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Operational Productivity: A New Route to Improving Insurance Competitiveness

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Operational Productivity:
A New Route to Improving Insurance Competitiveness

By Mark Foster-Collier and Kris Denton

For years insurance companies across Europe have been struggling with an accumulation of bad news. It's been an almost perfect storm of soft markets, low yields, increased regulation, and unprecedented natural catastrophes. The result has been forced mergers and divestitures, withdrawals from markets, and the sale of closed books.

In short, the insurance industry has been hammered, and the result is an all too familiar pattern: an announcement of reduced earnings is tied to an announcement of job cuts. Yet, without doubt, once things begin to improve, headcount and expenses will start to creep up, only to get cut with the next troubled earnings report.

It's a disruptive cycle of short-term fixes, and insurers know that to escape it they need to make fundamental changes to how they operate—perhaps even a total business transformation. But that's unrealistic at a time when most organizations are struggling simply to stay afloat.

Even without a 'big bang' solution, however, there's a path insurance companies can follow to give them more knowledge and control in stabilizing their business—a strategy that also offers a competitive advantage, since improving knowledge and control can allow products and services to be offered more efficiently and at a lower cost. The path to this solution is to tackle operational performance using supply chain operations as a model.

From Short-Term Fixes to Sustainable Productivity: Units of Work

Talk to any supply chain executive in product industries—from tablets to groceries to shoes—and you'll get an earful about "cost per unit." Let's say you have headsets that cost €10 to produce. By knowing the use and cost of each element in the production process, including FTEs, you can adjust the components of your supply chain to drive effectiveness, efficiency, and productivity. Done correctly, the result is reduced cost, increased profit, and improved competitiveness.

Many manufacturers, like insurers, operate at low-margins, and have learned to look beyond financially-oriented industry metrics like Operating Expense Ratios to stay competitive. Instead, they delve into the microeconomics of their business.

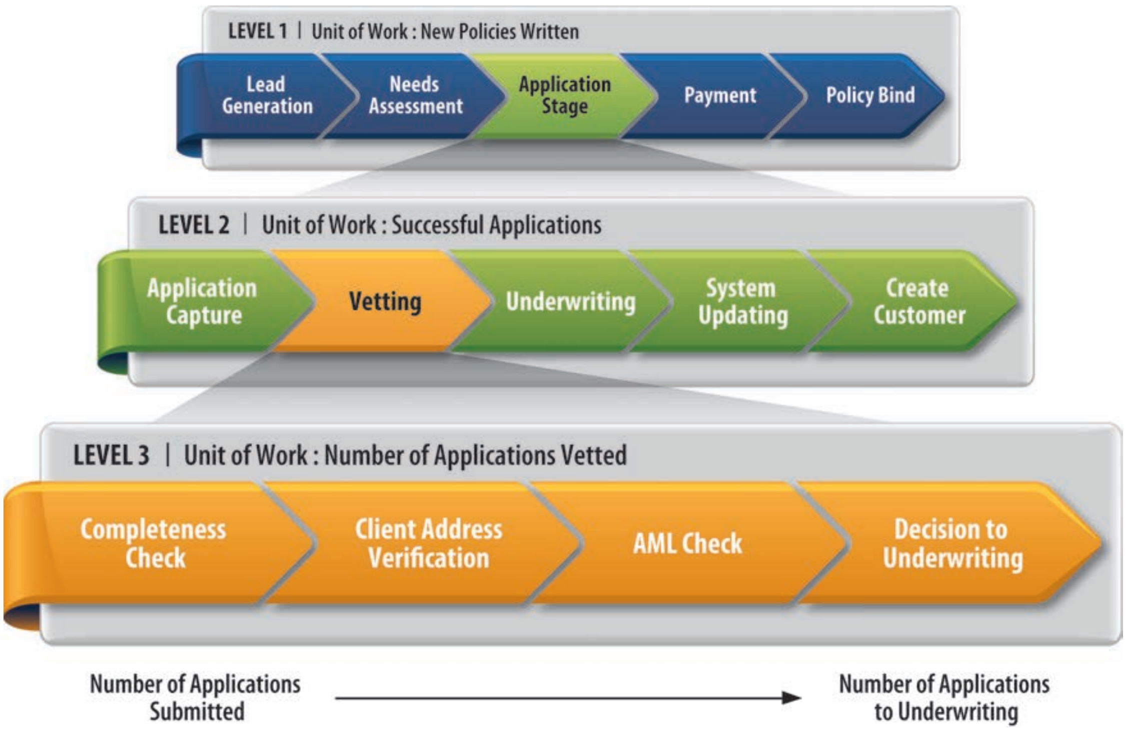
They examine processes in each work stage, what we've termed a "unit of work," to understand and improve each of the underlying elements that drive their costs and operating performance. Applied originally to the plant floor, manufacturers have extended this focus to include their entire supply chains. These microeconomic drivers include transaction volume and variance, work structure and required skill levels, cost and productivity per paid hour of both labor and capital, as well as number of hand-offs, process bottlenecks, and re-work.

This microeconomics mindset hasn't been pervasive in the insurance industry. Yes, there have been sporadic attempts to apply Lean/Six Sigma manufacturing principles to insurance, but with limited measurable impact on the bottom line. Internal arguments about the unique requirements of insurance, and concerns about preserving critical expertise in the "knowledge work" of insurance operations, usually doomed most of these earlier improvement initiatives. We've also seen many insurers waste enormous amounts of IT capital on automation without achieving sustainable returns from that investment—a pattern that's traceable back to a lack of sufficient attention to the microeconomic drivers of processes and performance.

Ironically, insurers stand to benefit perhaps even more than traditional manufacturing by attacking costs through "unit of work" productivity and other microeconomic drivers, since insurance products are virtual. Most of an insurer's cost is in headcount.

We have successfully applied the microeconomic unit of work approach in our own firm and elsewhere in the financial services sector, and it is just as applicable to insurance. As an insurance executive you can't simply rely on new products,

Process Disaggregation:



premium increases, or even emerging markets for higher profits. You also need to know the step-by-step performance involved in delivering services so you can manage them to create a streamlined, responsive, and profitable organization. As you examine performance and drivers in units of work, you'll find that even some of those old "core versus non-core" arguments can be exploded and your valuable and expensive subject matter experts (SMEs) can be focused on driving value and, through that, increased competitiveness.

The process starts with digging into your company's operating ratio. Many insurers use this as a key metric, but few use it to focus investment or productivity drives. How does this play out in new business processing for life insurance? By breaking down key steps in acquiring a new customer, for example, you can see there are a lot of hands—and associated costs—involved.

At the outset there's the marketing and lead generation, and a needs analysis based on a customer inquiry. Then someone has to create and discuss a proposal with the prospect. Once the proposal is accepted, the application form must be completed, submitted, processed, and vetted. Next comes underwriting, which may be automated or manual. The payment method must be activated and processed, and the system must be updated to include the customer information. Then you bind the policy and send the customer the policy schedule and welcome kit, which must be written, designed, and printed.

That's just for one customer. How many FTEs help customers through each of these processes in each branch and central location? What does it cost to recruit and process each new customer through each of these eight steps? Each of the steps represents a "unit of work" for potential improvement. So, let's say it costs €100 end to end to set up a new customer.

You can now examine options to bring down the cost to, say, €75. Can the work be structured to be done by fewer people or a different mix of people? How much of each workday are your SME's actually using that expertise versus performing other less valuable tasks? When you follow the work flow of a single customer setup across all of the units of work, do existing IT systems help or actually hurt productivity (i.e., multiple data sources must be consolidated by a person)? Do some agents require more support than others? Are there issues with different needs assessments? What are the variances between literature costs, given the detailed examination required to ensure that the documents are accurate and compliant with prevailing regulations?

In examining your operational processes you will likely discover duplicated efforts and system redundancies, or processes that require more steps than necessary because of aging exception-handling rules. All these inefficiencies are now exposed and correctable.

For a sense of how this would work, consider a company whose operating expenses continued to rise even after a 15 percent headcount reduction. The company examined its microeconomics by detailing and reviewing the steps used in the new business process and baselined its costs for onboarding new customers. For each step, the company calculated its productivity and cost per unit of work, comparing it to historical costs and competitive data.

Through this examination the company discovered a problem in the application vetting stage. Within this activity, the analysis showed 20 percent of applications were responsible for 80 percent of the effort and cost. Certain types of applications contained significant errors and had to be repeatedly checked. But more interestingly, not all of these applications had the same level of errors, but the same brokers made consistent errors.

By focusing on the brokers submitting the erroneous applications, two changes were initiated: Computer Based Training was provided to the brokers involved, and a simple change was made to the forms required for a class of products. With a huge reduction in vetting, the company's unit of work costs for new business dropped from €100 to €88. The company could then look at the remaining new business processes to streamline the unit of work even further; and with these efficiencies and lower operations costs, they could even bring down product prices to attract new customers.

This example shows that within the application, vetting, and underwriting processes there are numerous work steps which the unit of work approach categorizes as either transaction or knowledge steps. More often than not, the execution of the transaction steps surrounding the knowledge steps is performed by SMEs.

By isolating productivity, headcount costs, and knowledge versus transaction steps, you can increase the opportunity for improvement with even more options for making changes than the simple fixes described above, such as automating transaction steps or "leaning" processes. Or, perhaps it suggests the advantages of making investments in truly differentiating knowledge steps while rethinking core versus non-core activities.

The point is that now you can make choices that have both short-term and long-term benefits to the organization instead of being reactive to the markets or the forces of Mother Nature.

Two Opportunities

Examining your organization's core capabilities and the processes that deliver output gives you a functional understanding that offers two additional key opportunities. You can remove, reduce, or outsource areas that are not at the core of your value chain; and you can create a baseline of your current output production for each area. With actual historical operations data, trending different units of work allows you to zero in on those with declining productivity and make necessary changes.

As you get started, here are the key questions you'll want to ask:

- What are my core differentiating insurance processes?
- Which processes drive the greatest value and which represent the greatest cost?
- Which processes are increasing in cost faster, and why?
- Which processes are rapidly becoming commoditized and can be sourced differently? (Compliance is one area where we are seeing different models emerge.)
- Is there an accurate cost allocation model that spans organizational boundaries and departments?
- To what extent can I extend this analysis across multiple markets and geographies? Can this extend to product components as well as processes?

Conclusion

Insurers have three big buckets of activity that define their business: putting business on the books, managing the business while on the books, and settling the business when it comes off the books (that is, dealing with claims). While insurers generally use their combined operating ratio as the master metric—say, moving from 102 percent down to 99 percent—they tend to just cut the biggest numbers without delving into the precise metrics.

By changing your focus to operational productivity you could potentially move your operating ratio 10 to 20 points—doing it rationally and benchmarking yourself using value as your guide. This will help drive your firm's competitiveness. You can reinvest these gains into your pricing and servicing because you will understand precisely how your organization works, know that you're running it without fat, and know that you've made it nimble for when change is necessary.

The units of work model may not prevent earthquakes, floods, or new regulations, but it will help make your company better able than your competitors to survive them.

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