

Transforming the Insurance Industry To Increase Customer Relevance

How Cultural, Process, and Technology Change Can
Significantly Increase Shareholder Value for Insurers

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"We have been in the insurance business for more than 150 years, and now is the time for change."

—Ivo Furrer, CEO, Swiss Life, Switzerland

Introduction

From Apple to IKEA, we live in a world of innovative products, services, and experiences. Today's consumers are increasingly comfortable using social media, mobile phones, and PCs. With this technology, consumers can more easily find what they want, compare it with other items, get recommendations from friends, family, and colleagues, buy from wherever they're located, and tell each other about the experience afterward. The balance of power has clearly shifted from suppliers to consumers.

In response to this dramatic change, many companies have successfully transformed their business models to stay relevant to their customers. Apple, for example, has morphed from a PC maker to an entertainment giant, while Ryanair is making its fares virtually free by covering costs with adjacent fees from travel-related services. Within the financial services industry, HSBC now invites customers to provide input about new products, ING monitors interest rates and keeps customers up to date with Twitter, and Banco Popular recently launched a social media site designed specifically for older customers.

Despite these examples, many insurance companies continue to rely on the traditional business model of selling large numbers of products designed for mass markets through agents and brokers. From an insurer's point of view, establishing personal relationships with customers happens only when a claim is made. For consumers, insurance is seen as a commodity. Beyond a certain point, there is little differentiation between core insurance products and providers. In this environment, consumers often choose their insurance products based solely on price.

In a highly competitive industry that is not traditionally known for innovation, changes in demographics, technology, and business models are creating significant new opportunities for insurance companies to defend market share and grow revenues. In fact, the insurance industry is at a crucial tipping point. Insurers can either prosper by becoming more relevant, or continue along the same path and see business slowly deteriorate as customers migrate to companies with more innovative solutions and business models that better suit their needs.

By focusing on three major innovation strategies—1) identify profitable target customers; 2) develop new products and services for these target groups; and 3) create media-rich

experiences to serve customers—insurers can increase profitability by 15–20 percent within five years, according to estimates from the Cisco® Internet Business Solutions Group (IBSG).

Trends Impacting Customer Relevance

Four trends are influencing insurance companies with regard to customer relevance:

1. Heightened consumer expectations
2. New entrants and niche players taking market share from incumbents
3. Demographic shifts that are creating new opportunities
4. Consumers' comfort level using new technologies

Heightened Consumer Expectations

In today's Internet- and mobile-enabled world, customer expectations are being shaped by daily transactions and interactions with companies across various industries. For example, Amazon.com has raised standards for online service, while Hilton Hotels and Harrah's Casinos have become well known for providing superior customer experiences. As a result, insurance companies must establish their own benchmarks for service delivery against those of leading experience providers, not their peers.

Threats from New Entrants and Niche Players

The inability of traditional insurance companies to deliver what consumers expect is creating an opportunity for new entrants and niche players to erode the market shares of incumbents. Sheila's Wheels, for example, is a successful online niche player that provides affordable car, home, travel, and pet insurance for women. Targeted products and services include insurance for lost purses and discounts at female-friendly automotive repair shops.

Tesco, one of the world's largest retailers, launched its personal finance business in 1997. Over the past 14 years, the company has used customer data (with their permission) from its highly successful loyalty program to target prospects and refine product and service offerings. In 2007 (the last year of its joint venture with Royal Bank of Scotland), Tesco Personal Finance (TPF) made \$300 million in profits and set aggressive growth targets after taking full ownership of TPF in July 2008.¹

Demographic Shifts Creating New Opportunities

The world's population is aging rapidly. Every second, two people turn 60.² And the large majority of people over 60 have never been healthier.³ Given these trends, budgetary estimates point to significant fiscal challenges. For example, the European Union (EU) predicts an increase in public spending for pensions of 2.4 percent of GDP until 2060.⁴

At the opposite end of the spectrum, young people are becoming a significant target segment for insurers. Cisco IBSG estimates there are currently more than 90 million underinsured young people across Europe.⁵ There will be strong competition for this large market segment since it represents the next generation of core customers for insurers.

These demographic shifts, especially among members of Generation Y (also known as "Millennials," and defined for the purposes of this paper as consumers born between 1982 and 1992) and baby boomers (consumers born between 1946 and 1964), are creating

unprecedented opportunities for the insurance industry. Insurers can now create and offer products and services that meet the specific needs of distinct customer groups. For example, baby boomers should be open to learning about savings instruments to protect their current standard of living, while younger consumers may want to spend some of their disposable income on products that help them purchase homes or cars in an era of tight credit.

Consumers' Comfort Level with New Technologies

Today, consumers have countless choices for products and services from a myriad of companies across multiple channels. Greater use of the Internet for virtual communication, entertainment, and commerce has also made customers much more informed. This increased comfort level with new technologies has spawned a new breed of consumers capable of quickly finding, evaluating, and purchasing products online.

With regard to insurance, people now use the Internet to find and compare products. Several companies are taking advantage of this trend to make it even easier for consumers to buy from the lowest-cost provider. Comparis.ch (Switzerland), Confused.com (United Kingdom), and Versicherungsvergleich.de (Germany) are three examples of firms providing information that allows consumers to compare a wide range of insurance offerings.

Current Business Model Creates Significant Challenges

Within the non-direct distribution model, agents currently control access to customers, inhibiting insurance companies from learning about and adapting quickly to changing customer needs and market conditions. In fact, research conducted by Cisco IBSG indicated that this knowledge gap results from not working with customers in the presales phase, as well as from ignoring the overall experience of customers as they search for information, receive advice, and acquire products.⁶ It is important to note that this constraint does not apply to direct insurers, enabling them to use consumer insights far more efficiently.

In addition, the frequency and quality of interactions with customers is perceived as low because they are limited to issuing policies and resolving claims—two stressful events for consumers when working with insurance companies.

Finally, many insurers question whether their distribution channels add enough value in the sales process or are aggressive enough in acquiring new customers. There is widespread concern that agents and broker channels are too costly given the way they serve customers.

This has caused providers such as State Farm to move aggressively to help improve their channel partners' sales and service capabilities, and to implement direct selling methods. This is helping ensure customers benefit from the high-touch service of agents, while providing the convenience of a direct model.

For insurers that move too slowly, structural inefficiencies in the old sales model present numerous challenges, including limited customer insights, lack of innovation, low perceived customer value⁷ and loyalty,⁸ high IT spending with limited returns,⁹ and poor financial results.¹⁰

Business Model Transformation

The cumulative impact of the current challenges makes industry transformation imperative. Fortunately, the global economic crisis, while abating, gives insurers a window of opportunity to transform their business models and reconnect with customers by truly understanding their needs and providing products and services that are relevant to their lives.

This transformation, however, will require new ways of thinking about company culture, business processes, and technology investments. Most important, change will depend on a high level of *innovation across the organization as well as radically improved collaboration with customers*. To be effective, insurers should focus on three things:

1. Determine and target promising customer groups
2. Create customized, bundled solutions of existing products and adjacent services
3. Deliver products and services through the channels that fit the lifestyles of targeted consumer groups

1. Determine and Target Promising Customer Groups

Successful companies target specific customer groups that offer attractive returns. In fact, target marketing has become a winning strategy for companies to differentiate themselves in mature markets. For the purposes of this paper, we have selected two customer segments—Generation Y and baby boomers—since these groups offer significant opportunities for insurance providers based on each group's unique needs.

Generally, Gen Y customers are independent and earn more than they did in their teenage years. This group is encouraged by a consumer-based society to seek immediate satisfaction. Given this profile, young people are not interested in pensions or annuities, and prefer to have insurance products sold to them in different ways.

In contrast, baby boomers want to remain an important part of other people's lives and are looking to remain active after retirement. Protecting wealth and maintaining health dominate their thinking and actions. Baby boomers also want to stay independent and have the freedom and resources to travel. For example, 30 percent of British adults aim to retire abroad, while 80 percent want to travel internationally after retirement.¹¹

2. Create Customized, Bundled Solutions

New products and services from insurance companies must appeal to the needs and desires of targeted customer groups, while offering immediate customer satisfaction. This approach will require insurance companies to bundle their core products with adjacent value-added services to become relevant to customers' specific life situations.

Example 1—Innovative solutions for baby boomers: As discussed, people in the later stages of life have a wide range of concerns about finance, health, property, inheritance, independence, and travel. Rather than playing a limited role in offering baby boomers peace of mind through traditional products, insurers could expand their role to become the main source of information, products, and services that help their customers keep healthy, remain independent, and stay connected with friends, family, and society.

As an example, imagine a married couple in their mid-sixties. Since the main income contributor retired three years ago, their retirement savings have dropped about 20 percent

due to the economic crisis. Because they planned carefully and have an annuity and a whole life insurance policy, however, they believe they can still enjoy a nice lifestyle. They also want to travel as much as possible and stay connected with friends and family (their daughter recently gave birth to their first grandson).

What if this couple's trusted insurance company was able to be a single source for all types of services related to their situation? What if the company's offerings included a secure portal that allowed the couple to access financial advice over the web or through their mobile phones? What if the insurer also partnered with healthcare providers, security firms, telecom providers, and travel and hospitality businesses to bundle and offer these services on the same portal at attractive rates? This type of bundled solution will make insurance companies more relevant to their older customers.

Example 2—Innovative solutions for Gen Y customers: Most insurance companies ignore Gen Y consumers because they believe this customer segment doesn't have the means or desire to buy traditional insurance products. Gen Y consumers, however, are essential to insurance companies' futures. This makes it critical for insurers to recruit young consumers early so they can become loyal customers when the time comes to purchase more traditional insurance products.

Younger consumers are already spending large amounts of discretionary income on products in other industries such as music, clothing, mobile phones, and video games. Younger consumers buy these products because they provide fun and enjoyment, and enhance personal relationships with their friends.

For example, an innovative solution for Gen Y consumers could combine a savings product for wealth accumulation with adjacent services such as social media-based experiences that teach sound financial principles. Functions could also include ways for parents to supervise transactions and options for relatives to deposit money as gifts. This type of solution would help younger customers build a stronger affinity with the insurance company through on-going interactions and allow providers to attract the next generation of customers who will drive their businesses for years to come.

3. Deliver Products and Services Through the Right Channels

Bundling innovative products and services will be possible only by changing the current insurance delivery model. One option is to fully integrate value-added services into the product itself. Another, more flexible approach is to add or change services based on specific customer requirements by adopting an aggregation model. With this approach, an aggregator bundles insurance products with value-added services, information, and interaction capabilities that are then provided to targeted customers. This is a "win-win" situation because it makes the process of transformation easier for insurers while providing a convenient "one-stop-shop" for customers.

Insurers can deploy the aggregation model in two ways:

- **Work with an established company that serves the needs of specific customer groups by providing white-labeled products with the offering.** In this case, the aggregator represents a distribution channel that owns the customer relationships. Fund Lab of Credit Suisse, for example, bundles approximately 2,500 funds from more than 60 providers to allow customers to choose the product that best fits their needs.

- **Build the necessary capabilities and expertise in-house.** This approach allows insurers to manage the customer experience directly, earn additional fee-based income, and control their own brand positioning. Establishing effective in-house capabilities, however, requires sizable investments to develop new services, establish a different culture, and reposition the brand.

The Journey to Customer Relevance

To ensure a successful transition from a traditional business model to one that is more customer-focused, Cisco IBSG recommends insurers take a structured approach. From its work with leading insurance and financial services companies, Cisco IBSG has developed a seven-stage transition process:

Stage 1—Select specific customer groups: The intent of this step is to identify and prioritize groups of customers with similar characteristics that offer untapped business opportunities. Examples include high-net-worth individuals, expatriates, small and medium-sized businesses (SMBs), and young consumers.

Stage 2—Gain customer insights: To truly understand consumers, insurers must learn about the deep-rooted needs and emotions that cause them to buy products and services. To gain these insights, new research methods are required.

For example, a team of researchers from Bank of America spent three months observing and interviewing people in Atlanta, Baltimore, and San Francisco to discover how they managed their finances as they went through their daily routines. Over the course of the research, two themes emerged. First, many people rounded up the amounts of their checkbook entries because this method made it faster and easier to balance their accounts. Second, many baby boomers with children weren't able to save money either because they didn't have enough funds to meet their basic needs, or because they had trouble controlling their impulse buying. This type of "on-the-ground" research often results in ideas for innovative new products and services (see Stage 3).

Stage 3—Design innovative solutions: To develop innovative, new insurance solutions, it is important to bring together the most creative thinkers from across the company. In this phase, it also helps to work with customers and partners to co-create new solutions.

The Bank of America example spawned a new program called "Keep the change." Each time a customer buys something with a Bank of America Visa debit card, the bank "rounds up" the purchase amount to the nearest dollar and transfers the difference into the cardholder's savings account. After just two months, the program had 2.5 million members, with 700,000 people opening new checking accounts and 1 million customers signing up for new savings accounts.¹²

Stage 4—Fully utilize company assets: Insurance companies already have many valuable assets that are required to build innovative solutions. These include trusted brands, partner relationships, and extensive distribution networks. Currently, however, many of these assets are not fully utilized to offer relevant value propositions to customers beyond the standard set of insurance products. Even so, these assets can make it easier for insurers to create, launch, and deliver innovative solutions.

Stage 5—Aggregate services and information with standard products: Today, customers must bring together all of the various components needed to meet their insurance needs. Buying a car is a great example. Customers must select the type of car they want from the dealer, and then choose the insurance company they want after the deal is done. By offering the car along with financing and insurance at the point of sale, many car companies, including VW and Ford, have created powerful financial services units that now have control over the customer value proposition. In this scenario, consumers are also happy because they save time and get a good deal on the packaged services.

Stage 6—Interact with customers more often: According to a report that ranks the world's top 100 brands, the most-engaged companies—those that interact with their customers using social networking tools such as blogs, Twitter, and Facebook—increased revenues 18 percent in the past 12 months, while the least-engaged companies saw revenues drop 6 percent over the same period.¹³

To fit in with today's consumer-oriented world, the insurance business model must evolve from one that interacts with customers infrequently to one that creates an ongoing, relevant conversation. Only when insurance companies are connected to customers will they be able to sense their needs, respond with relevant solutions, and gain their trust. To do this, Cisco IBSG recommends insurance companies begin to measure contact frequency and interaction quality with customers as soon as possible.

Stage 7—Provide excellent experiences at every touchpoint: Insurance companies must drive excellence into and across their value chains. By focusing on processes that “touch” customers, and by creating touchpoints that customers access directly, insurance companies can differentiate themselves from competitors by delivering excellent shopping experiences. While most insurance companies have launched projects to improve service quality, many of these efforts have been driven by isolated organizations and lack a process-oriented, end-to-end view to make them successful.

Suggested Approach

Implementing innovative solutions that combine products and services for targeted groups is challenging. These types of solutions cut across organizational boundaries and existing lines of business. In addition, the new business model may conflict with the existing company culture. To overcome these challenges, Cisco IBSG recommends insurance companies take the following steps during the transformation process:

Take “green-field” approach to innovation: Create a separate organization, insulated from the core business, to develop the new solutions. This fosters a protected environment where innovative thinking can develop and flourish without being stymied by the limitations of the current organization. This method also protects the new operation from resistance that might arise from within the existing organization.

Allow for special governance: Assign a business unit CEO to sponsor the new organization. This will give the new unit the protection and support it needs to succeed. Next, select a high-profile executive to lead the effort. Then, assign a small, highly qualified team of employees, and empower them with the resources needed to get the job done.

Think big, start small: Create a broad vision for how the company should build value for customers. Ask the team to focus on the most promising solutions first to accelerate time to

market. This will enable the new organization to achieve success quickly in order to gain additional support from the rest of the company.

Information Technology Implications

Making the transformation to a customer-relevant business model has significant implications for the use of information technology (IT). Today, most IT investments are allocated to maintain and consolidate legacy systems. While this may lower costs, it adds little to improving the customer experience, driving innovation, increasing agent productivity, or reducing time to market for new products. In addition, most insurance companies do not have a single view of the customer, which hinders cross-selling and up-selling. And finally, most insurers lack true multi-access capabilities for partners and customers.

Use Portals To Bundle Content from Partners

Portal solutions help bundle content from different partners into complete, easy-to-use solutions. Portals also offer a consistent look and feel for both consumers and agents, and can be personalized to tailor information and services to meet specific needs or access requirements. Rich collaboration tools can be integrated with portals, making it easy for consumers to interact with insurance companies and other service providers.

Invest in the Network as the Platform

Today, most insurers view the network as a commodity. To deliver the experience expected by today's tech-savvy consumers, the network infrastructure must be viewed more strategically since it connects and provides access to all of the components necessary for insurers to increase customer relevance. Given this, most insurers will need to upgrade their networks to provide easy access, acceptable response times, interoperability with partners, and secure, trusted access to services and information.

Add Collaboration Tools for Rich Customer Interactions

The most important factor for building trust with customers is to have regular, value-added interactions with them. Today, insurance providers (including channel partners) have no regular dialogue with their customers. This is due to several factors:

- It is difficult for consumers to get to the right person to answer even simple questions.
- Most interactions are paper-based.
- Customers must visit their agents in person to get personalized advice.

Consumers expect better service than they are receiving from their insurers today. To meet customers' needs, insurers should create a collaboration architecture that offers anytime, anywhere access through any device they wish to use.

Financial Benefits of the New Business Model

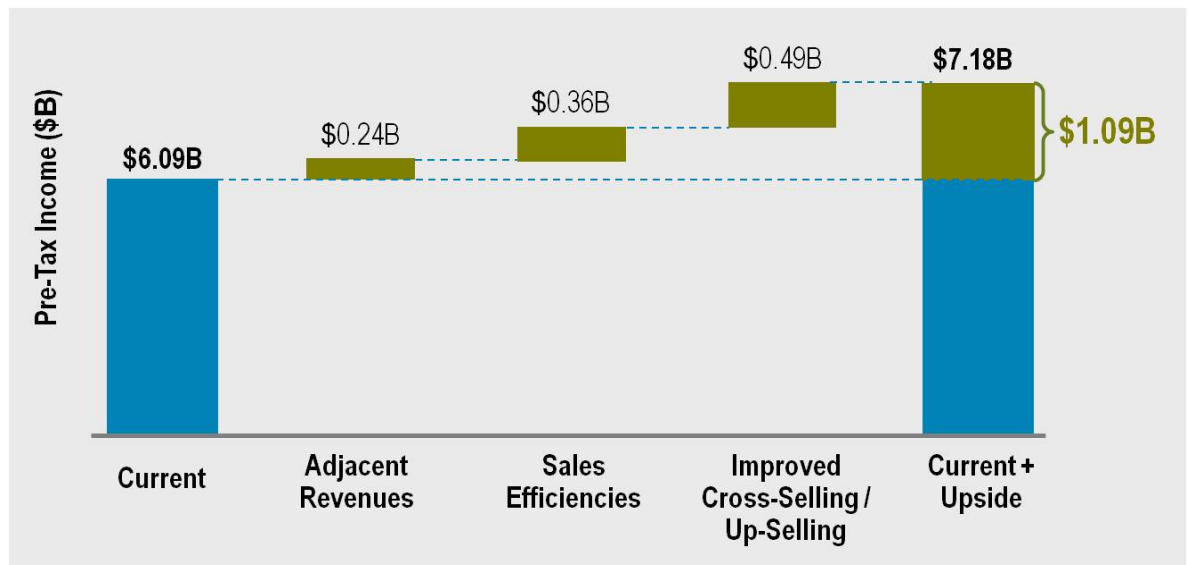
By using newly gained customer insights to create relevant offerings and service models, insurers can increase profitability in three areas (see Figure 1):

1. **Adjacent revenues:** Commissions from third-party providers for selling adjacent services will create new revenue streams. The Cisco IBSG Research & Economics Practice estimates that adjacent products can provide an incremental income source amounting to 5 percent of total pretax income. This is comparable to insurers' EBITDA

margins for core insurance products. For a model insurer with revenues of \$114 billion and income of \$6 billion, this equates to an additional \$0.24 billion in pretax income.

2. **Sales efficiencies:** Solutions that offer more customer value can be sold at lower costs with less effort, increasing the revenue productivity of agents and insurers' internal sales organizations. The Cisco IBSG Research & Economics Practice estimates selling costs can be reduced by \$66 per product. For the same typical insurer, this equates to a cost reduction of \$0.36 billion, which directly adds to net income.
3. **Improved cross-selling:** By offering solutions that address specific life situations, insurance companies can increase customer satisfaction and premium income through better customer retention, and easier cross-selling and up-selling. Cisco IBSG estimates that raising the number of products per customer by just 0.2, from 2.5 to 2.7, will have a significant impact on revenue growth. For the same typical insurance company mentioned earlier, this equates to an additional \$9.2 billion in revenues and \$0.49 billion in pretax income.

Figure 1. Insurers Can Increase Pretax Income from Adjacent Revenues, Sales Efficiencies, and Improved Cross-Selling and Up-Selling



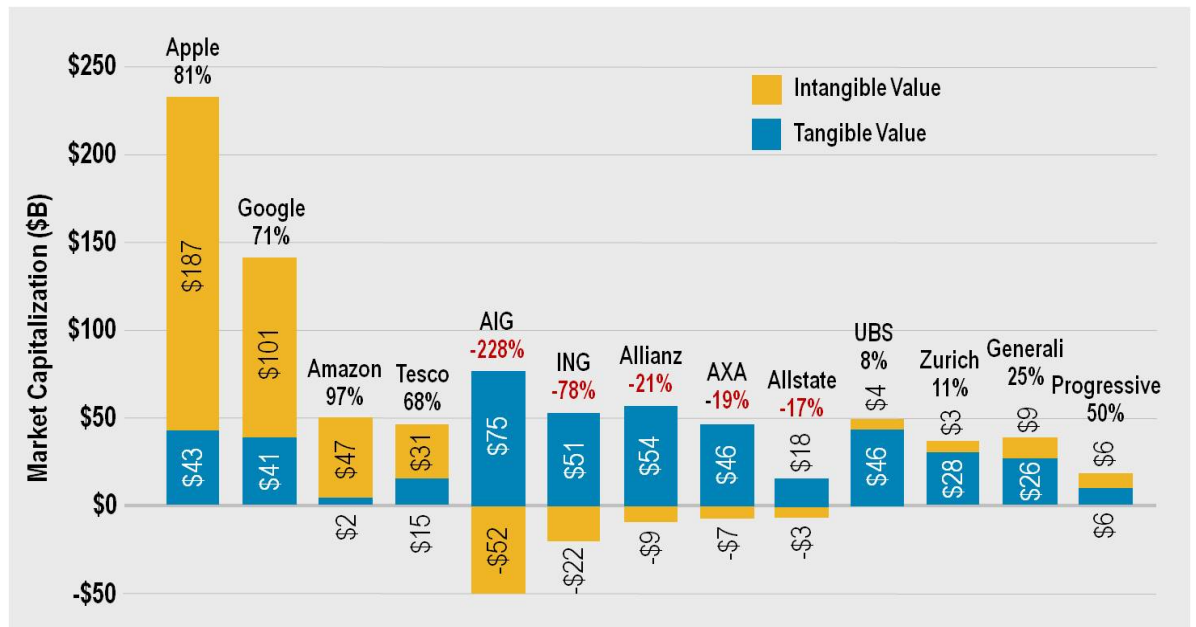
Source: Cisco IBSG Research & Economics Practice, 2011

When these three areas are combined, the Cisco IBSG Research & Economics Practice believes a typical insurance company that invests in customer relevance can increase its profitability by 15–20 percent within five years, or an additional \$1.09 billion of pretax income per year, as shown in Figure 1.

In addition to these tangible value improvements, there is also an opportunity for insurers to create intangible value for their shareholders. The world's most highly valued companies are also those with significant intangible assets such as admired brands, strong customer loyalty, and differentiated value propositions (see Figure 2). For example:

- By putting customer experience and preferences at the center of its product development strategy, Apple has grown the company's stock price fivefold in just the past five years.¹⁴
- By offering its superior retail services and supply chain capabilities as an adjacent service, Amazon enabled its stock price to outpace that of its competitors (by 300 percent versus eBay, and by 200 percent versus GSI Commerce).¹⁵
- By launching an integrated solution that combines health protection and income-preservation products supported by assistance services and specialized advice, Generali Group, an Italian insurance company, expected to add 150,000–200,000 customers and increase its revenues by €3.5 billion (\$4.6 billion) within three years.¹⁶

Figure 2. Market Capitalization by Tangible and Intangible Value



Sources: Cisco IBSG Research & Economics Practice, 2011; Thomson Reuters, 2010; company annual reports

Conclusion

Given the significant challenges insurance companies face today, it is important for executives to think seriously about transforming their companies' business models to better understand and become more relevant to their customers. Doing so will not only improve short-term results, but promote revenue growth, financial stability, and prosperity.

Recent trends, including heightened consumer expectations, new market entrants and niche players, significant demographic shifts, and advances in technology, have created an important window of opportunity for innovative insurers to act now. By deploying the methodology described in this paper, insurers have a low-cost, limited-risk, high-return way to make transformation possible.

Insurers that take steps to transform their business models to become more customer-relevant can improve employee and agent productivity, increase their customer base, grow total lifetime customer value, and create additional revenue streams from new business

models. Overall, Cisco IBSG estimates that a typical insurer can increase profitability by 15–20 percent within five years through the approach described in this paper.

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Doug Handler and Joel Barbier of Cisco IBSG's Research & Economics Practice, and Michael Adams of Cisco IBSG's Strategic Communications group, contributed to this paper.

Endnotes

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More Information

Cisco Internet Business Solutions Group (IBSG), the company's global consultancy, helps CXOs from the world's largest public and private organizations solve critical business challenges. By connecting strategy, process, and technology, Cisco IBSG industry experts enable customers to turn visionary ideas into value.

For further information about IBSG, visit <http://www.cisco.com/go/ibsg>.

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