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Setting the stage for transformation

Why do P&C insurers need to be more nimble?

As insurers scout for avenues to achieve sustainable top- and bottom-line growth, a significant opportunity is available to generate higher risk-adjusted returns and outperform the competition by capitalizing more swiftly on shifts in the market. Changes in business environment and demand affect profitability of different lines in a variety of ways. If multiline property and casualty (P&C) insurers can fine-tune their business mix to scale down in underperforming lines and ramp up to capitalize on those that appear poised to outperform, they should be able to achieve an improved return with lower overall risk. This likely requires a flexible, portfolio-management approach to business strategy, distribution, human capital, processes, and capital allocation.

For this strategy to be impactful, carriers need to capitalize on emerging opportunities before competitors do, when the profit potential is likely the highest. To move faster than the competition, insurers should be flexible enough to spot and quantify preferred markets and shift gears nimbly. The speed at which a carrier can accomplish this will separate market leaders from laggards.

Take the case of specialty business (see note). Successful multiline writers often enjoy higher returns from their specialty subsidiaries than from their standard line P&C units as well as the overall P&C market. While for some companies higher operating leverage and greater pricing freedom are key factors behind this outperformance, an important driver is the ability of specialty carriers to quickly and effectively respond to changing market conditions and local customer needs. The entrepreneurial business models that these specialty writers employ incent business leaders to constantly look for prospects with higher profitability potential and focus their resources on quickly acquiring market share.

While not as numerous as in the specialty space, there are examples within personal lines as well. For instance, a large national P&C insurer had invested significant time and money in mapping the age and quality of roofs as part of a larger initiative to improve risk selection in its homeowners’ line of business (LOB). With an expectation of above-industry returns, the company increased focus on its homeowners’ business. As a result, the company outperformed the industrywide combined ratio by a healthy seven percentage points, and its return on equity (ROE) increased by 10 percentage points year over year.

An important driver of success is the ability to quickly and effectively respond to changing market conditions and local customer needs.

*Note: A company’s subsidiary with more than 70 percent of its direct premium coming from “Other Liability” (admitted specialty) lines or “Excess & Surplus” (E&S) lines was considered a specialty subsidiary. Companies are not required to report E&S as a separate LOB in their National Association of Insurance Commissioners statutory filings. Hence, S&P Global Market Intelligence checks Schedule T (Active Status) for each company by each state. Premiums collected from states where they have a license status as “Surplus Lines” or are “registered but not licensed” are considered as E&S premiums.

1 S&P Global Market Intelligence.
Defining “nimble”

Being nimble is the ability of insurers to rapidly ramp up or scale back the focus and capital allocated among lines of business to benefit from potential profitability variations.

Theory supported by empirical data

Using a model portfolio of six key P&C lines, which was representative of the portfolio of a large multiline P&C insurer, we tested the effect of capital reallocation on overall company profitability for three different scenarios where the shift of business volume between lines was limited to 10 percent, 15 percent, and 20 percent. The results in all three scenarios suggest that insurers have an opportunity to achieve an incremental alpha with lower portfolio risk (Figure 1) by better aligning their capital allocation decisions with the return outlook for the LOBs.

Methodology:

1. The analysis uses the concepts of Modern Portfolio Theory—a mathematical concept to optimize risk-adjusted returns of a portfolio of assets that are not perfectly positively correlated.
2. The analysis is based on a model portfolio of six key P&C LOBs—personal auto, homeowners, workers’ comp, fire & allied lines, fidelity & surety, and ocean & marine—accounting for nearly 70 percent of annual industry premiums.
3. The model is based on historical industry-level data and back tests for opportunities to improve ROE by changing the business mix with top-line constraint for the model portfolio. The model tested the impact on profitability for three scenarios where the maximum shift in the business volume between different lines from one year to another was limited to 10 percent, 15 percent, and 20 percent.
4. Portfolio risk is calculated by applying the portfolio risk formula, using the standard deviation of historical returns, correlation between LOB returns, and weights (percentage Net Premiums Written).
What could be impeding insurers currently from being more nimble?

Our research suggests that a multiline insurer’s standard operating model could likely be one of the roots of the problem. Looking back a little over 10 years, when the economy was booming and investment yields were relatively strong, success in the P&C market was directly proportional to the volume of premium a company could bring in, and the operating model that best suited this rapid expansion was a decentralized one.

The decentralized model, however, created and in some ways necessitated business units that were independent of one another. Such “siloed” operations may now be hindering cross-divisional collaboration, as well as the sharing and repurposing of internal resources. Like turning the proverbial ocean liner, current business models are often complex and slow to adapt to short-term market opportunities.

Still, the decentralized model has its advantages, such as speed of decision-making and greater specialization. In that light, perhaps the solution to becoming more nimble across the company lies not in dismantling the current model, but in building bridges among an insurer’s internal silos to infuse greater, company-wide flexibility.

Main elements of the nimble insurer transformation

Similar to any other transformation program, the nimble insurer initiative has several moving parts, which are in turn dependent on the existing capabilities of an insurer. That means there may not be a single, set formula. However, in its purest form, a nimble insurer initiative should help companies respond more quickly and decisively when faced with two fundamental strategic questions: “Where to play?” and “How to win?”

• “Where to play?” requires carriers to bolster their forecasting capability so they can determine with sufficient certainty before their competitors which businesses are likely to outperform, assess potential market opportunities against their capabilities, and plan accordingly.

• “How to win?” is about developing and implementing nimble capabilities in distribution and other core functions, which can help the carrier reap maximum benefits from this initiative.

The nimble insurer approach suggested here posits a new strategic framework featuring five key building blocks that can infuse greater flexibility and agility into insurer operating models. The objective is to effect a series of adjustments in an insurer’s day-to-day operations, while creating a competitive advantage that could be sustained over time.

2 S&P Global Market Intelligence.
Limitations of P&C insurers’ current operating models

Several barriers constrain a carrier’s ability to dynamically shift focus across LOBs

Insurer ambitions to quickly increase focus on outperforming lines are often thwarted by a number of interdependent organizational and operational constraints. Considerations related to distribution and inherent product/customer characteristics create friction and limit the speed at which an insurer can shift focus. Figure 2 highlights major constraints insurers may need to overcome to become a nimble insurer.

The existence of these constraints is likely something fundamental in insurer operating models. P&C insurers typically function in decentralized, multi-divisional structures divided by customer segments, product lines, and/or regions. While these structures have certain advantages, such “silied” operations may ultimately hinder cross-divisional collaboration and company-wide flexibility. Internal resources—such as personnel, operating budgets, and capital—once committed, are often difficult to withdraw or repurpose quickly. As a result, insurers often lack the necessary flexibility to capitalize on shorter-term market opportunities.

Also, while decentralization provides insurers with the benefits of specialization, it might hinder cross-sector flexibility in operating processes, IT systems, and product platforms, given their unique linkages to individual business units. For example, over time, carriers often end up developing a multitude of product features with dozens of pricing models, making product development and management overly complex, time consuming, and in the end a difficult challenge for risk and compliance, while impeding strategic and operational flexibility.
Moreover, an insurer’s performance management and compensation structure could become a self-defeating barrier to flexibility and obstruct mid-course corrections. As a result, business managers with profit and loss (P&L) responsibility are incented to optimize the top- and bottom-line performance of their own division or LOB, rather than the overall company performance, which may lead to suboptimal results. This situation can be further exacerbated due to complex and disjointed capital computations due to the multiplicity of capital management approaches that insurers often apply to cover the economic, accounting, and regulatory aspects of their business.

This results in siloed operations that fail to foster collaboration and innovation across LOBs and inhibit operational agility. Importantly, carriers operating in such an environment are often prevented from focusing on a bigger-picture outlook for profitability based on short-term shifts in market conditions. Such a model may be appropriate for a high-growth phase where capacity utilization is usually not a concern. However, as carriers go through different economic cycles that potentially impact certain LOBs or products more than others, siloed, decentralized structures could generate suboptimal enterprise-wide results over the long term.

As a result, multiline P&C carriers should consider the advantages of building capabilities to allow dynamic adjustments to their mix of LOBs and the capital and resources allocated to them, so they can respond more quickly and effectively to a spike or a dip in one line versus another, with minimum internal disruption.

In searching for a potential solution to this conundrum, it is useful to consider lessons learned from the specialty insurance market, as well as other industries. A few examples are included in the following three case studies.
Anticipating customer demand
Case study from the retail industry

Demand for a one-shouldered cocktail dress exploded a few years ago, and retailers rushed to stock up on the "hot item." Yet in just a few weeks, the same dress was passé and unsold inventory filled the remainder racks, ultimately resulting in costly markdowns. Clearly, fashion retail is one industry that has to keep up with fast-changing customer preferences in real time.

In a paper published in the London Business School's *Business Strategy Review*, authors Donald Sull and Stefano Turconi cite the example of one European retailer that successfully navigated this conundrum by adopting an opportunity-pull approach, in which retailers respond rapidly to shifts in the market, rather than depend upon the traditional designer-push model—in which a designer dictates what is “in.”

According to their research, the company continuously scanned and analyzed real-time data from multiple sources, studying fashion and non-fashion trends impacting customer preferences. These analyses were not aimed at making accurate long-term predictions but rather to spot patterns in the data that pointed to possible opportunities or threats emerging in the near term.

The company also had an "ear to the ground" through an effective store-to-designer-to-manufacturing communication loop that helped them to better gauge customer preferences. Store managers, for example, not only relayed hard data back to their designers, such as orders and sales trends, but also soft data in the form of customer reactions and the "buzz" around a new style. Store managers looked through hundreds of unsold items customers tried on without buying, trying to ascertain the reasons and to spot any patterns that could be shared with the designers.

Using this proactive, grassroots strategy the company was able to spot and respond to shifts in the market in just a few weeks, versus an industry average of six months, helping them significantly outperform their old-guard competitors.

Lessons for the insurance industry

For insurers, this case study from the world of fashion emphasizes the importance of tracking and analyzing real-time, demand-related variables from multiple sources—especially those closest to the customer—to spot near-term opportunities and threats.

It also points out the importance of establishing a mechanism where providers are able to collect valuable hard and soft information across all their customer touchpoints and relay it back to their finance and business decision makers.

These steps could help insurers better anticipate demand trends and in turn more effectively estimate the profit potential of different business segments.

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Building a flexible delivery model
Case study from the automotive industry

Following the financial crisis, customer preferences started changing rapidly, creating a mismatch in the car models produced versus demand. Since most automakers operated in a one-model-per-assembly-line approach, some assembly lines had to be pushed beyond peak capacity while others lay idle, leading to an overall drop in efficiency.

The solution that one large US auto manufacturer adopted was adding flexibility to its assembly lines. The company invested in renovating its flagship plant so it could not only make a variety of models, but also equip them with different kinds of powertrains—conventional or electric. The renovation was supported by a cross-training program for pertinent workers in the plant, which enabled them to build and repair models with different powertrain systems. This enabled the company to build up to six different vehicles on two different platforms with little to no downtime for tooling changeover.

With a flexible assembly line, the auto giant could not only reduce its downtime, but could also vary the mix of cars produced to quickly match any underlying shift in market demand.

Lessons for the insurance industry

There are similarities between the insurance industry’s current “manufacturing” process and the one-model-per-assembly-line structure of the automobile industry. Most insurer business models are organized by LOBs, customer segments, geography, or a combination of all three, backed by dedicated core functions such as sales, underwriting, policy administration, client servicing, and claims. Typically the divisions work with fixed capacity defined in terms of capital, risk appetite, and personnel. While there is a growing trend, particularly among larger insurers, for resources across multiple business units to be co-located in a shared service center or center of excellence, interaction and resource sharing between these units is typically limited to the support functions such as human resources, IT, general administration, etc.

While capital and resource allocation decisions could be improved with the portfolio theory approach discussed in this paper, greater flexibility in the operating model could be achieved with initiatives such as flexible staffing, which we will explore in the next section.
Creating an enabling environment for entering and exiting markets
Case study from specialty insurance

With a focus on sustainable underwriting outperformance, one large American insurer set its sights on creating an operating environment that enabled it to enter and exit lines quickly as pricing trends developed and new business opportunities emerged.

Although specialists have a built-in competitive edge thanks to their knowledge in dealing with particular risk classes, there are still operating model lessons to be learned from the specialty markets for multiline standard carriers.

To assess the potential of emerging opportunities, the carrier devoted funds to “start-up” ventures within the company, which allowed it to introduce products rapidly. At the same time it invested in gaining robust underwriting capability for all of its business segments, which enabled it to model segment profitability under different conditions with more confidence than less experienced competitors. This helped in selecting the risks to build a book that offered the most likely chance of a positive outcome, while exiting or reducing those that had an expected payout below expectations.

To align executive behaviors with profit objectives, the company put in place a set of goals against which performance was measured—managers of subsidiaries were rewarded for higher profitability and value creation, while those at the corporate level were appraised on the way they allocated capital across business lines to maximize organization-wide returns.

The results of such discipline were ultimately manifested in the company’s loss ratio, which averaged 62 percent from 2011–2015—well below the industry average. This was a huge driver of its financial outperformance.

Lessons for the insurance industry

This case study underlines the benefit of dynamically allocating capital across business lines. Having the underwriting know-how and management discipline to write business only at favorable prices while declining potentially underpriced risks is key to realizing such a strategy. At the same time, having the right set of performance incentives is a critical enabler of this overriding discipline.

Standard and specialty insurers alike can mimic this strategy by investing in their ability to analyze profitability by different LOBs, while creating and enforcing the right set of performance goals.
A nimble insurer would be defined by several key capabilities that would help it to determine more effectively “where to play?” and “how to win?” The carrier would have a very clear idea about the projected contribution from each line as well as the most optimal business mix. It would have an agile distribution function capable of both providing market intelligence as well as quickly adapting to shifts in product focus and pricing. Its operations would be flexible enough to seamlessly absorb additional workloads from businesses with enhanced focus and vice versa. Last but not least, the culture of the organization would recognize flexibility as a core competence and incent participation and collaboration.

## Characteristics of a nimble insurer

### A framework for flexibility and transformation

We define below a “flexibility framework” featuring five elements (see Figure 3) that can help P&C insurers navigate through this transformation and become more nimble.

- The first element—flexibility in governance and management—orchestrates the transformation and ensures that the new nimble processes are executed and maintained on an ongoing basis.

- The next two—market sensing and product portfolio analysis, part of “where to play?”—are intended to help insurers identify and agree on the direction they have to take to maximize return.

- The last two—flexibility in distribution and in core operations, part of “how to win?”—aim to help carriers reach their goals more efficiently and effectively.
1. Flexibility in governance and management

Becoming a nimble insurer requires commitment from stakeholders across the organization. “Nimbleness,” therefore, must be recognized as a strategic priority and owned by the carrier’s executive committee. The final decision for any shifts in focus and significant reallocation of capital and resources ultimately resides with them.

However, along with direct involvement of the CXOs, a carrier’s flexibility initiative requires active participation from the LOB heads. One way to accomplish this may be to expand the executive team to operationalize the nimble initiative by forming a “flexibility committee,” comprised of CXOs and LOB heads.

The flexibility committee’s primary job, based on the insights from the product portfolio analysis as well as the company’s strengths and positioning, is to decide the final portfolio mix for the organization over a particular time period. This should allow the carrier to more effectively identify new products or additional lines of business to develop, enhance existing products, as well as determine the benchmark targets for ramping various lines up or down.

The flexibility committee also has to work with the human resources department and individual operational teams to recognize flexibility as a key competency, as well as create performance metrics and incentives to embed that requirement within an organization’s culture. It is important that the LOB heads fully understand the reasons behind any reallocation of resources, and that steps are taken to minimize any negative impact on them in the short term. Insurers might go so far as to consider setting aside additional incentives for those operating in lines that are de-emphasized, funded possibly by the incremental alpha produced from newly emphasized lines.

Since this initiative makes flexibility a strategic priority throughout the organization, appointing a “chief flexibility officer” might be in order, either as an added responsibility for an existing executive team member, or even as an additional position to that leadership unit if necessary, to purposefully drive and orchestrate the flexibility initiative. This could also ease the burden on the flexibility committee in terms of overseeing the implementation process or the day-to-day nimble operations.

Throughout this process, flexibility governance—either through a flexibility committee or some other governing mechanism—has responsibility for communicating with internal and external stakeholders to ensure awareness, understanding, and support for the initiative.

Nimbleness must be recognized as a strategic priority and owned by the carrier’s executive committee.
In addition, the committee should establish a process to continuously monitor and review the evolution of the flexibility process, as well as be prepared to make tweaks to facilitate the effort, based on continuous learning.

**The building blocks**
- Executive buy-in
- Flexibility committee
- Chief flexibility officer
- Clear financial goals
- Performance management

### 2. Market sensing
This step calls on insurers to develop an innate understanding of the profitability drivers for all products at different price points and coverages across several parameters, such as industries, customer segments, and geographies. This understanding, when coupled with in-house market research capabilities (which use predictive models to estimate parameters such as product demand and pricing trends), should allow carriers to form a more reliable outlook for their product portfolio.

In addition, insurers have an opportunity to spot these trends and opportunities early on, by combining input from their existing market research capabilities with regularly updated feedback from their front-line “listening posts” — namely, their agents and brokers or direct sales force.

While most carriers might already be getting feedback from their distribution force, it is usually not channeled within a single reporting system and analyzed to derive insights relating to short-term opportunities. Thus, insurers may not be realizing the full benefits of this information at present.

With predictive modeling becoming pervasive throughout the insurer value chain, and with analytics ever more entrenched in an insurer’s day-to-day operations, coordinated, actionable market intelligence via distributors is well within a carrier’s reach. Such first-hand data, combined with increasingly granular actuarial assessments based on comprehensive analysis of individual segments and relevant macroeconomic conditions, would help generate a more wide-ranging and impactful market sensing report.

**Listening posts for better forecasting**

Insurers could have an ear to the ground by systematically collecting qualitative and quantitative market intelligence from their sales channels, synthesizing this information across LOBs, and then relaying the data throughout both the business and finance sides.

3. **Product portfolio analysis**
Capturing incremental alpha requires placing a bet on which LOB(s) will likely generate the desired target, based on market intelligence and an understanding of short-term profit drivers. To accomplish this, carriers need to develop an integrated view of their current and forecasted portfolio performance, based on the leading indicators of volume and rate trends, as well as broader macroeconomic developments, which can be sliced and diced and viewed in multiple ways depending upon the intended audience.

During our research, we found that the accounting infrastructure at some carriers is likely still not sufficient to accurately provide a cost-based analysis of performance across lines of business. If so, this may be the starting point for insurers: transforming their finance function to be able to provide business leaders with reliable information about performance by individual LOBs. It requires a common approach to calculating performance parameters, such as ROE, and a transparent method for charging back expenses across products. This would provide insurers with a report card on the performance of their current product portfolio, as well as the basic foundation necessary to perform the next level of analysis.

Carriers may also need to develop an internal risk-adjusted capital adequacy framework that accounts for economic as well as regulatory factors under one integrated capital management system. Having a combined view of capital would
enable insurers to conduct a thorough bottom-up analysis of their risks by product line and risk type and apply the approach that is most meaningful for mitigating the particular exposures to each, leading to more transparency and consistency in pricing and underwriting. Such a strategy would help insurers to more fully understand the capital consumed by different books of business, allowing better assessment of risk-adjusted return on capital by various LOBs.

Companies can integrate their sensing data with modern portfolio theory (MPT) concepts to identify their optimal product mix. This involves conducting a thorough sensitivity analysis of their product portfolio across different variables and parameters to arrive at the most likely and most optimal product mix. MPT may not only enable carriers to identify which specific lines to ratchet up or down, but could also provide them an estimate of the extent of capital and other resources that need to switch hands among lines, and the expected contribution to risk-adjusted returns.

This information should be shared with the heads of all business units and the flexibility committee, whose members can weigh in with their real-world experience to finalize the targeted business mix for the organization.

4. Flexibility in distribution

To translate decisions on portfolio shifts into effective outcomes, carriers likely need to adjust various levers for demand management. The levers employed should depend on the desired outcome, particularly to limit any potential damage in the carrier’s relationship with its distribution force and customers.

To accomplish this, carriers that are looking to de-emphasize a particular line, product, or region could do so by changes in their pricing and underwriting policies (see Figure 4). To ramp up in a particular line, carriers could offer additional incentive compensation to their agents and brokers beyond any standard commissions paid on such business.

In some cases—for example, if a carrier is looking to enter an entirely new line of business or different geographic area—new relationships may need to be established with agents and brokers capable of delivering business for those products or locations. A wholesaler may need to be engaged to quickly access business in a new line or state, or a carrier may choose to test the waters by selling such business direct to consumers.

In any case, carriers likely need to design agency engagement programs to proactively communicate with their distribution force—particularly with key agents—about the reasons behind any changes in strategy or shifts in emphasis to retain trust and loyalty among those selling their products.

Technology solutions could also be helpful here. Advanced analytics can facilitate a sensitivity analysis of demand versus pricing and other product features to pinpoint and accelerate whatever adjustments are necessary. Incentive management systems could provide insurers with the ability to rapidly adjust commissions, manage complex payment schemes, and provide some self-service functionality to agents.

It should be noted that compared to brokers and independent agents, captive agents are often at a higher risk of losing customers altogether if an insurer decides to de-emphasize a particular line, because they may have no alternative source

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<tr>
<th>The building blocks</th>
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<tbody>
<tr>
<td>Robust accounting infrastructure</td>
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<td>Integrated capital management framework</td>
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<tr>
<td>Modern portfolio analytics</td>
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<td>Business unit commitment</td>
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Carriers may need to develop an internal risk-adjusted capital adequacy framework that accounts for economic as well as regulatory factors under one integrated capital management system.

**Figure 4. Levers to emphasize/de-emphasize focus on specific LOBs**

<table>
<thead>
<tr>
<th>Distribution and marketing levers</th>
<th>Product levers</th>
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<tbody>
<tr>
<td>• Incentives for new business</td>
<td>• Pricing</td>
</tr>
<tr>
<td>• Sales support for agents</td>
<td>• Coverage terms and conditions</td>
</tr>
<tr>
<td>• Volume incentives for direct staff</td>
<td>• Value-added services</td>
</tr>
<tr>
<td>• Targeted marketing support</td>
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</table>
of coverage. Hence, carriers with an exclusive distribution force could therefore encourage captive agents to broaden their capabilities by selling additional lines of insurance and perhaps other financial products and services as well—providing training and support when necessary—to improve their value proposition and the viability of their distribution force over the long run, while enhancing their own flexibility. Carriers could also consider reducing dependence on the captive agency channel by at least partly diversifying to more flexible channels such as independent agents and direct sales over the Internet.

For example, with the growing need for straight-through processing, especially in standardized products, companies could continue to automate underwriting and claims assessments where possible. Insurers may achieve greater speed, efficiency, and cost-effectiveness by automating activities such as quoting, application processing, underwriting, policy issuance, and initial claims assessment, among other activities.

Insurers also should not neglect the human component in flexibility and consider innovative approaches to address any imbalance in staff utilization. Individuals are often tied to their business unit, either because people tend to weigh the risk of change to be greater than the potential opportunity or because business managers with P&L responsibility are reluctant to let go of their high performers.

It is, therefore, imperative that the right incentives are put in place as insurers start ramping up or down on a more frequent basis. The operations/staffing team should continuously monitor shifting human resource requirements across teams, business units, functions, and geographies, and be positioned to proactively offer cross-staffing options and load-sharing mechanisms. To enable this practice they would need to provide the right level of training while documenting and standardizing processes as much as is feasible across the organization.

Our analysis suggests that flexible staffing would likely be more applicable for functions such as sales and marketing support, customer service centers, policy administration, and even harder-to-find skills such as data scientists and those with niche IT capabilities.

Carriers could also consider creating a “bridge team”—utilizing a small, permanent group of top-performing personnel cross-trained across multiple lines and functions that could be “flexed” when necessary to help capture incremental alpha. Bridge-

The building blocks
• Demand sensitivity analysis
• Proactive communication
• Incentive compensation management system
• Agency engagement programs

5. Flexibility in core operations
The fifth element deals with infusing flexibility into an insurer’s core day-to-day operations. Indeed, there are areas where flexibility could make or break a carrier looking to shift gears in a hurry. Potential choke points include sales and marketing, call centers, policy administration, underwriting, and claims.

Depending on strategic intent, the current adaptability of an insurer’s operations, as well as the feasibility of cross-training, carriers could apply a range of solutions to improve operational nimbleness, including:

• Increased automation
• Shared services
• Flexible staffing

To begin with, carriers should study all of their support functions and design individual strategies for each, keeping long-term objectives in sight.
From the drawing board to implementation

Becoming a nimble insurer may be a multi-year journey. An important preparatory step is to conduct an as-is assessment of an insurer’s current capabilities. This “flexibility diagnostic” (Figure 5), comprised of a series of questions structured around the five elements of flexibility enables carriers to evaluate the current state of the major functions that will likely be impacted during a nimble transformation. Using an interview and checklist methodology, this assessment tool could help insurance companies relatively quickly estimate the overall time and effort needed to inject greater flexibility into their organizational structure.

Figure 5. The flexibility diagnostic

<table>
<thead>
<tr>
<th>Flexibility in governance management</th>
<th>Flexibility score*</th>
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<tbody>
<tr>
<td>Market sensing</td>
<td></td>
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<td>Product portfolio analysis</td>
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<td>Flexibility in distribution</td>
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<tr>
<td>Flexibility in core operations</td>
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*Note: This is a representative flexibility score.

Key assessments

- Do you have a culture of regularly reviewing the portfolio of businesses and capital allocations?
- Do you have an integrated and collaborative decision-making structure, which involves at least the CEO, CXOs, and all LOB/divisional heads?
- Does your organization have a formal process of knowledge-sharing across LOBs?
- Do you have a dedicated business analyst team to gather market intelligence?
- Do you formally collect information from agents/brokers on market dynamics?
- Do you have the technology and people to conduct advanced demand forecasting?
- Do you base your capital allocation decisions on profitability outlooks for LOBs?
- Do you have an internal risk-adjusted capital adequacy framework that accounts for economic as well as regulatory factors?
- Do you utilize advanced financial concepts to analyze organization-wide performance?
- Do you utilize systems such as incentive compensation management to handle agent and broker commissions?
- Do you utilize CRM systems to handle advertising and other marketing activities?
- Do you have a relatively straightforward product-pricing strategy, with a standardized rule-set and limited number of exceptions?
- Do you cross-train your staff to function in multiple lines of business?
- Do you provide cross-staffing opportunities to your staff to work across multiple lines?
- Do you utilize technology for core operations?
**Piloting for success**

As with any transformation project, to overcome inertia and effectively manage change, insurers should approach the flexibility initiative in a phased manner, starting with a pilot in segments or lines that are more viable for capital adjustments:

If the speed at which business focus can be realigned is the defining characteristic of a nimble insurer, “adjacency” traits of the lines under consideration set the “speed limit.” LOB adjacency is characterized by the flexibility of a carrier’s distribution channels and the similarities between the product lines being considered—specifically the skill sets required in delivery and support functions, as well as the customer segments being served. Within our nimbleness and speed framework, adjacency can be viewed as the measure of friction.

As depicted in Figure 6, the exclusive agency has lower channel flexibility compared to independent agents or brokers because exclusive agents are at a higher risk of losing customers if an insurer decides to de-emphasize one of its product lines given an inability to place clients elsewhere in many cases. In other words, the speed at which a company could shift LOB focus within an exclusive agency environment would be slower due to likely distributor resistance to change (i.e., greater friction) versus other channels.

This concept, therefore, is probably least applicable to those personal lines insurers that depend exclusively on captive agents. Conversely, it is most applicable to large commercial and specialty lines insurers that sell primarily through brokers and independent agents.

Additionally, relatively similar or “adjacent” businesses such as homeowners and auto insurance that have an overlap in the target customer segment and require similar skills for delivery and support (i.e., lower friction) may lend themselves more readily to the nimble concept. On the other hand, shifting business between large commercial and personal LOBs could be challenging given that the two have very little overlap, in terms of customer segments, products, or in the support skills required.

Companies could also experiment with the concept within a single line while shifting capital between various geographies, if they do not already do so. Additionally, along with front-office functions, middle- or back-office operational functions (such as claims) could also be considered for the pilot.

In addition, the pilot could serve as a hothouse exercise, drawing lessons from the concepts outlined in the report on minimum viable transformation published in the Deloitte University Press “Business Trends” series.* Pilots should be specifically designed, not as a proof of concept, but to test hypotheses and gain knowledge about the biggest unknowns that could sink such an initiative. It is also essential that such pilots remain “minimal” so that lessons can be learned quickly, with less disruption to the overall operation, and with lower upfront investment. This not only de-risks the implementation to a large extent, but also allows a carrier to run a pilot without necessarily being well established in the building blocks outlined previously in the flexibility framework.

Carriers could look to pick up speed in an organization-wide implementation once the pilot phase is completed and any adjustments are determined because, as suggested in Deloitte’s “Minimum Viable Transformation” report, as soon as a company floats a new idea in the marketplace, it has effectively shown its hand to competitors—who are then in a position to learn from the market’s reception to its introduction as well.

The nimble differentiator

Establishing the elements of the flexibility framework can allow an insurer to spot, assess, and react to market opportunities faster and in a more efficient manner, thereby maximizing return on investment.

The market-sensing ability that insurers can create by combining the inputs from their existing research capabilities with feedback from their front-line distribution force should enable them to spot opportunities early on. At the same time, product portfolio analysis using MPT concepts would allow insurers to analyze and assess these opportunities collectively and determine the optimal allocation of available capital. Enhancing distribution and operational flexibility would help P&C carriers shift resources quickly to support the emphasis on one line versus another with minimal internal disruption.

In today’s information age, the time frame open to a company to benefit from any strategic advantage is shrinking rapidly. Thus the speed at which a carrier can shift gears and seize short-term market opportunities will likely separate market leaders from laggards. A key new competitive differentiator therefore is the ability to adopt more agile business models. Insurers have to become more adaptable to new competition and rapidly changing market conditions and begin the “nimble transformation” early on, before competitors beat them to the punch and seize the opportunity. The nimble initiative can help an insurer achieve the speed necessary to win in today’s and tomorrow’s increasingly competitive environment.

Calls to action

- Determine if the journey to becoming a nimble insurer is the right one for your company
- Assess the flexibility readiness in different areas within your company
- Identify the priority areas on which to focus
- Run a pilot program to test and assess the concept’s viability
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