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DIGITAL DISRUPTION IN THE US SMALL-BUSINESS INSURANCE MARKET

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INSURERS KNOW THAT MANY small businesses in the US—those with up to 30 workers—will eventually buy insurance directly online. What insurers don't appreciate is how fast this shift is likely to happen.

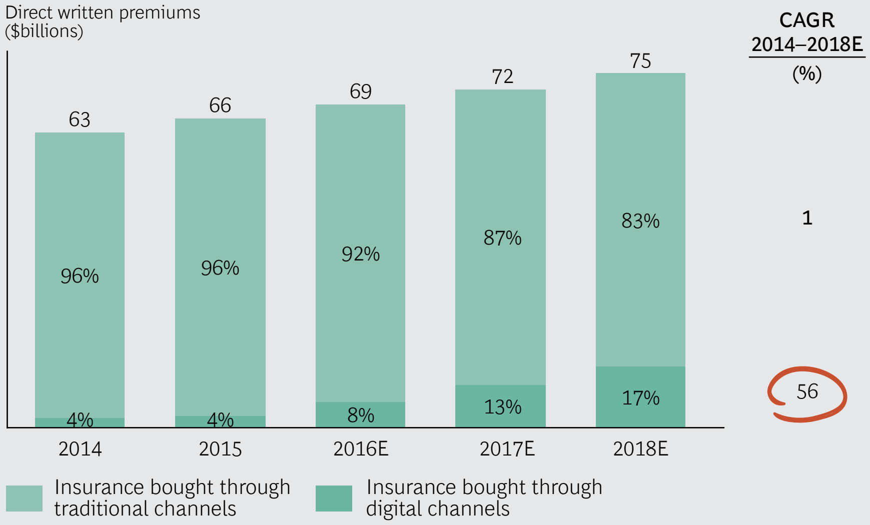
According to estimates by The Boston Consulting Group (BCG), about 17% of premiums in the US small-business market will be digitally underwritten by 2018. (See the exhibit, "Digital Underwriting Is Taking Off in the US Small-Business Insurance Market.") If that is achieved, it will be more than four times the level of 2015 and represent about $13 billion in direct written premiums. Traditional insurers thus face a choice: they can either go after that market now or try to make up the ground later.

In the past, change has come slowly to small-business insurance, and it has been characterized by high retention rates. However, the structural and generational changes taking place in this segment of the US insurance market have created a situation in which the old truths no longer hold.

From California to New York, small businesses are sprouting up at an astonishingly fast clip; half of the companies that will be in operation by 2018 don't yet exist, according to BCG analysis. Many of these new businesses—particularly the so-called microbusinesses, with one to four workers—will be operated by millennials and Gen Xers, who are very comfortable with all things digital. Entrepreneurs in these age cohorts often don't make a clear distinction between work hours and personal time, which means that the lines between activities covered by commercial insurance and those covered by personal insurance could become similarly blurred.

What's more, millennials and Gen Xers do not feel bound to traditional ways of obtaining insurance. When these tech-savvy businesspeople start buying general-liability insurance, property insurance, and business owner's policies in the next couple of years, they won't think twice about bypassing traditional insurance offerings, with their cumbersome purchase processes and complex clauses. In fact, if the right offer is available

Digital Underwriting Is Taking Off in the US Small-Business Insurance Market



Source: BCG analysis of companies with up to 30 workers.

online or via a smartphone app, these businesspeople might not even bother to familiarize themselves with traditional offerings.

So even as the small-business insurance market grows—to an expected $75 billion in direct written premiums in 2018, up from $66 billion in 2015—not all providers will benefit. Instead, the market will split, creating huge swells of opportunity for some and threatening others, including many in the brokerage space.

Sparking the Disruption

A variety of companies have begun taking initial steps toward creating the market disruption. These companies include long-established carriers, such as The Hartford Financial Services Group, Progressive Casualty Insurance, GEICO, and Allstate Insurance; new entrants, such as Insureon (an online insurance agent), Intuit (a software company focused on financial and tax services to small businesses), and Overstock.com (an online retailer that has added insurance products for its customers); and a growing number of venture-backed startups. Nobody has cracked the code yet, however.

The carriers that will ultimately capture the digital small-business opportunity must address two challenges simultaneously. The first is to develop simple, modular products that make the experience of buying and using insurance much easier and more straightforward than it is today. Digital options that offer a way to accomplish something a small-business owner can't do conveniently via an analog form of insurance, for example, could catch on quickly. These include abilities such as toggling between personal-use and business-use car insurance depending on the kind of trip being taken and reducing the level of business owner's insurance with a smartphone app when an independent contractor is between projects. Documents that replace legalese with plain English, and applications that integrate consumers' social-media and e-commerce accounts so basic information can be automatically populated online, will make insurance interactions more convenient.

The second challenge for carriers is to devise a truly digital operating model. This will mean de-emphasizing manual processes, "high-touch" customer service, and face-to-face interactions in favor of digitized processes, self-service, and new offerings that customers can access through just about any channel. These changes will be especially important when it comes to the claims process, which is characterized by multiple interactions. Some policyholders of personal home and car insurance already use digital technologies for such activities as uploading pictures, making appointments at auto body shops and checking the status of claims via their mobile devices. At the moment, such applications are much less common in the small-business realm—but that will change. In the event of property damage or a lawsuit, the ability to allow straight-through processing instead of a more manual approach could be a differentiator for small-business insurers.

Companies that touch off the small-business disruption will initially do so using one of three distribution approaches:

- **A digital-direct model,** in which a carrier with a strong brand and sufficiently broad product coverage offers greater speed and simplicity.

- **An "e-brokerage" model,** in which a broker capitalizes on its back-end technology and carrier relationships to create a platform that gives small businesses both choice and breadth of coverage, not unlike Expedia's offers for consumers in the travel market.

- **An aggregator model** that allows small businesses to comparison shop, and which a disruptor can use both to generate leads and to gain fees or commissions.

These three models will coexist, at least for a time. Inevitably, they will increase transparency and spur greater price competition. They will also drive down expense ratios, since insurers will have to set themselves up to be more frugal, efficient, and nimble in the new competitive environment. Collectively, these digital-centric models will steal share away from the traditional face-to-face brokerage models.

No-Regret Moves for Carriers and Agents

In the UK, where disruption in the small-business insurance market is more advanced than in the US, digitization has already created winners and losers, primarily on the basis of the speed at which they have embraced new technologies. (See the sidebar, "The UK Market Shows How Quickly Fortunes Can Change.") Companies that rapidly adjust their usual organization and culture also come out ahead: the most successful carriers are those that have managed their digital insurance businesses separately from their traditional insurance businesses, at least during start-up.

In the US, the winners among traditional carriers will mostly be those that rapidly develop strong digital offerings, prove to be skilled at managing channel conflicts, and offer a reimagined customer experience. Carriers that are slow to adapt, have significant channel conflicts, or think that they can leverage IT systems built for traditional, highly complex products or larger corporate clients will have a tough time getting ahead. These slower-moving companies may also find themselves facing disintermediation at the hands of e-commerce giants such as Apple and Amazon, which have digital expertise in abundance and have not been shy about moving into sectors that may originally have seemed outside their realm.

The agents and brokers with the best chance of surviving disruption will be big distributors that leverage carrier relationships and manage to quickly roll out digital services. Mom-and-pop agents will be the most vulnerable during this period of transformation because they lack the wherewithal to build digital capabilities and the brand awareness to attract millennial and Gen X customers.

This suggests a set of no-regret moves for both carriers and agents in the US. Carriers should create standardized, modular products; invest in strengthening their model-based pricing capabilities; develop new e-commerce IT capabilities; and establish digital, light-touch models. These moves will make their products easier to understand and to underwrite digitally, help them generate traffic, and attract the interest of top online agents. The actions will

THE UK MARKET SHOWS HOW QUICKLY FORTUNES CAN CHANGE

Events in the UK offer a glimpse of how quickly the small-business insurance market can move toward disintermediated insurance products, including digital offerings.

From 2011 to 2014, the Direct Line Insurance Group, a former division of the Royal Bank of Scotland, increased its share of the UK's small-and-midsize-enterprise insurance market from 2% to 7% by focusing on simple products that customers could buy directly through whatever channel they chose, including their tablet computers or smartphones.

Other insurers that then jumped in with their own digital investments were able to at least hang on to their market shares. Aviva, for instance, introduced an online-trading insurance platform—enabled by an investment exceeding £50 million—that allowed the company to keep its market share of almost one-third. Similarly, AXA Equitable Life Insurance rolled out a new direct digital channel that allowed the company to hold onto its share of the market—one-fifth to one-quarter—as well. Slow movers, however, watched their market shares erode.

In addition to showing how quickly traditional insurers can lose ground, the UK market dispels the myth that brokers and agents are indispensable: more than one-quarter of all small-business insurance is now bought without the help of an intermediary. And while the regulatory framework in the UK differs from that in the US, these events show that channel disruption in the US insurance market is not only possible but can happen quickly once it starts.

also allow carriers to leverage third-party big data and to tighten up and simplify the underwriting process.

The no-regret moves for agents include repositioning themselves to be part of an omnichannel world—a world in which disintermediated interactions between customers and carriers are as common as agent-led interactions—and solidifying their carrier relationships as a way of building stronger ecosystems. Agents will need to bring in new people and invest in their talent to make this transition. By taking these actions, agents will improve their ability to match customer needs with different carriers' appetite for risk and to develop more efficient and customer-centric sales and service models.

Millions of new small businesses are founded each year, and they will increasingly buy their insurance online. This preference for digital solutions will force insurance providers to adopt some fundamentally new market approaches. Carriers that want to hold on to their market share will have to develop new products designed for the digital age and come up with lower-cost operating models. Agents that want to retain their relevance are going to have to find different ways of providing value to buyers that may prefer less contact, not more.

Many companies are developing online insurance services that have a chance of appealing to small US businesses. Carriers and agents that underestimate the need for speed will be left behind when the inevitable disruption comes. The time to get going is now.

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