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Updates on Insurance 2020—Innovating Beyond Old Models

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INSURANCE QUO VADIS?

Predicting the future of insurance can be somewhat straightforward. Both the history and temperament of this industry constrain the realms of its potential for change. In addition, this is a business steeped in the paramount nature of its guiding principles and is equally tied to the information provided by the record of its transactions. Periodic forays into the art of forecasting by insurers often just confirm doctrine instead of establishing a foothold for change. When considering the projected uses of technology, insurers tend to focus on point solutions or keeping up with market peers. Overall, predictions tend to be short range, aimed at optimizing current operations and are linear projections for business outcomes.

It is easy to see the insurance industry's potential for robust market activity. The combination of classic protection products and an increasing number of financial services in an expanding global economy creates a target-rich environment. Traditionally, the task going forward would be to navigate the opportunities while efficiently servicing stakeholders. However, as we approach the end of the first decade of a new century, it is very important to increase the scope of our vision and consider what the insurance industry could become.

There is a concern that the current mode of operations, regardless of the line of business, will reach a point of diminishing returns in the near term. Even before the difficulties that marked 2008 as one of the most tumultuous years on record for financial services, the capabilities of current technologies and the potential of emergent ones almost guarantee that the next several years will mark a fundamental change in the insurance industry. The question is, how can insurance carriers profit from these changes? Shouldn't closer attention to a spectrum of systemic operational risks include any area that impedes flexibility and agility? How can consumers be better served? What strategic challenges will serve as catalysts for change and be components of active enterprise risk management? How must the industry evolve to meet the needs of demanding customers?

The IBM Institute for Business Value considered all these elements in interviews and market research among global industry executives about the future state of the insurance industry. This research made it clear that change is on the mind of insurance executives around the world, with 70 percent expecting significant change. The analysis of the collected information determined that there are four large-scale trends that will likely confront insurers and their stakeholders in the year 2020.

These large-scale or "mega-trends" are:

1. Active and informed consumers across demographic groups reward nontraditional operators.
2. Technology virtualizes the value chain and lowers barriers to entry.
3. Mainstream insurance products are dynamic and provide more consistent performance.
4. Regulatory coordination and use of affirmed industry standards broaden to global scales.

NOW WHAT?

The study showed that while market forces demand real innovation in business models, insurers consistently focus on the optimization of products, processes and services. This activity often leveraged information technology (IT) advances over the course of several decades. For many carriers the result was an organization that mistook optimization for innovation.

This approach has produced two outcomes. First, although it is clear that some insurance carriers, agencies and brokers are exceptions, many have little to show for the many years of optimization they practiced. For example, from 1955 to 2006, the U.S. property and casualty (P&C) insurance industry had a return on equity (ROE)

below the average for all U.S. industries more than 87 percent of the time. Changes in value chain automation, data management and the use of online mechanisms made over the course of the last several decades were at the tail end of larger technological or societal changes and were directed toward improving existing processes and mechanisms. If they continue to follow this course, carriers will logically see diminishing results. It is likely that either an existing competitor or a new entrant from outside of traditional insurance – such as a retailer, social computing purveyor or other service industry constituent – will capture a portion of the market.

The second outcome from the industry's focus on optimization is in opportunity costs. There is an uncalculated cost from the insufficient, or even absent, application of innovation, especially in business models. So, although making improvements in processes and operations via the use of increasingly advanced technology felt like the right thing to do, those activities became a proxy for innovation. Such activity supplied a stream of revenue enhancements of sufficient stability to please executives and provide them with fodder in discussion about how they were supporting company strategy, meeting risk management objectives or achieving monetary goals.

Presenting these two primary findings established a straightforward tension among insurance stakeholders; if the insurance industry is reticent about the recognition and use of innovation, how should it go about implementing change that incorporates innovation? And, given that the subprime drama and its resulting aftershocks seem to reward those insurance players that acted in the most conservative manner, why should the industry even think of innovating? Aren't conservatism and innovation mutually exclusive?

CONNECT TO POLICYHOLDERS

The answer to the last question is a clear "no." While insurance customers expect stability and trustworthiness from their providers, another recent IBM Institute for Business Value study has shown that, for the United States, only around 40 percent actually do trust the insurance industry. On the other hand, they do expect to be served well and in a timely manner, and in a way that addresses their personal needs. Consumers feel transparency in insurance to be low – and so are expectations. Any step toward more customer orientation is a step in innovation – without having to resort to a high-risk, all-or-nothing mentality.

THERE IS AN UNCALCULATED COST FROM THE INSUFFICIENT, OR EVEN ABSENT, APPLICATION OF INNOVATION, ESPECIALLY IN BUSINESS MODELS.

For example, personal lines insurers in both life and non-life could take a page from the banking playbook to energize their marketing campaigns. Rather than utilizing the historical practice of relying on industry-specified "life events," such as acquiring a drivers license, getting married or having children, an insurer could prepare younger children (10-15) for their eventual interactions with the insurance industry.

Banks have long established programs and accounts for "young savers," and have made available courses on handling credit for teenagers. In the insurance arena, a similar program might involve school presentations on the mechanics of risk, or, rather than the typical sponsorships of sports, taking a logical next step with youth organizations. That step could include activities such as insurance-sponsored clubs that tune kids into the concepts of risk management and practicing safety in the environments where children interact the most, such as home, school and public events. It is important to remember that the first exposure of most young people to insurance comes in a negative way when they are expected to contribute to the cost of their automobile insurance premiums. We believe helping youth understand more about

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this important aspect of financial management would be of significant benefit to the insurance industry.

Another suggestion, prompted by our study, for what carriers can do to deal with the imminent impact of demographic change is to actively investigate the opinions, attitudes and expectations of policyholders. Although it is a relatively safe assumption that older groups can be approached with well-understood mechanisms such as surveys and promotional campaigns, younger groups will require a more modern approach. Carriers need to leverage social computing tools, including blogs (Web-based logs or diaries of activity made available to specific groups or the public), social computing sites, such as Facebook or MySpace, and online communications push devices, such as audio and video (broad)casting. These tools allow a carrier to integrate marketing outreach and provide near-realtime demographics research that can become a vital component in dealing with younger consumers.

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Keeping up with demographic trends as expressed in the use (or abandonment) of various technologies, political leanings and other discoverable information will also uncover the trend toward personalization. It is becoming clear that more and more consumers are increasingly disenchanted with mass marketing and seek individual attention as well as customization of their "insurance" interactions. Indeed, signs from our research point to a need for risk management that is both active and personal.

MODELING MARKETING TO BEHAVIOR

Today's behavioral patterns are different than the traditional ones, but still predictable. The concept of predictive analytics as applied to customer behavior follows reaction to controlled triggers (like marketing campaigns) and thus allows companies to "manage" their customer portfolio into an optimal spread on a value/loyalty matrix.

It is worth mentioning again that we can learn a great deal about how to apply technology such as predictive analytics by looking at how it is applied outside of insurance. The airline industry leveraged such a tool to help it better understand loyalty programs – allowing a huge step forward from the simple miles programs to programs focused on marketing real value. Translated to insurance, customer equity management would mean redefining and maybe even re-creation of customer distribution channels more in tune with reality.

Customer experience today is interactive. The Internet, starting with what is now referred to as Web 2.0, is no longer a simple mechanism that pushes marketing content. It is now a conglomeration of views, discussions, trends and offerings that reach self-targeted audiences. It has become the infrastructure for what is now called social computing – and with continued maturation will include innovations such as the semantic Web. Think of this as a network of interconnected Web sites that, by design, publish or make known the meaning of the content they manage and more specifically, the data they contain. This will allow for more efficient machine-to-machine exchange of data and information in support of collaboration among all users, including insurance stakeholders.

In the P&C industry, operational innovation is still best seen in the well-known efforts of Progressive Casualty Insurance Company. It innovated in pricing and underwriting by creating and developing the concept of usage-based pricing that leverages telematics. Telematics is the use of wireless technology to provide interactive information to and from a moving vehicle such as a car or truck. This Ohio-based insurer was the first to sell auto insurance on the Web and is seen as a leader in the direct market as well. Progressive continues to innovate with its high level of claims servicing and dedication to policyholders. GEICO has broadened its offering to include what we have referred to in the IBM Insurance 2020 study as "adjacent spaces" by offering automobile mechanical breakdown coverage, which acts like an extended warranty for a vehicle if purchased within the mileage limits of the plan.

The use of telematics and remote sensing within the insurance industry is broadening in scope. Risk services that offer prevention – something already happening in industrial (commercial) insurance – become viable in private lines P&C. This allows for new business models on one hand and gives insurance the opportunity to overcome its negative image as expensive and reticent when a claim actually occurs. Our data have shown that 75 percent of U.S. consumers would like insurers to help

them in preventing automobile accidents, and are willing to trade personal privacy (and premiums) in exchange for security and convenience.

The life insurance business has innovated in less obvious ways by combining coverages and adding flexibility to standard coverages. Life companies need to attack the oft-quoted maxim that “life insurance is sold, not bought” and overcome the negative perceptions that plague this industry. The opportunity to leverage new technologies will only be fulfilled when internal impediments to progress receive the same attention that optimization of existing processes receive. Younger generations need to be won over with a new approach to dealing with the realities of complex lives and the new aspects of culture that arise in a world that continues to grow smaller as technology evolves.

CONCLUSION

As the insurance industry struggles along with the rest of its financial services brethren to operate in the current global recession, it must consider the true value of innovation. While innovation is often linked to advances in information technology, we know that is only a component of success. Innovation can come in the form of modified processes, new business models, distribution channels and simple organizational change. Our oft-repeated message phrased slightly differently is that insurers should reduce the focus on improving what they know how to do and look to what they could be doing in light of the change that swirls around them.

Industry observers and stakeholders should take special care to examine how the industry reacts (or takes advantage of) the current climate. Some carriers will dig in and focus on time-honored mechanisms to weather the storm, finding shallow solace in activities that optimize their efforts via trendy technology and the latest management trends.

A key aspect of success will undoubtedly involve information technology since the core of all insurance is the processing of data into information and ultimately into knowledge. The next generation of risk management is one where the focus is not on simply mechanizing the processing of data, but on modeling and automating the smart processing of risk information. The semantic Web, active and passive remote sensing, and intelligent systems are tools for insurers to use that will provide the risk mitigation needed to meet the demands of a new century. ☆

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