top issues

Are you fit for growth?

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Are you fit for growth?

When it comes to scrutinizing costs, most insurance companies can say "Been there, done that. Got the t-shirt." Managers are familiar with the refrain from above to trim here and cut there. The typical result is flirtation with the latest management trends like lean, outsourcing and offshoring, and others. However, the results tend to be the same. Budgets reflect last year's spend plus or minus a couple of percent in the same places.

Meanwhile, managers attempt to develop strategies to capitalize on the trends reshaping the industry – customer-centricity, analytics, digital platforms and disruptive delivery and distribution models. Yet, after all of the energy companies exert to reduce expenses, there is often little left over to spend on these strategic initiatives.

Why do you need to look at your expense structure?

A variety of pressures have led carriers to improve their cost structures. In all parts of the market, low interest rates and investment returns are forcing carriers to scrutinize costs in order to improve return on capital, or even to maintain profitability to stay in business.

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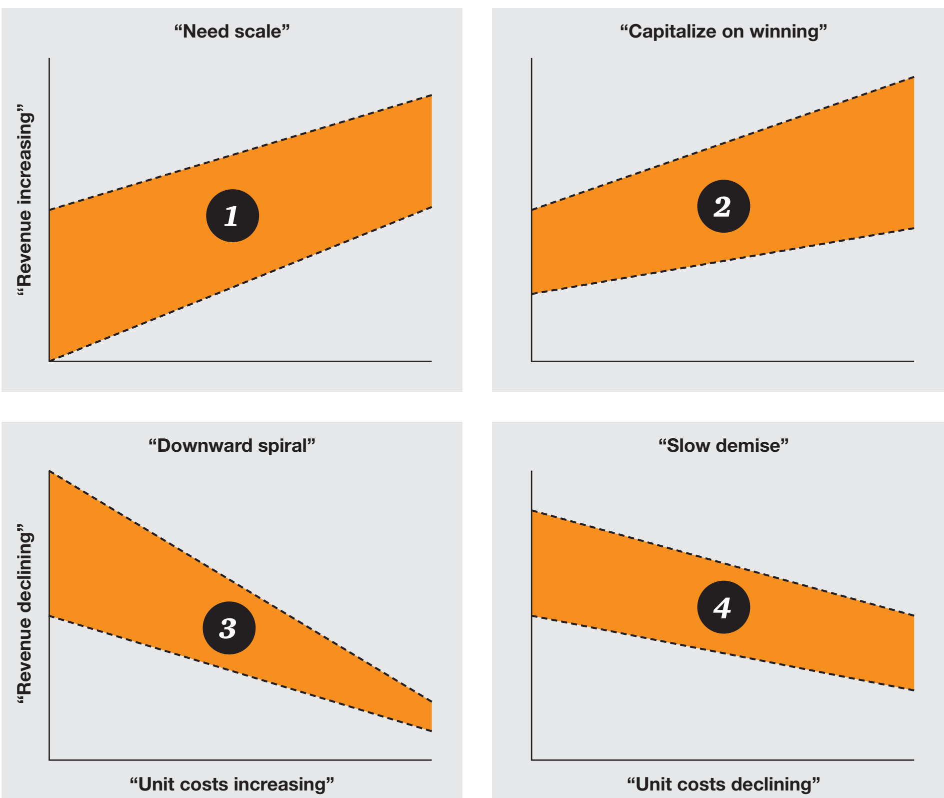
P&C carriers with lower-cost distribution models have been able to channel investments into advertising and take share, forcing competitors to reduce costs in order to defend their positions. Consolidation in the health, group and reinsurance sectors have forced smaller insurers to either a) explore more scalable cost structures or b) put themselves up for sale. For life & retirement companies, lower interest rates have taken a toll on the competitiveness of investment-based products.

This spells trouble for companies that have not adequately sorted out their expense structure. And a shrinking insurance company sooner or later will run afoul of regulators, ratings agencies, distributors, and customers. Even if expenses are shrinking but revenue is declining more quickly, then the downward spiral will accelerate. It is virtually impossible to maintain profitability without growth. Expenses increase with inflation, tick upward with each additional regulatory requirement, and can spike dramatically when attempting to meet customer and distributor demands for improved experiences and value-added services.

The reality is companies have to grow, and that's difficult in a mature market, especially in times when "the market" isn't helping. What's the key to success then? In short, growth comes from better capabilities, service, customer-focus, and products – all of which require on-going investment in capabilities.

Figure 1: Reducing Costs: "Been there, done that?"



	Description	*Potential path forward*
1	You're winning in the marketplace, but you'll need scale to win over the longer term.	New channels, partnerships and business models that significantly change the cost curve.
2	You're winning in the marketplace and your cost structure is helping.	Capitalize on the opportunity to knock out competitors or leverage capabilities into new markets.
3	You're losing in the market place and are not, or cannot control costs.	BPO may be an option. Or a merger. You'll need to move fast because distribution, regulators and rating agencies will not stand idly by.
4	You're losing in the marketplace, and though it doesn't happen often, your costs are improving.	Consider all the options, including initiatives with room to get more strategic about both growth and cutting costs.

The math doesn't work unless you're finding ways to spend less in unimportant areas and allocate those savings to more important ones. If your answer to any of the following questions is "no," then it's important that you look at your allocation of resources for capital, assets and spend:

- Are you making your desired return on capital?
- Are your growth levels acceptable?
- Do you have an expense structure that lets you compete at scale?

The transformation of insurers from clerk-intensive, army-sized bureaucracies to highly-automated financial and service operations has been a decades-long process. The industry has invested heavily enough in standardization and automation that one would expect it to be a highly efficient, well-oiled machine. However, when we look under the covers, we see an industry with a considerable amount of customization and one-offs. In other words, it behaves more like cottage industry than an industrial, scalable enterprise.

We know that expenses are difficult to measure, let alone control. But why are they so intractable? As we intimate above, the issue is scale. The industry's poorly kept secret is that insurers, even larger ones, have sold many permutations of products with many different features. All of these have risk, service, compensation, accounting, and reporting expenses, as well as coverage tails so long the company can't help but operate below scale.

Why are expenses so intractable? The issue is scale.

What defines operating at scale for you? A straightforward way to answer this question is to consider whether or not you're operating at a level of efficiency on par with or better than the best in the marketplace. Where do you draw the line? The top 10 to 15 percent? The top 20 to 25 percent? Next, ask yourself if you, in fact, are operating at scale. Remove large policies and reinsurance that disguise operating results, sort out how many differentiated service models you are supporting. Are you in the bottom half-of-performers? Are you in the top 50 percent, but not the top quartile? Are you in the top quartile, but not the top decile?

Every insurer needs a more versatile and flexible expense structure in order to fully operate at scale and be more competitive. We explain immediately below why this is especially urgent now.

Competition is changing

Customers now have access to a wealth of information and are increasingly using it to make more informed choices. New market entrants are establishing a foothold in direct and lightly assisted distribution models that make wealth management services more affordable for more market segments. Name brands are establishing customer mind-share with extensive advertising. FinTech is shifting the way we think about adding capabilities and creating new capabilities near real time. Outsourcers are increasingly more proficient and are investing in new technologies and capabilities that only the largest companies can afford to do at scale.

The competitive landscape will continue to change. More products will be commoditized – after all, consumers prefer an easy-to-understand product at a readily comparable price. As they do now, stronger companies will go after competitors with less name recognition, scale, and lower ratings. Customer research and behavioral analytics will more accurately discern life-long customer behavior and buying patterns for most lifestyles and socio-demographic groups. The role of advisors will change, but customers of all ages will still like at least occasional advice, especially when their needs – and the products they purchase to meet them – are complex.

Table stakes are greater each year and now include internal and external digital platforms, data-derived service (and self-service) models, omni-channel distribution models, and extensive use of advanced analytics. The need to improve time-to-market has never been more important. Scale matters. Because they can increase scale, partners also matter even more than in the past. If they have truly complementary capabilities, new partners can help you improve your cost curve because you can leverage their scale to improve yours (and vice-versa).

In conclusion, all companies – regardless of scale – need to ensure that their capital and operating spend aligns with their strategy and capabilities and the ways they choose to differentiate themselves in the market. In this transformative time, the ones that can't or won't do this will fall increasingly behind the market leaders.

Implications: Leave no stone unturned

- Managing expenses is a job that is never finished. Even if you've already looked at expenses, it doesn't mean that you get a pass from scrutinizing them afresh. You will always have to keep rolling that particular boulder up the hill. Acknowledging that you could always manage expenses better is the first step to doing it well.

- Identify and commit to the cost-curves that get you to scale. This may require new thinking about sourcing partners and which evolving capabilities hold the most promise for the future of the company. How transformative do your digital platforms need to be? Can the cloud help you operate more efficiently and economically? How constraining is your culture, management and governance?

- Every company needs to invest. Every company needs to be "fit for growth." You will need to increase expenses where it helps you compete and decrease it where it doesn't. Admittedly, this is hard to do, but the companies that don't do it successfully will be left by the wayside.

Contacts

Bruce Brodie
Managing Director, PwC Strategy&
+1 646 471 3311
bruce.brodie@pwc.com

John Dixon
Manager, Insurance Advisory Services
+1 617 530 4266
john.w.dixon@pwc.com

Bonnie Majumdar
Manager, Insurance Advisory Services
+1 646 471 1291
baishali.majumdar@pwc.com

www.pwc.com/us/insurance

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