September 2006

BCG | FOCUS

Operating for Value in Insurance

Why is it that some insurers succeed in having a low loss ratio, a low expense ratio, and high customer satisfaction, whereas others struggle to get their operations to acceptable performance and cost levels? The reason is fairly simple: low-level performers often focus on just one dimension of their overall enterprise—business, operations, or IT—whereas top-level performers tend to have an end-to-end design that optimizes all three dimensions.

Adopting an end-to-end design is critical for insurers that wish to improve operations—and to use that improvement to raise their overall performance. This type of approach has enabled some multinational players that started out with a better-than-average cost position to cut their expense ratios by an additional 30 percent, while simultaneously improving the productivity of their sales forces. Such achievements are the envy of legions of insurers that are still struggling to improve operations and boost profitability.

Many insurers today are already considering new operating models. They are wondering, for example, whether they should consolidate operations across labels into shared service centers, outsource or offshore policy administration, attempt cross-border synergies in operations, or build integrated IT systems for all labels and products. In many cases, there is a governance question attached to these issues—such as whether to create a group COO or CIO function.

Yet the efforts of insurers to improve operations have often been unsuccessful. While the most common reason for failure may be taking a one-dimensional approach (such as focusing on purely operational or purely IT issues), other frequent missteps include trying to force a standardized operating model onto fundamentally different business models (such as using the same life-insurance products, processes, and systems in both the bancassurance and broker channels) and not giving sufficient consideration to the impact of change initiatives on staff. The pitfalls are many indeed.

In our view, there *is* a way for major insurance companies to improve operations significantly—and in so doing, lift the performance of the entire company to previously unattainable levels. But in order to succeed, insurers must have a clear framework to follow. We call such a framework *operating for value.*

What Is Operating for Value?

Operating for value makes the value created by operations explicit by concentrating not only on reducing costs but also on creating opportunities for additional revenues through higher-quality service. The framework consists of three basic initiatives, all of which seem straightforward but typically meet substantial roadblocks:

- Design a new target operating model and IT architecture (using the desired customer experience as a starting point)
- Draft a road map that leads to the target operating model
- Install governance structures that ensure effective implementation

In general, the roadblocks that insurers face to adopting an end-to-end design involve internal lines of accountability that prevent end-to-end thinking, work forces that lack sufficient motivation and incentives, and legacy IT systems that complicate change initiatives. Overcoming these obstacles requires true engagement from senior management. In fact, the operating model must become a top item on the CEO's agenda if lasting improvements are to be achieved.

Ultimately, insurers that do not take steps to create value from operations will find themselves trailing behind competitors that have already started to transform themselves.

Design a New Target Operating Model and IT Architecture

Consider the transformation that Dell Computer brought to the PC industry, shifting the way PCs are sold. Both corporate and retail buyers can fully customize their PCs online instead of having to go to dealers. Dell's operational model, or *back end,* facilitates this by continuously simplifying products and consistently refining processes that allow the company to build to order and to ship directly from manufacturing plants. In other words, Dell's business model and operating model complement each other perfectly. This is not a coincidence but a clear example of clever design.

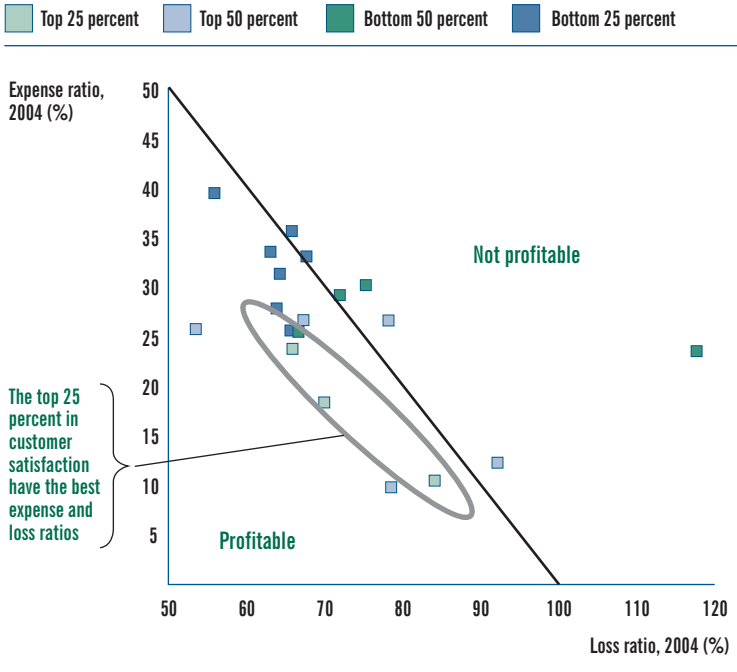
Unfortunately, this sort of alignment—which also leads directly to higher customer satisfaction—is typically achieved only by best-in-class players in the insurance industry. Moreover, for such players, high levels of customer satisfaction are usually accompanied by the best expense and loss ratios, the strongest growth in policies, and the sharpest reductions in cost per policy, as illustrated by the German nonlife-insurance market. (See Exhibits 1, 2, and 3.)

When insurers design their new target operating model and IT architecture, they should start by defining the desired customer experience, which facilitates a true understanding of how the performance of operational processes creates value for the business. In our view, there are two basic types of operational processes, and they create value in different ways. *Complex operational processes,* such as underwriting disability insurance for self-employed individuals, create

EXHIBIT 1

INSURERS WITH HIGH LEVELS OF CUSTOMER SATISFACTION HAVE THE BEST EXPENSE AND LOSS RATIOS

Example: German nonlife-insurance market



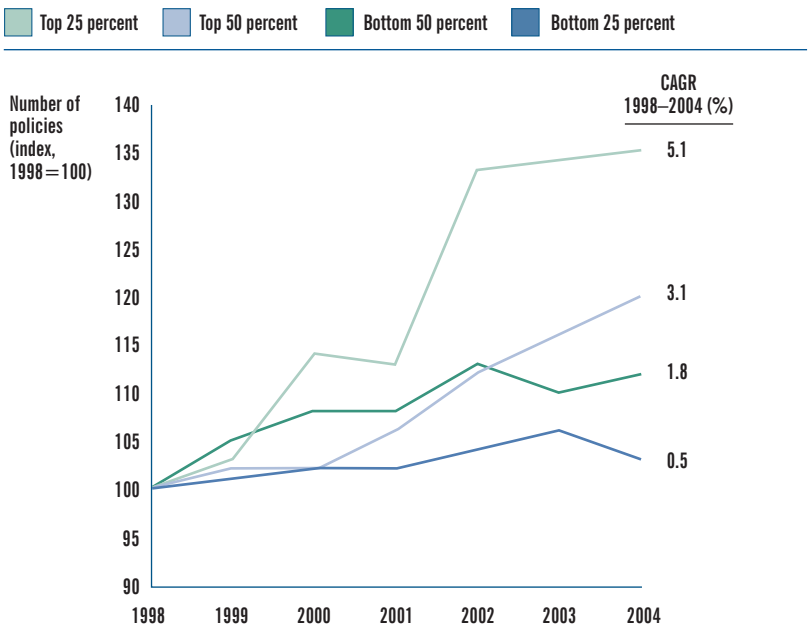
SOURCE: BCG insurance database.

NOTE: Customer satisfaction is defined as the percentage of "very satisfied" and "completely satisfied" customers.

EXHIBIT 2

INSURERS WITH HIGH LEVELS OF CUSTOMER SATISFACTION SHOW THE STRONGEST GROWTH IN POLICIES

Example: German nonlife-insurance market



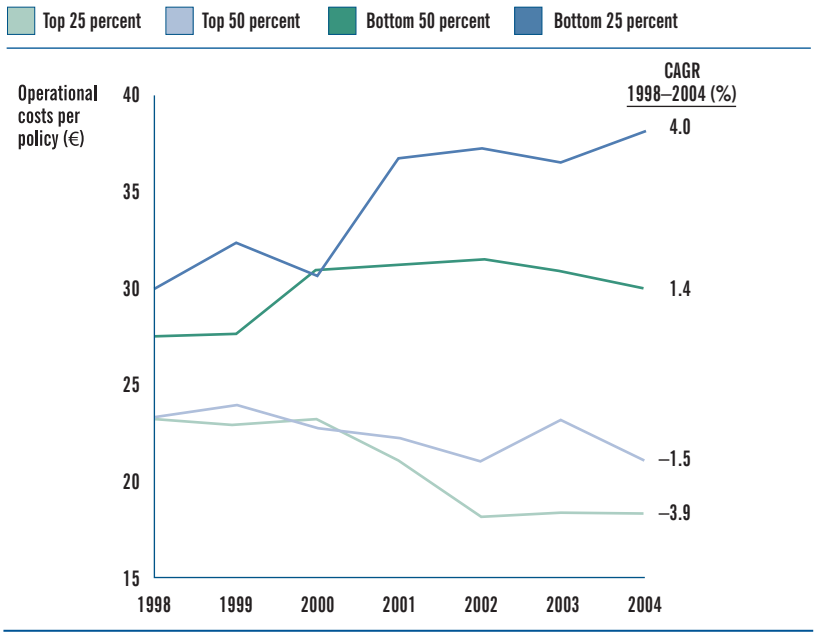
SOURCE: BCG insurance database.

NOTE: Customer satisfaction is defined as the percentage of "very satisfied" and "completely satisfied" customers.

EXHIBIT 3

INSURERS WITH HIGH LEVELS OF CUSTOMER SATISFACTION SHOW THE SHARPEST REDUCTION IN COSTS PER POLICY

Example: German nonlife-insurance market



SOURCE: BCG insurance database.

NOTE: Customer satisfaction is defined as the percentage of "very satisfied" and "completely satisfied" customers.

value through influencing the customer's purchase decision and through exercising business judgment (for example, by determining the probability that a claim will need to be paid out). *Standard operational processes,* such as paying out small claims, create value mainly through their level of efficiency.

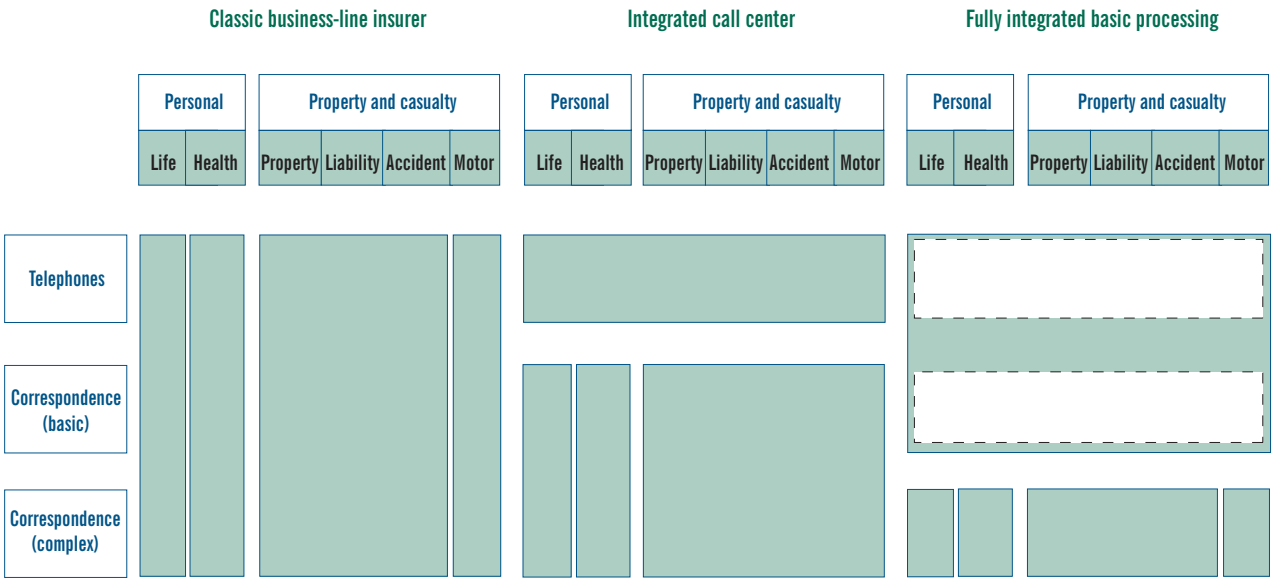
Insurers also need to understand how business choices drive the costs of operational processes—costs that typically rise if the business allows too many variations and exceptions to the core products and services offered. Indeed, the exact nature of complex and standard processes for any insurer is determined partly by its business model and product portfolio.

Once the complex and standard operational processes have been identified and fully defined—with the requisite active input from senior product and channel managers—the next step is to translate these processes into a sharply focused target operating model and IT architecture that keep the end-to-end perspective foremost in mind.[1] Exploring different options for the operating model can spark discussions and help address such issues as which operational processes should be fulfilled by customers themselves (for example, filling in a form on the Web), which processes should be handled by first-line support personnel shared across business lines, and whether the customer relationship is ultimately managed by the corporate entity or by sales agents. (See Exhibit 4, page 4.) In essence, the target operat-

1. For a more in-depth treatment of IT management and architecture issues, see *Creating IT Advantage in the Insurance Industry,* BCG report, April 2005.

EXHIBIT 4

THERE ARE MANY OPTIONS FOR OPERATING MODELS



SOURCE: BCG analysis.

NOTE: In this framework, only retail and SME business are relevant; there are no larger companies.

ing model should be aligned with the business model by starting from the desired customer-service level—both by segment and by channel.

The redesign of an operating model can sometimes be carried out on a product-by-product basis. One Dutch insurer, for example, increased its motor-insurance market share fivefold within a year after launching a fully redesigned product, resulting in a significant staff reduction in underwriting and policy administration. The insurer accomplished the streamlining by redesigning underwriting rules, implementing a new IT system, and fostering direct communication with brokers through the company intranet. These steps, along with striving for a higher degree of automation to lower overall operational costs, helped the insurer provide near-immediate delivery of offers to brokers and lower prices through a better selection of risks.

Draft a Road Map That Leads to the Target Operating Model

Because every insurer's business model, risk appetite, and target operating model are different, there is no standard road map for change. Indeed, a good target operating model and IT architecture are just two of the necessary ingredients for a successful transformation and must be accompanied by strong commitment from senior management, a well-designed communication plan, and deep understanding of both people skills and the dynamics of effective training. Moreover, achieving early successes is a critical element of attaining real change that will raise long-term profitability. A list of quick wins can often be created through a concentrated, one-week study of all operating processes, using a standard checklist and an external facilitator.

BCG's operating-for-value framework contains eight specific levers for drafting a road map that leads to the new target operating model (See Exhibit 5.) These levers are not applied incrementally but in a holistic way. For example, improvements are carried out from both a customer and a front-office perspective, with clear and measurable performance targets. An end-to-end process architecture is defined, from sales all the way through claims handling. IT and business processes are both optimized, capturing the value of new technologies. Furthermore, the employee perspective is an integral part of each lever, and careful planning is needed to ensure that proper training is provided and that the desired skills are actually

acquired by the staff. Let's examine these levers one by one.

Optimize processes. Many insurers are already applying methodologies from the manufacturing sector, such as Six Sigma and Total Quality Management, to improve their processes. But these efforts are often applied from an isolated, operations-only perspective, whereas the most effective way to improve processes is by looking end to end. For example, one leading insurer has operations and sales teams work together during negotiations on complex group-life contracts, the goal being to ensure that the contracts fit within the capabilities of both operations and the IT system. This sort of teamwork does not imply selling just simple products to end customers but is a practical matter of steering negotiations toward parameters that can be handled smoothly by both operations and IT. By applying the end-to-end perspective, this insurer benefits from lower processing costs while the customer benefits from a higher service level.

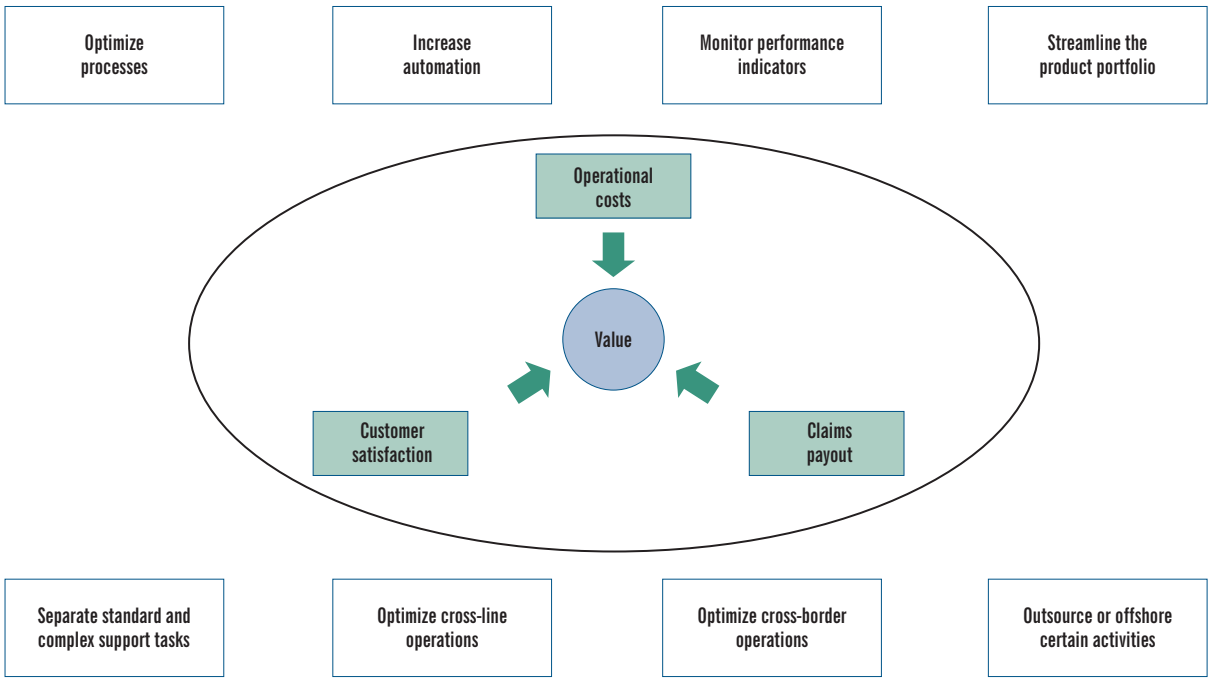
Increase automation. Using straight-through processing (STP) for activities in which no business judgment is required typically delivers large savings per activity. For complex activities, workflow and digital-file systems can help manage operations. Again, taking an end-to-end perspective makes actions more effective. For example, in order to increase its level of digital delivery (and therefore STP), one insurer took two basic measures. First, brokers were told that digital requests would always receive priority over paper requests. Second, an easy-to-use portal with access to all products was built to help brokers save valuable sales time. These measures combined to provide a higher level of service to brokers and allowed an increase of around 50 percent in the STP rate—as well as a comparable decrease in operational costs.

Monitor performance indicators. Paying close attention to relevant performance indicators is a prerequisite for success. For example, the digital delivery and STP rate of requests and claims must be consistently tracked. Also, when a clear split between front-office and back-office activities is introduced, it is essential to have the following:

- Key performance indicators (KPIs) that accurately reflect the service level agreements (SLAs) that are most relevant to cost levels and to customers

EXHIBIT 5

THERE ARE EIGHT LEVERS FOR DRAFTING A ROAD MAP THAT LEADS TO THE TARGET OPERATING MODEL



SOURCE: BCG analysis.

- Incentives for the senior managers responsible for these KPIs
- Transparency within operations that enables timely answers to clients' questions on the status of their claims or requests

Streamline the product portfolio. The number and complexity of products that any insurer offers are important drivers of operational costs, yet few insurers have successfully narrowed their portfolios. The risks of terminating products include lost sales volume and large IT migration costs. But putting mechanisms in place that help avoid product proliferation, as well as focusing sales efforts on a few selected products, can aid in streamlining the scope of offerings.

Separate standard and complex support tasks. Dividing support tasks into standard activities that can be handled by first-line generalists and complex activities that need the attention of second-line specialists lowers costs and leads to better service. Standard tasks are typically characterized by a high rate of occurrence, low actuarial risk, and clear rules and procedures to follow. The generalists can be steered on efficiency and scale, whereas the specialists should be steered on the effectiveness of their decisions. The flip side of the split is a potential increase in hand-over costs between first- and second-line support—for both the insurer and the customer.

It is important to note that the extent to which such a split is possible is related partly to the insurer's chosen business model. Consider a business line that sells through brokers and that regularly allows exceptions to standard product conditions. In this situation, a generalist support person might stick to the regular product conditions too strictly, resulting in lost sales and a lower service level.

Optimize cross-line operations. When insurers leverage scale through cross-line operations, standard tasks can be performed more efficiently and complex tasks can be performed more effectively. For example, one insurer, by combining first-line support for its life and property-and-casualty businesses, was able to raise productivity among call-center employees, enhance service levels, and increase cross-selling to existing customers. A key challenge in integrating these standard activities is getting a single customer view in the IT system—one that also meets legal restrictions. One example of bundling specialist tasks is combining expert groups for personal-injury claims across different lines of coverage. For example, by pooling claims for a specific type of injury across business lines, insurers can better afford a true specialist in the field, which allows for more effective decisions regarding liability.

Few major insurance companies have successfully streamlined their product portfolios.

For insurers, efforts to separate standard and complex support tasks and to optimize cross-line operations often raise the issue of whether they should create a shared service center for their operations. (See the sidebar "Should Insurers Integrate Operations into a Shared Service Center?")

Optimize cross-border operations. Multinational insurers should try to leverage group synergies in order to prepare for a future in which cross-border operations will be more important than they are today. But since regulatory climates, the nature of competition, and customer preferences differ among countries, so do business models—mandating different requirements for operational processes and organization. In our experience, opportunities to directly integrate operations across borders are quite limited. However, by separating standard support tasks from complex, business-model-specific support tasks, international productivity figures can be viably compared. In addition, creating transparency and carrying out internal benchmarking exercises can foster cross-border synergies by stimulating best-practice sharing—although differences in market conditions, product portfolios, channel mixes, and other business elements must be considered.

IT infrastructure and applications for standard tasks can already be shared across borders to some extent. An optimal moment to further this initiative is when a major investment is required in current IT systems. Obviously, greenfield operations represent the ideal opportunity to roll out target operating models and their corresponding IT architectures.

Outsource or offshore certain activities. In our experience,

once overall operations have been improved using the initiatives described above, additional savings of 20 to 30 percent of operational costs can be achieved by outsourcing and offshoring.[2] Standard processes such as policy administration, customer profitability evaluation, and Internet customer support are often the first processes for which offshoring to low-cost countries is considered. But insurers must take extra care to ensure that the required customer experience is maintained by training offshore personnel sufficiently regarding country- and business-model-specific issues. Such training enables the insurer to provide a more personalized level of service and also helps operations personnel understand the nature of the sales function's relationship with clients in different markets.

Cost reduction will remain a premier benefit of outsourcing and offshoring, but building new capabilities can be a major benefit as well. A caveat is that, when approached from a one-dimensional operations or IT perspective, outsourcing and offshoring can result in limited flexibility for long-term business and process improvements. Moreover, it is clearly more difficult to offshore complex operational processes than standard ones.

In addition to understanding the eight specific levers described above, insurers should also grasp that having a new target operating model typically results in additional requirements for their IT landscape—such as increased support for standardized processes and an integrated customer view across all products. Unfortunately, there is no silver bullet for IT system enhancement. In most cases, the IT landscapes of insurance companies are highly complex, owing to the legacy of policies sold and to a high level of integration among systems. As a result, insurers have developed their IT systems incrementally over the past few decades.

Along with continuing incremental development, two other options should be considered for improving IT systems. One alternative is to develop new, separate systems for new products. A second alternative is to replace the current IT landscape entirely. Both of these options, although potentially riskier than incremental development, may be more effective in terms of cost or time, depending on the specific situation. Introducing standardized IT applications can also be a way of enforcing harmonized processes, which contributes to the implementation of the target operating model.

Install Governance Structures That Ensure Effective Implementation

Operating for value is not just a one-off project that lasts for a few months. It is a permanent

2. See "Tradable Labor: A Tide That Will Not Be Turned Back." BCG Opportunities for Action, November 2004.

SHOULD INSURERS INTEGRATE OPERATIONS INTO A SHARED SERVICE CENTER?

The term *shared service center* (SSC) refers to an independent organization that carries out specific business functions for internal clients. These functions can include underwriting, claims handling, finance, and human resources, among others.

The first step in deciding whether to set up an SSC is to understand how SSCs help create value, which in turn depends on whether the functions provided are considered complex or standard. For standard activities, SSCs create value by increasing efficiency through scale, whereas for complex activities, they increase effectiveness by bundling scarce resources into centers of expertise. In addition to these direct benefits, creating an SSC provides momentum to improve operational processes.

The second step is to understand the risks that are involved in creating an SSC. Potential risks include losing the end-to-end perspective through the formation of an independent organization. In addition, the implementation risk of creating an SSC is high because of the large amount of resources required.

Since risks are lower for standard operating processes, SSCs are typically created for functions such as payments, IT infrastructure, and finance. Also, an industry tendency is to create SSCs for first-level call centers. SSCs for complex operational processes do exist but are less common. The closer the processes are to core insurance operations, the larger the impact on the business model and therefore the larger the risks.

new way of approaching how operations can be continuously optimized. Naturally, success requires effective governance structures and management approaches for both operations and IT. Above all, it is imperative to have the commitment of senior marketing, sales, finance, operations, and IT executives in order to make the required transformation. If the targets are perceived as being related solely to operations, the end-to-end perspective will be lost.

A pitfall for many insurers is that operations get a standalone cost-reduction target, with limited attention paid to improving service levels or lowering claims payouts. For example, one financial-services company, much of whose revenue was generated by mortgages and policies linked to them, sought to improve back-office efficiency and cost levels. It initially lowered costs by reducing idle capacity. When interest rates changed, however, large peaks occurred in the number of mortgage requests, causing long lead times and poorer service levels for brokers—who then channeled their requests to competitors. It soon became clear that mortgages and the life insurance tied to them offered very attractive margins for this company, so keeping some idle capacity in operations during quiet periods was more than compensated for during peak periods.

The key governance question concerns which specific aspects of operations should remain the responsibility of individual business lines and which aspects should be the responsibility of the group entity. Indeed, operations always play an important role in the overall value proposition of business lines, but there is often a need for a substantial increase in value creation by operations—requiring a group-directed overhaul. This governance question can usually be solved through organizational measures or through steering mechanisms.

If targets are perceived as being just operations related, the end-to-end perspective will be lost.

Solving the governance issue through organizational measures can involve steps such as integrating operations across business lines and across borders, and putting groupwide operations under the responsibility of a single COO. The business lines should agree on the SLAs (in terms of cost and service quality) for both standard and complex operational processes.

In our experience, when insurers follow a path of this nature, both standard and complex operational processes should be moved under the responsibility of the COO. The reason for such a move is that business lines, in situations where they are responsible for complex processes only, often find it difficult to have the discipline to avoid getting involved in standard processes as well. In addition, operational interfaces between generalists and specialists work less effectively if people are in different organizational units.

Solving the governance issue through steering mechanisms starts with creating performance transparency regarding operational processes—particularly on aspects such as cost efficiency, customer satisfaction, and claims payout ratios. After transparency has been established, best practices and areas for improvement can be identified across business lines. The identification of best practices tends to work best with standard processes because they allow for better comparisons across business lines after correcting for country- and channel-specific influences. With this approach, there is still a need for a coordinating role, but it can be a function of either the COO or line management.

The objective of each of these governance approaches should be to ensure that synergies are captured and that all initiatives are in line with the target operating model and IT architecture. In addition, in order to realize IT synergies and the target IT architecture, a management process should be installed to test whether major IT initiatives can be deployed and whether they are in line with the target IT-application architecture. For example, one international insurer allows its subsidiaries to decide on their own IT budgets, but it has also formed committees of CIOs and CTOs to drive commonality and cost savings. The company's IT-infrastructure services have been centralized, with large IT expenditures being reviewed by the group CIO in order to prevent double investments.

* * *

In our view, candidly answering the following questions can be a first step in helping insurers determine whether their target operating model is sufficiently robust to carry their company toward a future of sustainable growth and prosperity:

- What are our target service levels for core operational processes? How are they differentiated for various customer segments and channels?
- Which of our operational processes are best-in-class right now, given the service level we wish to provide for our customers?
- Who in our company is responsible for the development and optimization of an integrated process architecture across business lines?
- How well are our IT systems prepared for our target operating model? How are innovations in IT identified to help us shape our target operating model?
- How do we ensure that requirements from sales and operations are taken into account in our product-development process?

Forward-thinking companies that have thoroughly answered these questions will be better prepared to make a quantum leap in their service quality and cost position—as well as in overall performance and profitability—than companies that have not taken the time to proactively plan their future.

Since its founding in 1963, **The Boston Consulting Group** has focused on helping clients achieve competitive advantage. Our firm believes that best practices or benchmarks are rarely enough to create lasting value and that positive change requires new insight into economics and markets and the organizational capabilities to chart and deliver on winning strategies. We consider every assignment to be a unique set of opportunities and constraints for which no standard solution will be adequate. BCG has 61 offices in 36 countries and serves companies in all industries and markets. For further information, please visit our Web site at www.bcg.com.

About the Authors

Frans Blom is a senior vice president and director in the Amsterdam office of The Boston Consulting Group. You may contact him by e-mail at blom.frans@bcg.com.

Gunther Schwarz is a senior vice president and director in BCG's Cologne office. You may contact him by e-mail at schwarz.gunther@bcg.com.

Martin Danoesastro is a manager in BCG's Amsterdam office. You may contact him by e-mail at danoesastro.martin@bcg.com.

Wendell Kuling is a project leader in BCG's Amsterdam office. You may contact him by e-mail at kuling.wendell@bcg.com.

Acknowledgments

The authors wish to thank the following people at leading insurance companies for commenting on drafts of this document: Arndt Bickhoff, Managing Director at AMB-Informatik; Frank Hüppelshäuser, Head of Customer Care at AMV; Hanno Petersen, CIO at ARAG; and Martin Tschopp, Head Group IT & Business Operations at Swiss Life.

The authors also wish to acknowledge the valuable contributions of their colleagues Heiko Franken, Thomas Reichert, Christophe Duthoit, Stefan Bleyhl, Nicolas Schneider, Jean-Christophe Gard, Hanno Ketterer, Huib Kurstjens, Ralf Dreischmeier, and Thomas Achhorner.

Grateful thanks also go to Philip Crawford for his editorial guidance, as well as to other members of the editorial and production teams, including Katherine Andrews, Gary Callahan, Kim Friedman, and Sara Strassenreiter.

For Further Contact

For inquiries about this report or about BCG's Financial Services practice, please contact the authors in Europe or our regional experts in the Americas and Asia-Pacific:

Americas
Ian Frost, Vice President and Director, Chicago
E-mail: frost.ian@bcg.com

Monish Kumar, Vice President and Director, New York
E-mail: kumar.monish@bcg.com

Asia-Pacific
Andrew Dyer, Vice President and Director, Sydney
E-mail: dyer.andrew@bcg.com

Thomas Achhorner, Vice President and Director, Beijing
E-mail: achhorner.thomas@bcg.com

To receive future publications in electronic form about this topic or others, please visit our subscription Web site at www.bcg.com/subscribe.

The Boston Consulting Group

Amsterdam	Hong Kong	Paris
Athens	Houston	Prague
Atlanta	Jakarta	Rome
Auckland	Kuala Lumpur	San Francisco
Bangkok	Lisbon	Santiago
Barcelona	London	São Paulo
Beijing	Los Angeles	Seoul
Berlin	Madrid	Shanghai
Boston	Melbourne	Singapore
Brussels	Mexico City	Stockholm
Budapest	Miami	Stuttgart
Buenos Aires	Milan	Sydney
Chicago	Monterrey	Taipei
Cologne	Moscow	Tokyo
Copenhagen	Mumbai	Toronto
Dallas	Munich	Vienna
Detroit	Nagoya	Warsaw
Düsseldorf	New Delhi	Washington
Frankfurt	New Jersey	Zürich
Hamburg	New York	
Helsinki	Oslo	

BCG

www.bcg.com