

Financial Foresight

Cost management for Insurers: Competing effectively in a slow growth environment



Like other players in the financial services industry, insurance company profitability has been adversely affected over the past few years by slower growth rates, lower investment returns, extreme pricing pressure, and a variety of other challenging factors. As a result, many insurers have taken immediate actions to reduce costs.

“While rapid staff reductions, hiring freezes, salary cuts, and project postponements can generate short-term savings, they normally provide little in the way of long-term benefits. Such a near-term focus can actually hamper insurers’ ability to capitalize upon future opportunities when business conditions rebound,” says Boris Lukan, a principal with Deloitte Consulting LLP who leads their Property and Casualty (P&C) Insurance Consulting practice in the U.S. “To achieve sustainable savings and position themselves for long-term success, insurers need to approach cost management with a strategic mindset. The goal should be to better align your cost structure and operating model with the strategic priorities of the business.”

Cost cutting vs. cost management

Effective cost management begins by recognizing that cost management is different from cost cutting.

Traditional cost cutting often lacks a strategic focus. Line managers receive directives from senior leadership to reduce budgets by some targeted amount using whatever means they deem appropriate. Frequently, this results in an indiscriminate, uncoordinated, and ad hoc approach to expense reduction. The effort punishes efficient operating areas, adversely affects service and quality, lacks accountability, and can leave companies weaker and less able to innovate, serve customers, and grow.

Strategic cost management (SCM), on the other hand, can help companies balance reducing costs with selectively investing in needed capabilities. SCM involves cross-functional coordination, and can help ingrain cost-management discipline as part of the organizational culture, keep the focus on inefficient operating areas, and aligns cost with strategic priorities. Its use can yield sustainable benefits, and makes organizations stronger and better able to compete.

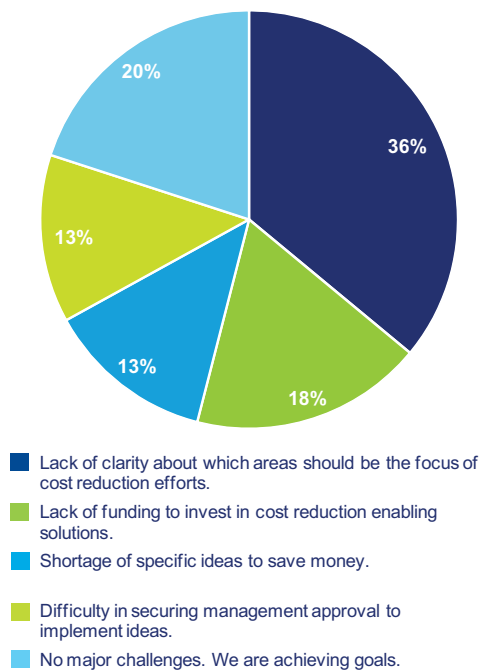
When insurance companies design strategic cost management programs, they typically begin by answering four fundamental questions:

- How much do we need to cut?
- How quickly do we need to realize the savings?
- Are we willing to increase costs in selected areas to better align our cost structure with our strategy?
- How much operational risk are we willing and able to tolerate?

The answers to these questions will help shape the dimensions of insurers’ cost management programs. For example, if savings targets are modest, a focus on third-party spend may be sufficient; if savings targets are more significant, then companies may need to expand the cost pool to meet their objectives. Process redesign, organizational redesign, infrastructure changes, and perhaps even revisiting the design of the company’s underlying operating model may be necessary.

Insurance companies face a number of challenges when looking to rein in costs. According to a recent, informal poll that Deloitte conducted among some 400 insurance executives, 36% say that lack of clarity about which areas should be the focus of cost management efforts is the primary challenge facing their organization in its efforts to manage costs. Other challenges cited were a lack of funding to invest in cost reduction enabling solutions (18%), a shortage of specific ideas to save money (13%), and difficulty in securing management approval to implement ideas (13%). Only 20% said their organizations face no major cost management challenges.

What is the primary challenge facing your organization in its efforts to manage costs?



Cost management approaches

Strategic cost management programs are normally comprised of four major types of analysis, known as levers, that can generate specific opportunities for sustainable savings:

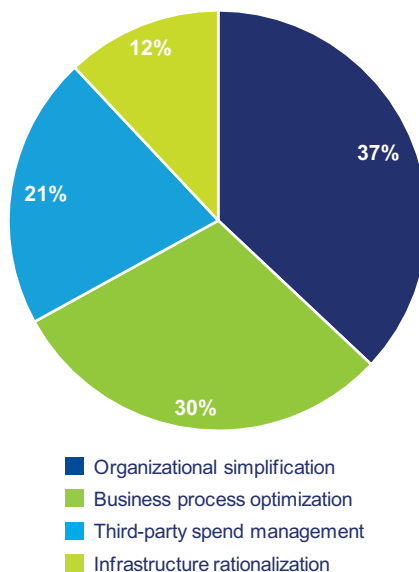
- **Business process optimization (BPO).** Representative activities include implementing predictive analytics, redesigning business processes, outsourcing business processes, and improving policies and procedures.
- **Organizational simplification.** Insurers can achieve cost savings by expanding span of control and removing layers of management, eliminating duplicate functions, improving utilization and productivity, better managing talent, and extracting activities that add low value.

- **Third-party spend management.** Insurers can attain additional savings by focusing on vendors and business partners to manage demand, supply, and taxes. In addition to lower administrative expenses, P&C insurers also can realize sustainable loss ratio savings by lowering the cost of glass, auto rentals, auto body repairs, and other claim-related expenditures.
- **Infrastructure rationalization.** By examining its investment in cross-functional infrastructure, insurers can attain long-term savings by relocating functions, sharing services, rationalizing projects, consolidating software applications, hardware, and data centers, and optimizing information technology services.

“Achieving near-term improvements can provide some early wins that can build support for the company’s cost-management program as well as help fund later changes,” says Ted Goldberg, a director with Deloitte Consulting LLP and a leader in their Insurance Strategy and Operations practice. “Many times, the longer-term changes provide greater benefits, but they usually require greater investments in resources and also greater levels of risk.”

According to Deloitte’s recent informal poll, about two-thirds of the insurance executives surveyed report that either organizational simplification (37%) or business process optimization (30%) have made the largest impact on their organizations in the last 12 months. Fewer executives said that third-party spend management (21%) and infrastructure rationalization (12%) have had the largest effect.

Which cost management lever has made the largest impact on your organization in the last 12 months?



Engaging leaders and managing employees through the change

As insurance companies realign their cost structures, it is important for executives to embed an efficiency mindset into the organizational DNA. We see the evolution to a cost management culture taking place in five stages:

- **Stage 1:** Engage and rally senior leaders
- **Stage 2:** Build awareness within the organization
- **Stage 3:** Gain buy-in and support from individuals across all businesses
- **Stage 4:** Transfer cost management accountability by business line and function
- **Stage 5:** Build necessary structures to enable the business lines and functions

Effectively managing this evolution requires successful execution of six core strategies:

- Lead by example and enlist your peers to help you
- Own the “airwaves” and set the tone for employees, shareholders, and Wall Street
- Thoughtfully and decisively manage talent, and ensure that HR programs align with your talent strategy
- Measure what matters and hold the business accountable
- Focus on behaviors and drive the right behaviors with the right incentives
- Remove organizational barriers and align the organization with the cost management strategy

While insurance companies should consider applying these strategies to any effective cost management program, how they apply them will vary based on the scope, depth, and nature of the initiative. Below is a checklist that can be applied to any cost management program to gauge the degree to which the right change management activities are in place.

Cost management culture checklist

Lead by example... and enlist your peers to help you.

- Leadership team visibly supports the initiative
- Project leads have a plan in place to socialize initiative with the organization’s stakeholders
- Each leader has a personalized action plan to execute against

Own the airwaves... set the tone for employees, shareholders, and the Street.

- Internal and external audience groups are identified, segmented, and prioritized



Cost management case studies

Insurance companies that have implemented cost management programs have achieved substantial benefits. Here are three examples:

Case study No. 1 — Property and casualty insurer

Reduction in claims costs with minimal staff impact

Key challenges:

- Growing loss and expense ratios
- Savings needed to drive new growth
- Third-party spend a concern, especially managing suppliers
- Desire to leverage best practices

Program approach:

- Scope included both loss costs and administrative costs
- Used two cost management levers:
 - Third-party spend management
 - Business process optimization
- Sponsored by senior management

Results:

- \$100 million in annual savings
- Transformed supplier management operations — both enterprise and claims specific

Case study No. 2 — Life and annuity insurer

Savings in support areas to fund new investments

Key challenges:

- Expense ratio increasing
- Additional investments for growth required “bare bones” structure
- Multiple business units had overlapping services
- Structural changes to organization needed
- Quality and service levels needed to be maintained

Program approach:

- Scope included most General and Administrative costs
- General and Administrative areas had savings targets
- Used three cost management levers:
 - Business process optimization
 - Organizational simplification
 - Infrastructure rationalization
- Leveraged process-specific benchmarks for corporate areas

Results:

- Over \$30 million annual savings
- 40% reduction in General and Administrative headcount

- A set of key messages have been identified and pushed out, both externally and internally
- Communications/PR strategy has been developed

Thoughtfully and decisively manage talent... and ensure that HR programs align with your talent strategy.

- Target workforce segments are identified (e.g., critical roles, "stars," employees to separate)
- A point of view has been developed around the critical skill sets needed now and in a year
- Each workforce segment has a transition plan
- HR programs have been tailored and aligned by employee segment

Measure what matters... and hold the business accountable.

- Metrics/KPIs (Key Performance Indicators) in place align with a cost management/efficiency mindset
- Metrics and incentives have been communicated
- Strategic plan in place to drive governance and track metrics
- Competitive analysis supports metrics targets

Focus on behaviors... drive the right behaviors with the right incentives.

- Project team has identified behaviors that support a cost-efficient organization
- Gap between current behaviors and desired future behaviors defined
- Desired behaviors communicated to affected employees
- Incentives and disincentives are in place to influence behavior

Remove organizational barriers... align the organization with the cost management strategy.

- A clear vision of the organizational barriers and the supporting organization model identified
- Road map for future state organization structure and governance model developed
- Roles and responsibility changes communicated to employees

Insurance executives who participated in Deloitte's recent informal poll reported mixed results around the effectiveness of their cost management programs. 71% agree that their companies' cost management efforts have effectively realigned their cost structure and have

Case study No. 3 — Life and annuity insurer

Reduction in operating expenses through operational transformation

Key challenges:

- Operating expense performance lagged benchmarks, despite size advantage vs. competitors
- A significant and growing gap was projected between operating expenses and leadership commitments to shareholders
- Firm had been focused on top-line growth, without much emphasis on cost management

Program approach:

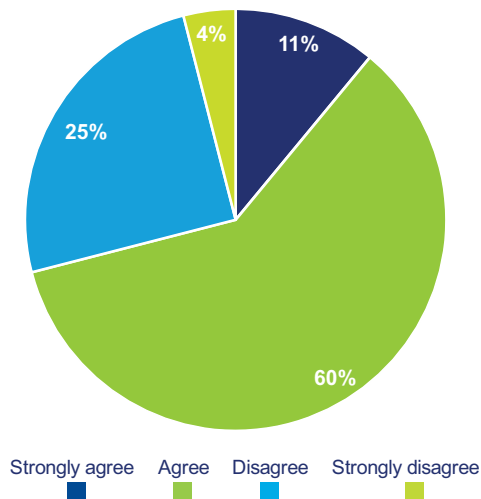
- Scope included most business processes
- Used four cost management levers:
 - Business process optimization
 - Organizational simplification
 - Third-party spend management
 - Infrastructure rationalization
- Business case developed for each opportunity
- Sponsored by senior management

Results:

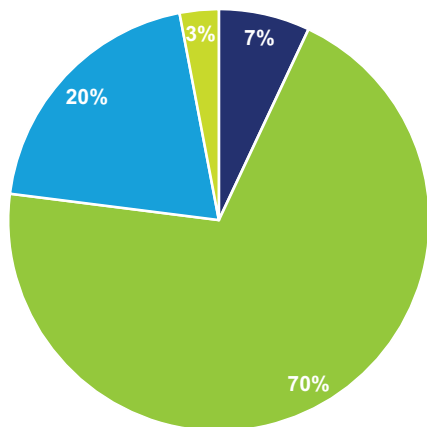
- \$100 million in annual savings
- Transformed supplier management operations — both enterprise and claims specific

positioned them for future success. In addition, 77% agree that their companies have approached their cost management efforts in a way that is consistent with sustainability principles.

My company's cost management efforts have effectively realigned our cost structure and have positioned us for future success.



My company has approached our cost management efforts in a way that is consistent with the principles just discussed.



Strongly agree Agree Disagree Strongly disagree

Sustaining cost management success

We believe the keys to cost management success are strategic alignment and sustainability:

- A well-designed cost management program should not only help an organization reduce costs, but also better align its cost structure with its strategic priorities.
- The size and speed of required benefits, as well as tolerance for operational risk, should drive program design.
- Companies should draw upon the four cost management levers (business process optimization, organizational simplification, third-party spend management, and infrastructure rationalization) to help identify strategies and tactics that are collectively powerful enough to appropriately align costs.
- Executives should be wary of tactics that reduce costs initially, but leave the organization susceptible to a cost rebound once the economy recovers.
- Companies should engage management and staff effectively by building awareness, obtaining buy-in and support, and ensuring that accountability for results rests with the appropriate individuals.

By adopting a strategic view of cost management, we believe insurance companies can both ride out the current economic storm and position themselves for future growth and profitability once the skies clear.

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For further information about cost management, please contact our specialists:

Boris Lukan
Principal
Deloitte Consulting LLP
blukan@deloitte.com
+1 312 486 3289

Ted Goldberg
Director
Deloitte Consulting LLP
tgoldberg@deloitte.com
+1 312 486 3049

Tina Naser
Senior Manager
Deloitte Consulting LLP
tnaser@deloitte.com
+1 212 618 4623

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