REFLECTIONS

OPPORTUNITIES OF OUTSOURCING IN INSURANCE INDUSTRY

S R Raghu

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1. Executive Summary

Tom Peters Once said, “Do what you do best, outsource the rest”. This line may pose a conundrum to some one trying to figure out benefits of outsourcing. Reading the above line in tandem will certainly assist the insurers about what benefits can outsourcing offer to their stakeholders and can also act as a key differentiator to their business. Several benefits can be derived by outsourcing, which has helped the services industry in transforming their business model to be successful financially, operationally and in offering better services to their customers. Initially it was the financial services and banking industry that were the front runners in the outsourcing marathon, and most of the companies did reap the benefits. However, the Insurance companies have been stragglers in this huge influx of outsourcing opportunities. Even though some of the insurers might be aware of the benefits of outsourcing, they may lack in understanding the outsourcing model or there is a possibility of companies in turmoil of operational planning of outsourcing.

However, things are changing in insurance industry with companies adopting or taking new initiatives enabling information technology across different functions and processes. This paper tries to bring out the opportunities of outsourcing in insurance vertical, covering the common business processes enabling technology. Further, the paper attempts to list down some of risk factors involved in the whole cycle of outsourcing. It also tries to address the uncertainty of operational planning, so that it shouldn’t act as an impediment, but instead gives an impetus to insurance players in reaping the benefits of outsourcing.

About the Author

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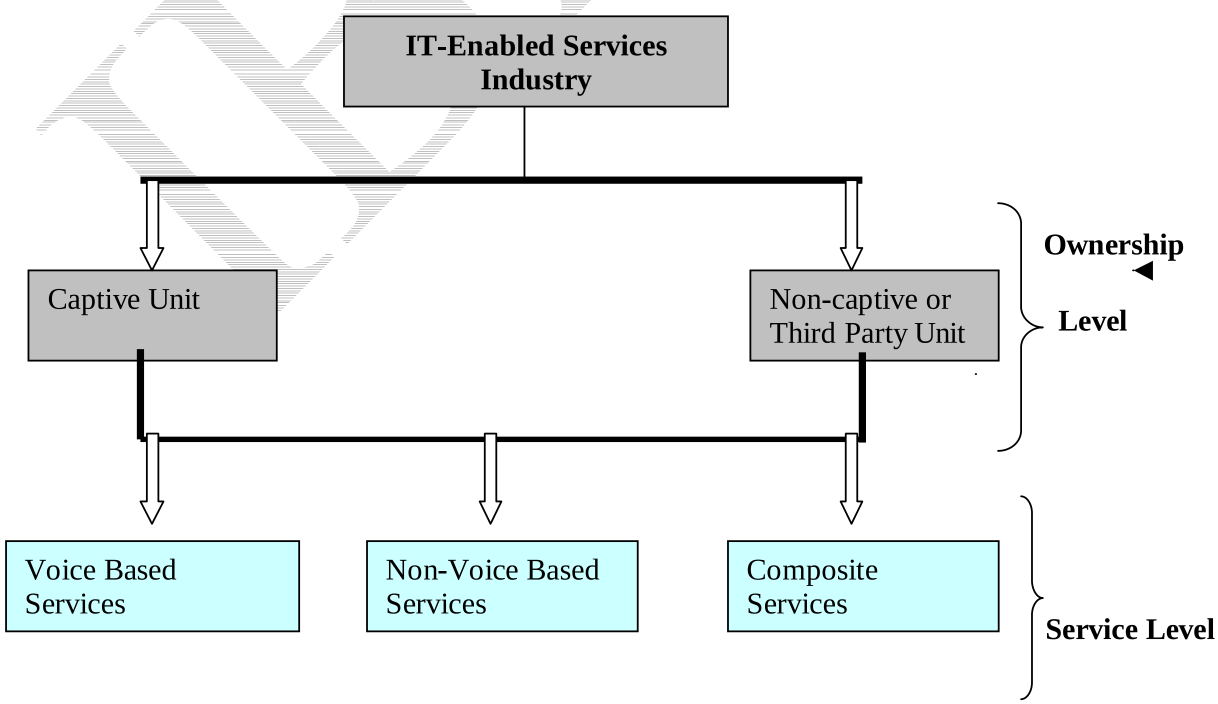
2. Introduction

The simplest Web definition of Outsourcing is 'the delegation of non-core operations or jobs from internal production within a business to an external entity (such as a subcontractor) that specializes in that operation'. Outsourcing is a business decision that is often made to lower cost or to focus on core competencies. The most common examples are call centers, accounting, data processing and payroll outsourcing. Business process outsourcing may also involve the use of off-shore resources to support the business. But, there is a misconception in people's mind that BPO is synonyms with Call center. Therefore, before we get into the outsourcing story, let us try to understand the industry at a macro level and address this misconception.

The ITES industry may be segmented based on the kind services the firms offer or on the ownership of the firm that outsource the process.



The above diagram tries to simplify in understanding the segmentation of the industry. Here the industry is differentiated at two levels,

a) First level is ownership level

b) Second level is service level

a) Ownership Level Segmentation:

Under ownership level, there are two major units namely, captive and non captive or third party unit. Both the units can be either Multi National or Indian based companies.

A captive centre usually handles proprietary (core) processes that are consciously retained within the family entity for greater control and ownership. To put in simple words, these are the units which own and manage their own business processes and do not depend on external vendors. Usually Multi national companies set up their own captive centre either to offshore or near shore some of their core and non-core processes.

A third party or a non-captive centre handles business processes of more than one company. There core strength lies in managing multiple processes across different functions and delivering to the client as per their service level agreement. For e.g., a third party center in India may manage an insurance companies policy administration, a bank credit transactions and the payroll of a big manufacturing company. The key differentiator between a captive and third party is the sense of proprietary and control over the business.

b) Service Level Segmentation:

From a service level perspective, both the captive as well as third party service providers can offer either all or one of the services to their clients or to their business as mentioned in the above diagram.

Voice based services are basically call centres (both inbound and outbound) where a customer service executive sitting in India, answers to the calls from either client site or from the customer location.

Example of a call centre services include, telemarketing, customer support, technical support, help desk etc.

Non-voice based services are those where data processing or transaction processing is undertaken. In non-voice based services, a process executive will process a transaction or a data or generate a report

Example of non-voice services includes, transaction processing, claims processing, Accounts receivable or accounts payable, data conversion etc.

Composite services are those where there both calls are answered and transactions being processed.

Let's take an example of a US insurance company which has outsourced some of its non-core activities to a third party service provider. The third party is into composite services and takes care of both customer support and transactions processing. Let's say a policy holder wants to raise a claim on his policy, he calls up the insurance company to clarify some of the doubts with regard to the claim. Here call will be routed to the third party service provider who takes the call and answers to the queries.

The same policy holder sends his claims form along with supporting documents for claim settlement. The forms will be sent to the third party center to fulfill the claims. Now the non voice based services gets active, the process executive will follow the set of guidelines given by the client, process the request and update the system about the status of the claim. These two activities are entirely different from the process perspective; the former is a voice based activity and later becomes a non-voice related activity.

These processes can be either core or non-core to the enterprises. Generally, those processes that are the source of competitive advantage and, therefore, owned and operated by the enterprise are known as core processes. These activities help achieve differentiation in both financial and operational performance and are imperative for strategic decisions making.

Non-core processes are those processes that do not necessarily provide competitive advantage, and may act as a support to the core business.

Mentioned below are some of the core and non-core activities of a typical service oriented company.

Core Activities	**Non-core Activities**
Risk Management	Customer support
Tax returns Filing	Tech support
Financial analysis	General accounting
Treasury operations	HR/payroll processing
Financial reporting	Data processing
Underwriting	Premium accounting
Reinsurance	Out & In bound call centres
Cash management	Indexing
Portfolio analysis	MIS

Some of the Top players in Captive and Third party ITES industry

Third Party Service Providers

Genpact

WNS Global services

Wipro BPO

HCL

ICICI One source

Accenture

IBM

ACS

24/7

Captive ITES companies

HSBC

CitiBank

HP

Goldman Sachs

JP Morgan Chase

Intel

2.1 Market Size of ITES in India

India is fast turning into a major ground for outsourcing Business processes and other software related jobs. Offshore outsourcing in India is developing with new companies- both medium as well as large ones- setting up their operations. As mentioned earlier, in the initial days of business process off shoring to India, BPO was synonymous with call centers-primarily in customer service, and telemarketing. However, due to fall in the revenue realization and margins, companies consciously started focusing on what is popularly called "non-voice" opportunities In India.

The Global outsourcing market as per Price water house coopers is as follows

2000	USD$ 119 Billion
2005	USD$ 234 Billion
2008 (est.)	USD$ 310 Billion

Source: PriceWaterCoopers

Mentioned below are the figures available from NASSCOM (National Association of Software and Services Companies) which is the umbrella organization for IT software and services companies in India. These are the figures with respect to the export in the ITES industry. There is a 40% growth rate in the ITES exports for the year 2005-06 and it is expected to grow to USD 8-8.5 billion in FY 2006-07.

ITES-BPO Exports (USD billion)

ITES-BPO	2002-03	2003-04	2004-05	2005-06
Exports (USD bn)	2.5	3.6	5.2	7.3
Domestic (USD bn)	0.2	0.3	0.6	0.8
Employment (no. of ppl)	171,000	245,000	348,000	470,000

Source: NASSCOM

Most of research analysts and consultants are very bullish on the ITES sector in India and they hope the growth rate to pick up momentum over next years. There is a high demand for man power both at the entry level and managerial level in managing the accounts.

2.2 Importance of Outsourcing in Insurance Industry

Insurance companies have traditionally been among the slowest adopters of outsourcing/off shoring. However shrinking margins, higher claims disbursement and increasing competition in recent years, especially post 9/11, have forced insurance companies to look at outsourcing/off shoring to improve efficiency and channelise resources towards the core functions of product development and innovation. The size of the insurance industry, with over 1500 P&C insurance companies and 1300 health insurance companies in the US alone makes insurance outsourcing an attractive market. The success of the early adopters will determine future growth rates. Several niche providers with relevant domain expertise are emerging and encouraging insurance companies to outsource more value-added services.

Some of the key drivers of insurance off shoring include:

- Cost saving
- Focus on core processes
- Speed to market
- Technology risk
- Better quality through specialized services
- Deregulation of insurance markets
- Availability of credible service providers
- Minimizing risk through multiple delivery locations

3. Insurance Industry Processes

Insurance business is a process oriented business and if you look at the traditional value chain of an insurance company, there are basically five functions which form the value chain. A diagrammatic representation of insurance business value chain will look like:

(Source: Swiss Re Economic Research & Consulting)

A holistic view on the value chain reveals that there are some more functions involved in insurance business which merit attention.

In order to break down the traditional value chain of insurance business from the outsourcing point of view, we need to differentiate at generic level, namely,

- Core to the company
- Non-core to the company

We shall then drill down into processes to the functional level and place each of the processes to the concerned function. The basis of differentiating core and non-core processes follows current practice adopted by insurance companies and analysis of some of the processes that are outsourced by insurance companies to offshore vendors.

3.1 Core and Non-Core Business processes of an insurance company

Core Processes	**Non-Core Processes**
Product Planning	Policy related forms design
Business analysis and Technical design	Outbound/Inbound call centre
Policy pricing	New business data entry
Marketing activities	Voice support to agents and policyholders
Field Underwriting	Premium posting
Claims evaluation, examination and litigation	Account reconciliation ,Accounts payable and receivable
Performance Management services	Returns bank items
General Accepted Accounting Principal	Suspense clearance
Financial statement analysis	Waiver of premium cancellation
Investment functions	Premium refund
Reinsurance	Account transfer
Portfolio analysis and decisions	Policy owner services
Product filing with regulators	Claims registering
Agency Management	Payroll processing

3.2 Functional wise process differentiation of an insurance company

In this section, the value chain is further elaborated, based on functions carried out under each segment. Each function lists down different processes that are carried out that may be core or non-core to the business. The process is categorized as,

Difficult to outsource

Potential to outsource

Widely outsourced

The Difficult to outsource processes are core to the business which forms the part of the mainstream business activities.

Potential to outsource processes are those which supports the main stream business and have the potential of outsourcing.

The Widely outsourced activities are pure operational or the transactional level activities

Product Development

- **Product Planning**
- **Business Analysis and Technical design**
- **Policy Pricing**
- **Policy Wording**
- **Policy related forms Designing**

Marketing & Distribution

- **Direct sales and promotion**
- **Marketing activities**
- **Outbound/inbound telesales**
- **Advertising**
- **Support activities such as agent compensation, performance tracking of agents and sales force, training etc**

Underwriting & New Business

- **Field underwriting (Reviewing applications, gathering additional information and making decision)**
- **New business data entry**
- **Voice support (to agent and new policy owners)**

Premium Accounting

- Premium posting
- Account reconciliation
- Returned bank items
- Suspense clearance
- Waiver of premium cancellation
- Premium refund
- Unreserved premium posting
- Account transfer

Policy Owner Services

- Loan processing
- Withdrawals
- Discounts and loadings adjustments
- Policy surrender
- Dividend payment
- Non-forfeiture option
- Non-premium bearing endorsements
- Premium bearing endorsements
- Request for information
- Outbound/Inbound call

Claims Processing

- Registering claims
- Indexing
- Data entry
- Editing, referencing and verification
- Invoice processing
- Payment
- Recovery of overpayments
- Adjusting overpayments
- Claims evaluation, examination and litigation

Support

- Cash receipts and disbursements
- Recording cost details
- Book keeping
- HR administration
- Payroll processing
- Accounts payable/receivable
- Performance management services
- Recruitment and staffing
- GAAP
- Financial statement general ledgers

Corporate treasury functions

- Investment functions
- Portfolio analysis and decisions
- Reinsurance
- Periodic evaluation

-Insurance Functions

- XXX
- XXX
- XXX

-Processes

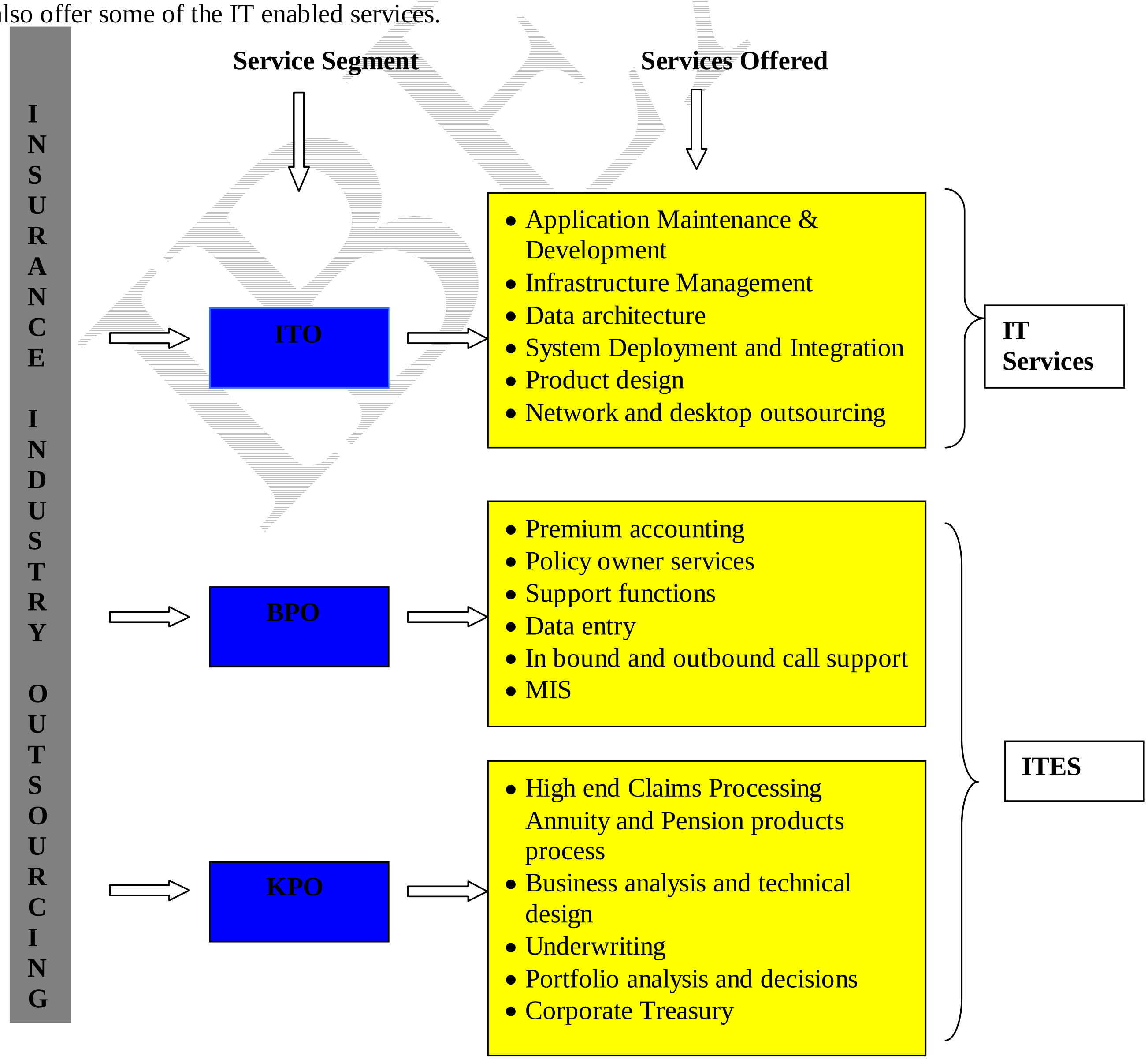
Let's take an example of product development function, which is one of core functions of insurance business. This deals with designing and development of new products or product variant within a product line. The red points under the box are the activities that the product development dept carries out. Activities such as product planning, policy pricing or business analysis requires vast domain expertise and experience; therefore the companies would wish to retain these as their in house operation.

Let's take a look at the policy owner services function, which is purely operational activity handled by the operations team in an insurance company. Companies widely offshore these function to other low cost countries to gain cost advantage so that they can focus more on core activities such as product development, underwriting etc.

There may be processes within a department, which are both core and non-core. For instance, in claims processing; some of processes like, indexing, claim registration or data entry can be outsourced to a TPA or to an external vendor. Some of the payment activities, which have the potential of outsourcing, can be outsourced taking into consideration, the internal and external environment. Processes related to claims evaluation, litigation or examination could be retained as in house activity as these need deep understanding of the problem and may require frequent interaction with several parties involved in the overall claims settlement-right from customer to legal experts.

4. Outsourcing Model for Insurance Industry

The model shown below gives an overview of the outsourcing covering the end to end services from Information Technology Outsourcing to the new buzz in the industry called ‘Knowledge Process Outsourcing’. It also includes different services offered under each outsourcing segment. The model is based on the services a company can offer to its clients. It is possible that all the three services can be bundled as one and can be offered to the clients. For e.g., an IT services vendor who is currently offering services in Application maintenance and development and infrastructure management to an insurance company, may also offer some of the IT enabled services.



5. Information Technology Outsourcing in Insurance Industry

Information Technology Outsourcing (ITO) is the contracting out of IT service to one or more external organization (some times called vendor) responsible for managing and delivering the required services to the client organization. Although the industry was an early adopters to IT outsourcing (ITO) and offshore models, growing concerns over the proper role of outsourcing and the stability of global sourcing models has had a negative effect on the industry.

Evidence of the problem can be seen in the drop in ITO use in 2004. A Gartner study (conducted in June 2005 among 85 U.S.-based insurers with more than $100 million in net annual premiums) found that 41% of life and 34% of property and casualty (P&C) insurers are outsourcing IT projects. This is a significant decline from the previous year, when 53% of life and 57% of P&C insurers used ITO at year-end 2003.

6. Business Process Outsourcing in Insurance Industry

Business Process Outsourcing (BPO) is the delegation of one or more IT-intensive business processes to an external provider that, in turn, owns administers and manages the selected processes based on defined and measurable performance criteria. Business Process Outsourcing (BPO) is one of the fastest growing segments of the Information Technology Enabled Services (ITES) industry.

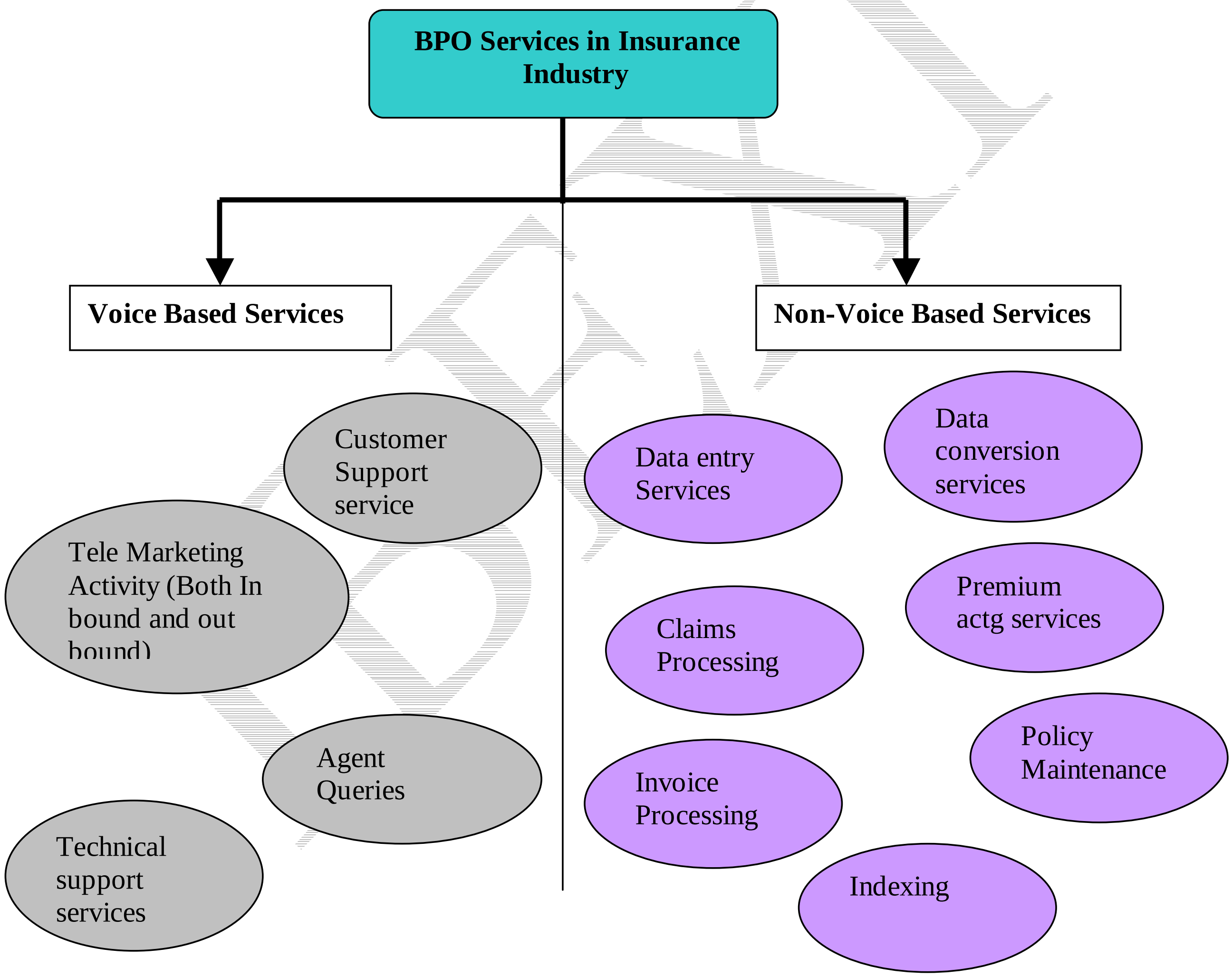
The various challenges facing the Indian BPO industry are

a) Multi national companies setting up their own captive centers

b) The big global customers are showing an increasing preference for the large and global technology service providers for sourcing their IT needs, having strong BPO division.

c) Cost saving is not only the reason for outsourcing. Companies are looking beyond the cost factor such as value added services.

Some of services offered by the BPO companies to their clients include



6.1 Data Processing Services

- Data entry from Paperwork received
- Data entry from Image file in any format
- Business Transaction Data entry like sales / purchase / payroll.
- Data Entry and compilation from Web site
- Data Capture / Collection
- Data Entry from hardcopy/Printed Material into text or required format
- Data Entry into Software Program and application
- Receipt and Bill Data Entry
- Catalogue Data Entry.
- Copy, Paste, Editing, Sorting, Indexing Data into required format etc.

6.2 Data Conversion Services

- Conversion of data across various databases on different platforms
- Data Conversion via Input / Output for various media.
- Data Conversion for databases, word processors, spreadsheets, and many other standard and custom-made software packages as per requirement.
- Conversion from Text to Word Perfect.
- Conversion from Text to Word to HTML and Acrobat
- Convert Raw Data into required MS Office formats.
- Text to PDF and PDF to Word / Text /Doc
- Data Compilation in PDF from Several Sources.

6.3 Policy Maintenance / Management

- Record Changes like Name, Beneficiary, Nominee, Address
- Collateral verification
- Surrender Audits
- Accounts Receivable
- Accounting
- Claim overpayment

- Customer care service via voice/email etc.

6.4 Customer Support Services

Customer support services centers to manage customer concerns and queries through multiple channels including voice, e-mail and chat on a 24/7 and 365 days basis. A lot of services can be offered in the customer support center, like answering queries on the pending claims, endorsements, request for policy statement etc.

6.5 Technical Support Services

Technical support offerings include round-the-clock technical support and problem resolution for the back office systems and applications. These include installation, product support, and troubleshooting.

6.6 Telemarketing Services

Telesales and telemarketing outsourcing services target interaction with potential customers for 'prospecting' in new products and services, up-sell / promote to an existing customer base to complete the sales process online. Example: Outbound calls to sell insurance policy to existing bank account holders.

7. Knowledge Process Outsourcing in Insurance Industry

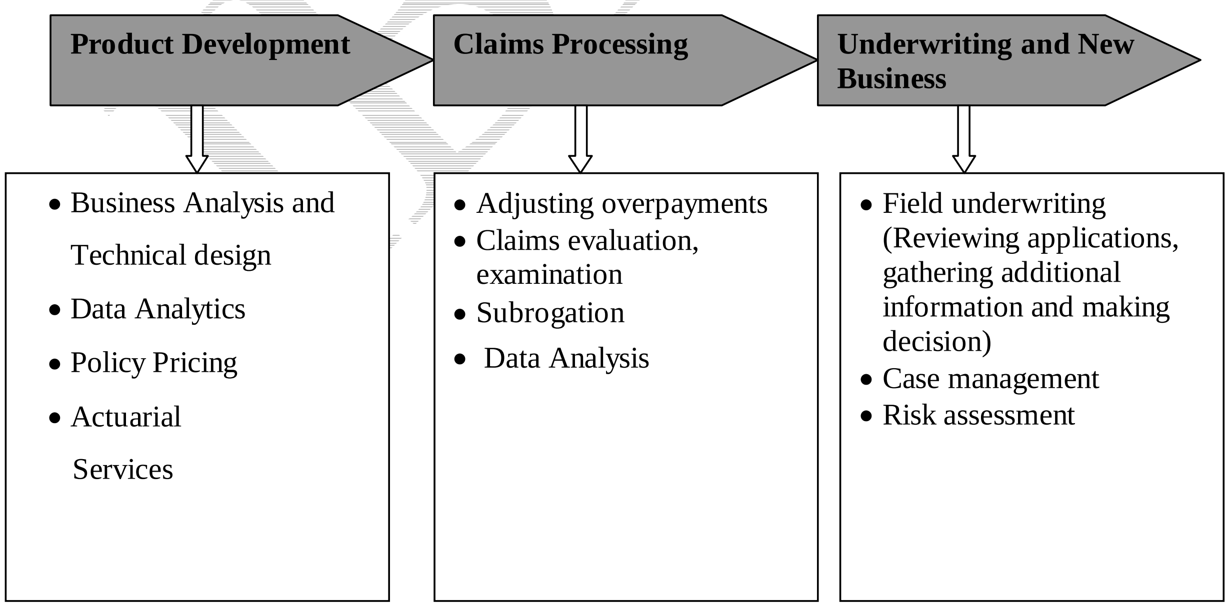
In its annual publication Strategic Review 2005, Nasscom has concluded that the high-end activity of the BPO industry—the KPO or knowledge process outsourcing could be worth $15.5 billion by 2010. According to earlier estimates, the BPO industry itself was expected to be about $20bn by 2008; hence a very significant portion of the sector—in excess of 50% is now projected to be knowledge based.

Knowledge process can be defined as ‘high added value processes chain where the achievement of objectives is highly dependent on the skills, domain knowledge and experience of the people carrying out the activity’. An Evalueserve report gives a crisp definition of the new phenomenon. "KPO is the off shoring of knowledge-intensive business processes that require significant domain expertise." Explaining the difference between KPO and BPO, the report adds, "Unlike conventional BPO where the focus is on process expertise, in KPO, the focus is on knowledge expertise."

While analysing the different processes of insurance industry, activities which fall under the basket of core to the company and which requires vast domain expertise and knowledge, might be called as knowledge processes. Managing these as ‘in-house operational activity’ is more expensive because of high operating and manpower cost. Insurance companies, based on the sound assessment of the core activities, can outsource to low cost countries to gain cost advantage. Some of the processes which are of high end processing and can be considered for captive outsourcing are detailed below

For example, under claims processing function, some of the activities mentioned in the box can be outsourced by the insurers to their captive processing centre. In this segment, data analysis, claims evaluation or examination can be done by back office processing centre while further litigation and settlement can be done by the front office people within their jurisdiction.

7.1 KPO Services in Insurance Industry:



Corporate Treasury Functions

- Performance management services
- Recruitment and staffing
- GAAP
- Financial statement general ledgers
- Portfolio analysis
- Reinsurance

8. Risk factors in Outsourcing

Outsourcing is fraught with many risks, whether it is carried out onshore, offshore or near shore. Whenever an insurance company makes a decision to outsource a business process, the company has to diligently analyse the various kinds of risks associated with the business process both from the outsourcer and outsourcee, and chalk out a plan to mitigate these risks. Risk reduction and management is essential to the success of the outsourcing effort.

Some of the risks faced by the insurance companies and the different ways the service providers can mitigate those risks are discussed below.

1. People risks: These are the risks relating to the human resource of the service company. There could be different types of people risk like attrition, lack of knowledge transfer, criminal acts by employees, errors and omissions etc.

Mitigation Strategies by the Service providers

a) Companies should have pre-employment and periodic medical examination for all their employees.

b) Companies should set up an in house medical centre for check up and should provide nutritious food to the employees, especially for those working in night shift.

c) With regard to criminal acts by employees, the companies should have information security management standards like ISO 17999 and BS 7799.

d) There should be internal security system such as employee should not be allowed to carry any electronic devices or computer peripherals.

e) Clearly defined metrics in transferring the knowledge to the vendors and a well documented process flow or methodology could benefit the users.

f) Another way to avoid errors is to have a proper training for its employees and also having check list or a good document of do's and don'ts during processing a transaction or logging a call.

2. Technology Risks:

Risks like, system down time, network down time, poor IT infrastructure which leads to technical break down or data theft.

Mitigation Strategies by service providers

a) Well equipped IT infrastructure which could back up for the systems and does not interrupt the work of the company.

b) Effective fire walls in the system will reduce the data theft or data transfer from one terminal to another and will keep the data safe and secure.

c) Quarterly system audit should be undertaken to find out if there are any deviations in the system

d) One more option is to have multi delivery centres which could take the process from one centre to another and deliver to the client on timely basis.

3. Legal Risks

Legal risks include, breach of contract, plagiarism of intellectual property rights, client data pilferage, sub-contracting to smaller players.

Mitigation Strategies by service providers

The above risks are very imperative in the whole outsourcing game plan and any slippages or ignorance in mitigating these risks could lead to huge damage on the business and may lead to losing client account. Indian regulatory authorities haven't instituted necessary regulatory framework for the BPO industry. The main law or regulation that affects BPO companies in India is the Indian IT Act 2000.

Even after getting certified, Indian BPO companies still long way to meet on the regulatory front. The principal regulations that affect Indian BPOs are the Sarbanes-Oxley Act, HIPAA (Healthcare Insurance

Portability and Accountability Act), GLBA (Gramm Leach Bliley Act), UK Data Protection Act, FDCPA (Fair Debt Collection Practices Act) and the US-EU Safe Harbour Agreement.

Some of the above mentioned risks can be mitigated by,

a) Having good internal process and procedures in place and a strict follow up or review on the control mechanisms.
b) The companies should appoint a legal advisor or a consultant in drafting the SLA and strictly adhere to the norms mentioned in the SLA.
c) Companies should ensure proper fraud detection and prevention system by having extensive security policies
d) Audits need to be done at regular intervals by the internal IT team as well as by third party auditors.

9. Conclusion:

In insurance vertical, the key differentiating factor among the players is the level of services offered to their customers. Insurance being one of largest industry in terms of customer base, the real challenge for the companies is to retain the policy holders, as retention is directly proportional to better customer service. Due to immense competition and growth in volumes, insurers should be a position to manage these volumes and serve their customers better.

Even though information technology has to some extent helped the companies in serving their customers efficiently, but the ITES comprising of both BPO and KPO services should be seriously looked at by the insurance players to serve their customers. Outsourcing can create wide opportunities across different functions and offer many benefits to the insurers.

10. Terminologies used:

CRM-Customer Relationship Management

GAAP-Generally Accepted Accounting Principal

MIS-Management Information Systems

NASSCOM-National Association of Software and Services companies

TAT-Turn Around Time

TPA-Third Party Administrator

SLA-Service Level Agreement

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