

Better, faster, cheaper? Business process transformation in the insurance industry



**An Economist Intelligence Unit white paper
sponsored by EDS**



Preface

Better, faster, cheaper: Business process transformation in the insurance industry is an Economist Intelligence Unit white paper, sponsored by EDS. The Economist Intelligence Unit bears sole responsibility for the content of this report. The main author was Aviva Freudmann and the editor Simon Tilford. The findings and views expressed in this white paper do not necessarily reflect the views of EDS, which has sponsored the publication in the interests of informed debate. It is based on the following research activities.

- The Economist Intelligence Unit conducted a wide-ranging global survey of 49 senior executives of insurance companies about their organisations' plans for business processes.
- To supplement the survey results, the Economist Intelligence Unit conducted in-depth interviews with six senior executives of insurance companies worldwide.

July 2005



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Executive summary

Intense competition is driving a growing number of insurers to take a closer look at the way they manage business processing. Insurers' cost structures have traditionally been higher than those of banks, because of a proliferation of legacy systems, the use of labour-intensive networks of agents and brokers to sell products, and the ubiquity of paper-based processing of underwriting and claims. Mounting competition from low-cost direct providers, which distribute products and service accounts by telephone and internet and often base themselves in low-cost countries, means that the expensive cost structures of established players are no longer sustainable. In addition, regulatory demands in Europe and the US for improved transparency and internal controls are driving a re-examination of internal systems.

Insurers are creating tighter links among departments and reorganising business services along process lines. They are looking at which of their business processes are core to their business—and therefore should be kept in-house—and which are non-core and are thus candidates for partial or full outsourcing. So far they have mostly opted to place processes in internally shared service centres, but over the next few years they are expected to adopt more ambitious restructuring strategies, including outsourcing to offshore third parties and offshoring to subsidiaries abroad.

Based on a survey of 49 insurers worldwide and a programme of in-depth interviews with business leaders and industry analysts, this briefing paper looks at the dynamics of successful reorganisation in the insurance industry and draws a number of conclusions.

● **The drive for greater scale.** More often than not, reconfiguring business process typically means centralising processes in an internally shared service. Three-fifths of the survey respondents already employ these, and the proportion is set to rise to over 90% in three years' time, while over 70% plan to be outsourcing to a local third party. Moreover, almost half of the insurers surveyed expect to send work to third parties offshore within three years—only investment banks are more open to this strategy—whereas almost one-third expect to be offshoring to company-owned facilities.

● **Core activities are kept in-house.** Insurers remain wary of outsourcing higher-value-added processes such as underwriting or marketing and distribution activities. Indeed, just 26% of insurers see outsourcing as the appropriate strategy for claims processing, despite the fact that this is one of the most routine functions they perform. According to the survey results just 4% of insurance companies currently outsource marketing functions, compared with 15% of financial companies as a whole and 25% of retail banks.

● **Geographic variations.** There are big differences in the attitudes of North American and west European insurers to outsourcing and offshoring the processing of business services. Just one-quarter of European insurers plan to be offshoring to third parties abroad within three years compared with 65% of their North American counterparts. Contrasting attitudes to offshoring are starker still, with just 8% of European insurers expecting to pursue this strategy in three

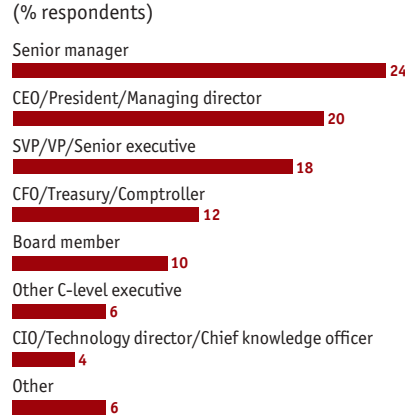


Who took the survey?

A total of 49 senior executives participated in the Economist Intelligence Unit's survey. Almost three-quarters were C-level executives or board members; the remainder were senior managers.

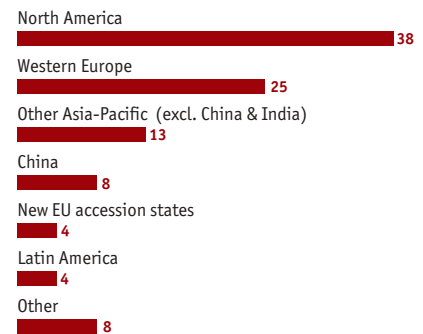
Nearly half the companies surveyed have a market capitalisation in excess of US\$1bn and 20% in excess of US\$8bn. Responses were drawn from a wide range of geographies, but western Europe and North America accounted for over 60% of the survey.

Which of the following best describes your title? (% respondents)



Source: Economist Intelligence Unit, 2005

Where is your company headquartered? (% respondents)



Source: Economist Intelligence Unit, 2005

years' time, compared with one-third of North American insurers.

● **New competitors.** In the race to offer streamlined, low-cost services to customers, so-called direct insurers—which concentrate on delivering services via telephone and the Internet without the expense of networks of sales agents and brokers to distribute their products—have a competitive advantage. They are not burdened by costly legacy systems and are more able to

use the cheaper processing options afforded by outsourcing and offshoring.

After lagging behind other financial services companies, such as retail banks, insurers are now moving quickly to streamline their business processes by removing duplication and automating as many steps as possible. However, the challenges are daunting and established players will have to move quickly if they are to remain competitive against new entrants with much lower-cost business models.



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Drivers of change

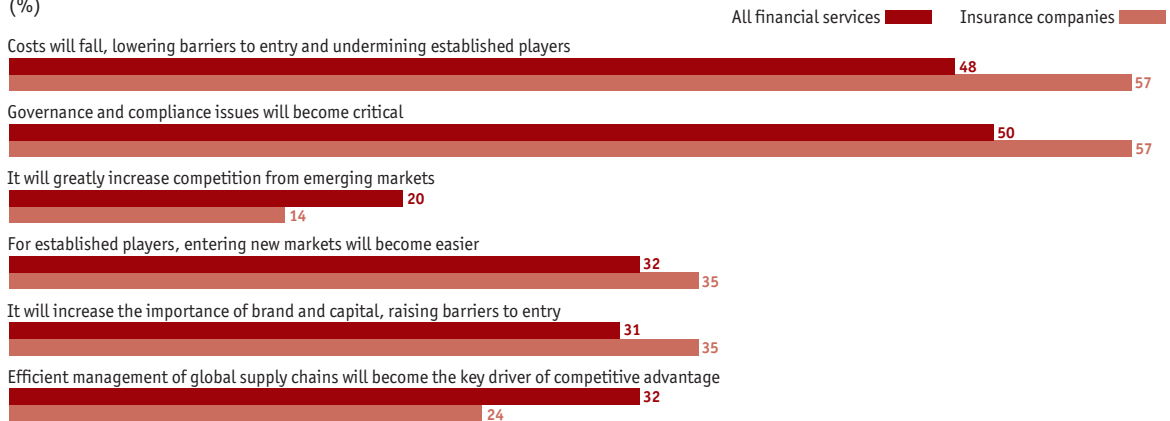
Insurance companies face a number of challenges to their profitability. The sector's cost structure is high as a result of its reliance on expensive networks of sales agents and brokers to distribute products, and on paper-based systems to process new policy accounts and claims for coverage. At the same time, the industry is facing new demands for transparency and improved internal controls, for which such paper-based systems are inadequate. For example, new capital-adequacy requirements taking shape in Europe under the Solvency II directive will require more sophisticated internal controls on underwriting and operations, while new transparency requirements introduced in the US, following the discovery of questionable sales practices in the insurance brokerage business, will also require reform of existing internal systems. Moreover, at a time when the lines between insurance and banking are

becoming blurred, insurers are going to have to match the lower-cost structures of their competitors in the banking industry.

As a result of all these trends, they have—somewhat belatedly—started to examine their management for enterprise-wide services such as human resources, front-office functions such as sales and customer service, and back-office functions such as underwriting, policy renewals and claims administration. As a result of intensifying competition, especially from new Internet-based providers and retailers, over two-thirds of insurers expect reducing the unit cost of business processes to be their biggest challenge in five years' time. Those that have already done so report dramatic improvements in cost effectiveness. According to Etienne Aubourg, head of information technology (IT) outsourcing at Axa, a French insurance and fund-

What will be the biggest changes to the competitive landscape of the financial services industry brought on by business process outsourcing?

(%)

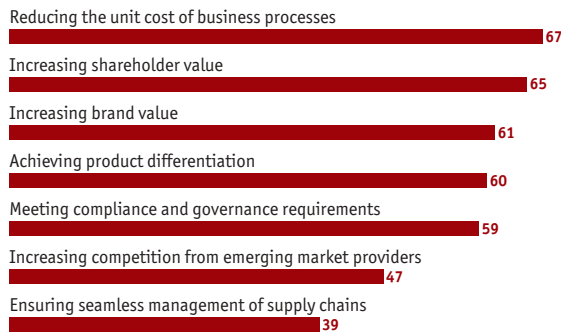


Source: Economist Intelligence Unit, 2005



How significant do you think the following challenges will be to your organisation in five years' time?

Extremely or very challenging (%)



Source: Economist Intelligence Unit, 2005

management company, the industry's sustained period of depressed investment income and poor underwriting results in the early 2000s "was a wake up call and gave us an opportunity to tackle real issues."

Shared utilities

Insurers chose internally shared services utilities—particularly those located in the home country—as their preferred method for streamlining business processes. These centralise the processing of similar

Which of the following strategies is, or would be, the most effective in improving the efficiency of your organisation's business services?

Insurance companies (%)



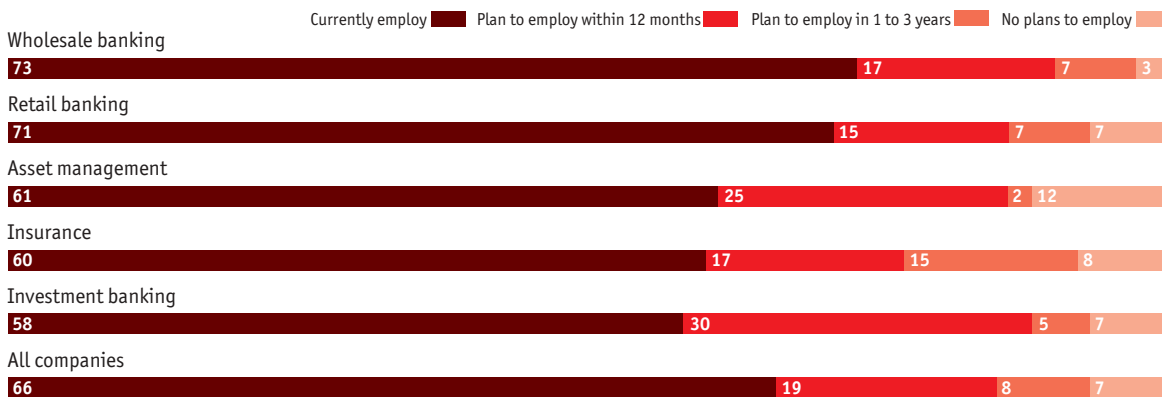
Source: Economist Intelligence Unit, 2005

transactions from all, or most parts, of a company, thereby driving down unit costs, encouraging standardisation and boosting productivity. About 40% of respondents named internally shared services as the most effective strategy for transforming business processes, compared with 26% who opted for offshoring either to a subsidiary or a facility owned by a third-party.

In terms of the strategies in place, 60% of respondents already use internally shared services, and over 90% plan to be doing so in three years' time. One company that has established an internally shared services centre is Axa, which is consolidating its IT infrastructure and operations into a central shared

Do you currently employ internally shared services or do you plan to over the following time periods?

(% respondents)



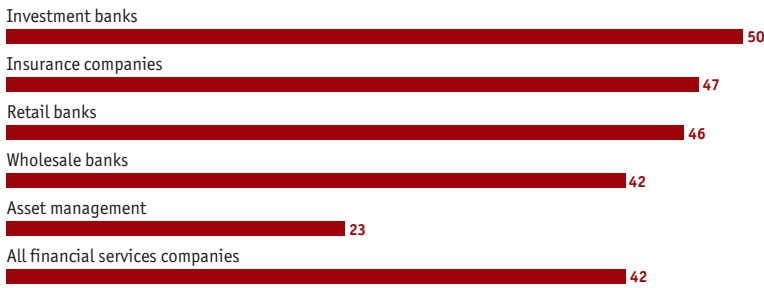
Source: Economist Intelligence Unit, 2005



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How significant a change will increasing competition from emerging market providers be to your organisation in five years' time? Extremely or very significant (%)



Source: Economist Intelligence Unit, 2005

centre called Axa Tech. "We are trying to reduce complexity by having standard infrastructure," said Mr Aubourg. "Over time, Axa added many new applications and created a lot of complexity, which we have to clean up. This costs money, but we found that standardisation increases productivity and quality."

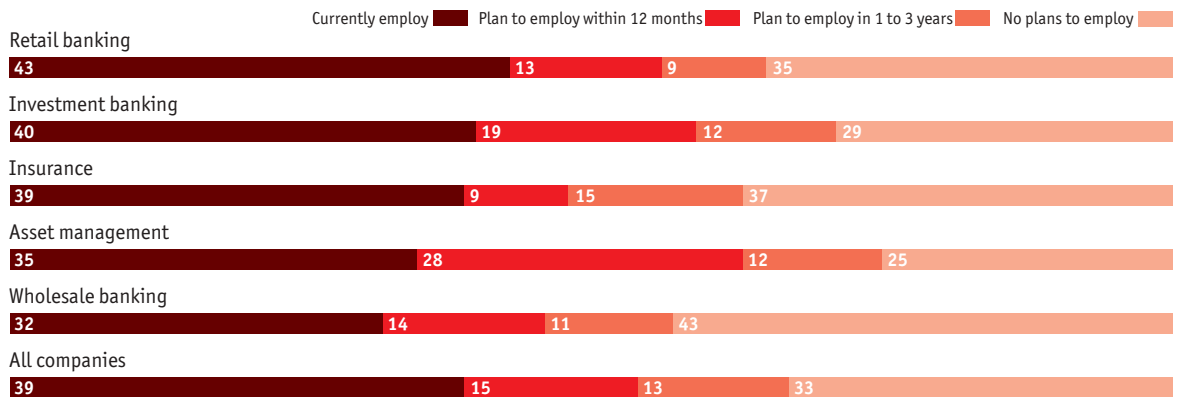
An illustration of the changes that Axa has made is provided by its subsidiary in Germany. This was experiencing a low renewal rate on quotations requested by customers when their policies expired. Research showed that customers expected to receive a quotation within three days of policy expiration, but

that fewer than 40% of quotations were received within that period. By redesigning and simplifying the quotation process, the company was able to ensure that all quotations went out within three days of policies expiring. The company reported that renewals subsequently increased significantly.

In addition to cutting the unit cost of transactions, insurers are looking to business process transformation as a way to upgrade customer service, with 40% of the companies surveyed seeing the need to provide seamless delivery of services as a principal challenge. For example, many insurers are reconfiguring their systems to provide a single point of contact for customers filing claims. The emphasis on seamless management of supply chains is a response to competition from direct providers and from competitors based in emerging markets offering round-the-clock, automated services.

Often the first step in using a shared services centre, whether internal or external, is to centralise document management. Kotak Mahindra Old Mutual Life Insurance, an Indian insurance company, has taken the first steps in this direction. "At the moment, documents from various branch offices are being sent to the head office in Mumbai, where they are

Do you currently employ externally shared services or do you plan to over the following time periods? (% respondents)



Source: Economist Intelligence Unit, 2005



scanned,” said Mr G Murlidhar, the company’s Chief Financial Officer (CFO). “The scanned documents are then fed electronically to a data management centre, which is run by a third party, which stores and retrieves the data. We have just launched a pilot project for six branches that will improve on the current system. The six branches will feed the documents electronically direct to the data management centre.”

Externally shared utilities—separate entities that provide services to unrelated companies—are also gradually making inroads into the insurance industry. This concept already operates successfully in the retail banking industry, where companies link their systems into shared electronic payments systems such as SWIFT, joint cheque-clearing platforms, and systems for multilateral clearing and settlement of securities transactions.

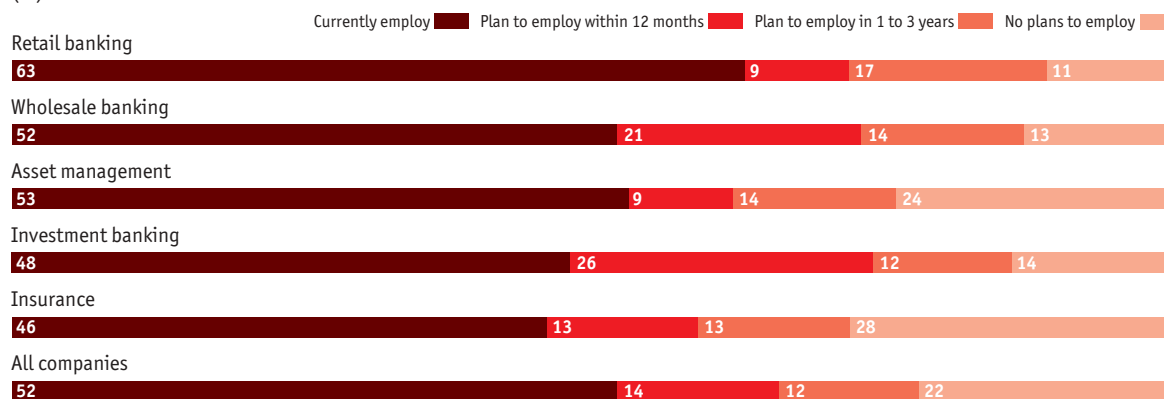
One such example is provided by Lloyd’s of London, which established Kinnect, an electronic platform that exchanges risk data and wordings between brokers and underwriters on the London market. Although successful, it illustrates the difficulties of establishing externally shared utilities in the insurance industry. “One of the reasons that computerisation has not

advanced very far in the insurance sector is because of the plethora of different business processes,” said Iain Saville, head of business process reform at Lloyds of London. “Since the market has lots of one-to-many interactions, the challenge is to get enough pattern into the process so that it’s worth anyone’s time to impose a structured work flow. There is not the prior agreement to harmonise and standardise processes and to structure the data so that you can then say, now I can manage this process better through a decent electronic workflow management system.”

Outsourcing and offshoring

Insurance companies are less willing than other financial services providers to outsource business processes to local third-party providers. According to the survey results, just 46% of insurers currently do so compared with 63% of retail banks. One reason for insurers’ greater reluctance to employ this strategy is almost certainly the result of the insurance industry having been relatively protected from competition in clearly segmented national markets. However, with the competitive landscape of the insurance industry changing fast, insurers are now starting to embrace

Do you currently outsource to a third party locally or do you plan to over the following time periods?
(%)



Source: Economist Intelligence Unit, 2005



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outsourcing, with over 70% planning to do so to a local third party within three years.

There is little indication of insurers outsourcing anything other than low-valued-added activities. Just 26% see outsourcing as the appropriate strategy for claims processing, despite the fact that this is one of the most routine functions performed by insurers. Indeed, compared with other financial services companies such as retail banks, insurers tend view more of their business processes as core to their business and, therefore, unsuitable for outsourcing. Mr Murlidhar, of Kotak Mahindra Old Mutual Life Insurance, explains where his company draws the line between core and non-core functions: “in a business such as insurance, core functions like underwriting

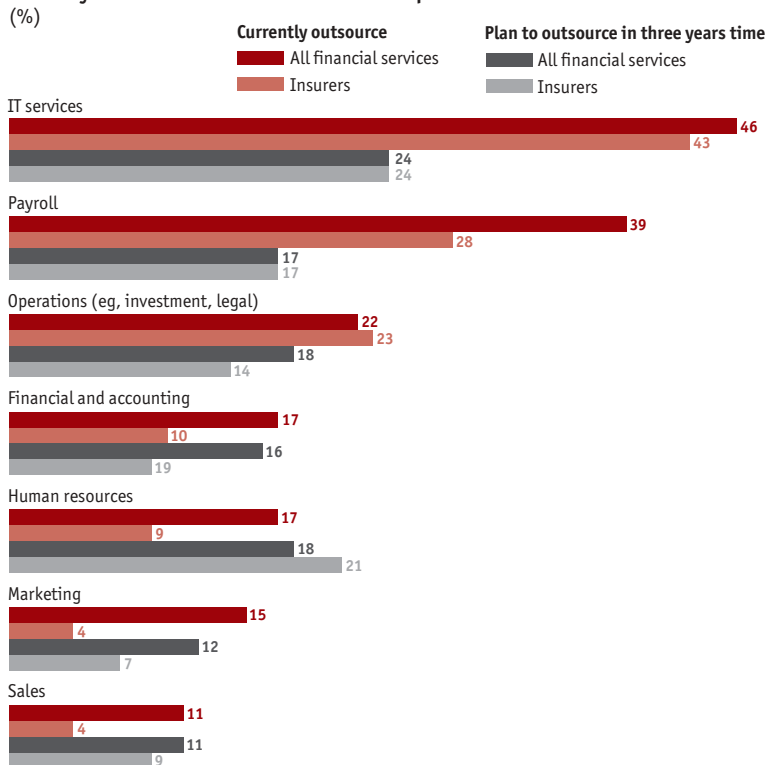
and essential elements of customer care have to be handled and controlled by us internally and cannot be outsourced. Thus, we are looking at increasing efficiencies in these services internally. However, low-end work like data-capture and simple calls are outsourced to a third party, which also runs our data-management centre. It handles simple questions such as the surrender value of policies and paid-up amounts.”

Insurers are also more sceptical than other financial services companies of the merits of outsourcing enterprise business services. According to the survey results just 4% of insurers currently outsource marketing functions compared with 15% of financial companies as a whole and 25% of retail banks. Moreover, there is no indication of this changing, with just 7% of insurers planning to outsource marketing over the next three years. Jon Bradbury, CFO of Winterthur Life Hong Kong, explains: “our business depends on retaining customers, so outsourcing distribution and marketing functions is extremely risky”. While distribution and marketing remain in-house, the company has outsourced various IT functions.

Much of the publicity surrounding business process transformation—for insurance as for other types of companies—concerns offshoring: sending work to lower-cost countries. According to the survey results insurers do plan to shift work offshore, either to third-party providers, or to foreign facilities. Almost half expect to send work to third parties offshore within three years—only investment banks are more open to this strategy—whereas almost one-third intend to be offshoring to company-owned facilities.

Breaking the survey results down by geographic region reveals huge variations in attitudes towards outsourcing and offshoring. North American insurers are much more open to these strategies than their European counterparts. Just one-quarter of west European insurers will outsource to third parties

Which of the following enterprise business services does your organisation currently outsource and which does it have no plans to outsource?

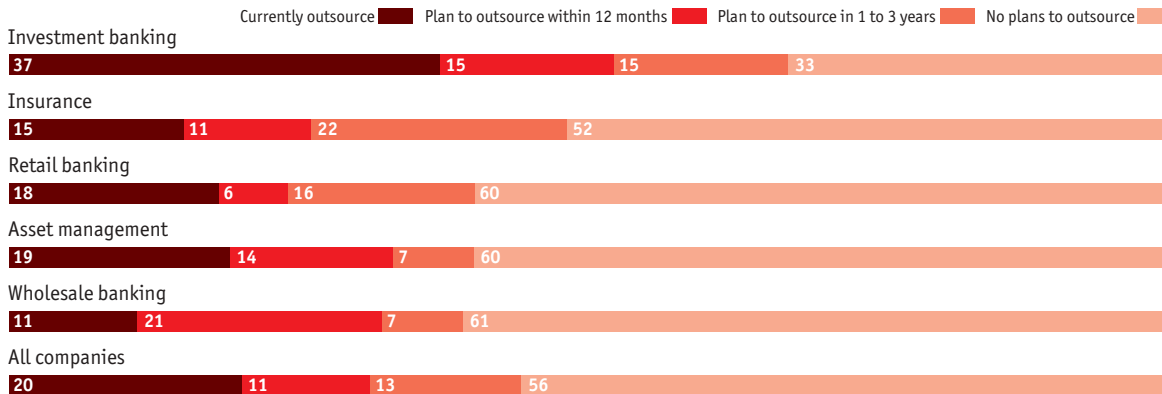


Source: Economist Intelligence Unit, 2005



Outsourcing by industry

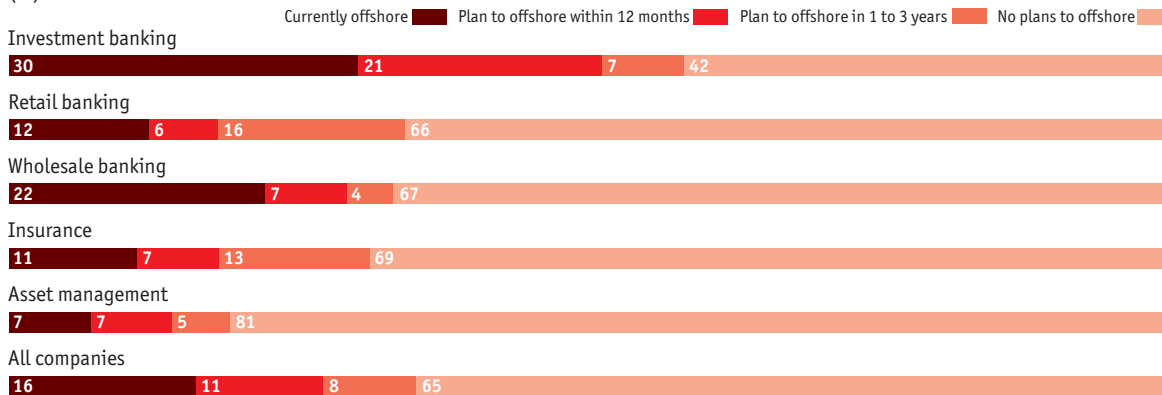
Do you currently outsource to a third party offshore or do you plan to over the following time periods?
(%)



Source: Economist Intelligence Unit, 2005

Offshoring by industry

Do you currently offshore business services to a subsidiary abroad or do you plan to over the following time periods?
(%)



Source: Economist Intelligence Unit, 2005

abroad within the next three years compared with 65% of North American insurers. Contrasting attitudes to offshoring are equally stark, with just 8% of west European insurers planning to offshore, compared with over one-third of North American ones.

The survey suggests a number of reasons for the differing attitudes of west European and North American insurers. Fully 92% of west European insurers cite reputational risk as a factor in determining where to locate outsourced activity,

compared with 82% of North American ones. Indeed, European companies often experience negative public relations when they announce plans to move jobs offshore, with Prudential Assurance in the UK being one such example. "There was very adverse commentary in the press when we first announced we were moving jobs to India in 2002," says Steve Ferrari, service development director for the UK and Europe. "Moreover, last year there were lots of stories in the press about poor quality of service in offshore call

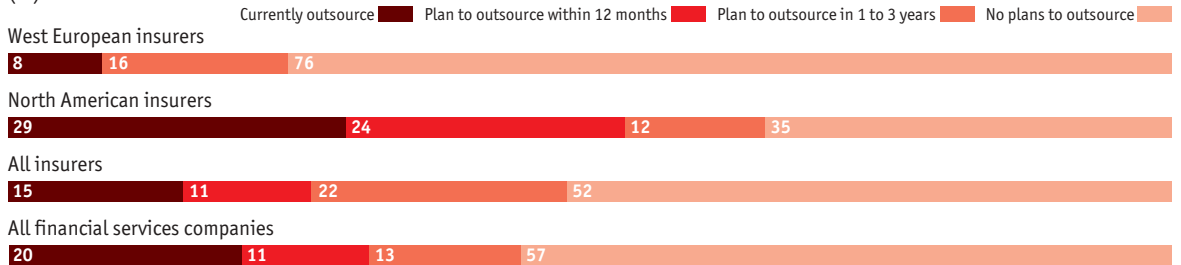


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Outsourcing by geography

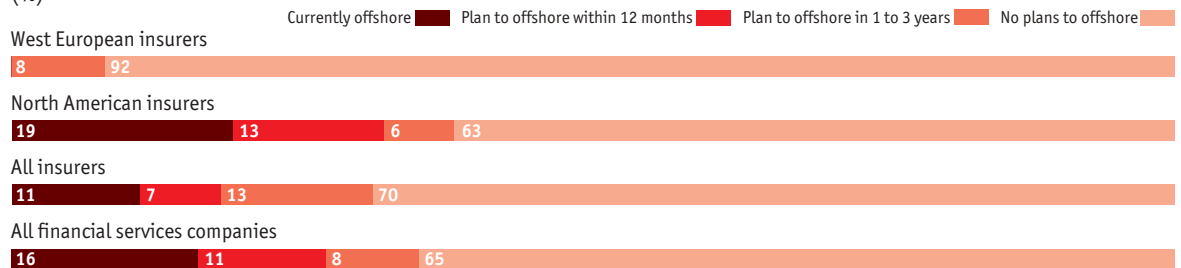
Do you currently outsource business processes to an offshore third party provider and do you plan to do so over the following time periods? (%)



Source: Economist Intelligence Unit, 2005

Offshoring by geography

Do you currently offshore business processes or do you plan to do so over the following time periods? (%)



Source: Economist Intelligence Unit, 2005

centres, although we have been happy with the quality of the work done at our Mumbai centre.”

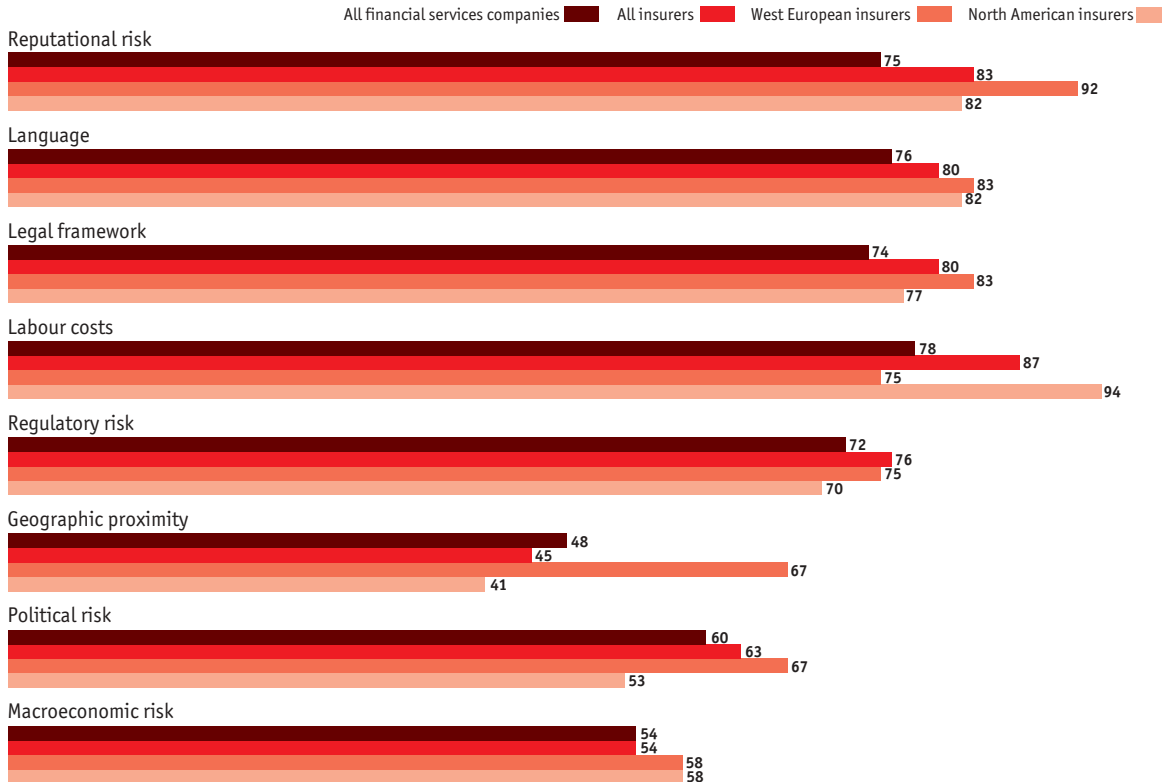
Another reason for the reluctance of west European insurers, at least continental ones, to shift activity to low-cost locations, is language barriers. It is easier for US and Canadian companies to outsource work to English-speaking India, for example, than it is for continental European insurers serving local markets in Europe. This is illustrated by the importance that west European insurers place on geographic proximity when deciding where to locate activity. (On this point there is a split within Europe, with UK insurers being far less concerned about ensuring that outsourced activities are kept close to home.) It is also likely that labour market regulation in Europe—which inhibits

large-scale transfer of jobs offshore—and stricter data-privacy laws in the EU than in North America provide further explanations.

Nevertheless, perhaps the most important reason for the slowness of west European insurers to outsource and offshore abroad is that their business processing is not yet sufficiently organised internally to make outsourcing or offshoring a realistic strategy. Lloyds of London, which is trying to introduce common standards for electronic data exchange among brokers and underwriters on the London market, says there is still a long way to go. “At present, claims in the London market typically involve a broker and an underwriter swapping pieces of paper,” said Mr Saville. “It would make much more sense to start the claims-



How important are the following factors to your organisation in determining where to locate outsourced activity?
(%)



Source: Economist Intelligence Unit, 2005

handling process by submitting an electronic file, and then allowing everyone with authorisation to see it electronically.”

There may be risks to outsourcing and offshoring—but there are also risks in not doing so. By failing to leverage cheaper, and often more flexible labour, in low-cost locations, insurers could place themselves at disadvantage. The example of Royal & Sun Alliance, a UK insurer, certainly suggests so. It decided to outsource work to a third-party provider, which runs

call centre and software development operations in India, and has no concerns about the offshore location of the service provider. According to Tony Chaudhry, the company’s infrastructure director, “we have a mix of onshore and offshore software developers and call centre employees. In both cases, we view the Indian operation as just an extension of UK operations, even though they are run by a third-party provider. We expect the arrangement to help us improve both quality and productivity.”



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Conclusion

Enhanced profitability and improved service are key drivers of moves to re-engineer business processes, but insurers are also responding to a third imperative: compliance with changing regulations concerning transparency and financial reporting. All three factors are leading insurers to look closely at how they can make their management of business processes more efficient, abandoning legacy systems and cumbersome paper-based practices in favour of automated and streamlined processing.

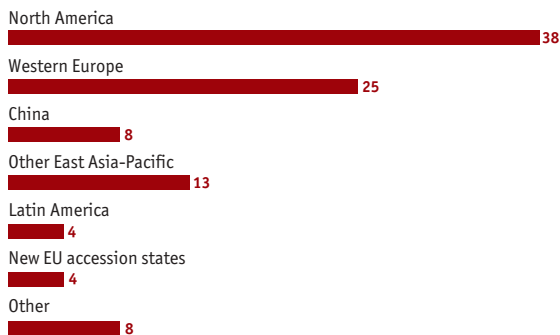
As more insurers re-engineer their business processes through expanding their use of internally shared services, participating in externally shared utilities and outsourcing, the insurance industry will become more efficient. However, it will also become more competitive, as new entrants with low-cost business models and unencumbered by inefficient legacy systems cut the cost of insurance services. Only the fastest-moving among the established players will flourish in this environment.

Appendix: Survey results

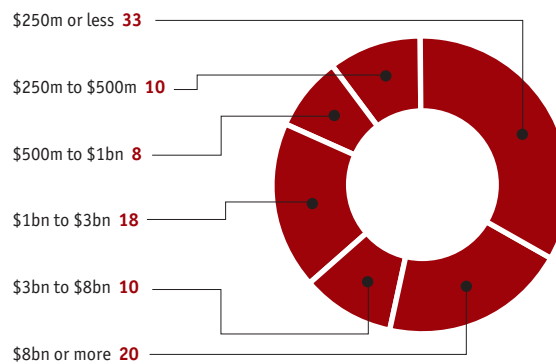
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A total of 57 senior executives participated in our online survey on business process transformation in the insurance industry. The survey was conducted between March and April 2005, and our thanks are due to all those who shared their time and insights.

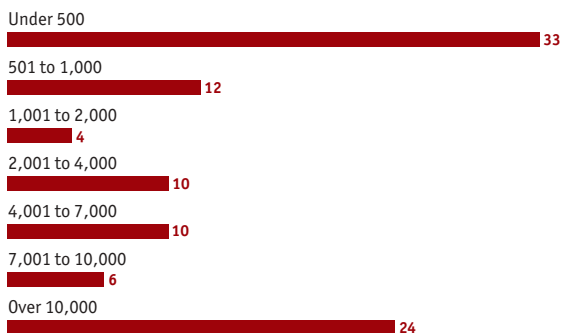
Where is your company headquartered? (% respondents)



What are your organisation's global annual revenues in US dollars? (% respondents)



How many employees does your organisation have? (% respondents)



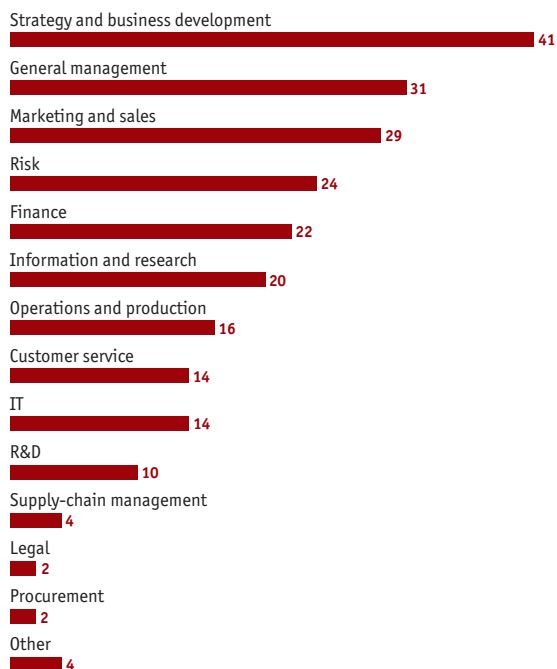
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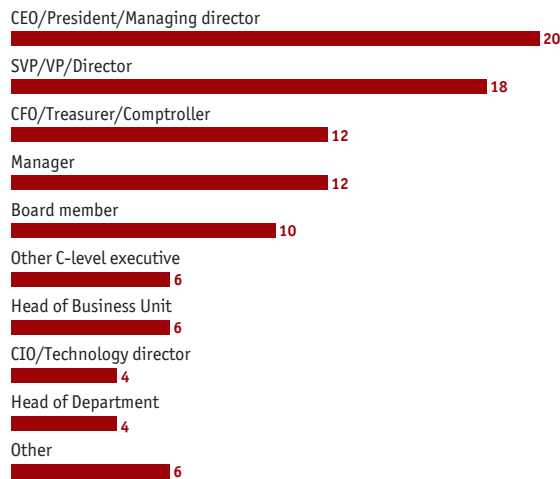
What are your main functional roles? Please choose no more than 3 functions.

(% respondents)



Which of the following best describes your title?

(% respondents)



How significant do you think the following challenges will be to your organisation in five years' time?

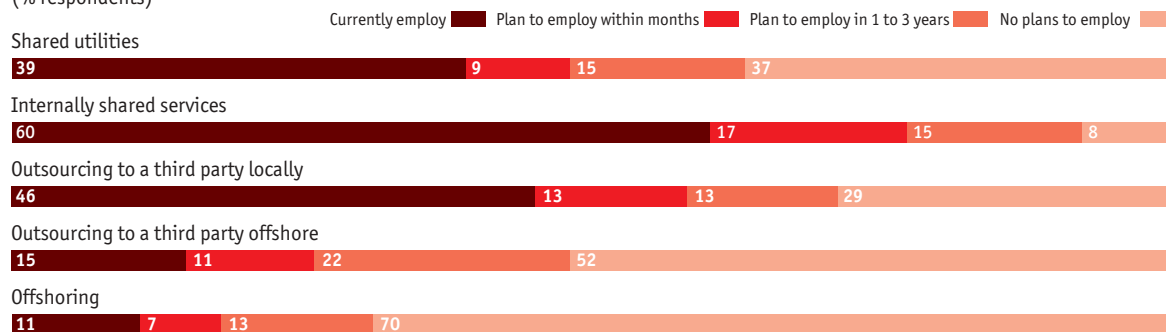
Rate on a scale of 1 to 5, where 1=extremely challenging and 5=not a challenge.

(% respondents)



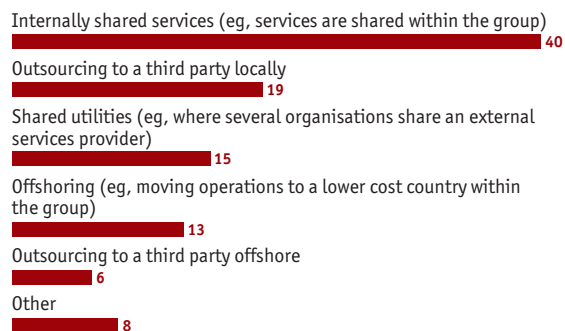
Which of the following strategies for optimising business processes does your organisation currently employ and which does it plan to employ?

(% respondents)



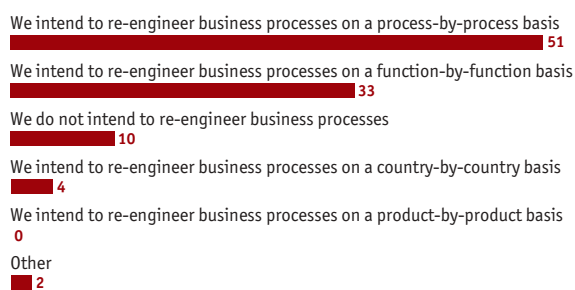
Which of the following strategies is, or would be, most effective in improving the efficiency of your organisation's business services?

(% respondents)



Which of the following statements best describes your organisation's plans to re-engineer business processes?

(% respondents)



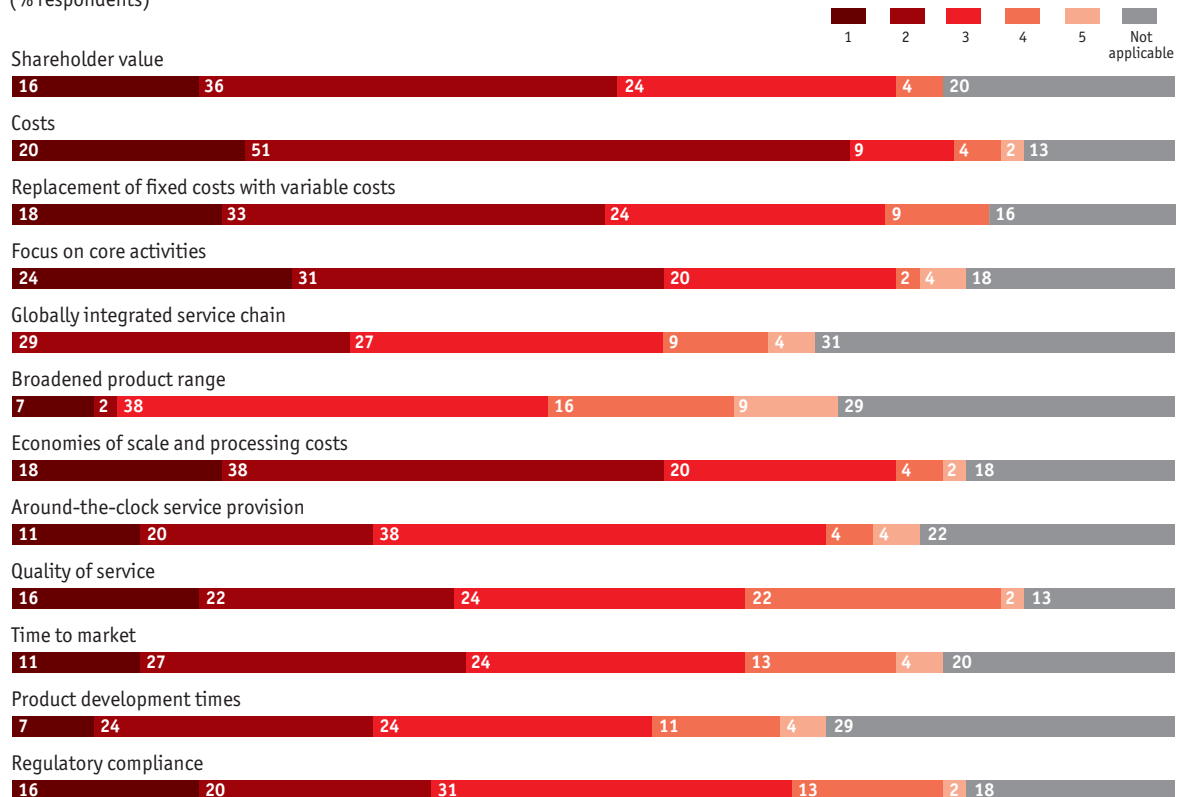
Appendix: Survey results

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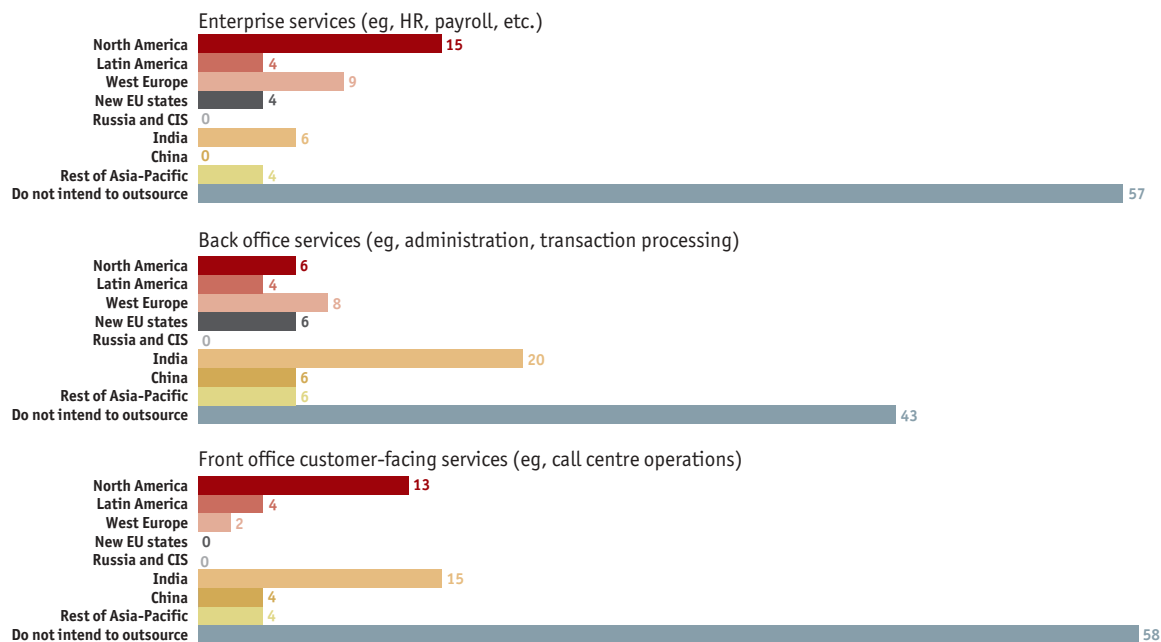
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If your organisation uses, or plans to use, business process outsourcing, how do you expect the following factors to be affected over the next five years? Rate each on a scale of 1 to 5, where 1=strong beneficial impact and 5=strong negative impact.

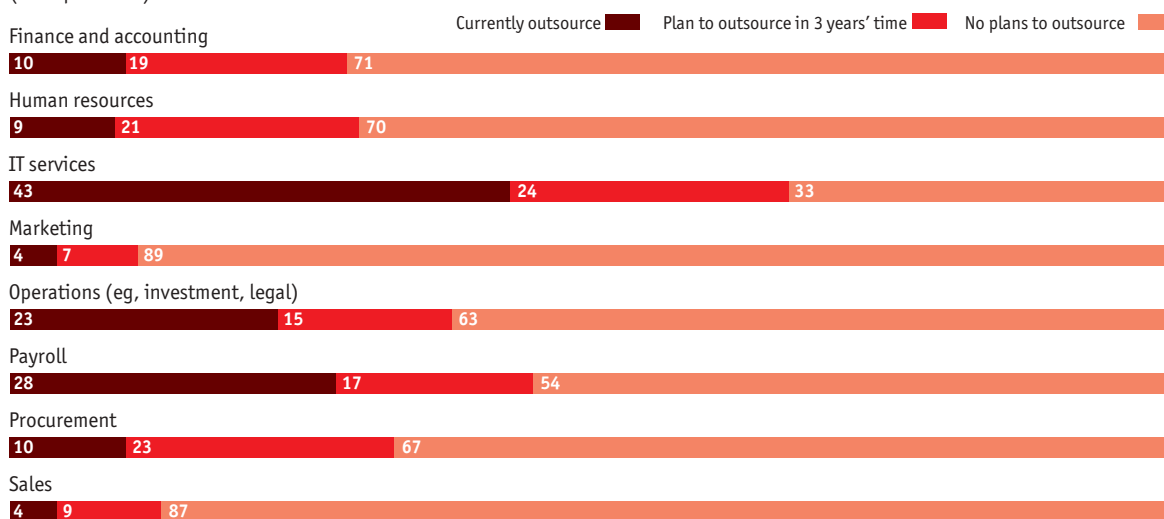
(% respondents)



Which business processes and services does your organisation feel comfortable outsourcing to the following countries/regions?
(% respondents)



Which of the following enterprise business services does your organisation currently outsource and which does it plan to outsource in three years' time?
(% respondents)



Appendix: Survey results

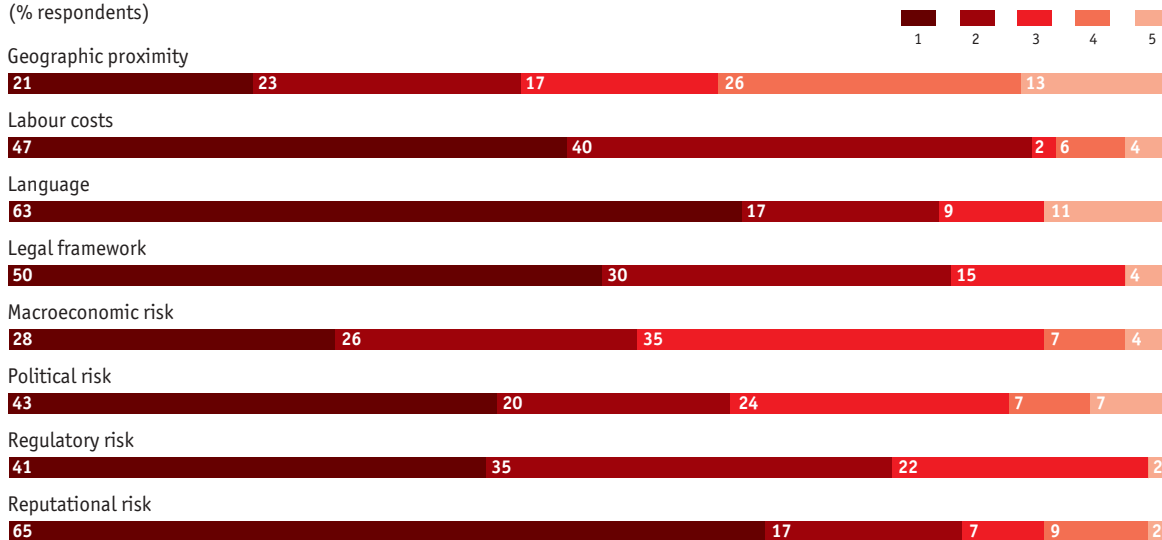
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How important are the following factors to your organisation in determining where to locate outsourced activities?

Rate on a scale of 1 to 5, where 1=extremely important and 5=unimportant.

(% respondents)



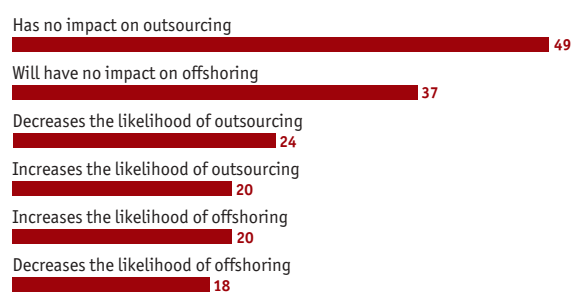
What will be the biggest changes to the competitive landscape of the financial services industry brought on by business process outsourcing?

(% respondents)



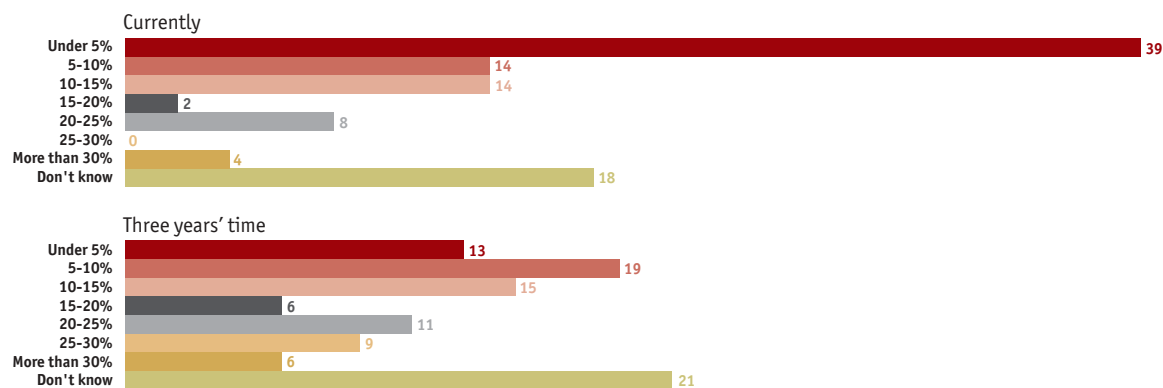
In your view, what is the impact of legislation such as Sarbanes-Oxley and Basel II on your organisation's decisions to outsource/offshore business processes?

(% respondents)



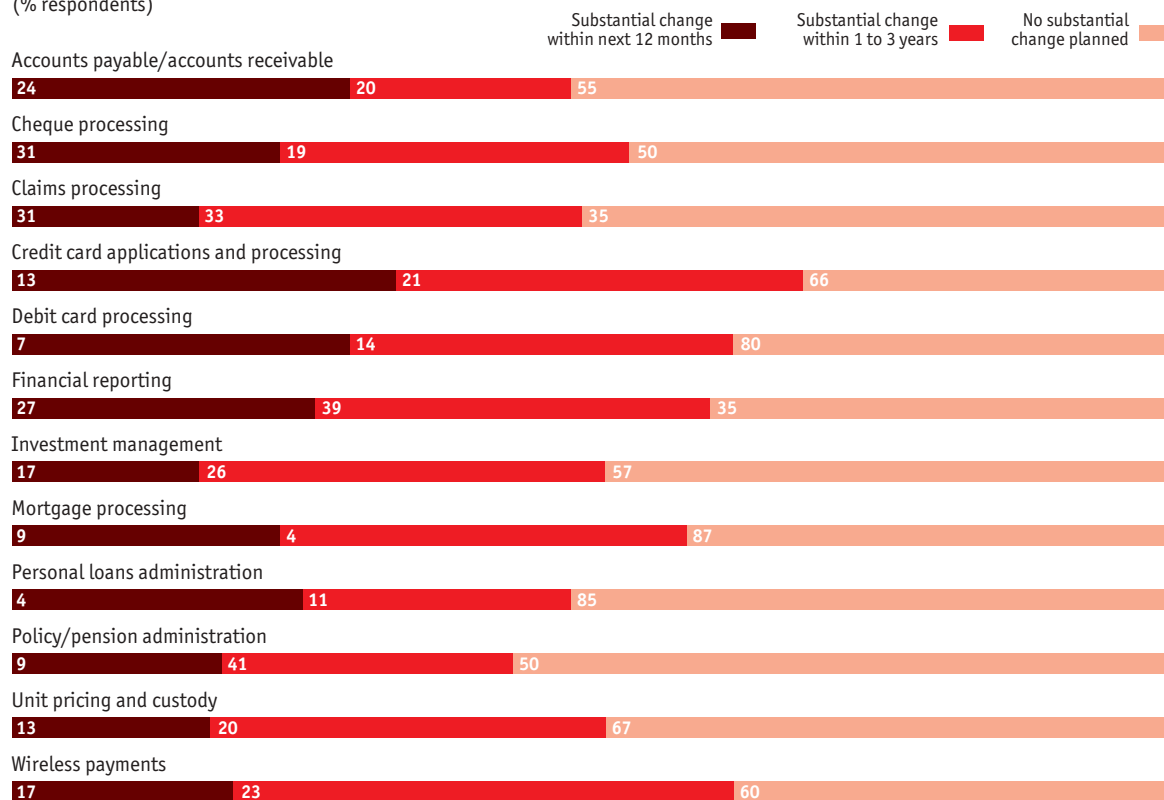
What do you estimate the cost of your organisation's business process outsourcing contracts to be as a proportion of overall costs at present, and what proportion do you expect them to comprise in three years' time?

(% respondents)



Which payment and credit processes does your organisation plan to re-engineer over the following time periods?

(% respondents)



Appendix: Survey results

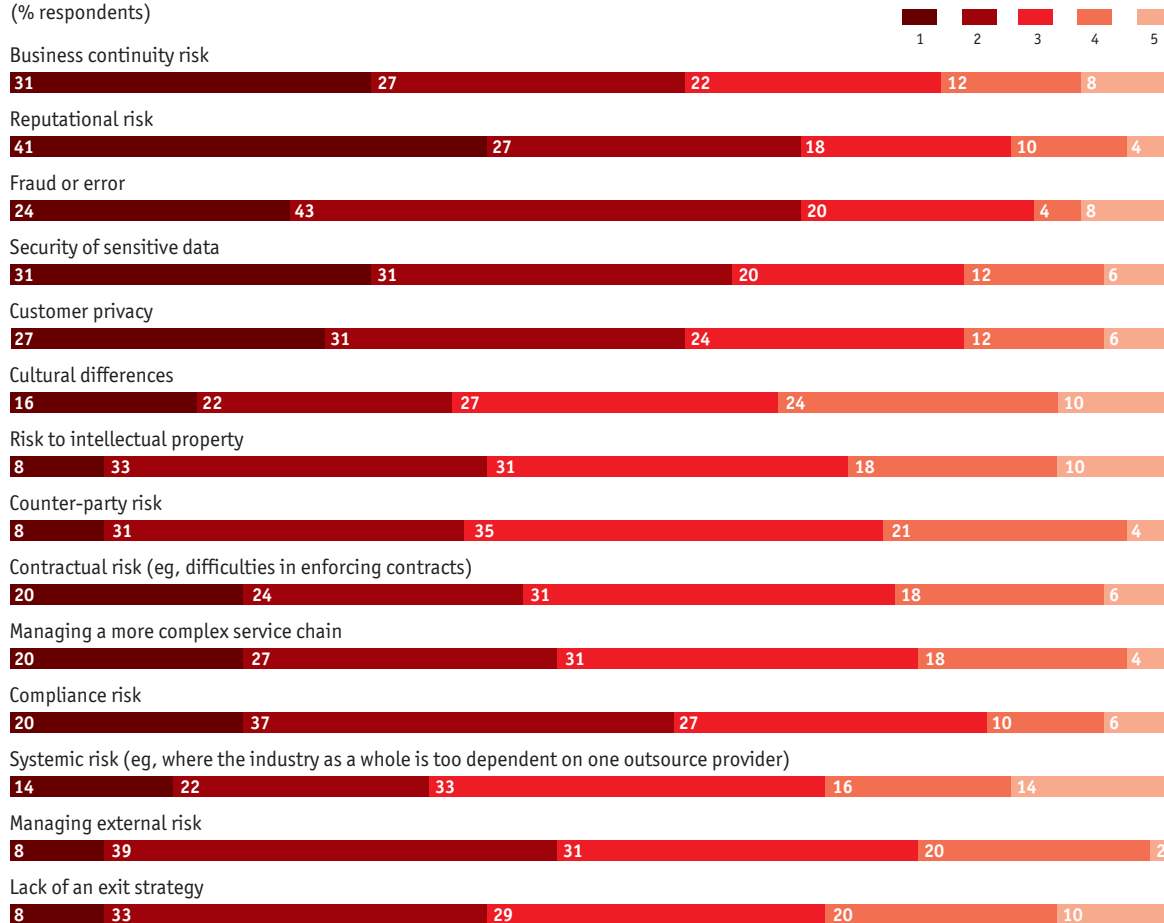
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How significant are, or would be, the following risks to your organisation as a result of outsourcing business processes?

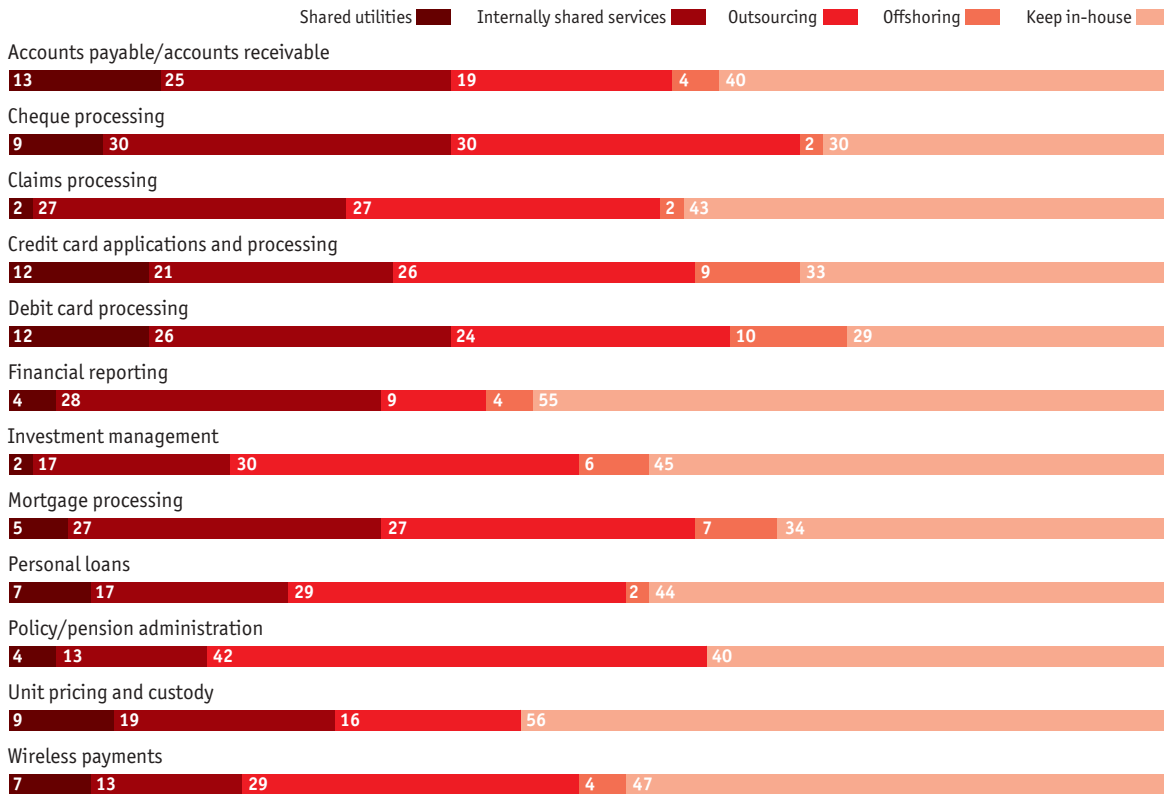
Rate on a scale of 1 to 5, where 1=very significant risk and 5=not a risk.

(% respondents)



Which strategies do you consider most appropriate for each of the following processes?

(% respondents)

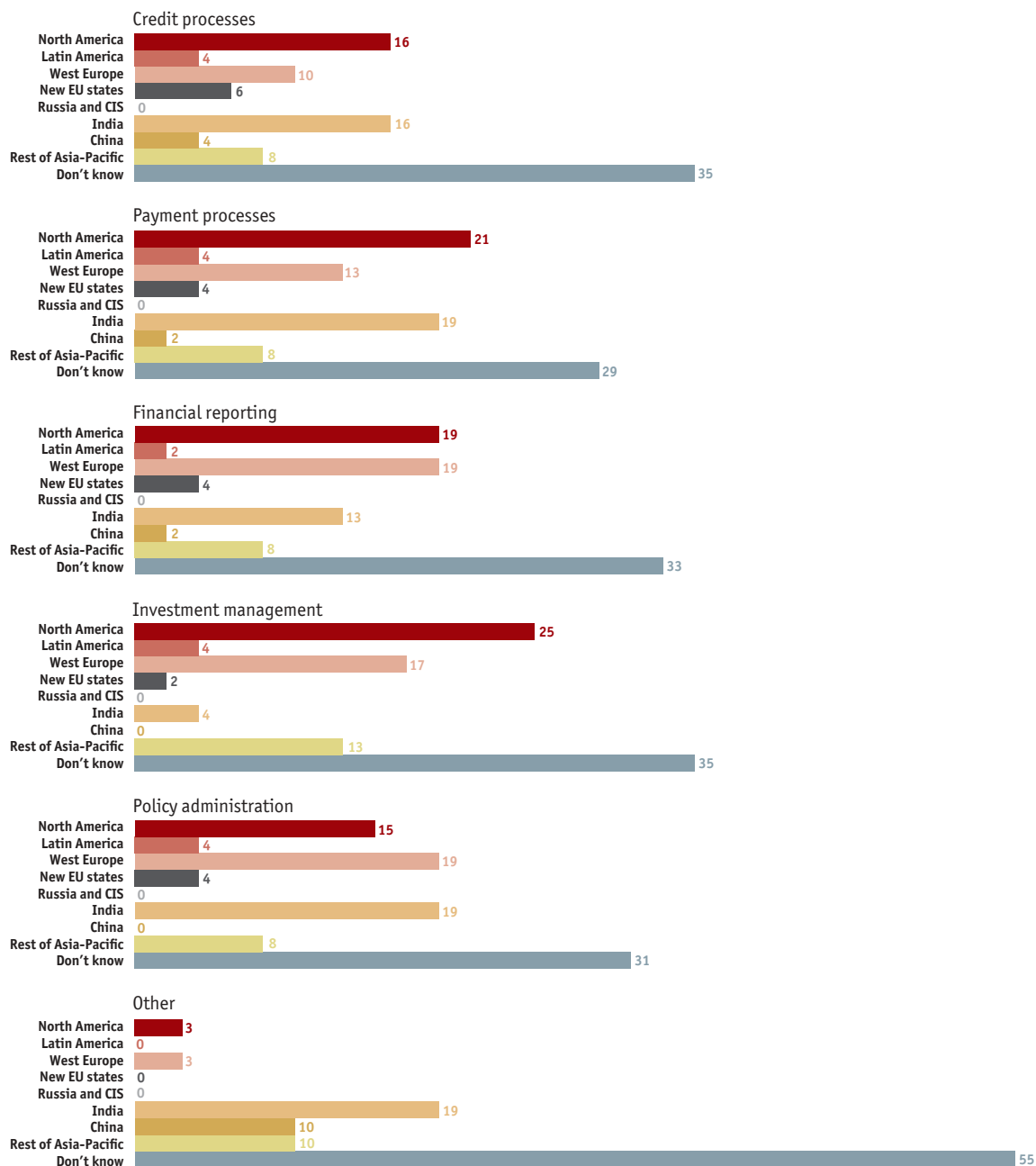


Appendix: Survey results

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Which country/region is the most attractive destination for the outsourcing of the following payment and credit processes?
(% respondents)

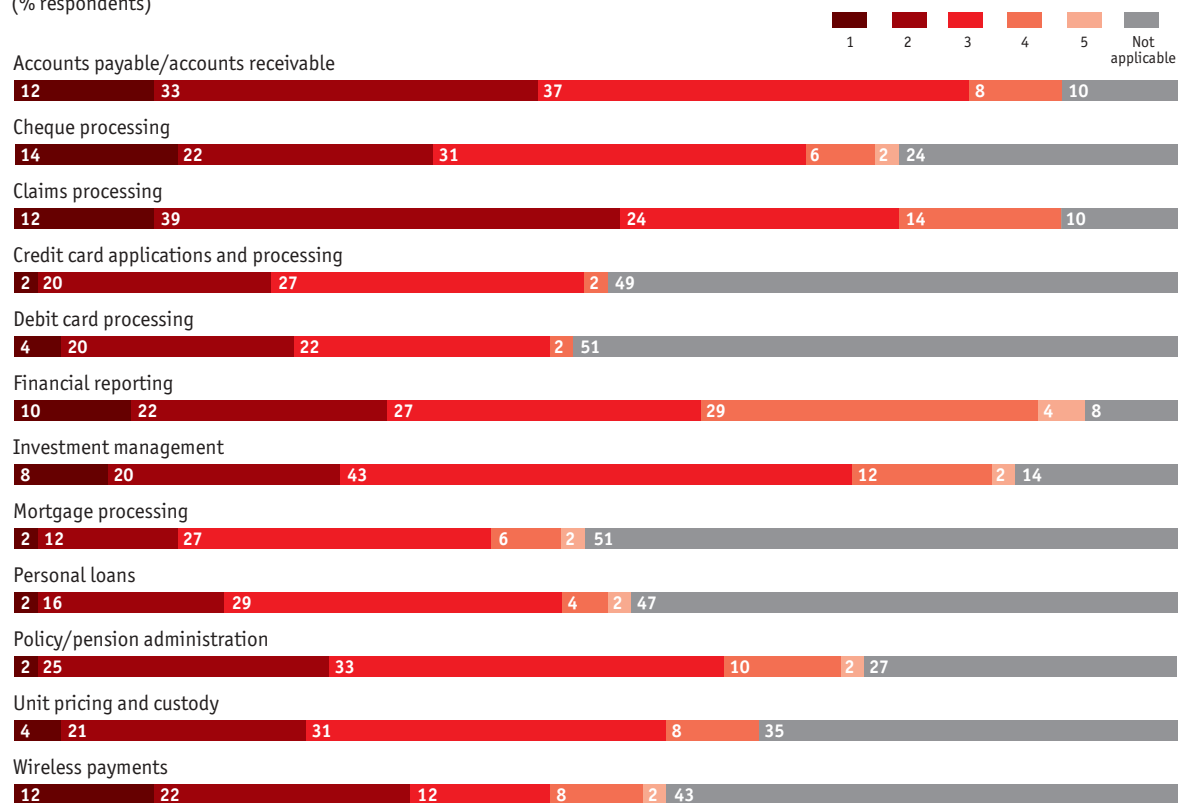


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Better, faster, cheaper Business process transformation in the insurance industry

How do you expect the unit cost of the following payment and credit processes undertaken by your organisation to develop over the next five years? Rate each on a scale of 1 to 5, where 1=costs will fall sharply and 5=costs will rise sharply.

(% respondents)

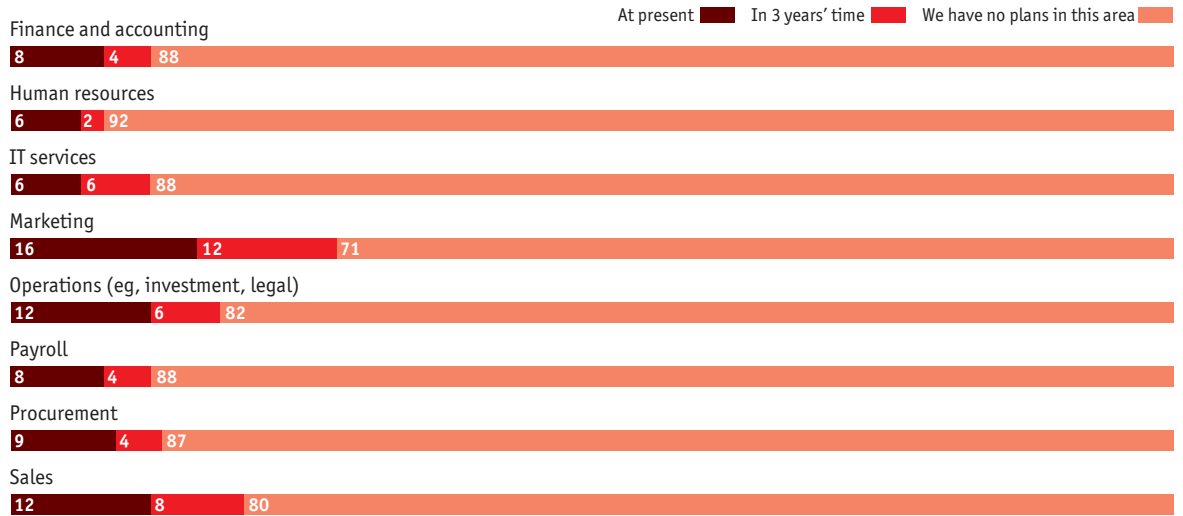


Appendix: Survey results

Better, faster, cheaper

Business process transformation in the insurance industry

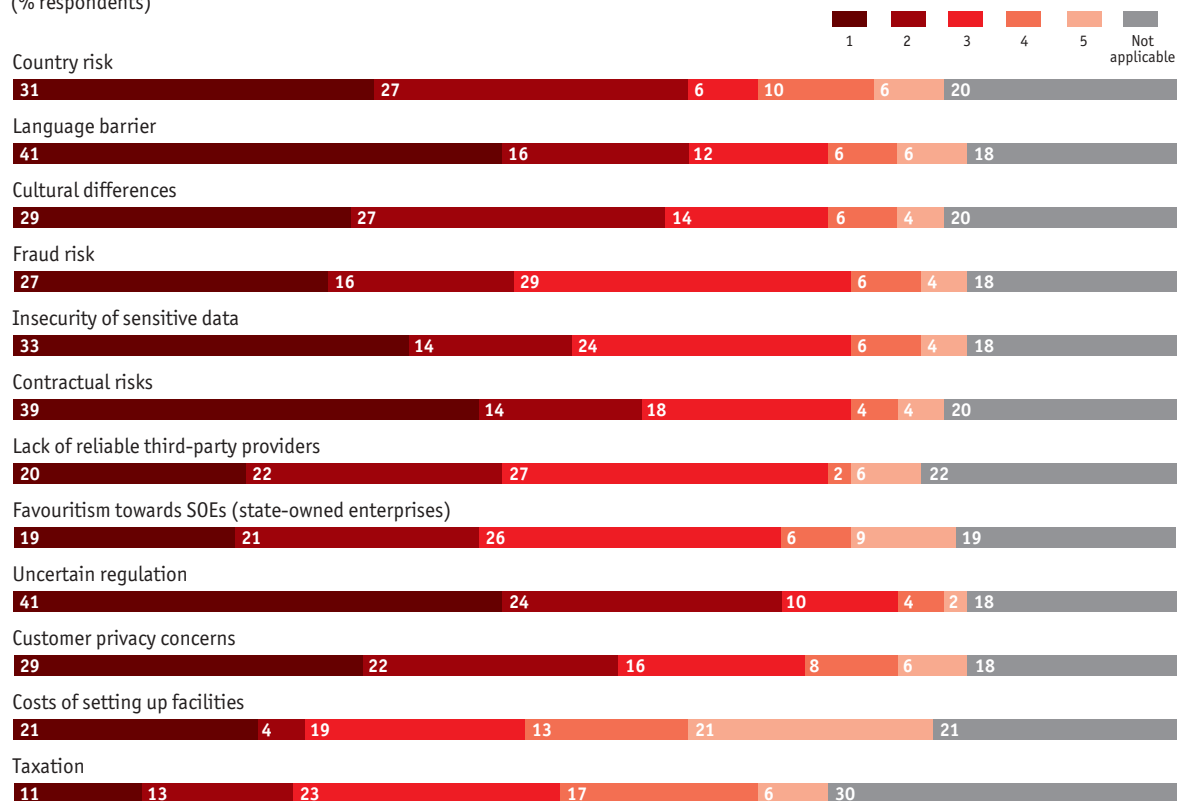
Which of the following activities do you currently undertake in China and which do you plan to undertake in three years' time?
(% respondents)



What are the principal obstacles for your organisation to locating business services and processes in China?

Rate each on a scale of 1 to 5, where 1=Unimportant and 5=Critically important.

(% respondents)



Appendix: Survey results

Better, faster, cheaper

Business process transformation in the insurance industry

Which of the following business processes do you currently carry out in China and which do you plan to carry out in three years' time?
(% respondents)



Although every effort has been taken to verify the accuracy of this information, neither the Economist Intelligence Unit nor the sponsor of this report can accept any responsibility or liability for reliance by any person on this white paper or any of the information, opinions or conclusions set out in the white paper.

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