Part 1: Trends and disruptions

About this case study

The past two years will likely be earmarked as one of the most disruptive years of the last century. It is, however, not nearly the most disruptive period we have lived through so far. While the combination of a global pandemic, a major election year, grassroot business activism and environmental activity influence consumer and market trends and fuel political and geopolitical unrest, history shows that we have not only faced but overcome worse.

We might not be able to predict the future per se. But if there is one thing that we can learn from our past it is the importance of resilience, agility and business analytics quality to successfully navigate an uncertain, volatile and ambiguous environment and find (and walk) the thin line between surviving disruptive problems and leveraging new emerging opportunities.

Trends from lifestyle changes, increasing digitalization and data as well as accelerating climate change have affected and started transforming the insurance industry landscape for the past decade or so. However, a real transformation or paradigm shift has, so far, not happened, and many say it is long overdue.
Motor insurance, to zoom in on one segment, a good area to practice business model transformation. It links very directly to the transportation and mobility industry, which is directly and indirectly touching the life of almost every individual - and which is affected by a multitude of disruptions.
From new technologies and lifestyle trends, its interdependency with innovation in related sectors (such as energy and communication but also revolutions in the manufacturing industry) as well as its global interconnectivity and interdependency create an environment buzzing with opportunities and threats alike – highly volatile, and difficult to navigate.

This is the context in which we would like to invite you to embark on an experimental experience to practice and perfect a probabilistic approach to strategic business model transformation.

This case study has been designed to foster decision-making quality in a disruptive environment under time pressure and practice the strategic and operational skills required in a cross-functional cross-cultural team setting.

As a team you will be taking over the management of a fictive motor insurance company in this industry. We will present you with information and data that highlight the industry background, the company history as well as specific data related to the company you will be managing in a competitive marketplace.

Without revealing too many details about the insurance company and marketplace you will be working on in the second part of the case study, here is a little background information: it will be a relatively new player emerging that wants to differentiate the business model to scale effectively and leverage the flexibility that comes with the smaller size to catch market share from existing incumbent players. These players in the same marketplace that have a significant financial advantage, but are weighted down by legacy architecture and, in many cases, too long decision-making processes.

This case study has been created for you to practice:

- How to overcome organizational obstacles and act on new opportunities

- How to position your organization to turn disruption and change (reactive approach) into an advantage (proactive approach).

- To identify problems before they happen so that you can pre-solve them, customers' needs before they express them, and game-changing opportunities before the competition.

- To develop the ability to identify the driving forces of predictable change

This case study has five distinct phases:

1. Analyzing the ecosystem (radar chart exercise)
2. Understanding the business model of the company you will be managing and the environment and market data
3. Drafting a strategy for your company
4. Deciding on a strategic roadmap
5. Presenting your strategy to a panel (board of investors)

In this first part of the case study, we ask you to

- <u>Read through the information provided</u> to you about the ecosystem of the motor insurance industry

- <u>Conduct a radar chart analysis</u> of the disruptions and/or trends you can identify and map them as either a thread or an opportunity as well as in terms of relevance using the radar chart attached.

Trends and disruptions shaping the insurance industry landscape

The social and economic framework is changing, and that is impacting more than one industry.

In the following pages we have summarized some of the major forces that have been identified as being critical to the motor insurance industry and that we will be working on for this case.

Why we can most likely agree that these forces are all relevant and to be taken into consideration, decision-making depends on making the best possible assumptions on which forces will dominate, or even combine, and thus be critical for players in the industry to adapt their business model proactively.

Please take the time to read through the information given on these driving forces of the ecosystem and then move to the attached radar chart to map them out as instructed.

The forces listed below are in no particular order.

- Lifestyle changes

Over the past two decades, a multitude of small to major factors has resulted in significant lifestyle changes. While the recent accelerated climate of general social instability has impacted if and how people travel, work and move, the added economic pressure from a spike of raw material prices and inflation has added to the overall insecurity.

Additionally, demographics have changed. With the now upon us exit of the baby-boomer generation from the active workforce, several effects can be felt. While living in major urban agglomeration was required and desired due to proximity to workplace amongst others the increased options of working remote as well as emerging gig economy combined with the rising costs of living have changed these dynamics.

All these combined trends do not only affect if and who buys insurance, but also how these customers will compare, buy and then stay engaged with their insurance company. It will also change the type of insurance that people are requiring, in alignment with these changed lifestyle and mobility trends.

Our relationship with the car is changing, too. Car ownership is on the decline, particularly among urban millennials and other city dwellers, as people factor in the perceived high cost of car ownership as well as alternatives such as ride hailing and car sharing. Every rise of gas prices puts additional pressure on households who decide against car ownership if they can. In addition, the youngest generations are much more sensitive to environmental impact and many turn to alternative means of transportation.

- Data and cyber security

In recent years we went from big data to everything is data. While both high volume and fairly easy access to data has great advantages, such as an option for more personalized policies, better algorithms and potentially beneficial pricing models for customers, data privacy concerns are and remain at the forefront of the debate.

While insurance companies have started to systematically implement increasingly rigorous security protocols and end-to-end encryption, the fear of how data is collected and how it is used remains. Even though a majority of organizations that store and transmit identifiable consumer data are turning to advanced encryption, AI and other security protocols to comply with stringent security standards outlined by frameworks such as SOC 2 and ISO 27001, new partnerships to share and leverage consumer data has raised the question again as of who owns and can use, sell or otherwise share data and what consent of the user is required and needed – or not.

Every occurrence of algorithm biases and/or discrepancies in data collected reduce consumer trust and one major incident of a well-known insurance player might create ripple effects across and beyond the industry.

Last but not least, while consumers might trust their insurance company with their data in a more or less conscious way, it is a different story for data provided or needed by an increasingly automated vehicle. Users tend to be more concerned of their vehicle being subject to fraud or a cyber-attack and related incidents. While consumers are willing to give up a surprising amount of their personal data in exchange for personalization of products and services, convenience or discounts, it seems that for many, geolocation data is very sensitive. As usage-based insurance gains mainstream adoption, these consumers may face increasingly disproportionate premiums for refusing to give up their privacy – if regulators do not step in.

- Regulatory

Considering the charged past of the financial services industry, strong directives and regulations are, by now, considered an industry standard. From Solvency II, the Insurance Distribution Directive to IFRS 17, there is widespread compliance.

However, the recent rise of more hybrid if not fully newly emerging insurance models has brought regulators back on the forefront of the conversation. The regulatory focus grows ever larger, incorporating the full insurance value chain – including finance and governance.

On the one hand, it is not clear how regulation of data collection and usage will be handled moving forward. There is a growing debate concerning data governance regulation and the privacy rights of individuals. Not only does that affect if and how data can be used for advanced algorithms, new regulations around data security and fair pricing would likely necessitate technology upgrades and process changes that add costs and complexity.

This means that insurers struggle to keep up and incompliance with new regulations, and the cost of compliance rises at the same time.

- New players in the marketplace

After a first wave of disruption by new players arriving on the marketplace, the industry landscape has started including and making room for InsurTech players in different ways.

However, more third-party insurers are now emerging – from more traditional financial (banking) institutions to data players as well as car manufacturers (that leverage new vehicle development with increased automation to throw their hat in the ring to propose insurance products that match their vehicle capabilities). They understand that being the hub that collects driver and vehicle data from embedded telematics devices in vehicles gives them an excellent position to distribute insurance or sell data to insurers and thus access a new value stream. Some manufacturers are already equipping vehicles with telematics devices and partnering with insurers.

For automakers specifically, being potentially able to offer data-driven insurance at the point of sale enables them to broaden their portfolios of financial services and reposition themselves along the insurance value chain, as well as delivering value-added services to support their brand differentiation. Managing these subscriptions in-house will grant automakers a chance to keep in touch with customers as well as improving their customer relationship management programs. Drivers' positive experiences with automakers as insurers will also affect the consumer preference towards a particular car brand. And finally, a direct access to customers and their cars would create huge databases for delivering personalized recommendations.

There is also a stronger emergence of partnerships and mergers, even linking to other directly related industries, to fulfil the quest to create a more seamless user experience for the consumer related to his or her lifestyle choices.

With the exponential increase of volume and importance of data combined with advanced analytics, players that have excelled in that area (such as a Google, Facebook or Amazon), that have a global reach, very advanced analytical skills, proven platforms and consumer trust and loyalty, might be tempted to not only offered well-targeted, tailored products, but also began to cherry-pick low-risk customers. If they did so in significant numbers, the insurers' business model, whereby premiums collected from low-risk policyholders contribute to the claims of high-risk ones, could fall apart.

- Economic and Financial Fragility

Due to the effects of the pandemic of the past 2 years combined with current geopolitical pressure, not only financial markets but also households are in turmoil. With inflation rising across all continents combined with environmental worries, there is limited confidence in the upcoming future.

This general climate of uncertainty holds back financial investments, especially in newly emerging business models, but also affects households and organizations alike in their purchasing power.

New alternative currencies add further to the disruption, as their long-term sustainability and effect is yet to be evaluated.

- Technology innovation of the auto industry

Latest innovation in the automotive industry must be looked at closely. On the one hand, it allows to proactively work on insurance models that are adapted to the newest technology and implement supreme predictive analytics models. They are the baseline for more wide-spread usage-based automotive insurance, where policies are based on driving behavior.
On the other hand, insurance companies can try to leverage said technology to find ways to give stronger incentive to consumers for risk-reducing behavior and get closer to the user.

Increased car connectivity and the creation of a system of engagement around the car, opens new distribution channels for selling motor insurance or cross-selling different insurance products to the driver. By exploiting in-car telematics, insurers can learn more about their customers to identify potential opportunities to cross- and up-sell supplementary products and policy features.

Technology also allows interconnectivity and exchange of data to create a product and service ecosystem for consumers.

While there is potential, there is also significant limitation. The interconnectivity and real-time access of data is fairly advanced in selected urban settings. However, rural areas are lacking behind. In addition, if the volume of data would increase to the extend required to make more autonomous vehicles function, the infrastructure is as of now not in place to accommodate such large data transfer faultlessly.
This is one of the reasons the National Highway Traffic Safety Administration (NHTSA) notes that fully automated cars, while technically possible, will take another decade or two to become mainstream, if and only if the infrastructure is put in place. In addition, given the costs of acquiring a new car and the increasing lifespan of a vehicle of 11-15 years, the transition will be slowed down even further.

Insurance providers should also watch out for the increasingly open question of liability with more autonomous vehicles. The question of who is liable when in a crash - the human driver, the vehicle or even the automaker – and, as a consequence, who needs to be insured, is only at the beginning.

Last but not least, the big question-mark remains consumer acceptance of partially or even fully automated vehicles, which will depend a lot on their confidence in these new technologies.

- AI

A rapidly rising number of underwriting platforms are generating impressive gains in speed and efficiency, while working hard to include social media data and functionalities. AI holds the potential for real-time data collection and processing, enabling insurance companies to optimize underwriting as well as claims and appeals processing. Increasingly, AI is also being used for fraud detection and to mainstream and optimize virtual assistance such as chatbots. As AI can be used across the value chain it leads to favorable financial impact as well as, ideally, better modelling and increased customer satisfaction.

Against effectivity gains stand the risk of discrimination through profiling, which has become a sensitive topic and raises the risk or potentially opportunistic pricing. In addition, it is unclear how these various effects will put pressure on lawmakers related to data privacy.

- Consumer expectations

Customer's expectations have changed significantly, and digital technology has accelerated this transformation. Overall, customers have become more demanding. One the one hand they want simplicity: 24-hour access and quick delivery, clear, relevant information about a product's features, particularly in relation to pricing. However, they also want innovative, tailored services. An increasingly technology-savvy customer expects products and services to be highly flexible and adapted to their unique lifestyle.

On the other hand, there is a need for a solid backbone of options for consumers to speak and address a real customer representative or agent when a problem arises and have human and personalized interactions, which is forcing omni-channel support.

In the shorter term, fulfilling this goal is a chance for insurers to improve profits in their core business. Higher customer satisfaction, driven by the improved service and faster processing times that digitization delivers while still providing an option for personal connection, is itself a driver of profit through increased customer retention. At the same time, by digitizing their existing business, carriers can remove significant cost across the value chain, further increasing customer lifetime value.

This is even more relevant because loyalty to a specific brand has declined steadily. New forms of community management of consumers through more personal interaction with "their" brand are taking hold, closely related to lifestyle preferences and values, and foster more lasting bonds of loyalty.

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