Insurtech – Opportunities and Challenges

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For some years now, Fintech has been a topic that has garnered a lot of interest from a range of diverse players from Asia, to Silicon Valley, and the City of London. Fintech is a broad sector of technology disrupting parts of the financial services sector such as payments, loans, trading and fundraising.

Recently, a similar pattern has emerged in insurance – Insurtech, which promises to significantly change, and in some cases, disrupt the industry. Investment in this approach is a necessary, but not sufficient condition for success. Winning will require deliberate choices by insurers regarding their participation in the Insurtech ecosystem.

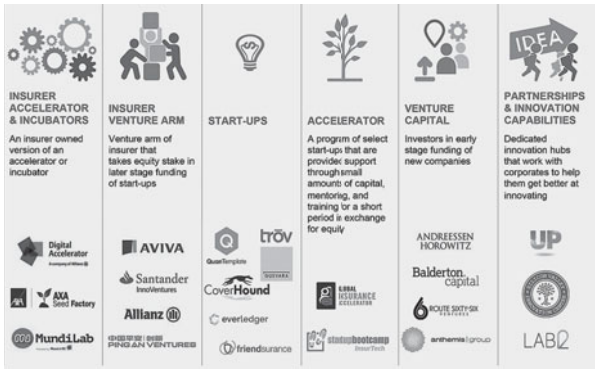
1. Definition

Celent defines Insurtech as the rapidly expanding development and application of new technologies and operating models that are intended to fundamentally change current business models, financial models, and/or industry ecosystems. It can potentially impact every part of the insurance value chain on both the property/casualty and life/health/annuity sides of the industry. Insurtech's potential impact may also extend beyond current insurance industry boundaries, to include advice, protection and security; as well as emerging risks and changing social behavior.

2. Insurtech Opportunities

2.1 A New Ecosystem

New actors are entering the insurance sector. Celent identifies this new community as the "innovation ecosystem". The last 12 months have seen the start of several insurance-specific technology accelerators. Corporate venture arms continue to launch with a strategic focus on insurance solutions. A new breed of independent venture capital firms, external to insurers, is now investing in insurance solutions. Significantly, several hundred startups have launched concentrating on the application of new technology to insurance opportunities. Figure 1 shows the range of actors in the insurtech ecosystem.



Source: Celent

Figure 1 The Insurtech Ecosystem

A relatively new breed of operation in insurance, the accelerator model has a long history in the technology sector. Accelerators attract startups through an application process, and provide support through seed money, mentoring, and training for a limited period (three to four months). An administrator usually takes single-digit slices of equity in return for access to subject matter experts, an innovation program, education, and

mentorship. Incubators are organizations that work in a similar way, but usually deal with propositions which are at earlier stages of development. There may or may not be an ownership aspect to incubators.

Direct investment from venture capital may be from an external, independent firm, or from an insurer-controlled entity. After angel / seed funding, these organizations become involved in what comes next — series A (testing market fit) and B (scaling) funding. External venture capital firms invest for high growth potential. In exchange for the capital, these firms take a percentage of equity in the business. Deals will vary, but the companies usually request some measure of control over strategy and will have one of their staff on the board. External venture funds seek return. Internal funds look for strategic partnerships (developing new capabilities, exploring emerging technologies, or accessing new markets) and may or may not look to realize a specific investment threshold within a defined timeframe.

Insurtech efforts may involve entities within or outside an insurer's organization. Insurer innovation laboratories seek to leverage the subject matter expertise of employees and combine this with the technical expertise in new firms. Labs often also include a cultural component – socializing the idea of innovation and, ideally, smoothing implementation by casting a wide net and fostering engagement. They usually have a separate budget so that their projects do not have to compete for funding against operational, day-to-day, initiatives. They may be part of a line of business organization or may be operated as part of an innovation Center of Excellence. The use of labs has become increasingly common in insurance.

These options carry different tradeoffs for insurers. For example, investing in an independent accelerator has opportunities and possibilities that are very different from creating a venture capital arm. In fact, the area attracting significant public attention is the capital investment made by several well-known brands such as Aviva, Allianz, and Axa in Europe, American Family and Northwest Mutual in the United States, and PingAn in China. The size of funds allocated to investing in innovation is in a few cases considerable. Axa's Factory has 200 million euros (approx. 217 million dollars), and Aviva has set aside 100 million pounds (approx. 128 million dollars), according to company websites. The attention is drawn to these activities because it is such a departure from the "usual" insurer business.

However, venture arms are just one pathway into the innovation ecosystem, and a method only available to a few of the very large insurers. Selecting the best option(s) requires an understanding of insurer preferences.

2.2 Insurer Preferences

Insurer should make choices regarding how to engage with the new ecosystem based on their individual preferences related to willingness to fail, need for speed, level of financial investment, human capital investment, and level of IP ownership required. Table 1 provides a framework of the important dimensions to consider.

DIMENSION	CHALLENGE
Willingness to fail	How open is the insurer to try new ideas, knowing that some will never be implemented?
Speed of implementation	How quickly does the firm need to see results that will move the needle?
Financial investment	How many zeroes are there in the check required to fund the initiative?
Human capital investment	What is the absolute number of people involved?
Level of IP ownership desired	How much control is required over the intellectual property?

Source: Celent

Table 1 Insurer Preferences

A low tolerance for failure is a widely recognized characteristic of insurers and other financial institutions. This is a useful trait in an industry that is charged with fiduciary responsibilities – if someone is taking care of your money, you want them to be extra careful with it! However, this lack of willingness to fail is a significant barrier to Insurtech involvement, where an experimentation mindset is required.

The next dimension is the estimate of the time period required for an Insurtech initiative to result in the desired impact. Typically, incremental efforts have a shorter

timeframe than disruptive ones, which seek to create a new market or satisfy an underserved customer group. An insurer should consider its appetite for patience regarding business impact and/or payoff.

Insurers must also create consensus regarding the preferred level of financial investment in Insurtech. These investments are not found as a traditional line item in standard insurer budgets.

Some insurers use their Insurtech activities as a vehicle to change company culture. These programs encourage higher levels of risk-taking, employ cross-functional, collaborative workgroups, and usually include an intense focus on customer experience. If an organization seeks to make these activities part of the company fabric, it will deliberately include higher levels of participation, which requires an increased level of human capital investment.

Is it important that the insurer owns the intellectual property being created by the model? Is the primary objective of the Insurtech activities learning about new techniques (implying a low level of concern about IP ownership), or is it acquiring new knowledge to create a barrier to competition (implying a high level of concern about IP ownership)? The answers to these questions will inform which models are more attractive.

The alternatives in the Insurtech ecosystem detailed in Figure 1 involve different considerations along this preference map. For example, incubators play a numbers game. Typically, numerous startups are invited to participate, and only a few survive. Thus incubators have a high failure rate. Incubators match a company that has a high willingness to fail — one where it is permissible to endure the high number of propositions that never make it to implementation. In contrast, accelerators select participants which are usually more advanced in their development so they do not churn through as many candidates as an incubator.

3. Making Choices

Matching insurer preferences with the characteristics of the different Insuretech approaches provides a decision framework that is unique and aligned with the company. An example is provided in Table 2.

TYPE	WILLINGNESS TO FAIL	SPEED	FINANCIAL INVESTMENT	HUMAN INVESTMENT	LEVEL OF IP OWNERSHIP
Incubator	●	○	○	○	○
Accelerator	◖	◖	○	○	◖
Venture Arm (partial investment)	○	●	◖	○	◖
Venture Arm (purchase)	○	●	◖	◖	●
Lab	●	●	◖	◖	●
Innovation COE	◖	●	◖	●	●

Source: Celent
Key: ● = high, ◖ = medium, ○ = low

Source: Celent

Table 2 Decision Model

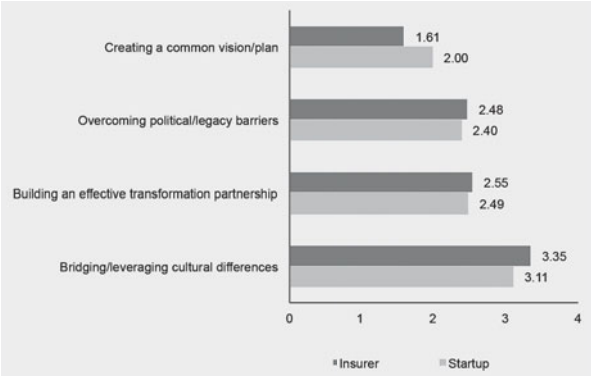
As an example of the application of this model, consider partial investment by an insurer venture capital arm. The due diligence performed when making a partial investment screens out many propositions that would not make it to implementation. Organizations with a low tolerance for failure appreciate this extra insurance. Likewise, this screening means that business impact is realized faster, so speed is rated as high. Additionally, venture capital investments usually involve substantial amounts of capital. The level of investment drives a high financial investment rating. In terms of human capital investment, insurer venture activities are typically run by a few employees with merger and acquisition and/or venture investment backgrounds. Thus, the firm does not need to assign significant, scarce internal human capital to the effort.

Finally, as compared with incubator and accelerators, the direct purchase in a company gives a higher level of control over intellectual property. However, since ownership is not complete, neither is the ability to direct IP as the insurer might wish, so level of IP ownership is rated as medium.

Comparing the characteristics of the different parts of the insurtech ecosystem with the preferences of an insurer in terms of approach offers a sufficiently rich perspective on qualitative and quantitative variables on which to make decisions among the alternatives. Choosing carefully increases the success of both implementation and integration.

4. The Partnership Challenge

Once the preferred paths are chosen, the effectiveness of the partnership between the insurer and the ecosystem directly impacts the success of these investments. Thus, it is important to understand what makes such relationships work most effectively. Celent surveyed both "sides" of the relationship – 62 insurers and 35 insurance-focused startups – to identify best practices in these partnerships. Respondents were asked to rank the challenge areas in making transformation work. They assigned a 1 to the area that has the largest impact and a 4 to the one with the smallest impact.



Source: Celent

Figure 2 Ranking of Partnership Best Practices

The ranking shows the importance of a common plan for the partnership – something that can get shortchanged in the rush to deliver "something" to market. All change programs benefit from a shared vision. However, because Insuretech initiatives involve significant uncertainty, shared vision/plans have particular value. As the efforts proceed, it is often necessary to continuously examine learnings to date, "pivot," and change direction as needed. This is a standard practice in technology companies, but such adjustments are less familiar to insurers. A common understanding of goals and objectives allows a partnership to clearly assess how a pivot affects previously agreed goals, and this understanding facilitates consensus and assists with adjusting plans for the way forward.

Insurers which are making progress with the emerging Insurtech ecosystem approach it with specific tactics. They deliberately invest time and management capital in creating a shared vision for their initiatives with startups. Insurer subject matter experts mentor startup employees to transfer industry knowledge. Some insurers invest in specific roles to manage partnerships outside the standard procurement process. Prospective partners participate in insurance-specific innovation accelerator models as a way to learn and network in this new ecosystem.

5. Conclusion

The emerging approach to Insurtech involves groups that face different challenges and may have opposing goals. Industry incumbents face the burden of their legacy systems, their aversion to failure, and a habit of extended decision cycles. Newcomer technology firms lack the capital to underwrite risk, do not understand the regulatory environment, and cannot scale easily. Venture capitalists seek maximum returns in the shortest time available.

Success with Insurtech requires an understanding of the new ecosystem as well a review of insurer priorities. It will take time to work out the best ways to accomplish new partnership models, but the barriers faced by all sides will force them to adjust. Once the preferred models are chosen and activities are begun, insurers which are making progress concentrate on closing the divide between the prevailing cultures between the different actors in the ecosystem.

To increase their probability of success, insurers are encouraged to:

- Develop an Insurtech strategy which is congruent with business strategy and consistent with cultural norms. Let this inform and guide the pathways into the innovation ecosystem.
- Acknowledge the adaptation of culture required to truly leverage what is available. Openness and collaboration are key.
- And last, but not least, continue the investment of management time and financial resources in digital transformation.