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Influencing Outcomes in a Consolidating Insurance Industry: Three Keys to Value Creation

by Pia Tischhauser[1]

It's easy to see why the colourful term 'merger mania' has been applied to the global insurance industry. Axis–PartnerRe, Willis–Towers Watson-Gras Savoye, ACE-Chubb and Anthem–Cigna are just a few of the high-profile acquisitions announced around the world in 2015.

But behind the triumphant headlines, a stark reality lies. Within the global insurance sector, only 51 per cent of acquisitions created value; 49 per cent actually destroyed it.[2] How can insurance executives influence the probability of success in mega-mergers that are, statistically speaking, simply a coin toss? This article presents a strategic framework of best practices to address the full life cycle of insurance acquisitions—proactive target search, disciplined deal execution and effective post-merger integration (PMI)—to accelerate transactions and help maximise value creation.

First, a little background.

A confluence of forces drives consolidation

A multitude of macro-level forces impact the insurance industry and will continue to propel consolidation over the next five years. These forces include:

- *Regulatory requirements:* Capital requirements, such as those contained in the Solvency II Directive in the EU, continue to intensify, putting pressure on both independent insurers and conglomerates. Other requirements, such as IMD2, PRIIP and MiFID2[3] will likely decrease some consumers' willingness to pay current levels for financial advice.
- *Low interest rate environment:* Interest rates are likely to stay for some time—at least in mature markets—making profits in traditional life insurance difficult if not impossible.
- *New competitors:* Players as varied as supermarket chains (e.g. Tesco) and technology companies (telcos) are in a position to disrupt the insurance value chain using collected customer data and owning the 'last mile' to the customer.
- *New operating models:* Incumbents find it more difficult to play across the entire value chain, creating vulnerability to specialists disrupting existing models such as price-transparent aggregators. Midsized insurers that still handle all aspects of their business internally will face rapidly declining efficiencies.
- *Big data and predictive analytics:* Insurance companies are prime candidates to exploit analytic insights into

[1] Senior Partner and Managing Director, Global Leader - Insurance Practice, Boston Consulting Group.

[2] One-year relative total shareholder return (RTSR) of completed acquisitions (%). The Boston Consulting Group's analysis of insurance sector is based on 778 transactions involving insurance companies between 1990 and 2014 (Standard Industrial Classification Codes 6311, 6321, 6331, 6351, 6361, 6399, 6411). Analysis includes only transactions with deal value >USD 25m and share transfer >75%.

[3] IMD2 = Insurance Mediation Directive (new IDD—Insurance Distribution Directive), PRIIP = Packaged Retail Investment and Insurance-based Products; MIFID2 = Markets in Financial Instruments Directive.

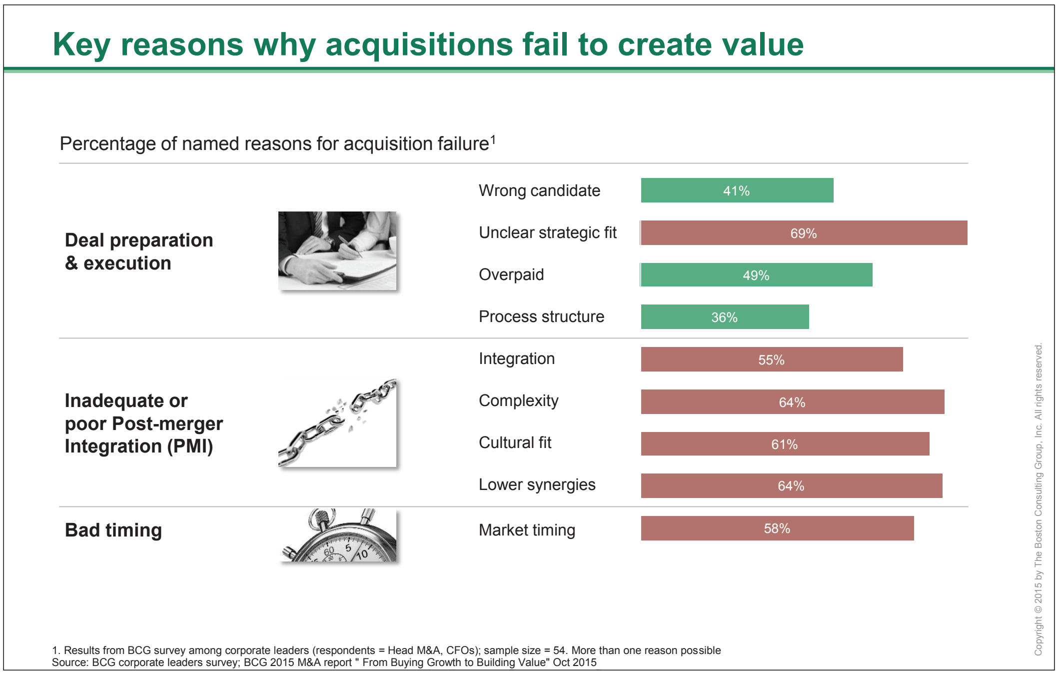
customer behaviour and needs, but building the technology, culture and teams to do so is easily cost-prohibitive.

- *Limited organic growth opportunities:* Mature markets are consolidating and while risks increase, the insurance industry has not been successful to convince customers to buy insurance to cover risks beyond the most basic. Emerging markets present market share growth options, but profitability lies only in the future. Scale can be achieved most realistically through acquisition.

More than a mathematical transaction

Against this backdrop, failed recent merger attempts illustrate the fact that successful insurance mergers require more than mathematical transactions calculated in a vacuum. Furthermore, the 49 per cent of insurance mergers that are completed and still fail to deliver value fall prey to a wide range of culprits:[4]

Figure 1: Key reasons why acquisitions fail to create value



Source: Boston Consulting Group (2015).

Three keys to creating M&A value

Insurance executives can significantly enhance their ability to drive value-creating mergers by adhering to the three-pronged strategy outlined below.

Key #1: Proactive target search

Many insurance acquisitions are made opportunistically, in a time-pressurised window, with an investment bank providing the target. Here, candidates are analysed largely on their financials, which are ultimately only one component of a successful acquisition.

Instead, acquirers should actively seek proprietary deals, employing a proven, systematic approach and analytic framework. All aspects of the merger must be thought through prior to the transaction—including potential bids by competitors and interlopers and not aim at completing the transaction, at any or all costs.

[4] Results from the Boston Consulting Group survey among corporate leaders (respondents were heads of M&A and CFOs). See Boston Consulting Group (2015).

Key #2: Disciplined deal execution

Deal teams are driven to complete deals. However, due diligence can reveal that acquisitions that initially looked attractive truly aren't. Acquirers should focus on assessing key value drivers during the due diligence period and walk away from a deal if meaningful future value cannot be extracted. 'We have already invested so much time,' is not a sufficient reason to complete a poorly conceived transaction.

Key #3: Effective, thorough post-merger integration (PMI)

Inexperienced deal teams often do outside-in estimates of synergies and integration costs, failing to include business operations people in the discussion. Effective PMI requires bearing integration—of businesses, people, processes and technology—in mind from the start of the due diligence period. Realistic synergy expectations can be formed only when there is operational experience on the deal team. Adding deep insurance industry knowledge to the process and planning and successfully executing PMI accelerates downstream value creation.

PMI complexity is driven by hard and soft factors

Fully 49 per cent of the time, acquisitions that appear to be financially attractive transactions do not deliver value because of poor post-merger integration. A best practice approach to assessing integration examines five key factors:

- *Geographic footprint and number of countries:* Sometimes mergers do not deliver economies of scale due to profound differences across the countries insurance companies operate in. The success of the merged company depends on managing the integration process to derive synergy.
- *Legal entity structure and regulatory context:* Ideally, the merged entity should operate as one legal entity structure. There can be numerous legal and regulatory hurdles. For example, in the U.K., Part VII of the Financial Services and Markets Act 2000 enables a book of insurance policies to be moved from one legal entity to another. For some purposes reinsurance will suffice, but if the acquirer wants to separate the policies permanently from the transferor, reinsurance is insufficient.[5] This is just one example of a PMI issue that is best assessed prior to the acquirer making an offer to the target.
- *Brand, product and channel landscape:* Pure financial analysis rarely examines the target's brand, products and distribution channels, with an eye on operating a converged entity. Insurance companies have some of the most recognisable branding in the world, presenting significant equity, and these decisions cannot be made lightly. For example, when Axa bought Winterthur, there was almost an identity crisis, albeit short-lived on whether the Swiss town of Winterthur should now rebrand itself into Axa. After a four-year journey, the transition to Axa has been made in most countries. Trygg–Hansa logo incorporates a life preserver, and life preservers emblazoned with the company's name are ubiquitous in Scandinavia. The situation captures a classic quandary as to whether acquired brands should be kept or rebranded, based on customer equity and overall strategy.

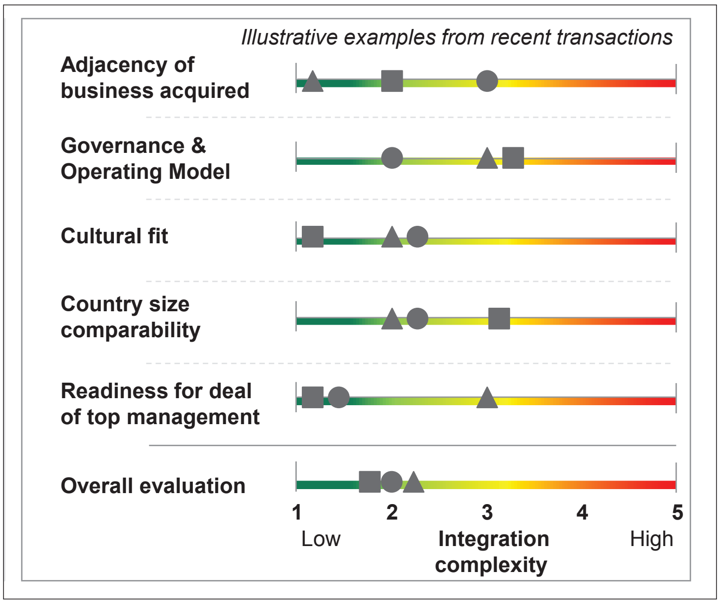
Distribution channels present a similar issue—some companies have brokers, others their own agents and still others sell direct to consumers. These important tactical issues must be thought through to drive value in the merged entity; they can also be deal-breakers.

- *IT/operational landscape:* Most insurers' IT shops are heavily weighted towards legacy systems. On paper, these costs may appear low and thus attractive, but acquirers will inevitably need to invest significantly to upgrade core business systems. This impacts ultimate value and can substantially alter deal terms.
- *Organisational/cultural fit:* A high number of adjacencies—in M&A, similarities between two organisations—allow the acquirer to most effectively evaluate a target. For example, an insurer that sells auto insurance (short-tail products, high turnover, automated sales process) will have difficulty in assessing the potential value of a low-adjacency target that sells B2B (business-to-business) commercial insurance, using qualified underwriters and a high-touch sales process.

[5] 'Part VII Transfers,' *The Actuary*, *http://www.theactuary.com/archive/old-articles/part-5/part-vii-transfers/*

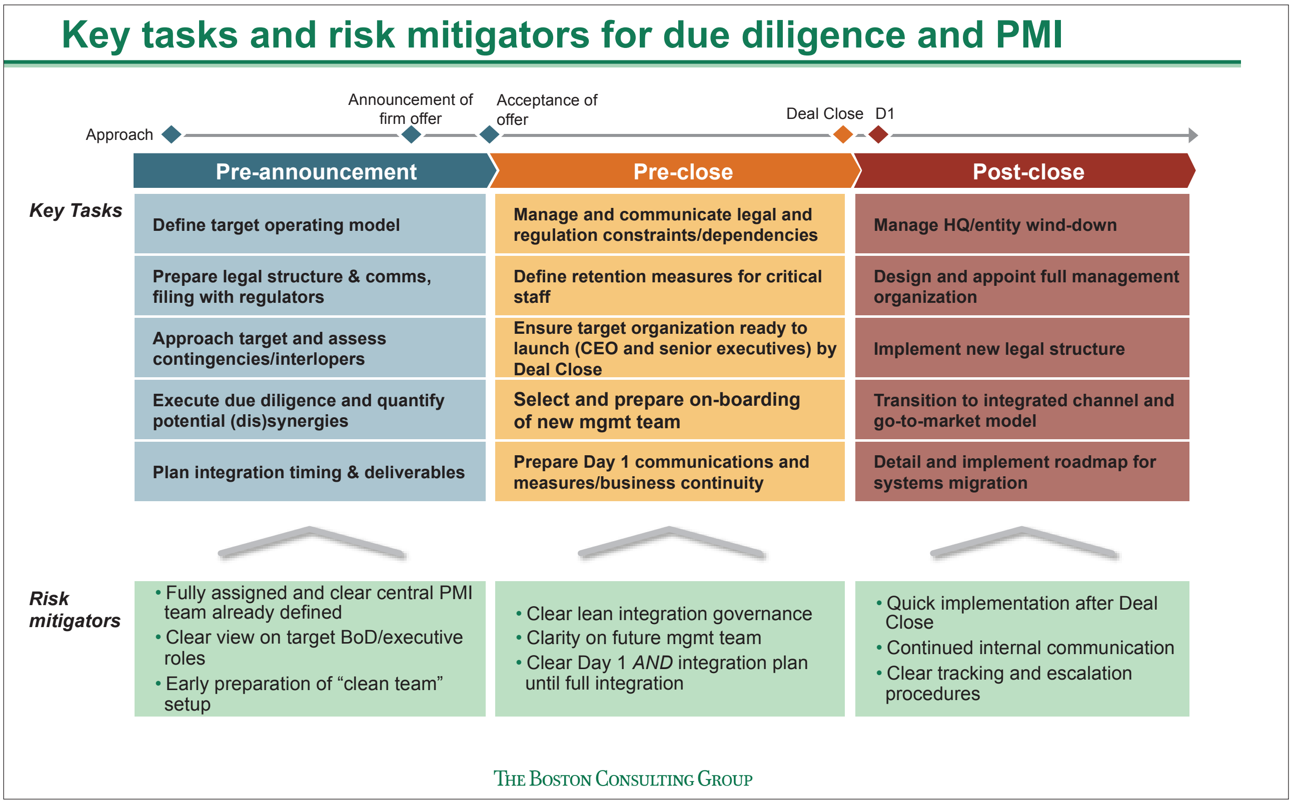
The impact of organisational and cultural fit cannot be underestimated. Figure 2 illustrates where three recent major insurance mergers fell on a complexity continuum. All three announced mergers were mathematically attractive, yet one failed.

Figure 2: Five key drivers of organisational integration complexity



Source: Boston Consulting Group (2015).

Figure 3: BCG methodology to help acquirers to significantly accelerate value creation before, during and after target acquisition



The road to value

While the ‘three keys to value’—proactive target search, disciplined deal execution and effective post-merger integration (PMI) are essential in their own right, their application within a coordinated timeline unlocks the true potential for M&A value. Figure 3 provides an orchestration framework for effective insurance mergers. The role of the clean team: trusted intermediary

In M&A scenarios, the clean team is responsible for collecting relevant data, safeguarding and analysing it, and presenting all manner of recommendations to the acquirer. It ensures that sensitive competitive information and data on the target company’s business (prohibited from disclosure before deal close) are fully captured. After clearance, the clean team facilitates fast information exchange between both parties.

A clean team is therefore particularly relevant in insurance M&A, where antitrust concerns may delay an acquisition.

Beyond the deal

In sum, it’s clear that creating value in today’s consolidating global insurance environment goes far beyond financial compatibility between two companies. By applying the ‘three keys to value creation,’ merger partners can mitigate the industry’s 49 per cent risk of value destruction and dramatically boost the odds of long-term success of the merged entity.

Reference

Boston Consulting Group (2015) *From Buying Growth to Building Value*, *Increasing Returns with M&A*, by J. Kengelbach, G. Keienburg, K. Gjerstad, J. Nielsen, D. Walker, S. Walker, Boston, MA: Boston Consulting Group, from *https://www.bcgperspectives.com/Images/BCG-From-Buying-Growth-to-Building-Value-Oct-2015_tcm80-198704.pdf*.