As disruption mounts, insurers and reinsurers are facing huge strategic challenges in maintaining competitiveness, driving change and delivering all-important growth.

Perceived wisdom has been that these are mutually exclusive goals, but in this report PwC Strategy& sets out why they can coexist if organisations are committed to being fit for growth.

Is the (re)insurance industry fit for growth?

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Introduction

With margins squeezed, growth hard won and disruption mounting, (re)insurers are under pressure to bring down expenses further and faster than ever before – marginal savings aren't enough to compete. Yet they also need to invest in the technology and innovation needed to meet fast rising customer expectations.

Can they do both? We believe they can by ensuring they're fit for growth.

Late last year, PwC polled 25 insurers for its Fit for Growth (FFG) insurance survey[1] to help gain a better understanding of the issues they face regarding reducing expenses and investing for growth.

Drawing on the survey findings, as well as insights from PwC's 20th Annual CEO Survey[2], we outline in this paper why moving the business forward requires a rethink of strategy, costs and, most important of all, how they align. The focus of fit for growth is to optimise, rather than just cut, expenses to ensure your business can sustain competitive relevance and maximise its potential. This means investing in good costs (capabilities that differentiate your business, move it closer to customers, and enable it to develop new value propositions) and eliminating bad costs (non-essential areas of spending).

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1 http://www.pwc.com/us/en/insurance/publications/fit-for-growth-survey.html?_ga=2.31882750.1134016194.1504177577-782303347.1499967272

2 http://www.pwc.com/gx/en/ceo-survey/2017/industries/pwc-ceo-20th-survey-report-2017-insurance.pdf

The forces reshaping (re)insurance

Figure 1: How concerned are you about the following business threats to your organization's growth prospects?

Source: Insurance CEOs participating in PwC's 20th Annual CEO Survey

Change and disruption

The industry will undergo significant, disruptive change

The insurance industry globally continues to be the most disrupted of any sector[3]. In our work with (re)insurers, we've noticed anxiety about the technological changes coming from current competitors, start-ups, and Silicon Valley that are reshaping the industry. When asked them what posed the greatest threat to their operating models, the most popular response (44% of all Fit for growth survey respondents), was "market disruption or the use of new technology." Second on the list was "changing customer needs and offerings from new market entrants" (24%). These responses outweighed concerns about lack of customer insight, availability of talent, regulatory change, and the economic environment combined.

Disruptive shifts in the way reinsurance business is transacted include growth in insurance-linked securities (ILS) or similar structures. These lean and agile vehicles are forcing reinsurers to either adapt their business models to compete or set up their own structures to participate, which is putting traditional ways of transacting business and placing risks under pressure. While you are finding more efficient ways to execute your current processes, competitors are bypassing them altogether. The threat of new entrants, whether in the form of alternative capital structures or start-ups, is a concern for almost two thirds of insurance CEOs.

Technology could have an even bigger impact, with 86% of insurance CEOs believing that it will either completely reshape or have a significant impact on their sector over the next five years and 83% seeing it as a threat to their growth prospects[4].

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3 Based on the percentage of CEOs who are extremely concerned about the threats to their growth prospects from over-regulation, the speed of technological change, changing customer behaviour and competition from new market entrants. Source: 'Embracing possibility, boosting innovation: Key findings in the insurance industry from PwC's 20th CEO Survey' (http://www.pwc.com/gx/en/ceo-survey/2017/industries/pwc-ceo-20th-survey-report-2017-insurance.pdf)

4 'Embracing possibility, boosting innovation: Key findings in the insurance industry from PwC's 20th CEO Survey' (http://www.pwc.com/gx/en/ceo-survey/2017/industries/pwc-ceo-20th-survey-report-2017-insurance.pdf)

Need to grow

Most companies know that growth is critical to long-term success. Most are somewhat or very confident in their ability to grow, with many having growth targets that far outpace those being achieved in the industry as a whole. We therefore expect there to be haves and have-nots. The haves include companies that believe they can outperform competitors through better execution of the tried-and-true strategies that are common in the industry. We expect have-nots to have the self-awareness to know that they are not out in front of the market and are therefore waiting for the storm to pass.

As we expected, not all carriers are pursuing growth at all costs. Only 30% of FFG survey respondents said that top line growth was their primary strategic focus. However, only 9% were willing to admit that growth was of minimal focus, while the remaining 60% of carriers took a more balanced view.

The confidence game

The US insurance market is mature and growing at a very slow rate; from 2011-2015, the P&C industry grew at 3.4% CAGR, while life and health grew at a rate of 1.4%. Growth rates in the London/specialty market are similarly modest, with most companies concentrating on bottom line performance and only showing growth in niche areas where they can achieve good margins. Many are making a virtue of walking away from business. Even in the emerging markets such as Asia or Latin America, which typically represent a smaller proportion of global insurance activity, growth has slowed with a focus on profitability.

However, FFG survey participants are more bullish, with 63% indicating that they would grow at rates greater than 5% over the next three years, while 15% were targeting growth rates above 10%.

In our 20th Annual CEO survey, we asked which activities, if any, insurers were planning in the coming twelve months in order to drive corporate growth or profitability. Over 80% of insurers indicated that they'll rely on organic growth, and approximately 60% said they'll rely on cost reduction (see Figure 2). A significant number of respondents also are planning some kind of structural change, including M&A, joint ventures, and/or outsourcing.

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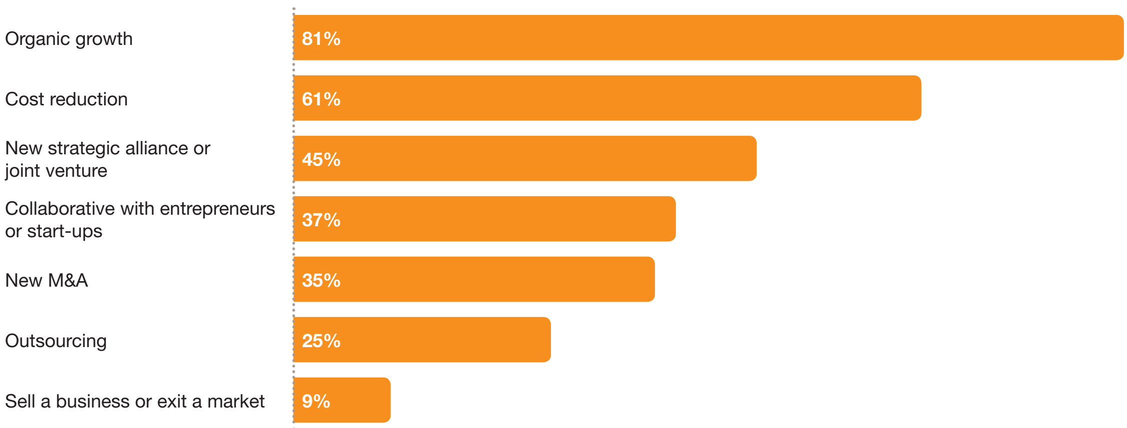
Figure 2: Which of the following activities, if any, are you planning in the coming twelve months in order to drive corporate growth or profitability?



Source: Insurance CEOs participating in PwC's 20th Annual CEO Survey

These responses illustrate how difficult it is to have a strategy that doesn't focus on growth, even in one of the most challenging rating environments in current memory.

Capturing market share more important than new markets

FFG survey participants' number one goal was increasing market share of selected current products (46%), some way ahead of the 15% that indicated their top goal was to expand or enter new distribution channels through, for example, digital agents, brokers or banks. Another 15% indicated launching new products was their primary growth goal. These response rates suggest that the competitive landscape has fewer bold and aggressive players than we previously thought. This may create an opportunity for truly aggressive companies to play hard-ball.

Containing expenses

Overall the industry is treading water on expenses

For most carriers, spending is habitual, but cost-cutting is routine. Companies have been through expense reduction initiatives in the past, and will do so in the future, but these initiatives are rarely a top priority. Over the past five years, expenses have moved in lockstep with revenues at P&C carriers (at 3.4% based on our analysis of 2010-2015 results) while they have increased slightly more than revenues in the life and health industry.

The stories underlying these top level indicators vary extensively. One could infer that the industry is keeping up with increased regulatory demands and attempting to do the same with rapidly evolving customer expectations. But, barely keeping up is not winning.

Expenses are a "low grade fever"

Expense management is undoubtedly a constant boardroom topic, but was a number one priority for only 20% of FFG survey participants. More than half thought that their expense structure was worse than competitors', and only about 20% of them felt that expenses were on-par with the competition. Only 20% felt that they were doing better.

It's clear that cutting costs has become "business as usual", but rarely is it a top strategic priority. Three-quarters of FFG survey respondents have been at companies which have undergone expense reduction programmes in the last three years. While reducing expenses is a near-universal battle, it's typically only as serious as a low grade fever.

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Three-quarters of the respondents have undertaken people-related efforts, including changes to staff size, or span of control changes, reorganisations, or changes to their sourcing model. Roughly 40% referenced technology initiatives.

However, when we asked, "Do you believe your company's management of expenses is optimised to profitably achieve its strategic objectives over the next 3 years?", almost 75% indicated a need to further improve?

At many companies, inadequate expense management is affecting spending on key strategic initiatives, perhaps indicating the degree of difficulty in moving spend from one area to another:

- **Consumer Strategy:** When we asked, "To what degree is your end-consumer strategy driven by a desire to reduce your company's overall expense position?", almost 54% of carriers responded that the end-customer strategy is driven to a moderate or high degree by the company's overall expense position.
- **Product Strategy:** When asked, "To what degree is your product strategy driven by a desire to reduce your company's overall expense position?", 45% indicated a moderate to high influence.
- **Distribution Strategy:** When asked, "To what degree is your distribution strategy driven by a desire to reduce your company's expense position?", over 43% of respondents indicated that distribution strategies were impacted to a moderate to high degree by their desire to reduce their expense position.

PwC asked executives about the kinds of changes they have made to drive down expense levels. Three-quarters of the respondents have undertaken people-related efforts, including changes to staff size, or span of control changes, reorganisations, or changes to their sourcing model. Roughly 40% referenced technology initiatives.

We believe that a range of efforts including the use of robotics to eliminate work – to not just reduce costs, but eliminate them – will be increasingly common among companies that are intent on realising an improved cost curve.

In the face of change, (re)insurers are adopting two basic ways to play

Each market force can inform strategic priorities

Industry players are struggling to cut costs, while sustaining the investment needed to fuel growth. We find that, overall, (re)insurance is a low growth industry and barely keeps expenses in line. We continue to believe that virtually every company needs to achieve sustainable cost savings so that they can channel investment into the areas that will fuel growth. We compare these two broad strategic approaches or ways to play below:

	Make existing business fit for growth	*Steer into the headwinds... and re-position as a new player*
	Continuum	
Change and disruption	• Innovate the operating model • Exchange with and learn from InsurTechs	• Redefine/disrupt the core business • M&A and Divestitures • Spinoffs • Joint Ventures and Partnerships • Create a pure digital player
The need to grow	• Lock in existing customers • Build omni-channel service and distribution approach • Re-design the customer journey to create a new service experience • Enhance product portfolio	• Expansion into new/emerging markets exploiting the protection gap • Develop propositions beyond insurance • Build differentiating capabilities or a specific niche
Containing expenses	• Top-down and bottom-up driven cost transformation focused on taking out “bad cost” • Continuous cost management • Advanced automation and robotics to increase efficiency	• Set up zero-based IT architecture, aiming for close to Straight-Through Processing (STP) • Strategically use utility providers and collaboration for services or products not developed in-house

Source: PwC

In reality, many (re)insurers adopt elements of each strategy in different segments of their business and as the chart illustrates, these choices often sit on a continuum. We have described some of the typical characteristics of each while accepting that every company is different.

Some more specific examples of the activities that underpin those ends of the spectrum are outlined below.

Make your core business fit for growth

Our FFG insurance survey results imply that a majority of companies have institutionalised expense management. In other words, expense management is steady as she goes, business as usual.

Are you waiting for the disruptive storm to pass? If the answer is yes, and your wait is a conscious decision, then we believe that this may be a reasonable approach for many (re)insurers. Capital constraints are real. Channel conflict is real. Risk tolerance is real. Opportunities are not necessarily clear or apparent. It's critical to know when to step into the arena and when to stay on the sidelines. Change happens – and in the current environment, it's coming fast and furious. The changes are also irreversible and therefore transformation is necessary and inevitable.

Our FFG insurance survey results imply that a majority of companies have institutionalised expense management. In other words, expense management is steady as she goes, business as usual.

Overall, the industry is only just keeping up with managing expenses in line with growth. There has been no significant overall change in the industry cost curve, but we know from working with (re)insurers that some companies are in fact making substantial progress. Their operating expense ratios are showing the impact of recent investments, with the benefit expected to come through soon. Many other companies chronically backslide, allowing expenses to creep upward.

Through disciplined expense strategies, supported by robust change management and talent strategies, some companies can target competitive market positions, top-quartile expense structures, and leading products and services. These (re)insurers are looking for opportunities to arrive at scale, whether through various organisational refinements, process improvement, selected off-shoring or outsourcing, and by generally maintaining an "expenses first" mindset. They typically look to gradually gain market share by entering adjacencies, and avoid structural change or pursuing high-risk strategies because they hold one or more of the following to be true:

- Disruption is basically outside the planning and risk management horizon, so the best course is steady as she goes and focus on transforming the core business.
- Real innovation is beyond the risk appetite of the company (or they think they're just not good at it).
- There is a lack of critical mass to pursue opportunities that would lead to major shifts – either the organisation is too small, or the budget/free capital doesn't exist, or both.

This approach to the market makes sense for companies with successful franchises and relatively little free capital to pursue other strategic options. These companies can find themselves positioned to opportunistically respond to market opportunities, even acquisitions in some cases. That said, we have observed that players adopting this strategy typically either allocate too little money to initiatives that require bigger bets, or sit on the sidelines when there are opportunities they should take advantage of. However, we've also seen even heavily constrained companies shift their positioning with bold planning and realistic change management time horizons.

Marginal efficiency savings can no longer guarantee survival and success. (Re)insurers need to pinpoint resources and sharpen operational capabilities in a way that enables them to sustain relevance in a fast-evolving marketplace.

Embrace change and re-position as a new player

Some companies are taking a more aggressive approach. They are responding to any or all of the market forces that have motivated them to embrace the long-term forces shaping the industry and re-position themselves in terms of expense management:

1) Technology-driven change that is creating opportunities to significantly change cost curves;

2) Market activity (i.e., acquisitions, divestitures, and spin-offs);

3) New approaches to aggressively partnering with market entrants, notably InsurTech, that are creating both opportunities and disruption;

4) Regulatory changes, whether global, US (FSB, Dodd-Frank, FOI) or European (Solvency II); and

5) Tax law changes that may cause (re)insurers to change reinsurance agreements and re-examine where their workforce is and where they make their investments.

The crucial priority isn't the costs you cut, rather where you focus resources to stimulate growth and differentiation – strategic cost reduction. This includes digital transformation that can not only sharpen the precision of risk selection and pricing, but also deliver more tailored and targeted client solutions at a fraction of the cost.

Beyond technology are opportunities to refocus resources away from low-returning business towards higher value and higher return opportunities, both in fast growing geographical markets and underinsured exposures such as cyber and environmental risks. Indeed, the key differentiator within strategic cost reduction isn't technology so much as the strategic ambition and underlying culture of innovation and customer focus within the organisation.

Focusing on radical change

For companies that want to operate nearer to the turmoil of disruptive forces and redefine their business, we suggest that the governance model embraces risk with a fail-fast innovation mindset.

Companies with the right capital structure, assets and franchise, or the right stock price can drive structural change and position themselves as close to the action as they choose. They typically can identify the opportunities that change and disruption create. Large, well-funded organisations have the advantage of the ample capital to invest in innovation and acquisition. We also believe that steering into the headwinds provides the "air cover" to take a more aggressive approach to expenses, by enabling cultural, governance, and other structural changes that are not typically considered (at least not seriously) in steady as she goes.

Over 90% of our FFG survey respondents indicated that the existence of legacy technologies was a roadblock to executing change initiatives. Accordingly, many companies find themselves in a catch-22. If the need to change is real, and legacy technology is the main thing that is holding you back, then it's probably time to break out of the business as usual mode.

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We expect robust activity to continue through the balance of 2017, given strong interest in specialty insurance, consolidation in the brokerage space, divestitures of legacy blocks and expansion into new technology-enabled lines of business.

Companies that have the risk tolerance, capabilities and capital – and want to be in the middle of disruption and innovation – pursue some or all of the following:

- **M&A –** The insurance sector continued to be very active on the M&A front with 387 announced transactions in the sector in 2016 and total deal value in 2015/2016 reaching $150bn[5]. Deal activity was driven by Asian buyers eager to diversify and enter the London/Lloyd's or US markets, divestitures designed to free up capital, and insurance companies looking to expand into technology, asset management, and ancillary capabilities. We expect robust activity to continue through the balance of 2017, given strong interest in specialty insurance, consolidation in the brokerage space, divestitures of legacy blocks and expansion into new technology-enabled lines of business. Specifically in the global reinsurance and specialty markets, as prices continue to be under pressure, the attractiveness of scale in negotiating terms is a constant theme.
- **Investments in Innovation/InsurTech –** (Re)insurers are stepping up investment in innovation, often in partnership with InsurTech[6]. According to PwC's DeNovo platform, InsurTech companies raised over $1.6b in funding in 2016, continuing the strong growth seen in 2015 and prior. Concerns that InsurTech would take the place of traditional insurers seem misplaced – however, start-ups with point solutions and agile technology are more often creating value through efficiency (such as in the area of payments) as much as front-end solutions. Insurers are getting smarter at partnering with this increasingly important part of the ecosystem, and can reap the benefit in expense ratios as well as pricing or loss mitigation. A further benefit is the impact of a more innovative mindset on traditional insurers and reinsurers when tackling efficiency challenges.
- **Transformation Partners –** Companies are moving IT infrastructure to the cloud, utilising software-as-a-service (Saas) and platform as a service (Paas) models to provide newfound flexibility (often expense reduction is a secondary goal of these initiatives) in IT delivery and operating models. Companies are using IT outsourcing and BPO to bifurcate businesses of the past from those of the future, and thereby focus on new operating models.
- **Captive Shared Services Centres –** Many large carriers have already established or are in the process of establishing global shared services centres to reduce costs. While offshoring certain functions (i.e. IT testing) is commonplace, we are already seeing some (re) insurers take more radical steps and offshore additional corporate (e.g. tax, finance and HR) and market-facing functions. In some cases, (re)insurers are looking to bypass the use of labour arbitrage and automate tasks, if not eradicate them altogether. Robotic process automation (RPA) is an increasing part of operating model re-design, with proofs of concept readily turning into substantial adoption of technology (often also from InsurTech roots). These applications have radically lower error rates than humans, work 24/7 and, if combined with machine learning or AI, can teach themselves to be smarter. Even in the global reinsurance market, often seen to be reliant on experience and judgment due to the complexity of the risks underwritten, efficiency savings of up to 40% have been seen already in core business processes.

5 PwC's snapshot publication "2017 outlook for M&A in insurance, reinsurance and global risk" September 2016 (https://www.pwc.com/bm/en/insurance/assets/uk-insurance-m-and-a-deals.pdf)

6 http://www.pwc.com/gx/en/industries/financial-services/publications/insurances-new-normal-driving-innovation-with-insurtech.html

Can the industry get fit for growth?

Through our experience of working with (re) insurers, as well as the survey responses outlined in this report, the desire to demonstrate growth is as real as the cost challenge facing those players. Disruption is occurring around us, with technology and capital creating seismic shifts in the competitive landscape and how business is transacted. Companies are attuned to these forces, but the degree of urgency in response is varied across the market. Fit for growth is just one framework or way of thinking which can help make the strategic focus on optimising cost a core part of how your business chooses to play.

The margin for error and opportunity to create returns have never been more compressed, so companies need to have a defined strategy, as well as be agile in response to these forces. In our view, the ability to optimise cost through the utmost discipline, whether business-as-usual or initiative-driven, needs to be as much a core competency in successful (re)insurers as risk selection or capital allocation. Only through a strategic focus on cutting bad costs can scarce resource be freed up to invest, allowing (re) insurers to grow and compete with new services, products or geographies. As the most disrupted of any industry, the need to be fit enough to stay ahead has never been greater.

In our view, the ability to optimise cost through the utmost discipline, whether business-as-usual or initiative-driven, needs to be as much a core competency in successful (re) insurers as risk selection or capital allocation.

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If you would like to learn more about Fit for Growth in general, please see our recently published book, Fit for Growth: A Guide to Strategic Cost Cutting, Restructuring, and Renewal.

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