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Open innovation – enabling insurers to adapt and thrive

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DEAR READER,

Welcome to edition 54 of the Capco Institute Journal of Financial Transformation.

In this edition we explore recent transformative developments in the insurance industry, through Capco's Global Insurance Survey of consumers in 13 key markets, which highlights that the future of insurance will be personalized, digitalized, and connected. Other important papers cover topics high on global corporate and political agendas, from ESG and climate change to artificial intelligence and regulation.

The insurance industry has been undergoing transformation in recent years, with insurers responding to the needs and expectation of tomorrow's customers, for products that were tailored, flexible, and available anytime, anyplace, and at a competitive price.

COVID-19 has accelerated such change, forcing insurers to immediately implement programs to ensure they can continue selling their products and services in digital environments without face-to-face interaction. New entrants have also spurred innovation, and are reshaping the competitive landscape, through digital transformation.

The contributions in this edition come from a range of world-class experts across industry and academia in our continued effort to curate the very best expertise, independent thinking and strategic insight for a future-focused financial services sector.

As ever, I hope you find the latest edition of the Capco Journal to be engaging and informative.

Thank you to all our contributors and thank you for reading.

Lance Levy, **Capco CEO**

OPEN INNOVATION – ENABLING INSURERS TO ADAPT AND THRIVE

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ABSTRACT

The insurance landscape has changed and continues to evolve at pace. Fueled by record levels of startup investment, new market entrants encroaching, and BigTech circling how should insurers respond? How can they balance the pressure of near-term commercial requirements and effectively manage resources today while simultaneously driving innovation to ensure they are still relevant tomorrow? Indeed, is this even possible? What is for certain is that this cannot be achieved with an incremental approach to transformation alone. This paper explores the critical role that “open innovation” – the partnering with external innovation – will play in enabling incumbents to adapt and thrive in this rapidly changing market.

1. INTRODUCTION

As the world slowly adapts to a “new normal”, there is a creeping realization that for most, if not all, incremental transformation will soon not be enough to ensure longer-term relevancy.

The market has changed and will continue to do so at an even greater pace. New competitors are entering and the success stories of tomorrow lie simply with those that can offer a range of innovative and flexible products to customers in a way that interests them.

360% | THE INCREASE IN INSURTECH INVESTMENTS, GLOBALLY SINCE 2015

The advantages of big business have slowly crumbled away. Companies now need to look further ahead. They need to move beyond “agile” and become “predictive”. To be comfortable being uncomfortable. To embrace risk, become experimental, and potentially significantly reimagine their businesses.

Over the coming years, new entrants from BigTech (e.g., Amazon) and others from outside of the industry (e.g., Tesla) will fundamentally change the construct of insurance as we know it.

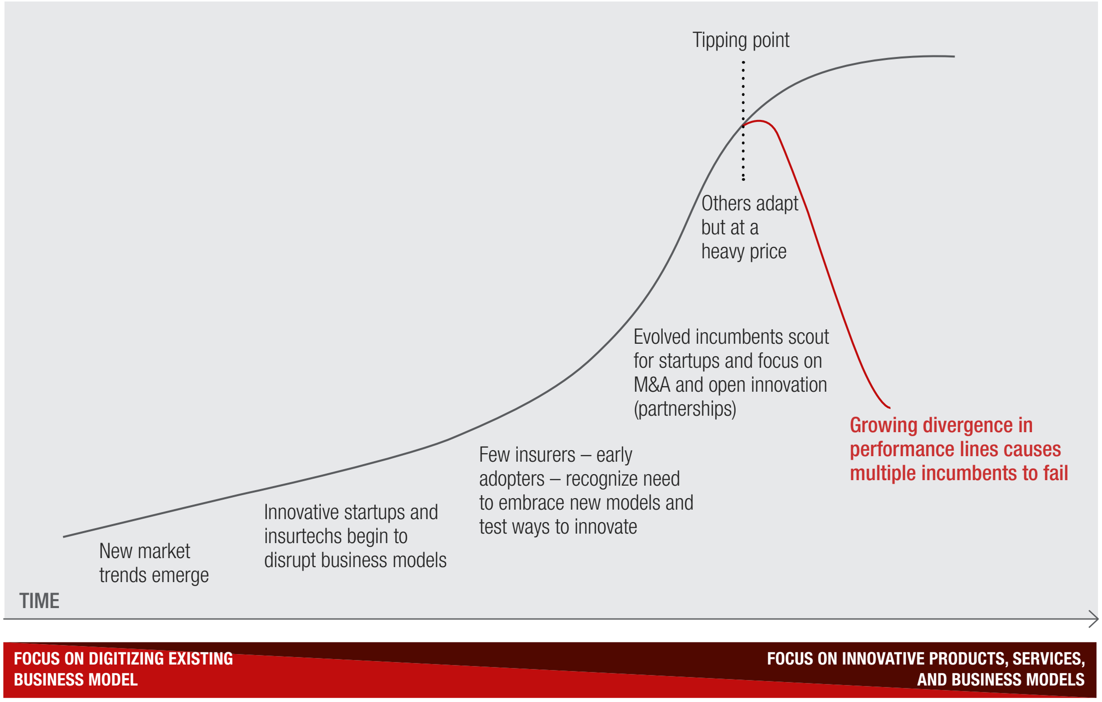
This paper explores the critical role that “open innovation” – the partnering with external innovation – will play in enabling incumbents to adapt and thrive in this rapidly changing market.

2. WHAT IS OPEN INNOVATION?

Open innovation is the term used when a company does not just rely on their internal capabilities for innovation. Rather, they use one or multiple external sources to drive innovation. Most commonly, it is used to reference the partnering with external insurtechs.

It is well recognized that insurance has barely changed in the past 100+ years. It is easy to attribute this to an inability to innovate, but in truth most companies have not seen the strategic imperative to change. Most are incentivized on performance no further than three to five years out. It is almost an inevitability that near-term commercial pressures take priority.

Figure 1: The changing insurance landscape



Whilst the past couple of years have accelerated the digitization of the industry, companies now need to think beyond moving their operations online and start to focus on new innovative products, services, and business models.

Over the coming five to ten years the industry will see more change than ever before. Maintaining the status quo, doubling down on digitization, and transformation, and not innovating, is now simply not an option.

The market will continue to evolve, and it will reach the point that when – not if – there is sufficient strategic imperative to respond, it will be too late for the incumbents. Either the resources will not be there, or the innovation capability will be too immature to respond appropriately. And so that leaves us with an industry with little experience in transformative innovation and yet one that needs to deploy radical change seemingly overnight.

The good news is it can be done. And it can be done primarily through open innovation.

3. THE BUY VERSUS PARTNER VERSUS BUILD CONUNDRUM

There are some well-known fundamentals that need to be in place for successful innovation: an appropriate culture and a forward-thinking CEO being two of the most important. But the actual innovation toolset is not particularly complicated. The options are to build it yourself, to buy it in, or to partner with external innovators. On paper, there is always a good argument to build it internally. And it is often a preferred route.

Companies already have the ideas, talent, assets, competencies, capital, and, most importantly, the customers. Combined with familiarity of the internal operations, it means that it should be easier to develop, produce, and ultimately sell what has been created, whilst maintaining IP and any trade secrets.

At the same time, it is important to also recognize that most companies tend to be inward looking and lack market orientation. They have processes, structure, and culture that tends to be complex, risk-averse, and siloed, and higher-risk projects will often be deprioritized.

What we have seen is that internal innovation rarely works out. Businesses struggle to create the right environments for ideas to incubate, let alone scale. Governance models, budgets, and controls throttle the opportunity for success.

Those that have experimented with building internal capability – whether it is the setting up of innovation labs or teams dedicated to R&D – have indeed now mostly closed those units and shifted focus to working with the external innovation ecosystem.

And so that leaves us with “buy” or “partner”.

Mergers and acquisitions provide almost immediate access to resources, capabilities, revenue, or even clients. From a time to impact perspective, it is a highly attractive option. Whilst the difficulties of integrating new acquisitions into an existing business are well documented, they are not insurmountable. The greater barrier is the frequency and scale this can be done at, especially when the application of strategic experimentation must exist. With experimentation comes failure. For mergers and acquisitions, there is a very real and significant cost to failure.

Whilst we are likely to see continued growth in mergers and acquisitions, the number one route to successful, rapid, and effective innovation is through partnering with insurtechs, or as it is also known, open innovation.

Open innovation provides access to technology and businesses that are already built, have validated traction, and established market fit. The financial commitment will be significantly lower and the likelihood of success greatly increased.

To best capitalize on the opportunity open innovation brings, companies must align potential partners to where the greatest need and opportunity lie. They must look beyond the near-term, understand the trends that will be impacting the industry over the next five to ten years, and start scouting external innovation opportunities that can help them adapt and thrive. Once this becomes a regular and distributed capability across organizations, it will not be long before open innovation will become the most important weapon in the innovation armory.

In the first half of 2021, we tracked more than 200 new partnerships across insurers looking to bolster service provision with data analytics, AI, and machine learning, as well as those looking for distribution. This currently represents a year-on-year open innovation growth of around 40%.

4. THE ROLE OF INSURTECH IN OPEN INNOVATION

Insurtech, as a term, has been around for the past five years. For some it is insuretech, for others InsurTech. However it is written, the label provides a catch-all for the technological innovations impacting the world of insurance.

When publishing our recent Insurtech 100 – a list of the leading insurtechs globally – we analyzed close to 200,000 startups and scaleups that have a material impact on the insurance industry. What is most interesting when analyzing these insurtechs is that most now actively position themselves as “enablers” to the industry as opposed to a once commonly held perception of “disruptors”.

To date, only a very few full-stack insurtechs have “disrupted” insurance. Most have failed to realize sufficient traction and scale to be considered genuine competition to the established players.

The vast majority are companies designed to work with incumbents to improve or evolve their offering. When considering the number of insurtechs out there, the maturing of the market, and the mutual need to work together, it is no wonder that open innovation is here to stay.

No longer is the rhetoric “death by a thousand papercuts”, rather it is a more sophisticated and nuanced journey of ecosystem collaboration and experimentation. Where this becomes even more exciting is when considering the future of insurtechs.

Every year, an increasing amount of is poured into insurtechs – both emergent and more established. Since early 2020, we have also seen a rise in investors from outside the industry entering insurance, in addition to the private equity entering the earlier markets, both adding more capital to the glut already available.

$84.5bn | TOTAL GLOBAL INSURTECH INVESTMENT IN 2021 (Q1-3)

45% | OF ALL INSURTECH DEALS WERE EARLY STAGE INVESTMENTS

So far this year we have tracked over U.S.$45 billion of investments across 914 deals – more than any comparative time period. Most interesting, when considering the future of the industry, nearly 45% of all the deals went into early stage insurtechs – Series A and below.

At the other end of the spectrum, we have also seen a growing spate in IPOs. Whilst this indicates a maturing market, the media interest surrounding the multi-billion dollar valuations acts like a magnet attracting new entrepreneurs from within and outside of insurance. Plus, the IPOs also release capital back to their early investors to redeploy into new innovation.

All in all, the future for insurtech looks bright. As does the opportunity for incumbents to work with these businesses to jointly develop new futures, assuming, of course, they can realize the value these conditions might represent.

5. DEVELOPING OPEN INNOVATION CAPABILITY

Open innovation will become a critical enabler in delivering both short- and long-term innovation success. Developing robust processes for scouting, tracking, and partnering with insurtechs will be critical to developing the products, services, and business models of the future. However, as with any form of innovation, there must be buy-in to it from leadership. And ultimately the knowledge of how to scout for and work with external innovators must be disseminated across the individuals working in the business. This in itself can take time and why we stress the importance of engaging with this topic early.

Of those incumbents that have developed successful open innovation processes, almost all now make use of Insurtech Scouting platforms – Sønr being one of the examples of this in today's market. By tracking millions of companies around the world, Sønr is able to provide data-led insight on the latest market trends – both in the short and long term. Additionally, the platform provides detailed information on the startups and scaleups reshaping insurance, as well as key strategic intelligence on how other incumbents are innovating.

When Sønr is applied across a business, individuals are able to get an external lens on the art of the possible, a better understanding of the trends that will be impacting their area of expertise, and the ability to shine a spotlight on the individual companies that can help accelerate their transformation or innovation roadmaps.

Additionally, with built-in open innovation tools, knowledge and best practice can be shared across the business and ensure teams are working as efficiently and effectively as possible.

But an insurtech scouting platform is just the first step to successful open innovation.

Incumbents need to reach out and connect with the insurtech ecosystem. They need to be considered and selective as to whom they engage. Relying on inbound enquiries from startups is not recommended – you need a proactive approach to identifying and engaging those of greatest potential value to your business.

This is a critical step to ensure that your efforts are aligned to a need or opportunity. This has proven time and again to be the single most effective route to making a partnership translate into value for both parties – a fundamental requirement after all. It will result in the teams who have to work on the project recognize the value it brings; the leaders signing off resource and budget recognize the cost savings and expedited time to value.

Then comes the process by which one engages a startup or scaleup. Depending on the nature of the opportunity this will, of course, vary, but there are processes that can be applied to validate opportunities within a matter of weeks, with minimal financial commitment and resource interruption.

Finally, it is worth pointing out that this must not be a one off. A single successful partnership, and even an innovation award off the back of it, does not mean you have cracked it. Innovation needs to be continuous, and open innovation, in particular, woven into the day-to-day planning and execution.

6. NOW IS THE TIME FOR OPEN INNOVATION

In ten years' time, people will not buy insurance the same way as they do today. Nor will the construct of insurance be the same.

Let us consider just one trend set to change the market – embedded insurance – the ability to get coverage at the same time as a product or service is bought.

There is no question that over the next decade, the e-commerce and BigTech giants such as Amazon and Alibaba will dominate the embedded space. They already have control of the customer journey, as they hold the transaction data, device data, plus customer profiles, trust, and communication.

By embedding insurance, these tech players get to leverage their hard-earned brands into additional high margin revenue streams and create a deeper, longer relationship with their users.

It is also worth pointing out that consumers are increasingly willing and able to make very high value or complex purchases – such as cars – online. In short, society's accelerated consumption of digital services will create a similar acceleration towards embedding insurance in the digital world.

So where does that leave the insurer of today? Or the broker?

Over the past few years, there have been a handful of companies that have experimented with innovation seriously. Whilst there has been plenty of money spent and much criticism on what has and has not worked out, these companies now know what tools they need to innovate and have refined and embedded the processes enabling them to deliver meaningful results.

This is a huge advantage for them. They have put themselves in a position where they can continue to shape their own future, respond and adapt to external threats with speed, and be open to whatever change the industry sees over the coming years.

If this is not true for your company, it is not irrecoverable ... as long as you act quickly.

The long and short of it is the market is moving fast and will continue to accelerate. To be part of that future, continuous innovation will be critical. And the quickest, low-risk, greatest upside route to innovation? That's right, open innovation.

Those that embrace open innovation will build the capabilities required to adapt and thrive. Those that do not, face the very real danger of becoming irrelevant. Maybe not in the next three to five years, but quite possibly in the next ten.

7. CONCLUSION

Todays' insurance landscape is set to change significantly over the coming years and open innovation will play an increasingly critical role in enabling companies to predict, adapt, and remain relevant.

Companies must develop their capability to track and monitor the market; no longer is it sufficient to analyze the activity of your traditional competitors. Companies must keep across the trends impacting the industry, predict and understand the risk of new entrants from outside insurance, and become intimately knowledgeable on the startups and scaleups that best align to their needs and opportunities.

Once market intelligence is rooted and distributed across the business, it is then time to create both the culture and environment for open innovation to succeed, as well as the processes to scout, test, and scale new products and services.

If there is one new addition to your 2022 planning, it is open innovation. You cannot and should not wait to better understand the market and start experimenting and creating new futures for your business.

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Capco, a Wipro company, is a global technology and management consultancy specializing in driving digital transformation in the financial services industry. With a growing client portfolio comprising of over 100 global organizations, Capco operates at the intersection of business and technology by combining innovative thinking with unrivalled industry knowledge to deliver end-to-end data-driven solutions and fast-track digital initiatives for banking and payments, capital markets, wealth and asset management, insurance, and the energy sector. Capco's cutting-edge ingenuity is brought to life through its Innovation Labs and award-winning Be Yourself At Work culture and diverse talent.

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