the QR code from your smart phone

https://www.bcgperspectives.com/Images/evolution_revolution_how_insurers_stay_relevant_digital_world.pdf

INSURANCE AND TECHNOLOGY: THE EMERGING ROLE OF ECOSYSTEMS IN INSURANCE

BY BCG & MORGAN STANLEY

BCG AUTHORS: MICHAËL NIDDAM, JEAN-CHRISTOPHE GARD, JONATHAN KOOPMANS AND NICHOLAS BARSLEY

NEW INSURANCE-INDUSTRY ECOSYSTEMS, DRIVEN by the advance of digital technologies, could disrupt the industry and put unprepared insurers at risk, according to a new report by The Boston Consulting Group and Morgan Stanley Research.

The report, Insurance and Technology: The Emerging Role of Ecosystems in Insurance, defines the new ecosystems as digitally enabled networks of companies, individual contributors, institutions, and consumers that interact in new relationships to create combined services and mutual value.

Noninsurance companies in the ecosystems—including Web businesses, car manufacturers, and utilities—could threaten incumbents across the industry's entire value chain, the report says. The new entrants will profit from stronger client relationships, deeper customer insights, and better control of risk objects.

Insurers that fail to adapt to the new entrants and shifting environment are in peril of being marginalized as mere providers of capital for shrinking risk pools, according to the report.

Several catalysts will contribute to the growth of insurance ecosystems, according to the report. Among them are the rapid adoption of digital technologies and connectivity—such as the Internet of Things and wearables—and rising consumer expectations for tailored and sophisticated products. As a result, insurers will need to cooperate with noninsurance businesses to develop and deliver relevant new offerings.

The study identifies three distinct categories of insurance ecosystems that will likely be pivotal to the future of insurance, many of them driven by new players:

- "Segment of one" distribution, delivering personalized offers that are based on deep customer insight; these ecosystems will often be driven by retailers or start-ups
- "One-stop shop" ecosystems, orchestrating a broad array of services that fulfill

an integrated set of customer needs—such as “everything I need to lead a healthy life”

- Connected-object ecosystems, offering real-time monitoring of key risk objects, such as cars or homes; these models have the potential to significantly reduce insurers’ risk exposure

Device connectivity is growing exponentially and will play a particularly strong role in the new ecosystems, the report says. In 2020, for example, 80 to 100 percent of shipped cars will have embedded connectivity. Yet for connected cars—and many other emerging ecosystem products—insurers will be competing to collaborate with only a limited number of relevant global partners. Therefore, to forge partnerships, insurers must invest in developing technological capabilities and demonstrate their capabilities.

While the report portrays a bearish future for incumbents that fail to react, it sees opportunities for proactive insurers: “those that specialize, reengineer business processes and technology, and partner intelligently.”

The report builds on a study released last year by BCG and Morgan Stanley, Evolution and Revolution: How Insurers Stay Relevant in a Digital Future, which was based on interviews with more than 50 senior executives of insurers and technology providers and a proprietary survey of insurance consumers in 12 countries. That study found that the insurance industry has been slow to respond to the growing threat from technology and was falling short of consumers’ high expectations. It concluded that a step change in customer engagement was needed.

This is a joint publication by BCG and Morgan Stanley, to read the full report and disclosures, please use the below link or scan the QR code from your smart phone

https://www.bcgperspectives.com/Images/Insurance-Tech-Ecosystems-April-2015.pdf

MINING THE UNTAPPED GOLD IN SME COMMERCIAL INSURANCE

BY TIM HOYING, RASHI AGARWAL, SEBASTIAN RAPSCH AND YASUSHI SASAKI

GLOBAL INSURANCE COMPANIES FACE tough competition, weak markets, sluggish growth, and low returns. Yet most insurers are not fully tapping a golden opportunity to build a larger and more lucrative business. It involves customers that many carriers already serve but rarely interact with and revenues obscured by the cash from larger lines of business.

In a detailed global study, The Boston Consulting Group identified the untapped opportunity that lies in serving the growing commercial-insurance needs of small and medium-size enterprises (SMEs). BCG's research included an extensive survey of 2,500 small businesses in six of the largest developed SME insurance markets—the U.S., the UK, Italy, France, Germany, and Japan—and focus group interviews that explored the insurance decision-making processes of small business owners. The results are a detailed and surprisingly different understanding of small-business insurance needs, preferences, and behaviors, as well as strategies that can enhance insurers' profits.

SMEs are a growing force in the global economy, yet they remain an afterthought to many large insurers, which generally perceive SMEs as a scattered market of small customers, best handled at arm's length through intermediary agents and brokers. In most markets, SMEs account for almost a third of the value of all commercial-insurance premiums—in a global market whose estimated value is nearly $1 trillion in annual premiums, including captives and reinsurance.

SMEs, for their part, have shown little interest in dealing directly with commercial carriers. They have preferred having broker and agent intermediaries help them navigate the complex market and choose appropriate coverage from the multitude of commercial-insurance offerings. In addition to property and casualty coverage, offerings include auto, transportation, liability, workers' compensation, and malpractice insurance.

BCG found, however, that SMEs are more open to direct interaction and outreach from insurers than many carriers have expected. So in addition to using the traditional agent channel, carriers have the opportunity to find other ways to interact with SME customers. Our research results and work with insurers have helped us identify four approaches that astute and proactive carriers can pursue—individually or in combination as a multichannel approach—to build a larger and more profitable SME commercial-insurance business:

- Design targeted outreach initiatives that don't threaten existing intermediaries but build a true multichannel interaction model with SMEs.
- Improve the value proposition for brokers and agents.
- Develop a "hybrid direct" model that provides semicustomized offerings, advice, and information.
- Develop new data capabilities and targeted analytics to maximize customer value

To read the full report please use the below link or scan the QR code from your smart phone

https://www.bcgperspectives.com/Images/Mining_Untapped_Gold_in_SME_Commerical_Insurance_Nov_2014_tcm80-176514.pdf

LESS IS MORE

LEAN 2.0 PROGRAMS IN THE GLOBAL INSURANCE INDUSTRY

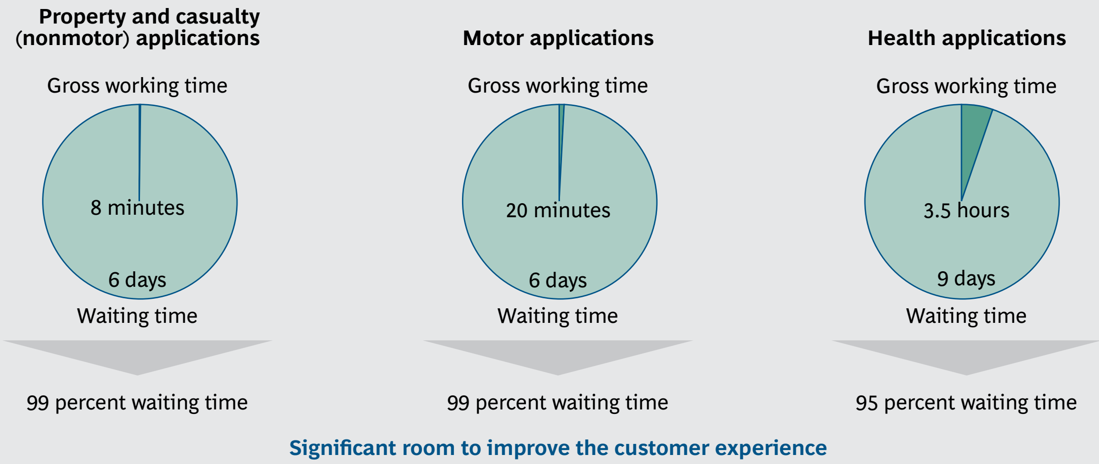
BY CHRISTOPHER FREESE, TIM HOYING, ROMAN REGELMAN, WILLIAM YIN, AND SEBASTIAN BOSSUNG

INSURERS KNOW THAT LEAN processes make for satisfied customers, but many grapple with the basic challenge of how best to create them. The demands of insurance customers are increasing when it comes to speed of processing and quality of service, and the payoff from delivering on those demands is growing in kind, given how important positive customer experiences and recommendations are these days in winning new business. Simple and lean processes are not just a significant factor in cost competition but also the foundation for superior service quality and long-term customer retention.

The industry faces a number of specific challenges in attaining this ideal. Many processes involving sales, administrative work, and external partners have developed over long periods and have become correspondingly complex. At the same time, media usage habits now require new access channels, which need to be integrated without increasing complexity even further. The same goes for introducing new products and pricing or integrating company businesses by making acquisitions or merging. Ultimately, the continued cost pressure is forcing the entire industry to keep increasing efficiency just as demands for quality and service are growing.

It is therefore no surprise that almost all insurance companies have launched optimization programs under the heading of "lean" in recent years. But it is also little wonder that these efforts have achieved varying degrees of success. The fact is that many insurance companies are still spending a great deal more than necessary, and the costs are adding up as duplication of effort and reliance on manual processes cause mistakes and increase processing times. According to our analysis, this type of waste constitutes up to 30 percent of non-value-creating work and can climb as high as 80 percent in extreme cases. Waiting time typically consumes at least 95 percent of application processes. (See Exhibit 1.) In the case of property and casualty (nonmotor) policies, that equates to eight minutes of actual working time every six days. The shortcomings often stem from lack of scope and in-

EXHIBIT 1 | Waiting Time Typically Takes Up 95 to 99 Percent of the Application Process



Source: BCG analysis.

put. For instance, many companies elect to optimize single processes or departments. In very few cases do they evaluate and improve their processes on the basis of customer perspectives and with lean principles integrated throughout the organization.

Enter Lean 2.0, a modern take on the production efficiency philosophy that creates leaner, stronger, and more customer-oriented processes. Lean 2.0 establishes a way of looking at activities within the company so that waste can be identified where it occurs and improvements are integrated into everyday work to improve quality and the customer's experience. With Lean 2.0, the customer may be an end consumer or the internal organization. What matters is that processes are viewed holistically, or "end to end." (See the sidebar "Five Practical Ideas for Your Lean 2.0 Program.")

If Lean 2.0 is to be more than a buzzword for further management discipline—and if it is to yield greater customer and employee satisfaction on a sustainable basis—then insurers should actively consider what has worked for other companies on the road to becoming a lean company. Companies that have been successful in this respect have dutifully considered and answered four basic questions before setting the wheels in motion.

What are our objectives? "Less waste, more customer focus" is an understandable desire. But if you want to be successful with a Lean 2.0 program, you need specific and ambitious targets for an improved customer experience, higher employee involvement, and real economic benefits. Companies should compare their present standing with where they want to be positioned in the future, whether that's next year or three to five years from now. Our experience has revealed that processes can be 15 to 30 percent more efficient in as few as 12 months and that most of these savings can be realized with little or no adjustments to IT infrastructure.

The targets of a Lean 2.0 program, however, must entail more than just mere process improvements. They need to include prospects for slimming down the business model, the organization structure, or the IT architecture. Programs without specifically defined financial, customer, and employee targets quickly lose momentum and run the risk of losing traction as time goes on.

In this context, assessing priorities and translating set targets into subtargets and project steps are tasks for management. Typical problems that insurers have battled with—for instance, deciding between quicker claims processing to increase customer satisfaction and making sure claims are valid in the first place—ultimately fall on management's ability to get involved and make consistent decisions.

FIVE PRACTICAL IDEAS FOR YOUR LEAN 2.0 PROGRAM

Five factors are essential to the success of Lean 2.0 programs:

- *Customer Orientation.* Improvements should be seen from the customer's perspective to ensure that the organization does not revert to its past practice of optimizing single processes or departments.
- *Performance Tracking.* A central contact point should monitor compliance with priorities and support sustained progress.
- *Specific Targets.* It must be clear what the program should achieve—both strategically and financially.
- *Pragmatism.* Not every problem needs to be addressed with a big solution; many little steps are often more successful in delivering long-term integration and savings.
- *Skills Growth.* Employees who acquire new skills or develop new competencies during the lean program should be recognized accordingly (for example, through certification) in order to create a network of lean "messengers" and foster a lean culture.

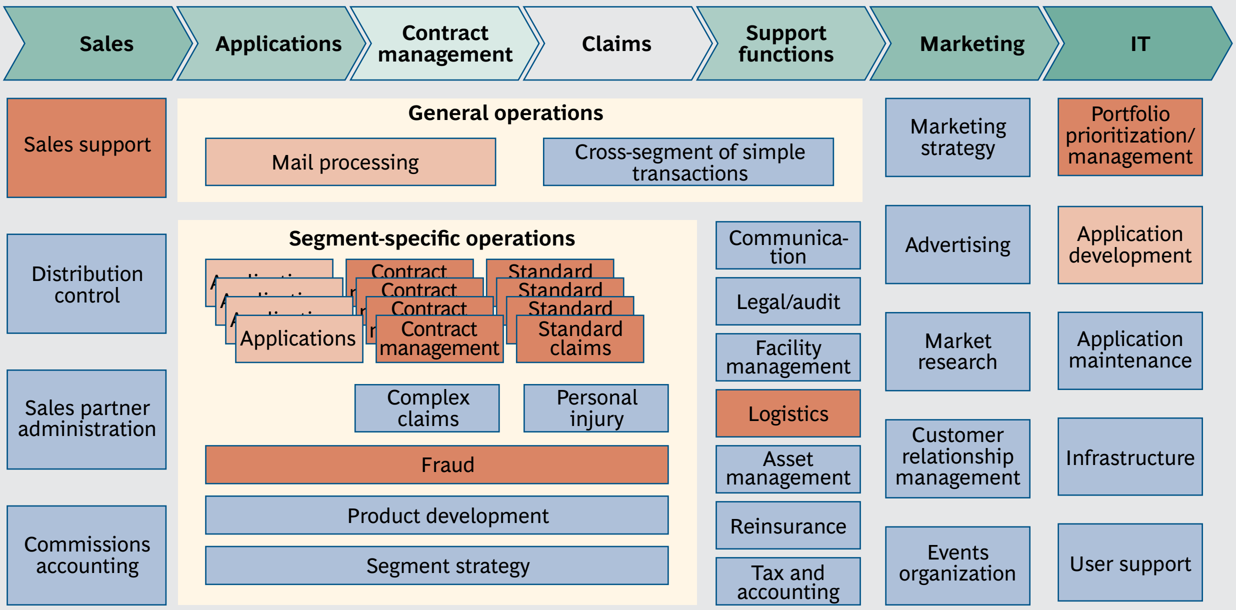
Where do we start? Nothing is as convincing as concrete results when it comes to establishing internal support for lean efforts. Pilot projects are a recommended way to demonstrate the advantages of a Lean 2.0 program and build momentum for further action. The processes picked for pilot treatment should cover multiple organizational units to demonstrate the overall effect of lean processes. They should also be highly relevant to the organization—meaning they exhibit high frequency and capacity, such as those supporting claims—and they should show the potential for savings barring any IT investment. While each pilot should be tailored to the company's specific needs, there are typical "hot spots" of waste in insurance companies that are ripe targets for pilot programs. (See Exhibit 2.)

How can we reach the entire organization? After a successful pilot phase, the expansion of the Lean 2.0 program can begin—without shying away from "sacred cows." Management must make clear decisions about which processes have high, medium, or low priority and should use benchmarks and expert opinions to identify processes that are especially in need of improvement. As the program expands, skills will be developed on the job—with employees acquiring know-how by actively working on projects—and shared and sharpened through training measures.

In the initial phase, a dedicated team should serve as a competence center, composed of lean experts from the pilot phase who have since returned to their respective units to apply their knowledge there. By rotating trained employees, Lean 2.0 approaches can spread throughout the company. Companies can further support these goals and underscore the importance of lean initiatives by making experience with lean programs a prerequisite for certain management positions. The goal is to gradually have the lean culture internalized in the company so that it is part of everyone's daily routine.

How can we ensure that change is substantial? Ultimately, any Lean 2.0 program should pay for itself. For that to happen, organizations need certain prerequisites: a dynamic network of employees who have experience with lean, an infrastructure with appropriate tools and methods, and clearly articulated arguments from senior leaders for simplifying processes, effectively communicating management's expectations of a Lean 2.0 program, and actively collaborating to implement changes. Lean leadership is about the continued involve-

Exhibit 2 | The Insurance Process Includes Hot Spots That Often Exhibit the Most Waste



Source: BCG analysis.
Note: Red areas represent operations that typically have the greatest improvement opportunity for applying lean practices. This does not represent a complete landscape—only a selection of the largest processes shown. Processes that involve the sales field force are only shown if they are part of back office processes.

ment of the company's top performers in the program—and about defining a framework for success so that progress can be monitored and can form the foundation of a comprehensive and continuous dialogue about quality and cost.

LEAN 2.0 ISN'T a onetime feat used to optimize processes for short-term successes. Rather, it seeks long-term transformation by recognizing that all activities that generate waste and do not add value only serve to weaken the company. Each and every employee shares responsibility for improvement by making problems visible and treating them at their root instead of simply allaying the symptoms. In the end, Lean 2.0 programs are successful when organizations show a willingness to rethink behavior on a fundamental level and, if necessary, effect a forward-thinking cultural change.

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HOW AIG MOVED TOWARD EVIDENCE-BASED DECISION MAKING

BY MURLI BULUSWAR AND MARTIN REEVES

NEW DEVELOPMENTS IN DATA science offer a tremendous opportunity to improve decisionmaking. Machine learning, pattern recognition, and other predictive analytics tools can constitute a source of competitive advantage for those companies that adopt them early on; but like any new capability, there is an enormous gulf between awareness, intent and early engagement, and achieving significant business impact.

How can companies better manage the process of converting the potential of data science to real business outcomes? How can companies go beyond merely generating new insights to changing behaviors—not only of their employees, but customers too? We would like to offer some lessons from AIG's early experiences with deploying new analytical tools to leaders across industries who may be considering embarking on a similar journey.

In January 2012, AIG launched the "Science Team." One might be surprised to find a Science Team in an insurance company. However, Peter Hancock, President and CEO of the global insurance giant, saw a huge opportunity to apply evidence-baseddecision making in an industry which was still very reliant on individual expert judgment and in so doing to create not only tactical but also competitive advantage. By early 2014, 130 people from diverse scientific and managerial backgrounds were devoting themselves to realizing the team's mission: To be a catalyst for evidencebased decision making across AIG.

The Science Team intentionally refrains from using the words "data" or "analytics," as the team's capabilities stretch far beyond these two disciplines: behavioral economists, psychologists, engineers, and change management experts work handinhand with data scientists, mathematicians, and statisticians. And for good reason: this multidisciplinary approach is essential to go beyond merely generating new insights fromdata but also to systematically enhance individual human judgment in real business contexts. Ninety percent of the team was recruited from beyond the insurance industry to enable it to challenge the status quo approach to decisionmaking. The Science Team not only prepares data and builds models, but also emphasizes the identification of business opportunities and education, change management and implementation—the complete value chain from framing questions through to changing behaviors.

Key factors in the success of the Science Team's efforts to date include the following:

Start by focusing on questions and problems that matter. A small proportion of workers' compensation claims account for a large proportion of complexity, contention, delay and losses for AIG: 10 percent of claims account for almost 60 percent of costs. Claims severity predictors therefore play a huge role in improving outcomes by enabling earlier and more accurate targeting of intervention measures like physician review and special investigations. This is a good example of the power of fully embedding the technical solution in the business: the result is not only better predictions and lower costs, but also better outcomes for customers.

Ensure that the mandate stretches beyond producing insights—supporting the change and learning process across the organization. AIG not only supports embedding solutions and managing change to realize specific opportunities, but has also launched a companywide initiative to improve quantitative and decisionmaking skills using both physical summits and ondemand, modular online learning tools.

Work with early adopters to demonstrate significant wins which are visible to the whole organization. Much of AIG's business relies on agents and brokers. Relationships are assessed and prioritized based on volume, value, potential, and their overall effectiveness. The decision platform which AIG built is able to accurately predict the retention and "submission" (proposal) efficiency of single brokers—a level of microsegmentation and prediction which few others in the industry have been able to achieve. Every day, aggregated and deepdive performance analytics, presented in a user-friendly visual format, are pushed to the fingertips of sales managers to support decisions on how to manage the network of intermediaries.

Don't make the effort dependent on one or two initiatives: adopt a portfolio approach. In pioneering new approaches to decisionmaking not every effort can be a success and companies should therefore not bet only on the success of one project. In addition to the examples above, AIG currently has around a dozen decision making related projects at various stages of development.

An iterative, rapidcycle adaptive approach is much more effective than a planned, single step change—much of the learning occurs by taking action. Preventing fraudulent claims is an important area for AIG due to its significant financial impact. AIG has developed proprietary tools and models that identify predictive patterns in claims data using machine learning, predictive modeling, link analysis, pattern analysis and other techniques. After starting from scratch, the second generation of AIGdeveloped tools already identify almost twice as many cases of fraud than leading vendors' offerings. First applied to workers' compensation, the same approaches are being now being rolled out across multiple businesses. This example illustrates the importance and power of an iterative, learningbased approach to solution development. Ironically, this involves a bias to action rather than planning or analysis—even in the area of analytics!

Plan for impact on multiple time horizons, combining immediate evidence of value, some mediumterm big wins as well as a transformational longterm perspective. In addition to the shortand mediumterm solutions mentioned above, AIG is also contemplating some bolder, longerterm initiatives which could potentially change the business model and the scope of the business. For example, it is looking at possibilities like assessing damage claims for auto accidents using image analysis of photographs, or measuring and modulating risk assessments using sensors and telematics.

The constantly evolving tools of data science will both enable and require companies to continue to improve how they make decisions. It's selflimiting to only improve existing decisionmaking, however—companies need also to be alert to the opportunity of creating fundamentally new ways of making decisions, and even to reconsider the business models and the firm's activity footprint, as a result of the opportunities unleashed.

THE GLOBAL LEADERSHIP AND TALENT INDEX

THE SMART WAY TO IMPROVE CAPABILITIES—AND CREATE VALUE

BY VIKRAM BHALLA, JEAN-MICHEL CAYE, PIETER HAEN, DEBORAH LOVICH, CHING FONG ONG, MUKUND RAJAGOPALAN AND SHAILESH SHARDA

TOP EXECUTIVES INTUITIVELY UNDERSTAND that they cannot win without the right people and the right skills. In surveys, they consistently rank leadership and talent management at the top of their agenda but express frustration with the return on their investments in this area. (See How to Set Up Great HR Functions: Connect, Prioritize, Impact, BCG Creating People Advantage report 2014-2015, December 2014.)

Unlike other disciplines, such as corporate finance, leadership and talent management is a relatively undeveloped field in the application of data- and evidence- based approaches to value creation. Most companies do not address the most fundamental questions around leadership and talent development, despite huge expenditures—$ 40 billion annually by some estimates. Still, some companies get it right. Not surprisingly, these companies tend to be market leaders in their industries.

The BCG Global Leadership and Talent Index (GLTI) is the first tool to precisely quantify a company's leadership and talent management capabilities. It is the product of a multiyear effort that culminated in a recently completed study of more than 1,260 CEOs and HR directors at global companies.[1] (See the sidebar, "Whom We Surveyed and What We Asked.")

The power of the GLTI lies in its simplicity. It is a 20-question survey that places a company at one of six leadership and talent management capability levels and suggests ways to systematically move from one level to the next. It quantifies the revenue and profit gains that companies can expect from moving up the index. Here are the high-level findings:

- Leadership and talent management capabilities have a surprisingly strong correlation with financial performance. "Talent magnets"—those companies that rated themselves strongest on 20 leadership and talent management capabilities— increased their revenues 2.2 times faster and their profits 1.5 times faster than "talent laggards," or

Leadership and talent management is a relatively undeveloped field in the application of dataand evidence-based approaches to value creation.

those companies that rated themselves the weakest.

- The performance spread on leadership and talent management capabilities was wide. The talent magnets had an average capability score of 2.5 (on a scale of –3 to 3), while the talent laggards had an average score of –2.2.

- Companies—even talent laggards—that move up just one level will experience a distinct, measurable, and meaningful business performance return.

For companies struggling to improve their leadership and talent management capabilities, or for those that want to reach the next level of excellence, the GLTI will lay out an improvement plan based on their starting position and existing capabilities, and it will anticipate gains in business performance as improvements are made.

Quantifying Leadership and Talent Management Capabilities

Companies rarely manage their talent as rigorously as they manage their balance

WHOM WE SURVEYED AND WHAT WE ASKED

The 1,263 executives surveyed work for a wide variety of companies around the world. We allowed only one respondent per company. Slightly more than half the respondents, or 55 percent, work in professional services, industrial goods, consumer goods, and the public sector. Technology, media, and telecommunications companies and financial services companies accounted for 17 percent of the sample, followed by health care, energy, and "other."

The respondents were based in 85 countries altogether. Forty percent were based in Europe and 30 percent in Asia, of which 19 percent were from emerging markets within Asia. The Americas, with 23 percent; Africa, with 3 percent; the Middle East, with 2 percent; and "other" made up the rest of the sample.

We divided leadership and talent management into 20 specific capabilities, grouped into six categories. We asked executives to assess their company's relative strength on each of these capabilities on a six-point scale, from –3 (strongly disagree) to 3 (strongly agree).

Based on these answers, we classified companies in the top and bottom 5 percent as talent magnets and talent laggards, respectively. Between those extremes, we created four intermediate levels, each accounting for 22.5 percent of respondents: low performers, average performers, high potentials, and high performers. Finally, we asked respondents to provide their company's two-year revenue and profit growth.

This setup allowed us to assess these companies' overall leadership and talent management capabilities and draw comparisons with other companies based on business performance. We were also able to isolate individual capabilities to see how they correlate with performance. Specifically, the index identifies which capabilities matter most at each level and which capabilities in particular will help companies move to the next level.

The study shows a correlation, not a causal relationship, between capabilities and business performance. Still, the findings are consistent with our observations at client companies, and we believe them to be directionally correct. Of course, context and judgment matter in defining a leadership and talent management strategy.

sheet. This is in part b ecause people development is hard to quantify. In order to put sharp edges around what is often considered a soft area, we divided leadership and talent management capabilities into six categories:

- Strategy: Planning leadership and talent needs over the short- and long-term, in line with the strategy and aspirations of the company; developing initiatives to meet those needs and tracking and measuring the initiatives
- Leadership and Talent Model: Defining clear leadership competencies specific to the company's strategy and culture, and embedding those competencies in selection, development, promotion, and reward processes
- Talent Sourcing: Finding leaders and talent, both internally and externally; tailoring employer branding to specific talent pools; managing and developing successors effectively
- People Development: Systematically nurturing people by providing comprehensive and structured development opportunities, training, and tools
- Engagement: Fostering meritocracy and engagement throughout the company, especially among leaders and top talent
- Culture: Requiring top leaders to take responsibility for leadership and talent management by adhering to corporate values

The spread in these capabilities was wide, so we divided the companies according to six levels of performance to dig deeper. At either end, we grouped companies representing the top and bottom 5 percent of the pool: the talent magnets and the talent laggards. In the middle, we had four equally sized groups of companies: low performers, average performers, high potentials, and high performers. On average, the talent magnets had an average capability score of 2.5 (on a scale of –3 to 3), while the talent laggards had an average score of –2.2. (See Exhibit 1.)

The Value of Superior Leadership and Talent Management Capabilities

Companies with strong capabilities in leadership and talent management outperform those with weaker capabilities, as Exhibit 2 vividly illustrates. This is true across the entire spectrum of performance, not just at the extremes. At each successive level of performance, revenues and profits rose by an average of 15 to 20 percent and profits by 5 to 15 percent. This correlation is intuitive but had never previously been broken down and quantified.

The strategy and talent sourcing categories had low overall capability scores, but the companies that got these capabilities right were handsomely rewarded. As illustrated in Exhibit 3, companies that scored in the range of talent magnets in the strategy category had twice the revenue growth of companies that scored in the range of talent laggards, and they had 1.8 times the profit growth. At the same time, strategy was the lowest-scoring category, suggesting that most companies have weak capabilities in this area.

Companies with strong capabilities in leadership and talent management outperform those with weaker capabilities; this is true across the entire spectrum of performance.

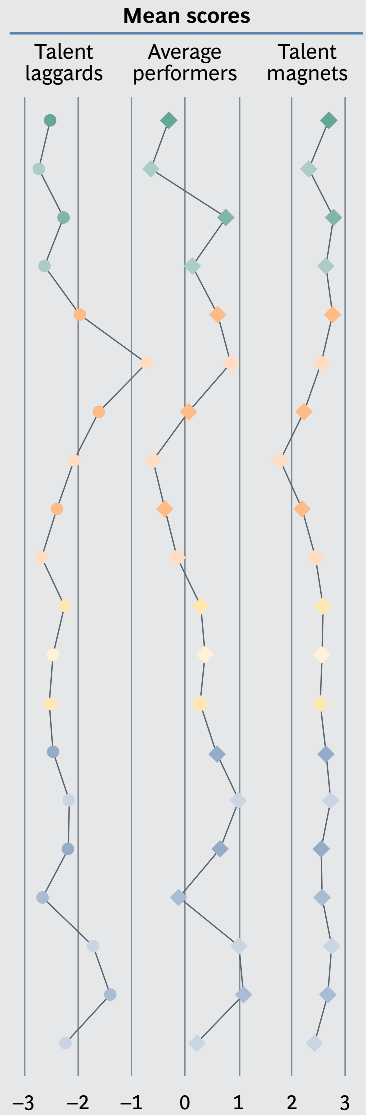
Likewise, talent sourcing should be a priority. This is not simply ab out finding external candidates, which most respondents said their companies do well. It includes establishing transparent, efficient, and enterprise-wide talent management processes, developing a pipeline of successors, and tailoring an employer brand for specific talent pools. These are relatively weak capabilities at most companies.

It turns out that ten capabilities correlate strongly with business performance. (See Exhibit 4.) Companies that are strong on these typically deliver strong business performance, too. The three capabilities with the greatest payoff all require the active participation of leaders: translating leadership and talent plans into clear and mea surable initiatives, devoting significant time to leadership and talent management, and making leaders accountable for talent development.

The companies that excel at leadership and talent management have figured out how to

EXHIBIT 1 | How Companies Score on Leadership and Talent

Strategy	1. Plan long-term leadership and talent needs strategically
	2. Translate leadership and talent plan into clear and measurable initiatives
Leadership and talent model	3. Define and agree upon leadership competencies
	4. Apply leadership competencies consistently in selection, promotion, and reward process
Talent sourcing	5. Identify internal talent to meet leadership needs
	6. Source external talent successfully when required
	7. Embrace diversity as a sourcing strategy
	8. Tailor employer brand to specific talent pools
	9. Develop pipeline of successors for leaders and top talent
	10. Establish clear, effective, and universal talent management processes
People development	11. Implement a broad range of development tools and opportunities
	12. Develop talent systematically
	13. Make leaders accountable for talent development
Engagement	14. Foster a meritocracy through performance management processes and senior leadership
	15. Demonstrate high engagement of leaders and top talent
	16. Encourage leaders to foster employee engagement
Culture	17. Leaders devote significant time to leadership and talent
	18. Leaders embrace and promote corporate values
	19. Leaders and top talent recommend the company to their friends
	20. Leaders foster employee engagement



Sources: BCG Leadership and Talent Index survey (1,263 respondents); BCG analysis.

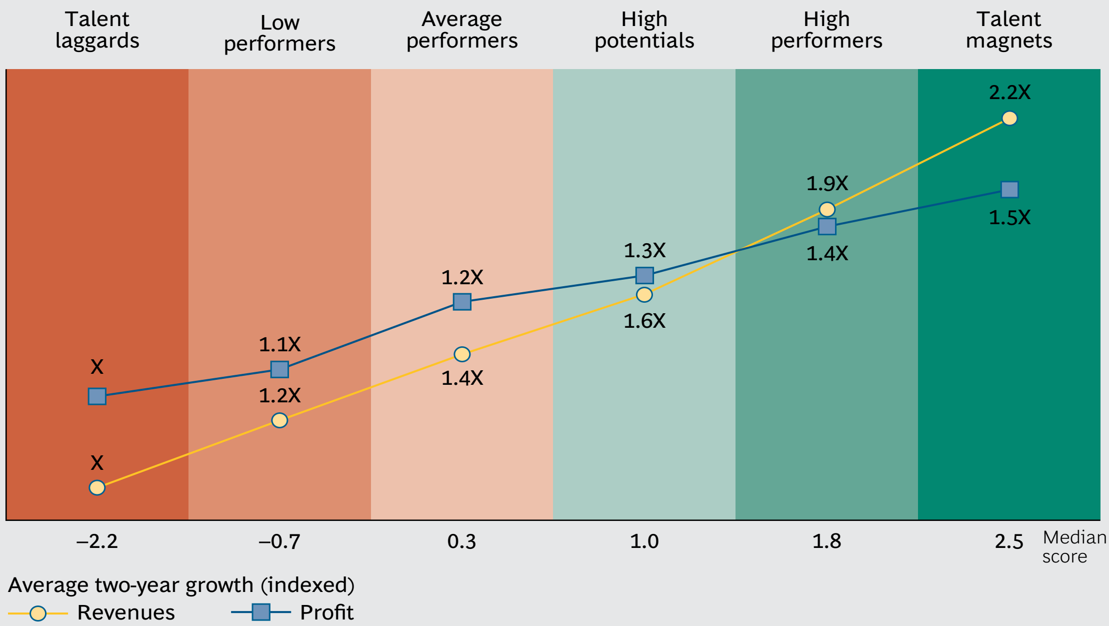
involve their leaders, not just the HR team, meaningfully and regularly in people development. In fact, leaders at high-performing companies can spend more than 25 days a year on leadership and talent management activities.

Moving Up the Ranks

The GLTI allows a company to benchmark itself against the global database in order to get a sense of where it ranks and why. This provides visibility into the capabilities that it needs to improve and the potential benefit of improving them. As we will see in the next section, it also creates a company-specific agenda for becoming best in class on these capabilities.

For each level—talent laggard, low performer, average performer, and so on—the GLTI assesses how the capabilities of companies at the next level drive business performance. This analysis reveals the most important leadership and talent management capabilities that companies need to build in order to reach the next level. (See Exhibit 5.) Even more powerful, the GLTI can identify the most relevant capabilities for a company based on its specific leader-

EXHIBIT 2 | GLTI Scores Correlate with Financial Performance



Sources: BCG Leadership and Talent Index survey (1,263 respondents); BCG analysis.

ship and talent management profile. Companies can thus follow a logical and structured path to achieve best in class.

That said, a few clear priorities emerge for companies at each capability level:

- Talent laggards need to fix the basics. An overall leadership and talent development culture is generally absent at

EXHIBIT 3 | Strategy and Sourcing Are Low-Scoring but High-Potential Categories

	Performance of talent magnets versus talent laggards		Mean score
	Revenue growth	Profit margin	
Strategy	2X	1.8X	0.1
Leadership and talent model	1.5X	1.6X	0.7
Talent sourcing	2.4X	1.3X	0.4
People development	2X	1.4X	0.5
Engagement	1.9X	1.6X	0.9
Culture	2.6X	1.7X	0.8

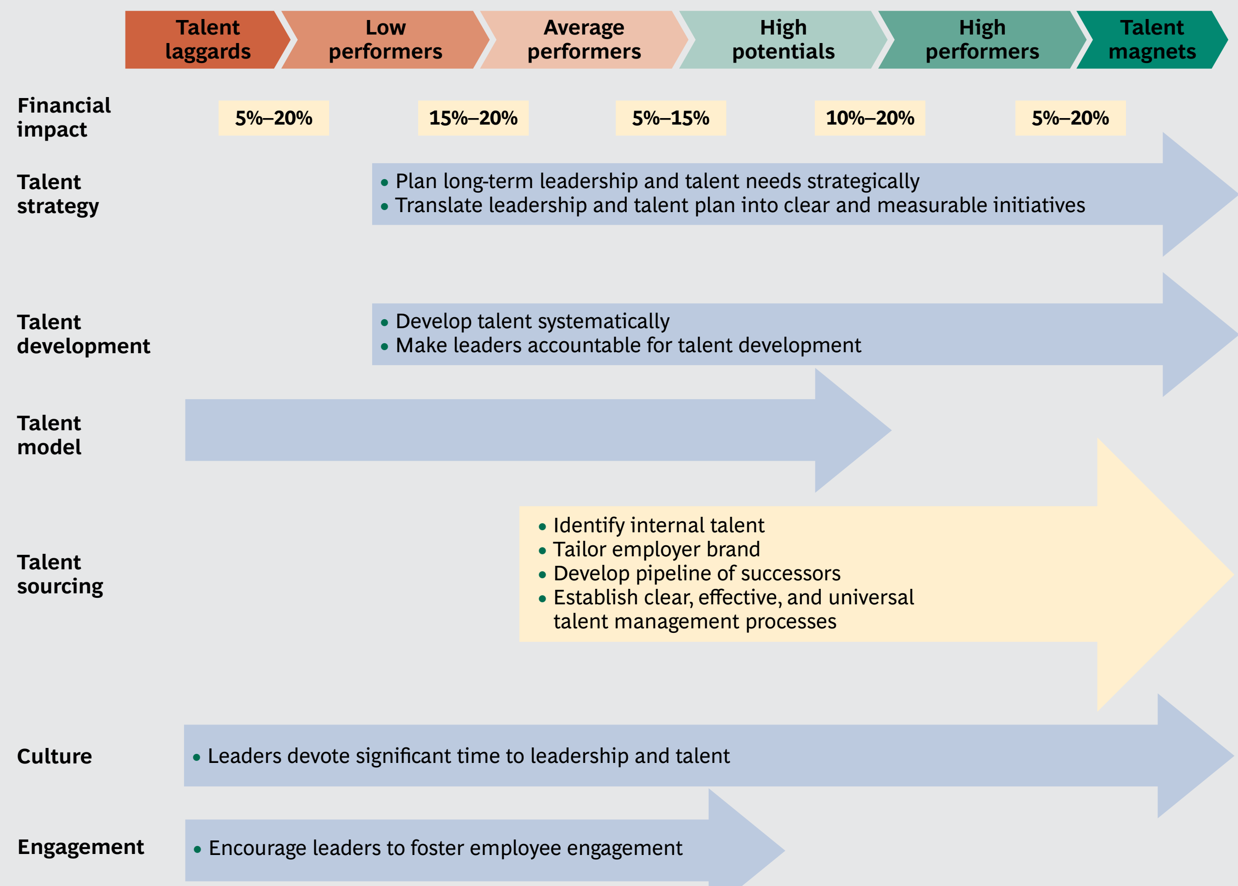
Sources: BCG Leadership and Talent Index survey (1,263 respondents); BCG analysis.
Note: For each category, we compared average revenue growth and average profit margins of companies whose responses were in the range of talent magnets and talent laggards.

these companies. They need to put in place a leadership model that clearly articulates the competencies that their leaders should demonstrate. In other words, they need to have a common language that describes the contributions and behaviors of leaders that are essential to the business strategy. Their senior leaders must focus on developing and grooming talent and putting in place leadership and talent management systems. These are important capabilities that must be continually nurtured. By fixing the basics, talent laggards can move ahead.

- Low performers need to cement the foundation. Low performers tend to have a leadership model in place, but it is not an integral part of their people processes. They need to embed the desired leadership competencies into recruiting, performance management, and reward systems and establish structured training and development programs to develop those competencies. Like talent laggards, they need to continually nurture a culture of people and leadership development.

- Average performers and high potentials need to sharpen strategy and talent sourcing and focus on long-term leadership development. At this level, companies generally have core leadership and talent processes and planning in place. To move ahead, they need to align their leadership and talent plan with their business strategy and actively measure and track progress. They need to pay special attention to sourcing talent externally by tailoring their employer brand to specific talent pools, and they need to identify and groom internal talent for future leadership roles. Culture is important at every step but

EXHIBIT 5 | Improving Leadership and Talent Is a Step-by-Step Process



Sources: BCG Leadership and Talent Index survey (1,263 respondents); BCG analysis.

especially at this level. Unless senior leaders demonstrate substantial commitment and ongoing support of these initiatives, the company is unlikely to become a high performer.

- High performers and talent magnets need to continually adapt themselves to changing leadership and talent needs. The companies with the strongest leaders and talent have long-range strategic processes and an ongoing commitment to such initiatives as corporate universities and leadership academies. Leadership and talent systems are not only fully embedded in the organization but also capable of evolving along with the changing needs of the business. These companies regularly conduct strategic workforce planning, succession planning, and talent diversity exercises.
- While talent magnets are stronger in terms of each capability, what really sets them apart is their ability to be much more strategic in planning their leadership and talent needs and in defining specific and measurable follow-up initiatives. Leadership and talent management issues are on the senior executive agenda; leaders prioritize and spend time on these issues more than in other companies.

When Should You Use the Global Leadership and Talent Index?

The GLTI removes the guesswork in building leadership and talent management capabilities. Best of all, it is simple to administer. The short, 20-question survey will clarify not only the overall leadership and talent capability of a company but also a tailored agenda to improve.

The recommendations in the previous section are for the average or typical company within each category. The GLTI also enables individual companies, with their unique mix of capabilities, to precisely quantify their leadership and talent management capabilities and lay out an improvement plan that quantifies the value of making specific and targeted improvements.

Companies too often burn out on expensive leadership and talent investments that fail to deliver. The GLTI gives companies a structured step-by-step approach to de veloping stronger leaders, improving their overall talent profile—and ultimately their business performance and chances of success in strategy, transformation, and change.

For a company-specific assessment and tailored report, send an e-mail to GLTI_Support@bcg.com.

What really sets talent magnets apart is their ability to be much more strategic in planning their leadership and talent needs and in defining measurable follow-up initiatives.

NOTE
1. These companies and their executives were participants in our annual People Advantage survey of executives conducted with the World Federation of People Management Associations.

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THE SIX STEPS TO PRICING POWER IN INSURANCE

BY JEAN-CHRISTOPHE GARD AND OFIR EYAL

Although pricing has become an increasingly critical factor in achieving competitive advantage in the global insurance industry, many companies are still trying to find the right balance in their pricing schemes. Simply put, insurers need a system capable of attracting new business and retaining profitable existing business. But the schemes must also be sufficiently robust to overcome severe cost challenges.

Why are so many insurers struggling with pricing? The reasons vary and tend to be country specific. And they are not mutually exclusive.

For some companies, the problem is that despite price increases, their systems and processes have not reached a level of sophistication capable of delivering their intended pricing strategy. For others, overcapacity in their markets is driving prices down. One overarching trend, particularly in mature markets, is that customers are increasingly discerning and price sensitive. In addition, the entry of direct players and price aggregators has meant greater transparency, which allows customers to choose the least expensive deal. This transparency has contributed, in particular, to the commoditization of the motor-vehicle insurance industry. Some companies are feeling the effects of many of the above circumstances simultaneously.

Fortunately, there are concrete actions that insurers can take to improve both pricing strategy and price realization. We call these actions the six steps to pricing power in insurance.

Building a Sturdy Pricing Process

In our view, insurers can enhance their pricing capabilities by acting on the following six imperatives:

Improve portfolio price management. Too few insurers have reached their potential in terms of maximizing retention of the most profitable clients and improving the profitability of low-value clients. This goal can be achieved only by gaining a deeper understanding of one's own client base and by developing increasingly granular segmentation. The ability to generate deep client insight from comprehensive data collection is critical, particularly for identifying prospects for cross selling and for adding higher-margin auxiliary coverage alongside principal policies.

Sharpen new-business pricing. Many insurers are tempted to attract clients with initial deep discounts, hoping for price appreciation at renewal time. But this strategy is proving increasingly ineffective. Insurers need to leverage data not only from their own client portfolios but also from a thorough examination of industry-wide buying behavior in order to both optimize the pricing of new business and reinforce risk management. Insurers should also incorporate more realistic assumptions into customer lifetime-value projections in order to avoid being taken unawares when customers choose not to renew policies.

Minimize the variation between list and street prices. Sales forces always have a certain amount of leeway in offering price discounts. But discount budgets are often abused, resulting in a distorted overall pricing structure and the generation of unprofitable portfolios. Minimizing the discrepancies in intended price, rating structure, and actual price is especially important in a business intermediated by agents and brokers. Moreover, the distribution of discount budgets must be controlled and linked to agents' overall performance. Agents who misuse their discount budgets should be penalized by having their pricing discretion curtailed going forward.

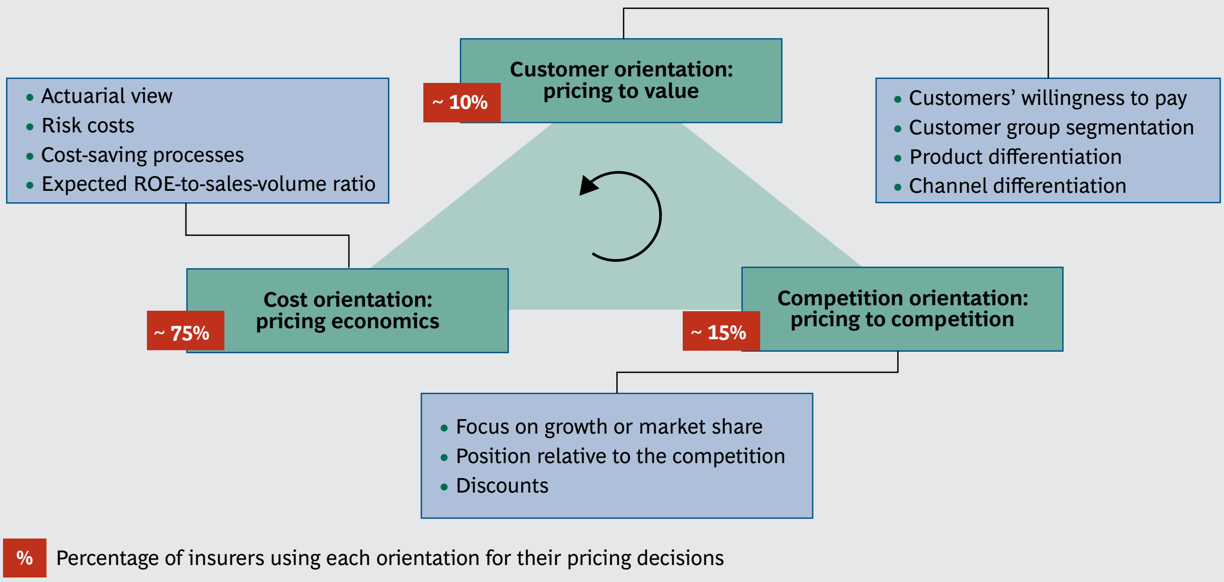
Align distribution objectives with companywide goals and pricing strategy. Insurers' distribution networks are typically remunerated on the basis of top-line performance only. And in some cases, new business earns higher commissions than renewals. The result of such compensation schemes can be insufficient focus on retention and sales that lack the potential for long-term profitability.

In our client work, we have observed that aligning distribution incentives with organizational objectives is crucial to success. Insurers need to base their design incentives on the bottom line (loss ratio) as well as on the top line. Furthermore, insurers need to provide agents with tools such as alternatives to monetary discounts (including higher deductibles, free supplementary coverage, and vouchers for future renewals) and access to first-rate customer-relationship-management systems that can help them retain their best customers. Agents should also receive regular training updates on how to retain customers and provide the best possible sales experience.

Incorporate customer and competitor elements into pricing. Many insurers are adept at setting cost-oriented pricing structures that are based on claims experience. But few excel at incorporating client price sensitivity and prevailing market prices (those of competitors) into their own pricing. Although some insurers might say that regulations in their market do not allow demand-based pricing or that their agents do not like it, we have seen organizations find innovative ways to work within regulatory frameworks, ultimately earning returns of up to 5 percent of gross written premiums. (See the exhibit, "Insurers Need to Incorporate Both Customer and Competitor Elements into Pricing Strategies.")

Strengthen the organization's infrastructure. To ensure that pricing initiatives can evolve smoothly, insurers need to put in place "enabling" organization structures and processes. These should include a strong actuarial team, as well as sharp managerial oversight capable of translating the business strategy into a disciplined pricing strategy. Most insurers need a step change in pricing processes, including better dialogue among actuarial, marketing, and senior-management teams—with the last being truly able to understand, monitor, and critique the work of the actuaries. In addition, insurers need more frequent and dynamic updates to their pricing systems. Updating, in many cases, involves a fair amount of organizational courage and

Insurers Need to Incorporate Both Customer and Competitor Elements into Pricing Strategies



Source: BCG analysis.
Note: ROE = return on equity.

willingness to try new systems, conduct pricing tests, and stretch boundaries in terms of common practices.

Doing It Right

Some insurers are ahead of the curve in developing pricing systems that strike an effective and efficient balance. They achieve sufficient margin, overcome cost pressures, and at the same time attract new customers—first-time buyers and those previously served by competitors—and retain the best existing customers. Such companies tend to have systems and methods that have emerged as best practices in the industry.

For example, some insurers have developed and integrated elasticity curves into their pricing systems for several hundred microsegments in motor vehicle insurance. Such players are able to optimize microsegment-level pricing decisions on the basis of sophisticated analysis of the microsegment's attractiveness, its historic behavior in response to price increases, and competitors' previous pricing moves.

In a similar vein, our client work and proprietary research have enabled us to develop a customer insight methodology aimed at identifying customers' rationales and decision-making processes in purchasing or renewing insurance—with possible behaviors segmented into what we refer to as customer "pathways." The pathway choice can depend on a variety of factors, such as how and when the customer becomes aware of a price increase and whether the increase is expected. Applied to a motor-vehicle insurance portfolio, pricing decisions can be optimized if insurers anticipate the likely reactions of each customer to a price increase or decrease at renewal time. Such knowledge helps insurers tightly manage the tradeoff between premium increases and customer churn.

We have seen that customer reactions can be segmented along a few typical pathways. Each pathway presents contrasting elasticity curves, allowing for differences among customers with distinct characteristics normally used to assess technical risks—such as the type of motor vehicle, age of the driver, and frequency of claims filing. By incorporating behavioral data into pricing decisions, insurers can generate significant impact: up to 3 percent in premium increases (with a given churn rate) or a reduction, by one-third, in departing customers as a result of a given average premium increase.

Getting Started

Insurers considering a program to improve pricing should ask themselves questions such as the following in order to put themselves on the right path:

- Is our pricing strategy bringing us all the benefits it should?
- Do we truly understand the dynamics of customers' reactions to price changes?
- Do we have the organizational capabilities to deliver a pricing step change that will give us a significant edge over our competitors?
- What investments should we make in order to close any gaps in our pricing abilities?

Insurers that take the initiative to address the many pricing-related challenges (and opportunities) will very likely find themselves benefiting from their efforts in the years to come. They will be surer of having a finger on the pulse of their customers and will be well positioned to react with pricing moves. They will also know which moves will bring the best net result. Insurers that fail to take action may end up playing a guessing game that will diminish their pricing power going forward.

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A ROADMAP FOR WINNING AS INSURANCE GOES DIGITAL

BY RALF DREISCHMEIER, JEAN-CHRISTOPHE GARD, MICHAËL NIDDAM AND ALPESH SHAH

In many industries, the changes brought about by digital technology are already evident. Industries as diverse as entertainment, travel, and retail have been disrupted by the emergence of new players using technology to create products and services that offer something new or better. These digital-only players have staked out a valuable position with consumers—and traditional companies are feeling the impact. Just ask the TV companies competing with Netflix, the travel companies competing with Travelocity and Expedia, and the retailers competing with Amazon.

The insurance industry has taken longer to join the rush to a universe of bits. The sales model of agents helping consumers figure out which products to buy has largely remained intact in Western countries, and most insurers haven't yet felt a big impact from digitization on their revenues.

That is changing as more and more consumers begin to handle their insurance transactions online. A new ecosystem is taking shape, and it will affect every part of the insurance-industry value chain. Companies that don't adapt will become increasingly vulnerable.

The good news is that digitization doesn't necessarily mean that traditional insurers will be "Amazoned." In every area of insurance, all over the world, traditional insurers can use the Internet, mobile technology, and social media—as well as some reworked legacy technologies—to fend off new rivals and get ahead of long-time competitors. The challenge lies in coming up with a roadmap for digitization: where to start, what to change, how much to invest, and how to make it all happen.

Consumer Attitudes

Consumer attitudes toward insurance are changing. In its most recent survey of consumer sentiment, The Boston Consulting Group (BCG) found that approximately 15 percent of consumers in Western nations would, if possible, conduct all of their transactions with insurance providers remotely. That was up from roughly 5 percent two years earlier. Another 50 percent or so would prefer their dealings with insurers to be a hybrid of online transactions and interactions with sales or service people, up from 30 percent two years earlier. In our opinion, the percentage of remote-only users would be higher if the interfaces for common transactions—such as buying a policy, submitting a claim, and modifying an existing policy—were easier to use and more intuitive. But the shift in attitude, which is happening across all socioeconomic groups and applies to every type of insurance, should be enough to get the industry's attention all by itself.

The trend of consumers handling more of their insurance needs on their own is already evident in the early stages of the insurance-buying process. The vast majority of consumers do the bulk of their initial research online, using tools such as search engines and comparison engines, over which insurers have little control. Most of these customers do still turn to agents to finalize their purchases, and that may lead some insurers to think that their traditional networks retain their old relevance. But in many cases, the only real utility provided by insurance agents lies in clarifying and confirming the many policy details that are confusing online. Indeed, in the eyes of consumers, insurers' websites are among the worst of any major industry. Recent research by BCG in the U.S. highlights the dissatisfaction that consumers feel when they interact digitally with their insurers. (See Exhibit 1.) But this dissatisfaction is not limited to the U.S.; consumers in most other parts of the world feel it, too. (See *Evolution and Revolution: How Insurers Stay Relevant in a Digital Future,* BCG report, September 2014).

Digitization Is Critical in Three Parts of the Value Chain

Most insurance companies understand that digitization is starting to have an effect on the way they do business. But very few of them have devised a roadmap for how to change. Perhaps the best place to start is with the three parts of the value chain on which digitization is likely to have the biggest impact: internal operations, go-to-market strategies, and risk.

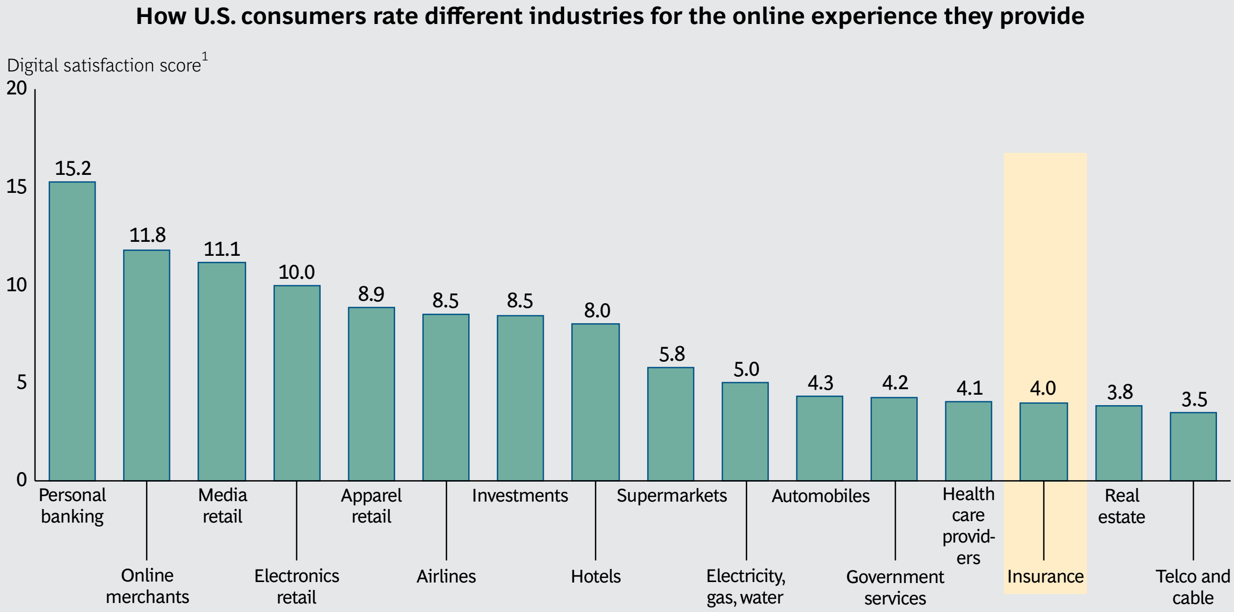
Internal Operations. Insurers have made the most headway here. The benefits stem partly from straight-through processing, which reduces insurers' use of paper processes and lowers their transaction costs. Digitization of operations also involves developing interfaces for providers such as physicians and hospitals—again, with the goal of streamlining processes and reducing costs.

In many cases, the new guard of digital-only competitors already has paperless processes and highly efficient approaches to handling transactions, which has allowed them to build a significant advantage in terms of variable costs. The per-policy processing costs of one digital-only automobile insurer who shared this information with us, for example, are 30 percent lower than those of traditional insurers, with which the digital-only insurer is starting to compete. If traditional insurers are to remain competitive, they must move faster to make their legacy systems more flexible and better able to operate in real time. This is a significant implementation challenge that will require a lot of planning and investment.

Another way to increase efficiency is by introducing self-service portals. Such portals could allow policyholders to do certain transactions online, without any paperwork or assistance. Insurers face a challenge with the self-service approach, however—which is how to go beyond the mere digitization of existing processes and offer an experience that truly takes advantage of the medium. If insurers believe that providing self-service means simply allowing their customers to access forms online and send those PDFs back via an electronic process, they will be missing both the point and the larger opportunity.

Even insurers that have a clear sense of what they should be offering in the way of self-service need to figure out how to make such investments pay off. In the current structure of the industry, independent

Exhibit 1 | Consumers Think That the Digital Experiences Offered by Insurance Are Among the Worst



Source: BCG Digital Satisfaction and Value Survey, March 2013 (n = 3,135).
[1]Based on maximum difference scaling: consumers distributed 100 utility points across segments to reflect their perceived digital satisfaction; segment scores do not add up to 100 because of data weighting.

agents develop customer relationships and, in many cases, handle customer service as well. More self-service options could reduce the burden on these independent agents without necessarily increasing customers' loyalty to the insurers themselves. This is an unintended consequence that insurers should take pains to avoid.

Go-to-Market Strategies. By far the biggest go-to-market opportunity for insurers involves the development of direct sales, which usually take place online and are not brokered by an intermediary. These sales have been slow to materialize in the industry because of resistance from traditional sales channels and because of the inherent complexity of insurance products. Perhaps not surprisingly, insurers that have seen early success with direct sales haven't had any channel conflicts to worry about; they sell insurance online or through telephone fulfillment staffs and don't rely on agents to generate business. One example is CosmosDirekt, a German insurer that surmounted the complexity issue by putting the application and approval process for term life insurance entirely online. The company has since built on its success in term insurance and is now offering other kinds of insurance.

CosmosDirekt is not alone; other innovative insurers have also gotten over the complexity hurdle and are using a simplified interface to sell directly to consumers. Another good example is Oscar, a start-up health insurer serving residents of New York State in the U.S. With its intuitive graphics and easy-to-use search tools, the company's online service is bridging the gap that has traditionally separated consumers from insurers.

Direct sales are destined to take significant share from traditional insurance channels, making investments in this area not just an add-on source of revenue but a competitive necessity. However, direct sales are only going to work for insurers that rethink how they build, develop, and market their products. The experience needs to feel new, not like the same old interaction transferred to a new medium.

The second big go-to-market opportunity for insurers lies in giving their full-time salespeople digital-sales tools. Such tools include customer-relationship-management systems that help with some aspects of lead generation and customer service, and that make it easier for sales agents to up-sell and cross-sell. The tools also include portable devices. For instance, the German insurer Allianz started a pilot project in Italy in which agents bring iPads on their visits to clients' homes and places of work. The agents are able to display benefit information and generate price quotes on the spot, eliminating the inconvenience of follow-up meetings and increasing the likelihood that customers will make impulse buys. When programs involving portable devices are properly implemented, insurers can realize significant productivity gains, with agents managing as much as 25 percent more business than they did previously.

Another very important thing for insurers to learn is how to gain more visibility when consumers are researching which insurance products to buy. Affinity marketing—the tactic of teaming up with a well-known brand in order to bring an offer to a prospect's attention—can play a big role here. In the U.S., for instance, New York Life Insurance has a deal to sell life insurance and annuities to members of the AARP, an organization with a membership of 37 million retirees. In China, the online insurance company Zhong An has started out with some can't-miss affinity partners, including the shopping site Alibaba, for which Zhong An will insure property and cargo; the Internet gaming company Tencent; and Ping An Insurance, one of China's largest insurers. Most of the new digital insurers that have captured significant premiums have done so with the help of an affinity partner. Affinity marketing helps insurers show up on consumers' radars at an earlier stage of the research process.

Risk. This is the dimension in which digitization has the greatest financial potential, and some insurers have already begun pilots in this area. But the business models involving risk reduction are embryonic, and there is no clear roadmap for moving forward. Very few insurers have had significant success in this area.

Underwriting is one area of risk in which insurers could capitalize on digitization. The science of using actuarial tables and other statistics to create and price insurance products has been around for well over a century and is quite mature. But information from social media, GPS systems, and big data could lead to improvements in insurers' ability to assess risk.

For instance, auto insurers are starting to use data gathered by telematics devices and mobile-phone applications to determine premiums for new clients—a segment-of-one approach that could make it possible for demonstrably safe drivers to pay lower premiums. That data could also help the auto insurer adjust the prices of policies in subsequent years and more accurately assess the risk of each policyholder. (See "Big Data: The Next Big Thing for Insurers?," BCG article, March 2013, and "Bringing Big Data to Life: Four Opportunities for Insurers," BCG article, July 2014.)

Big-data analytics could help insurers more accurately assess other kinds of risk as well. For instance, a mortgage life company might be able to use data from social networks to estimate its loss reserves more accurately by spotting lifestyle changes and recognizing how they might increase an insured person's risk. And in claims management, companies with more sophisticated approaches to data are already doing a better job of identifying outlier claims, thus reducing their exposure in an area that has historically accounted for a disproportionate percentage of payouts. For example, if an insurer is able to recognize that the injuries suffered by someone in a car accident are atypical, it could arrange for more effective early treatment—thereby lowering the total reimbursements it must make to hospitals and physicians.

The intersection of devices and loss prevention—the vaunted Internet of Things—presents another wide-open area of opportunity. It's easy to imagine how payouts could be reduced if property and casualty insurers used sensor-driven devices to detect and respond to events such as water leaks, break-ins, and fires, for instance, or if health insurers equipped cardiac patients with heart-monitoring devices that immediately forwarded abnormal readings to the patients' physicians. What's harder to imagine is the business model: figuring out who to partner with, how to pay for the devices, and how to set up exclusive deals with device makers.

Early pilots are under way in all of these areas. The British insurer Aviva is using unstructured data, including online spending habits and public Facebook postings, to get a sense of its customers' lifestyles, do predictive modeling, and set premiums for life insurance policies. Some companies—including Aviva and two U.S. insurers, Progressive Casualty Insurance and Allstate Insurance—are also experimenting with using data from mobile apps and in-car telematic devices to price automobile insurance. It's too early to know how these initiatives will fare, but we think that, in the aggregate, risk initiatives have considerable promise. (See Exhibit 2.)

Unfortunately, risk is also one of the areas in which traditional insurers face the biggest threat of disruption. One need only consider the strategy followed by Rakuten, Japan's largest online retailer, to understand the frontal assault that Internet companies can make on insurers. A couple of years ago, Rakuten bought AIRIO Life Insurance; Rakuten is now in a position to use the vast amount of data it has on Japanese spending habits—seven out of ten Japanese are repeat Rakuten customers—to price the life insurance policies that it sells to consumers.

Or consider what might happen if Google, whose footprint is considerably larger than Rakuten's, decided to get into insurance. Given what Google knows about consumers, it's not hard to imagine the company being able to offer a more innovative approach to risk assessment—and therefore to insurance pricing—than the one offered by traditional insurers. Regardless of how or where the Internet data giants might enter the insurance ecosystem, it is clear that they could alter it profoundly and irrevocably.

There's also the possibility of competition from companies that haven't traditionally been direct sellers of insurance, such as automobile original-equipment manufacturers, airlines, and telecommunications companies. In short, the threat to insurers' business models could come from just about anywhere.

EXHIBIT 2 | Insurers Are Pursuing Some Promising Initiatives

Time frame	Initiative	Description	Financial benefit	Other benefits
Near term	Agent enablement	Give agents software and support to make them more efficient	+	Aids in agent recruitment
	Digitization of claims pricing	Reduce paper transactions to lower costs	++	Increases attractiveness to business partners, including hospitals and physician networks
Medium term	Direct sales	Allow consumers to buy insurance products directly, without the help of an agent	+++	Helps insurers compete for less wealthy customers and for "digital natives," for whom being online is a way of life
	Self-service portals	Allow customers to do simple transactions online, without staff help	+	Encourages customers to return to insurers' websites
Long term	Improved claim assessment	Use big data, including social media, to identify outlier claims	+++++	May keep insurers from being disintermediated by data giants
	Improved loss prevention	Use sensors to limit damage from insurable events, such as fire, theft, and illness	++++++++	May help insurers avoid losing market share to device manufacturers and utilities

Source: BCG analysis.
Note: The number of "+" signs indicates the degree of potential benefit.

Developing a Roadmap for Digitization

For insurance companies, digitization is a complex equation with three variables: consumers' evolving preferences, changes in insurers' internal operations and technology, and emerging ways to assess, analyze, and manage risk. These changes create the possibility of a very different future. Direct players could become business process outsourcers, offering their platforms for others to use as delivery mechanisms for low-cost insurance products. Internet specialists and affinity marketers could alter traditional insurance-distribution channels. Data giants could become the engines behind risk assessment. Equipment makers and utilities could make off with part of the claims business. No part of the value chain is safe.

To best position themselves for success, insurers must develop a roadmap that takes into account four factors:

- *The Altered Ecosystem and New Partnership Possibilities.* As new players emerge—in some cases with unique value propositions—traditional insurers will have to decide how to position themselves. This starts with an analysis of how their part of the insurance ecosystem will develop. In some areas, traditional insurers may remain at the center of the ecosystem and have an opportunity to federate within it. But this won't be a natural role for many insurers. In other areas, traditional insurers won't be at the ecosystem's center no matter what they do, and they will have to find other ways of creating value.

  Picking the right position in the ecosystem will require scenario analysis, fresh thinking, and the ability to place and manage multiple bets.

- *New Innovation Models.* Traditional players will need to become more flexible and make learning a priority. They may be able to achieve these goals by doing more of their product-development work outside of their core organizations, perhaps using a corporate venture-capital model. This could allow insurers to surmount some of the challenges inherent in their own organizations. The products developed by these spin-off ventures could be reincorporated into companies' portfolios, or they could remain external and be marketed by a new entity, depending on which approach makes the most sense.

- *Products and Services That Are More Consumer-Centric.* While no one yet knows which new products will become popular, the insurance offers that consumers will have access to will clearly be very different from those available today. For insurers, the key is to reimagine the whole consumer experience. Companies that do this well may find that they are able to engage their customers in ways that have previously been impossible. With its Facebook-like features, Oscar's website has achieved a level of "stickiness" that is rare in the insurance industry. Approximately 5 percent of Oscar's customers return to the site on a daily basis—quite a feat in an industry where consumer interactions rarely occur more than once a month and sometimes happen as infrequently as once a year.

- *The Need to Modernize IT During a Period of Rapid Change.* When it comes to their technology infrastructures, traditional insurers are caught in a difficult spot. On one hand, they need to be able to start delivering some of the benefits of digital technology to their customers quickly. On the other hand, they are sitting on top of legacy systems which, by their nature, can be changed only through a prolonged, multistep process.

  The answer is a two-speed IT transformation, which means rolling out some new digital services even as insurers move toward a long-term overhaul of their legacy architectures. This is a difficult balancing act for most IT departments. IT orthodoxy often calls for investing in big-bang projects that can take years to complete. Given the current level of change in the industry, an insurer would be ill advised to pin all its hopes on one big-bang initiative. Instead, the company must have secondary and tertiary initiatives that are already producing returns.

While predicting the exact timing is impossible, we expect that the impact of digitization will hit the insurance industry with full force in the next three to five years. Developing a roadmap now will help insurers preserve flexibility and give them a chance of winning no matter what comes—and when.

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BRINGING BIG DATA TO LIFE

FOUR OPPORTUNITIES FOR INSURERS

BY ERIC BRAT, PAUL CLARK, PRANAY MEHROTRA, ASTRID STANGE AND CÉLINE BOYER-CHAMMARD

MANY INSURANCE COMPANIES ARE tapping into large, fast-moving, complex streams of big data and applying advanced analytical techniques to transform the way they do business. But in the life insurance industry, using big data seems to be low on the executive agenda.

Life insurance companies are taking a backseat approach to big data for many reasons. Perhaps the most important is that these companies have little available data to begin with. This is partly because they have limited interactions with customers and partly because a company usually does not get much additional data from a customer once an application for a life insurance product is completed. What's more, the data itself often involves significant issues of privacy, including health, behavioral, and lifestyle information that can be highly sensitive and, in some countries, tightly regulated. (See "Data Privacy by the Numbers," BCG slideshow, February 2014).

Yet after conducting a comprehensive survey of the industry, we have found that forward-thinking life-insurance companies are overcoming these challenges through four growth strategies. Some are using big data and advanced analytics to improve business processes and expand into new markets, thereby generating significant revenues and profits. Others are building long-term, trusted relationships with customers. These insurers are offering valuable new or improved products and services in exchange for personal data that customers provide voluntarily. The new offerings may help clients improve their health or may provide access to insurance for people who are considered risky or expensive to serve.

The landscape is changing. Companies that get ahead of these shifts will discover new opportunities for efficiency, growth, and innovation.

Life Insurers Can Profit from Big Data in Four Ways

Big data and advanced analytics can help insurers gain access to a great deal of information that consumers might be persuaded to share—if the companies craft the right incentives, add value, and create an easy platform for engagement.

We have observed that the four growth strategies have two dimensions: the intensity of the customer relationship and the degree of expansion into new markets. The first dimension allows companies to grow by selling more products to each existing client and by increasing loyalty. The second dimension fuels growth by broadening the client portfolio—that is, by selling to new clients. (See Exhibit 1.) Several leading insurers around the world are currently exploring these approaches, in some cases building partnerships that are beginning to transform the way business is done.

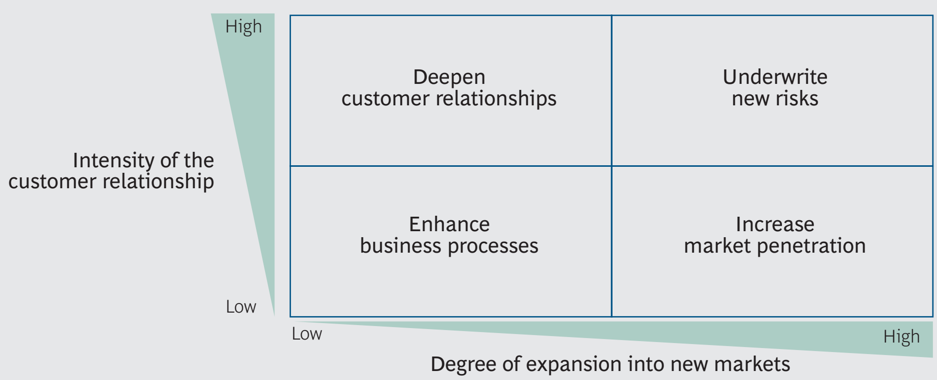
Enhancing Business Processes. Big data and advanced analytical tools and techniques are already boosting operational performance significantly. Some companies, for example, have generated an increase of 5 to 15 percentage points in the *placement rate,* which measures how many people purchase a policy after beginning the application process. Other companies have reduced the length of the application process from weeks to hours.

In underwriting, some insurers are improving risk assessment during the underwriting process by including more relevant big-data variables in existing analytical models. Aviva, for example, has experimented with selectively replacing costly and inconvenient medical exams with predictive modeling of risk based on enhanced data. A study of 60,000 Aviva applicants found that nontraditional data was as effective in identifying potential health risks as blood and urine tests.

In distribution, companies are improving agent recruiting and retention by developing predictive models to identify, select, and retain the best sales performers. In near real time, these companies track metrics such as early customer-lapse rates, disclosure rates (how much information an agent is able to obtain from an applicant), and average policy size. They also design incentives on the basis of these indicators in order to move performance in the right direction. What's more, they provide agents with advanced sales-support tools. For instance, MassMutual Financial Group has developed a mobile app that highlights the customers who are most likely to buy a policy. The system has increased placement rates by 5 percent in 18 months.

Finally, in marketing, companies are using advanced analytics to better model both the likelihood of customers buying a product and the risk of customers cancelling coverage. These companies are also enhancing lead generation and qualification. One global insurer in Asia generates high-quality new prospects for its sales operation through predictive modeling of data

Exhibit 1 | Life Insurance Companies Use Big Data to Power Four Growth Strategies



Source: BCG analysis.

from a retail banking partner. The insurer's advanced algorithm analyzes information about customers' previous insurance purchases, age, gender, income, assets, and length of relationship with the company to compile a list of millions of sales prospects with higher propensities for buying life insurance. The company expects this new source of leads to constitute 10 to 15 percent of total qualified leads in the future, representing an important source of growth beyond the saturated market of traditional, branch-based customers.

Increasing Market Penetration. Some companies are expanding into new markets with leaner, faster underwriting processes powered by big data and advanced analytics. They are even automating underwriting processes to lower costs, when relevant. This allows insurers and intermediaries to serve new market segments in a profitable way.

Consider, for example, how companies have sometimes been hesitant to sell to the middle market, often defined in the U.S. as households with annual incomes of $35,000 to $100,000. The contracts have traditionally been regarded as too time-consuming to underwrite, and the commissions they produced were too low. Yet the middle market represents billions of dollars in potential annual premiums and serves as a bridge to sales of other financial products, such as annuities. Automating the underwriting and distribution processes for this segment reduces costs and allows companies to profitably sell products with lower margins.

SCOR Global Life, for instance, offers a real-time, fully automated underwriting solution called Velogica, which helps life insurers in the U.S. create affordable products for the largely underserved middle market. Decisions are communicated to an agent in less than a minute in 90 percent of cases, and fewer than 5 percent of applications require human intervention. A rules engine collects and automatically processes external data from sources such as the MIB Group, motor vehicle reports, and prescription databases. More than 1.3 million applications have been underwritten to date with the system.

Deepening Customer Relationships. A few companies are using big data and advanced analytics to extend their offerings with trust-based services that increase the intensity of the customer relationship, gaining mutual benefits for customers and insurers. In exchange for providing more data to insurers, customers receive a product that offers more than simple peace of mind and protection. Companies can also include services that influence behaviors and help people make life-extending changes.

These approaches get around the significant information asymmetry in the life insurance business. Insurers often do not know much about a customer's health over the life of a policy, and as a result they lack information about the evolution of the mortality risk. Policyholders, on the other hand, often know a great deal—but may not be willing to share it.

Consider how Discovery has circumvented this problem with a wellness and loyalty program called Vitality. Customers who subscribe to the insurer's program enter information about their lifestyle and health-related behaviors, receive an annual health check, and take other tests to assess exercise, eating habits, and stress levels. Based on their participation in the program and changes they make to their behavior, customers receive Vitality points that they can redeem for discounts at a range of health, fitness, shopping, and leisure-activity partners. Customers who maintain their healthy habits also receive markedly better pricing on the company's insurance products as an added incentive to sustain their prevention practices.

Customers benefit from discounts, rewards, and a personalized program to improve their health. Insurers gain by receiving a great deal more data to better select risks and generate higher retention and loyalty. And society is well served by the reduction of negative behaviors that account for the vast majority of expenditures related to health.

Discovery estimates that it has achieved a reduction in lapsed policies of as much as 52 percentage points and a reduction in mortality of as much as 34 percentage points for most active participants in the program. (See Exhibit 2.) In addition, the company estimates that Vitality has increased operating profits by almost a full percentage point. The program recently expanded beyond its original base in South Africa through partnerships with major insurance companies, such as Prudential in the UK, Humana in the U.S., Ping An Insurance in China, and AIA in Singapore and Australia.

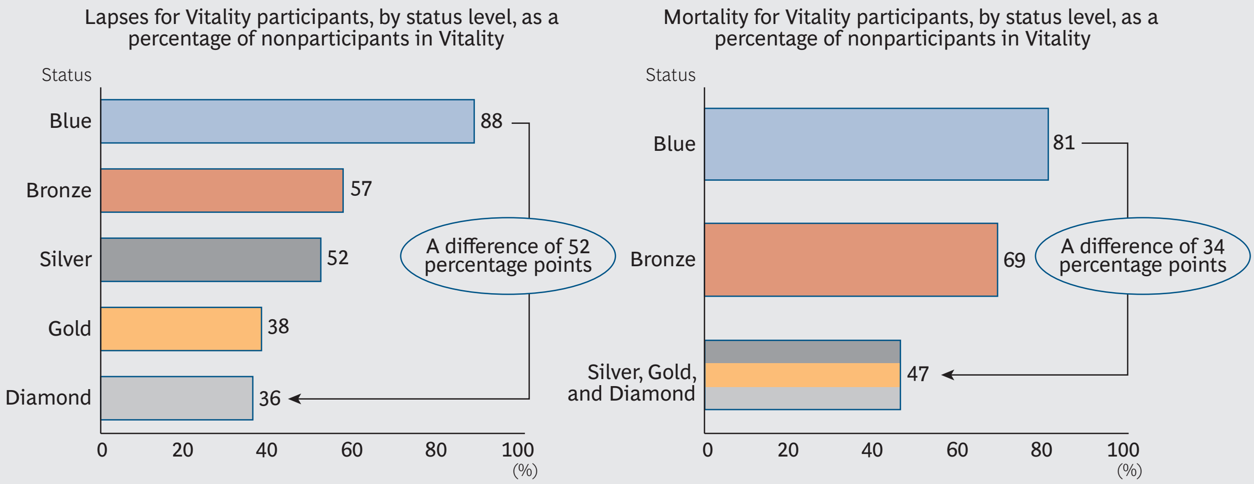
Underwriting New Risks. A handful of companies are on the leading edge, using big data and advanced analytics to underwrite entirely new risks that previously could not be covered profitably and to increase the intensity of the customer relationship. Life insurers used to assess health risks just once, at sign-up, asking questions about lifestyle behaviors linked to a higher risk of mortality. Now, trusted insurers can access data regularly volunteered by high-risk customers in exchange for insurance that had at one point been unaffordable or unavailable.

AllLife provides affordable life and disability insurance to policyholders who suffer from manageable diseases, such as HIV and diabetes, and who agree to adhere to a strict medical protocol. Patients get monthly health checks and receive personalized advice on managing their conditions. With the client's permission, data is pulled directly from medical providers. If a client does not follow the treatment protocol or discontinues treatment, benefits or coverage can be lowered or cancelled after an initial warning. The company assesses its risk every three to six months, rather than just once.

Clients who have participated in prevention programs have boosted their health and lengthened their life expectancies. Six months after enrollment, the immune systems of HIV patients, for example, improved by 15 percent on average—even without treatment. At the same time, AllLife benefits when clients take voluntary measures to reduce their risk and increase the flow of health information to the insurer.

Exhibit 2 | Discovery's Vitality Program Demonstrates the Rewards of Greater Customer Engagement

Vitality participants remain customers longer ... / **... and have lower mortality rates**



	Blue status	Bronze status	Silver status	Gold status	Diamond status
Requirements	Registration	15,000 points	35,000 points	45,000 points	Gold status for three years or more

Sources: Public presentations by Discovery and interviews with the company's executives.

The company is growing at an annual rate of 50 percent and aims to insure 300,000 HIV patients by 2016. An investor claims that AllLife's model is highly profitable and that the company's risk is not much higher for HIV clients than it is for clients who do not suffer from these diseases.

How Life Insurers Can Get Started

These strategies demonstrate that policyholders are indeed willing to share personal data with insurers in exchange for improved customer relationships, lower pricing, richer rewards, or previously unavailable or unaffordable coverage. When insurers add voluntary data from risk assessments (such as health exams) and nontraditional data sources (such as behavioral or unstructured data), they can significantly reduce the information asymmetry that exists between themselves and their customers. They can also open up vital new pathways for growth.

Companies can enhance their ability to generate competitive advantage from these strategies with the following actions.

Start with data-intensive business processes that have clear business potential. In the short term, insurers should focus on the "moments of truth" that occur in situations where companies already have a lot of contact with clients, such as underwriting, claims, and fraud detection. (See "Big Data: The Next Big Thing for Insurers?" BCG article, March 2013.)

Develop proprietary data. In an industry with limited information, the only way to build long-term advantage is to develop one's own data sets. For instance, automakers using telemetric data from customers' cars have built a unique value proposition that will be hard to displace. (See "Telematics: The Test for Insurers," BCG article, December 2013.) Some insurers may gain an advantage working on their own, as Discovery has done. Others, depending on their size and existing capabilities, may need to rely on partnerships to some degree.

Break down information silos. Traditionally, analytical expertise has resided in the actuarial department. But it now often resides in other departments as well. The ideal team should be able to cooperate across departments and should include marketing, actuarial, claims, data science, and legal functions. In some cases, companies may need to give an executive responsibility for exploring new avenues of product design and risk assessment through big data and advanced analytics.

Build trust through mutual benefit. In such a heavily regulated industry, companies must create trust with both consumers and regulators. Insurers must demonstrate how greater access to personal data produces clear advantages for both consumers and society through new products and services. (See *The Trust Advantage: How to Win with Big Data,* BCG Focus, November 2013.)

The truly transformative potential of these strategies will take time to play out. Over the long term, these approaches will open up important avenues for growth and innovation for companies willing to experiment now.

Insurers that excel at these and other strategies to intensify the customer relationship and move into new markets will catch up to—or even surpass—more nimble companies that are already in the game. They will win the best clients, reduce risk, increase loyalty, and create more opportunities to cross-sell products and services.

The rest will risk falling behind or ceding the most attractive customer relationships and emerging markets to others.

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TELEMATICS: THE TEST FOR INSURERS

BY ERIC BRAT, DAVIDE CORRADI, OFIR EYAL, TIM HOYING AND YASUSHI SASAKI

Telematics, the wireless technology that delivers safety services, route information, and entertainment to motor vehicles, presents auto insurers with a significant opportunity to create new value. By utilizing the technology's ability to transmit precise data on vehicle location and driving behavior in nearly real time, insurers can de-average pricing models, capture a greater share of the low-risk-driver market, cut the costs of managing claims, and enhance the overall customer experience.

The telematics landscape is still evolving, of course. But different types of stakeholders—including automakers, telematics service providers, wireless network providers, and hardware companies—have been busy getting into position and forging future strategies. Insurers, for their part, are gradually becoming more active in developing telematics-based coverage. Nonetheless, customer penetration remains low.

A series of recent interviews conducted by The Boston Consulting Group revealed that the hesitancy of some insurers to increase their investment in telematics might be based on misconceptions about the technology's potential for creating value. At the same time, many insurers are aware of the data advantage that telematics can bring and of its vast commercial potential. In our view, the moment is right for insurers to further explore the telematics opportunity.

Tapping into the Technology

Telematics uses the satellite-based Global Positioning System and other wireless technologies to track the movements of vehicles and monitor driving behavior. This capacity to measure exactly when, where, and how a car is driven—including the g-force impact of a collision—has the potential to revolutionize the motor insurance industry through usage-based pricing. Instead of such traditional elements as age, address, and past driving record determining the premium, a driver's current behavior behind the wheel becomes the significant factor. The value proposition for customers is basic: the safer your driving—as established by, for example, driving frequency, speed, rate of acceleration, route familiarity, and road conditions—the lower your bill.

Although more than 70 insurers worldwide currently offer telematics-based products, penetration is no greater than 1 percent in most markets—roughly 3 million policies globally. Italy is the most advanced market, with 19 of its top 20 insurers participating and a penetration rate of 3.5 percent. Italian insurers expect penetration to rise to 10 to 13 percent within the next few years.

Other major markets such as the U.S. (where 10 of the top 25 insurers participate) and the U.K. (8 of the top 10) are also in the game. According to our interviews, U.K. insurers expect telematics penetration to rise from less than 1 percent of policies now, to 7 to 10 percent within three years—and to around 15 percent within five years. In Japan, many automakers are installing telematics equipment into new vehicles, and interest among Japanese insurers is rising.

Growth in telematics-based insurance solutions will be driven by the various stakeholders' openness to change and will differ by market. Competitive dynamics will obviously play a role, as more insurers vie for advantage in this growth area of their industry. The rate of customer uptake will also be critical, particularly in high-premium segments such as young drivers.

Moreover, some potentially game-changing forces may provide momentum. For example, new regulatory measures such as eCall—a pan-European initiative scheduled for 2015 that will enable faster location and rescue of car accident victims through the use of telematics—could boost consumer adoption. So could the fact that more automakers in many markets are thinking of installing telematics systems as standard equipment. Furthermore, the EU Gender Equality Directive, as well as the possibility of new legislation concerning age discrimination, may limit insurers' ability to use traditional gender- and age-based pricing methods. Should such constraints arise, data gathered by telematics devices will be that much more useful.

Yet given the potential benefits, why has telematics penetration remained so low? According to our interviews with insurers, automakers, and other stakeholders, wider adoption may be hindered by some common misconceptions.

For example, some insurers think that telematics might be too expensive, requiring the professional installation of costly, state-of-the-art black boxes in vehicles. In fact, as lower-cost hardware and software—such as self-installed boxes and smartphone apps—gain more acceptance, these approaches will likely reap significant telematics benefits at a reduced cost. This in turn will make the economics of telematics relevant not just for high-risk segments such as young drivers but for medium- and low-risk segments as well. (See Exhibit 1.)

The key to winning will be smart customer segmentation. Insurers need to find the right telematics product, value proposition, and hardware device for each segment. Such alignment will widen the appeal of telematics for market groups such as women, young families, and early adopters of technology who are not necessarily in traditionally high-premium segments.

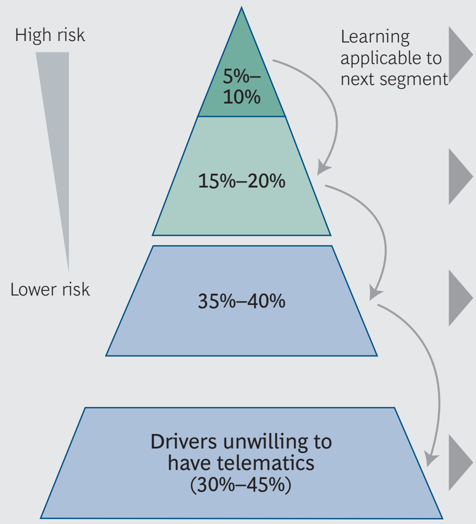
We also observed from our interviews that some insurers think that a small product portfolio is sufficient to make them viable telematics players—hence their relatively low levels of investment. In truth, there is not much, in terms of learning and economics, that insurers can do with a negligible telematics offering. A certain degree of scale is needed to gain real competitive advantage and generate profits.

Of course, in order for insurers to maximize the benefits of telematics, they need to understand more than just the common misconceptions. They must also know how to generate real value from the technology.

Generating Real Value Using Telematics

In our experience, telematics-based solutions can lift the combined ratio 15 to 20 percentage points over the traditional

EXHIBIT 1 | The Availability of Less Expensive Devices Makes Telematics Relevant for Multiple Segments



	Premium price relationship to driving	Discounts available to safe drivers	Telematics, main uses
Professionally installed or OEM device (plus apps)	Fully linked	Substantial discount	Pricing, claims management (collisions, fraud detection)
Self-installed device	Closely linked	Moderate discounts	Data collection, pricing, retention, claims
Smartphone plus car connectivity	Loosely linked	Limited discounts	Data collection, retention, marketing, introduction to the technology
No telematics offer			

Source: Interviews with insurers and brokers; BCG analysis.

auto-insurance book. These benefits stem from numerous sources, including enhanced ability both to gather detailed information on driving behavior and to select lower-risk clients. More broadly, long-term advantages come from the ways in which telematics changes key elements of the insurance value chain. Consider the following elements of insurers' operations.

Pricing. Telematics allows insurers to select individuals from broad actuarial groups. Such granular segmentation can lead to a climate in which the insurers with the most innovative pricing models are certain to attract the lowest-risk customers, leaving higher-risk customers with other providers. The flow of accurately priced customers to the telematics product can cause the risk profile of drivers served by traditional insurance to deteriorate, pressuring non-telematics insurers to raise premiums. Insurers that offer telematics coverage can thus benefit from an influx of consumers seeking lower premiums, from reduced exposure to risk, and from retention of low-risk policyholders.

Indeed, since a driver's current behavior behind the wheel—as opposed to age, address, past driving record, and other traditional factors—is a significant element in determining the premium, a safe driver has an incentive to join a telematics program. And since telematics provides a set of personalized driving data that is neither attainable through standard underwriting nor currently transferable to other insurers, drivers have good reason to stay with their insurer.

Although insurers are just beginning to use data gleaned by telematics devices, the data have the potential to provide significant competitive advantage. A key challenge for insurers will be building the internal skills, capabilities, and infrastructure to take full advantage of the data that telematics can furnish.

Claims Management. With instant notification of accidents, more accurate assessments of who is at fault, detection and deterrence of fraud, and the ability to sort out claims more quickly (ahead of other interested parties such as automakers and attorneys), telematics can revolutionize claims management processes and efficiency—and lower insurers' costs at the same time.

The ability to capture such benefits will not come overnight: insurers must learn how to fully exploit the technology. In the long term, however, the results will be well worth the effort. Our analysis suggests that telematics can have as significant an effect on claims management as on pricing, although relatively few insurers have yet acted on either opportunity.

Loss Prevention. Leading insurers recognize the need to manage losses across the entire life of the policy. Telematics can help them bridge underwriting and claims points in several ways. For example, installation of the telematics box provides an opportunity for collecting additional information—such as the general condition of the client's vehicle. Such data can enable insurers to alert drivers ahead of time of potential malfunctions that could be dangerous. For instance, recently developed technology allows insurers to inform drivers if the tires on their vehicles are not adequately inflated. Moreover, insurers can frequently provide driving feedback to policyholders through a Web portal or smartphone app, thereby encouraging better driving behaviors and developing patterns of meaningful interaction with the customer. Such regular contact can also boost customer loyalty and retention.

Commercial Strategy. If insurers can devise the right service offering at the right time for the right segment, telematics provides a golden opportunity for them to clearly differentiate their value propositions. This, in turn, can have a positive influence on customers' perception of policy value. Indeed, leading players are trying to make motor insurance more service based, as opposed to primarily product and risk based. Telematics, with the range of services that can be provided in the event of an accident, lends itself naturally to this strategic shift.

Although some insurers still see telematics-based solutions as applicable primarily to young drivers, the use of self-installed devices, smartphone apps, and other innovative approaches can indeed change the playing field. Insurers may want the most sophisticated, fraud-proof, professionally installed devices for young drivers (in order to ensure data accuracy), but lower-cost devices should be sufficiently robust to provide insurers with highly useful data on medium- and low-risk customers. Proper segmentation, as well as a true understanding of the risk profile and potential value of each customer, will help insurers avoid cannibalizing their other existing businesses.

Telematics also influences the relationship between insurers and their sales channels, especially when agents are involved. There is a physical element of the product—the black box—to manage, and also, as premiums evolve from the flow of driving data, so do commissions. Agents in the Italian market, for example, initially resisted telematics because they feared potentially lower commissions. But the market has evolved. More agents now see telematics-based policies as clear and concrete value propositions that they can leverage to sell additional and profitable types of coverage. Moreover, they correctly perceive telematics as a way to protect their customer base from direct players. At one insurer we interviewed, more than 30 percent of customer acquisitions in the first half of 2013 were attributable to telematics-based policies.

Taking Action *Now* on Telematics

The evolution of telematics poses both opportunities and risks for insurers. In the short term, penetration is expected to grow steadily in most markets. But data asymmetry among players and the lack of well-defined data standards mean that early movers—using the superior data advantage that telematics provides—will be able to cherry-pick the best drivers currently being served by competitors, as well as retain desirable customers already on their books for longer periods of time. Winning insurers will seize this opportunity to make profitable gains in market share. The risk will fall mainly to those insurers that maintain the status quo and do not prepare for the anticipated growth in telematics.

In the medium term, as telematics becomes increasingly mainstream, regulators are likely to push for common data standards, as well as the easy transference of devices and data among insurers. In the long term, with so many forces exerting downward pressure on premiums, winning insurers will be those that have superior pricing, claims management, and loss prevention capabilities—all of which can clearly be enhanced by telematics, implying a strong need to get an early start in the game.

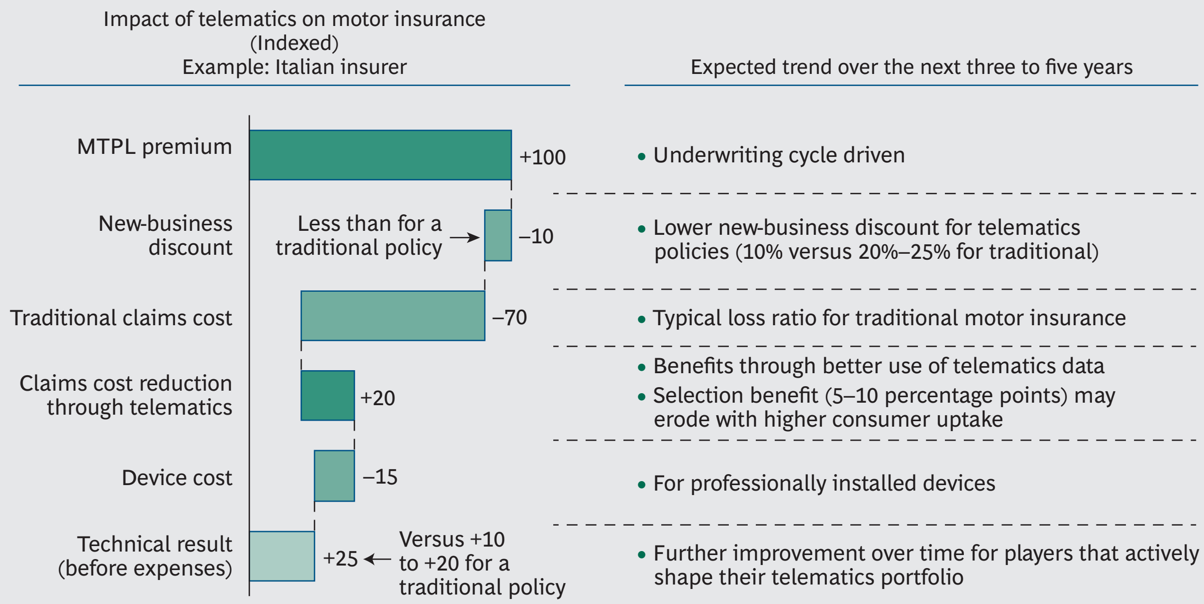
Moreover, interest by other stakeholders is poised to intensify. Automakers, for example, are increasingly moving into the insurance space—becoming more active in sales, distribution, and claims—much as they have become key players in financing new-vehicle sales over the past decade. For telcos, telematics represents a growth area for communication volume, making it a sizable strategic opportunity. Some telcos are already acting as telematics service providers to the insurance industry. And although the price element alone—lower premiums for safe and infrequent drivers—should provide ample motivation for consumers to explore a telematics-based product, insurers should also emphasize safety and security features as major benefits of the overall experience.

To be sure, the world is "going digital" in countless ways. Growth in telematics-based insurance will very likely be a part of this megatrend. With hundreds of millions of cars on the road worldwide, the implications are enormous. In the Italian market, for instance, telematics is already delivering visible benefits and is poised to bring more. (See Exhibit 2.)

In thinking about telematics, insurers in every market should consider the following truths:

- Installing telematics in motor vehicles is a pioneering step in the use of smart devices.
- Designing and using smart devices to monitor risks in real time will be critical for the insurance industry going forward.
- Big-data technology is a large part of this trend and will allow insurers to analyze large sets of data both to draw conclusions for risk selection and to customize coverage.
- Motor insurance is a first mover in telematics. But the same or similar

Exhibit 2 | Telematics Is Delivering Visible Benefits Today and Is Poised to Bring More



Sources: Interviews with insurers and brokers; BCG analysis.
Note: MTPL = motor third-party liability insurance.

technology could be applied to other types of insurance such as cargo, marine, household, and health.

Ultimately, insurers need to adapt their strategies and capabilities in order to be ready for growth in telematics. They should ask themselves how they might benefit from leveraging this innovative technology. Perhaps even more important, they should ask themselves another question: What are the consequences of being left out of the telematics game?

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REVOLUTION VERSUS REGULATION

THE MAKE-OR-BREAK QUESTIONS ABOUT AUTONOMOUS VEHICLES

BY NIKOLAUS LANG, ANTONELLA MEI-POCHTLER, MICHAEL RÜSSMANN AND JAN-HINNERK MOHR

The era of the autonomous vehicle (AV) is fast approaching.

What should automotive companies (also known as original equipment manufacturers, or OEMs), suppliers, regulators, legal authorities, rating agencies, road operators, and the public at large do to prepare for what is the greatest inflection point for the automotive industry since the introduction of the assembly line?

And what are the most significant technical, societal, and legal and regulatory roadblocks to the development, deployment, and mass adoption of AVs?

The Boston Consulting Group and the World Economic Forum (the Forum) have jointly developed and explored solutions for the most substantial obstacles to mass-market AV adoption in the social, regulatory, and industrial spheres. Our findings reinforce an overarching message: close cooperation among stakeholders is critical to the timely and successful deployment of AVs.

AVs will come in varying degrees of automation and required human interaction. SAE International (a leading global association of automotive engineers), the U.S. National Highway Traffic Safety Administration, and Germany's Bundesanstalt für Straßenwesen (the federal highway research institute) have defined a framework for vehicle automation. For the purposes of this report, we follow the SAE's definition, which consists of six automation levels that range from zero, meaning no automation, to five, meaning full autonomy for all traffic situations without any human interaction. (See Exhibit 1.)

AVs are the greatest inflection point for the automotive industry since the introduction of the assembly line

OEMs and new entrants, mainly from the technology sector, are taking divergent approaches to making autonomous driving a reality. (See Exhibit 2.)

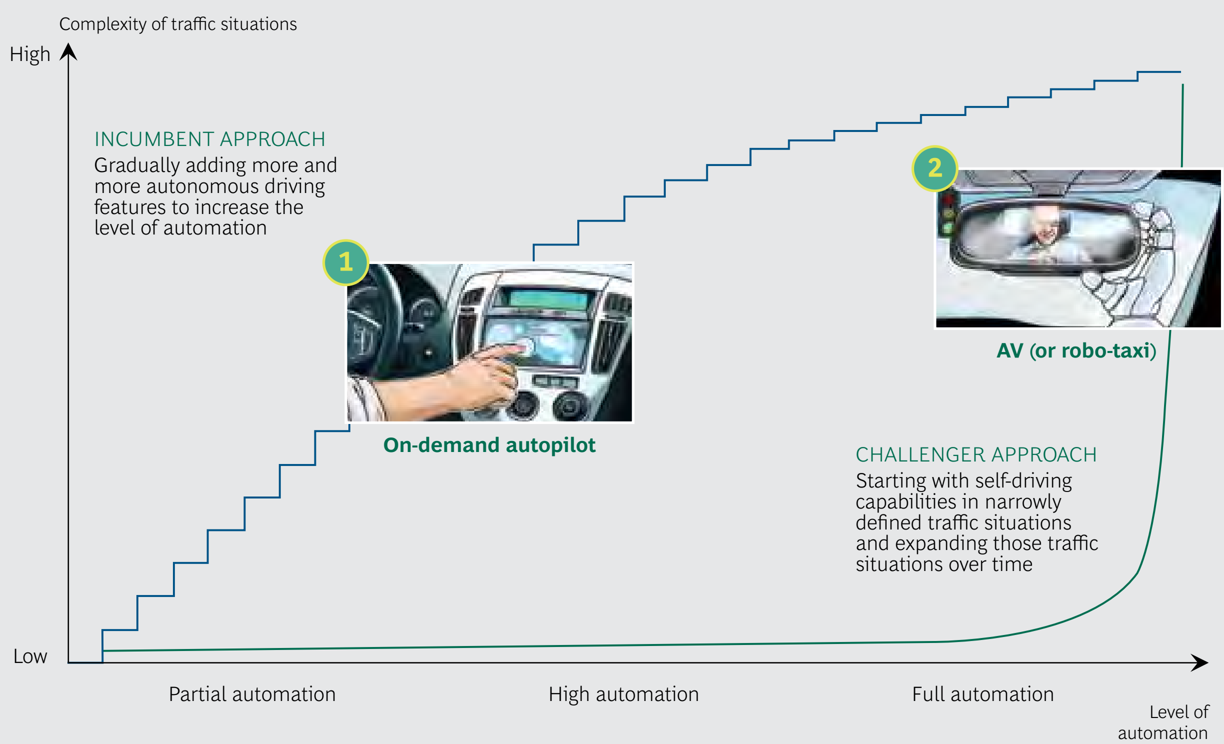
Exhibit 1 | Vehicle Automation Levels

Automation level	Execution of steering, acceleration, and deceleration	Monitoring of driving environment	Backup performance of dynamic driving task	System capability
0 No automation	Human driver performs task	Human driver performs task	Human driver performs task	Not applicable
1 Driver assistance	Human driver performs task; System performs task	Human driver performs task	Human driver performs task	Certain defined traffic situations
2 Partial automation	System performs task	Human driver performs task	Human driver performs task	Certain defined traffic situations
3 Conditional automation	System performs task	System performs task	Human driver performs task	Certain defined traffic situations
4 High automation	System performs task	System performs task	System performs task	Certain defined traffic situations
5 Full automation	System performs task	System performs task	System performs task	All traffic situations

Human driver performs task   System performs task

Sources: SAE International; BCG analysis.

Exhibit 2 | Two Vastly Different Approaches to AV Development



Sources: World Economic Forum; BCG analysis.

- Industry incumbents—that is, OEMs—favor an incremental approach, believing that enabling technologies must mature and that social obstacles must be cleared before fully autonomous operation can be achieved. In the interim, OEMs will follow a well-established path to market, introducing autonomous features first in the premium automotive-market segment.

- The tech companies and other new entrants favor an alternative approach. In keeping with the tech industry's culture of rapid prototyping, most challengers are pushing hard for early trials of their technology and use of the findings from those trials to improve the technology on the fly. Rather than introduce their products on the mass market, they will likely seek alliances with fleet operators such as municipal governments, taxi services, or businesses and educational institutions in need of shuttle services to transport people around large campuses.

For all their differences, incumbents and new entrants face a common set of challenges, which we review in the chapters that follow.

To read the full report please use the below link or scan the QR code from your smart phone

https://www.bcgperspectives.com/Images/BCG-Revolution-Versus-Regulation-Sep-2015_tcm80-195553.pdf

CUSTOMER-CENTRICITY IN FINANCIAL SERVICES GOES DIGITAL

BY RALF DREISCHMEIER AND BENJAMIN REHBERG

IN A PREVIOUS ARTICLE, The Boston Consulting Group argued that, for retail banks, a focus on customer-centricity—defined as a way of operating "based on trust and fairness that uses knowledge of customers to meet their needs and achieve sustainable, valuable, long-term relationships"—is becoming an increasingly important differentiator in the marketplace.[1] The same holds, we believe, for financial services companies broadly. Tomorrow's winning players, we expect, will be the sector's most customer-centric companies. They will have developed a truly deep understanding of their customers and will be able to satisfy their wants and needs in a manner that meets, if not exceeds, expectations in all critical areas, including product selection and availability, interaction experience, service quality, channel accessibility, and communications.

Rapidly evolving digital capabilities—particularly mobile, social-media, big-data, and cloud technologies—offer financial services companies entirely new opportunities for understanding, serving, and engaging customers. These capabilities will be powerful allies in the pursuit of greater customer-centricity. Many companies recognize this but—given the range of possibilities and the speed with which the technology is advancing—are uncertain about how to proceed. Yet time to think things through fully and at an unhurried pace is a luxury that many businesses might not have. Customers' expectations regarding what is possible in today's digital landscape continue to rise—as does the ease with which a customer can identify a competitor that outdelivers and move his or her business.

Whether by carrot, stick, or a combination of the two, then, most financial-services companies will be propelled further into the digital space as they strive for greater customer-centricity. Our advice: be bold and proactive— even if it means making mistakes. For those that move quickly, there is high potential for sizable early-mover advantages. Indeed, a handful of companies are already pushing the envelope aggressively on this front and reaping rewards.

The Digital Edge

Today's evolving digital capabilities can help financial services companies achieve greater customer-centricity by breaking some of the key compromises the industry has had to wrestle with historically. In the past, the form, frequency, and caliber of companies' interactions with customers have been governed to a great extent by operational limitations. Legacy systems and back-office restrictions (for example, independent computer systems and data centers that are siloed by business line) have curtailed companies' options regarding product design and delivery, targeting, communications, and service levels in general. The notion of being able to serve customers when, where, and how they want to be served, with products that meet their specific needs, has remained more a vision than reality.

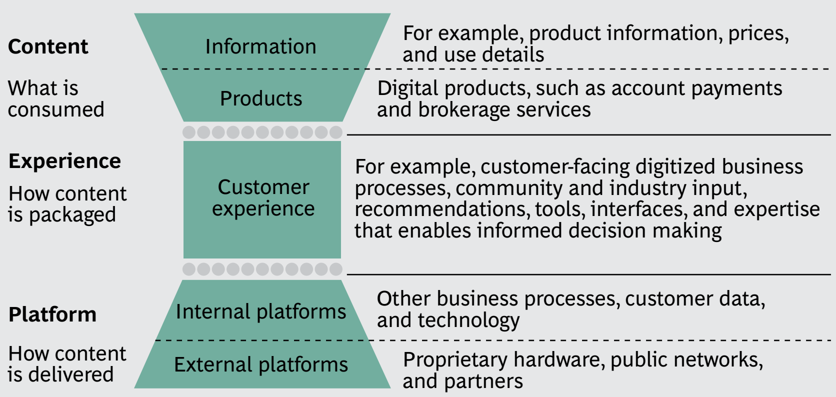
> Tomorrow's champions will exploit the possibilities afforded by customer-centricity.

But available digital capabilities can change the game.[2] They can liberate financial services companies from these constraints by enabling the delinking, and subsequent loose rejoining, of content (that is, what is consumed), experience (how it is consumed), and platform (how it is delivered).[3] (See the exhibit below.) The resulting ability to modularize, package, and deliver content (including products, services, and information) in new ways—supported by ubiquitous mobile Internet access through, for example, smart devices, cloud technologies, and service oriented architecture—opens up a wide range of new options for greater customer centricity.

To get a sense of the possibilities, consider a highly popular service that many banks already offer customers: ATM locator maps that can be accessed with a mobile phone. In the not-too-distant past, getting such information (literally) into customers' hands would have been highly difficult, to say the least. Now, however, it is relatively straightforward. And, critically, the bank, by "mashing up" digitally enabled capabilities made available by others—such as mobile data access through the mobile-phone-service provider, a software delivery ecosystem through an app store, GPS technology included in the smartphone, and the digital map provided by a third-party Web service—can deliver this service without having to make its own material investment. All the bank has to do is provide its ATM-location data and create the app that serves as the conduit for the desired customer experience.

Tomorrow's champions of customer-centricity will, no doubt, actively exploit the possibilities that this new reality affords. What suite

Digitization Offers New Opportunities for Linking Content, Experience, and Platform



Source: Center for Information Systems Research, MIT Sloan School of Management.

of capabilities will tomorrow's state-of-the-art, digitally enabled players possess and deploy? The following scenario is based on trends we have observed in our client work. Companies will utilize a big-data approach to understand direct and indirect communications and feedback from customers and prospects, including communications and feedback received through social media. They will use that information, coupled with hypothesis-driven analytics, to develop and tailor personalized products, services, delivery methods, and communications.

Companies will combine these with the capture and study of every transaction and touch point they share with customers through customer-relationship-management software to determine how they can improve the caliber of their interactions. They will model and test new products regularly, creatively, and efficiently—in specific regions, among specific customer cohorts, and for specific time periods—to glean new insights, employing a "fail fast, fail often" philosophy. They will present customers with a truly user- friendly and unified experience that is consistent across channels. The result will be greater customer satisfaction—coupled with a lower cost-to-income ratio.

A Current Exemplar: USAA

USAA is a leader in digitally enabled customer- centricity in the financial services sector. The Texas-based diversified financial-services player, whose products and services include banking, property and casualty insurance, credit cards, financial planning, and car-buying advice, caters to individuals (and their families) who currently serve or have served in the U.S. military. Its membership exceeds 8 million.

True customer-centricity demands significant changes at the organizational level.

The company is renowned for its focus on and deep relationships with customers. Its Net Promoter Score, for example—a widely recognized measure of customer loyalty—is consistently superior to the scores of its competitors: the company's 2012 score of 83 percent stands well above the industry average.[4] A major factor behind the company's success on this front has been its early recognition of and ongoing emphasis on the opportunities digitization affords. USAA was the first company to introduce mobile-phone check deposits using photos, for example. Coupled with the company's service-oriented IT architecture, digitization is, in fact, the critical enabler of USAA's highly successful "life events" approach, which is centered on meeting members' needs at various life events and stages (such as getting married, saving for a child's college education, and retiring).

Digitization also underpinned the creation of the company's unique member-experience initiative, which supports the strategy by integrating USAA's various lines of business into a single unified organization. (See the sidebar, "USAA's Wayne Peacock on Customer- Centricity.") And digitization, particularly the opportunities afforded by today's technologies, remains a vital part of USAA's ongoing efforts to improve and expand the customer experience. USAA customers can now, for example, use their mobile phones to pay their bills with text messaging, trade stocks with a mobile app, and change their ATM and debit-card personal-identification numbers.

The company's customer-centricity has been enabled by many other capabilities built over the years. Technology-driven efforts, including the early creation of a single file for each customer, the use of common frameworks and integrated middleware, adherence to principles of good engineering, and the integration of business and IT, have been critical. But actions on the cultural front, including strong commitment from leadership, a clear mission statement, an understanding that this would be a long-term effort, regular communication, and well-considered job training and rotation, have also been important. Organizational moves—for example, the creation of connect-the-dots functions, forums for the discussion of integration challenges, and the institution of metrics and a rewards system— have also played roles.

Getting Started

Although digital capabilities are the linchpin, they are not, by themselves, sufficient for achieving meaningful levels of customer-centricity, as USAA's example illustrates. True customer-centricity also demands significant changes at the organizational level, including changes in governance—for example, organizing around the customer rather than the product or channel. And it necessitates over-

USAA'S WAYNE PEACOCK ON CUSTOMER-CENTRICITY

Wayne Peacock is the executive vice president, member experience, at USAA. He oversees the company's marketing, channel management, sales, and service functions. He recently spoke with Jeanne Ross (director) and Martin Mocker (research scientist) of the Center for Information Systems Research at the MIT Sloan School of Management about USAA's focus on the customer. Below are excerpts from the discussion.

How has digitization enabled USAA's transition to a customer-centric model?

Its main contribution is that it has afforded us a single, unified view of the customer. Whether a customer is doing business with a USAA property and casualty company or the bank, or has purchased product A, B, or C, he or she has a unique identifier that transcends all of the individual operations at USAA. This has given us a huge leg up in our ability to be customer-centric.

What is USAA's ultimate aim regarding customer-centricity?

We truly aspire to become our members' trusted advisor, to be there every day and at those important times when our advice can help them achieve financial security.

Have the company's efforts toward customer-centricity been reflected in your client-based metrics?

Yes. Our efforts have paid us huge rewards, particularly in member loyalty, member retention, and member advocacy.

Has having a dedicated organization focused on the customer experience enhanced the company's efforts toward customer-centricity?

Yes. This is about serving members in a holistic way and over their entire lifetime. We recognized that to do that really well, we needed to get the company organized around members and their needs rather than around product silos or regulated lines of business. The creation of our member-experience division essentially did that. It integrated our frontline teams and call-center staff in a way that better serves members and better meets their needs by reducing the number of handoffs from one agent to the next. We then tied this into our digital channels and marketing function, because we saw that what our members were going through in life often required solutions that spanned our product silos and distribution channels. If we were organized the way we were in the past, members would be forced to jump across those silos, making for a completely different experience.

What have been the key factors that have allowed USAA to successfully execute an integrated strategy centered on members' life events?

First, we have a passion for serving members. Second, we have a leadership team that is calibrated around one "North Star," which is USAA's mission to serve the military community. Third, our leadership team's close physical proximity means that we're able to come together and talk about things face-to-face and understand both the qualitative and quantitative issues around tradeoffs. And we're getting better and better at doing that. In fact, the level of leadership alignment is probably the most powerful factor behind our success.

haul ing the company's culture to ensure that a paramount focus on the customer's interests becomes firmly embedded in the company's DNA. The company must change its orientation from How can we sell more of product X, Y, or Z? to What does the customer really want, and how can we provide it?

Actively committing to greater use of digital capabilities is an essential first step toward greater customer-centricity. It can also serve as a catalyst for broader customer-centricity efforts. If your company is just starting on the journey, begin by taking a critical look at the company's value chain and determining where digital capabilities might be deployed to support one or several of your core strategic aims. Define your precise objective: for example, We will employ digital technologies to improve our understanding of customer preferences regarding retirement-focused products, and we will use that understanding to improve our offering, customer experience, and, ultimately, our market share. Indeed, a better understanding of customers should be the primary focus for virtually any company starting down the digital path toward greater customer-centricity. Once an objective has been set, start with a pilot, leveraging your company's internal best practices.

For most financial-services companies, achieving game-changing levels of customer- centricity through the leveraging of digital capabilities will be a multiyear journey. But there is no gain in waiting.

NOTES

1. See Customer-Centricity in Retail Banking, BCG Focus,March 2012.
2. See "Winning in the Digital Economy: A New Focus for the CIO," BCG article, July 2011.
3. Peter Weill and Stephanie L. Woerner, "Optimizing Your Digital Business Model," MIT Sloan Management Review 54, no. 3 (Spring 2013).
4. Satmetrix, Net Promoter benchmark study of U.S. consumers, 2012. The Net Promoter Score is calculated by taking the percentage of "promoters," defined as "loyal enthusiasts who will keep buying and refer others, fueling growth," and subtracting the percentage of "detractors," or "unhappy customers who can damage your brand and impede growth through negative word of mouth."

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