

Digital Entrepreneurship and the Supportive Role of Insurance

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Digitalisation is fundamentally changing the way businesses are formed and operate. This is not solely a matter of technology but reflects changes in the way new businesses collaborate, design and deploy new products/services. Online platforms and associated application programme interfaces (APIs) are the essential architecture on which this new digital entrepreneurial ecosystem sits. Digital entrepreneurs are the key engineers of this digital transformation but by allowing them to focus on commercial and financial challenges without fearing the negative consequences of operational disruptions, insurance is also an important enabler.

Who is a digital entrepreneur?

Distinct from users of platforms, digital entrepreneurs produce and trade in digital artefacts – items stored on digital/electronic media that offer functionality and value to the end-user. Traditional entrepreneurs who sell goods online or independent contractors who (for example) drive a taxi as part of a ride-hailing platform, do not create digital artefacts, they merely use them to facilitate their business. By the same token, those who develop digital artefacts are not always entrepreneurs. Individuals may store and share software code or knowledge (via platforms like GitHub or Wikipedia) although their motivation is typically not to exploit a profit opportunity or develop the idea or concept into a business.

Digital entrepreneurs can generally be classified into three camps (Figure 1):

- Owners of digital platforms, both new and established.
- Tech start-ups/app developers – firms that produce new hardware or software for computers or mobile devices (often distributed through an existing platform).
- Intrapreneurs – employees of an existing firm who develop digital innovations inside the organisation (e.g. a new platform business model).



Figure 1: Digital entrepreneurs and the sharing economy



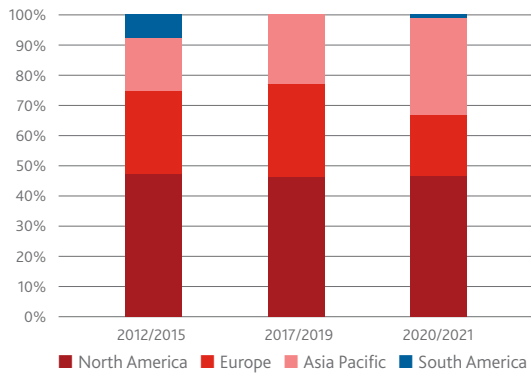
- (1) Self-employed refers to the sole proprietor of the business, a member of a business partnership or an independent contractor.
- (2) Online crowdwork offers paid work (sometimes subject to requester satisfaction) for specified tasks and the initiating actor is the requester.
- (3) Intrapreneurship is defined as entrepreneurship within an existing organisation whereby employees undertake innovation and pursue business opportunities.
- (4) 'Playbour' (the combination of play and labour) crowdwork is based on speculative or non-paid work and the initiative lies with the requester.

Source: The Geneva Association

Where is digital entrepreneurship most active?

Well-developed physical, financial and educational infrastructure means that the major advanced economies lead the world in digital entrepreneurship. North America and Europe rank highest in terms of new platform ecosystems. But developing economies are catching up fast with the emergence of key regional start-up hubs and rapid growth in new digital companies, especially those deploying artificial intelligence (AI), blockchain and robotics technologies. This is particularly true in Asia Pacific, which according to research firm Startup Genome, now accounts for close to a third of the world's top start-up ecosystems (Figure 2). More generally, platformisation is spreading beyond start-ups to established companies, who increasingly use 'Everything-as-a-Service' business models, and charge for the use of a product rather than selling it outright.

Figure 2: Share of top global start-up ecosystems, by region*



* Based on the global rankings of around 40 start-up hubs. Average ranking over the two years.

Source: Startup Genome¹

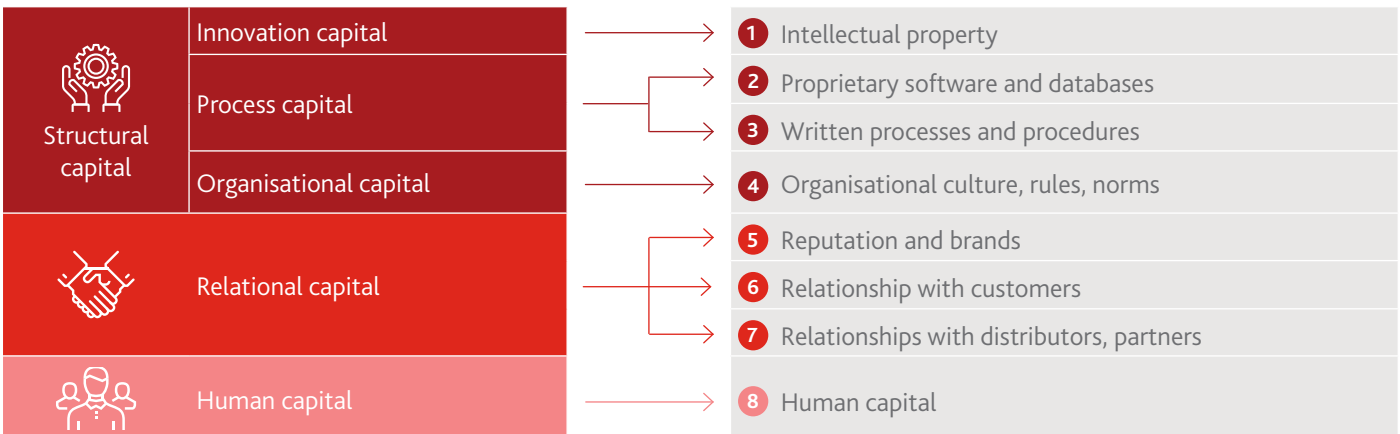


Navigating the evolving entrepreneurial risk landscape

An important corollary of new digital business models is the shift in major source of enterprise value. Compared with a traditional business, a digital firm will typically own relatively few physical assets and will generate much more of its value from intangible assets such as human capital, software and intellectual property (IP). While the rise of Big Tech companies epitomise the change, the phenomenon is more general. The share of intangible investments in total U.S. business investments has risen substantially (from under 15% in the early 1980s to more than 35% in 2020).²

Broadly speaking, the intangible assets of a business reflect the contribution of its people, both staff and founders (human capital), relationships with customers and suppliers (relational capital), and everything that is left when the employees go home, including software and IP (structural capital) – see Figure 3. For digitally-native enterprises whose business model is primarily or entirely online, the intense use of software and user-generated content supporting their platforms and websites are absolutely critical to their business.

Figure 3: Categories of intangible assets



Source: Lloyd's of London/KPMG³

1 Startup Genome 2021.
 2 Ocean Tomo 2020.
 3 Lloyd's of London/KPMG 2020.

The factors that influence the value of intangibles are, however, complex and not always fully understood. They include those that boost the firm's value as well as obligations and contingencies that undermine its net worth (i.e. intangible liabilities such as loss of reputation or unsafe working conditions or products that injure employees or customers and lead to possible legal claims). Intangible liabilities include potential obligations and contingencies that lead to reputation loss, IP infringements, claims for injuries or loss from platform/software users, or breaches of cybersecurity/privacy.

Intangible risks are difficult to quantify, in part because the legislation and litigation environment in which digital companies operate is itself still evolving. Yet if they crystallised, some could ultimately threaten the viability of a firm. Moreover, certain risks may lay dormant, especially as some intangibles are not recognised in formal financial statements, magnifying the possible damage that can occur before remedial action is taken.

Upgrading insurance

Not all risks are insurable, not least because some business risks are unquantifiable and largely non-diversifiable and are best carried by firms' investors. Nevertheless, insurance has a long history of adapting its solutions to help entrepreneurs cope with unexpected operational setbacks. Over time, the boundaries of insurability risk will move, in part due to the actions of entrepreneurs themselves, and as reliable data helps transform uncertainties into insurable risks. Commercial liability policies as well as affirmative covers like cyber and IP insurance will therefore evolve to accommodate some of the new intangible risks. Surveys by Aon/Ponemon indicate less than 20% of information assets are insured – suggesting a sizeable degree of underinsurance.⁴

Small businesses in particular are underserved by the insurance sector. According to one U.S. survey, 44% of small businesses who have been operating for at least a year have never had insurance.⁵ This is despite the fact that almost half did not have any other mechanisms in place to help mitigate against risks. That could reflect entrepreneurs' limited appetite for insurance, perhaps because they underestimate the scale and importance of some risks, especially those outside of their control. In another survey, more than a third of small businesses experienced an event that could have led to an insurance claim.⁶ The high speed with which digital businesses can be set up and grown, as well as the changing legal environment and limited risk management expertise, may foster such blind spots.

Initiatives by insurers to increase awareness of emerging risks and the benefits of insurance will therefore help boost the resilience of new digital firms. In particular, specialist insurance staff who understand start-ups' risk protection needs as well as clearer, more simply-worded policies would enhance the perceived value of insurance.

Alongside such marketing initiatives, insurers need to pursue ways to sharpen the value proposition of insurance through:

- **Product innovation** – parametric insurance may be particularly suited where loss results from lack of access to or underperformance of products/services rather than physical damage or injury. Examples include reputation risk protection based on bespoke indices, insurance-backed guarantees for AI software and business interruption covers for cloud/IT outage. Insurers can also support firms through value-added services or by guaranteeing the value of intangible assets used as collateral for loans or safeguarding investors against crowdfunding fraud.
- **Process innovation** – automated underwriting and streamlined distribution, including through partnership with InsurTechs and collaboration with entrepreneurs to collect and analyse key data, will facilitate flexible and customisable cover for digital start-ups.
- **Organisational innovation** – a reconfiguration of insurers' business models to embrace APIs will allow them to connect better with digital platforms and gather business-relevant information. This will uncover meaningful opportunities to create highly granular risk calibration models and realise new insurance opportunities that appeal to digital entrepreneurs.

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4 Aon 2020.

5 Next Insurance 2018.

6 Insureon (no date).