IIS – Leaders of Tomorrow Program Final Mentorship Paper submission

Digitalization

Turning an opportunity into competitive advantage

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Outline

"Digital" is becoming a top priority for many CEOs and certainly one of the trendiest buzz-words at the moment. According to the Towers Watson Global Insurer Survey (2015), Technology challenges and talent needs are the two top-ranked resource concerns among both Life and P&C companies. Indeed, the evolution of digital technologies has already disrupted many other industries that were unprepared or simply did not see how new technologies and changing consumer behavior would impact their dominant business models.

It is clear that this brings opportunity for a player to develop capability to disrupt the market. However on the other hand brings fear to players that have developed large and elaborate traditional distribution networks who see this as a threat due to channel conflict and/or cannibalization.

The thought of billions of devices connected to the internet is a scary one, especially for insurance companies with old legacy systems and data privacy concerns. It is important to think about what areas to focus on first, and not be overwhelmed by numerous devices/initiatives.

We explore how the digital revolution can provide multiple opportunities for insurers, namely:

- Increase Sales by Online Fulfillment
- Feed or Enable the Agent distribution Network
- Improve Customer Retention by offering better service
- Reducing claims experience by investing in wearable technology
- Enhance pricing ability by combing internal and external data

Here we examine the opportunity and scope for companies to develop a serious digital proposition, with a particular focus on in Asia. We start with the context and opportunity, and subsequently move into market trends and development, finally into the evaluation of a design strategy.

Context: How have companies grown in the past?

Historically companies have focused attention and energy on product innovation or distribution development. Customer level initiatives have not featured heavily in the inner strategy of insurance groups in Asia.

Back in the late 80s and early 90s, many executives moved out to Asia. This was in response to International Groups aspiring to have Asia contribute a significant share of business towards the Group Revenues and Results. Early movers[1] in this area were Manulife and Prudential plc[2]. It was fairly straight forward to predict the waves of growth that were going to come (based on items such as economic growth, underpenetrated insurance markets).

Let's take a closer look at Prudential for a moment. Prudential Asia CEO at the time, Mark Tucker, placed bets in Bancassurance (signed regional deal with Standard Chartered) and Unit Linked (created task force of 6 or 7 professionals going around the region, combined with 10 locals to execute on the ground). According to Prudential Executives, a task force of circa 50 people was created from Prudential Global HQ who were dispatched to Asia with the objective of following these two major initiatives.

[1] Excluding AIG who have been active in the region for decades

[2] In this entire document "Prudential" is intended to be Prudential (UK) plc

- Bancassurance was identified as an opportunity at the time as Insurance penetration was very low and there were significant savings in low yielding bank deposits in Asia. Prudential saw an opportunity to develop bancassurance with a view to converting idle bank deposits into life insurance savings products. In doing this, they signed a (pioneering at the time) long term agreement with Standard Chartered Bank.

- Unit Linked Insurance was an underpenetrated market at the time, and Prudential was a first mover in designing such products that allow the customers to benefit in the upside in market performance. This achieved traction in Asia due to the appetite of the customers to accept a certain level of volatility in the markets.

The Digital revolution has the potential to be the most disruptive tool of the Century, available to insurers. Looking back, other major disruption tools in the past were: the computerization of hard data from manual documents, real time pricing engines, and quantitative risk management. Many of these are technology related, though none would even compare to the scale of importance that digital could have. This is largely motivated by the fact that Insurers are set up in a very traditional fashion, and could be ripe for disruption. Let's take a closer look…

Context: How are insurance companies set up today?

We have traditionally been manufacturers of products, and the Sales function was outsourced to distribution channels. Our role as insurance companies has evolved to providing service and customer fulfillment.

This has led to creation of internal groups divided by distribution channel. On the life side this could be typically grouped by: Agent, Bank, Corporate, and Direct. On the P&C side this could be Broker, Agent. This model led companies to be organized in silos (by distribution channel which in turned feared disruption), being led by their dominant channel, and hence limited cross fertilization between such channels. For instance, for companies with a strong agent network or auto dealership network; they may have been reluctant to develop a serious direct channel. Even some of the household insurance names do not offer an online fulfillment of a simple auto insurance policy, where the website simply asks you to contact an agent or dealer.

We know that insurance among other industries is one of the last ones to adapt its model based on technological advancements. However, this is not so much about technology as it is about the radical change seen in behavior of customers. While their need for insurance might not have moved a lot, the expectations[3] have moved making it critical for insurers to close the gap.

The Opportunity: Understand the need and identify pockets for impact

The need for digitalization can be easily defined by studying the key changes in customer behavior affecting us:

- Customer's expectation of turnaround time has escalated tremendously
- Customers expect easy and seamless support
- Customers want the highest level of transparency

[3] See Exhibit 1 at end of document outlining a Harvard Business Review Survey

- Customers expect Omni-channel integration
- Customers expect you to monitor their communication and respond quickly
- Customers are more independent than ever – they want self-service

Impact pockets: Thinking strategically, Insurance companies have 4 main resources: Time, People, Money, and Information. We can think further to assess where the opportunities may lie…

  - Build new business
  - Retain customers
  - Enhance core strengths and capabilities

Digital can mean many things and may have different implications to different players. Some digital driven motivations are listed below together with examples of how they could be relevant:

Motivation	Examples
Build Business	Online Point of Sales Enablers for Existing Distribution Channels
Retain Customers	Improve Customer service Making communication more relevant by using data Net Promoter Score fulfillment
Build Capability	Improve operations e.g. data handling Agile Pricing Data analytics turning into commercial insights

Zoom in: Building Business

1. Digital Fulfillment

   There have been several attempts at offering a Digital offer to customers either as a "Pure Play" or by combing with a contact center. Let's look at a few examples:

   - **Lifenet** in Japan. This was set up as a Pure Play (Life insurance only) with no contact center. There was tremendous success initially in the Term Life area due to a significant price discount compared to other channels. The price advantage was sourced through a zero commission model and very low expenses (especially through no call center). Sales growth has started to suffer in recent years, perhaps due to the lower customer service. Lifenet has a difficult decision ahead of them as to whether to preserve their "pure" direct model (cost advantage) or develop a call center to respond to recent pressure. The market has reflected such sales drop in the company valuation:
     - In 2012 Lifenet completed an IPO with an implied valuation[4] of JPY 42.2 billion (2.6x P/B based on their 2012 equity)
     - In 2013 Swiss Re acquired a stake in Lifenet with an implied valuation of JPY 30.4 billion (1.9x P/B based on their 2013 equity), thus representing a significant discount on their IPO valuation.

[4] Implied valuation of 100% of Lifenet.

- **Cosmos Direct** in Germany. This is an online and telephone business model combined with a very sophisticated contact center. This started off as a pure Term Life offer (similar to Lifenet in the sense that the model was driven off a zero commission and price advantage approach); though has expanded out into Unit linked, Pension, Auto, Personal Property and Personal Liability insurance. Their approach is driven through price advantages and extreme simplicity in fulfillment. For instance, they are able to issue a Life insurance plan based on 7 underwriting questions that can be done online in a single go. The commonality in their offer is simplicity (no complicated products are offered), and their customer base is clearly defined as a young professional who is internet savvy (this model would struggle in markets where such niche segments are small). Cosmos has seen success as they are now the largest Direct Life insurer globally and the largest writer of Term Life in Germany.

- **Direct Line** in the UK. This company needs no introduction. A pioneer in digital offerings in P&C starting with telephone based auto insurance, and they offered a full online fulfillment as early as the very early 2000s (while most companies were still suffering the hangover from Y2K!). Their offer is now extended across all personal lines P&C products and also multi-channel by combining with retailers and affinity groups such as Sainsburys and Tesco. Their business is one of the largest direct insurance operations globally. Their main challenge is in capital and funding as they do not have a stable shareholder base. A consequence of this is that they need to manage their capital by reinsuring a large proportion of their business (>70% gets reinsured out via quota share), and thus transfer significant profits to the reinsurance market.

Opportunities have also come from non-insurers:

- Online Insurance Portals, similar to what we used to call "Managing General Agents". A clear example of this is the entry of **Greenstone**. This gives rise to non-insurance companies to enter the market as customer facing champions. Greenstone is a simple platform that packages insurance offers (from product underwriters) into an online offer that customers can visualize. This presents significant disruption since Insurers will become pigeonholed into product providers and become even further away from the customers.

We can note that there are several examples of digital fulfillment models around the world, although having said that most of the large successful ideas come from the smaller groups. The larger groups who have established distribution channels are hesitant to introduce such new channel as they are frightened of alienating their main source of income.

2. Sales Force Enabling

Above we saw players devoting attention to a pure digital model. However players who have large existing networks are taking a different approach…

- Ping An is investing in Venture Capital funds not only as Limited Partners, but also to capture innovation potential through their access.

- AIA has invested in "Nest" in order to gain access to technology[5], in turn to empower their agents.
- Prudential has been investing in Digital as a tool to offer lead generation to its sales people and allow their agents to better understand their customers.

What is interesting here is that while the traditional focus companies are not avoiding the Digital evolution; they are simply adopting it in a way that suits their strategy.

<u>Zoom in: Retain Customers</u>

1. Improve Service

   - Omni Channel

     This is an initiative to provide a single interface to the customer. This comes from a historical legacy within insurance companies that we are divided into internal silos (typically based on distribution channel). Omni channel aims to provide a single view to the customer so that they are able to service their policies through any means, be it through an intermediary, direct on the website or through a physical presence. Met Life has done a good job in this respect.

     In future, customers will choose[6] how they want to interact with their insurance company. Look at how we ourselves interact with Banks: we choose whether we want to go into branch/ use ATM/ online banking…

   - Contact Center Excellence: Other industries have made significant strides in this area, much beyond what insurance groups have been able to pull together; and a powerful call center could sit alongside a pure online model.

     - Some industries have developed algorithms to assign the "most appropriate" phone operator to the customer rather than the "next in line". Typically calls get put into queue and the next available operator would pick up the call. More modern companies have put together an algorithm to assign someone with a similar background to the caller to take the call. For instance a mother of two children may be assigned to an operator who is also a mother. This has the opportunity of significantly improving customer service.

     - Other industries have developed different algorithms that would detect the mood of the customer while on the call. So based on analyzing the voice pattern and tone of the customer, the system would put an image on the screen of the operator to indicate the mood (☺ / ☹) and this would trigger a certain action from the operator to tailor to the situation. This also has the potential to improve customer service.

[5] AIA also has two floors of its Stubbs Road HQ dedicated to Digital.

[6] See Exhibit 2 at the end of this document showing a Bain study on how customer behavior is changing

- Payment Mechanisms

  Despite the Silicon Valley boom taking place in the early 2000s, Insurers are still today implementing an online fulfillment facility. We are in an industry where direct debit is not a standard tool, and hence such payment collection mechanisms were implemented only recently.

  HSBC has launched a FX margin application (buy and sell currency from your phone) to suit the Gen Y population. Gen Y's demand the flexibility to browse the internet freely during the working day, while employers have been limiting internet access at the workplace. Hong Kong is a market where people like to watch and trade the financial markets. This became more difficult with company internet security policy. Such mobile application allows users to buy and sell currency positions freely at ease, so far mobile application is having a huge take-up. This has a use-case for young professionals with busy lives and IT restrictions. The limitation is that it could be restricted to a single market and single niche market segment.

Zoom in: Enhance Capability

Not only in terms of direct business enhancement, we can also look at areas to improve business intelligence to make better underwriting decisions, from digital generated data. Imagine if sensors could notify a home-owner remotely through a mobile app about a burst pipe or remotely shut down the water supply.

1. Agile Pricing Engines

   Competitive pressures over the last decade have reflected in how insurer pricing metrics have developed from simple claim models to complex peril based models overlaid with highly refined customer lifetime values that consider portfolio goals.

   Most insurers regularly monitor claim costs using complex models, many of these with customer insights or geographical classifications leveraging up-to-date customer information combined with rich external data. Such pricing enhancements have often improved combined operating ratios. Up to the minute sales information allows for pricing agility – insurers operating in more dynamic markets are realizing the benefits that can be achieved by being able to adjust prices within hours. Key benefits are: pricing sophistication, speed to market, operational efficiency and accuracy.

2. Enhanced risk control – Wearables and Glasses

   It was found by Zurich Global Corporate that the main cause for accidents in their commercial truck insurance portfolio was due to driver fatigue. In response to this, they had developed some connected glasses (with assistance from Silicon Valley). This is particularly interesting as it is a non-retail use of digital technology.

Fleet/Truck drivers would wear these (connected) glasses that would send retinal data back to a central hub. An early indication would be detected when drivers started showing signs of fatigue. If so, an operator would call the driver to force them to stop and rest. Key benefits include: better understanding of driving patterns and reduced claim costs. A further value proposition is delivered to the client in reduced truck damage frequency (and hence higher productivity).

3. Dynamic Pricing – Discovery and Vitality

   Discovery[7] has been successful in implementing dynamic pricing (a form of Usage Based Insurance[8]) into their life insurance plans by promoting healthy behavior and rewarding this with relevant price discounts on their insurance plan. Discovery has rolled out this initiative in partnership with Ping An in China, with AIA across Asia, with Generali in Europe and most recently with John Hancock in the United States. Advantages are that they can avoid adverse selection and promote healthy lifestyles in their customer base.

Selected Examples of Non-Insurance Initiatives

Renault (Data Gathering)	Connected Car that gathers data (apparently 60 different types of data) on the driver and driving pattern. They wish to sell this data onto 3rd party companies, including insurers.
Shazaam (A new source of revenue)	Shazaam is a trendy music application which allows users to obtain the name of a song (unknown to them) by simply playing 10 seconds of the song into the app. They are diversifying into predictive analytics on music trends. By compiling their databank of music requests, they are able to generate and predict future music trends. They have started selling such data to actors and 3rd party music companies. This has led to a new source of income for them.
Nespresso (Engaging customers into the design)	Nespresso typically has two segments of coffee drinkers: retail and club fans. The retail customers typically enter the physical shop and purchase the Nespresso products on offer. For the club fans, they tailor a user experience that allows them to contribute to the taste and build their own product in a DIY sense. We could see this concept developing in insurance where one day customers can "build" an insurance cover online.
KLM (Mediocre airline in terms of product and service, with great Facebook page)	In 2010, the Icelandic ash cloud incident clogged phone lines. They resolved this by implementing a communication channel on social media (with the help of 150+ volunteers, round the clock) via Twitter and Facebook; allowing customers to interact with their families overseas. By monitoring data collected on Facebook, this prompted them to build a new communication channel with customers.

[7] Discovery is a South African Insurance Group heavily focused on innovative and combining wearable and lifestyle behavior into insurance pricing
[8] Usage Based Insurance (UBI) is a recent innovation, most visible in Auto Insurance, where the price customers pay is determined by consumption (Pay As You Drive/PAYD) or behavior (Pay How You Drive/PAYD).

	This produced customer satisfaction that was inspired by the KLM team looking onto their social media platform to listen to what customers felt was important, and reacting appropriately. Today, KLM responds to customer enquiries on Facebook within 24 hours; while email and traditional channels take longer.

Summary: Designing a way forward

We've learned a lot of the Digital world by looking around the world for examples, and also benchmarking with ideas from outside of the Insurance sector.

There is no single solution for a Digital play. Companies will need to design specific Digital proposition based on what their company strategy is. We've seen above that players have different motivations to work with Digital:

- Increase Sales by Online Fulfillment
- Feed or Enable the Agent distribution Network
- Improve Customer Retention by offering better service
- Reducing claims experience by investing in wearable technology
- Enhance pricing ability by combing internal and external data
- Invest in Venture Capital in order to have access to Technology/Innovation

Hence the further development of digital capability will highly depend on what the main motivation is. Following this we can ask ourselves the following considerations to define our strategy:

1. Define the Digital Vision: What is our aspiration?
2. In what spaces will we play: Clear priorities and focus
3. How will we win: Clear plan of action
4. Distinctiveness: What differentiating capabilities do we need?
5. Implementation of the relevant support and information infrastructure do we need

One thing to be very careful of is to ensure that we do not OVERDO the digital initiative. It can be easy to think that there are so many ways to initiate and adopt digital. What is important is to tailor the digital need to the specific needs of the business.

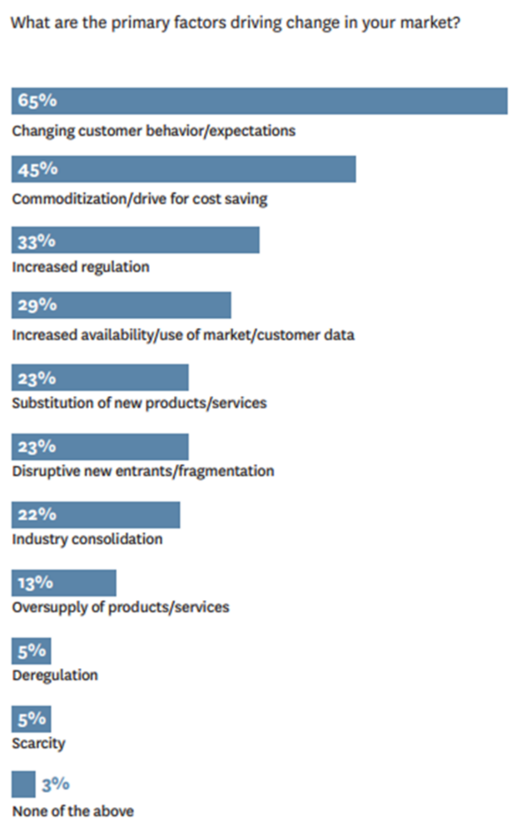
Gathering and understanding data has always been at the heart of what insurers have been doing, and insurers have already built data analytics teams. The main difference is that we now have much more data. One reality is that digital media radically transforms the way that customers interact with their insurance companies. Digital media offers unparalleled access to customers but does require a fundamental way in which the company things. In order to succeed, insurers need to create an ongoing dialogue with customers.

Any plan should include representatives from all department and functions, and have communication plans to educate the team on embracing digital media. After all, digital media is about making lives easier for customers.

Typical challenges of how such things would be implemented could include:

Repeatability vs. Flexibility	A new tool could either be designed for a single company/market, or could be leverage across an entire region. Given the earlier example of HSBC where that specific application is only relevant for a single segment in a single market – how easily would it be to replicate a solution in multiple countries?
Local customers	Typically insurance customers follow local behavior with little room for standardization across a region/continent. This will affect how features and benefits are to be designed, and to some extent, how costs can be leveraged for the company
Top Management in the country needs to buy in	It was mentioned earlier how companies are already organized into silos. A mind shift change will need to take place at company level in order to allow to a new way of approaching customers not by channel but by segment.

Exhibit 1 – Changing Customer Expectations (HBR article)



Source: Harvard Business Review

<u>*Exhibit 2 –Customer Behavior (Bain & Co article)*</u>

Source: Bain & Company