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RESILIENCE IN A RAPIDLY CHANGING WORLD: FINDING OPPORTUNITIES IN THE INSURANCE VALUE-CHAIN

In times of uncertainty, insurance carriers can remain resilient and continue to grow by stabilizing, reimagining, and transforming their operations.

Prior to COVID-19, many insurance carriers struggled to meet their cost of capital, ULAE was higher than desired and their speed of response to disruption and evolving customer expectations fell short.

As the impacts of COVID-19 continue to unfold, old challenges are being amplified and insurance carriers will need to grab hold of new opportunities and make bold moves in order to future-proof their business.

Strategy is Probabilistic

Every year insurance companies around the world conduct strategic planning processes. They aspire to set bold new direction, but due to competing priorities, there is limited progress and they often find themselves in a state of strategic inertia. Research by Mckinsey & Company shows that economy-wide, in multidivisional companies, the amount of capital allocated to each business unit from one year to the next is nearly identical; the mean correlation is .92 1.

There are myriad reasons for this, ranging from risk aversion to corporate politics to the idealistic quest for the perfect strategy. There is, however, an empirically substantiated way out; by recognising that strategy is about playing the odds. Research has shown companies that increase their batting average, so to speak, are more likely to succeed[1].

Insurance industry research has also confirmed that insurance carriers can take concrete, evidence-backed actions to move them in the right direction and, cumulatively, improve their odds of long-term success[2]. Finding the right opportunities and making purposeful, bold moves aimed at shifting resources, boosting underwriting margins and productivity, and delivering on a series of programmatic M&A deals can dramatically improve an insurance carrier's odds of achieving economic profit.

While these opportunities may sound instinctive, many insurance carriers fail to pursue them rigorously. By taking a hard look at the potential of your key initiatives against the five opportunities outlined below, you can get a realistic forecast of whether your strategy will improve performance.

Finding Opportunities in the Insurance Value-Chain

Based on their research Mckinsey found five opportunities across the value-chain to put insurance carriers on a positive trajectory[2]. These are:

- Dynamically shift resources between businesses
- Reinvest a substantial share of capital in organic growth opportunities
- Pursue thematic and programmatic M&A
- Enhance underwriting margins
- Make game-changing function improvements in productivity

Opportunity #1: Dynamically shift resources between businesses

Some insurance carriers offer customers too many legacy products that do not produce meaningful profit. These legacy products take attention away from distribution, product development, and policy administration. Instead, companies should reallocate capital to higher return-on-equity (ROE) activities and away from lower-ROE lines of business. Proactive measures are critical given the sector's highly competitive pricing environment.

Opportunity #2: Reinvest a substantial share of capital in organic growth opportunities

Reinvesting earnings in profitable and well-performing businesses is a reliable way to increase economic profit, but finding these opportunities has been challenging for many insurance carriers. Insurance carriers that actively pursue entry into new markets and introduce disruptive products and services will achieve higher margins (and ROEs) thanks to reduced competition at the vanguard.

Opportunity #3: Pursue thematic and programmatic M&A

The third opportunity centres on the use of programmatic M&A, an important approach for insurers with financial flexibility and access to available targets. A programmatic approach to M&A focuses on executing a series of deals in which no individual deal is larger than 30 percent of market cap but in which the total over ten years is greater than 30 percent of market cap. This is often done in thematic areas of technology and capability building or in extensions to new product lines and geographic markets. Typically, programmatic M&A outperforms both pursuing very large transactions and avoiding M&A altogether. By using a series of small, thoughtfully curated transactions to advance innovation and growth, programmatic acquirers have several advantages: they can simplify integration, avoid competitive bidding, and facilitate the exploration of new opportunities without committing large amounts of capital up front. This approach to M&A also enables more effective acquisition of new capabilities, such as digital and analytics.

Opportunity #4: Enhance underwriting margins

The fourth opportunity involves making ROE improvements through better underwriting and lower loss ratios—a particularly important objective given how, as a core competency of all insurance carriers and particularly in the P&C segment, underwriting efficiency can serve as a differentiating factor that leads to higher economic profit. Insurance carriers accomplish these results either through privileged access to particular customer segments or better use of customer or risk data through analytics.

Opportunity #5: Make game-changing function improvements in productivity

Insurance carriers feel continued pressure to reduce costs because of increasing price transparency, the effects of digitization, low interest rates and most recently the COVID-19 pandemic. It's generally recognized that even though the loss ratio has the greatest leverage, insurers benefit significantly from improving efficiency, lowering expense ratios, and increasing revenues per employee.

In the wake of COVID-19 there will be dramatic wave of efficiency and retooling that will occur over the next few years, and many industry executives are embarking on these high-ambition, enterprise-wide efficiency journeys now. When looking to drive next-gen operation value, program investments should be thought through with long-term cost-benefit implications in mind. Investing in such capabilities requires careful planning across all available options, including third-party service providers, insurtechs and fintechs, platforms and tools.

Final Thoughts

Research shows the odds of business success become exponentially larger as insurance carriers embrace several of these opportunities, while a strategy that does not incorporate any of these will likely fail [2]. Indeed, the CEO, CFO, other senior executives, and board members can use these opportunities as a test of strategies brought to them by their teams. Strategies that neglect to engage these actions typically have a one in ten chance of succeeding, compared with one in two (or better) for those that do.

Rather than thinking about strategy as primarily a matter of frameworks and broad themes, leaders should ask themselves what they are doing to capitalise on opportunities along the five dimensions that matter and whether efforts already underway are truly significant.

Insurance carriers looking to find opportunities to future-proof their business should look no further than their claims operations. While not core to the growth or profitability of their business, many insurers maintain their own claims operation to ensure consistency of outcomes, customer service and brand value. Yet, while maintaining their own claim operation, they are using valuable in-house resources that may not be in alignment with the overall growth strategy of the organization.

Insurance carriers would be wise to consider the guidance of the McKinsey report. This would mean dynamically shifting resources from an in-house claim operations model to an outsourced TPA model that would allow the organization to reinvest a substantial share of capital in organic growth opportunities while making functional improvements to productivity.

The Gallagher Bassett claims solutions model is able to provide superior outcomes, delivered through high-quality and aggressive claim management. Benefits of the model in the insurance value-chain include:

- **Increase profitability** through superior outcomes, powered by Gallagher Bassett's best practice claims management and cost containment strategies to reduce loss costs and unallocated expenses.

- **Brand alignment and enhancement** with a tailored customer experience based on go-to-market strategies.

- **Outpace your competitors** using analytics and digital capability powered by our Luminos claims system, to enhance the "human element" of claims management and improve claims decisions.

- **Proactively address claims industry challenges** such as talent recruiting and development, the ever-changing regulatory landscape, or managing catastrophe surge claims

In summary, whether it's the claims operation or other areas of an insurance carrier's business, improved economic profit is within reach for those willing to re-imagine and transform their business model and inject a newfound objectivity into their strategic processes.

SOURCES

[1] *Chris Bradley, Martin Hirt, and Sven Smit for Strategy Beyond the Hockey Stick: People, Probabilities, and Big Moves to Beat the Odds, first edition, Hoboken, NJ: Wiley, 2018*

[2] *How to win in insurance: Climbing the power curve, by Alex D'Amico, Mei Dong, Kurt Strovink, and Zane Williams*

GALLAGHER BASSETT

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