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No time to lose

How insurers can get transformation programs right

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ABOUT THE AUTHORS

Dr. Philipp Wackerbeck advises clients in the financial services industries on important strategic projects like growth and market entry strategies, reorganizations, large-scale transformations and particularly deals related projects including M&A, carve outs and debt and equity transactions. Based in Munich, he is a partner and the Global Head of financial services for Strategy&, PwC's strategy consulting business.

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The challenges insurers are facing

Insurance companies are navigating a period of extreme uncertainty that requires them to negotiate an unprecedented set of challenges at the same time. Over the past 12 months, the macroeconomic environment has shifted at extraordinary speed, from a relatively low-inflation regime to one where prices are rising at close to 10 percent on an annualized basis in many European economies.

As well as sparking much higher inflation, the multiple price shocks – energy, food, and industrial commodities – caused or exacerbated by the war in Ukraine, are increasing the odds of recession across the major developed economies. Forecasts for gross domestic product growth in the European Union in 2022 tumbled from 3.5 percent in March to 1.9 percent by July. For financial institutions, the direct impact of a deteriorating economy on investment portfolios and credit quality is likely to be significant.

This extraordinary confluence of events is especially challenging for insurance companies because it follows a long period of relative economic stability. This highlights a further key challenge facing financial services firms: no one who entered the industry within the past 15 years has experienced an inflationary environment like the one that exists today. The sector's lack of institutional knowledge across the ranks of middle management is therefore acute.

At the same time, a set of devastating environmental events all over the world have presented insurers with new challenges. They find themselves in the eye of this storm not only because of the implications of climate change for claims, but because their huge investment capacity puts them at the forefront of efforts to speed the transition to a low-carbon future. More broadly, the regulatory focus on ESG and society's expectations are ramping up, requiring institutions to develop a comprehensive and coherent approach to ESG across products and services, risk management and reporting.

This unusually testing background intensifies the central challenge facing insurance companies: how to adapt by transforming their organizations and operating models. Over recent decades, insurers and banks have responded to an accelerating succession of shifts in the business environment by launching multiple transformation projects – indeed many seem trapped in a state of constant transformation.

However, successful transformation projects are rare. Although insurers and banks continue to spend heavily on these programs, they have generally struggled to deliver the intended benefits. During 2020, major European financial services institutions spent an average of 5 percent of their revenues on change programs, with more than a third of our sample spending between 6 and 8 percent of revenues.

Yet total shareholder returns from the sector are unchanged at 2 to 3 percent a year, against 7 percent in other sectors; the cost/income ratio of Europe's top 100 banks lately stands at 72 percent against 70 percent in 2000; and the top property and casualty insurers' underwriting profits have shown no material increase over the past two decades.

Insurers therefore face a reckoning. It's time for a different approach to the levers that insurers typically pull to drive transformation – capital, costs, growth and distribution, ESG, technology, and people. In this paper we set out the benefits of each lever, as well as the difficulties companies have in achieving them. We then identify the lessons we have learned from working with clients as to how the most successfully managed transformation programs organize, deliver, and manage the change. Armed with this insight, insurers can start to deliver transformation at the scale needed in a time of such deep uncertainty.

"The complexity of transformation programs has increased incredibly over the last decades, yet the return on investment leaves much to be desired. In order to get these programs right, insurers need to fundamentally rethink how to approach and organize them."

Mukund Rajan, PwC Strategy&

SECTION 1

Against the current background of huge macro volatility and industry-specific pressures, firms must find new ways to improve their execution and use the benefits of transformation programs to position themselves for increased growth and profitability. The six areas we set out below represent the range of levers that insurers reach for to effect transformation. However, historically their efforts to use these levers to bring about change have enjoyed mixed success at best, and we identify the key challenges for each.

The transformation levers available to insurers: benefits and challenges of execution

Costs

Insurers' underwriting profitability has been meagre to non-existent over the past 15 years, forcing them to rely on investment returns to bridge the gap. The current stresses in financial markets make this situation increasingly unstable.

Cost-focused transformation follows three categories: short-term tactical steps, medium-term operational improvements, and long-term strategic redesign. The benefits are considerable: cumulative savings if all three approaches are applied can reach 30 to 40 percent.

However, most cost saving attempts fail to focus on a small number of high-impact projects, make half-hearted attempts to adopt Agile, have too few project champions outside the C-suite, and lack relevant metrics.

Distribution

Distribution is an increasingly complex issue for insurers and one that consumes a growing share of premium income. This trend is likely to intensify thanks to high inflation and a probable European recession that will reduce pricing power.

To optimize their distribution, improve customer retention, and avoid margin erosion, insurers need to decide which customer groups to focus on and customize their proposition across channels. Projects tend to struggle because companies lack detailed information to underpin decision-making, regard digitalization as a panacea, adopt excessively complex structures and processes, and fail to embed accountability at all levels of the transformation team.

Capital

The balancing act between risk, return, and capital is becoming more complex. A growing number of financial perspectives – accounting standards, tax rules, and internal priorities – must be understood, managed, and disclosed, while stakeholders are demanding greater transparency.

The benefits of effective balance-sheet management are felt both in the short term – through improved financial risk management and operational efficiency – and in the longer term in enhanced value creation, often by managing the risks of increased allocations to higher-yielding but illiquid assets. Yet, insureres still view capital and balance sheet decisions through a historical lens that may be less relevant. There is an urgency for them to act decisively to respond to – and capture opportunities from – what promises to be a volatile environment.

ESG

ESG considerations are now central for all financial services companies. Regulatory demands are becoming more rigorous and consumer expectations more demanding. The benefits of fully embedding ESG are broad. They include opportunities for premium growth and new revenue streams, cost and scale benefits, improved risk selection and capital efficiency, and a stronger employer brand.

However, benefits follow costs in this area and success requires active engagement across a wide range of ESG-related issues. Companies that treat ESG primarily as a compliance matter will not reach the point where the benefits of integrating ESG outweigh the costs.

Technology

Customer needs and expectations are changing, influenced by people's experiences of using digital services in other sectors, while new entrants have stolen a march on established players by launching innovative digital insurance propositions. Successful tech transformation can allow insurers to respond by addressing customer pain points such as underinsurance, complex online user experience, and demand for more flexible propositions.

However, established insurers are hampered in their transformation efforts by rather monolithic, legacy technology systems that are more difficult and expensive to maintain and upgrade. The huge challenges of upgrading these systems are exacting a heavy price: insurers are struggling to accelerate their speed of change, improve efficiency, and respond more effectively to disruption.

People

Widespread desire for hybrid working following the pandemic represents a major challenge for insurers: 84 percent of employees believe they can do their job just as effectively from home. So how should insurers balance operational effectiveness and compliance with the need to meet employees' aspirations for more flexible conditions?

Achieving the right balance will support efforts to evolve an insurer's operating model, deliver the capabilities that model demands, and increase employee satisfaction and productivity. However, many organizations run into trouble because they treat flexible working mainly as a question of HR policy rather than as a fundamental part of the business strategy upon which their success depends.

Conclusion

Insurers need to adopt new and different approaches in each of these six areas if they are to avoid repeating disappointments of the past and maximize the returns from their spending on transformation programs. That means changing the way they approach transformation programs of all kinds, whether addressing costs or optimizing technology. We set out the common elements shared by companies that have successfully done so in the next section of the report.

An additional perspective on the M&A environment

M&A has remained an attractive option for insurers over the past several years – from private equity-backed players, as well as insurers looking to buy specific capabilities (for example, brokers for better distribution). However, geopolitical instability, rising interest rates, and inflation have increased uncertainty over valuations and slowed deal-making among insurance companies this year. Just 27 transactions were announced in Q2 2022, down from 102 in Q1. While activity may pick up in the second half of the year as players search for value, the volatile, higher cost environment will necessitate greater focus on integrating and transforming purchased businesses to fully capture potential deal synergies.

SECTION 2

Transforming transformations: what needs to change?

Transformation projects have a long history in the insurance sector, although their nature has evolved over the decades. By comparison with earlier transformation cycles – investments in mainframe systems from the 1970s and the regulatory push through the 1990s to strengthen processes and controls, for example – today insurers must adapt to transformation cycles that have accelerated in pace and demand far greater focus on data and analytics capabilities.

The trend toward digitalization, which began in earnest around 2015, has seen companies start to embrace the cloud and move to a technology architecture based on microservices linked together with APIs. With each wave of transformation, the level of complexity has increased as more parts of the business and more third parties have become involved.

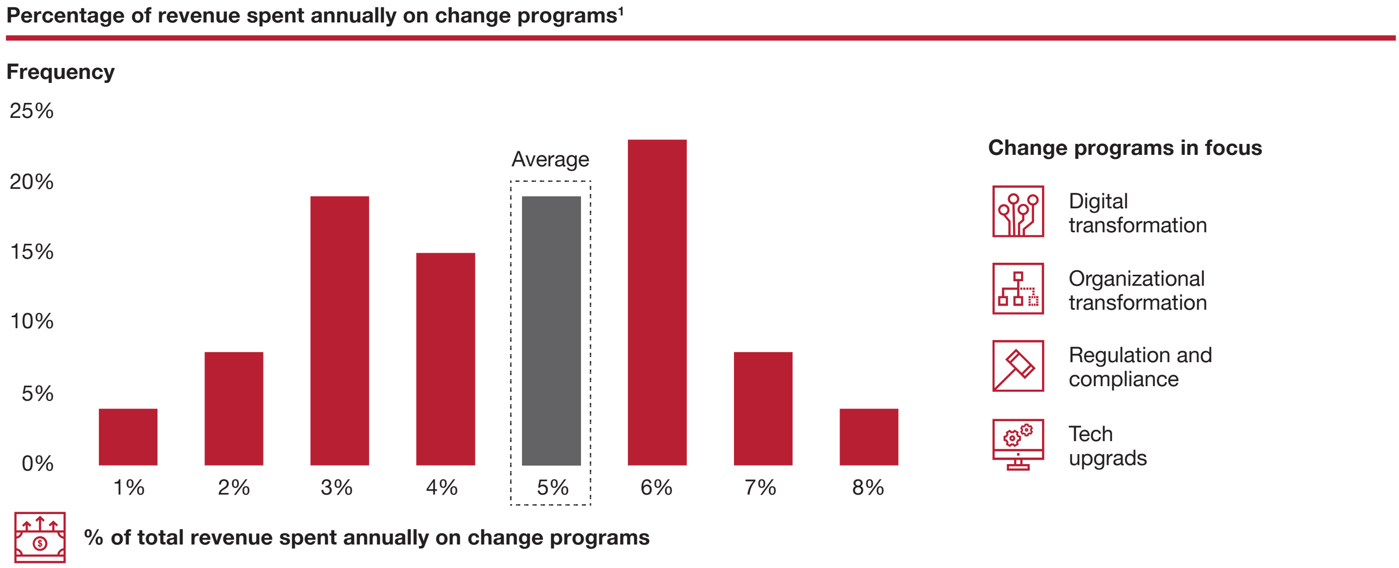
Yet in spite of heavy spending on transformation programs, insurers have struggled for decades to overcome the challenges of complex and accelerating change (*see Exhibit 1, next page*). As a result of the difficulties they encounter when attempting to pull the most common levers (*described in Section 1, above*), the benefits have remained elusive. During 2020, for example, major European financial services institutions spent an average of 5 percent of their revenues on change programs, but failed to move the needle in terms of shareholder returns, which remain stuck at 2 to 3 percent a year, while underwriting profits at the top property and casualty insurers are flat over the past 20 years.

Large insurers are complex organizations, typically running somewhat cumbersome and oftentimes outdated technology systems that have not been configured to deliver the services of tomorrow. Transformation efforts must also overcome powerful trends that are adding to the complexities: accelerating technological change including the migration to mobile; increasing use of partnering, outsourcing, and third-party solutions; the shift to hybrid work; and the difficulty of attracting and retaining talent.

To execute transformation successfully in an environment with so many variables, insurers would be well advised not to rely any longer on approaches that have required heavy investment, but produced such indifferent results. **Instead, they should fundamentally rethink the way they approach transformation.**

With profitability under pressure and the macro background extremely uncertain, it is more important than ever that transformation programs deliver the promised benefits. To ensure that happens, they need to look again at how they manage these programs and learn from organizations that have achieved success.

EXHIBIT 1
Impact of transformation programs in Financial Services



1 Selection of biggest European FS institutions and their announcements of change programs; refers to the year 2020;
Source: Company presentations and annual reports, Capital IQ, Statista, PwC Strategy& analysis

We have worked with several insurers – and large players in other industries – in supporting their most complex transformation programs. The drivers for change may be varied, but in our experience, successful transformation programs share common features that companies can use as a framework to help them organize, deliver, and manage change (*see Exhibit 2, next page*):

- **How to organize:** They structure project teams to focus on outcomes, for example by devolving budget responsibility to them; adopt effective governance models; and embed technology fully in the process.

- **How to deliver:** They build in accountability and devolve decision-making; take a pragmatic approach to delivery models by deciding when to deploy capabilities such as Agile; and actively manage "scope creep."

- **How to transform:** They aim to build lasting transformation capabilities across the organization; factor in the additional complexity created by hybrid work models; and rethink how information is relayed to decision-makers, preferring focused dialogue to lengthy management reports.

This approach offers a way out of the unproductive and debilitating cycle of constant change that many insurance companies find themselves in. Importantly, by using our blueprint for transforming transformations, organizations will be able to achieve tangible progress fast, identifying quick wins that will combat the danger of "transformation fatigue."

EXHIBIT 2
9 lessons for complex programs

How you organize	**Make your organization outcome oriented**	Bring together multidimensional skills in outcome-oriented teams that deliver differentiating capabilities
	Integrate tech for advantage	Think of capabilities holistically and develop the people, process, and technology components together
	Align leadership that sets the tone from the top	Credible leader for the program with direct access to the CEO, and an aligned leadership team – set the tone from the top
How you deliver	**Structurally create accountability for results**	Staff teams with the right talent, push decision-making to lower levels (e.g., judicious use of OKRs) and drive "2 in the box" accountability (e.g., business + function)
	Design a fit for purpose delivery model	Recognize that some things should not be delivered in an Agile manner – and that Agile delivery is a capability (not a methodology)
	Only take on complexity you can manage	Be ruthless about not taking on new scope – especially when the change in scope is accompanied by a change in team composition/ leadership
How you transform	**Build transformation enablement as a lasting capability**	Shift away from traditional change management programs – focus instead on building leadership and change capability within teams, working cohort by cohort
	Don't underestimate location	In an era of distributed delivery and hybrid work, don't underestimate the complexity introduced by a multi-location model – especially in a crisis
	Transform how decision-makers consume information	Shift away from lengthy management reports – instead focus on the quality of the dialogue and how critical information is escalated

Source: Strategy& analysis

We find that organizations that execute transformation programs successfully exhibit these nine common attributes in the ways they organize, deliver, and manage the change they are seeking:

Organize

- Successful organizations promote an outcome-orientated culture by creating cross-functional teams with a test-and-refine approach to implementation. These teams include members dedicated to building long-term transformation capability within the company and often have control of devolved budgets.
- They embed technology development within the program instead of running it as a separate stream and partner with external providers to build the capabilities required. They prioritize initiatives with high ROI and tech-related quick wins.
- The program is led by a small steering committee that provides visible leadership across the organization. The leadership structure is intentionally streamlined to drive rapid decision-making, make project ownership clear, and avoid overlap with the executive team.

Deliver

- To embed accountability for outcomes at all levels of the project team, people with complementary skills are put jointly in charge of delivery, while objectives and key results are used to ensure a focus on results. To support this, successful organizations ensure funding is in place for at least a year and create a small SWAT team to provide “surge” support where necessary.
- Successful transformations depend on a delivery model that is fit for purpose. Companies must recognize that Agile, for example, may not be appropriate in every situation. Instead, they should pilot new methods where they have strong leadership capabilities at lower levels in the organization.
- It is vital to manage the project scope actively to avoid taking on complexity that cannot be managed and avoid “scope creep” once the project is running. Companies should insist on capacity-based planning.

Transform

- Transformation expertise must become a lasting capability. Companies should make it a priority to identify authentic informal leaders within teams who can drive transformation from the grassroots. They should promote behaviors within teams that support transformation capabilities.
- Post-pandemic, successful transformation programs must rethink hybrid work models and the practicalities of distributed delivery. Teams should come together on a regular basis and their leaders must understand how team members absorb information, communicate, and collaborate.
- Companies must rethink how decision-makers receive information, favoring dialogue over PowerPoint and time-limited meetings. They should engage directly with users to obtain feedback on prototypes.

Insurance companies should assess the maturity of their organization against these nine attributes to identify which areas need to be addressed first. The transformation work can then begin, typically happening in four phases:

First, align as a team…

The first step is to unite around a single vision that encompasses business strategy, the company's operating model, its technology, and people. Then assess readiness across the three key areas – organize, deliver, transform – and identify gaps to be tackled first, as well as informal program leaders.

1

Then, design and plan…

The aim should be to take stock of existing initiatives, integrate coherently with them, and rapidly design what the company needs to build, with stages defined in terms of outcomes for the organization. This is also the point at which to set up the project governance and leadership, and to start identifying quick wins.

2

Do not neglect to set up the change…

At this stage the company must plan how it intends to take colleagues, customers, and stakeholder through the change process. The phasing of the project must be agreed at cohort level, informal change leaders must be identified and prepared, and a support-squad system should be put in place for complex changes. Delivery of quick wins should begin.

3

Deliver effectively…

Execute the project plan following the pre-defined steps agreed in the design and plan stage. The aim should be to deliver the enhanced capabilities the organization is targeting and transition them to BAU, but also to build in leadership and change capability with teams as a lasting skillset.

4

Case Study One: Finance function transformation

Prompted by approaching regulatory change, a global reinsurer launched a project to significantly upgrade its finance capabilities.

After the project began to go off course, the client drew on insights from PwC Strategy& and adopted a different approach. Instead of running in parallel, the technical and technological aspects were fully integrated into the project and its scope was rigorously controlled with all non-core items excised. The team also decided against using Agile, instead favoring a more technical approach to development. Finally, reporting requirements were reduced, with decision-makers receiving more targeted verbal updates.

As a result, the project was put back on track and achieved its goals ahead of the regulatory deadline.

Case Study Two: Digitalizing operations

A large property and casualty insurer launched a major investment project to digitalize its operations.

It adopted a holistic approach to the program, while enabling it to run on multiple tracks and so address specific nuances. All business functions were involved in the process from the start and the project leaders prioritized outcomes over processes: Agile was used where it made sense and traditional models otherwise. Plateau planning focused on self-funded "islands of stability" and capacity-based planning models were used at all times. Accountability for outcomes was devolved to individuals, preventing "hiding behind committees."

The program was delivered on time and achieved a high level of digitalization across core operations and distribution activities.

By learning the lessons of successful transformations, and changing the way they organize, deliver and manage complex programs, insurers can start to ease the transformation log-jam that has seen many companies running for two decades or more only to find they are standing still.

As a companion to this paper, we will shortly publish detailed deep dives on each of the six drivers of change that we have identified in this report. Stay tuned!

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