Executive Insights

In the Foothills of Excellence: Spotlight on Commercial Insurance Broking

There have been many prophecies of disruption in insurance, but change has been slow and the role of the traditional insurance broker remains pivotal in the world of commercial lines and specialist personal lines business.

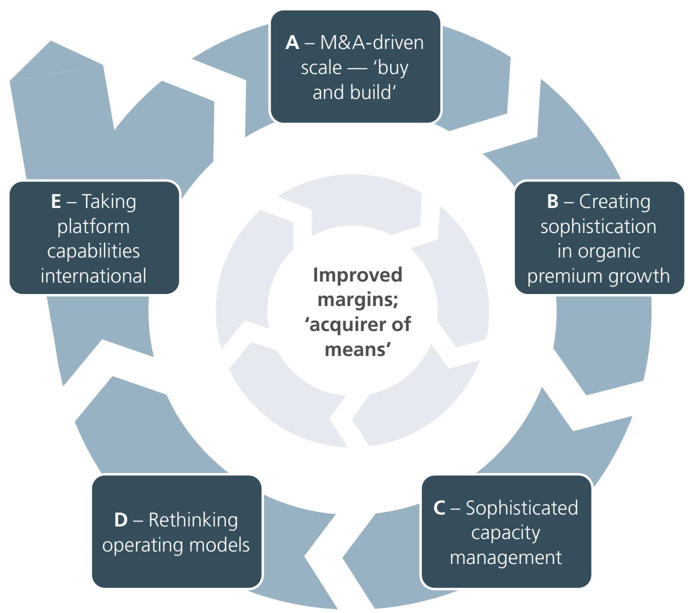
Insurance brokers handle over 100 billion euros of premiums p.a. in Europe alone, and similarly large quanta in North America and the growing markets of Asia-Pacific. Brokers' access to customers remains robust, from micro-SMEs to large corporates. Millions of businesses look to their brokers to help protect against risks, both old and new (e.g. cyber), and navigate remediation when risks translate into claims.

However, this trust-based relationship is not an excuse for the broking industry to stand still. Market forces, the advent of technology and higher customer service requirements have created an imperative for change – change that preserves the customer relationship while creating greater value for businesses and also enabling them to respond to future needs.

Change, however, is not straightforward, and brokers need to have a clear idea on the commercial agenda for their businesses. Scale is a significant consideration – whether to deploy technology or to be more effective in capacity management. Inorganic growth is a key enabler of this, and it is important that becoming an 'acquirer of choice' and an 'acquirer of means' is a key design objective for companies.

Figure 1

L.E.K.'s commercial insurance transformation playbook



Source: L.E.K. research and analysis

In the Foothills of Excellence: Spotlight on Commercial Insurance Broking was written by **Ashish Khanna** and **Pretam Singh**, Partners, and **Sam Halliday**, Principal at L.E.K. Consulting. Ashish, Pretam and Sam are based in London. We thank **Anna Ivanova**, Manager in L.E.K.'s London's office, for her valuable contributions to this *Executive Insights*.

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L.E.K.

In this *Executive Insights*, L.E.K. Consulting examines the key steps in the commercial insurance transformation playbook to achieve these objectives. These are pivotal in unlocking the significant value creation opportunity for customers, management teams and investors (see Figure 1).

A. M&A-driven scale – 'buy and build'

With the exception of a few large international brokers (e.g. Aon, Marsh) and a few aspirants to this category (e.g. AJ Gallagher, Howden, Ecclesia, Acrisure), broking has largely been a market of domestic participants serving the bulk of the mid-corporate, SME and specialist personal business in their respective countries.

The structure of these domestic broking markets has been, and continues to be, characterised by a high degree of fragmentation (see Figure 2) often measured in the thousands of companies, reflecting the origins of the industry as local 'community' advisors. However, the recurring revenue nature of these businesses' income streams has attracted significant private capital, including both private equity and debt, to fuel industry consolidation.

Consolidation and 'buy and build' strategies have allowed considerable value to be realised through valuation multiples arbitrage, increased buying power from capacity providers, and cost synergies.

While consolidation has proceeded at a variable pace, there remains considerable opportunity in most jurisdictions to continue 'buy and build' strategies with little apparent competition. Where the target pool has started to diminish, it is increasingly important to be positioned as both the 'buyer of choice' and the 'buyer of means', with well-defined and executed targeting and integration plans to realise the benefits of consolidation.

B. Creating sophistication in organic premium growth – from 'farmers' to 'hunters'

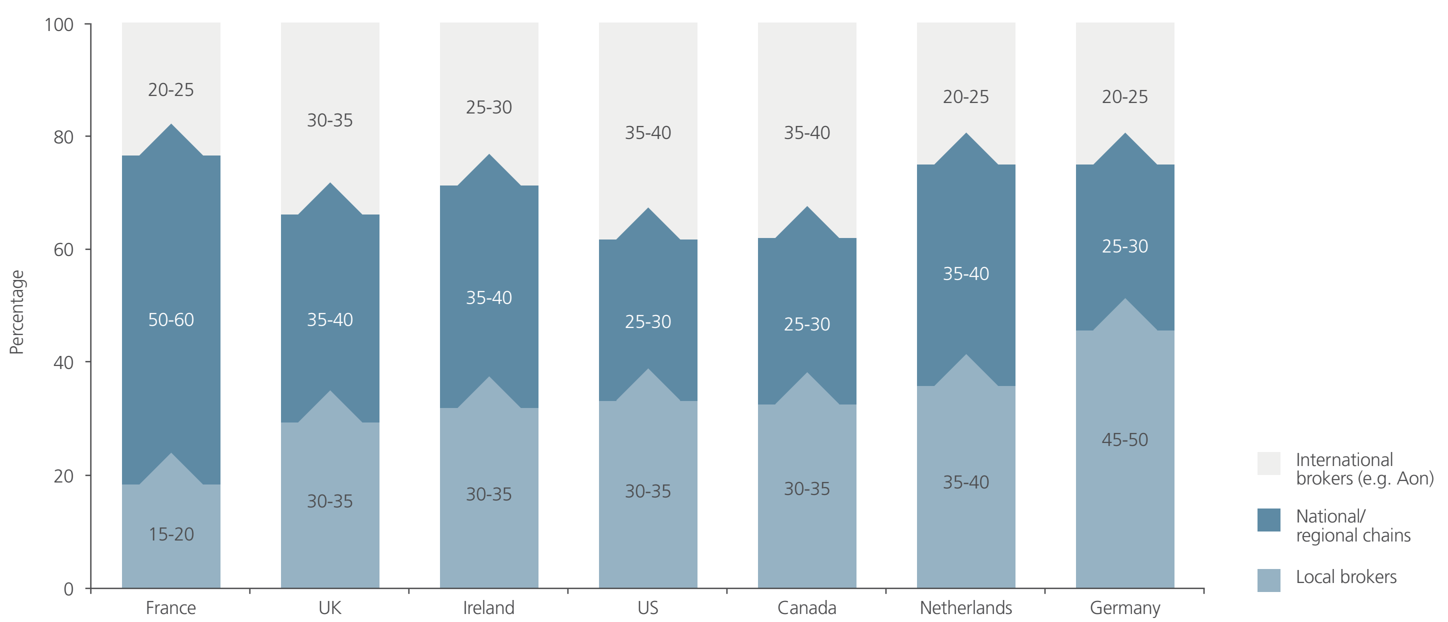
A constant due diligence question for investors is "So what happens to this business when the M&A flywheel slows down?"

A key part of the answer is a renewed emphasis on organic growth. For most of the industry, low single-digit organic growth rates have long been considered adequate when there is an attractive renewal annuity revenue stream and EBITDA is being added through acquisitions. However, this largely reflects a limited focus on the fundamental principles of commercial effectiveness and sales management to enable organic growth.

There are often significant opportunities to work with existing customers to:

- Understand the evolution of their risk profiles and drive additional coverage limits
- Unlock the considerable cross-selling opportunity where, for example, products like D&O or cyber have relevance but have not been discussed with clients

Figure 2
Broker market fragmentation, by geography and broker category



Source: L.E.K. research and analysis

- Realise the opportunity to build specialist insurance businesses (e.g. HNW) that share buying points with core B2B/SME customer relationships
- Adopt other products/propositions (e.g. employee benefits, disability products, health insurance) where the broker may have or could build capabilities

Equally, there are opportunities to drive new customer growth through an explicit focus on volume growth within the business, supported by targeted marketing, and the development of specialist schemes/delegated authority business to retail customers and on a wholesale basis to smaller brokers.

These growth initiatives do not come easily to businesses that have locally embedded ways of working. However, a well-designed programme that provides sales support mechanisms and incentive structures to change behaviours can often help in transforming organisational culture. In our experience, this transition from ‘farmers’ to ‘hunters’ at the front line of the company can quickly accelerate organic premium growth to double-digit rates, with the business becoming a more sophisticated and rounded risk management advisor for clients.

C. Sophisticated capacity management

Brokers have long relied on stable insurer partner capacity that is available on favourable terms and rates. However, they typically do not expend enough effort to assess the composition and fragmentation of their panel, which can often run into hundreds of insurers, as well as leakage to wholesale brokers. A rationalised and systematic approach to capacity management can usually yield sustainable income uplifts.

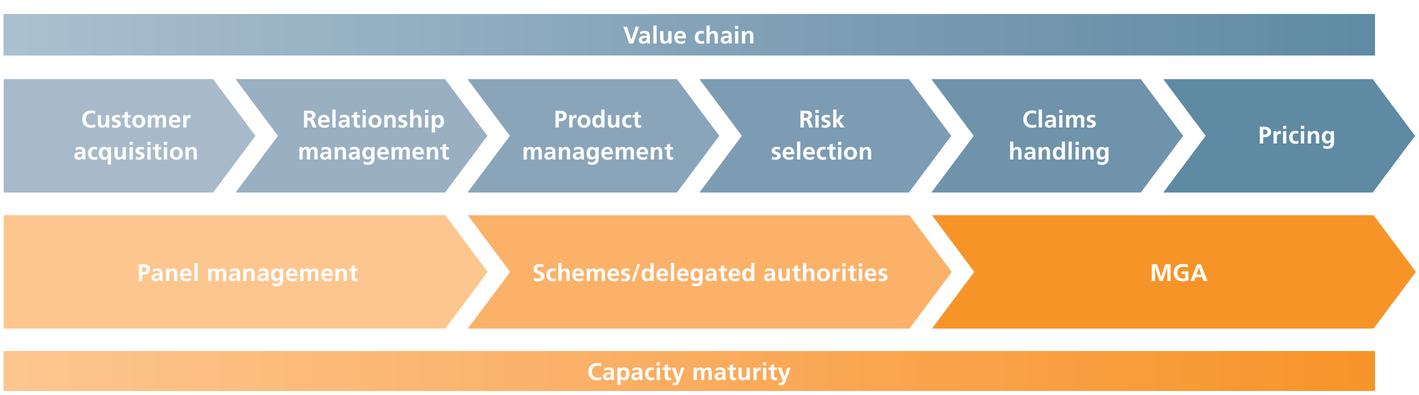
Furthermore, and sometimes despite the best of efforts, the benefits of profitable business accruing from brokers’ proximity to the customer and their management of the insured are not always passed through by the insurer partners. Those partners also do not fully reflect the needs of the customers in terms of product design.

Understanding whether brokers are capturing their fair value requires a close and data-led partnership with the insurers whereby returns are shared equably through enhanced commission rates or profit commissions (where permitted by regulation). This requires full clarity on the performance of a broker’s book with respect to the insurer P&L and what value they are driving for their partners. Building this intelligence requires disaggregating claims from the allocation of expenses borne in distributing and administering a policy, and from the costs of carrying the risk on the insurer’s balance sheet. Where such a partnership and ‘fair’ distribution of performance is not possible, finding alternative local insurer supply may be the first alternative, leveraging the scale of the broker.

There is also potential for a greater value opportunity in finding alternative capacity. This is more common in personal lines insurance where reinsurers have funded the emergence of a series of virtual insurers (e.g. Hastings, The AA), and they are increasingly embracing the opportunity to deploy capital to commercial lines MGAs run by brokers where there is evidence of underwriting capability and claims management experience.

This approach raises questions about the future structure of insurance distribution and the role of the various participants in the value chain. It is undeniably true that some brokers have the opportunity to realise further value and create better customer outcomes through their participation in the underwriting layer. This includes the development of schemes or delegated authority agreements with markets and, ultimately, MGAs (see Figure 3).

Figure 3
Value chain and commission in-play



Source: L.E.K. research and analysis

D. Rethinking operating models

For too long, insurance broking has adopted a 'one size fits all' approach. This may have been appropriate for small brokerages, but the scale of business now controlled by the consolidators (often into the hundreds of thousands of customers and policies) demands a fresh look at target operating models.

The key attributes of these new models are likely to:

- Be customer led and segmented with different channel choices, operational intensity and cost to serve (ensuring maintenance of personal contact where required and moving to digital where customers exhibit a preference)
- Be optimised for relevant customer journeys and brokers' commercial objectives, including placement behaviour
- Leverage technology and data to drive automation and reduce double-keying, including opening up systems to clients for self-service functionality
- Optimise operational footprints for back-office and mid-office functions

When executed well, operating models have the potential to transform the profitability of broking operations. Figure 4 indicates the potential to more than double EBITDA margins through a very high degree of focus on improving operational practices.

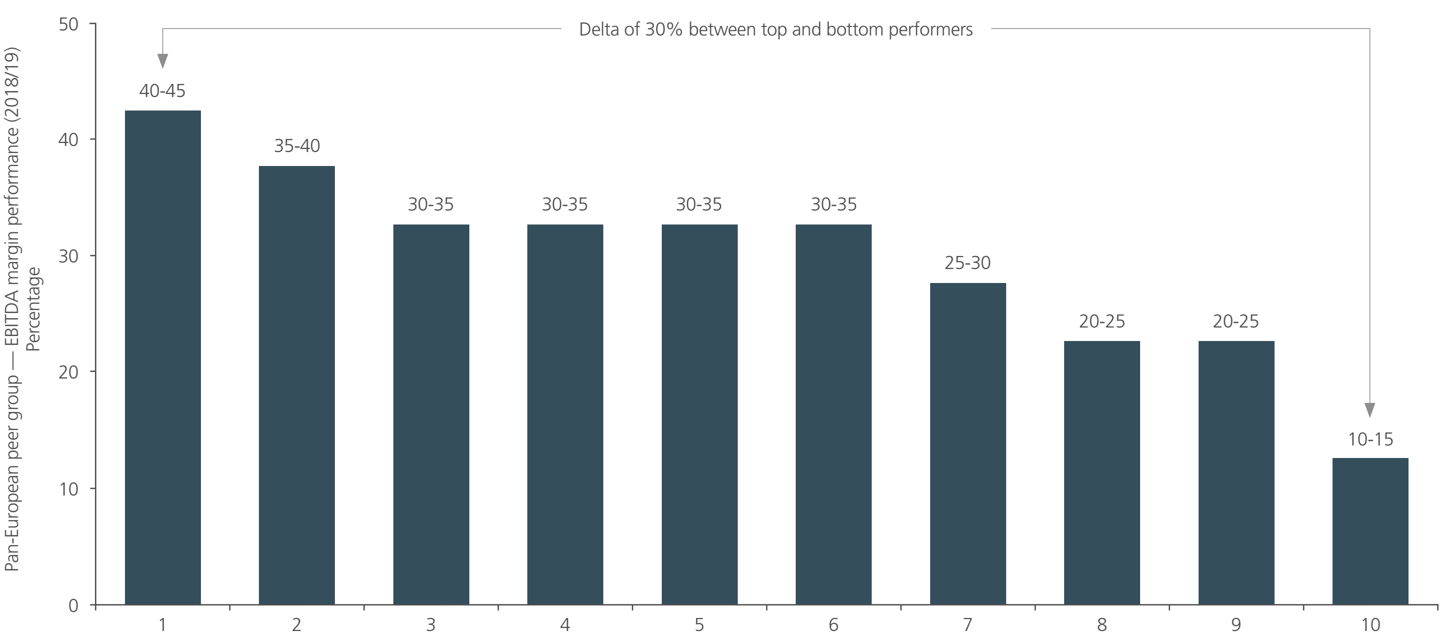
E. Taking platform capabilities international

Figure 2 highlights that broker fragmentation is common in all markets and, as a result, a 'buy and build' strategy may also have value creation potential internationally. However, should this consolidation opportunity be left to national champions, or is there a viable multinational strategy for erstwhile domestic players? The question that management teams of the latter group must address is the rationale to step outside their domestic markets and plant 'flags on the map'.

The approach could risk being a vanity project and distract teams from value creation opportunities in their home markets. But when executed alongside steps B-D above, we strongly support international growth for ambitious companies. Players that have the ability to systematically and purposefully infuse and transplant best practices in organic growth, capacity management/placement, and operating practices and technology stand a better chance of long-term success.

In addition to synergies captured in each national market, a wider multinational group also stands to benefit from placement synergies and access to new capacity markets, greater ability to control leakage of premium in specialist areas, and the potential to automate and/or centralise core capabilities at scale.

Figure 4
Benchmarked performance of brokers



Source: L.E.K. research and analysis

Why now?

The combination of technology advancements and increasing pressure from capital waiting to be deployed is creating an imperative for action.

Data and technology barriers that have historically held back the insurance industry are no longer an excuse. Various broker operating systems (e.g. Applied, Acturis, OpenGI, Anva) provide sufficient data visibility for a number of these initiatives to be actioned with confidence.

Further deployments of data warehouses and lakes, and in some cases CRM systems, are also starting to become commonplace, allowing for the design of sophisticated management practices. These environments create fertile ground for deploying robotic process automation and low- or no-code development to accelerate improvements.

The commercial insurance broking industry has proved its resilience through the COVID-19 crisis. Capital, while plentiful, wants to invest behind sophisticated platforms that can execute against the full suite of value creation levers, in particular where a time-limited and meaningful roll-up opportunity still exists.

Management teams and investors alike would be well served to take decisive steps to realise their business's full potential.

About the Authors

Ashish Khanna is a Partner in L.E.K.'s London office. His primary focus is on financial services, covering insurance, asset/wealth management, banking and other specialist markets across both B2B and B2C settings. He has substantial experience in strategy, decision support, mergers and acquisitions, and performance improvement projects across the U.K., European and global markets. Ashish holds an MBA from INSEAD.

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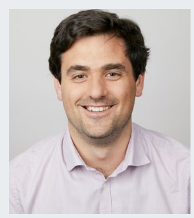

Sam Halliday is a Principal in L.E.K. Consulting's London office where he focuses on the Insurance sector. Sam has experience across the value chain in multiple geographies where he's worked with clients to maximise premium capture at the front-end, improve value capture and processing through organisations and optimise capital allocation in risk carrying. Sam holds an MEng from Oxford University.

About L.E.K. Consulting

L.E.K. Consulting is a global management consulting firm that uses deep industry expertise and rigorous analysis to help business leaders achieve practical results with real impact. We are uncompromising in our approach to helping clients consistently make better decisions, deliver improved business performance and create greater shareholder returns. The firm advises and supports global companies that are leaders in their industries — including the largest private and public-sector organisations, private equity firms, and emerging entrepreneurial businesses. Founded in 1983, L.E.K. employs more than 1,600 professionals across the Americas, Asia-Pacific and Europe. For more information, go to www.lek.com.