

Benefits and Challenges of Sourcing Strategies in the Insurance Industry



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Different sourcing strategies have been introduced and are widely accepted in the insurance industry. They will continue to be adopted in the future as they allow for significant cost savings and improved process quality in core insurance and support processes. Furthermore, the appropriate implementation of sourcing strategies provides insurance companies with lower transaction costs and extended time for higher value activities. Project experiences and analyses show significant sourcing opportunities for insurance companies in the corporate functions but also along the core insurance value chain. However, benefits and challenges of sourcing strategies need to be recognized and managed carefully.

Different sourcing strategies

The insurance industry is experiencing significant changes triggered by market and regulatory drivers. Traditional and commonly accepted business models are being challenged and clients, regulators and other stakeholders demand a reorientation of insurance companies. The recent years have shown that insurance companies need to be flexible and agile in adapting their operating models based on the changing environment. Different sourcing strategies are the most common way to increase the operational flexibility of an insurance company.

Outsourcing of business processes (BPO) and outsourcing of information technology (ITO) is a standard practice. Outsourcing can be defined as contracting existing business functions or processes, which are not part of the core competencies of a company, to an independent organization. The idea behind outsourcing is simple: If a company wants to provide all services exclusively in-house, it is often losing its focus and does not maximize its full market potential. From

a labor arbitrage perspective, many activities are being outsourced in nearshore and offshore locations. However, due to factors such as expert knowledge, there is also a tendency towards outsourcing locally or nationally.

The contracting of certain business functions to a third party can be done in a local (domestic / onshore), nearshore or offshore location. An alternative to outsourcing are captives or shared service centers (SSCs). SSCs can be described as organizational units executing processes for internal customers across several business units from support functions, e.g., human resources, information technology, finance, to core business functions, e.g., product management, claims management. Therefore, shared services can be described as internal service providers or a form of outsourcing within the own company. But shared services are more than just the centralization or consolidation of similar activities in a single location. By centralizing activities, the advanced use of information technology enables geographical independence and the ability for parallel processing. Both sourcing options, outsourcing and shared services, facilitate the leverage of low cost resources / infrastructure, the standardization of processes, allowing for economies of scale, synergy realizations and improved quality of services.

Figure 1 shows four dimensions that need to be considered in connection with sourcing strategies. While the structure dimension focuses on the number and nature of functions considered for sourcing, the coverage dimension analyzes whether services are covered domestically, regionally or globally. The location dimension has to answer if sourced services are being provided in local, nearshore or offshore locations and the ownership dimension determines if the

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Ownership	Internal	Joint venture	External
Location	Local	Nearshore	Offshore
Coverage	Domestic	Regional	Global
Structure	Single function	Multi function	

Figure 1: The four organizational dimensions to be considered with sourcing strategies

sourcing of functions will be provided by internal service providers, e.g., SSC, as joint venture or by external service provider, e.g., outsourcing to an independent organization.

BearingPoint's proven approach to define and implement the ideal sourcing set-up by functional areas consists of a process driven assessment. Different factors need to be considered to determine the optimal sourcing decision. The key decision criteria are business criticality, e.g., business risk, differentiation, location dependency, e.g., skills, culture, political / regulatory constraints, and performance, e.g., operational effectiveness, customer experience. This approach defines whether an activity or process should be improved locally, carried out through shared services, i.e., set-up of an SSC, or considered for outsourcing – nearshore or offshore outsourcing if the location dependency is low, local

outsourcing if the location dependency is high. The operating process assessment allows determining the preferred option. Such an assessment with its opportunity filters and resulting opportunity prioritization matrix is illustrated in Figure 2.

European sourcing trends in insurance

Project experiences and studies highlight various sourcing opportunities along the insurance value chain. Traditionally, companies realized new sourcing strategies in the area of corporate functions with a primary focus on the information technology department. Looking at the more recent developments, insurance companies started to recognize the potential of sourcing options along the overall insurance value chain.

The suitability of sourcing along the value chain is illustrated in Figure 3 for the core insurance functions and in Figure 4 for the corporate functions.

A recent pan-European study¹ analyzed the current status and future trends of shared services in the financial services and the insurance industry. The survey results illustrate that SSCs are commonly accepted throughout the insurance industry. Nearly fifty percent of the SSCs were established more than three years ago, most of them as managerial and independent units. The majority of the SSCs are controlled in a rather traditional way, led by C-level or functional leaders. This supports the assumption that cross-business centers or cross-functional centers are not very common. So far the companies have concentrated on support processes, e.g., information technology, human resources or real estate. The majority of firms have not yet taken or recognized the opportunity to extend the focus of shared services to further value-added services in areas such as finance, risk and core business processes. Some more recent developments indicate that some companies started to recognize the potential of sourcing options also on certain core insurance processes. SSC in the financial services industry are mainly domestic or nearshore entities and have primarily a country or regional scope. Eastern Europe has been emerging as a major shared service location.

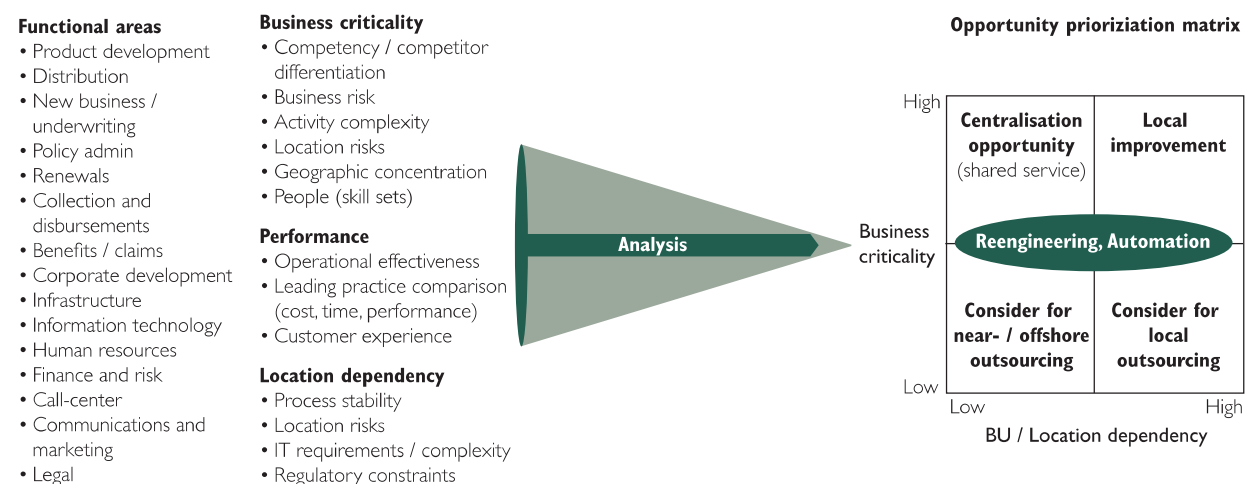


Figure 2: Process driven assessment through opportunity filters and prioritization matrix

Product development	Distribution	New business	Policy admin	Renewals	Collection and disbursement	Benefits / claims
Underwriting analysis	Multi-channel-strategy	Issuance (focus on country-wide centralization)	Policy inquiry	Pre renewal	Bill preparation	Claims submission
Product lifecycle analysis	Intermediary compensation	Quoting	Policy maintenance	Issuance	Bill presentment	Assignment
Pricing strategy and execution	Relationship strategy and management	Underwriting	Endorsements	Rating and quoting	Receive remittance	Disbursement
Actuarial analysis «rate adequacy»	Segmentation strategy and planning	Pricing	Reinstatements	Underwriting	Due and unpaid	Issuance (focus on country-wide centralization)
Competitive analysis	Channel management (planning, execution)	Rating	Rewrites		Ledger accounting	Claims maintenance
Legal and regulatory compliance	Intermediary training		Policy requests			Claim validation
	Sales generation		Cancellations			Litigation management

Outsourcing / SSC Suitability: High Medium Low

Figure 3: Outsourcing and shared service center opportunities for core insurance functions

Main findings and improvement areas:

- More innovative forms of shared services like «centers of expertise» centralizing expert know-how for availability across the group are emerging.
- Only the minority of SSC are currently managed by a dedicated leader, designated to focus on the continuous professionalism of the center's service delivery. This also inhibits the set-up of more complex cross-business and cross-functional shared services.
- Compared to other industries, financial services companies are lagging behind in setting-up shared services for finance processes like financial accounting, controlling and financial analysis.
- Certain core business processes like payment services, billing, collection and disbursement, recovery, and security transactions have a high potential for being set up as shared services.
- Soft factors such as education and availability of qualified personnel including language skill availability are key factors for selecting a SSC location followed by security and privacy of data and intellectual property.

Benefits and challenges of shared services

While the financial aspect of cost savings is an important factor for decisions towards shared services, it should not be the predominant one. In addition to the financial benefits, many SSC have improved their standardization of processes and methods, moved to lower transaction cost and extended time availability for higher value activities. Process excellence improvements were always supported by improved IT infrastructure (straight-through processing) and actively managed service level agreements. The main challenges seen with SSC implementation are the handling of cultural differences and the availability of qualified personnel.

The BearingPoint study reveals that decision makers who have already implemented an SSC for financial services processes rated the benefits higher than respondents of companies that have not yet implemented it. It has also been stated that further cost and service quality optimization in SSC can be achieved through continuous improvement programs, integrated enterprise resource

planning (ERP) / IT platforms and end-to-end process reengineering. For the implementation of SSC a «top-down approach» is key to success. In a top-down driven approach, senior management, based on corporate strategy and a target operating model, decides which functions and businesses will be migrated to SSCs. Almost all financial services institutions which have chosen a top-down approach achieved significant cost savings and were more successful than companies where the use of an SSC was made optional. To operate SSC successfully it is essential to carry out change management activities to overcome cultural differences even after the rollout phase. Furthermore, a positive working environment attracting talented professionals and the provision of trainings are other aspects to be considered to overcome these challenges.

Innovation

According to the aforementioned study, companies with a perceived «medium» or «high» innovation level were early adopters of the SSC concept. They overcame some of the difficulties and realized

Corporate development	Infrastructure	Information technology	Human resources	Finance and risk	Call-center	Communications and marketing	Legal
Vision	Real estate planning	Business / IT strategy	Recruiting	Asset management	Telemarketing	Internal information	Compliance
Define strategy	Real estate maintenance	Data strategy and architecture	Learning	Accounts receivable	Acquisition of new clients	Public relations	M&A
Implement strategy	Fleet management	Sourcing strategy and management	Development	Accounts payables	1 st level customer care	Advertising	Litigation
		Functional analysis and design	Payroll	Reporting and planning	Development of existing clients	Client events	
		Technical analysis and design	Staff events	Controlling	Problem solving		
		Functional and integration testing	Outplacement	Billing			
		User training		Dunning			
		Application management					

Outsourcing / SSC Suitability: High Medium Low

Figure 4: Outsourcing and shared service center opportunities for corporate functions

significant cost benefits. While the support of the management is a prerequisite to adopt and realize strategic initiatives like SSC, employees are recognized as an important source for creating and detailing such innovative approaches.

Senior executives should not only support innovative initiatives like SSC but also engage in driving new and unusual solutions. But they are not the sole source for new ideas. Many new solutions to existing problems come from employees, if an enabling company culture supports innovative thinking behavior. Therefore employees are an important source for creating innovative solutions like SSCs. They need to be supported through a management which motivates them to think and work innovatively. The adoption of a new technology or organisational form will not succeed, if the employees refuse to use it and if the support of the management is lacking.

Usually, highly innovative companies do not plan to (re-)locate their SSC to Eastern Europe or Asia but rather to domestic regions. Companies with a me-

dium innovation level, on the contrary, prefer Eastern Europe or Asia as SSC locations and opt for domestic regions to a lesser degree.

Flexibility

Recent studies showed that flexible operating models are an important factor for a profitable company. SSCs are one of the options to create a flexible operating model. The factors of resource allocation and process standardization are key elements. Based on the centralization of the resources in a shared service center, companies can realize economies of scale and therefore optimize their allocation of manpower. Furthermore it facilitates the process to adjust the workforce size and the location criteria in an optimized way. Locations can be chosen based on the availability of talent and skills and the total cost of services. Focusing on the skills, it is crucial that the workforce market is able to provide the required resources from an experience, education, culture and also language perspective. A further flexibility advantage

of SSCs is the possibility of covering different time zones.

Costs

The BearingPoint study illustrates that the use of shared services provides a significant opportunity for the financial services industry to reduce its cost base and increase its overall profitability. A majority of SSC realized more than twenty percent cost savings with several cases exceeding thirty percent. Due to economies of scale and greater organizational and financial ability to invest in technologies, e.g., to automate and streamline processes, large financial services companies achieve higher cost savings than smaller institutions. The study participants ranked financial benefits in the back office processes the highest. However also for market and client-facing processes like customer care, the implementation of a SSC can reduce costs and improve quality and expertise. Investments into SSC are paying back in the medium term. Most companies expected to break even within three to five years, but study results indicate that

many SSC investments already reached the pay back zone within three years of their launch.

The companies who have not yet been able to meet their financial goals by implementing a SSC mainly mentioned the following reasons for their lack of success: Execution problems in transition and migration, poor quality of personnel and processes, insufficient standardization and harmonization of processes and systems and large retained local organizations which have not yet been made redundant, e.g., due to legal restrictions, lack of trust and quality of shared processes, corporate power maps and politics.

However, the cost aspect should not be the main criteria for implementing shared services. In fact, many Eastern European countries are no longer low-wage countries, e.g., Czech Republic or Poland, or will soon no longer be, e.g., Romania or Bulgaria. In addition, not only labor costs, but also, e.g., coordination costs, labor laws, social plans including severance payments or expensive expatriates, can reduce the benefits of SSC.

Processes

Moving to a shared service center provides the opportunity to realize harmonization and synergies among processes and execution of standard tasks. It is important to implement common rules about execution of activities that should be transparent to the organization.

One of the key decisions when migrating to a shared service center concerns the question whether processes should be «lift-and-shift» or «fix-and-shift». Michael Lyons, Managing Director and Head Finance Operations L&H at Swiss Re, explains that «lifting processes from one location and shifting to another provides the opportunity to standardize and harmonize processes. He has a strong preference towards the lift-and-shift approach, because the responsibility to align rest with dedicated resources assuming these processes.» As part of the SSC strategy it is important to analyze

the two options and to perform a cost, benefit and risk analysis.

Culture

For the successful operation of SSCs, it is essential to carry out change management activities to overcome cultural differences before, during and even after the rollout of the SSC.

Michael Lyons points out that «it is crucial not to underestimate the emotions occurring through the migration of activities. Attachment to the past and personal commitment to colleagues who are leaving can only be overcome with dedicated change management. The acceptance for the new organizational structure will come eventually but significant change management efforts are needed to get the buy-in from the employees on all levels.» In addition, a positive working environment that attracts talented professionals and training for all concerned employees are further aspects to be considered to overcome these difficult challenges. The positive effects on the own tasks need to become visible and every employee needs a clear and specific vision of what he is going to do in the organization in the future. As a matter of course, the people who leave need to be handled with respect, sensitivity and dignity. Cultural differences and challenges may occur not only during the set-up of a SSC but also in the operational phase and need to be managed carefully. It is crucial to focus not only on the people in the SSC but also on those in the retained organization and thus enable an optimal collaboration.

Systems

Standardization of the processes and collaboration between local and central entities are important elements for the success of a SSC. Therefore in most cases the set-up of a SSC requires changes in the system landscape. It is recommended that some of the collaboration processes are enabled or even automated by workflow and business process management

tools. Furthermore harmonized administration systems will reduce the complexity and improve the efficiency of SSCs. For example, finance SSC set-ups are quite often supported by a global template approach and a migration to one instance of finance systems, e.g., one general ledger.

Conclusion and Outlook

Realizing sourcing options such as shared service centers and outsourcing are a common practice in the insurance industry. Nevertheless there are still significant opportunities for most insurance companies along the end-to-end value chain. Sourcing set-ups help to further increase the flexibility of operating models. Cost reduction is no longer the main driver behind a sourcing decision. Nevertheless, as location decisions result in considerable investments, it will not be possible to realize constant cost savings through repeated SSC relocations. Cost saving realization based on labor cost arbitrage resulting from lower salaries in nearshore or offshore locations will become more difficult.

Limitations will not only be infrastructure, language skills and availability of qualified resources but also data and intellectual security and privacy. Therefore it will be increasingly important to realize further optimization potential in process automation and standardization. The human factor is still the key success factor. Cultural differences, skill availabilities but also the collaboration between shared service centers and the retained organization cannot be underestimated and need to be addressed through dedicated change management.

Note

- 1 BearingPoint, Survey: Shared Services Industry Specific and Trends in the European FS Market, 2010.