The Future of Insurtech Investment: Possible Trends Emerging in the Post-Covid-19 Insurance Market

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Insurtechs have changed the face of insurance in recent years challenging the industry to develop new solutions and products. However, the sector will need to adapt once again in order to perform in the post-Covid-19 insurance landscape.

Entrepreneurs are a breed unto themselves. They always start with a huge amount of enthusiasm and an attitude that says «that needs fixing» and «I will do it». Entrepreneurs are capable of constant, rapid and monumental change. They possess the focus needed in order to hone in on a specific problem and find ingenious ways of solving it. But the most common quality amongst successful entrepreneurs is flexibility. The ability to rapidly adapt the strategy and to align with feedback allows not only entrepreneurs, but also individuals and organisations to disrupt.

Only a very small number of disruptions were the result of someone having the «right» idea from the get-go and deploying it without problems or pushbacks. In most cases, ideas grow, develop and evolve stepwise over a longer period of time. Yet all change starts with that bombastic claim that whatever had been done up until now was wrong, outdated or insufficient. A new way is needed, a better, quicker and simpler way. No matter how big the industry is, how big the players are, there is always room for improvement, for change, for evolution. And few industries are as big and have as many large and established players as the insurance industry. In 2015, insurtechs came out of the blocks, as a separate category from fintechs, to challenge the insurance industry, to develop new solutions and products. To change everything.

Introducing Investments in Insurtechs

Alas, if only it were that easy. It takes money, lots of money. Starting an insurer is mind-blowingly expensive. Regulatory requirements, processes and disclosure obligations, capital rules and requirements, pricing methods, data security obligations and more. It is an expensive exercise and one that is difficult to tackle in its entirety. Insurtechs, and thus by extension investors in insurtechs, for the most part, recognise this and thus have been investing along the entire insurance value chain, predominantly in three main areas: core systems, distribution and product factories. Rather than tackle the whole industry in one go, they would attack it piece by piece.

Why Insurance and Insurtechs?

Simply put, there is an excessive amount of inefficiency in the insurance industry. This is not a secret and almost everyone in the industry knows it. And because of these inefficiencies, there are huge opportunities to be had, margins to be extracted and ultimately lots of money to be made. Unfortunately, no one has yet really been able to put their finger on where the most profitable inefficiencies are. It is a bit like a gold rush. Everyone knows it is there, but no one knows exactly where.

So, lots of prospectors are out there, taking a punt, hoping to be the ones to find that big gold deposit before everyone else shows up to the party. That is essentially the insurtech industry right now. They are out there, probing, exploring, looking for the large inefficiencies that they can solve in a profitable way. A lot of money has been invested, a lot of products have been developed, with some

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successes and many failures. But no one has cracked it yet. No one has found and solved those really large inefficiencies that we all know exist or feel would be transformational for the insurance industry. This means the big wins are still out there, and hence companies will continue to look for these wins, startups will join the exciting rush and investors will continue to fund these explorations for a while yet. In attacking the insurance industry, insurtechs have been doing so broadly across three main areas, namely: core systems, distribution and product factories.

Core systems

This is the newest area that insurtechs are looking to disrupt. Learning from their own struggles to engage incumbents, either because of process, IT or funding reasons, insurtechs are now more convinced than ever that this is where the real problem lies. According to Gartner, global IT spending is projected to be USD 3,9 trillion in 2020, and insurance comprises about USD 375 billion per annum across Europe and North America alone (Gartner, 2020). Companies are under immense pressure to deliver IT efficiencies as well as cost savings and insurtechs are here to help. Everything from Imburse's industry-leading enterprise payments services, to policy management systems from companies like Duck Creek and Socotra, all the way to claim systems are fair game and areas that a lot of attention is given to.

It is in this core systems area that established and large companies find insurtechs' view that «things are broken and we can fix» far less offensive and threatening. Enterprises are genuinely curious to see if these new solutions can add the value and efficiencies which they desperately need. This is where most of the new insurtech investments will go. Stickiness is high, spending is high, selling to one company does not mean another «no longer wants it» and the same problems seem to exist in all the markets globally, allowing for great replicability.

Distribution

Almost all initial plays in insurtechs were distribution plays, relying on the premise that we can do more for the customer. We can make them happier, and by doing so they will pay us more money, never lapse, bring all their friends and never claim. That would be nice. Plus, there is less regulation. Lots of money was invested in the new insurtechs that would change it all, but it was not to be. The customer acquisition cost (CAC) in the insurance industry was underestimated, especially when starting from scratch. It is not about winning the first 100, 1 000 or 10 000 clients. It is about winning 50 000 clients per product per year, every year. It is about building a book of business that has a stable, priceable experience and produces many years of income, without the continuing need and cost to acquire new customers.

Most insurtechs struggled, and still do, to hit critical mass. Maybe some would do ok with 10 000 clients, but to really disrupt, to really move the dial and change the industry you would need more. And investors will demand more. Hence, we saw a lot of acquisitions, incumbents buying the technology for distribution arms, some partnerships to make tools and features available to distribution channels at arm's length, and many closures, both bankruptcies and pivots. I see little money going into distribution solutions going forward.

There is a fundamental fear that FAANG companies (Facebook, Amazon, Alibaba, Netflix, Google) and others will enter the insurance space. Fears that are so far proving right as we see Tesla, Amazon, Ant Financial, Tencent, Alibaba and Revolut being active in the insurance space. And this list will grow. More household brands with incredibly strong distribution capabilities are showing more resilience in these times, with the ability to make the major sales and to offer a portfolio of products to enhance stickiness and to cope with regulatory demands.

Product Factories

So, it turns out distribution is hard, expensive and fraught with requirements and regulatory obligations when it comes to insurance. If only selling was just selling and taking the commission, then it would be so much easier. So, what is next? Oh yes, products. That is what people want, right? Cool new products. In fact, they want personalised, customised products in combinations that are specific to their needs. This is where the next wave of insurtechs were convinced the biggest disruption will take place, and the most opportunities will be found. There is still a massive coverage gap because people have the feeling that the wrong products are being sold to them (according to the insurtechs). So, off goes an army of people and insurtechs, building new products in the three main categories of new products, new charging models and new pricing models.

New products: New products are built on the premise that insurance companies have so far missed the trick and left a gap in the market that they are not closing. Possibly the existing ways of thinking cannot come to a solution or insurers do not want to close that gap for whatever reason. Either way, insurtechs want to launch new products, trying to figure out how to price them, reserve for them, value them and calculate capital requirements, write policy wording for them and then, finally, how to sell them. But, as they are product factories, usually they can only acquire a few thousand clients and really struggle with the required number of new customers beyond this. They need incumbents and global reinsurers to back them. However, I believe that money will continue to flow into these insurtechs, specifically, into those which provide coverage where gaps emerge as a result of new risks or which offer insurance solutions for unpriceable risks due to new data emergence (such as cyber insurance and business interruption).

New charging models: New charging models such as pay-as-you-go (PAYG) insurance are generally built on the premise that «insurers are useless, do not care about their consumers and could not bother offering charging models for their products that customers actually need»[1]. We saw a massive increase in the number of insurtechs that sell traditional products with a pay-as-you-go approach, such as pay-per-mile motor insurance, pay-as-you-live life and health insurance or pay-per-trip travel insurance. Where these companies have managed to hit an often emotional nerve with consumers, they have found good traction and good growth, but again only up to a certain point. It turns out that the pool of consumers demanding this type of insurance is limited to only a smaller part of the insurance population. Now we see incumbents like Progressive, Discovery, Axa and more offering similar propositions to those same customer segments, being better positioned to win given the existing trust and convenience of their brands. Again, insurtechs in this space need incumbents and global reinsurers to back them and it is proving not so easy to change everything. Money will still be available for a short while yet, mostly on the back of the euphoria of Lemonade, but my prediction is that for this type of insurtechs, investment will dry up soon.

New pricing models: New pricing models are built on the premise that insurers do not have the right motivation to drive prices lower and thereby to charge customers fairly. The hope here is that insurtechs in this area will correct this. We are talking about insurtechs launching things like peer-to-peer products, motor telematics, health telematics and parametric products. This is an area that has probably seen the most activity, with the lowest return. Its biggest challenge is that these features and functionalities are only useful and interesting for a small part of the population and are often seen as gimmicks, with consumers concerned that the data will be used against them. Insurtechs operating in this business area have traditionally struggled with scale on their own and always needed an incumbent to drive this forward, either as product provider or as distribution partner. This area should see continued investment in insurtechs enabling the pricing of these products or providing the technology to offer it. However, the actual deployment will be done by incumbents, hence full insurance plays will not see much more funding.

Conclusion

I see two main areas for true, multi-billion-dollar successes. Those who become key enablers to incumbents who already access the majority of the insurance markets and those that enable the major consumer brands to become distributors without needing to get any of the dirty insurance stuff anywhere near their brands and systems. To enable the consumer-facing brands will require a good combination of distribution and product solutions, whilst enabling incumbents to succeed will require a good combination of product and core systems solutions. This is where I see most of the investment going in terms of insurtech funding. Who will be the one making FAANG successful in insurance, and who will be the one convincing existing insurers of today to spend their multi-billion-dollar IT budget on them instead of their own systems? These will be the big winners and those who will make a difference in the insurance market.

Notes

1 I saw this quote in an insurtech's pitch to an event with investors and insurers.

References

Gartner. (2020). Gartner Says Global IT Spending to Reach USD 3.9 Trillion in 2020. Retrieved from: https://www.gartner.com/en/newsroom/press-releases/2020-01-15-gartner-says-global-it-spending-to-reach-3point9-trillion-in-2020.