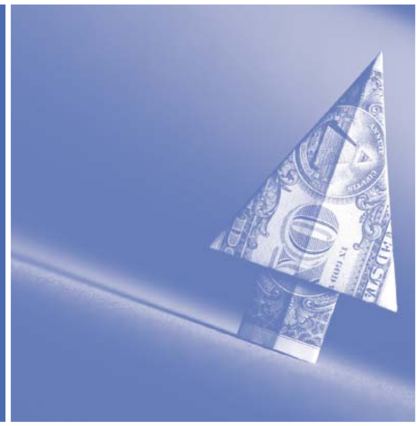
IBM Business Consulting Services

New competitive weapons in the insurance business

Insurance component business modeling



An executive brief

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Introduction

In an environment of increasingly intense competition for consumer mind- and wallet-share, insurers are seeking innovative ways to successfully retain and increase marketshare and grow profitably. New approaches for achieving business objectives and transforming processes and culture are showing real promise for this industry. These approaches are based on component business modeling (CBM), a new way to analyze the business and determine when and where resources should be focused based on where the real value resides. This emerging design methodology and associated tools are being used successfully to rethink fundamentals and introduce profound change. Leaders in the industry who are embracing a CBM assisted transformation are capitalizing on core competencies, realizing major productivity improvements, and significantly reducing costs.

Strategies are being set for differentiation

In today's marketplace, top executives are honing strategies to leverage the scale and capabilities they have achieved through mergers, acquisitions, and alliances. The boardroom is expecting productivity and service level improvements that leapfrog the competition. The pressure is on. The difficulty for most insurance organizations lies in understanding what differentiates their particular, unique organization from the competition.

As industry leaders position themselves to adapt and thrive in an environment of continuous, unpredictable change, a new approach is required to analyze and transform the business. Many companies are turning to CBM or component business modeling. CBM is providing a useful framework for better understanding what an institution has – for identifying the real differentiating assets. And it is an insightful and different way to rethink business models and processes.

A time of exceptional challenges

Unquestionably, it is an exceptionally challenging environment for all insurance businesses. Staying competitive means strengthening and enhancing capabilities while significantly cutting costs. Financial Services companies that are in the insurance business for the long haul are struggling to keep their customers satisfied and loyal and are trying hard to find ways to grow share.

As the competitive landscape has become tougher, insurers have been taking a hard look at what *really* differentiates them from their competitors. They are positioning themselves to adapt and thrive in a dynamic business climate, where customer needs and business partner alliances are subject to quick change.

Many insurance companies are seeing a need to address distribution channels, using a variety of approaches to make agents more effective and productive, and equipping them with skills and tools to sell more complex products. For some, it means integration of multichannel business processes and systems and more effective use of alternate channels.

Industry participants, in attempts to attract third-party distributors, grow market share, and trim cost, are placing more focus on areas such as:

- *Speed-to-market* with innovative products
- More *frequent product introduction*
- *Straight-through processing* to reduce the time it takes to make underwriting decisions and issue policies, because the quicker the response, the more likely the business will be placed with the company
- *Realtime access to up-to-date information* by producers and the company call center staff to make the organization "easy to do business with"
- Significant *reductions in service times*
- More *flexible producer compensation* structures.

An inside look is often revealing

Insurance business processes such as customer acquisition, policy administration, claims and benefits payments, and customer service are heavily dependent on the quality and efficiency of systems and the technology infrastructure. Unfortunately, most companies have new business, policy administration, claims and benefits payments, and producer compensation systems that were implemented in the 1970s and 1980s. As a result of the large number of mergers and acquisitions that have taken place over the years, many companies have multiple systems performing similar functions. There has been relatively little attention paid to consolidating systems or making them work well together. To differentiate and address core systems deficiencies, a number of insurers have developed or taken point solutions that are designed to address a very narrow range of business needs and linked these to existing core legacy systems. While these applications helped the business, many are now constraining the businesses by extending system change times, thus preventing the business from reacting quickly to meet new market challenges. Rapid changes in customer expectations and technology make it extremely difficult for insurance companies to compete in today's environment against both traditional insurers and agile new competitors.

Many insurance companies typically take six months to a year to develop and roll out a new product. In order to stay ahead of, or at least even with, the demands of the increasingly sophisticated and demanding customer set, that time frame needs to be reduced by at least three to four months. Speed-to-market is not just a competitive weapon. It is a survival requirement.

Customer expectations of speedy response for the insurance application and post-issue service process are being shaped by experiences with other financial products such as mortgages. In the life and pensions market, term policies, usually with low margins, constitute more than 50 percent of new business written at many life insurance companies.[1] As face amounts increase to meet the protection and investment needs of today's consumers, more and more underwriting is required, resulting in increased decision times and processing costs. Variable products exacerbate the problem, being more complex and requiring even more producer and company involvement to make the sale. The fact is that new business processing time for life insurance needs to be reduced to two weeks or preferably less. For lower face amounts and lower issue ages that require no medical tests, customers expect a "jet issue" with the policy being delivered two to three days after application submission. Straight-through processing significantly reduces the time it takes to make underwriting decisions and issue policies. The quicker the company's response to the client, the more likely the sale will close. Those organizations unable to make business decisions rapidly will lose out to more nimble market participants.

In the non-life insurance market, there are two key levers for insurers: sustainable, profitable growth and driving down costs. In the past, higher investment returns encouraged insurers to focus on ways of bringing business into the organization and relying on investment income to offset underwriting losses, without having a clear understanding of the core profitability of the business written. Lower investment returns are now driving the need to focus on achieving product profitability through improving process efficiencies and reducing core operational costs.

Because of complex, poorly documented business rules, it is often prohibitively expensive to acquire a book of business and convert the data so that these acquired policies can be serviced with the company's existing systems. With information about policyholders and coverages spread over systems that have been created and modified over the decades, consolidating information and help ensure data consistency across multiple databases has proven to be an elusive goal for most major insurance companies. With the large number of mergers and acquisitions that have taken place over the years, most companies find themselves running multiple systems that perform similar functions, sometimes with different associated business processes. This complicates the requirement for availability of realtime information access by producers and company service centers. Being consumer friendly or "easy to do business with" isn't easy and yet it is an imperative for success. The lack of convenient access to timely, accurate information also makes it difficult if not impossible to make decisions and take actions that impact the bottom line. Think about trying to determine the profitability of a new product by distribution channel without available, accurate and thorough information!

Dramatic improvements are necessary

In a recent global study, IBM asked more than 450 CEOs to identify the most critical imperatives for success in today's economy.[2] Their top responses – to achieve differentiation, responsiveness and efficiency – are a clear endorsement of business fundamentals: strong, differentiated value propositions are critical for growth and profitability; organizations must be able to sense and respond rapidly to customer and marketplace changes; cost structures and business processes must be adapted in a flexible manner to maintain productivity and reduce risk.

As the business environment has become more and more challenging, insurance companies are taking a hard look at their core competencies and placing greater focus on what differentiates them from the competition, paying less attention to, and spending less on, commodity-like functions. They are attempting to move to an on demand environment with variable cost structures that enable them to accommodate fluctuations in market demand and corresponding transaction volumes without a serious impact on profitability.

For most insurance enterprises, this all boils down to facing some tough and sometimes ugly challenges at home. Dramatic improvement in underlying competencies is required – it's about making the basics work and work extremely well, well enough to drive marketplace *differentiation*, well enough to capitalize on *variable cost* options, well enough to provide the *agility* required to exploit market opportunities. This means fixing areas like claims, customer service, underwriting, and policy administration.

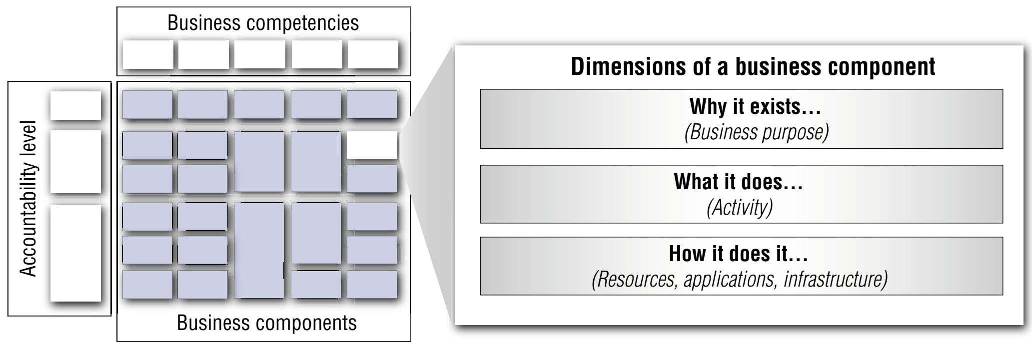
Although product and service silos are still widely prevalent within most financial services institutions, the monolithic view of the enterprise is fading, as is vertical integration. Whether of their own volition, or spurred by new players arriving on the scene with significantly improved value propositions for particular parts of the value chain, companies are beginning to specialize and then turn to others to supplement capabilities that are not core competencies. Since only a few large companies are able to span the full range of products and services in a vertically integrated manner, more firms are focusing on areas where they have comparative advantage. This shift from vertical integration to a network of affiliated institutions means that distributors will own the customer interface while specialists with deep product expertise will be the ones to develop new products based on segment-specific customer insights that the distributors provide. Many firms have moved past the internally integrated design and have learned to work with a few select partners. These "strategically partnered" firms identify key functions along the industry value chain where outside help would be of advantage. They then leverage the low transaction costs of the global connectivity platform to build connections to multiple external specialists. Creating a value network that includes a mix of industry-specific, best-in-class providers, taking advantage of scale efficiencies, and tapping into low-cost labor pools provides the agility, quality, and variable cost structures necessary to compete effectively in this challenging environment.

In this environment of networked affiliates, facilitated by advances in technology, connectivity, and evolving industry standards, the customer will benefit. With access to best-of-breed products available through a variety of distributors and vastly improved service levels, clients will receive a winning proposition of both seamless service and a superior product.

Component business modeling... leading the way

Industry leaders are using CBM to break down traditional business silos. With CBM they are able to map business strategy to business components, identify key areas of competitive differentiation, and understand where there are opportunities to maximize the cost-effectiveness of nonstrategic components. Component business modeling provides a framework for viewing the business as a network of individual components. Once processes and organization are dissected into discrete, understandable, and manageable components, the unique building blocks that make up the company can be identified. Viewing these components autonomously helps decision-makers cut through historical organizational boundaries that have built up through the years, typically along product, channel, customer, geographical, and informational lines. It helps determine when and where resources should be focused. It makes it easier to determine where the real value comes from. It helps define how to source applications. Some may be best provided through existing internal assets or by implementing new systems, while others might be best sourced via commercially available applications packages.

Figure 1. The Component Business Model.



"Component business model"
An enterprise design that aggregates business activities into cohesive and loosely-coupled components that can be shared across a firm.

"Business component"
An individual business module that contains similar activities supported by appropriate assets, such as people and technology

Source: IBM Business Consulting Services.

CBM can be used to drive the business strategy while minimizing operational complexity by:

- Simplifying the business into a set of reusable components while breaking down business silos
- Mapping business strategy to components and identifying key areas of competitive differentiation
- Understanding the opportunities for maximizing the efficiencies of nonstrategic components.

Using a CBM approach helps companies transform their business and achieve their target processing environment. By taking advantage of best-in-class components, regardless of source, a company can be better positioned to react quickly to opportunities and threats.

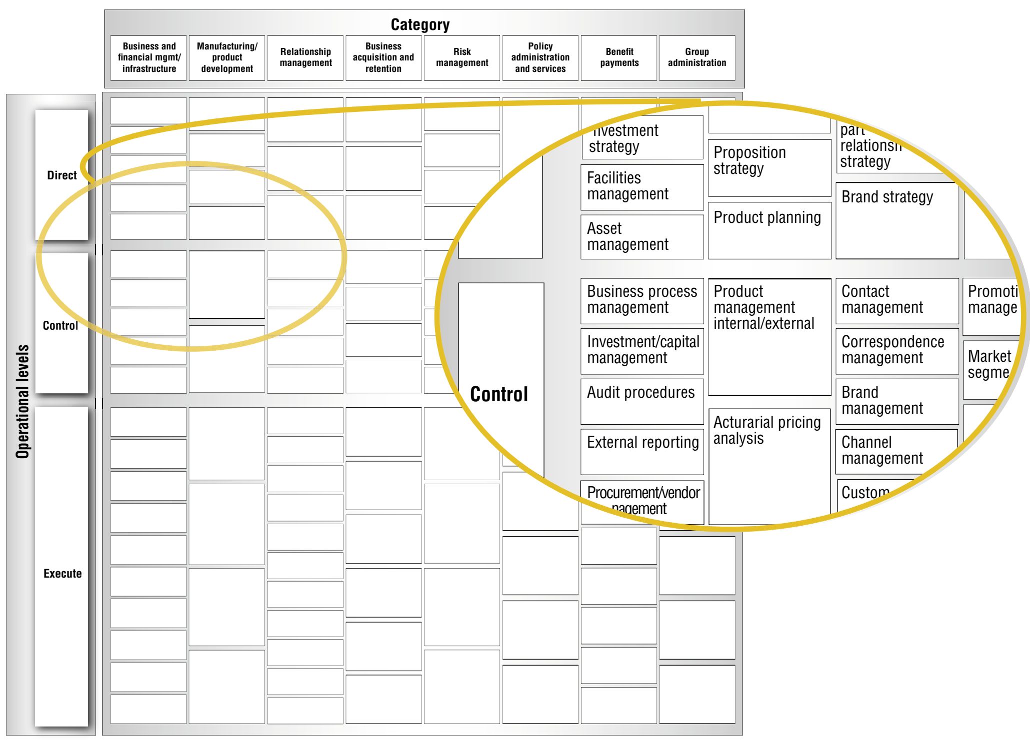
Life and pensions – A typical life and pensions insurance company is organized with line functions grouped into two major entities in addition to corporate functions such as finance and human resources:

- Product manufacturer
- Distributor

Within the *manufacturing* entity, the lines of business (LOBs) are typically aligned by insurance product, so individual life products are supported by one LOB, retirement products by a second LOB, group life by a third LOB, disability products by a fourth LOB, and so on. Within the *distribution* entity, the lines of business are typically organized by channel. Sometimes, the common support functions, such as information technology and call center operations, are duplicated by LOB, although there is increasingly a trend to share these functions across the enterprise. As a result of the organizational structure historically in place, it is common to find duplication of functionality across the business applications and a multiplicity of unique business processes that vary by product and/or distribution channel.

CBM models a business as a network of collaborating, specialized business functions or "business components." Business components are described in terms of activities, organization and supporting technology. CBM seeks two main insights: first, to find sensible groupings of tightly coupled activities that can be optimized as a unit; second, to understand and optimize how these business components work together through a network of information exchange and control, to collectively meet the needs of the business.

Figure 2. Illustrative example of the typical components that comprise a life and pension insurance component business model.



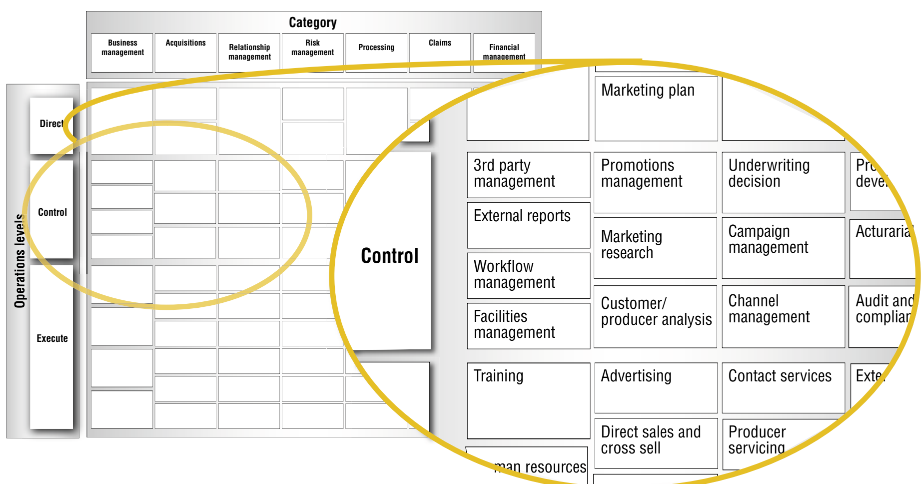
Source: IBM Business Consulting Services.

Using the CBM methodology involves looking at the business by identifying the *unique* and *standalone* set of business building blocks or components, regardless of product or distribution channel. The resulting insurance CBM map can be used to determine the value contribution provided by a component.

Non-life – Non-life insurers today typically operate with a vertically integrated business model with Distribution, Manufacturing, Processing Operations, Risk and Financial Management and Technology Management each reporting to a different executive, with duplication of function in systems supporting each area. The complexity of this model makes it extremely difficult for insurers to make material reductions in the cost base.

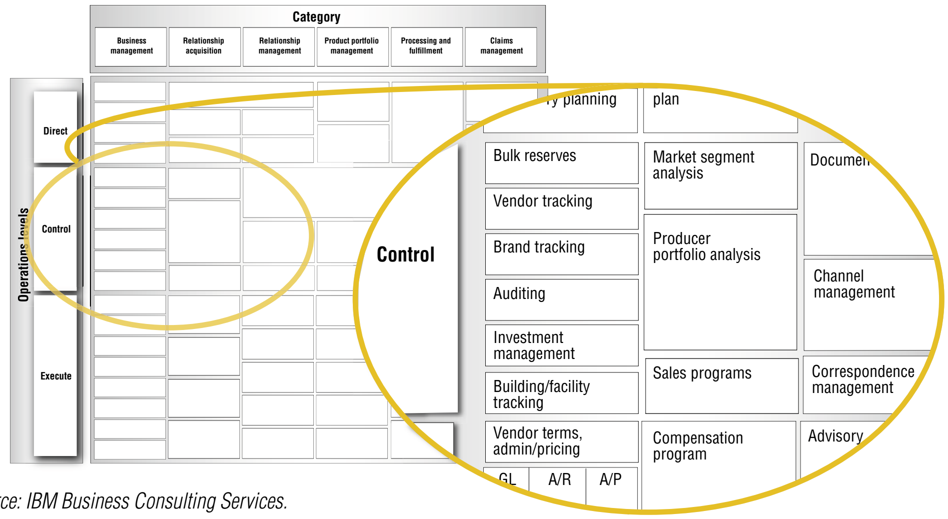
Given the financial challenges of today's business climate, insurers cannot afford to have capabilities duplicated across product silos, with each product operating its own processes, product-specific channels, and systems. Through the use of CBM, insurers are able to analyze their businesses and the competencies required, to assess and understand what components are unique and standalone versus those that are shared, and identify components that are currently contributing to operational and cost constraints.

Figure 3. Illustrative example of the typical components that comprise a non-life commercial lines insurance component business model.



Source: IBM Business Consulting Services.

Figure 4. Illustrative example of the typical components that comprise a non-life personal lines insurance component business model.



Source: IBM Business Consulting Services.

As can be seen from the examples in Figures 3 and 4, there are differences in the competencies required to operate the commercial lines and personal lines businesses. There are, however, a number of areas where competencies could overlap and opportunities to consolidate could be realized.

CBM methodology

CBM provides a structured framework that is designed to identify gaps, determine investment opportunities, and identify critical initiatives to implement for value creation.

CBM projects involve three phases:

- *Insight* – During this phase, a business component model is developed for the enterprise. The building blocks of the organization are defined. The firm is viewed or modeled as a network of collaborating components. Areas of opportunity are identified.
- *Reengineer and rethink* – In this “architecture” phase, the business is assessed and technology gaps are analyzed. The value contribution of each component is determined and the key differentiating components are identified.
- *Implement* – In this step, opportunities are prioritized and a transformation plan or roadmap is developed. Detailed business cases are built for each opportunity so investments can be intelligently prioritized.

The CBM methodology and architecture also links to a broad range of accelerators developed by IBM consulting teams. These accelerators have been proven to shorten implementation time, improve quality, reduce risk, and accelerate benefits. They are specific to the insurance industry and are comprised of:

- *Reusable knowledge capital* that will help jump-start projects including requirement templates, process models, integration specifications, and insurance data models.
- *Component designs* to assist in the development of a Web-front end or systems integration. There is also a toolset provided around our insurance models that includes:
  - Key performance indicators by business process
  - Suggested organization design and staffing levels based on business transaction volumes and product complexity
  - Detailed functional specifications
  - Several predefined Use Cases that can be used to "jump-start" the documentation of business requirements needed for building the application/system components
  - User interface design documents
  - Application and technical reference architecture diagrams
  - Nonfunctional requirements
- *Community of technology partners* that have worked with IBM to streamline the implementation approach.
- *Proven architectures and methodologies* tailored to the insurance industry, including the IBM Insurance Application Architecture.
- *Experienced people* who have successfully implemented insurance solutions. These subject matter experts have knowledge of the details of insurance business processing and management and are able to evaluate leading vendor solutions for illustrations and new business processing, policy administration, claims, workflow automation products, and other various popular software package options.
- *Solution centers* to demonstrate solution approaches and assist in establishing a potential end-state for clients.

Benefits of component business modeling

Companies that are using the component business modeling framework are finding that the effort leads to benefits beyond what was initially anticipated. CBM makes people think differently about the business. It forces people to view the business from a new perspective. For many organizations, it has instigated a call for real change. It has provided a rallying point for transformation.

As key players around the world set strategies for differentiation, they are pursuing CBM-based change to help expose the true sources of value and to drive improvements. In addition to serving as a means for aligning business and IT strategies and priorities, use of CBM is prompting greater appreciation and cohesion among the various parts of the business. Modeling a business as a network of components can lead to improvements in three critical areas: efficiency, strategic planning, and flexibility. The resulting component map can be used to rationalize processes, organization, and technology; to identify duplicate functions; to pinpoint functions that could be automated; and to assess the value contribution of each component. Legacy transformation can be initiated around variable cost models. This is particularly useful for companies that have grown rapidly through a series of mergers and acquisitions; companies faced with reconciling multiple platforms; companies with dispersed and decentralized systems; companies that are typical of the insurance and financial services industry profile – composed of a hodgepodge of disparate systems, redundant function, disjointed operations, and inconsistent service levels.

Insurance companies around the world tap into only a fraction of their customers' total revenue potential and have been known to consistently lose a portion of their customer base each year. But, as an insurer is able to focus on the customer segments it is best equipped to serve and becomes more responsive to those customers' needs, customer defection will likely dissipate. How would your company's revenue be impacted if you could double your consumer wallet-share penetration and reduce your attrition by half?

In some insurance companies, certain high-cost, recurring processes, like new insurance application input, may be replicated across several distribution channels, each with its own set of forms and its own processes. These processes often operate with disparate systems and yield varying degrees of performance across business units. What savings might be generated if you could consolidate redundant systems and processes into a single set of enterprisewide components with no duplication of functions?

Typically, more than 75 percent of large insurance companies say that their legacy systems require unacceptably high maintenance costs which can directly effect their ability to adequately fund new investments.[3] What kind of differentiating technology could you invest in if you were able to reduce IT maintenance costs by 20 percent or more? And, what if 40 percent to 50 percent of your remaining IT cost was variable and based on actual usage?

The bottom line

Companies can eliminate duplicate business processes and achieve organizational realignment by leveraging component-based methodologies.

Insurance companies that use the CBM approach to move to an on demand operating structure are able to offer their customers a superior value proposition. Being a *focused* insurance company means being able to provide distinctive products and services that customers will value, able to target the right customers, and able to concentrate on developing a deep understanding of that segment's needs. Customers of a *responsive* insurance company can interface with sales and service personnel seamlessly through multiple channels. Cycle time is reduced and customers wait less. And, an on demand insurance company with a variable cost structure can share its savings with customers through more attractively priced products.

Insurance company business transformation is a major undertaking. To significantly improve success rates, it is important to capitalize on the experience and expertise of a business partner who has in-depth knowledge of insurance products and proven transformational methodologies and approaches for the insurance business.

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With consultants and professional staff in more than 160 countries globally, IBM Business Consulting Services provides clients with business process and industry expertise, a deep understanding of technology solutions that address specific industry issues, and the ability to design, build and run those solutions in a way that delivers bottom-line business value.

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