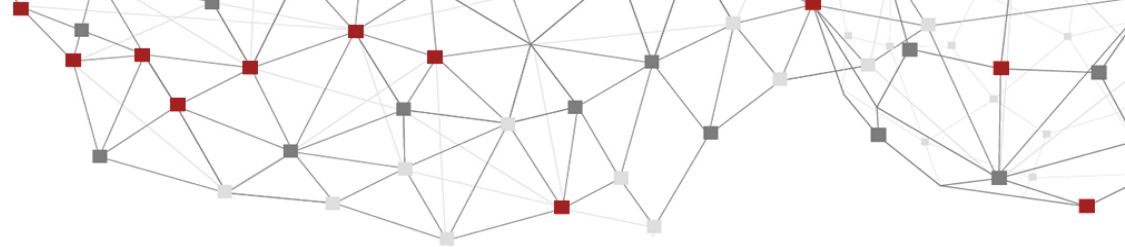


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Japan's Insurance Sector post-COVID

Where to From Here?



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EXECUTIVE SUMMARY

As of May 2020, Japanese insurers have mobilized rapidly in response to the COVID-19 pandemic. The sudden decrease in global interest rates and significant restrictions on people's movement are necessitating changes to product portfolios, distribution models, and business operations.

However, business continuity and crisis management are only half the story; while there is a pressing need to react quickly to fast-moving events, insurers must also reassess their long-term strategy. The need for establishing customer trust and supporting them through a time of need has rarely been greater.

We expect the market to be significantly different over the longer term and here is what insurers should focus on:

- Evolve product portfolios to reflect lower interest rates and changes to underlying risks—this extends to optimizing underlying investments (to achieve the desired yield) as well as extending into adjacencies to capture new revenue streams
- Become digitally enabled across customer interactions, distribution (including agents/ banca partners), core operations, and back-end processing to support new ways of working and evolved risk profiles
- Integrate more tightly with suppliers to support their customer promise—in the short run, this means working with them to creatively support their businesses.
- Rethink the operating model—beyond organization structures and processes, successful insurers will critically rethink their workforce strategies, cost structures, physical presence, and organizational culture to build resilience and adaptability.

The successful insurer of the Post-COVID era will be the ones that take a holistic approach to rethinking their business (beyond just reacting to market dynamics).

Insurers can move in this direction by calibrating their mid- and long-term strategies around six key areas: strategy & brand, distribution, finance & liquidity, workforce, operations & supply chain, and being proactive about the regulatory agenda. In short, insurers must watch the immediate situation, but with a firm focus on the emerging future to deliver on customer promises and stakeholder expectations.

Impact of COVID-19 on Japan

As of May 2020, Japanese insurers have mobilized rapidly in response to the COVID-19 pandemic. For insurers who have predominantly relied on face-to-face (F2F) distribution and people-intensive operations, the battleground extends to all fronts: mass customer acquisition, running the business, and delivering on claims.

Domestic sales have declined significantly because insurance agents are unable to meet with customers and reduced discretionary spending given the possibility of unemployment. While the impact to date on general insurers is less pronounced, few expect this trend to continue. If the experience of other regional markets is any indication*¹, Japanese insurers should expect a double-digit decline in new businesses in the initial months of the restrictions and a low, single-digit reduction in annualized premium income thereafter. Several insurers have started making regular compensatory payments to their agents*², further impacting profitability and liquidity. Market volatility and declining interest rates have challenged investment portfolios and overseas business interests further.

Yet, a relentless focus on business continuity will only get you so far—insurers need to have one eye on the future to emerge strong and capture the significant market opportunities that emerge. In this context, we see three broad scenarios developing over the next ~12–18 months, both globally and in Japan outlined in the figure below (Exhibit 1).

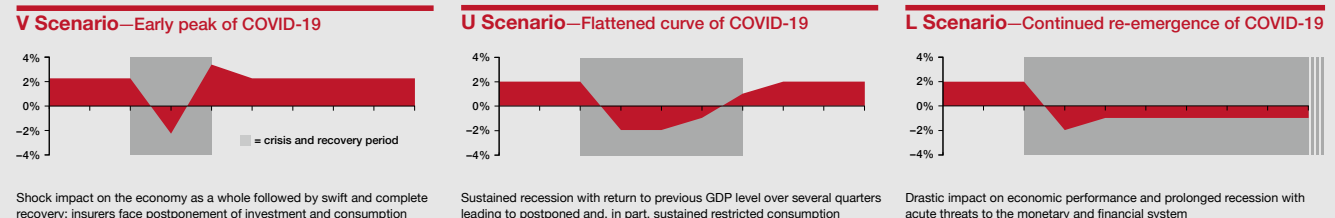
Our house view is that scenarios U and L are most credible and insurers will need to adapt accordingly. After crisis management, as national governments gradually pull societies out of hibernation, opportunities will arise for insurers who act now to position themselves to emerge stronger in the post-COVID times. To respond effectively, Japanese insurers need to cater to four Japan-specific issues:

- A significant shift toward remote working
- Regional variances in COVID related economic impacts
- A higher degree of manual operations vis-à-vis global peers
- Improve governance of their global portfolios

EXHIBIT 1

COVID-19 crisis: overview of possible economic scenarios

GDP Change (quarterly) through crisis, recovery and beyond



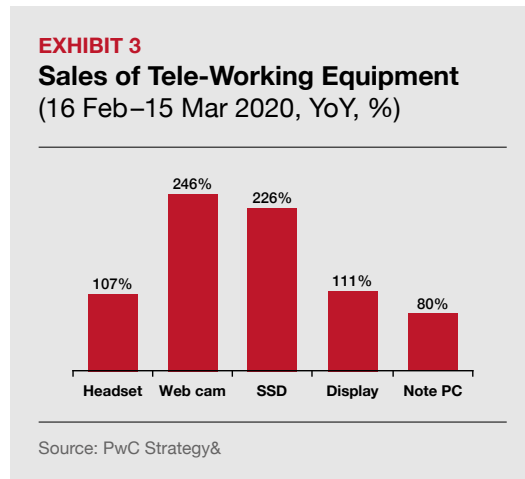
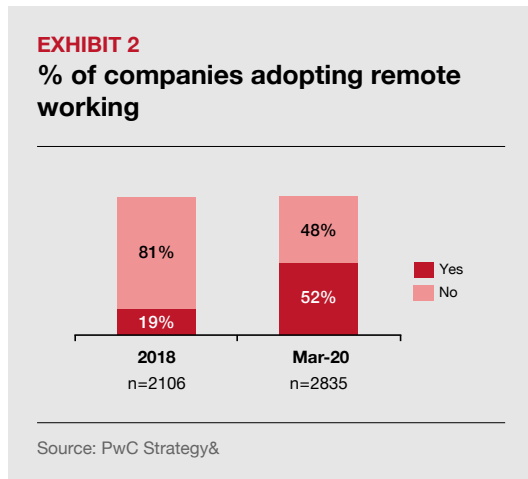
Source: PwC Strategy&

*1: Insurance Journal, 2020. "Hong Kong Insurers Say Sales Have Fallen to 'Almost Nothing' Due to Coronavirus", Accessed June 30, 2020. <https://www.insurancejournal.com/news/international/2020/02/06/557700.htm>.
Global Data., 2020. "South Korea's life insurance business to decline in 2020 due to Covid-19, says GlobalData", Accessed June 30, 2020. <https://www.globaldata.com/south-korea-s-life-insurance-business-to-decline-in-2020-due-to-covid-19-says-globaldata/>

*2: Top 5 Japanese insurer announcement

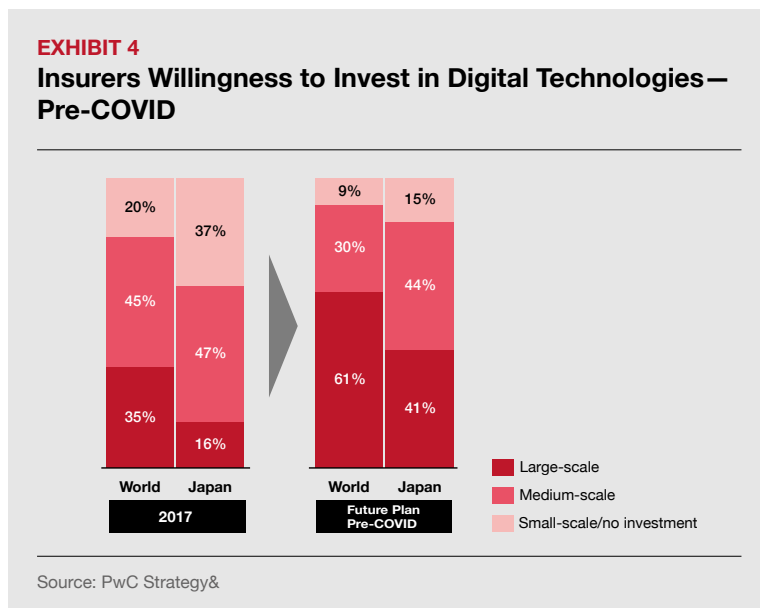
- **A substantive, sustained shift toward remote working by employers and employees.**

The medical requirements for social distancing necessitates a high proportion of staff work from home (Exhibit 2), and companies (and staff) are investing to do so; for example, the purchase of remote working equipment has risen sharply this year (Exhibit 3). Some changes may likely remain post COVID, with profound implications for how insurers manage their workforce, real-estate, and product portfolios (i.e., as underlying risk evolves).

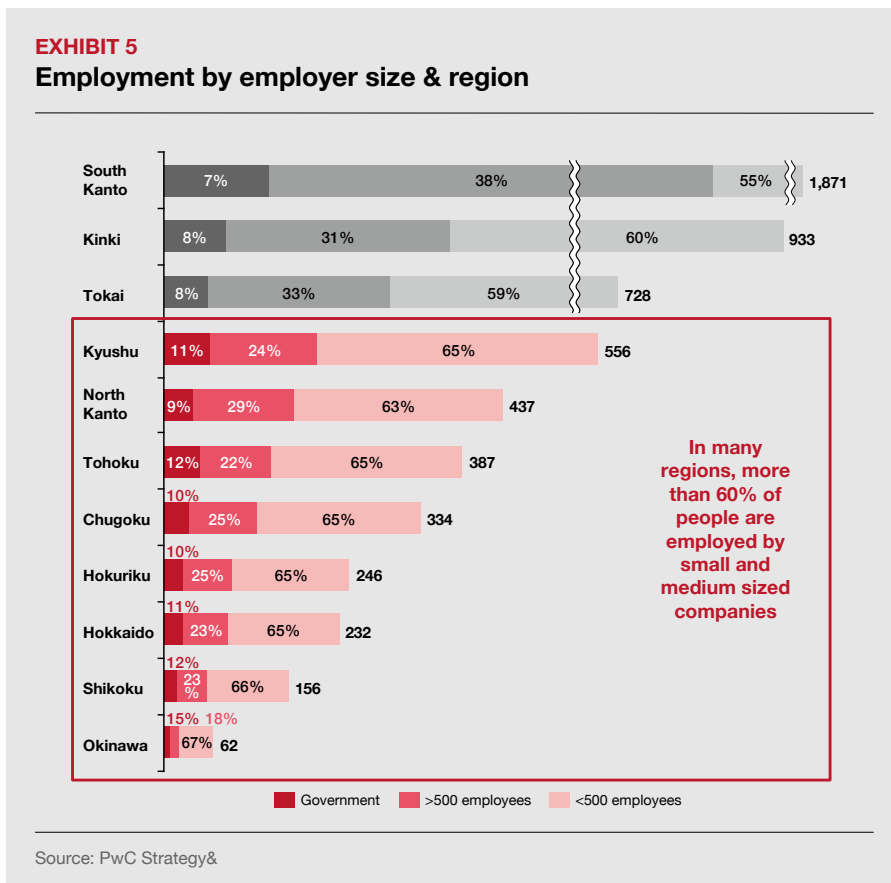


- **A higher degree of manual operations vis a vis global peers has left Japanese insurers facing additional challenges in responding to the current operating environment.**

There are constraints associated with physically getting staff to locations to execute manual, paper-based processes. In parallel, the significant volume of non-digital records has posed business continuity and risk management challenges that are difficult to resolve in the short term. Local insurers who have typically underinvested in digitization compared to global peers are already revisiting these plans (Exhibit 4), but will need to accelerate them as business stabilizes.

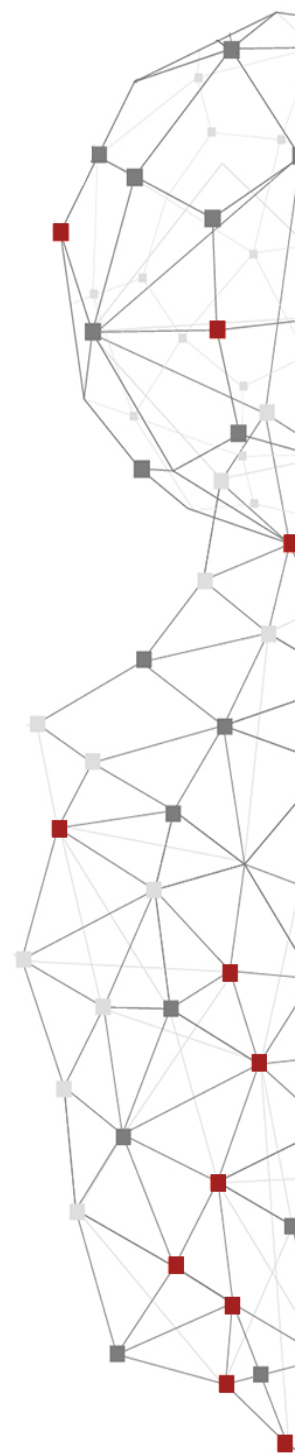


- **Disparities in the impact of COVID-19.** By sheer size, the largest impact (based on population) will be in Kanto, Kinki, and Tokai. In the rest of Japan, 65%+ of the working population is employed in small- and medium-sized enterprises (SMEs), who face lower employment security (Exhibit 5).



The immediate impact will be on new businesses as customers reduce the amount and types of cover they hold. While there is an urgent need to support SMEs and freelancers with working capital solutions in the near term, over the mid to long term, we envisage a slight decline in SME-oriented products and propositions. Beyond evolving distribution models, insurers will need to think about the types of products that can cater to the diverse workforce—now and in post-COVID times.

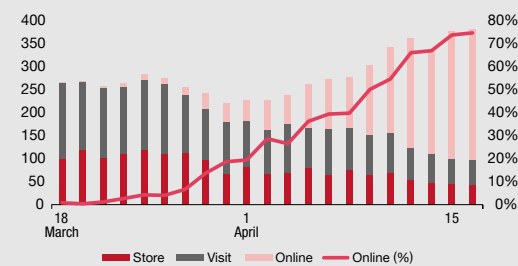
- **Management of global portfolios by Holding Companies.** Over the last decade, Japanese insurers have nurtured global portfolios to tap into attractive markets and investment opportunities—the economic upside and yield arbitrage opportunities more than offset the cost of integrating and governing global businesses. However, with the precipitous decline in interest rates and a declining global economic outlook, this arbitrage opportunity has also diminished. Additionally, the nature of these portfolios may require incremental capital contributions (e.g., to cover increased income protection claims). While not a direct issue for Japan operations, we expect this to be an area of significant interest for top management in holding companies.



As an initial response, many insurers are evolving their business practices. Several have significantly curtailed agent and staff sales visits, closed physical locations, reduced working hours, and established A/B teams (Exhibit 6). Others have increased website use, with many substantively shifting to digital channels (Exhibit 7). However, these are only near-term measures; tackling longer-term impacts will require deep examination across four main dimensions:

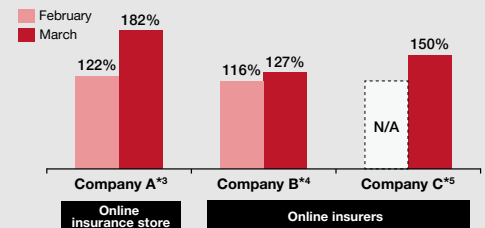
- Product portfolio and value chain participation
- Workforce and real-estate management
- Operational resilience and agility
- Role as stable, long term Institutional Investors

EXHIBIT 6
Company A*³ # of consultation by type (2020)



Source: PwC Strategy&

EXHIBIT 7
Sales trend for online insurance (# of contract, 2020 vs 2019)



Source: PwC Strategy&

*3: Large Japanese Insurance Distributer

*4: Major Japanese Direct Insurer

*5: Top 10 European Insurer in Japan

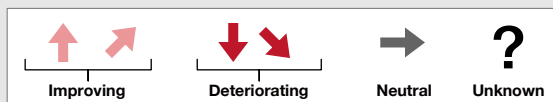
Longer Term Impact on Japanese Insurers

From disrupted value chains to workforce anxiety, all business aspects are being impacted. Japan's fiscal stimulus package is one of the world's largest*⁶, and its interplay with health data pertaining to the local progression of COVID-19 should underpin scenario planning. While acute in the short term, the combinatorial impacts of these aspects will have more substantive impacts across the product portfolio over the longer term (Exhibit 8).

EXHIBIT 8

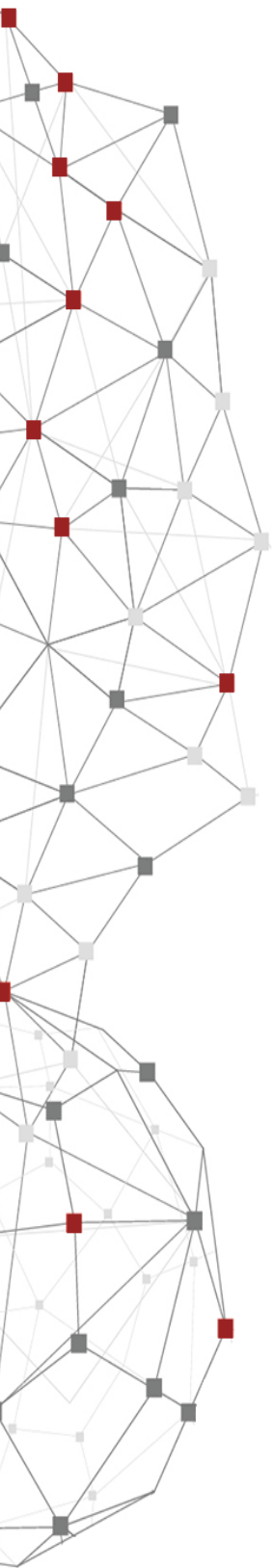
Impact on Insurers Products & Business

		Premium	Loss Ratio	Long Term COVID Impacts
Property & Casualty	Fire & Marine	? More businesses closing but shipping likely to increase—unclear if two will balance out	→ Usage patterns of surviving businesses remain largely unchanged	• Largely unchanged as businesses re-emerge—but will trend with overall population/economy of Japan profile
	Compulsory Auto Liability	↘ Reduced vehicle demand and customers choosing to drive at non-peak periods	↗ Changed driving frequency and behavior improve loss ratio assumptions	• Economic slowdown, continued travel restrictions and declining car ownership rates will reduce premiums
	Voluntary Automobile	↘ Reduced vehicle demand, changed driving conditions, and customers saving money	↗ Changed driving frequency and behavior improves loss ratio assumptions	• Mixed impact on loss ratio—likely lower in the short term but higher in the long term as driving increases to maintain social distancing
	Personal Accident	↘ Slight reduction driven by reduction in short and long term travel	→ Usage patterns may be “safer” but volume loss could increase unit cost	• Demand likely to remain stable and likely to follow broader market/societal trends
	Other Personal (Pet, Travel, etc.)	↓ Underpinned by spending on discretionary items subject to customers' belt tightening	? Changes in usage pattern unclear	• Less requirement for travel • Increase in other personal items insufficient to offset loss
	Property & Misc. Casualty	→ Ownership and occupancy unchanged—but some shift to cheaper policies	→ Usage patterns largely unchanged	• will trend with broader Japan population and economic profile (e.g., people seek lower cost housing)
Life	Whole / Term	↘ Few discretionary purchases by customers and likely for lower ticket amounts	→ Base mortality and morbidity largely unchanged—assumes COVID will be controlled in next ~12–18 months	• Sustained shift in acceptance of remote working resulting in changes to underlying risk profile • assumes COVID will be controlled over the next ~12–18 months
	Endowments & Annuities	↓ Flight to preserve cash or substituting into other traditional policies	↘ Increased cost of generating returns and hedging in a low-rate, volatile environment	• Shift toward larger ticket sizes—lower rates for foreseeable future will necessitate (pricier) high grade real assets to generate returns
	Hospitalization & Surgery (3 rd Sector)	↗ Increased demand for health cover and services—if you can reach the customer	? Changes in usage patterns and mix uncertain	• Increased demand for health related policies (and services) as customers continue to become more health conscious
	Group Insurance	→ Longer term contracts with expectations of employers to provide cover	→ Base mortality and morbidity unchanged	• Sustained shift in acceptance of remote working resulting in change to underlying risk profile



Source: PwC Strategy&

*6: Japan's fiscal stimulus in response to the COVID-19 pandemic is pegged at ~20% of GDP, which is on par with Germany and the UK and ahead of Australia and Singapore.



Once in a generation shifts in customer behavior will profoundly impact market dynamics. A drive to frugality will see customers purchasing fewer and lower ticket whole / term policies, but potentially more on supplemental health cover. Substantive and long lasting shifts in real estate usage, travel and socialization patterns, and personal asset ownership will impact longer term risk profiles. **First**, we expect a shift in product portfolios—especially for life insurers—away from capital intensive products as savings oriented products will have to work much harder to generate returns. Products like unit linked ones might appear attractive but their capital efficiency should be stress tested given solvency requirements. **Second**, core operations need to be a lot more digitized—not only to provide flexibility in business operations, but to respond to and remain relevant to long term changes in customer behavior. Given the expected decline in volumes in some parts of the portfolio, reducing the expense ratio (through digitization) will be critical to maintaining profitability. **Third**, digitization will extend to distribution models—not to replace agents and partners, but to support them with more time to spend with customers. Several tools are available from fintech-type providers, and there is an opportunity for insurers to accelerate efforts by buying capability. **Fourth**, insurers should integrate better with suppliers (e.g., *repairers, hospitals, other service providers*), distribution partners (e.g., *agents, banks, etc.*), and for the Group business, with large corporates (e.g., *to put in place programs to manage safety and mental health whilst working from home*).

A second major change will be around workforce and real-estate management.

The high degree of manual and paper-intensive processes among Japanese insurers has necessitated large workforces, offices and branches. COVID-19 has forced insurers and sales forces to work remotely and challenge existing norms; as we emerge from this crisis, successful insurers will rethink how and where they organize their people and activity. Managing this requires a greater focus on organizing the workforce (including for continued remote work) and investing in a base level of digital/remote working skills for all staff. From a real-estate perspective, this is an opportunity to re-examine the scale of corporate headquarters/operational centers and rethink the format of sales branches. Done correctly, there is a real opportunity to redeploy savings from the former to the latter.

A third area, which Japanese insurers will have to develop is building resilience and agility within their businesses. This will require more than just training staff; specifically, there needs to be a deeper focus on the interconnectivity between people, processes, and governance. First, governance structures and controls should be updated for a changed environment. Second, customer and non-customer facing processes need to be redesigned to focus on digitization and distributed execution, that is, “one process, distributed execution.” This means greater standardization and “designing- in” controls (vs. traditional model of relying on human oversight). Lastly, all managers must be trained on how to lead distributed teams on a regular basis. The benefits of achieving this include increased workforce flexibility, better customer customers; improved employee value proposition; and increased operational capacity.

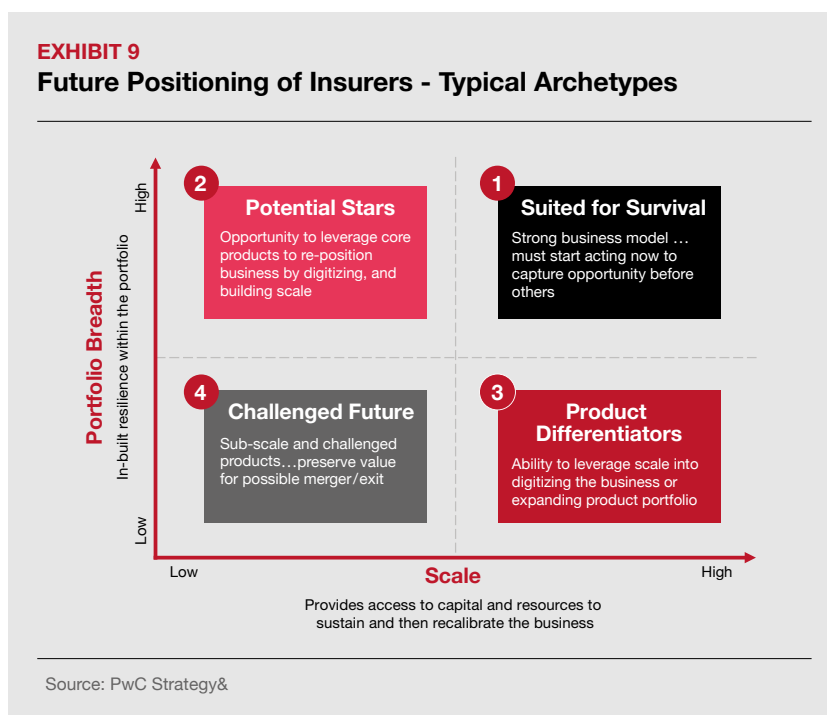
A fourth longer-term impact is the role of insurers as large institutional investors.

Portfolios/allocations of large institutional investors will shift due to lower global interest rates and structural changes in asset valuations (e.g., commercial real estate). In addition to ALM requirements, insurers will need to seek yields for savings-oriented products that have already been sold and redesign future savings—oriented products. There are fewer highly rated investments, and longer tenured (e.g., infrastructure) investments come with liquidity constraints. Insurers should revisit their investment strategies and the products that can be supported through those strategies.

Actions for Insurers

The fast spread of COVID-19 pushed most businesses to uncharted territory. It is tempting to become internally focused, but insurers' response to customers and society in the present times will dictate their future public perception. The first steps should be directed toward customers; reiterating your value propositions, providing a clear way for customers to get help, and developing solutions to operational challenges with customers in mind (even if the solution is not perfect). For example, in China, an insurer has fast-tracked claims (and accepted the risk of a higher loss ratio) and waived deductibles. Only then, should insurers start thinking about their longer-term business response.

There is no doubt the insurance landscape will be significantly altered over the long term from customer, employee, and product perspectives. It is also possible that some of these changes will be acute enough to force market consolidation providing opportunities for stronger players. The actions available to insurers will be influenced or constrained by their archetype which are presented in the Exhibit 9 alongside. These are based on the current scale and portfolio breadth of insurers (*i.e. structural factors that enable or constrain their businesses*).



Estimates suggest that the global economy will take at least ~12–18 months to return to something resembling “normal” conditions—but what exactly it looks like is still unclear. It is also clear that we have to get used to emergencies like COVID-19 in a world of growing uncertainty, instability, and interconnectedness. We are familiar with some systemic threats like climate change and cyber-attacks and are already adapting to them—a similar approach is required for the post-COVID environment. Insurers need not wait; irrespective of their archetype, there are actions insurers can start now to position themselves (Exhibit 10).

EXHIBIT 10
Actions Insurers Can Take to Emerge Stronger

	Mobilize	Stabilize (Start now to execute over the medium term)	Strategize (Think now to guide long term choices)	Archetype Specific Options (Start thinking now)
Crisis Management & Response		<ul style="list-style-type: none"> Ongoing scenario planning and stress testing of financial, operational and reputational risk 	<ul style="list-style-type: none"> Customer charter—demonstrate how you will support for future crises Be clear on your purpose 	
Strategy & Brand	Immediate crisis management and business continuity planning efforts largely completed—now at monitoring stage	<ul style="list-style-type: none"> Liquidity solutions for Small and Medium Enterprises (SME) (and other) for other Strengthen customer loyalty by capitalizing on minimized risk (e.g., motor, value added services) Reprioritize and rationalize project portfolio 	<ul style="list-style-type: none"> Review product portfolio mix and compare with client needs Recovery + growth strategy Fit for purpose operating model 	<ul style="list-style-type: none"> 1 3 Strategic M&A—of other insurers and capabilities 1 Global portfolio optimization 2 Build distribution partnerships
Distribution		<ul style="list-style-type: none"> Make better use of existing sales related assets—lead trackers, savings calculators, etc... i.e. drive adoption Design and deploy digital sales support tools in the hands of agents and drive adoption Better link direct and F2F sales channels 	<ul style="list-style-type: none"> Rethink agent/banca sales experience—and retrain/hire to deliver on that experience Redesign branch/agent office formats and rethink location strategies 	<ul style="list-style-type: none"> 1 2 Redesign sales process to make it digital centric 1 2 Invest in direct distribution and customer engagement 3
Finance & Liquidity		<ul style="list-style-type: none"> Extending credit/working capital to business partners Re-insurance strategies Recalibrating capital/valuation models 	<ul style="list-style-type: none"> Closed block/legacy portfolio strategy Lapse management Accurate valuation on illiquid investments & overseas portfolios 	<ul style="list-style-type: none"> 1 2 Partial Sale of back-books 4 Divestments 2 4 Capital/Liquidity Management
Workforce		<ul style="list-style-type: none"> Workforce stabilization and planning Base level of digital & remote leadership training for staff and agents/partners (inc. adoption of existing tools) Personal development & personal projects 	<ul style="list-style-type: none"> Workforce strategy & digital upskilling Improved agent value proposition Real estate location strategy 	<ul style="list-style-type: none"> 1 2 Targeted recruiting campaigns to capture candidates from others
Operations & Supply Chain		<ul style="list-style-type: none"> Ensuring continuity of supply chain through targeted investments and working capital solutions Digital tools to agents—chat, VC, shared screens, etc. Digitization and automation of core processes 	<ul style="list-style-type: none"> Design-in cyber security and data privacy—before digitizing processes IT Infrastructure & end of life strategy 	<ul style="list-style-type: none"> 1 3 Tactical sales campaigns 1 2 Digital adoption campaigns of existing tools and systems
Tax, Trade & Regulatory		<ul style="list-style-type: none"> Financial reporting and disclosures Replan & recalibrate regulatory programs currently underway—IFRS, LDTI 	<ul style="list-style-type: none"> Global governance models (for those with multi-national portfolios) 	<ul style="list-style-type: none"> 1 2 Captive re-insurance to better access global capital markets

Source: PwC Strategy&

So, the actions that you, as insurers, take now will build resilience and adaptability in your organization, starting with the following:

- **Test, Test, Test:** To loosely paraphrase the advice of WHO Director General Dr. Tedros Adhanom, companies must adopt a “Test! Test! Test!” policy by taking a scenario-based approach to business planning. Insurers have historically run sophisticated financial scenario tests (e.g., solvency), but they now need to expand this to customer- and employee-facing processes and develop market approaches, product portfolios, and physical infrastructure.
- **Assessing Resilience in Product Portfolios:** The rapid decrease in global interest rates has wreaked havoc on investment portfolios; for life insurers, this has markedly increased the cost of capital (especially in legacy portfolios). It is unlikely that rates will increase for some time. Stress testing your current and legacy products including using health analytics will enable you to better negotiate with re-insurers (near term) and optimize your post-COVID portfolio (long term).
- **Digitize the Customer Interaction:** Profound changes in customer behavior brought about by COVID19 means insurers should rethink customer interactions - the need to digitize sales, customer management, and claims management has never been higher. Contrary to dogma, digital efforts need not replace agents and staff - it can actually give them back more time to spend on higher value activities (e.g., *spending time with customers*) and support better risk management. The time to start acting on this is now.
- **Revisiting Governance and Controls:** Current (local and global) governance models and controls must be redesigned for an operating environment in which risks rapidly translate across national boundaries and one where much work may be conducted remotely (even in post-COVID times). As you design these controls, ask the following question: “Why can we not do this remotely”? (e.g., using physical vs. electronic signatures for supplier contracts) and design in this digital governance for customer facing and internal processes.
- **Rethinking the Workforce:** Near-term efforts have necessarily focused on staff safety, tactical resource management, and team splitting. To position for the future, insurers must start thinking about their workforce strategy including the mix of required skills, where employees need to be (physically) located, incorporating a comprehensive digital upskilling program, instilling remote team leadership skills for all managers, and rethinking career pathways.
- **Redesigning the Operating Model:** Without a doubt, successful insurers will be more digitized, more adaptable, more resilient, and potentially more dispersed post COVID. Beyond organizational structures, you need to define how parts of your company work together and the requisite collaboration, information flows, and infrastructure fidelity.

So to from here? Japanese insurers have already successfully mobilized in the face of COVID-19. The next step is to stabilize operations, and then re-strategize for the future. This should necessarily focus on business models and organizational change. Insurers who can align their COVID-19 response with their long-term strategy will be able to emerge stronger. We encourage you to explore your scenarios and stress-test them and, in doing so, focus on the implications to your strategy over the coming weeks and months.



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Issue: July, 2020

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