Are your strategy and structure fit for purpose?
As we’ve noted previously,1 balancing growth and profitability is no easy trick as major changes unsettle an industry that has been used to gradual change. “Business as usual” approaches are faltering in the face of generational shifts in customer needs, rising capital requirements, new regulatory burdens, low interest rates, disruptive technology, and new competitors. Many companies aren’t getting the results they need from textbook moves, such as fine-tuning marketing programs, updating products, enhancing customer service systems, and beefing up information technology systems.

Strategic success now requires a structural response, and companies can’t adapt to current conditions without modernizing often antiquated structures. Before attempting to implement new strategies, companies need to re-evaluate operating model dimensions such as capital deployment, organizational design, tax positioning, and governance.

In a changing insurance industry, strategic execution often requires a new structure.

We recognize this is easier said than done. Structural impediments take many forms. Some companies lack scale to generate profitable growth under new capital requirements. Others with siloed, hierarchical organizations lack the flexibility to respond quickly to market shifts. Poor technological capabilities often hamstring old-line insurers facing newer, more digitally-oriented rivals. And tax reform looms as a potential threat to profitability in certain business lines.

We’ve seen three common industry responses to these pressures:

- Recognition of the need for structural change, but have yet to carry it out. Some companies have plans in the works, or are debating their merits, opportunistically waiting for the right deal to come along.

- Hunkering down behind existing structures, making only minor tweaks, and hoping to emerge from the storm without too much damage. For some this is rational because they are constrained. For other companies with more viable options, company culture may be removing certain options from consideration too quickly.

Companies in the first two groups are giving themselves a chance to compete and ideally prosper. But the third group is not making strategy equal structure.

1 Please see last year’s Fit for Growth insurance survey report and 2016 Top Insurance Industry Issues.
Most insurers work diligently to improve their businesses across several dimensions. They seek more insight into consumer needs and behaviors, nurture unique capabilities to differentiate themselves from competitors, modernize products and distribution strategies, and embrace digitization. These are all sound approaches, but are inadequate to address the uncertainties facing insurers today. The familiar “good to great” rallying cry assumes a certain stability in underlying economic and market conditions that hasn’t been the case since the financial collapse of nearly a decade ago.

The crash and its aftermath undermined pillars of many insurance business models. We’ve seen years’ worth of modest industry growth – just over three percent for P&C companies, and barely over one percent for life insurance companies.

This long stretch of sluggish global growth has pressured revenues and forced insurers to compete harder on price. Persistent near-zero interest rates are squeezing profit margins, especially in life insurance. Moreover, tougher accounting rules are driving up costs while heavier capital requirements weigh down balance sheets and dilute returns. Compounding these challenges are potentially destabilizing effects of recent US tax legislation on earnings and growth. Taxes may rise for some insurers, an unexpected outcome that could force them to raise prices or find other ways to protect shareholder returns. Substantive impacts may result from falling corporate tax rates, offset by the limiting of deductions for affiliate premiums, limits to the deductibility of life reserves, accelerated earnings recognition and a slowing-down of deferred acquisition cost deductions.

Competitive dynamics also are shifting as expanding “pure play” asset managers such as Vanguard and Fidelity block growth avenues for insurers. Other companies and some new entrants are innovating and experimenting with strategies to disrupt distribution. Still others, including private equity firms, are looking at ways to change the cost-curve through aggressive acquisition and sourcing strategies.

To be sure, some long-term trends could benefit selected insurers or at very least shift the risks. Longer life spans and the shift of responsibility for retirement funding to individuals may drive demand for annuities and other retirement products.

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However, many companies are as unprepared to capitalize on these opportunities as they are to meet long-term challenges. Often the problem comes down to scale. Some insurers lack the resources to build new distribution platforms and customer service capabilities in growing markets like group insurance, ancillary benefits and retirement plans. While markets for individual products may be easier for new entrants, establishing expensive platforms for asset management, retirement, and group are more difficult – driving a desire for scale and putting more pressure on sub-scale competitors.

Sometimes the issue isn’t scale but a failure to respond quickly enough as conditions change. Buying habits are changing, notably through online channels (though our research indicates that for bigger and more complex transactions, most people still want help of some sort of “human” interaction before actually buying). It takes investment and experimentation for companies to try and then refine new models. Some companies haven’t built needed assets and capabilities or adjusted to evolving distribution patterns and consumer buying habits.

The ideal response to each challenge and opportunity will vary for each company, depending on its unique characteristics and circumstances. Few companies have the scale to fix all of their problems on their own. In virtually every case, the right solution will involve structural change.

A time for structural change
The link between strategy and structure has become apparent to many management teams, particularly in life insurance. Major life insurers are taking dramatic steps to add scale, open new distribution channels, augment capabilities, drive down costs and rev up growth and, where regulation is burdensome or profit-prospects dim, exit geographies and business-lines. Recent transactions in the sector show the range of structural options to advance strategic goals in a changing marketplace.

As companies recognize that traditional approaches to annual planning, project funding approvals, and technology architecture may be getting in the way of innovation and their ability to respond to changing market conditions in real time, they are rethinking and redesigning core processes to help the company change.

Sometimes, the best choice is to move out of harm’s way. Companies can preserve margins by exiting businesses targeted for higher capital requirements or costly new accounting standards. For example, Metlife’s 2017 Brighthouse spinoff bolstered its case for relief from designation as a SIFI (systematically important financial institution) and associated capital requirements. Exiting US retail life insurance markets also enabled Metlife to focus on faster-growing businesses that are less vulnerable to rock-bottom interest rates. As another example, The Hartford recently announced the sale of Talcott Resolution to a group of investors, completing its exit from the life and annuity business.

When scale is an issue, the solution may lie outside the company or in new structural approaches:

- Some insurers form partnerships to expand distribution, diversify product portfolios or bolster capabilities. Companies also adjust their scale and capital structures through mergers, acquisitions and divestitures. Sun Life paid nearly $1 billion in 2016 for Assurant’s employee benefits business, filling gaps in its product portfolio and gaining scale to compete with larger rivals. MassMutual’s purchase of MetLife’s broker/dealer network in 2016 enlarged the MassMutual brokerage force by 70%, and freed Metlife to pursue new distribution channels.

- New product lines offer another path to faster growth or fatter profit margins. Several insurers have moved into expanding markets with lower capital requirements, such as asset management. Voya, Sun Life, and Mass Mutual have acquired or established third-party asset management units to capitalize on investment expertise they developed managing internal portfolios.

- The Hartford recently announced an agreement to acquire Aetna’s U.S. group life and disability business, deepening and enhancing its group benefits distribution capabilities and accelerating the company’s digital technology plans.

- We also see companies establishing technology-focused subsidiaries, like Reinsurance Group of America’s (RGA) RGAx and AIG’s Blackboard.

Still other companies have moved aggressively to improve their cost structures:

- Insurers seeking greater financial flexibility have divested assets that require significant capital reserves.

- An insurer that offloads its own defined-benefit plan to another via pension risk transfer (PRT) frees up capital and eliminates ongoing pension funding requirements. Other cost-saving moves focus on workforce expenses. In addition to reducing staff, such measures include relocating workers to low-cost areas or jurisdictions offering significant tax incentives.

Structural change drives strategic execution
Companies that launch ambitious structural initiatives may under-appreciate the role of culture in making new structures work. Culture is a set of norms, mindsets and behaviors that have developed around existing organizational structures. The two are tightly linked, and one can’t change without the other changing, too. Structural change will force changes to operating models and cultural change may be necessary to drive it.

A new structure without corresponding changes in culture amounts to little more than a redesigned table of organization. Culture also influences a company’s willingness to make the deep structural changes in time to avert a crisis. Those who wait until changing market conditions have undermined their operating models put themselves at a disadvantage. Nevertheless, few companies attempt structural change in “peacetime.”

Absent a crisis, directors usually provide guidance and perspective and monitor indicators such as growth and profitability, while management takes responsibility for achieving specific strategic objectives. Successful companies, by contrast, continually reassess their structures in light of evolving market conditions. They understand that organizational structures aren’t permanent fixtures, but strategic choices they need to reconsider as circumstances and objectives change.
Amid the constant drumbeat of change in today’s insurance industry, successful companies are meeting structural challenges with structural solutions. Approaches vary from company to company. Some add scale or enhance capabilities, while others streamline cost structures or exit lagging business lines. With the right cultural support, these structural responses position a company to capitalize on industry changes that confound competitors.

Based on our experience, companies that adjust their structures ahead of a crisis exhibit three distinctive cultural traits:

- Directors track management’s allocation of resources against key strategic priorities.
- Directors and managers make clear to everyone throughout the company that “the truth” is not only welcome, but expected.
- Directors make sure the company’s talent, capabilities and know-how align with its goals.

Complacent organizations that don’t make structural changes until a crisis hits also have three distinguishing characteristics:

- They over-emphasize “cascaded objectives” that often conflict.
- They rely excessively on “can-do spirit” as a plan of action.
- They exhibit unwarranted confidence in their own prescience and planning capabilities.

Which scenario typifies your organization? Are you confident your structure and culture are fit for purpose?
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