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STRATEGIC PLAYS FOR RECESSION RECOVERY

How insurers can outmaneuver uncertainty and outpace competitors

INTRODUCTION

The global economy is suffering a marked decline that will likely continue into 2021[1]. U.S. GDP declined 4.8% on an annualized basis in the first quarter, the steepest contraction since the last recession, and the Federal Reserve forecasts it will contract 6.5% for the full year[2, 3]. Compounding this is the fact that no recession since World War II has begun with interest rates as low as they are now—muting the Fed's economic recovery policies.

Insurance companies are feeling the impact in their valuations, their investment portfolios, and in compression on their top-line revenues. **A shrinking economy inevitably means less demand for insurance products and less revenue potential for insurers.** As physical distancing restrictions to prevent the spread of COVID-19 ease and businesses reopen at full capacity, the medium- and long-term effects on economic conditions in various markets remain unclear. In our view, there are four potential recovery scenarios:

1. Second wave

In this outcome—a likely one in many markets—a second wave of the virus throws the economy for another loop. That strains the healthcare system and leads to additional closures, deepening the economic setback. GDP would drop by 5 to 15%, with the recession lasting 8 to 12 months assuming a vaccine becomes available.

2. Steady, slow recovery

In an equally likely outcome, the economy starts to reopen as the curve begins to flatten, but consumers are wary of working and shopping as they did before COVID-19. That means a lasting impact, with GDP down 5 to 15%, and a lengthy recovery time of 12 to 24 months.

3. Recurring shutdowns

In this scenario, waves of COVID-19 overwhelm the healthcare system through to 2022 without an effective vaccine in production, causing prolonged challenges, drained consumer confidence and a GDP drop of 15 to 30%. This is less likely than the first two scenarios as it would require a widespread lack of credible governmental response to the virus and the inability to bring an effective vaccine to the market.

4. Quick rebound

In this outcome—the least likely in our view—people return to work in the service sector in large numbers, the health system can control the pandemic, and the economy recovers. As a result, consumer sentiment returns quickly, and GDP declines by 5% or less in a short-lived recession of less than 6 months.

We are already seeing signs of the two most probable scenarios.

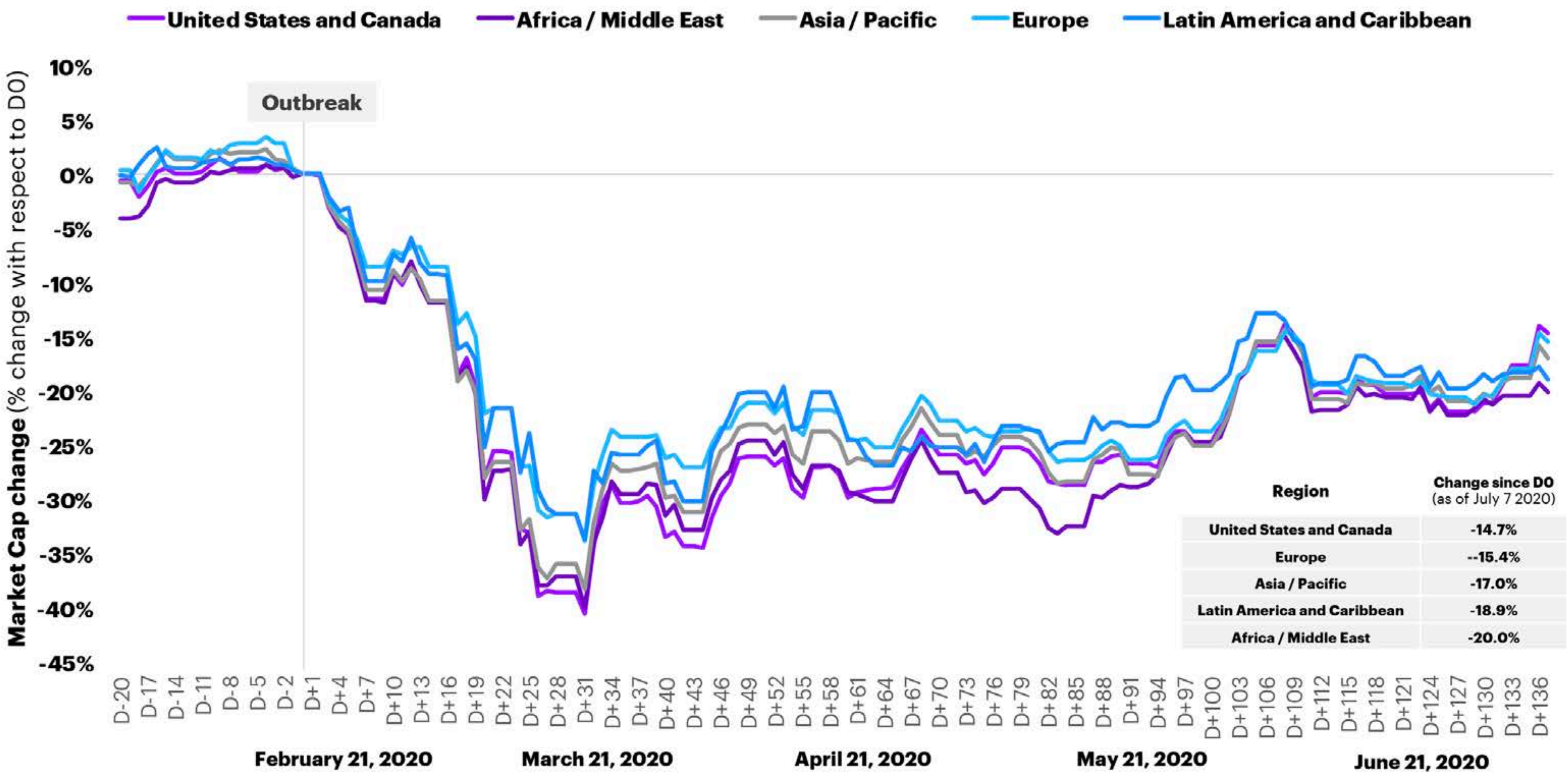
It appears likely that we will see GDP contractions of 5 to 15% under a recovery that could take up to two years. As a result, insurers may feel jittery about spending and compelled to cut costs. Many are likely to follow the standard playbook that views tactical cost cutting as the right short-term recessionary response. However, research suggests that more structural cost reductions, focusing on permanent operating model transformation, implemented in tandem with selected strategic growth investments tend to yield better results.

In this report, we analyze both the macro-economic impacts of today’s environment on the insurance industry and the data revealing strategies used by insurers to outperform competitors during previous recessions. With these patterns in mind, we present insights to help insurers test the resiliency of their own strategies and outmaneuver uncertainty.

THE IMPACT OF COVID-19 ON INSURERS

The COVID-19 crisis has pummeled the market capitalization of insurers (Fig. 1) faster than previous financial crises. Specific lines, like trade credit, inland marine, and workers' compensation, are at particular risk, as are segments such as the small- and medium-sized business market.

Fig. 1. Insurance Industry Market Cap Trends Since the COVID-19 Outbreak



Source: Accenture analysis based on Capital IQ data and global publicly listed insurers. Outbreak D0 = Feb. 21, 2020, the reference date for COVID-19 cases first officially reported outside Asia.

For life insurers, the pandemic has had far-reaching effects.

Some U.S. life insurers have seen increased awareness of and demand for their products[4]. Others are adapting to a wave of online applications; with more than a quarter having expanded their automated underwriting practices and 20% having waived or postponed paramedical requirements[5].

The positive effects for life insurers include potential new opportunities to capture a greater share of prime growth markets. Meanwhile, the shift towards digitalization and online purchasing creates an opportunity to enhance distribution strategies and streamline underwriting processes. On the other hand, an increased adverse selection risk means life insurers must now develop new underwriting criteria to mitigate risk exposure.

P&C insurers are also benefiting from the increasing use of digital tools as a means of interaction. Like life insurers, they are seeing more opportunities to develop and enhance digital interaction models that can better support existing distribution and servicing channels.

However, P&C insurers are more likely to face a shift common to recessions: consumers are more price sensitive. This means customers are more likely to shop around for alternatives, increasing the need for retention. Declines in the number of policies and premiums from insured assets are also compressing top-line revenues.

Among the challenges compounding the situation for both life and P&C insurers are:

- Interest rates will likely remain low—close to zero in the U.S.—until at least the end of 2022, which means further damage to investment income and profitability
- Possible regulatory interventions threaten margins and the adequacy of loss reserves
- Premiums in the market are likely to contract
- Technology and operational security will need to be revisited due to the disruption caused by remote services

LESSONS LEARNED FROM RECESSIONS PAST

A decade ago, researchers from Harvard University assessed actions taken by 4,700 public companies from various sectors during the previous three global recessions: 1980 – 1982, 1990 – 1991 and 2000 – 2002[6]. They looked at the three years before, during and after those recessions and identified the fundamental ways companies reacted, looking at specific combinations of changes in how they allocated resources.

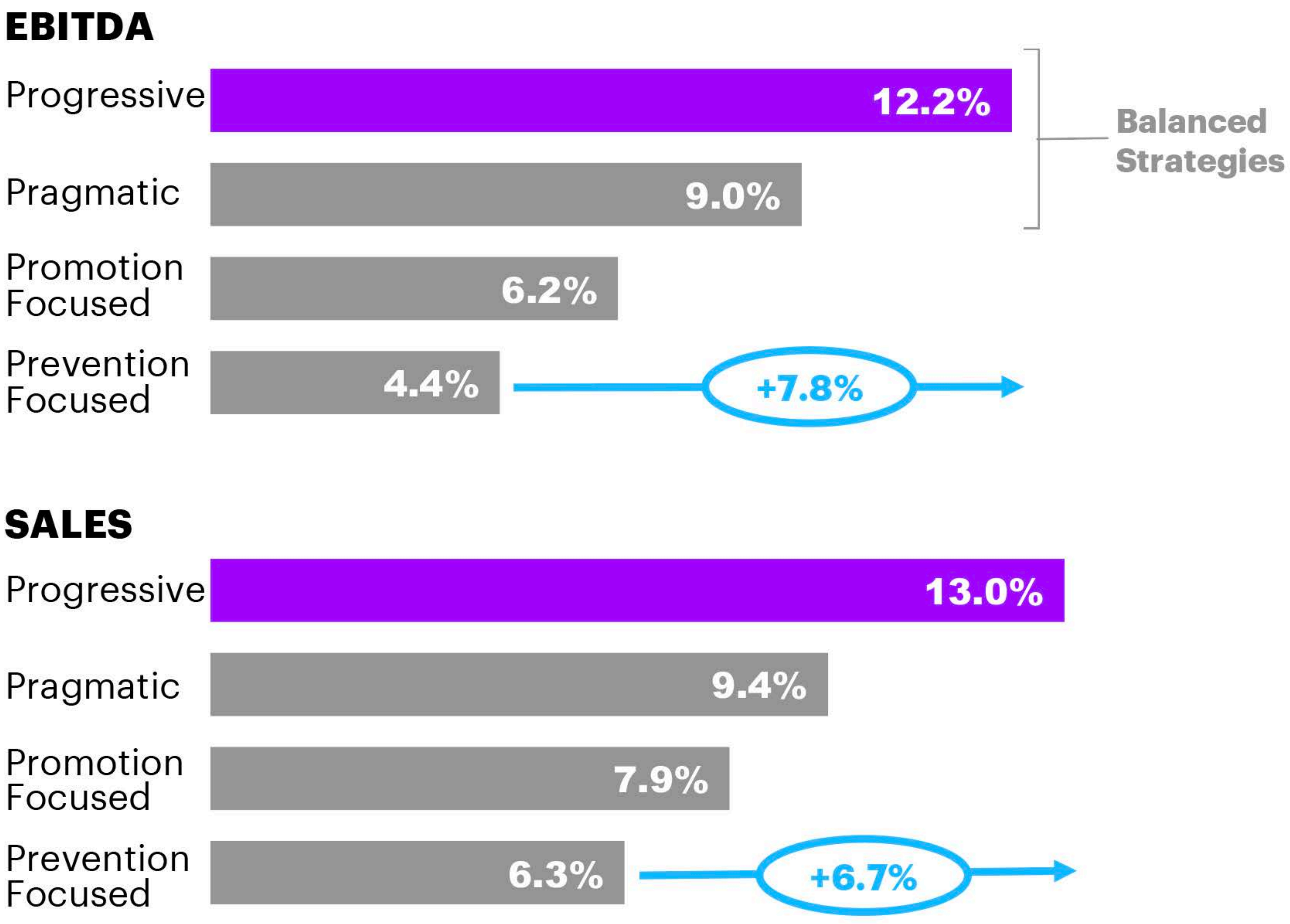
According to their research, 17% of the businesses went bankrupt, were bought out or went private before the recession ended. Of those that survived as public companies, most were "painfully slow to recover." Three years on, about 80% had failed to reach their pre-recession growth rates for sales and profits.

Only 9% of the surviving companies were in a better financial position and outperforming competitors following the recession. This small pool of winners did not typically take the approach of cutting costs and investments faster and deeper or the "Prevention Focused" strategy, as the researchers labeled it. Nor did they take a "Promotion Focused" strategy of doubling-down on strategic investments and opportunistic acquisitions. Instead, the winners were more likely to combine targeted cost reduction with selective reinvestment in growth.

Companies that took a balanced approach generally outperformed competitors when measured on key financial parameters (Fig. 2). Those that followed a "Pragmatic" strategy, combining cost-cutting focused on headcount reduction with some level of investment, had a 29% probability of outperforming their competitors.

However, the biggest winners—with a 37% chance of outperforming competitors—followed a "Progressive" strategy. "These companies reduce costs selectively by focusing more on operational efficiency than their rivals do, even as they invest relatively comprehensively in the future by spending on marketing, R&D, and new assets. Their multipronged strategy...is the best antidote to a recession," the researchers wrote.

Fig. 2. Average EBITDA and Sales CAGR by Strategy



Percentages, which are adjusted for industry averages, refer to the three-year compound annual growth rate.
Source: Harvard Business Review, 2010

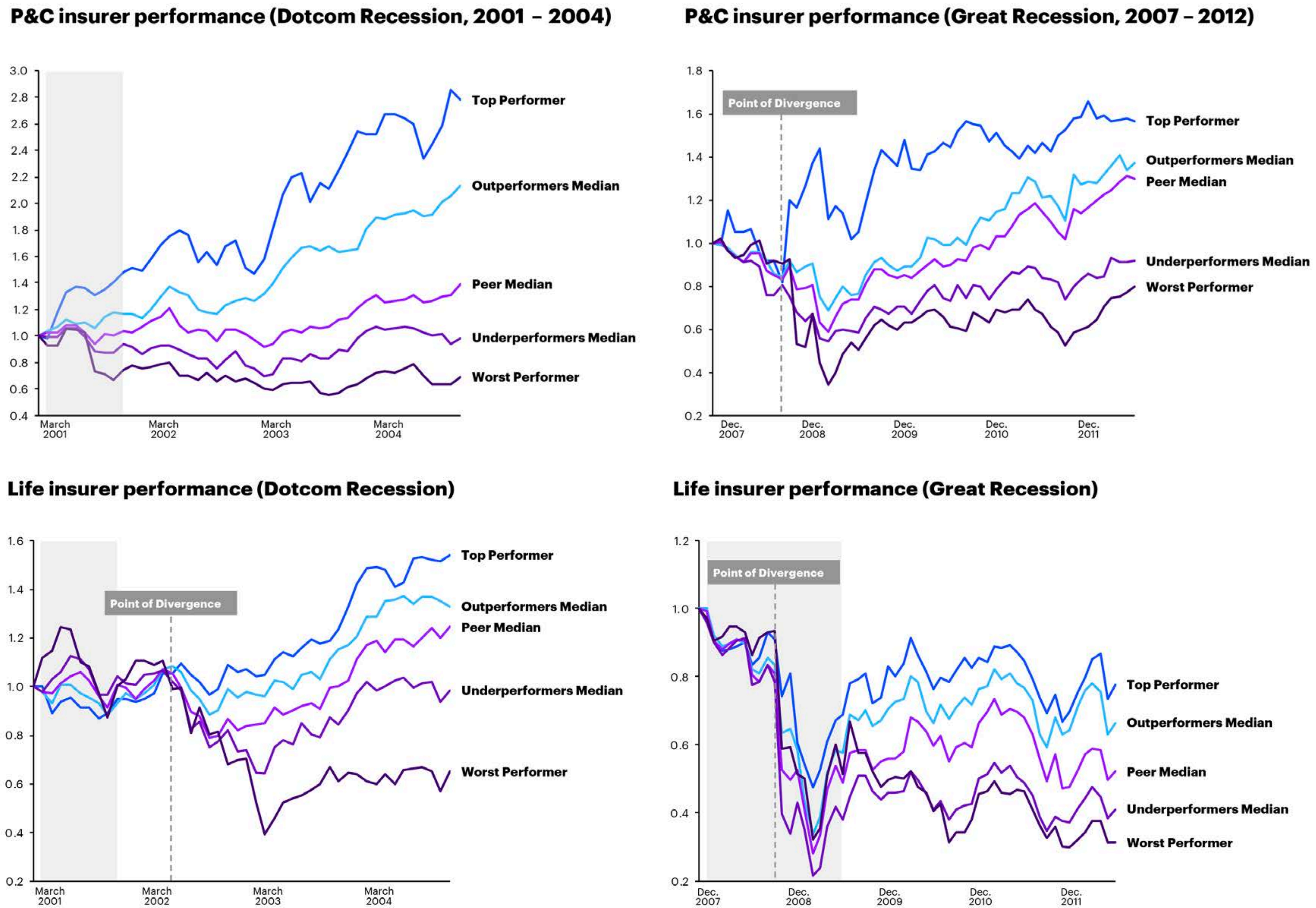
Now, a decade later, we wanted to discover what specifically drove insurers that outperformed in prior recessionary conditions and what learnings they might apply today.

It is interesting to note that the market did not immediately recognize the value these outperformers would create, and it took fortitude to stick with their strategy through the recession.

The “fast cost-cutters” were rewarded during the recession, but their inability to demonstrate growth hurt them significantly during recovery.

Figure 3 represents the execution of the best- and worst-performing P&C and life insurers during and after the 2000 – 2002 Dotcom Recession and the 2007 – 2012 Great Recession.

Fig. 3. Total Return to Shareholders Before and During the Dotcom and Great Recessions

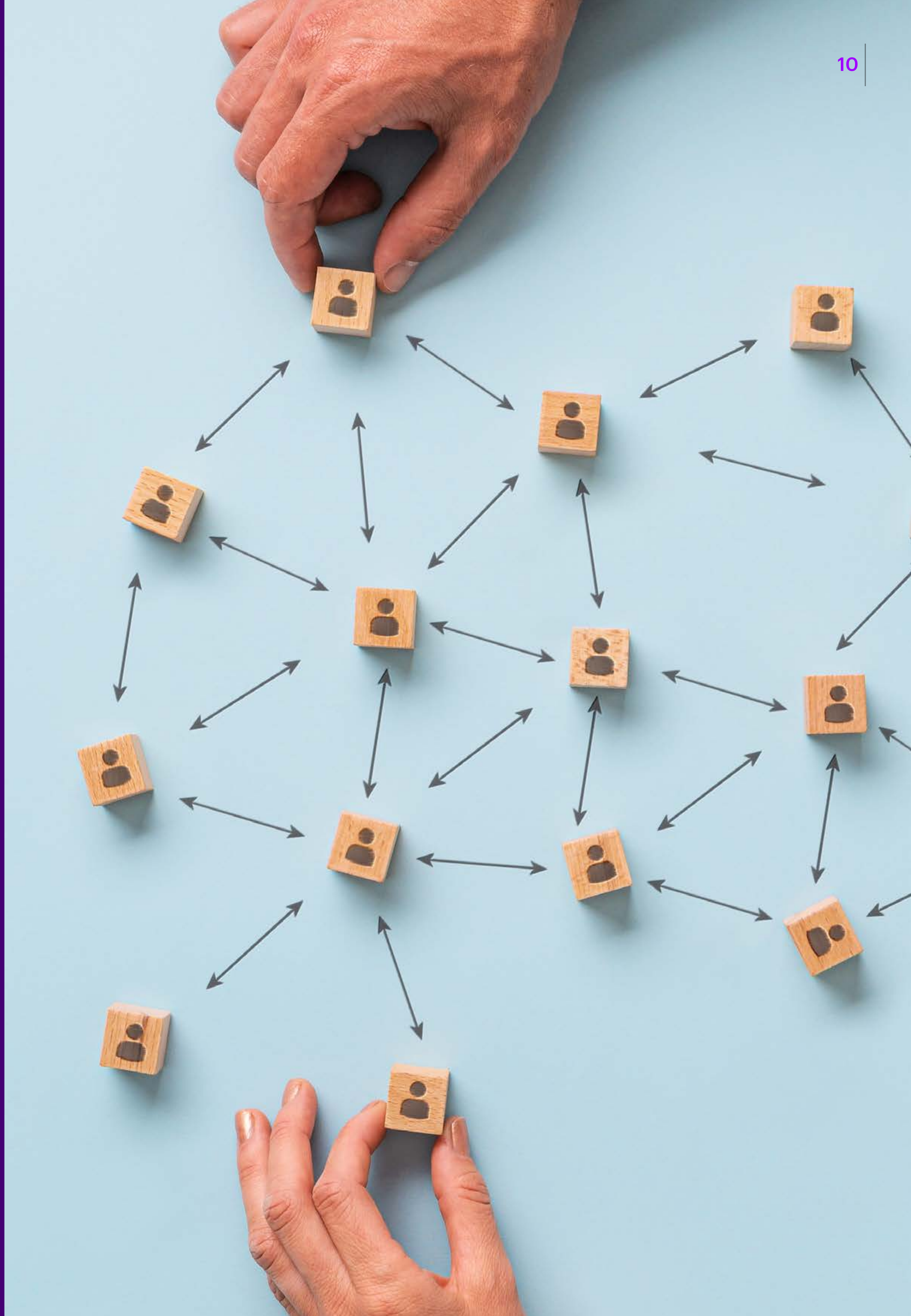


Represents the ending value of an initial investment of USD 1.00 in a company.
Source: Accenture analysis based on Capital IQ data, 2020.

We discovered that to emerge stronger on the other side of a recession, outperformers focused on two crucial areas in tandem:

They structurally reduced their costs during the recession in ways that changed how the work was done.

They surgically reinvested a portion of that value realized in supporting innovation and growth opportunities that were closely aligned to their core areas of competitive advantage, rather than making investments in new areas.



P&C Insurers in the Dotcom Recession

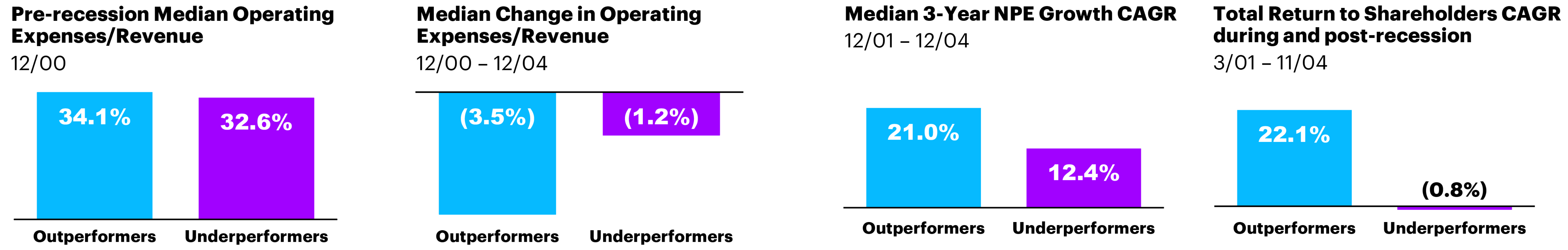
P&C insurers that outperformed through the Dotcom Recession boosted operating efficiency by improving their operating expense ratio by an average of 3.5% (Fig. 4). Underperformers, however, were unable to use the gains made in expense management to generate long-term advantage.

At the same time, outperformers used this freed-up cash to invest surgically in growth, which saw them achieve 9% higher growth than their underperforming peers and a 23% advantage in total return to shareholders. Underperformers were unsuccessful in investing in growth, which led to lower net premiums earned (NPE) growth and a decline in total return to shareholders.

Fig. 4. Comparing P&C Insurance Outperformers and Underperformers During and Following the Dotcom Recession

Outperformers focused on structural cost reduction...

...which freed up the cashflow required to invest in growth and innovation.

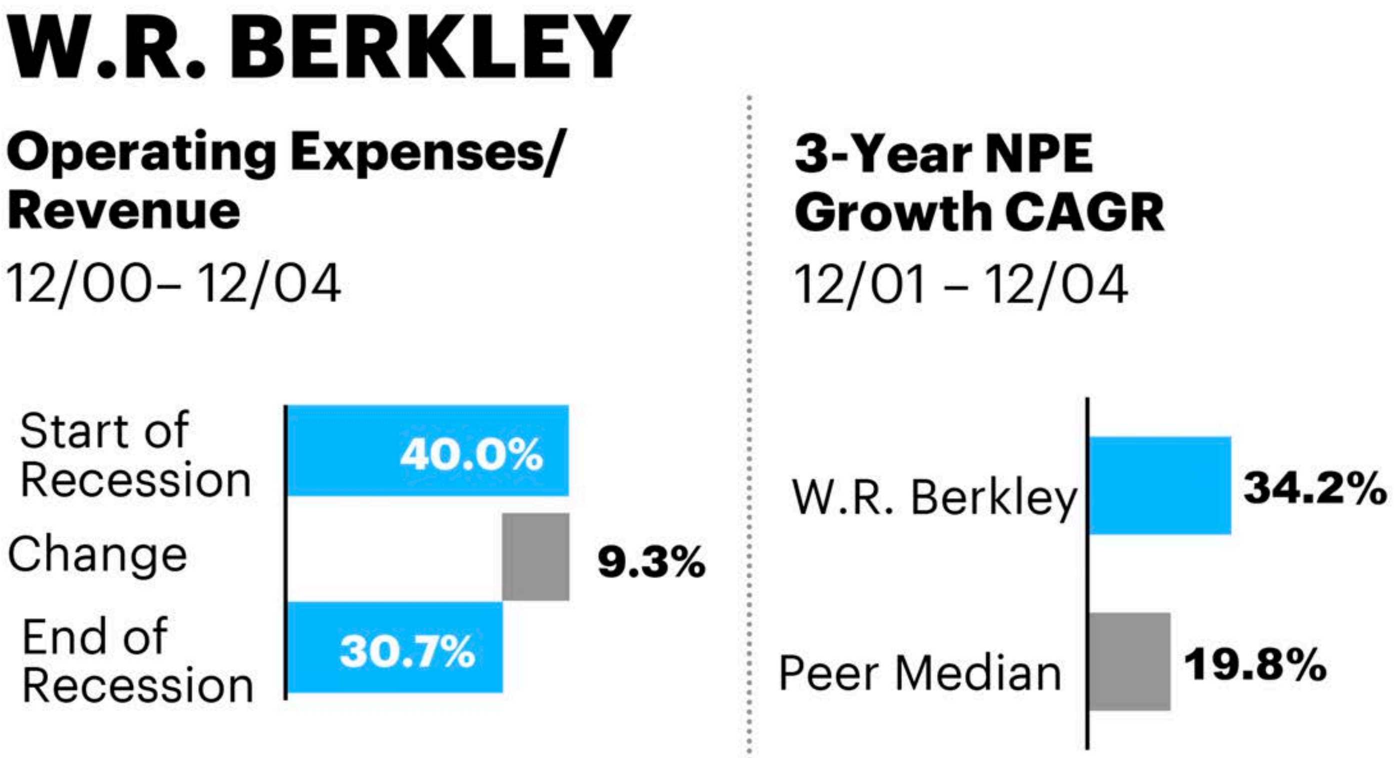


Source: Accenture analysis based on Capital IQ data, 2020.

P&C insurer W. R. Berkley, for example, made specific structural changes in line with their strategic focus to cut costs. They also consolidated regional companies and refocused their strategy on their areas of demonstrated competitive advantage, specifically in commercial insurance and specialty reinsurance. This allowed them to reduce costs, enhance their size and scale, and position themselves more competitively.

The business doubled down on its commercial line revenue investments while withdrawing from personal lines where they found it harder to differentiate.

Fig. 5. W. R. Berkley Performance During and Following the Dotcom Recession



Source: Accenture analysis based on Capital IQ data.

They started a specialty medical malpractice unit and formed a workers' compensation company in California for small-scale employers. They also moved into increasing levels of specialization for re-insurance to avoid commoditization.

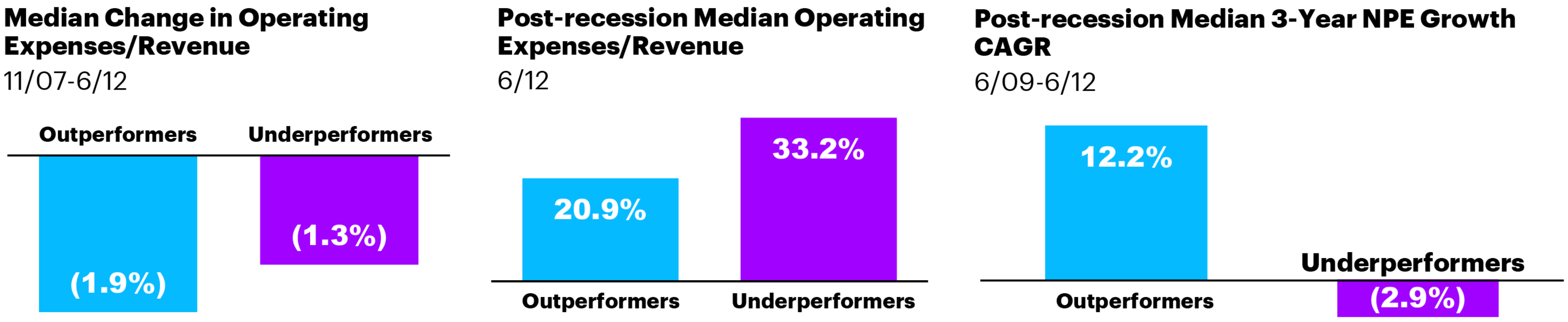
As a result, W. R. Berkley reduced their operating expenses/revenue ratio by 9.3%. In doing so, they roundly outperformed their peers in three-year NPE growth CAGR (Fig. 5).

Life Insurers in the Great Recession

Life insurers that outperformed structurally during the Great Recession changed their operating efficiency by cutting their operating expense ratio by 2% on average, further extending their cost advantage over their underperforming peers (Fig. 6). Underperformers, on the other hand, allowed early gains in expense management to slide, which left them worse-off than they had been before.

In addition, outperformers used the cash freed-up from structural cost reductions to invest surgically in growth. As a result, they grew about 15% faster than their underperforming peers from an NPE perspective. For their part, underperformers' NPE declined as they lacked an operating position that allowed for investment in growth.

Fig. 6. Comparing Life Insurance Outperformers and Underperformers During and Following the Great Recession



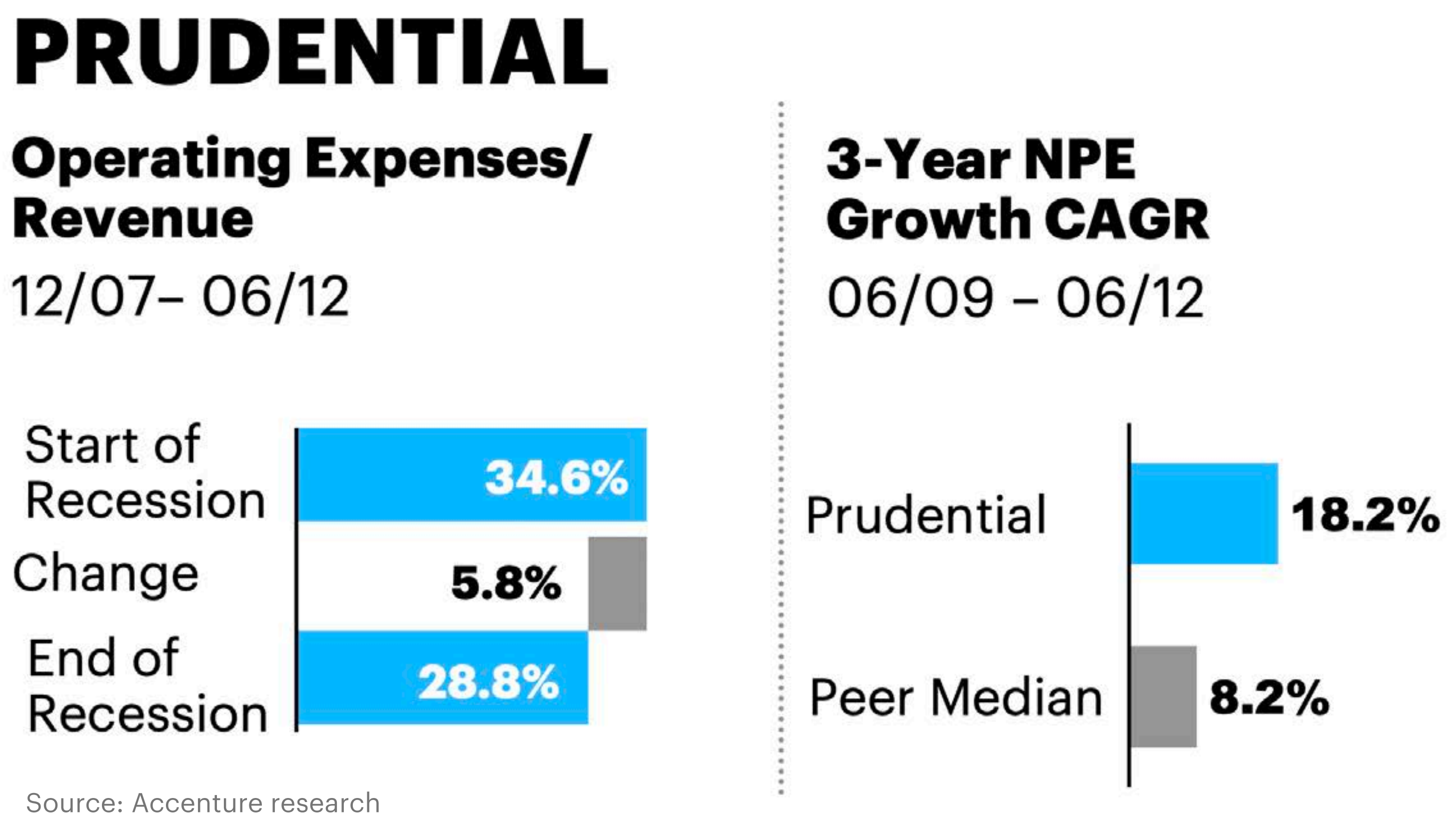
Source: Accenture analysis based on Capital IQ data.

Take Prudential's U.S. life insurance business, for example. At the start of the Great Recession, the company's cost structure was slightly disadvantaged in comparison with industry peers. Prudential boosted operational efficiency by identifying cost synergies between business units, redeploying assets from non-insurance subsidiaries to their core domestic insurance business, and improving risk management by streamlining data collection, analysis and decision-making processes. They also stopped selling annuity products that had proved unprofitable.

Prudential then invested associated savings by:

- Targeting the growing baby-boomer segment with a retirement product that offered a longer guaranteed income
- Coordinating sales efforts across lines of business (LoBs) with optional life insurance sales through group-benefit employer clients
- Investing in digital with a specific focus on providing a cohesive customer experience
- Establishing a cross-LoB program that focused on financial wellness
- Expanding distribution channels by deepening relationships with third-party distributors

Fig. 7. Prudential Performance During and Following the Great Recession



Source: Accenture research

Consequently, Prudential comprehensively outperformed its U.S. life insurer peers (Fig. 7), improving operating expenses/ revenue ratio by 18% and beating their peers' median score for three-year NPE growth CAGR by 10%.

These examples show a pattern of structural cost reduction coupled with focused efforts on bolstering very targeted areas of competitive advantage.

Importantly, however, the specific areas of improvement and investment differed based on each insurer's positioning and what their management teams anticipated in terms of the future environment.

Devise, Refine and Implement Your Strategy

When devising your strategy, it is important to keep time-tested patterns in mind and objectively assess the approach that you and your leadership team are taking.

Is it one of minimizing loss or risk?

Or is it a more strategic approach that seeks to balance both the near-term pressures with the need to emerge stronger from this challenging environment?

Success requires dispassionately evaluating your current competitive position, your likely points of advantage, and your points of exposure or weakness. It also requires articulating how you believe the future environment will evolve:

What will drive the changes?

How will those manifest?

What will the likely outcomes be?

Additionally, emerging stronger means assessing how resilient your strategy is:

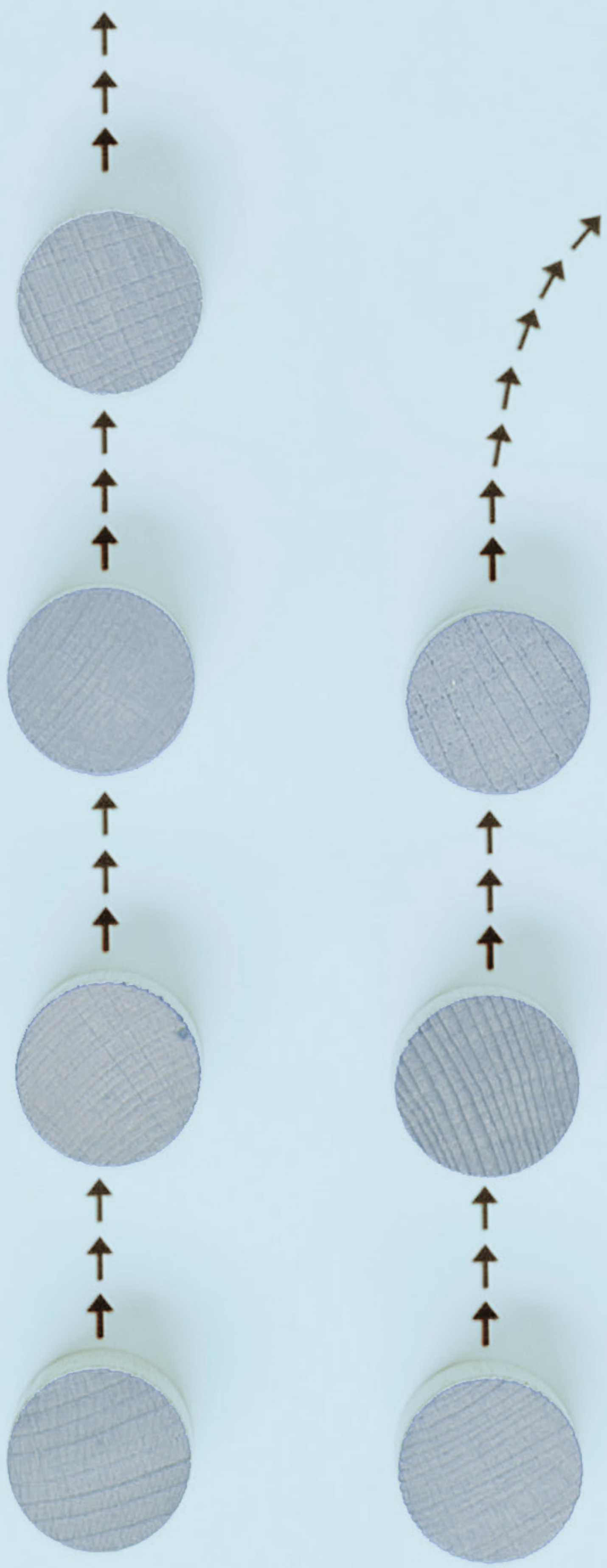
How would your business fare in these potential scenarios?

Would your cost structure and capabilities be competitive?

How do your current plans position you in each scenario?

And would they allow you to pivot quickly if a lower-probability situation emerged?

Lastly, it is key to outline your strategic response.
Based on an objective understanding of your competitive position and the resilience of your current strategy, adjust as needed both to tackle today's challenges and to position your business for profitable growth tomorrow.



EMERGING STRONGER FROM THIS RECESSION

The evidence shows that insurers outperformed their peers in previous recessions through structural cost reduction and strategic reinvestment of those savings in core sources of competitive advantage to drive growth.

STRUCTURAL COST REDUCTION

When we say "structural cost reduction," we are talking about fundamental changes in the way the work gets done. These changes often involve automation to replace manual activity or to restructure work; then aligning the organization to support new ways of working. These types of actions make it very difficult to backslide in costs. While an across-the-board headcount reduction is faster to implement, it often results in costs creeping back in.

STRATEGIC REINVESTMENT OF SAVINGS

The other critical aspect is the lesson to be learned about investing for competitive advantage. While investing in new business opportunities is always important, it is much more difficult in a recession. **To minimize the insurer's business risk and focus growth in the highest opportunity areas, it is important to focus on the primary sources of competitive advantage.** For some insurers that may be the markets they serve or the distribution model they operate. For others, it may be more about core market segments.

As the research reveals, time-tested patterns of success consist of structural cost improvements coupled with strategic investments to drive revenue.

While approaches vary, generally these two aspects of recession recovery are performed in tandem rather than sequentially. Many insurers would need to consider common variables. Their individual strategies and choices would each reflect a unique competitive positioning and their leaders' beliefs about how the future will unfold.

The approaches of insurers that outperform in recessions offer three key lessons that may benefit all insurers as they take action in the current environment:

1. RECOGNIZE NEW OPPORTUNITIES

Recessionary times not only pose significant challenges, they also present opportunities to outpace competitors.

In recent decades, the speed at which markets have shifted and the sheer scale of those shifts has increased significantly. The current pandemic has highlighted not only how businesses and operating models must be prepared to transform, but also how few businesses had adequate plans in place to cope.

As we have demonstrated, insurers that approached the challenges of previous recessions in a targeted way had the best chance of emerging stronger. Optimal performance will not be achieved by those who go into survival mode and impulsively cut costs. Instead, insurers that outperform in this recession will find opportunities their competitors did not see. For example:

- W. R. Berkley's decision to double down on commercial insurance and concede their ability to compete in personal lines.
- Prudential's early decision to focus on financial wellness and make it key to their cross-LoB strategy

In this recession, digital capabilities are likely to become even more critical to driving structural cost reduction.

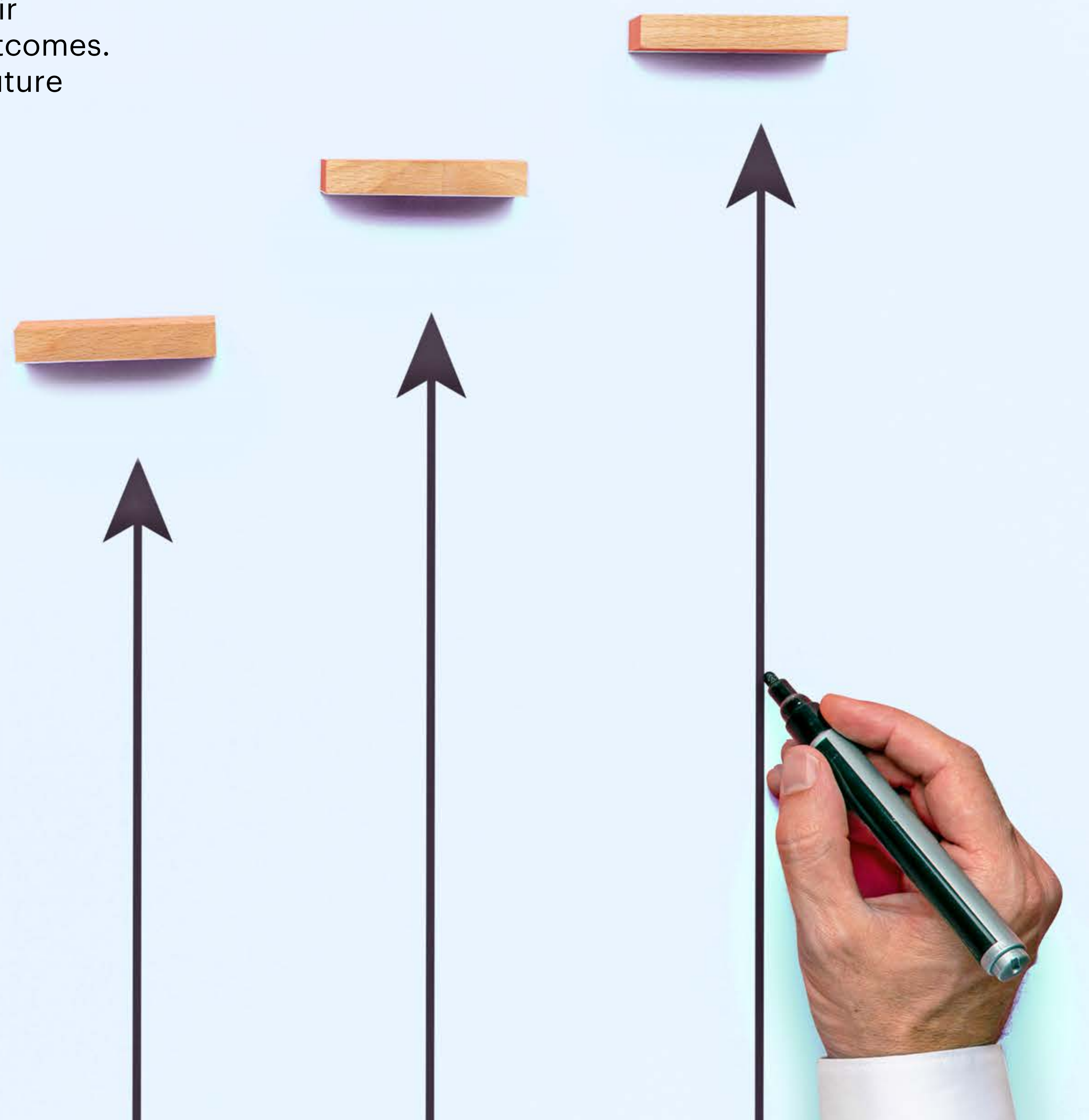
The pandemic has demonstrated the willingness of customers to embrace digital to get things done. Those behavioral changes are unlikely to entirely go away after the pandemic subsides. There is a great opportunity to capitalize on digital in new ways to support the insurer's business model, change the way the work is done and structurally reduce the cost base.

2. CONSIDER LONG-TERM IMPLICATIONS

The strategic decisions that leaders make in these times matter, and their implications will affect business performance potentially for the next decade.

Since the outcomes of this recession and the pandemic are far from certain, it is more important than ever to consider potential scenarios that may impact your business and test the resilience of your existing and new strategies, evaluating how well they are likely to hold up and deliver value in each potential scenario.

Such scenario planning will better equip insurers to assess and adjust their recessionary strategies based on long-term implications and potential outcomes. Developing the capabilities and mechanisms to identify and respond to future shifts empowers insurers to move with, or in advance of, the market.



3. IMPROVE ON THE PATTERNS

There are patterns of success that today's insurers can repeat with the benefit of innovative solutions to help automate and scale.

The patterns we can observe from previous recessions appear to be time-tested and consistent. That gives insurers entering this recession an additional advantage. By extrapolating from what has worked in the past, insurers can implement customized strategies that will allow them to outperform.

There are of course certain "no-regret" measures, or foundational investments relevant under most scenarios, that insurers can deploy. Solutions to enable additional automation and scale are readily available and more affordable than ever. Migration to the cloud is another proven way to structurally reduce costs and potentially reap security benefits.

A PATHWAY TO PROFITABLE GROWTH

The approach we have outlined here greatly increases the probability that an insurer will successfully navigate the current environment and emerge in a stronger competitive position.

Insurers who structurally reduce costs and then reinvest some of those savings to further strengthen areas of competitive advantage emerge from recessions in a much better position. With the current pace of disruption, crisis can come in any form and seemingly out of nowhere. When the next crisis comes, the insurers who seized opportunities now will have the insights they need to outmaneuver uncertainty and outpace competitors.

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