

Win in the flat world

Overcoming Scale Disadvantages in Life Insurance Operations

– Sanjay Kumar, Biji Thomas

How carriers with less than \$ 5B in annual premium revenues can overcome the cost disadvantages of scale they face in life insurance operations.

Abstract

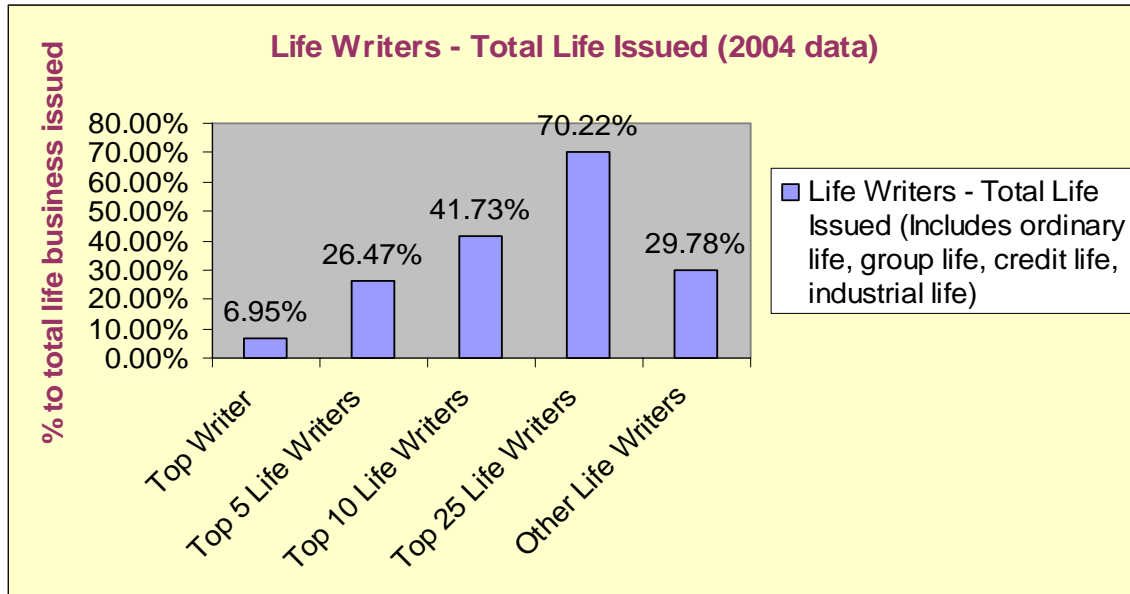
Our research indicates that a major contributor to the high operating costs incurred by mid-size carriers is the inefficiencies resulting from their heavy dependence on paper-intensive processes. This paper examines the cost disadvantages that this creates for mid-size carriers in the US life insurance industry due to a lack of economies of scale. It explains how mid-size carriers can especially benefit from document management and workflow technologies that can reduce manual effort and paper-intensity even in the context of smaller scale of operations.



Background:

The US life insurance industry is highly fragmented, with over 1,500 Life and Health Insurance carriers offering a wide portfolio of products. Even so, significant market share is concentrated in the top 2-3% of players. For instance, the top 25 life insurance companies collectively underwrite more than 70% of the total life policies issued. This naturally means that several carriers own a very small (less than 1%) share of the market.

Fig: 1



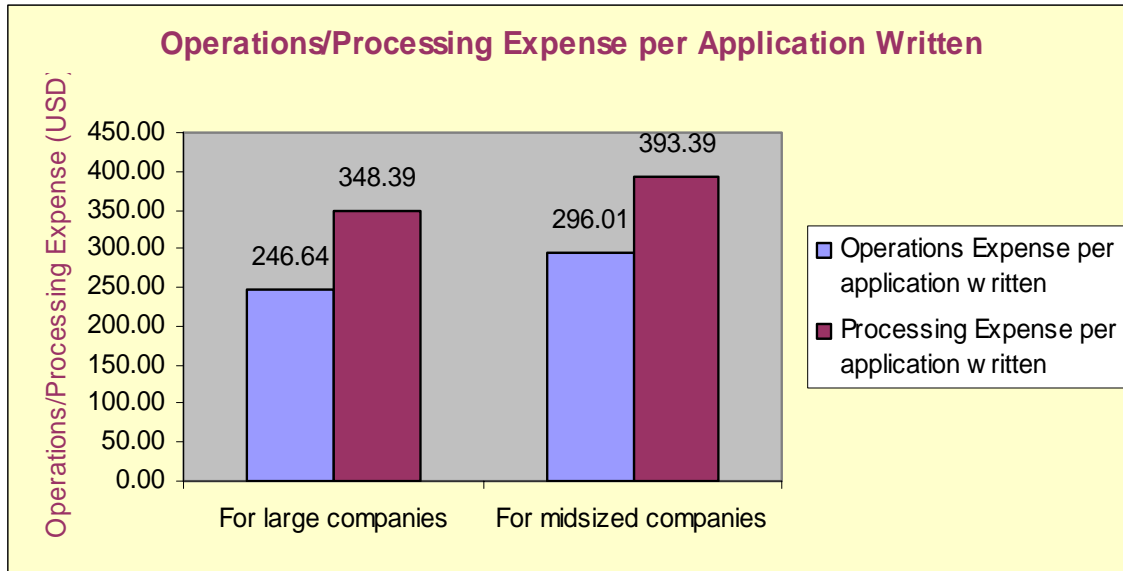
Source: Derived from Best Review Magazine. 2004 data through Infosys Analysis

According to the TCi LIONS Survey, 2004¹, the average operations cost incurred per application written varies with the size of the carrier. For mid-size carriers (defined as those with annual revenues of less than \$5 billion), the cost is \$296.01, whereas the corresponding figure for carriers with revenues of over \$5 billion, is \$246.64. In today's highly competitive marketplace, this gap of about \$50 per application written represents a significant competitive disadvantage to mid-size carriers.

The US life insurance industry is highly fragmented with as many as 1500 insurance carriers competing for a slice of the market.

¹ Annual survey conducted by TCi Consulting & Research (TCi) since 1996. All figures based on 2003 data.

Fig: 2



Source: Derived from TCi LIONS 2004 Survey

The difference is not hard to explain. Large carriers have a larger pool of policyholders and policies to manage and service. This ensures that their risks are spread more evenly and their losses are relatively more predictable. The larger volumes also allow carriers to spread their labor, information technology and facilities costs over a larger number of policies, thereby reducing the overhead allocated to each policy serviced. Larger companies thus inherently enjoy this “scale benefit” over their mid-size rivals.

Large carriers have an inherent advantage over small-to-medium size companies in controlling costs.

For most mid-size and small carriers, challenges related to “scale” are further exacerbated by paper-intensive and inefficient processes and low bargaining power with requirements vendors, channel partners and customers. All these result in additional costs being added to the cost structure of mid-size carriers.

The “new business” challenge for mid-size carriers

Insurers are today increasingly faced with a higher level of competition from non-insurance business entities such as banks, mutual fund companies, and investment advisory firms. In addition to being competitive, the life insurance industry is mature and has a fairly homogeneous set of products and services. Profitability in the industry today depends much on the insurer’s ability to control costs and offer products at competitive prices.

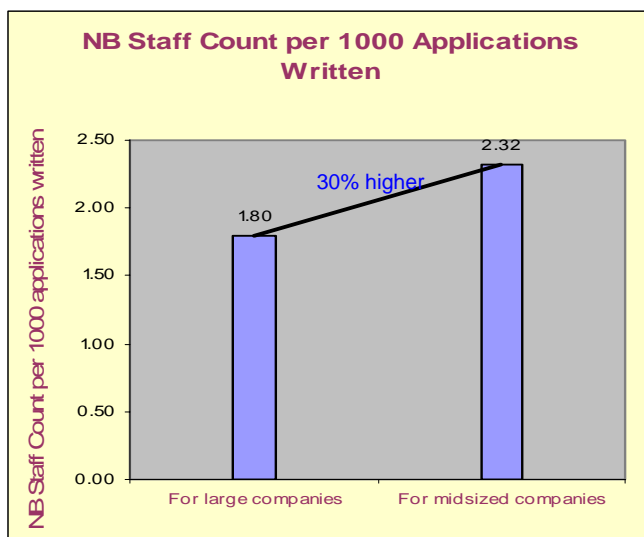
Increased competition and the commoditized nature of insurance products have made cost control all the more important and difficult.

New Business processing is a key candidate operation for cost control in life insurance operations, as it accounts for between 30% and 60% of a carrier's operating cost. A life underwriter receives a vast amount of information from multiple internal and external sources. Most, if not all, of this information is received in paper format. Significant manual effort and supervision are therefore required to manage intermittent receipt of paper, assignment of work, and monitoring case progress. This increases policy issuance cycle times, affects employee morale and fails to meet agents' and customers' service expectations. Other drawbacks of working with paper include the considerable storage costs and increased efforts in retrieval of information.

New Business, with its paper-intensive processes, poses a threat to the company's cost control measures

Small to medium-size insurance companies' feel these challenges more acutely. Their relatively smaller size limits their bargaining power when it comes to the price paid to external vendors for services rendered (requirements, credit history details, etc.). Intermittent business volume fluctuations also impact operational efficiency and increase the cost of doing business, due, among other things, to higher staff augmentation costs.

Fig: 3



Source: Derived from TCi LIONS 2004 Survey

Data available from the TCi LIONS Survey, 2004 indicate that the average New Business operations staff count per 1,000 applications written is about 30% higher in small to medium-sized companies compared to their larger counterparts. This means that compared to a large insurer, a mid-sized company writing 65,000 applications per year would require 34 additional staff to process the applications.

The small to medium carriers, due to their relatively smaller scale of operations, are more adversely affected due to these business challenges, as statistics prove.

Implications

In the short term, this will manifest as increased cost of procuring incremental business and higher product prices. In an industry that has traditionally been known for its high distribution costs and price competition, increasing the price of products is challenging, to say the least. The logical impact will therefore be on profits. Other fallouts could include financial instability leading to reduced budget for future investments, lowering of ratings by financial rating agencies like A. M. Best Co., increased scrutiny by regulatory bodies, customer attrition, and overall loss of competitiveness.

In the longer term, the quest for economies of scale and improved efficiencies could make smaller carriers acquisition targets, as consolidation increases opportunities to cross-sell, improves customer satisfaction, and aids in enhancing revenue efficiency. Financially weak insurers also face the onerous prospect of having to raise their capital levels to conform to standards to avoid regulatory punitive action.

Scale disadvantages can have debilitating effects on carriers' competitive position both over the short and long term. It is thus imperative for these smaller-sized companies to come up with creative and innovative ways to control NB costs.

The preceding discussion illustrates how optimizing New Business operations can enable management of small and mid-size life insurance companies to minimize the scale disadvantages they face, thus making the playing field more level vis-à-vis their larger competitors. Innovative application of workflow management technology and intelligent process reengineering can allow mid-size carriers to achieve this outcome, as discussed in the next section.

Eliminating scale disadvantages through Infosys' New Business Process Excellence (NBPE) solution

For mid-sized insurers facing high operating costs and operational challenges due to paper-based new business processes, Infosys' **New Business Process Excellence (NBPE)** solution offers an innovative, low-cost, high-ROI approach to realize significant operating cost reduction and other strategic benefits. By combining imaging, document management and workflow technologies with New Business processing domain knowledge, NBPE offers a roadmap for life carriers to eliminate paper-related inefficiencies. This translates into cost reduction per unit of policies underwritten.

The NBPE solution uses four “technology levers” to transform the way in which new business underwriting functions:

- **Electronic content capture:** Capturing content in electronic format early in the process using automated capture technology.
- **Intelligent content storage and management.** Storing electronic content in a usage driven manner creating several different views and work packets that facilitate context specific retrieval.

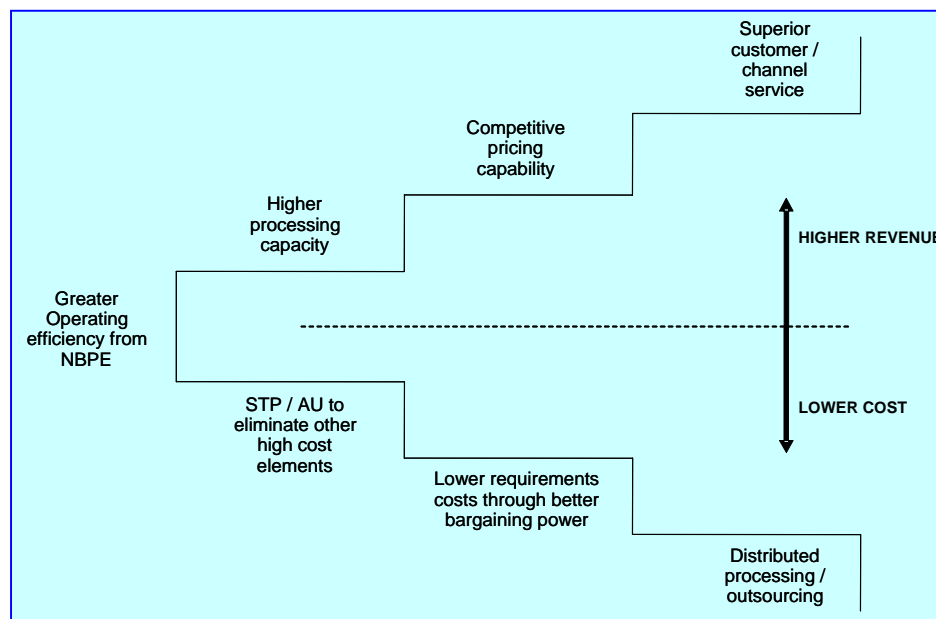
- **Automated, rule-based, content routing:** Codifying workflow rules and using these rules to route relevant work packets to appropriate processing resources at appropriate points in time.
- **Integration with legacy transaction systems:** Creating a plug-and-play, modular architectural basis for integrating these “efficiency enabling” technologies with legacy transaction systems.

The methodology and concepts incorporated in Infosys' NBPE solution help to eliminate the scale disadvantages experienced by small to mid-sized companies.

The primary driver for transformation is the conversion of paper into images up-front in the process, routing the images to the right processor at the right time, and managing the process in the most efficient manner possible. Given the issues of paper intensity and manual workflow and the resultant costs, Infosys estimates that mid-sized companies can reduce New Business operations costs by as much as 25%. Typical benefits include 10%-15% reduction in labor cost savings, 2%-5% reduction in cost of requirements, 50%-100% reduction in paper storage, warehousing and paper replication costs. On a per policy basis, this translates into significant cost reduction and hence in the “scale disadvantage”.

Benefits from the implementation of this solution can be both tangible and strategic. The reduced up-front expenditure required makes this solution more attractive to carriers.

The ‘multiplier effect’ comes from the additional processing capacity and revenue enhancing capabilities that NBPE creates for carriers. Further, NBPE lays the foundation for several other operational cost reduction initiatives such as straight-through processing, automated underwriting, electronic requirements ordering and receipt, distributed processing, and even business process outsourcing. Small and mid-size carriers can therefore dramatically lower their cost structure and eliminate the scale disadvantages by lowering the minimum efficient scale required for profitability in the industry.



Lower investments, higher Rol

An important, but often overlooked aspect is that of the up-front investment required to achieve these savings. A traditional approach to deploying imaging, workflow and document management technologies to overcome the challenge posed by paper-dependent business processes would cost several millions of dollars. Such a large investment is difficult to justify in the current economic environment. NBPE drastically reduces up-front investment required by accelerating the implementation cycle, using resources optimally and adopting appropriate[0] technologies at the lowest cost.

There are many other actions that could be (and indeed, should be) taken by small and mid-size carriers to eliminate the scale disadvantage highlighted in this paper. Small and mid-size carriers could merge, acquire or otherwise combine resources to increase scale. Carriers could also consider outsourcing some business processes to service providers who can benefit from scale in their operations and pass on these savings back to the carriers. However, we believe that these actions are less immediate, in terms of both ease of implementation and benefits realization, in comparison with the NBPE-led approach to eliminating operational inefficiency. Moreover, NBPE-led transformation of operations will facilitate many of these other actions.

Conclusion

Document Management and Workflow Management technologies are prevalent in the insurance industry. Many carriers have adopted these technologies to achieve different levels of process maturity. However, Infosys believes that the full business value of these technologies has not been leveraged. Given that New Business operations constitute a significant portion of total operating costs of life insurance companies, this represents a significant opportunity.

The LIONS Survey, 2004 has established that the unit cost of doing business is relatively higher for mid-size insurance companies vis-à-vis their larger counterparts. Infosys believes that small to medium-sized insurance companies can realize significant strategic and operational advantages by streamlining their New Business processes through Infosys' New Business Process Excellence framework.

Contact us:

For more information about the NBPE solution and how it can help your organization, please send an e-mail to biji_thomas@infosys.com.

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