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The future of insurance companies: Prospects from an interview study

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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**

THE FUTURE OF INSURANCE COMPANIES: PROSPECTS FROM AN INTERVIEW STUDY

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ABSTRACT

Like other traditional industries, the insurance industry is faced with the challenge of mastering the effects of digitization and digital transformation as well as other trends. To investigate the question of which business models will dominate the German insurance sector in the future, a total of 32 semi-structured interviews were conducted with representatives from the middle and upper management of German insurance companies. As a result, five business models, such as peer-to-peer approaches, could be identified, which the experts evaluated according to criteria such as complexity, risk, and radicalism.

1. INTRODUCTION

The insurance industry, like other industries, faces the challenge of mastering the effects of digitization and digital transformation, which has implications for various aspects of the value chain, including customer interaction, sales, claims, as well as the insurance products themselves. From a more holistic perspective, just like the implications of what happens on the financial markets and the changing demographic structure of customers, among others, digitization and digital transformation have implications for the entire business models of insurance companies. Yet, despite these ramifications, business model innovation in the insurance sector has received little attention in academic literature.

In fact, there is no consistent definition of the term "business model innovation", or "business model" for that matter, in the literature to date. The considerations presented in this article are based on the definition by Zott and Amit (2009).[1]

A business model innovation occurs when there are (a) changes in the content of business activities, (b) innovations in the way in which these activities are linked to one another, and/or (c) changes in responsibilities. One example is the outsourcing or commissioning of services for the realization of business activities that were previously implemented internally in the company. Business model innovation is also subject to a wide variety of influences that can either hinder or promote its realization. These can come from inside or outside the company.

In order to add to our understanding of digitization and digital transformation in the insurance industry, we undertook the following study. We conducted a total of 32 semi-structured interviews with representatives from middle and senior management of German insurance companies. The questions put to them included: 1) What types of business models currently exist in the industry and which are seen as most promising in the future? 2) What are the success factors for

[1] Zott, C., and R. Amit, 2009, "The business model as the engine of network-based strategies," in Kleindorfer P. R., and Y. J. Wind (eds.), The network challenge, Wharton School Publishing

business model innovation in the insurance industry? and 3) What are the potential barriers to achieving business model transformation?

The interviews were recorded, the data transcribed and anonymized, and then categorized, i.e., analyzed, using a coding procedure.

2. TRANSFORMATION AND POTENTIAL FUTURE BUSINESS MODELS OF INSURANCE COMPANIES

Looking at the core of the value chain, it can be stated that all elements – including product development, underwriting, operations/claims, marketing/CRM, distribution (channels) – are in a process of change. Another finding of the study is that the elements of the value chain are changing together. This reflects the close connection between the individual elements of the value chain. Furthermore, all interviewees confirmed the thesis that the importance of partnerships for the insurance industry will increase.

The importance of five potential business models has been evaluated in the interviews and these have been assessed against predefined criteria.

Provided below are short descriptions of the possible future business models:

- **IoT and prevention:** damage prevention generally with the use of internet of things (IoT).
- **Make more of it:** using a company's core competencies to exploit new business models, outside of the core business.
- **Orchestrator:** reduction of the value chain to a few core functions, collaboration with many external partners.
- **Peer-to-peer (P2P):** modified collective formation often with promise of repayment if no damage/claims are incurred, the role of the classic insurer recedes.
- **Caretaker:** insurers not only provide compensation in the event of a claim, but also support the customer in related matters, usually with services.

The legend used for evaluation criteria were:

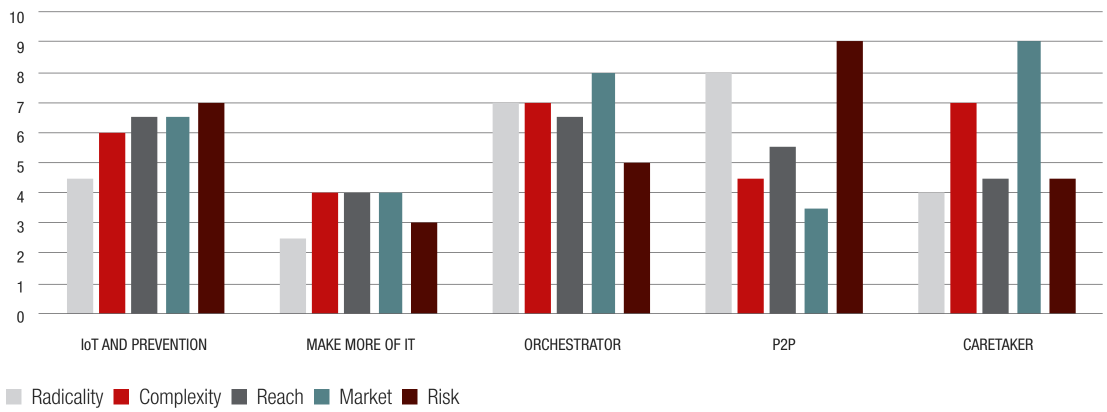
- **Radicality:** 1 is incremental, 10 is disruptive
- **Complexity (number of elements of the business model that are changed):** 1 is few, 10 is all
- **Reach:** 1 is new to the company, 10 is new to the world
- **Market:** 1 is niche market, 10 is mass market
- **Risk:** 1 is low risk, 10 is high risk of failure

The results of the interviews are summarized in Figure 1 and were as follows:

IoT and prevention is rated as having a high risk (7) but also with a potential for the mass market (6.5). In addition, IoT and prevention is seen as a topic that has a high degree of novelty (6.5), not only for the company itself, but also beyond the company. The interviewees agreed on the potential of IoT and prevention, but stated at the same time that it can be a challenge when participants outside the insurance industry want to participate.

The evaluation of **"make more of it"** is relatively low in terms of radicality (2.5) and low risk (3) compared to the other business models. The "it", meaning which core competencies can an insurer use to offer further services in addition to its core insurance business, certainly needs to be defined on a case-by-case basis.

Figure 1: Interview responses regarding possible future business models



The **orchestrator** is rated the second highest in terms of radicality (7) among the five business models. A common thread running through all of the interviews was that the discussion of the governance structure, in the sense of “who performs which task for the company?” is highly relevant. The orchestrator is a radical governance structure in which most of the value chain is outsourced. The orchestrator is certainly not transferable one-to-one to large existing insurance companies, but it represents a great opportunity for newly founded insurance companies.

The **P2P** business model is rated as both the most radical (8) and the riskiest (9). However, the fact that the model is only associated with a small market works against it. Almost all interviewees felt that they could not see much potential in the P2P business model.

The insurer as **caretaker** is considered not very radical (rated 4), but as being suitable for the mass market (9). Most interviewees agreed that the business model of the insurer as caretaker is relevant. Since many insurers already offer assistance services that go beyond the transfer of risk itself, this business model is possibly the closest to the current structure of the insurance industry.

3. FACTORS OF SUCCESS FOR BUSINESS MODEL INNOVATIONS IN THE INSURANCE INDUSTRY

Four of the seven success factors identified in this study for business model innovation in the insurance industry are related to human resources (Table 1). This is a strong indicator that human resources are essential for business model innovation in this industry.

Table 1: Factors of success for business model innovations

FACTORS OF SUCCESS	
HUMAN RESOURCES	MISCELLANEOUS
The right people are needed for business model innovation	Technology is a success factor for business model innovation
The ability to adapt is essential for the organization	Capital enables business model innovation
The mindset of people is important	To answer the question "make, buy or partner" is a success factor
New competencies of employees are necessary	

Insurance companies are not manufacturing companies, in addition to capital and IT, sales partners, employees, executives, and the board of directors are the most important resources they have. Hence, it is not surprising that human resources related topics are given such a high priority. It is, however, not clear whether the human resources related aspects receive the level of attention that other issues, such as creation of business cases, market research, selection of technology, etc., receive.

It was discussed in the orchestrator conversation that the topic of “make, buy, or partner” is a success factor for business model innovation. In an age when the world’s most valuable companies are primarily technology-driven, it is not surprising that technology was cited as a success factor, along with the need for capital.

4. BARRIERS TO SUCCESSFUL BUSINESS MODEL INNOVATION

Three major categories of barriers to business model innovation in the insurance sector were identified.

1. Regulation is already widely regarded as a hinderance to the insurance business; however, the interviews highlighted another aspect that should not be underestimated. Until now, regulation has been seen as an external problem, but internal regulations usually bind the company's activities even more so in order to ensure that no external regulation is violated with the consequence of possible penalties. However, this results in a vicious circle if the external regulator uses internal company regulations as a basis for future decrees, making them even stricter.

2. Industry identity is a hinderance for several reasons. First, there is an organizational cumbersomeness in many companies that resists innovation continuously, both from inside and outside. The phenomena described in science as “the not-invented-here syndrome” and “resistance-to-change” are still frequently found in the insurance business. However, it is also important to note that there are already numerous promising trends that indicate that these structures are effectively being broken down. Second, hierarchies that are strongly developed are often a barrier when it comes to flexible and fast decision-making capabilities. From an innovation perspective, flatter hierarchical structures would be advantageous. Third, there is still a strong risk aversion in many companies.

3. Competition is another factor that hinders the development of new business models, especially among the large insurers. This relates to the widespread assumption among companies that insurtechs could become a competitive threat en-masse. They should rather be understood as potential cooperation partners offering promising, future-oriented solutions.

5. CONCLUSION

The results of the interviews on the topic of business model innovation undertaken in this study can help us derive new ideas that can serve as food for thought, but they cannot cover the respective topics in their entirety. The findings lead to the following conclusions.

1. IoT as an aid to risk prevention: prevention should be considered across all product categories in insurance entities. IoT is an important driver of new prevention solutions. It is important for insurance companies to develop their own competencies in order to be able to evaluate new opportunities and not be misled by false promises.

2. Examine own governance structure: one advantage of globalization is that companies and customers alike can access services and products worldwide. Digitalization ensures that solutions can be implemented across continents using remote technology. This increases the likelihood that there will always be a provider who can perform a task better than the insurance company itself. The results from the interviews underline that partnerships will become increasingly important. It, therefore, makes sense for an insurance company to establish partnerships with service providers, companies from outside the industry, or startups in order to offer insurance customers new services, optimize its own value chain, or develop new business models.

3. Using technology: the influence of digitalization cannot be overestimated, as the interviews have confirmed. The traditional areas, such as damage or underwriting, should work hand in hand with IT. This makes it easier to find new, innovative solutions that serve the organization, sales partners, and customers in a more meaningful way. New technologies are a major driver of innovation regardless of the insurance sector and therefore require individual responses in each case. Insurance companies should be able to evaluate the new technologies in order to determine what they actually mean for their own business model. Cooperation with start-ups is one way in which insurance companies can benefit from new technologies.

4. Reassess the potential of people in insurance companies: human resources should be permanently strengthened in insurance companies and redefined as a success factor for business model innovation and beyond. Insurance companies should realize that people are the most important resource they have. People either buy the right technology solution or fall for false promises. People either come to work every day motivated and give their best, or they spend the whole day waiting for the end of the day. People are enthusiastic when talking to potential cooperation partners about a new business model, or they are more defensive when talking to partners because they don’t believe in their own company. New competencies are needed at all levels of the hierarchy to meet future challenges. The key words in this context are technological competencies, a mindset that welcomes change, knowledge of modern (agile) working methods, and the willingness to constantly improve one’s skills in order to be better prepared to master the challenges of tomorrow. Insurance companies should shape framework conditions, but it is at the same time just as important for each individual to consider how their current area of responsibilities will change in the future.

ABOUT CAPCO

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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