WHY CHINESE INSURERS LEAD THE WAY IN DIGITAL INNOVATION

By Tjun Tang, Michelle Hu, Michael Guo, and Angelo Candreia

THE SCALE AND REACH of digital innovation in China are beyond what we see in any other market. With nearly 725 million mobile internet users, a measured regulatory approach that supports innovation, and the continuous development of new, disruptive services by digital giants Alibaba, Baidu, and Tencent, digital platforms have become integral to everyday life in China. The Chinese insurance market has seen the same pace of innovation. As a result, insurers engage more directly with customers than in the past and develop offerings that target their unmet needs.

The new path, charted by new digital players and some leading insurers in China, stands as a critical challenge to traditional players. In addition, that path is a powerful example not only for insurers in China but also for those in countries that have yet to embrace digital strategies and could adapt Chinese innovations to their markets. All insurers need to understand how critical technologies—including big data, cloud computing, artificial intelligence (AI), blockchain, and the Internet of Things—will make innovation possible and how to master and integrate those technologies into their business.

The Digital Opportunity—and Challenge—for Insurers

The rewards are significant for companies that create a strategy that successfully uses digital channels. First, insurers can engage directly with customers. This is critical in an age when customers expect seamless interactions with product and service providers—an expectation based on customers' experience with retailers and companies in other sectors. A Morgan Stanley-BCG survey found that more than 50% of the consumers interviewed said they would be willing to switch insurers in order to have a better online or self-service interaction. Second, insurers can gain insight into unmet needs that provides ideas for new offerings. Third, insurers can gather information that helps them improve how they underwrite and market their products.

Despite those compelling rewards, the insurance industry has room for improvement when it comes to understanding and engaging with its customers. A BCG survey asked participants how satisfied they were with their interactions with their insurance company and with companies in other industries, including personal banking and apparel retail. Participants' ratings of the former were well below their ratings of the latter. Customer dissatisfaction creates an opening for players that can engage with customers more effectively, a development that could upend insurance company business models.

In China, digital companies are stepping into the breach. For example, Tencent, the owner of WeChat (which has more than 900 million users), officially launched an online insurance business in October 2017. It serves as a pilot, testing the effectiveness of promoting tailored insurance offerings to selected customers on the basis of their individual needs.

Meanwhile, Ant Financial is poised to change the dynamics of the industry. The company's efforts include building an online aggregation portal that will allow visitors to compare prices offered by various auto insurance providers. Such aggregation services can lead to significant disruption, as they did in the UK: auto insurers saw intense price competition, which put pressure on profitability.

Ant Financial has also developed two digital tools for insurers. The first is Ding Sun Bao, which remotely collects photos of external vehicle damage and analyzes them using AI-driven, deep-learning image recognition technology. The tool can dissect and assess the damage, reconstruct the scene of the accident, and remove glare. The technology learns autonomously through iterative comparisons on the cloud platform, giving an accurate assessment within a few seconds. The second tool is Car Insurance Score, which uses big data and AI technology to assess driver risk on the basis of the vehicle owner's profession, credit history, spending habits, driving habits, and other data. If Ant Financial, which already holds some insurance licenses in China, becomes a player in the auto insurance market, these tools, along with its aggregation service, could give it a significant advantage serving consumers and other insurance companies.

Tencent's and Ant Financial's innovations create both opportunity and risk for insurers in China. Companies that develop smart digital strategies—alone or by partnering with these digital players—stand to reap significant benefits. For example, those insurers will gain insights that they can use to improve their underwriting process and expand their access to new customer segments. Companies that do not craft a strong digital strategy, however, will likely see weak growth in their customer base. In addition, they could lose to digital players the slice of the margin they earn from distribution—not an insignificant amount given that roughly 30% or more of current industry premiums are related to distribution activities.

A Center of Innovation

China is a massive market that supports innovation: Consumers own more than 1 billion smartphone and tablet devices, and smartphone users in China spend, on average, more than three hours a day on a mobile device. Digital platforms such as WeChat—which has so many functions that it has been called "China's app for everything"—are deeply ingrained in day-to-day Chinese life. In addition, leading digital players are highly agile when it comes to new product development—rapidly piloting new products and services to learn what works and what doesn't. Then they refine or terminate new offerings quickly on the basis of market feedback. As a result, the market serves as a giant laboratory.

Innovation at Insurance Companies.

Insurers in China tend to move through three phases in their digital evolution. The first phase, which some entered more than a decade ago, focuses on digitizing the core business. This involves setting up online channels to reach both customers and insurance agents and automating back-end processes, including underwriting and claims processing. Typically, these steps lead to the creation of siloed, standalone sites for handling various types of insurance, such as auto, health, and life.

The second phase involves creating offerings that are not traditional core insurance products. These digital services are designed to help customers with day-to-day activities, such as making a doctor's appointment, or occasional ones, such as buying a home or car. By extending the type and number of offerings, companies increase the number of customer interactions and strengthen their connection to customers who purchase those services.

The third and final phase involves merging customers' accounts for digital services with their accounts for financial services, such as banking or asset management. By combining these accounts, companies gain an understanding of a customer's life, enabling them to provide better solutions. The result is offerings that are not only tailored to a customer's needs or life stages but also marketed to a customer in the most effective way.

A Case Study in Digital Evolution. Insurer Ping An Group has moved through all three phases in its digital evolution. The company tackled the first two phases simultaneously, digitizing its auto, health, and life insurance businesses while building four online vertical portals—auto, health, finance, and real estate. Each portal promotes digital offerings, such as car-buying services, online medical consultations, online wealth management services, or real estate listing services.

In addition, Ping An created apps to build connections with consumers in ways that are unrelated to insurance. So although Ping An has more than 153 million financial services customers, its various apps—including health care and medical platform Good Doctor, real estate app Ping An Haofang, and shopping loyalty program Wanlitong—have more than 400 million users.

In the third phase, Ping An is harnessing its engagement with customers and consumers—and the data those interactions produce—to better market its insurance and other financial services offerings. A key step was for Ping An to create a one-account model for its financial services and digital services businesses. That model is making it possible for Ping An to offer auto insurance to customers who recently bought a car through Ping An's auto site, for example, or mortgage and insurance services to those who recently bought a new home through the company's real estate site.

At the same time, information from digital services creates valuable leads for Ping An's 1.4 million insurance agents—one of the largest agency forces in China. Digital has enhanced—not diminished—the value of the agent, with Ping An's agents enjoying much higher productivity, on average, than other agents in China.

New Technologies That Are Critical to Digital Success. To innovate successfully, all companies—incumbents and new entrants—must master a number of new, somewhat interdependent, technologies:

- **Big Data.** Insurers that have repositories of big data have the potential to improve a number of practices, including how policies are priced and how fraud is detected. In the auto insurance industry, for example, the analysis of big data can help companies cut the cost of claims by 6% to 10% and nonclaim costs by 10% to 12%. Although insurers have access to large amounts of customer data today, in many cases it is disparate data that has been gathered through various business lines. Many companies have not invested in the infrastructure necessary to collect and integrate data so that it can be used effectively.

- **Cloud Computing.** Companies that use cloud computing reap two big benefits. They significantly lower their overall costs, eliminating the need for big IT investments, and they dramatically increase computing speed and capacity. The latter will be critical to deploying AI. But insurers in general have been slow to shift to cloud computing, in part because of the upfront costs associated with making the shift.

- **Artificial Intelligence.** AI is already being used in China for tasks such as spotting potentially fraudulent activity on the basis of claim patterns. But the technology has the potential to revolutionize the industry, improving the efficiency and effectiveness of every aspect, no matter how complex. Some auto insurers, for example, are conducting pilots that have drivers take photos of an accident and upload them to the cloud. An insurer then uses AI to value the claim and make an immediate settlement. This process significantly reduces the operational costs of claims assessment as well as the likelihood of paying claims that repair shops determine to be questionable or fraudulent.

- **Blockchain.** The use of blockchain—a distributed ledger system that records transactions across a large network of computers—is in its infancy in the insurance business. But the technology has the potential to lower costs, including those incurred in the underwriting and claims-handling processes, and to enhance the security of information, such as the data in medical records.

- **The Internet of Things.** The data collected from devices, whether a Fitbit or a car, can improve insurer underwriting. Effectively harnessing such information, however, will require proven big data analytics capabilities.

Zhong An as a Pilot for New Technologies. Zhong An, a digital insurer formed through the partnership of Ant Financial, Ping An, and Tencent, is in many ways the test case for how new technologies can remake the insurance business model.

Zhong An harnesses new technology at every stage of its operations, including product development and claims processing. For example, the company analyzes big data to identify unmet customer needs, develop products that address them, and create a highly effective marketing and distribution effort. Zhong An also analyzes proprietary data along with data from external sources and from its numerous e-commerce partners to competitively price products. For example, to determine health insurance premiums, the company analyzes exercise data secured through partnerships with makers of wearable devices.

In addition, Zhong An uses AI and blockchain technologies to settle online claims and help reduce fraud, and a cloud-based core IT system helps the company access significant computing power at relatively low cost.

The company's technology advantage has driven rapid growth. Launched in 2013, the company collected about $500 million in premiums in 2016, a 49% increase over the previous year.

Adapting the Lessons from China to Other Markets

Many insurers outside China are far behind the digital curve, particularly compared with players in China. And certainly there are significant differences between China and other markets. For example, the European insurance market has a long history, while the Chinese industry is much less mature. That creates challenges for European companies, not the least of which is the existence of numerous legacy IT systems that often cannot be easily connected.

Still, European companies can adopt and adapt some of the strategies employed in China. To do so, they must embrace three principles.

Be open to innovation. Many insurers outside China can list numerous reasons why specific Chinese innovations or products will not work in their markets. But the line between what is possible and impossible is often not as firm as it might seem. Companies need to look closely at innovations outside their markets—even outside the insurance industry—to see how aspects of those approaches can be incorporated into their own strategies.

Consider the barriers around privacy issues. Many insurers say that it is extremely difficult to use big data to target customers with tailored product offerings as companies in China do, owing to restrictions related to privacy concerns. But the reality is that China also has firm rules that protect the privacy of customer data. Chinese companies have adapted by asking customers to proactively share some of their financial data so that they can extend certain product offers to them. The bottom line: new thinking can unlock new opportunities.

Work to solve real-world problems. Insurers should not focus on how to market the products they have or the products they want to develop—they should focus on solving customers' problems. With customers' needs as their North Star, insurers can develop products that will find strong demand in the market. Zhong An's shipping returns insurance, which covers online shoppers for merchandise returns that e-commerce sites are unwilling to accept, is an example of a product designed to solve a customer problem.

Insurers have plenty of opportunities. Consider auto insurance in the age of telematics systems that can track driver performance. The advancements in safety and monitoring that are possible through such vehicles will help insurers not only create offerings to assist drivers but also price policies more efficiently.

Find the right partners. Successful companies find the right alliances and partners to deliver products that address customers' needs. For auto insurers, for example, this may involve striking partnerships with online sales platforms or OEMs as a way to make products easily accessible to customers. Home insurance providers, meanwhile, can link up with appliance manufacturers to offer monitoring and repair services for home appliances such as water heaters.

Insurers should also be open to technology partnerships that allow them to accelerate their digital innovation. Many technology companies—and even many Chinese insurers—are open to partnerships that would provide their technology platforms and expertise to insurance companies in markets outside China.

There is no doubt that digital transformation in the insurance industry creates significant challenges for established companies. But it also creates sizable opportunities for those willing to embrace the shift. Insurers that are open to new ideas, put customers' needs at the center of their efforts, and find the right partners will not only survive—they will thrive.

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