MERGERMARKET

Willis Towers Watson

New horizons

How diverse growth strategies can advance digitalisation in the insurance industry

The times are not just changing – they have changed. And the insurance industry needs to adapt to the new digital landscape. Organisations must deliver an innovative and future-proof digital transformation strategy or they risk becoming obsolete.

New horizons

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Foreword

Founded in 1866, Hartford Steam Boiler might not sound like an insurer at the cutting edge of digital technology. Yet the business, a subsidiary of Germany's Munich Re, is the proud owner of a stake in Waygum, a technology start-up that is working to develop applications related to the internet of things. The deal is just one of a string of similar transactions seen throughout the global insurance sector over the past three years, as businesses seek to capture the benefits of digital transformation.

Many leading players in the insurance sector concede they have not been as quick to embrace digitalisation as other financial services players. Yet this is now changing rapidly, with businesses committing sizeable sums to a variety of different types of projects. By the beginning of 2016, for example, the insurance sector had collectively made commitments to invest more than US$1bn in technology start-ups as part of the attempt to play catch-up.

It is against this backdrop that Willis Towers Watson has surveyed 200 senior-level executives to map the changing attitude of insurers to digital technologies and to examine the extent to which companies are using M&A strategies to realise their ambitions.

The survey identifies where insurers see the biggest holes in their digital capabilities and reveals how they plan to close these gaps. Do they believe, for example, that digital transformation can be led from within the company, or will the race to secure the benefits of digitalisation power a new wave of corporate transactions?

Inevitably, insurers' responses are nuanced. There are no one-size-fits-all structures for achieving the goals of digitalisation – insurers see a number of potential routes forward, many of which they will travel simultaneously.

Certainly, organic growth will play its part, with insurers investing increasing sums in internal innovation and R&D that is designed to deliver digital transformation. However, M&A and strategic partnerships are likely to play a greater role as time is of the essence and competition is fierce.

Insurers understand that the size of the prize is too valuable to ignore. For example, some 30 billion objects will be connected to the internet of things by 2020, each one constantly generating data from which actionable insight may be secured including improved underwriting, customer engagement, retention and faster new business processing. Across the insurance sector, the power and value of this technology, and many more, is almost incalculable. Now is the time for insurers to capitalise on these emerging digital opportunities.

Executive summary

Insurance playing catch up

In terms of digitalisation, the insurance sector is lagging behind other financial services in implementing digital technology. Well over half of those surveyed believe this to be the case. There are a number of reasons behind the sector's seeming reluctance to take advantage of the opportunities that digitalisation offers. The complex maze of regulations has often been cited by insurers as a reason for slow adoption and while this is valid, our survey reveals a deeper and possibly more disturbing reason – fear. Notably, the fear of failure or the fear of being first to market. While this is understandable, insurers need to put their heads above the digital parapet, if they are to engage with the next generation of policyholders.

Technology transforms

Despite the reticence within the industry, firms are in no doubt that technology will drive substantial changes. From distribution to policy servicing and loss adjustment, our survey reveals that no part of the process will remain untouched by technology. And, as technology evolves, insurers need to stay ahead of the game. While big data and mobile delivery is the wave of the present, blockchain is on the horizon and could be a game changer for the industry. With this level of transformation, insurers need to be in the driving seat, otherwise they risk getting left behind as leaner start-ups or tech giants take to the field.

Watch your back

Complacency and procrastination could spell disaster. Our survey reveals that few insurers believe that a challenger from outside the sector will steal a march and most think that digital change will happen relatively slowly, allowing incumbents to copy innovations and maintain pace. However, what if a technological giant with access to capital and greater brand recognition turned its sights on the insurance industry? The mobile phone industry, once dominated by Nokia and Blackberry, demonstrates how seemingly invulnerable market leaders can quickly be toppled by faster-innovating competitors. 'Wait and see' is no longer an option.

Time to change

Our survey shows that many firms acknowledge the need to move fast to transform themselves digitally. And they are utilising a range of options to get there – internal research and development; internal and external venture arms; partnerships and M&A or, more likely, a mixture of all these routes. Moreover, our survey shows inorganic growth via partnerships, minority stakes or outright acquisition will increase in the near future. This means that companies need to have the skills to adapt and to integrate innovative start-ups. And this will involve a change of culture and strategy.

Methodology

In the summer of 2016, Mergermarket surveyed 200 senior-level executives within the insurance industry. Some 42% of those surveyed work predominantly in the life sector, 42% work in the property and casualty (P&C) sector and 16% work in the health sector. The companies involved were split equally across the Americas, Asia and EMEA regions.

The survey included a combination of qualitative and quantitative questions, and all interviews were conducted over the telephone by appointment. Results were analysed and collated by Mergermarket and Willis Towers Watson, and all responses are anonymised and presented in aggregate.

Chapter 1
A digital destiny

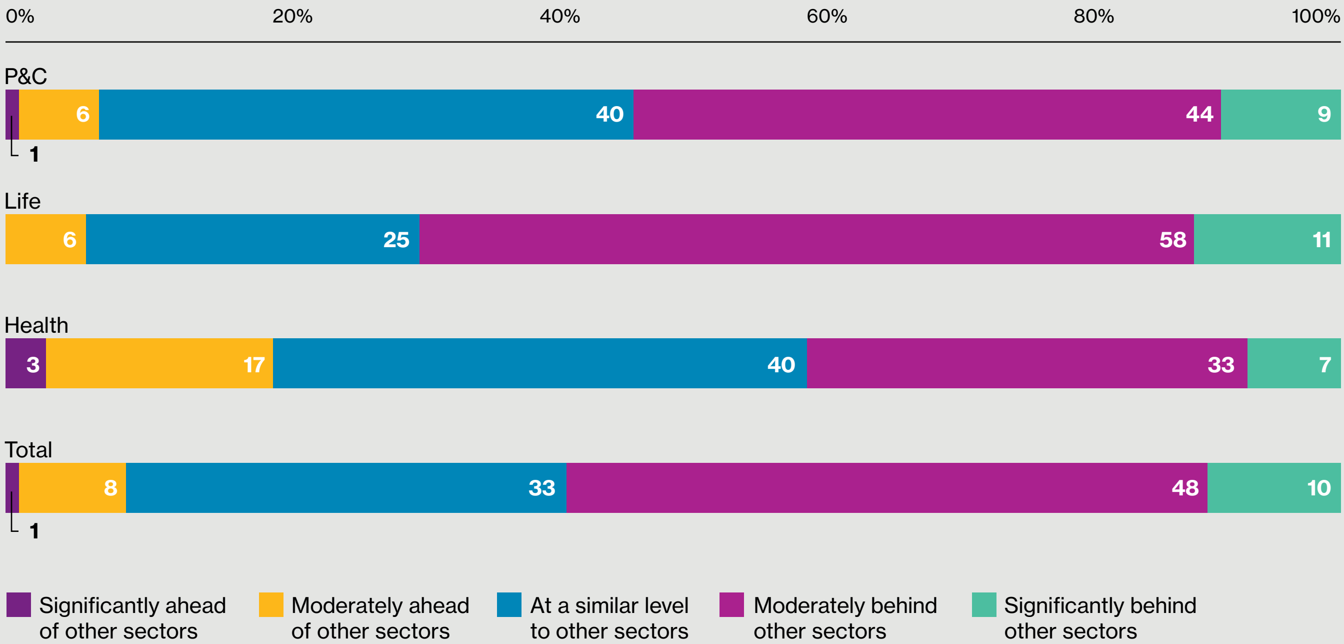
Insurers are behind their financial services peers in adopting digital technologies. This is as a result of regulations, reluctance and reticence, but times are changing fast

Insurers undoubtedly recognise the potential value of digital opportunities in both the front and back office. However, they are also realistic about the progress, or lack of it, made towards realising this potential so far. Organisations from across the sector accept they have not yet moved as quickly to embrace digitalisation as businesses in other areas of financial services.

Overall, more than half the respondents to this survey (58%) said insurance lagged behind other financial services organisations on implementing digital technologies. Firms in the health insurance sector are more likely to be pleased with their progress, with 60% ranking implementation as level with or even ahead of other sectors, while life insurers acknowledge that they are some way behind (see Figure 1). This may reflect advances such as the adoption of wearables in health, though other sectors are also adopting similar tools, such as telematics in auto insurance, for example.

However, firms accept that they need to build their digital function, whether through internally driven innovation projects or more external

Figure 1: **How would you characterise the level of adoption of digital technologies in the insurance sector compared to other financial service sectors?**



initiatives, including joint ventures and M&A activity. If they hesitate, they risk getting left behind as they fail to capture future generations and younger policyholders who are more likely to engage via digital distribution.

Adoption challenges

A number of different factors explain the difficulties insurers have had so far in pursuing digital opportunities. Most significantly, as Figure 2 shows, the complex and evolving regulatory landscape is clearly a challenge that stands in the way of insurers keen to digitalise – 42% of survey respondents cite this issue. That is likely to continue as insurers face further regulatory change in the years ahead – reform not only consumes resources as insurers focus on compliance but also poses new headaches as the industry attempts to digitalise while managing a new rulebook.

Another issue, argues Fergal O'Shea, EMEA Life Insurance M&A Leader at Willis Towers Watson, is that insurers have not traditionally had especially engaged relationships with customers. "Organisations such as banks have just had more contact with customers and that's given them a headstart," he says. "The quality and frequency of the information exchange between insurers and customers, who may simply be renewing a policy once a year, just isn't the same." Indeed, customer resistance (32%) and low frequency of contact between firms and their customers (22%) both feature in the main barriers to innovation.

Cost is also another major challenge with respondents bemoaning the length of time required to commercialise new technologies (32%) and the size of investment required to transform (24%).

Figure 2: **What have been the most important barriers to digital adoption in the insurance sector to date? (Please select the top three)**

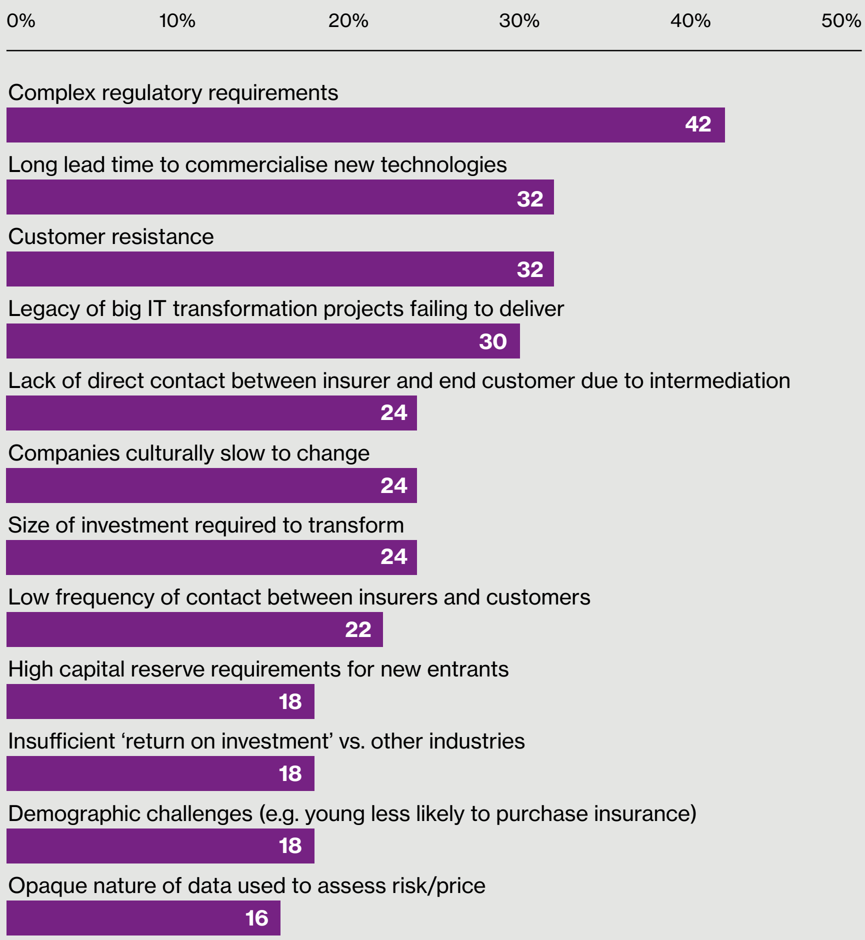
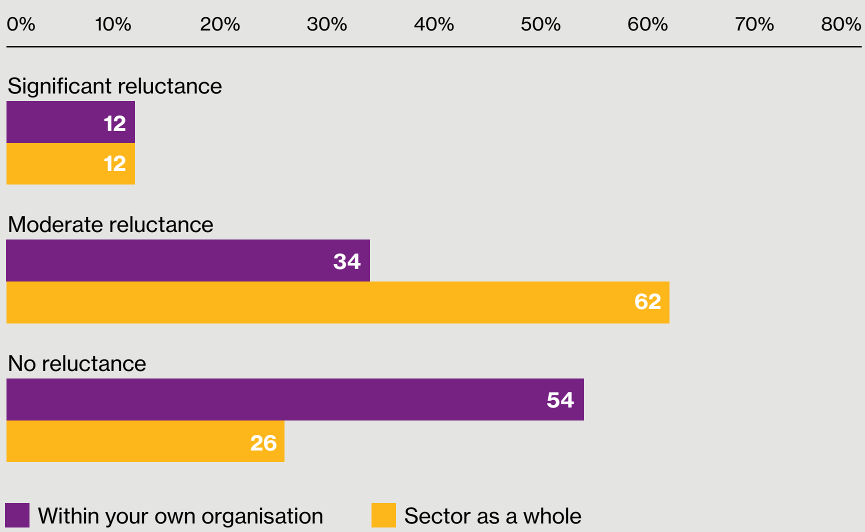


Figure 3: **Do you think there is reluctance towards being a leader in the adoption of new digital technologies within the insurance sector as a whole? And within your own organisation?**



"There is the fear of these systems not delivering, or causing problems in the existing business," says a senior vice president at a US insurer. "And the costs can be very high."

First mover fears

A significant percentage of insurers feel uncomfortable with the idea of taking the lead on adopting new technologies. While the allure of 'first-mover advantage' is often a compelling incentive for businesses that embrace innovation, insurers are nervous about being the first to try something new. As Figure 3 shows, almost three-quarters of insurers (74%) believe the insurance sector is characterised by a reluctance to show leadership in digital innovation; self-awareness may be an issue here too, since a much smaller figure (46%) see themselves in this way.

Essentially, insurers worry about the cost of learning lessons from which others will benefit. The chief technology officer of a Hong Kong-based insurer explains: "The size of the investment required, the regulatory issues at stake and the complexities of new technology are all considerable worries. There is significant reluctance to be the pioneer that does all the work to resolve these issues."

Digital needs

Nevertheless, insurers are now prioritising digital innovation. For example, almost half the respondents in this survey (42%) have now appointed a dedicated Chief Digital Officer (CDO) – and that figure rises to 60% in the industry-leading health insurance sub-sector (see Figure 4). Moreover, at those businesses where this role is in place, it is taken very seriously by the organisation's most senior management – more than half of all insurance company CDOs (55%) report to the CEO (see Figure 5).

Figure 4: **Do you have a dedicated Chief Digital Officer?**

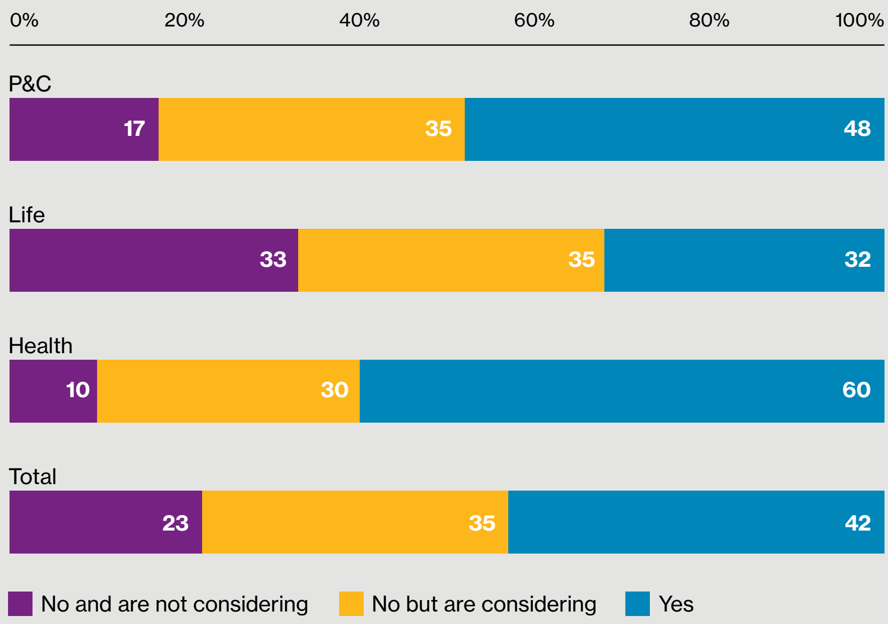
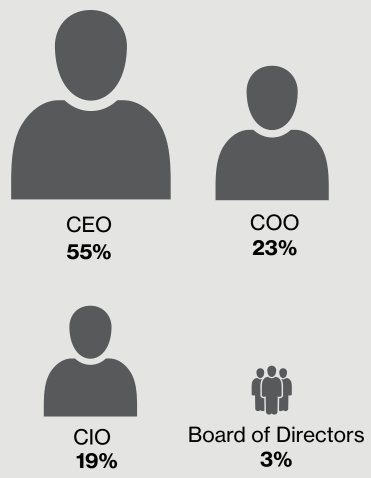


Figure 5: **If yes, who does the Chief Digital Officer report to?**



"It is crucial that someone in the C-suite has digital transformation as an objective and be measured on how it will contribute to the value chain," says Waheeda Narker, a Senior M&A Consultant at Willis Towers Watson. "They need to have specific measurable targets for how they will improve digital engagement, because that's when the business begins to take these challenges seriously."

Rafal Walkiewicz, the CEO of Willis Capital Markets & Advisory, also believes this prioritisation is absolutely crucial. "The stage at which the technology is at today allows connections between the front office distribution with the back office, and that changes the game completely, particularly when you add the third element of capital, and the way in which it is now possible to price and sell risk," he says. "We are facing a perfect storm where all the pieces of the puzzle, all three aspects of the value chain of creating an insurance product, are being disrupted at the same time."

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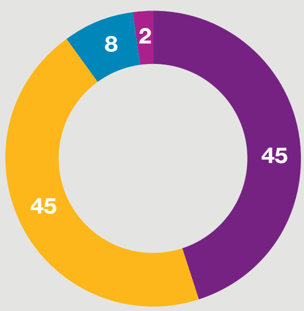
Rafal Walkiewicz, CEO, Willis Capital Markets & Advisory

Chapter 2
Disruptors, deals and distribution

The industry knows that it is playing digital catch-up, but it is determined to bridge the gap and many respondents see themselves as the disruptors who will change the industry

The growing prevalence of the CDO underlines insurance companies' realisation that they need to close the gap on other areas of financial services. Change is likely to be ever-more rapid, as insurers move from initiatives in distribution and customer service, to claims processing, customer retention and even product design.

Figure 6: **Who do you see as the most likely disrupters in the insurance sector? (Please select one)**



"We always advise our clients to have a view on what digital trends will have a material impact on their business over the next five to ten years," says Nicholas Chen, Head of Digital Solutions at Willis Towers Watson Asia Pacific. "The answer will be different for every company, but if you don't have that view, you can't build a digital strategy or vision."

Moreover, while part of the transformation process will inevitably have to be internal, insurers also need to have strategic outward-looking plans – new functionality and expertise in areas such as mobile platforms, robo-advice and data and analytics can often only be acquired rather than built organically. The right approach will vary from sub-sector to sub-sector and many insurers expect to explore several strategies simultaneously. But it is likely that we will see an uplift in dealmaking – whether traditional M&A activity or other types of partnership and venture – as insurers seek to acquire and deploy additional functionality at scale and at pace.

Indeed, while technology has sometimes been seen as an impediment to M&A success in the past, with insurers struggling with the challenges posed by legacy IT systems, it can now be a driver of future deals, says Willis Towers Watson's Fergal O'Shea. "Technology has historically been viewed as a risk to successful execution rather than an enabler, but that risk is now starting to be seen differently," he says.

The director of strategy at one US insurer says its view has certainly changed in recent times. "We just think it is cheaper to buy technologies and external teams to help us get access to new capabilities," he says. "Developing our own systems is expensive and difficult."

Disruptors and dealmakers

When it comes to digitally disrupting the industry, 45% of insurance companies believe they themselves will be the most likely to do so in the years ahead, while the same number tip start-up businesses to have the biggest impact (see Figure 6). However, it would be a mistake to assume that businesses in either of these two categories will endure in their current form as disruption and transformation takes place – it is likely that acquisitions, stakes and partnerships will proliferate as businesses seek to acquire the skills and tools required to prosper in an age of digitalisation.

It's also notable that relatively few insurers – just 8% – see new entrants from the technology sector as likely to disrupt their marketplace. While the likes of Google and Facebook are inevitably singled out as potential disruptors of many industries, insurers appear relatively sanguine about the threat they pose. However, as Figure 7 reveals, a fairly significant number (45%) believe that these companies are likely to make incursions into their industry over the next five years.

It would seem that insurers see their own dealmaking and internal innovation as the key to unlocking change. This is one reason why they have felt able to hold back from digital innovation, argues Willis Towers Watson's Gary Williams, who leads the global development of the firm's business management and customer management activities in the insurance sector. "With challenges such as complex regulation, high capital requirements, and relatively low returns on equity in some sectors, non-financial services businesses have focused on areas other than insurance, so there hasn't been a penalty on insurers for adapting slowly," he says. For more on this, see *Chapter 3: The routes to a digital future.*

Figure 7: **Do you expect existing large technology firms such as Google to make incursions into the insurance sector over the next five years?**

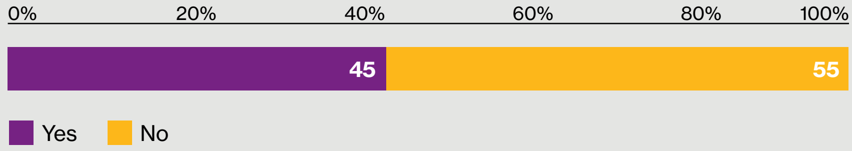
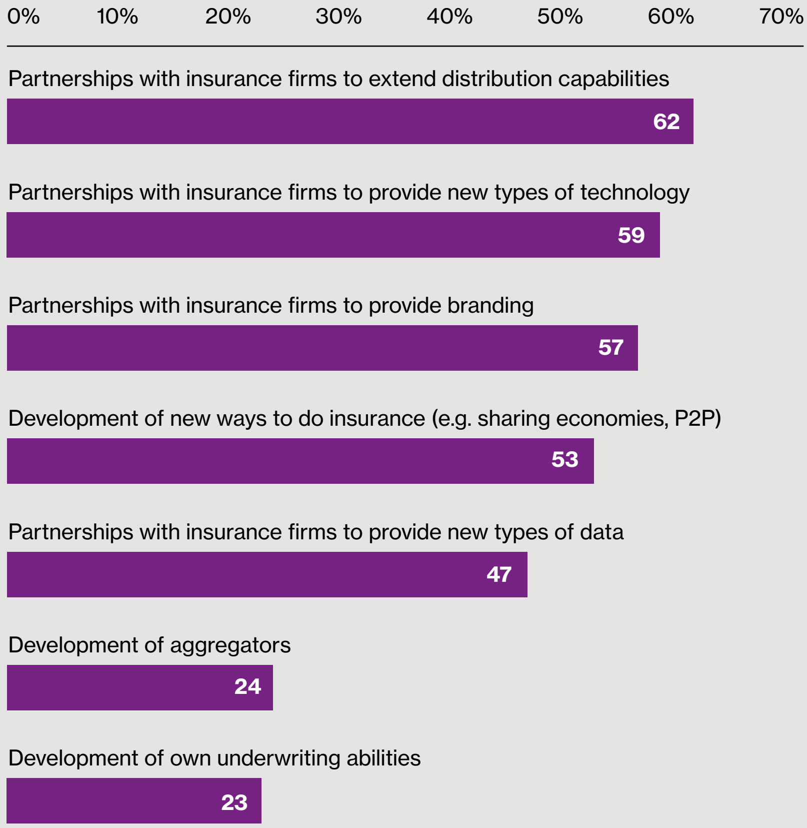


Figure 8: **If yes, in which ways (select all that apply)?**



Indeed, even among those insurers that do expect technology companies to move into the marketplace, the majority of such initiatives are predicted to be partnerships with incumbents. These new entrants are admired for the opportunities they offer to collaborate in areas such as distribution, technology and branding (see Figure 8). Again, these sentiments suggest that partnership – whether through overt M&A, stakes or joint ventures – may be the ideal option for insurers as they seek to take their digital strategies forward.

Such partnerships, our respondents say, are likely to bear fruit in a number of different areas. As Figure 8 shows, the ability to extend distribution capabilities, secure new types of technology, deliver more effective branding strategies, develop new business models and build new data partnerships are all potential drivers for firms considering deals and alliances.

"Technology has historically been viewed as a risk to successful execution rather than an enabler, but that risk is now starting to be seen differently."

Fergal O'Shea, Willis Towers Watson

Figure 9: **In which parts of the insurance industry do you expect to see substantial change from digital technologies in the next two years and the next five years?**

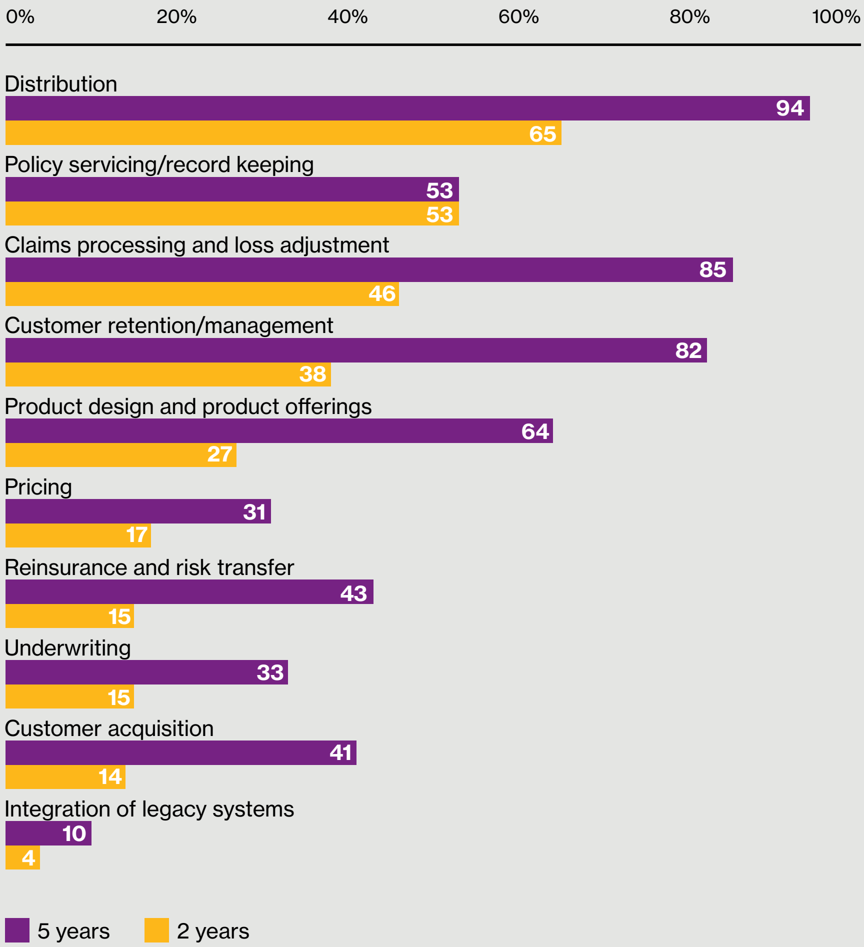
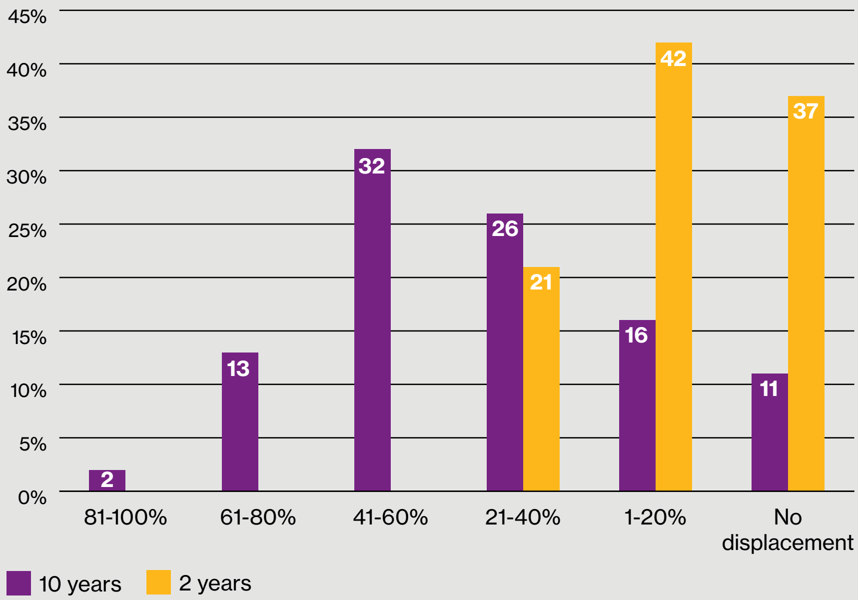


Figure 10: **To what extent do you think that intermediaries (agency model, brokers etc.) will be displaced by the use of new digital distribution over the next two years? And the next 10 years?**



Digital disrupts distribution

Inevitably, as insurers with limited resources ponder the best way forward, they will prioritise certain digital opportunities over others. Above all, distribution is set to be the area where digital technologies have the greatest impact over the next two years, as Figure 9 reveals – indeed, nearly all respondents (94%) feel that distribution will see substantial changes due to digital technologies in the next five years.

Insurers also see claims processing and loss adjustment, and customer management as two important focuses over this shorter time period. Over five years, however, other opportunities to innovate will rise up the agenda to join these priorities. For example, policy servicing and record keeping will be a key focus; so too will product design. We may also see products that are more relevant to different customer segments as a result of access to more information which will provide a better understanding of customers' preferences (though behavioural finance) and needs.

Nevertheless, distribution is a recurring theme for insurers surveying the digital landscape, offering as it does an opportunity to find new ways to market – and to build closer, more engaged relationships with the ultimate consumers of their products and services.

Intermediaries in the insurance sector, ranging from independent financial advisers to broker agents, are in the firing line as insurers pursue these new business models. As Figure 10 reveals, the threat is set to become more pressing over time – most insurers (77%) expect new digital distribution channels to supplant between only 0% and 20% of intermediaries' business within the next two years. However, within 10 years, the majority (73%) see between

21% and 100% of intermediary distribution being replaced.

“With new technologies making it simpler for customers to get access to insurance online, and with improved customer care services, the need for middle men will reduce,” says the chief technology officer of a Danish insurer. “More customers will contact the company direct and will not need to go through an intermediary.”

Again, this may change the M&A dynamic in the insurance industry. Where acquiring new distribution capacity was once a key driver for insurers considering acquisitions, this type of dealmaking may now become less common, even if it is replaced by M&A predicated on the need to secure technologies that enable digital distribution strategies.

Areas of impact

Insurers recognise the potential for digital technologies to transform their industry across a whole range of areas. While web and mobile delivery channels are the stand-out technologies over the next two years according to 77% of insurers (see Figure 11), areas such as big data and automation will make

Figure 11: **Which of the following (digital) technologies do you expect to have the biggest impact on the insurance sector over the next two years and the next five years? (Please select top two)**

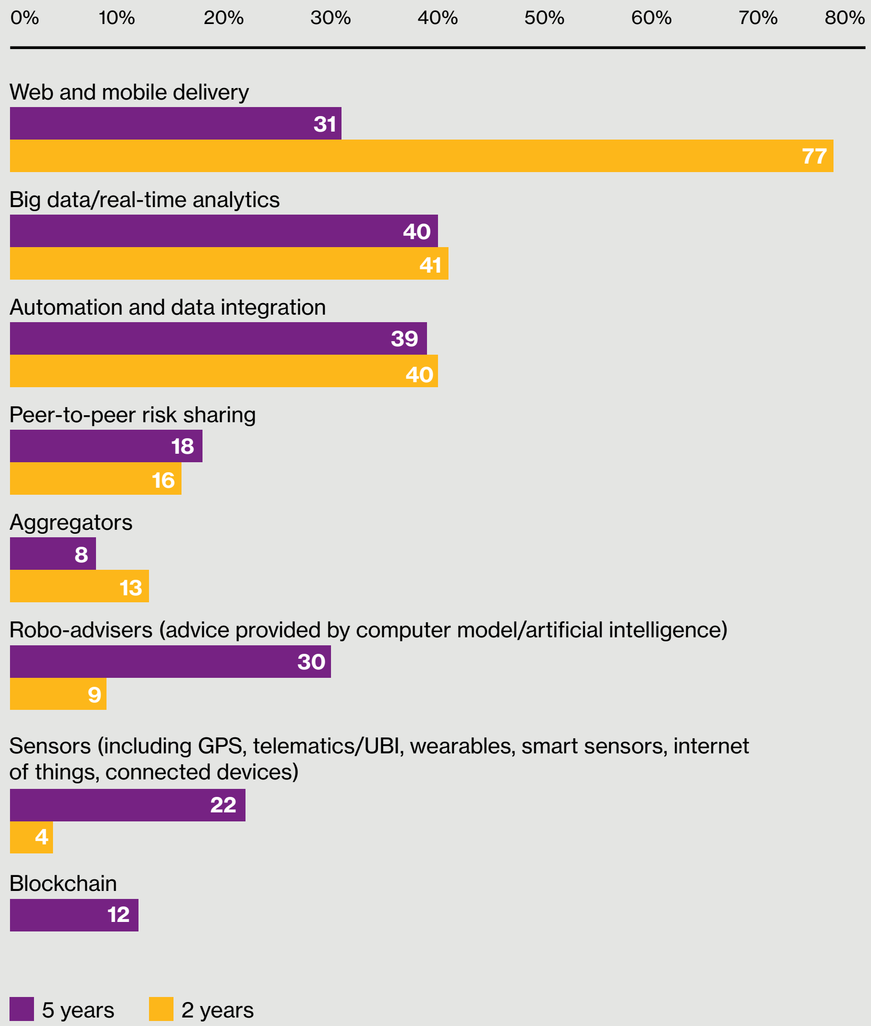
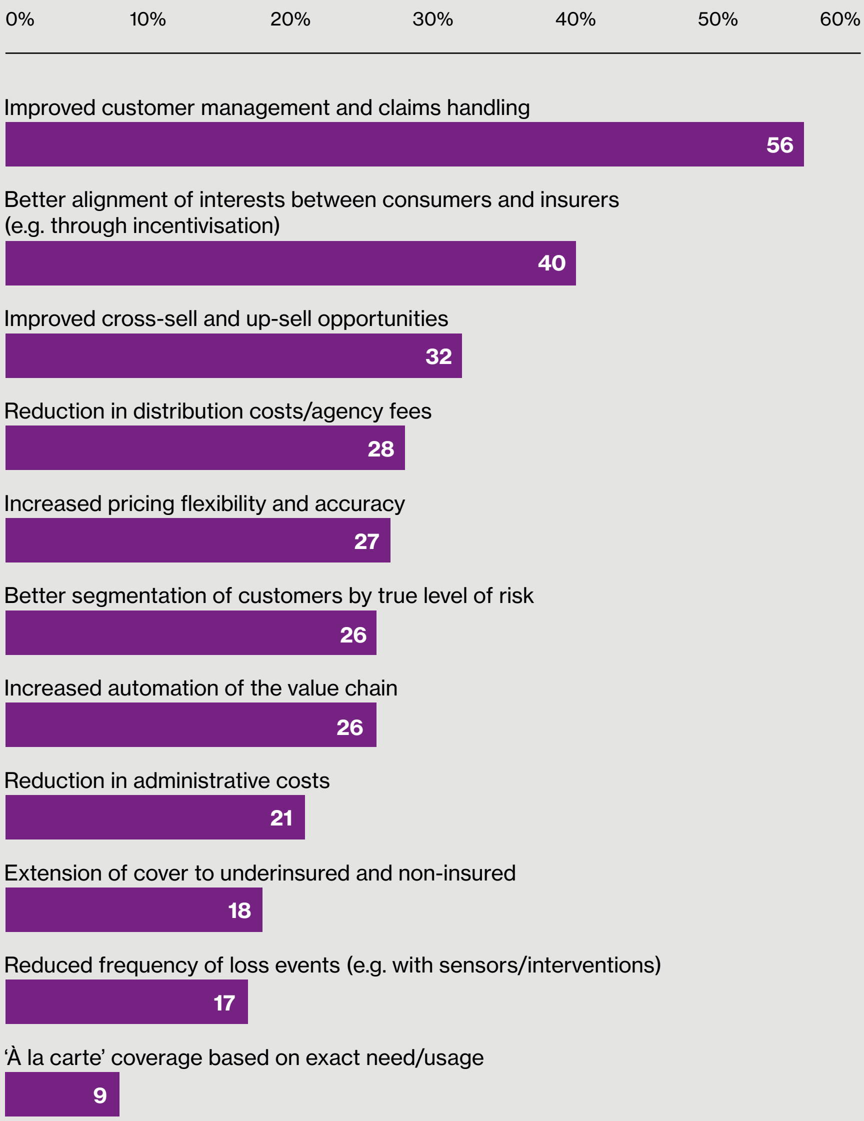


Figure 12: **What do you see as the most important benefits that can be derived from new digital technologies? (Please select top three)**



increasingly large waves over the next five years.

Insurers also see robo-advice as being a major impact technology over the next five years (cited by 30% of respondents), with sensors also tipped to be important (22%). In many of these areas, the tools and technologies now emerging are so far removed from insurers' previous experience – unlike, say, digital transformation of distribution – that external innovation models are likely to be their only way of acquiring adoption and implementation capacity. This is expected to lead to a wave of new M&A activity in the years to come.

Such developments are likely to bring a whole range of different benefits. As Figure 12 shows, more than half the respondents to this survey (56%) see improved customer management and claims handling as likely digital dividends, while 40% point to the ability to align the interests of consumers and insurers; that might include, for example, discounted motor insurance for drivers whose telematics sensors indicate they are less likely to have accidents.

The chief information officer of a Swiss insurer puts it in simple terms. "New technologies have already reduced our costs and improved our operational efficiency. We've also been able to develop better services for customers who want more bespoke products that suit their individual needs."

Over time, moreover, these benefits will multiply and broaden. Already, almost a third of insurers (32%) see cross-selling and up-selling opportunities from digital technologies, while more than a quarter (28%) look forward to lower distribution costs. Other potential benefits range from increased pricing flexibility to enhanced risk management practices.

In the end, however, Carsten Hoffmann, a director at Willis Towers Watson, argues that many insurers will come across opportunities they do not even know exist right now. "If we assume that the value chain of insurance remains more or less the same, then the big wins are probably going to be in claims, underwriting and sales," he says. "But, of course, digital technology can also lead to a change in the value chain and completely renew the business model – we may see a complete change in the way insurance is done."

Distribution in emerging markets

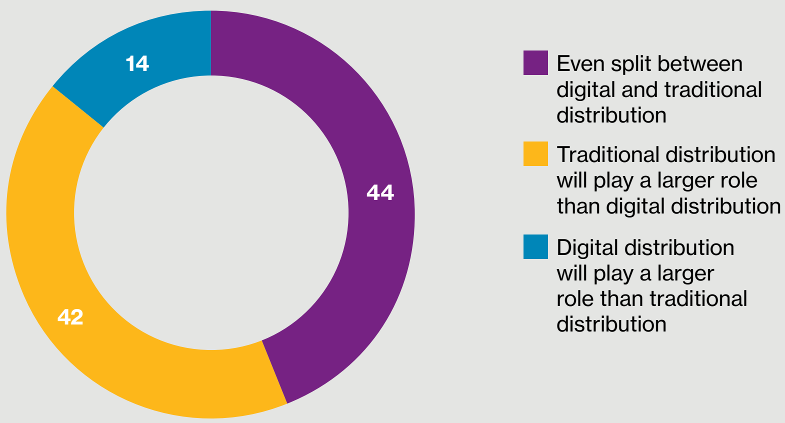
Our survey reveals how individual insurance sub-sectors feel about the impact of digital technologies

When it comes to digital distribution, insurers judge some markets as more promising than others for digital distribution models. For example, in emerging markets, firms do not necessarily see digital as their best bet of securing market share or expanding the customer base. Fewer than one in seven insurers (14%) see digital distribution as playing a larger role than more traditional models in expanding penetration in emerging markets.

This could come as something of a surprise, as digital tools have proved key in reaching previously under-served segments of the market in developing economies in other areas of financial services. The payments sector, for example, has pioneered the use of mobile channels to extend its reach. In insurance, however, distributing mainstream products, particularly in more complex areas such as life and health, may require greater customer interaction than digital immediately allows. Although, we have seen innovation in countries like South Africa, where health insurers have used digital technology to provide preferential rates by monitoring customers' behaviours such as gym attendance or the contents of a weekly grocery shop.

Not that new geographies are the only way to move into new areas for an insurer. Willis Towers Watson's Gary Williams points out that technology can be an enabler for product development too. "There are currently customer segments that are uninsurable because the risk is not easy to understand or to manage, but technology is changing that," Williams says. "For example, it's now possible to monitor the ongoing use of medication or check-ups, basically making sure that people are managing their conditions and they become insurable even when they have illnesses like HIV or diabetes."

Figure 13: **Do you think that digital distribution or traditional distribution is likely to play a larger role in expanding insurance coverage in emerging markets?**



New kid on the block

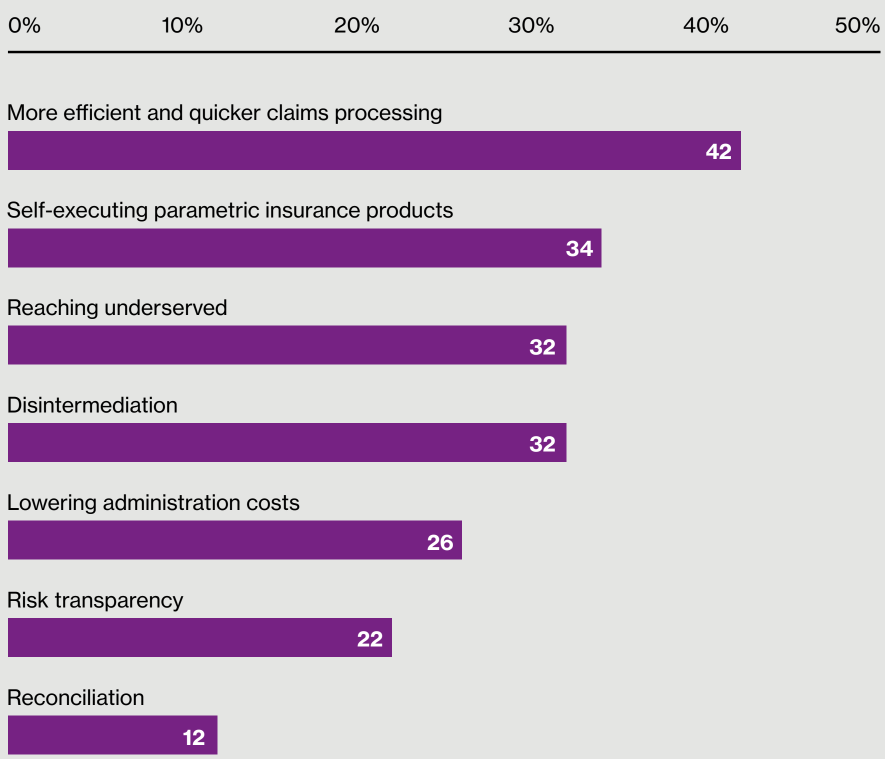
Insurers believe Blockchain has a big future in the industry

Blockchain technologies have not yet moved into the mainstream for insurers, but their day is coming, according to some survey respondents. Some 13% expect Blockchain – also known as distributed ledger technology – to have a huge impact on insurance within five years.

Moreover, as Figure 14 shows, this impact will be felt in a very broad range of areas, from more efficient and quicker claims processing to reaching underserved customer bases. The attractions of the technology – providing a secure, open-to-all record of transactional activity without any need for a central marketplace or exchange – include cost savings and transparency.

Meanwhile, Smart Contracts, a Blockchain application which verifies and executes the terms of a contract without human involvement, also has many potential use cases in insurance.

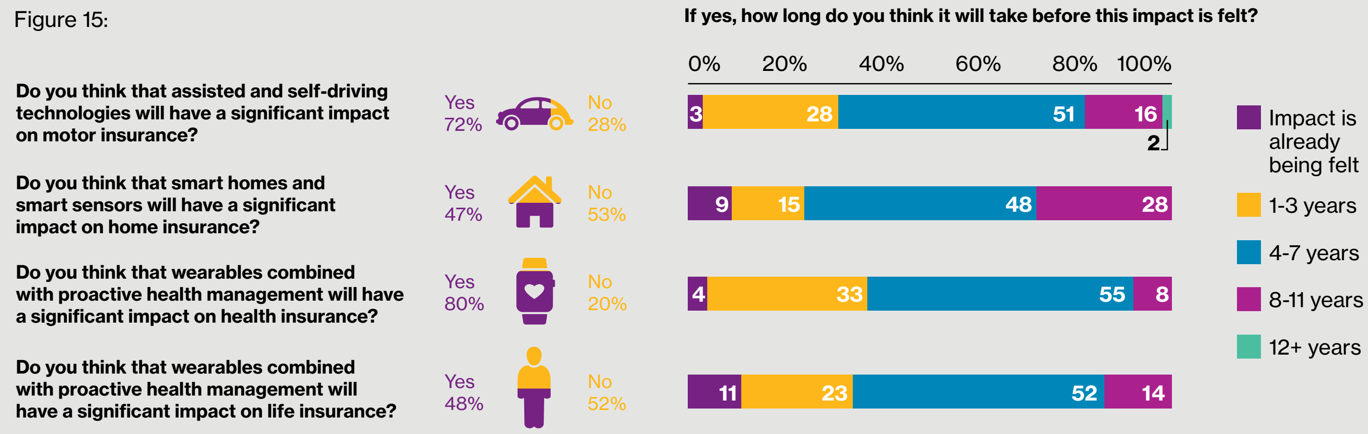
Figure 14: **Where do you think Blockchain and Smart Contracts will have largest impact on insurance? (Please select top two)**



Sector specifics

Our survey reveals how individual insurance sub-sectors feel about the impact of digital technologies

Figure 15:



Insurers in some sub-sectors believe they are further down the road of implementing digital technologies – potentially because the tools were available earlier or because the challenges posed by digitalisation to their particular business models were more straightforward to confront.

This story is portrayed in more detail in Figure 15, which gauges the extent to which insurers expect their sectors to be impacted by digital innovation, as well as how quickly they expect these impacts to be felt. For example, in the motor insurance market, where technologies such as telematics are in widespread use, 72% expect further developments, such as assisted and autonomous driving, to have a significant effect on their business.

By contrast, in the home insurance market, where new technologies have not yet made such significant inroads, only 47% are expecting smart homes and smart sensors to have a significant impact on their business. Indeed, the majority don't believe that the impact of these technologies will be felt for between four and 12 years, which is an absolute age in digital terms. To put that into perspective, disruptors such as Uber and Airbnb did not even exist eight years ago and yet, since then, have transformed the transportation and accommodation sectors. Digital disruptors are everywhere and insurers cannot afford to be complacent about the march of digitalisation.

In addition, separate sub-sectors take different views on the significance of the same technologies. For example, while more than three-quarters of health insurers are expecting technologies such as wearables and proactive health management to have a significant impact on their businesses, the figure drops to just over half (52%) in the life insurance sector.

These perceptions – both of the significance of particular digital technologies and the timeframe over which the impacts will be felt – are vital, for they will inform insurers' priorities for the future. And, in many cases, firms are being complacent about the impact of digital innovations. The majority feel that the impact of digital innovation won't be felt for between four and seven years – perhaps leading to procrastination. Insurers need to adopt a more aggressive mindset, engaging in M&A for example, to ensure they capture the digital dividends as they become available. Even in slower areas, they should be actively encouraging organic growth and research and development, while monitoring innovations outside their immediate environment.

Chapter 3
The routes to a digital future

M&A and partnerships are likely to trump internal investment as insurers seek to deliver digital transformation

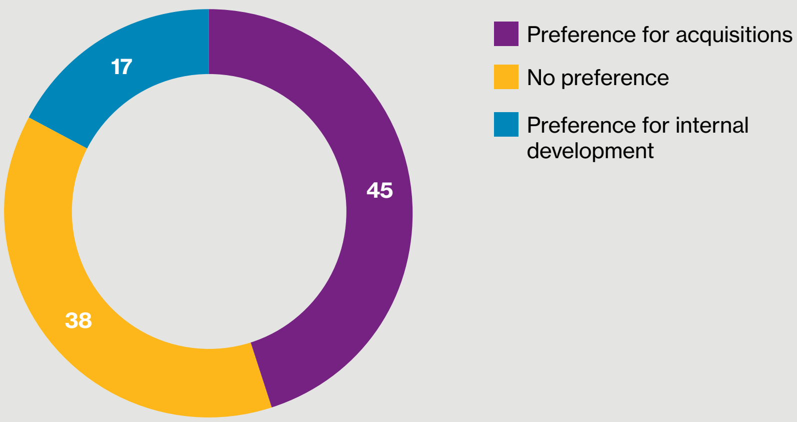
Insurers looking to achieve their full digital potential in the years ahead will need a variety of approaches to acquire, implement and commercialise digital technologies; moreover, these approaches should not be considered mutually exclusive.

One strategy is clearly to innovate from within. Many insurers are already devoting increasing resources to digital innovation – such technologies account for more than 40% of R&D spending at a majority of insurers in this survey – with initiatives such as internal innovation labs and even greenfield business units given almost free rein to experiment with new ideas.

However, internal innovation will only get companies so far, according to Heloise Rossouw, a Senior Consultant at Willis Towers Watson. “Often insurers don’t have the skills in-house because they are not technology providers. Insurers, obviously, bring a deep understanding of insurance, they have the data and customer trust,” she says. “But, on the technology side, companies are going to need to experiment with new partners.”

For this reason, insurers are embracing a more outwards-looking approach to innovation, searching for corporate transactions that can accelerate their digital transformation.

Figure 16: **Does your firm have a preference to acquire or develop digital capabilities internally?**



Such transactions are likely to include M&A, but traditional deals are not the only option.

For example, many insurers are investing in a disparate range of technologies via venture capital funds – either through their own in-house venture capital arms, or third-party funds. This may be an attractive way to make a number of small bets on nascent innovations, rather than betting the house on an as-yet unproven technology.

As insurers ponder these deals, their appetite for traditional M&A – particularly the large transactions

that the industry has seen in the past – may wane in favour of smaller and more specialist activity. At French insurer Axa, for example, new chief executive Thomas Buberl said earlier this year that his priority was to focus on digital transformation rather than to make large acquisitions. The Italian insurer Generali made a similar pledge last year, as it announced it had set aside £1.25bn to deliver digital transformation – its strategy includes a string of investments in venture capital funds with exposure to the Fintech sector.

"There isn't a long track record in acquiring digital capability through Fintech businesses," observes Willis Towers Watson's Fergal O'Shea. "But I think companies are now trying to feel their way round this."

As Figure 16 shows, the respondents in this survey have a clear preference for acquisitions that will see them gain digital capabilities, with almost half (45%) signalling that they see this as the way forward; by contrast, fewer than one in five insurers (17%) state that they have a preference for internal development.

That is not to say, however, that internal innovation efforts have no place at these insurers – it is about getting the balance right between organic and inorganic growth. Well over a third of the insurers in this study (38%) say they have no preference between the two routes – in other words, they will use both acquisitions and internal innovation as the circumstances suit.

"Often, it will depend on the type of technology we're taking about, as well as its cost," says the chief technology officer of a Brazilian insurer. "Internal development efforts have given us more control and have also been a cheaper strategy so far, but we are now planning acquisitions in areas where we need to move quickly or lack expertise."

M&A ramps up

So far, relatively few insurers have made outright acquisitions that were directly driven by their desire to acquire digital technologies. As Figure 17 shows, only 14% of companies have completed such a deal over the past three years – and the vast majority of those have undertaken just one transaction.

Insurers need to have a clear vision for the future, which then informs their M&A strategy, according to Willis Towers Watson's Gary Williams. "Companies need to have a strategy

"Often insurers don't have the skills in-house because they are not technology providers. Insurers, obviously bring a deep understanding of insurance, they have the data and customer trust. But, on the technology side, companies are going to need to experiment with new partners."

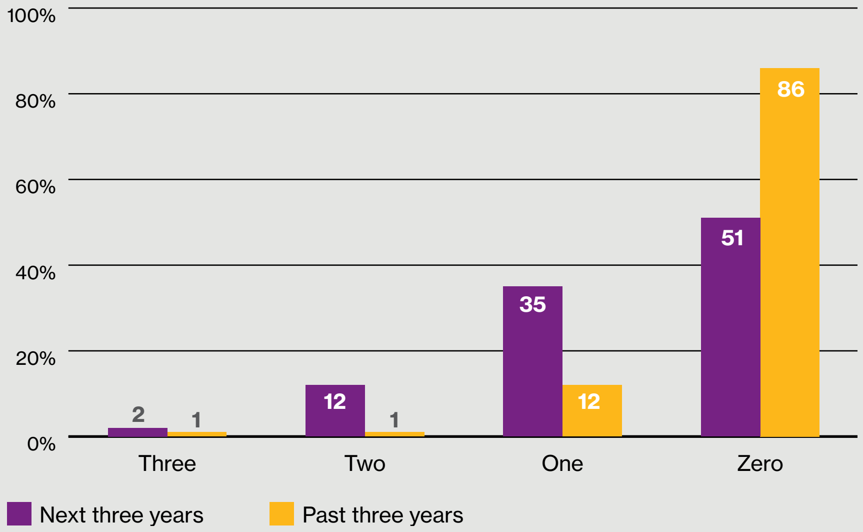
Heloise Rossouw, Senior Consultant, Willis Towers Watson

that may then involve M&A because dealmaking is a means to an end, not an end in itself," he says. "One of the fundamental questions is what role do insurers see themselves playing in the future – and many firms don't yet know."

In a low interest and equity return environment, companies are under pressure to deliver the required shareholder returns and are therefore looking to improve underwriting, customer retention, grow their customer base and improve margins which digital technologies can help to address. This suggests that both organic and inorganic growth in digital capability is a necessity and therefore a motivator for M&A in this sector. Fortunately, almost half the respondents to this survey (49%) expect to make an acquisition over the next three years. That includes the 14% of insurers that see themselves making more than one acquisition.

For Andy Staudt, EMEA Property and Casualty (P&C) Insurance M&A Leader at Willis Towers Watson, one area to watch is Asian businesses buying in Western Europe. "One of the big attractions of our market is that we have a very sophisticated insurance marketplace, and the tools

Figure 17: **In the past three years, how many acquisitions have you made that were directly driven by the desire to acquire digital technologies? How many do you expect to make in the next three years?**



"Companies need to have a strategy that may involve M&A because dealmaking is a means to an end, not an end in itself. One of the fundamental questions is what role do insurers see themselves playing in the future – and many firms don't yet know."

Gary Williams, Willis Towers Watson

and technologies are transferable back to their domestic markets," he says. One example is provided by the British telematics start-up Insure the Box, which was bought last year by Aioi Nissay Dowa Insurance of Japan.

Venturing forth

In practice, of course, insurers' ability to achieve such ambitions will depend on a broad range of factors – including the right targets becoming available. There will be considerable competition for what are perceived to be the best assets, with insurers coming under pressure to pay full prices for acquisitions despite the risks involved in anticipating which digital tools will deliver the greatest benefits. "For this reason, some larger insurers may feel they've really got to try and build up this capability internally themselves before they go down the M&A route," says Willis Towers Watson consultant Scott Spearman.

To that end, insurance companies are already making significant investments in digital innovation via their corporate venturing activities. As Figure 18 shows, close to a quarter of insurers (23%) already have a corporate venturing arm through which they invest in new digital technologies – and a further 28% are considering launching such operations.

In certain areas of insurance, moreover, this model is particularly popular – almost a third of respondents from the property and casualty side of the industry (31%) have set up a corporate venture arm already, while a further third (32%) are considering doing so. But even in life insurance, where this sort of investment has been slower to penetrate, well over a third of companies (37%) already have a corporate venturing operation or are considering setting one up.

Figure 18: **Do you have a corporate venture arm to invest in new digital technologies?**

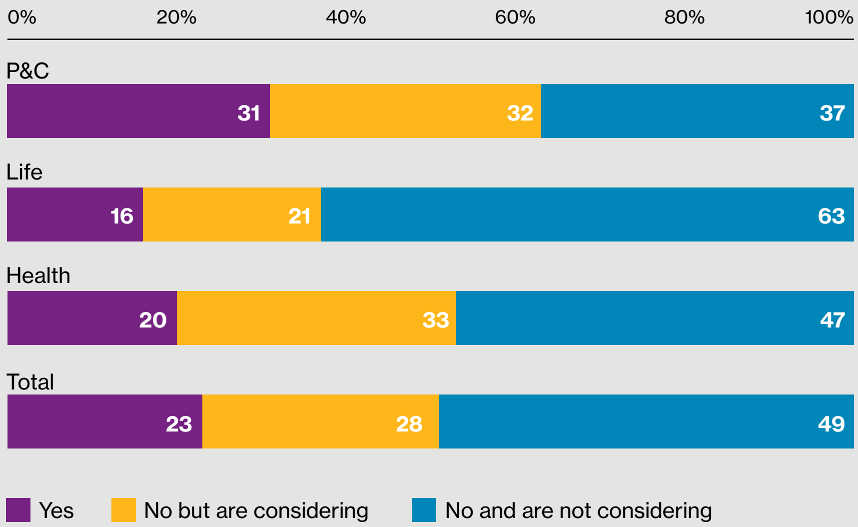
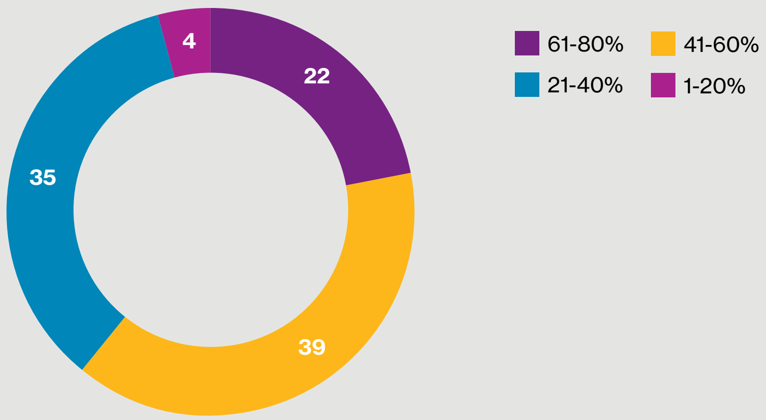


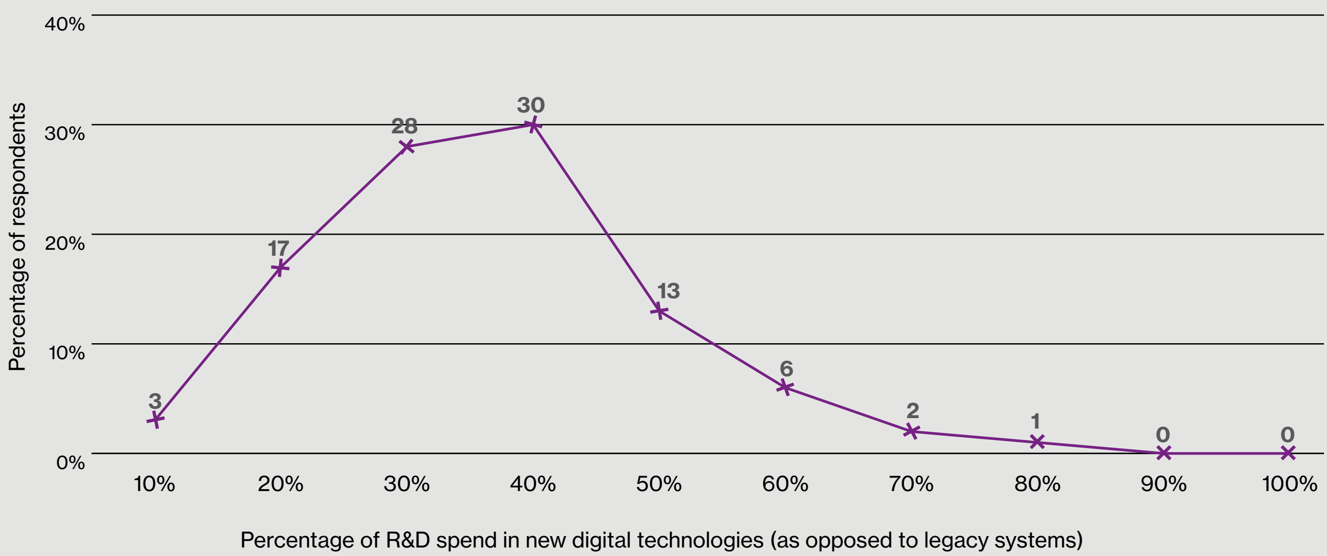
Figure 19: **If yes, what proportion of the investments in your corporate venture arm are directly related to insurance?**



In Austria, for example, the chief operating officer of a life insurance business says its corporate ventures arm is front and centre in its digital strategy. "We saw this unit as the best way of investing our capital in digitalisation," the executive says. "It's really improved the efficiency of our dealmaking."

One good example of what is possible is provided by the German insurance giant Allianz. It has launched an innovation lab in Asia, established a business unit called Allianz X with a brief to "identify, build and globally

Figure 20: **What proportion of your R&D spend is in the area of new digital technologies compared to investing in your legacy systems (to nearest 10%)?**



scale new businesses in the InsurTech space," and also made acquisitions – these include stakes in the robo-advice firm MoneyFarm and the Berlin-based fintech Simpesurance.

Some corporate venturing will inevitably be focused purely on investment return, rather than with one eye on technology with applications for the enterprise. Still, according to Figure 19, almost two-thirds of insurers (61%) say more than 40% of the investments made by their corporate venture arms so far are directly related to insurance.

R&D supplements M&A

As for insurers' internal innovation efforts, R&D spend continues to look healthy. As Figure 20 shows, for more than half the respondents in this study (52%), at least 40% of the R&D spending now goes on digital, as opposed to legacy systems. At substantial numbers of insurers, moreover, the figure is even higher.

Not all of this R&D will deliver results that insurers can use during the digital transformation process, but increasing numbers of businesses now take the view that 'it's good to fail' – they accept that there will be setbacks on their digital journey.

This is crucial, argues Willis Towers Watson's Carsten Hoffmann. "You do need to experiment, to try something, to look at the feedback and then to think about why something hasn't worked," he says. "It's an iterative process but that's not in the genes of insurance companies, so this is a cultural adjustment for them to make."

Equally, it would be wrong to think of internal innovation as an activity that is entirely self-contained. Many insurers are active participants in industry initiatives and working parties that aim to achieve digitalisation benefits. Others are collaborating to find the best way forward; and for some insurers, teaming up with partners in environments such as accelerator schemes has proved to be one useful strategy for developing innovation from within.

In addition, insurers need to think of new types of people as well as new types of technology that will drive innovation. Aviva, for example, has recently made headlines with its hire of Charles Reeves, who is now the company's head of visual design – he was previously employed at video games company Activision, where he led the design team responsible for the *Call of Duty* game.

Aviva have also recently created their 'Digital Garage', a brand-new digital environment in the heart of London's Tech City in Shoreditch. It aims to spearhead product innovation and development, harness the latest technologies and explore the way customers engage with their products and services.

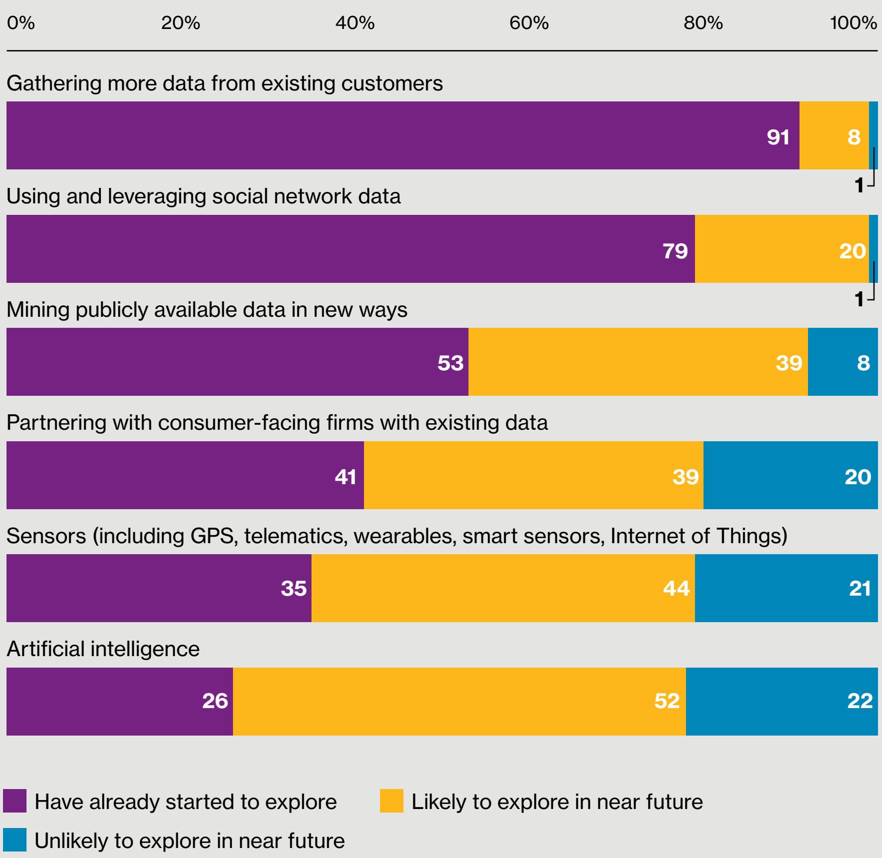
Data-driven solutions

Our survey shows that insurers realise the value of the data they hold and, more importantly, how they can analyse it more effectively

Insurers understand that data will often represent the key to unlocking the power of digital solutions – that these technologies will be underpinned by unprecedented amounts of information flowing into applications and tools. For that reason, developing data and analytics tools is a key part of the innovation race for the insurance sector.

This is an area insurers are more comfortable with. Figure 21 shows that many insurers are already making substantial progress in this area. More than nine in 10 (91%) are already exploring how to gather more information direct from their existing customers. Meanwhile, 79% are already using and leveraging social network data and more than half (53%) are looking at how to mine publicly available data in new ways. Partnerships with other organisations are another potentially rich source of additional data, while emerging technologies, from sensors to artificial intelligence, are already under active consideration.

Figure 21: **Which of the following sources of data generation have you explored?**



Driving forward a coherent data strategy may not be straightforward – particularly given the increasing focus on data privacy and cybersecurity in society at large. The forthcoming General Data Protection Regulation (GDPR) from the European Union will require careful governance and compliance planning. Nevertheless, data will continue to be a major focus for insurers, argues Willis Towers Watson's Rafal Walkiewicz. "The wealth of data that insurers have right now at the cusp of this technological revolution is very valuable," he says. "There is a window of opportunity to monetise it, through new partnerships and with new technologies."

Conclusion
No time for hesitation

The key lesson from this survey is that insurers cannot afford to remain in the slow lane when it comes to adopting digital technology

With digital transformation now rising up the agenda for the majority of insurers – and new entrants with a non-financial services background now beginning to circle – those companies that do not confront these challenges risk being left behind. Our respondents agree that while the window of opportunity for digitalisation in insurance is now wide open, it will not remain so forever.

There are a range of key takeaways from the research that can help insurers grasp those opportunities:

Have a digital strategy.
"It is important for insurers to have a digital vision and strategy that is clear throughout the organisation, and really understanding how digital will drive top line and bottom line growth. This will help prioritise what areas to focus on and allocate resources more efficiently and effectively. Companies that don't do this initial groundwork may find their businesses all over the place, making disparate investments into: new technologies, digital solutions, and forming partnerships that may turn out to be the wrong ones," says Nicholas Chen of Willis Towers Watson. This strategy must be based on the realities of the market in which you operate, including the evolving demands of customers, the competitive offerings of leading rivals and the digital opportunities available.

Visualise the future of your business.
An insurer's digital investment targets will depend upon where its sees its long-term future. "Think about where you see your business in 20 years' time – will you be a wholesaler, developing products for the whole market, or do you see yourself as a retailer that can slickly engage and integrate with other emerging retail models?" says Willis Towers Watson's Gary Williams.

Internal innovation will pay dividends, but be prepared to fail.
"We always read about the success stories but the reality is that not all your ideas will succeed and it's important to accept that and learn from your failure," says Willis Towers Watson's Carsten Hoffmann. Just as most start-up businesses fail, insurers need to accept that it just will not be possible to commercialise all their ideas – and that setbacks and failed experiments will help identify the innovations that do work for the business.

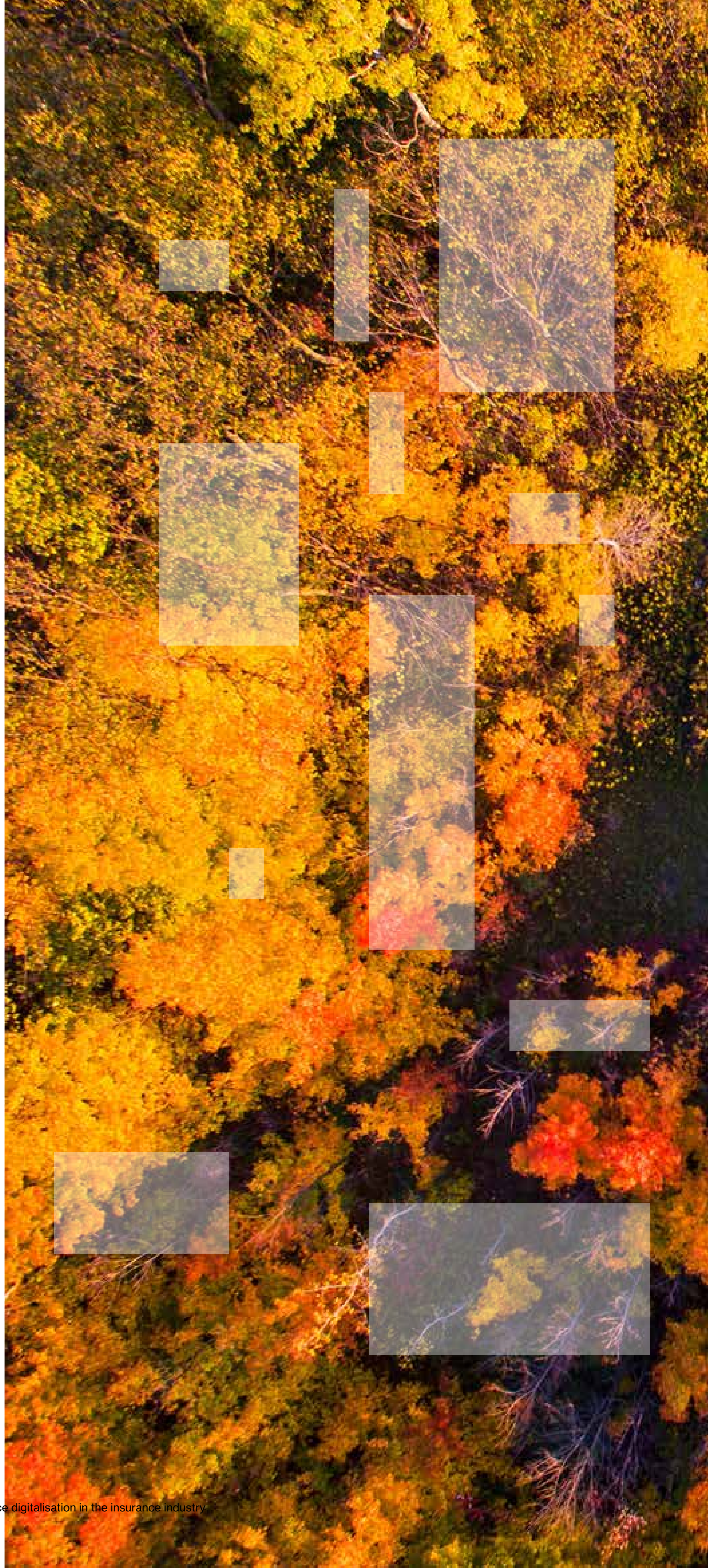
M&A is vital to the path to digitalisation.
"It's very difficult as an incumbent to have a large enough pipeline of technologies, so you're going to need to look outwards, to partnerships, to venture capital, to development and to M&A," says Rafal Walkiewicz of Willis Towers Watson. He believes the most successful insurers will engage in a broad range of external investments in order to achieve their goals. But, at the same time, M&A and organic growth are not mutually exclusive – insurers should examine opportunities for both.

Identify the data in your business and work out how to monetise it.
"Some of the applications of data and analytics technologies are only just emerging, but even now there is a huge benefit to come from looking at the data you already hold in your business and improving what you do with it," says Scott Spearman of Willis Towers Watson. In other words, concentrating on the future is important, but so too is unlocking the value of the present.

Consider whether the culture of your business is digital ready.
"Too often, insurers are risk averse and afraid of failure, and that's not a good basis from which to innovate, whether you're doing it internally or working with partners where you may stifle their entrepreneurial creativity," says Heloise Rossouw of Willis Towers Watson. One major challenge for insurers will be to make this cultural shift. They need to adopt a mindset where experimentation and failure are acceptable.

Future distribution and improved margins.

“To improve margins in the current low-return environment, insurers need to find margins in the way they do business and grow their customer base which technology can help with. Disruption in how firms do business is needed for product innovation as is improved engagement with future generations of policyholders which can improve customer lifetime value and profit margins,” says Waheeda Narker of Willis Towers Watson.



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