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Financial Services

# After the Land-Grab: Next Generation Success in Emerging Europe



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## Introduction

For nearly two decades the insurance markets in emerging Europe<sup>1</sup> have been a source of tremendous growth. However, following in the footsteps of more mature markets, growth rates are beginning to ease. Although growth will surely continue, albeit at a slightly lower rate, success for insurers has got tougher, and is set to get harder still: international players have accumulated dominant shares in most markets, few acquisition targets are left, competition is intensifying and the market is developing at a fast pace. Plain vanilla strategies are no longer enough to compete in this challenging market place, but with average insurance penetration at only a third of overall European levels and growth in other areas of the world slowing fast, insurers cannot afford to rest on their laurels. In order to succeed, insurers will need to transform themselves along all dimensions of strategy, channel, product and delivery, organisation and operations. The winners will reap a substantial prize.

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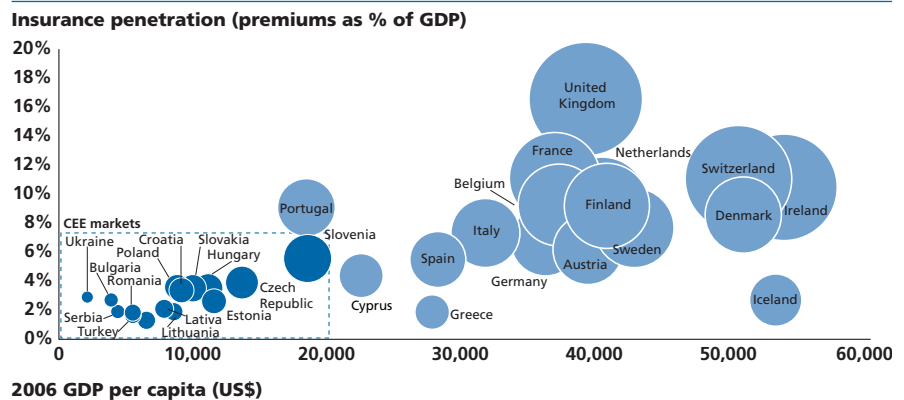
<sup>1</sup> Emerging Europe defined as Central and Eastern Europe, Russia / CIS, Turkey and other South East European countries

## Emerging Europe still highly attractive

As developed markets continue to mature and experience flat growth rates, emerging Europe is one of the most attractive global growth regions. The region remains underpenetrated (as indicated in Figure 1) – the forecast for rapid macroeconomic GDP per capita growth and hence increasing insurance penetration will generate attractive market growth rates for the region and for most individual markets. Figure 1 demonstrates this link, and also shows how scattered and skewed emerging Europe’s markets are.

While in this paper, we talk about the region ‘emerging Europe’ we recognise the immense diversity the region displays. Geography, culture, market size, political environment as well as the macro-economic and, perhaps more importantly, the maturity of the insurance market in each country vary significantly as you move east from Prague, Bratislava or Warsaw towards Russia and Ukraine or south towards the Balkans, Romania and Bulgaria. Further east, CIS markets are yet another very different animal.

**Figure 1: Insurance macro development in emerging Europe**



Note: Size of bubble shows 2006 insurance density  
 Source: Morgan Stanley, Swiss Re, Sigma, Oliver Wyman

## Plain vanilla is over

Since the opening of emerging Europe's markets in the early nineties, insurers have piled into the region in order to seize the growth opportunity. Market strategies have been rather unsophisticated – companies either opened greenfield operations aiming to export skills and experience gained in their home markets, often replicating existing business and operating models, or acquired local businesses. Acquisition strategies, integration quality and local management strength proved to be the main sources of competitive advantage.

However, this initial 'bonanza period' is reaching its limit; experience of other markets warns that plain vanilla market strategies will provide diminishing returns and concentration ratios will gradually start to reverse as some players fail to keep up.

Three underlying factors are changing the nature of the game:

- **No 'easy growth':** Each dollar of premiums is getting harder to pull through the door. International insurers have established leading positions in many markets, proving to be a dominant force and sucking up much of the new business. At the same time, attractive acquisition targets are few and far between and those that remain are demanding almost prohibitively high multiples. Moreover, remaining domestic incumbents are increasingly seeking stand-alone offensive strategies (rather than being bought up) and are working hard to stabilise their business
- **More sophisticated market:** The market and competitive landscape is getting more demanding and challenging, such that plain vanilla strategies riding the market growth wave are no longer relevant. Product innovation speed is high, channel proliferation and professionalisation are increasing and the quest for more efficient operating models is accelerating. Relative to the past, this kind of marketplace requires a step change in the view of management, business quality and underlying economics
- **Aggressive competition:** Partly as a consequence of the first two aspects, international insurers are in fierce competition, applying their most sophisticated techniques from other markets in an attempt to steal more growth. Professionalising operations, generating synergies and improving economics are top of the emerging Europe agendas and often the Group-wide agenda also. Even in today's tough economic environment, insurers have not been shy in dedicating more capital to the region. Indeed, Groups

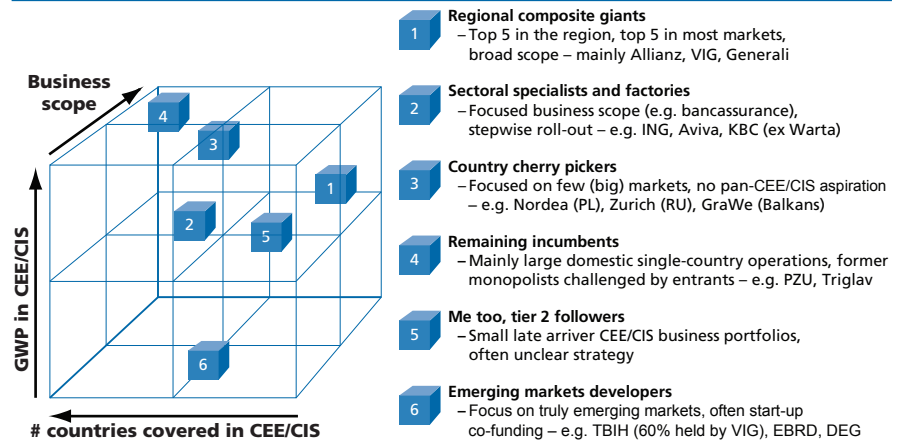
are fully aware that it is only if their share of fast growing emerging markets business (relative to their overall business) exceeds 25-30%, that markets will take a different view on the multiples and risk assessment that are applied to them

With plain vanilla strategies in emerging Europe reaching their limit, we look at today's competitive landscape and then provide recommendations for shaping the next generation strategy.

# Today's competitive landscape

While it is clear that new strategies are needed at this transition point in market development, they need to be specific for each player and cognisant of the different starting points for each of the international and domestic insurers in emerging Europe. Based on our analysis we have clustered insurance players in CEE along three dimensions – geographic span, business scope and size – and identified six distinct business models that describe the competitive landscape. Figure 2 highlights these business models and where they fit among the three dimensions of the business:

**Figure 2: Competitive positioning and business models in emerging Europe**



## Regional composite giants

Some insurers have succeeded in building a broad portfolio of typically composite insurance businesses spanning across emerging Europe. They have generally followed a mix of M&A and organic growth, and aspire to be in the top five in each market, managing a broad and heterogeneous mix of local businesses. The top three representatives for this business model are Vienna Insurance Group, Allianz and Generali – but even though they are well positioned, the next generation of competition for efficiency and product and channel innovation combined with continuous high growth, provide many opportunities for others to catch up. Threats are particularly poignant from other pan-emerging Europe composite players who to date have lagged behind this trio, despite their long legacies in the region.

While sharing the same business model, Vienna Insurance Group, Allianz and Generali differ significantly in their strategies. In the following case studies, we take a brief look at each of these to inform lessons for success, key challenges and future direction.

### **Vienna Insurance Group (VIG)**

This Austrian insurer was among the first movers in the region and has built a large portfolio through a combined inorganic and organic growth strategy. Among the international regional composite giants, VIG has the highest market share in CEE, with its recent acquisition of s-Versicherung. CEE generates 40% out of the total €7 BN GWP and will soon exceed 50%. The market has recognised their strong position as evidenced by the strong multiples applied and share performance.

VIG's business model has some unique characteristics:

- A collection of local businesses with a lean corporate centre, limited integration and strong local branding dominating the group brand
- In many countries operating several stand-alone businesses partly competing against each other as part of a diversification and market positioning strategy
- Promise of reinvesting local profits and strong cultural understanding of individual markets

While performance has been positive, the challenge now will be to exploit greater synergies while maintaining the business model.

### **Allianz Group**

Allianz adopted a different approach – focusing on acquiring large local businesses and stepwise integrating them into Allianz Group following a clear pattern along all elements of the value chain. They have rebranded the majority of acquired businesses and moved reasonably quickly along the integration path. Moreover, from a Group perspective the overall emerging markets impact on the Group's performance is still minor at approximately 10% of premium, generating relatively little analyst and investor appreciation.

An additional interesting angle is the expansion of Allianz in the banking space via Allianz Bank which is gradually increasing its presence across the region.

### **Generali Assicurazioni**

Generali's historical roots in the region have made it a natural market leader in emerging Europe. The main recent steps in building their emerging Europe portfolio result from the joint venture with PPF Group and bold moves into Russia. Whilst this has added substantial business volume, it has also brought complexity, requiring a concerted integration effort. While Generali's non-life business and agency distribution are performing well, bancassurance may become an increasing gap in the business portfolio with most pan-regional banks being tied into strategic alliances. Pressure for pan-regional synergies is likely to increase.

The challenge for Regional composite giants will be to maintain their leadership and continue to develop and refine their business models in order to fight off others who are chasing growth. They will need to find the right balance between getting local execution right in highly diverse markets while generating synergies in common areas. Whether they will succeed is a different question but we expect to see all players in this space continue to fight aggressively in the region, leveraging support in the form of capital and expertise from their Group centres.

## Sectoral specialists and factories

In order to access the growth in the region while navigating the extreme diversity across markets, many insurers have adopted and rolled out specialist business models which play to their strengths. The most prominent examples for specialists include:

- **Bancassurers** either in the form of strategic alliances and platforms like Ergo Austria with its strategic alliance with UniCredit, or in the form of more integrated players, such as KBC
- **Life insurers** focusing on occupational pensions, pension funds and asset management. ING is probably the most notable example in this space. For credit protection insurance, Europa is an interesting local player in emerging Europe, especially in Poland
- **Industrial and commercial insurers** focusing on the large industrial investments and assets in emerging Europe. This is a segment which is still largely covered by the local multi-line insurers with some role for international industrial insurers like HDI, AIG or Chubb

All these specialists play to their strengths and therefore are capturing opportunities in well-defined areas of the markets. However, many of the models are not pure plays, but rather need to be combined with other businesses in order to make the economics work given the nascent stage of many niches.

As markets mature we expect to see more defined specialist business models which allow a differentiated development somewhat independent from the mainstream. This will make a razor sharp strategy even more crucial for success.

## Country cherry pickers

The fragmented and heterogeneous nature of emerging Europe has been mentioned as a source of difficulty in developing a pan-regional strategy, and executing on the ground. However, some insurers – either by fate or by strategy – have focused their attention on a selection of countries thus using these natural barriers to entry to their advantage and ‘cherry picking’ in specific areas.

Typically, we have observed such cherry picking occurring in two directions:

- Focus on **selected big markets**, especially Russia, Turkey and Poland. Zurich Financial Services Group is a typical example for this as part of their re-entry into emerging Europe, having divested of many sub-scale businesses in the early 2000s
- Focus on **coherent geographic segments**, for example the Balkan countries, South Eastern Europe or former CIS countries. Small Austrian insurer GraWe is an example for the Balkans as is Euro Insurance Group in South Eastern Europe

The challenge for a cherry picking strategy lies around insight, impact and critical mass. Cherry pickers cannot draw on many lessons learned within a broader emerging Europe portfolio, and rely on bigger operations which may still struggle to achieve overall critical mass. On the other hand, cherry pickers can benefit from their business having clearer focus and less complexity than more heterogeneous and fragmented emerging Europe business portfolios. They can then use this more stable base to grow into other markets in the region.

## Remaining incumbents

There are few significant incumbents left in emerging Europe; however those that remain are noteworthy. For example, PZU is still one of the largest insurers in the region, Triglav in Slovenia is well known, and the Russian domestics remain strong despite many recent international entries. For these incumbents, **professionalisation** is the key word. While their legacies provide them with a strong base, they also prove to be a heavy burden, preventing incumbents being more agile as newer, more sophisticated entrants bring significant international expertise. Incumbents do have a chance of survival but must manage huge transition programmes aimed at upgrading their distribution networks, defending their customer base and building on their local brand and history, whilst increasing agility and innovation. As seen in Russia, some incumbents rely on international managers (e.g. Rosgostrakh's CEO) or minority shareholders (e.g. VIG at SSG Group) to manage that transition and to benefit from know-how transfer and change.

## Me too, tier 2 followers

Many of the second wave entrants into emerging Europe have followed a largely undifferentiated, 'me too' strategy. However, they are keeping a foothold, adopting a 'wait and see' approach in the hope of growing from their current positions. Many of these players will not realise significant value from their emerging Europe operations. In fact we believe many will disappear, divesting at some point and becoming the targets in the next round of consolidation. For a 'me too', tier 2 follower who is serious about the region, the strategy is largely clear: first make your initial foothold into a fortress, second seek innovative ways to grow beyond the current foothold, third do it now before it is too late, or instead look to divest into a buoyant market.

## Emerging markets developers

Some players – a mix of private equity investors and insurers – have built their business on first mover advantage in the truly nascent emerging markets. Ukraine used to be the main focus, but has now become a standard operation in many business portfolios. Georgia and other Caucasian or Central Asian countries of CIS are now the focus as are Macedonia, Serbia and Albania in South Eastern Europe. Companies like TBIH, the private holding which is majority-owned by VIG, is a typical example of this. Key features of such business models include their high risk per market and their operation which is almost like a private equity house in governance, culture and aspiration. Both of these mean that diversification is a must as is a clear transition plan from this nascent emerging markets incubator into a more stable business format.

# Next generation emerging Europe strategy

It is an exciting time in emerging Europe; a region which is on the verge between the end of the first generation market and competition, and the next generation of a more professional, competitive and innovative landscape.

Emerging Europe insurers face a bewildering variety of challenges in this tougher world. Our experience with clients in emerging Europe and in analogous growth regions leads us to believe that there are certain strategic imperatives which are common to all players. We have structured these along five building blocks for a next generation emerging Europe strategy:

- 1) Strategy and impact
- 2) Channel
- 3) Products and delivery
- 4) Organisation
- 5) Operations

## 1) Strategy and impact

Emerging Europe's rapid market development and dynamic competitive landscape requires strong strategic management as the overarching steer for business development. Success will come to those players that have a concise and innovative strategy and who move seamlessly from strategy to implementation. As such, you should actively:

- Anticipate the next windows of opportunity by learning from other markets
- Be bold and take significant steps
- Understand how to move from strategy to impact
- Develop a clear story around your strategy

## 2) Channel

The distribution arena is evolving at a fast pace with new channels emerging, the traditional agency channels transforming and the quest for customer capture becoming fiercer. As such, distribution and channel management are a very strong competitive differentiator. Arguably this is the centre-ground of the new battle, and in a follow-up article we will explore this in more detail. Our conclusion,

though, is that insurers should look at channel management holistically and position themselves at the forefront of transformation and professionalisation. As such, you should actively:

- Professionalise your agent sales force, treating distribution as a business development partner
- Optimise your branch and regional network, specifically in urban areas
- Build a bancassurance channel or shape alternative partnerships
- Prepare for serving the broker and independent channel effectively

### 3) Products and delivery

In much of emerging Europe insurance is a nascent industry, in many cases starting from motor lines, especially mandatory third party liability. With economic growth and increasing wealth, other lines emerge along what you could describe as Maslow's financial services pyramid in analogy. At the same time, the delivery of insurance develops rapidly with the establishment of actuarial expertise and a stepwise shift from a pure cash flow view to economically sound pricing, reserving, underwriting and claims. The resulting trade-off between a pure top line view and an economically grounded perspective is a struggle that many insurers face, especially in Russia and other nascent emerging markets. To balance growth and economics, you should actively:

- Anticipate the pyramid of product innovation with the right timing
- Establish expertise for and implementation of proper pricing, reserving and underwriting
- Manage your claims tightly and with strict control
- Institutionalise a professional finance and risk function as catalyst

### 4) Organisation

Responding to such a fast pace of change is difficult in theory, and even more so in practice. Indeed, it requires very effective organisation, often some significant steps away from the existing operations. Management quality, leadership and a strong operating model will be key differentiators in the next generation of competition in emerging Europe. To be effective as an organisation in this region, you should actively:

- Focus the Group centre or a regional hub on areas that have true added value
- Balance this with a fluid and flexible organisation which has a strong entrepreneurial spirit
- Manage your talent as your predominant increasingly scarce resource
- Ensure broader Group's understanding for specifics in emerging Europe

## 5) Operations

The complexity of a fragmented region like emerging Europe with its different languages, small but heterogeneous markets, different regulatory schemes and lagging infrastructure, can impose major barriers to efficiency improvement. So far, we have observed few synergies and scale economies except for a few factory business models. However, companies like Allianz with their efficiency and platform program, are investing to overcome these hurdles and to achieve a step-change in operational efficiency. It is now time to prepare and migrate to efficient operations platforms, including standardisation, shared services hubs for administration and centralised manufacturing. As margins tighten with market maturity, the pay-back will be significant. You should actively:

- Develop shared services hubs to build scale over fragmented markets
- Build centralised manufacturing with standard core processes
- Facilitate sharing between local businesses

## Conclusion

Emerging Europe is an exciting market opportunity. Many insurers have greatly benefited from the first generation of market entry. Now the second round of market development and competition is emerging – and the stakes are high for all. For those successful in round one there is a lot to defend and but still more to gain. For those lagging in round one there will be a set of new opportunities to benefit from Europe's growth engines. For all there is one clear message: take action now.



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