Winning with Technology

Information technology costs more than ever, is more significant than ever and affects every function, activity and task within the insurance industry.

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The value of efficient management in the field of information technology is increasing. It is equally important that the methods used to control the technology are subject to the unique conditions that apply to the insurance business today.

All managers with responsibility for developing a company's overall strategy need an answer to the following questions:

- Why do many insurance companies only achieve a limited return from their record-breaking investments in information technology?
- How can insurance companies use this technology to increase their competitive strength?
- How can technology and strategy be united?
- How can this new technology be successfully controlled?

Every year insurance companies invest 10-15 percent of their operating costs on information systems. Of these, most are used to maintain and improve routine tasks. A smaller proportion is used to develop strategic potential – the competitive advantages of the future. If management is to guide a company towards more efficient working methods and a future competitive advantage, they should consider whether this is the right balance. Let us start by taking a closer look at what today's technology commitments cost.

Routine Tasks

Around 90 percent of a company's system costs go on routine tasks such as the processing of insurance policies. Of course, routine tasks must be continuously improved to meet customers' expectations and to match competitors' initiatives. But I believe that these major investments in upgrading the efficiency of existing systems are possibly not in proportion to the value that could be obtained from other, perhaps bolder allocations of

scarce resources. For investments in routine tasks, the targets should be to achieve control over costs, to reduce the scale of investment and to utilise tried and tested solutions.

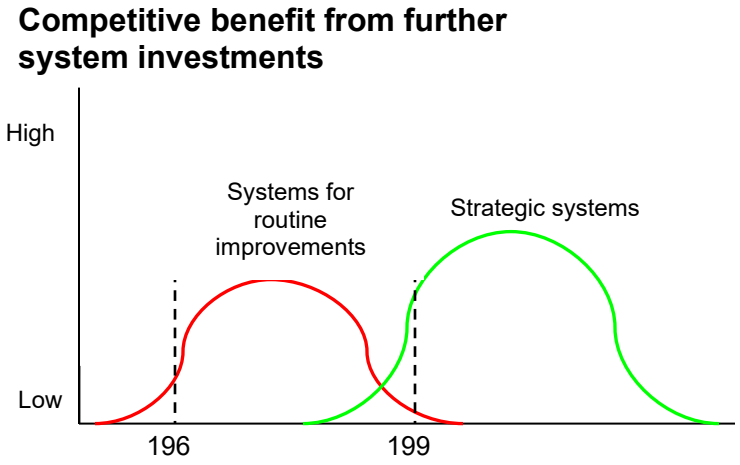
At present only ten percent of system costs will typically be spent on new initiatives in strategic areas. We define the strategic use of technology as new measures aimed at achieving significant competitive advantages. These are in contrast to projects that aim simply to automate or improve the efficiency of existing processes.

For strategic investments the aim is to sustain an efficient process that can identify new, useful systems. Examples of systems that provide strategic benefits might be those that:

- facilitate sales by generating customer profiles;
- customise products for individual customers;
- identify what attracts customers;
- help local managers to make decisions on business priorities.

Major Benefits

Once upon a time technology was able to make a significant contribution to improving routine tasks. These can still be made more efficient. But the marginal return drops a little for each given investment (see diagram).



If investments in information technology are to be worthwhile, insurance companies must master three things. They must manage routine costs and have a reasonable level of ambition in terms of new system development. They must be well organised so that in time they can develop the systems and the base technology that offers significant strategic benefits. And not least, they must master the management process that leads the company towards its technological future.

Managing Routine Costs

It is certainly necessary to invest in routine systems, although these rarely lead to an increase in competitive strength. Such investments usually relate to the back office functions in a company, and are often the same for the whole insurance industry. Examples include standard commercial activities such as bookkeeping, and tasks that are specific to insurance such as follow-up on sales, activities and commissions. In this respect, insurance companies should bear in mind three factors:

- *Invest selectively.* Many investments in new systems are simple processes that increase productivity and replace paperwork, without any real strategic benefit. We all agree that investments in this area should be limited. Yet many insurance companies stretch their limited resources by investing in such updates. In many cases the outlay would generate more value for the company if it were used for other projects with a higher potential return.

- *Avoid the role of the technological pioneer.* It can be a good thing not to be the first to try out the very latest product on the market. There are instead often tried and tested systems available, adapted for the insurance industry, where the price is on the right side of the cost curve. The life span of existing systems can often be extended significantly by means of selective upgrades.

- *Buy more off-the-shelf solutions.* This reduces both the cost and the risk of internal solutions. A purchased system can be up to one third cheaper, and at the same time the risks in the specification and development phase are reduced.

Dependence on External Parties

All insurance companies are dependent on external parties for base technology such as hardware, operating systems and general software. Off-the-shelf package solutions are often used for personnel and wage administration.

For most product areas there are only marginal variations in the various companies' functions. Yet most insurance companies, especially the large ones, have systems produced in-house. The reason for this is historical rather than rational. Many systems

have their origins in applications developed during the last 20 to 30 years. The systems have been adapted according to employees' work methods and the standards used to define each company's information.

The result has been a mishmash of database and manual processes. A newly launched insurance company, however, would invest in purchased solutions, if necessary also ordering modifications and changes.

There are now multi-function and integrated packages available for the most common product areas. Examples include systems that can process the entire production flow, new products such as fund-linked life insurance and claims processing.

Unfortunately off-the-shelf packages also involve risks. Many suppliers know less about insurance than they are willing to admit. They often lack an understanding of the conditions under which the Swedish market operates. This might, for instance, lead to far too many modifications having to be made to an off-the-shelf package.

Strategic Opportunities

Like many other companies, insurance companies are trying to identify the advantages of this technology, going far beyond automation of work routines. The aim is to use the technology to outmanoeuvre the competitors. To do this, the benefits must be identified and exploited in an efficient way. Three factors must be linked together:

- *The company's strategy*, i.e. which customer groups, products, work methods and skills must be prioritised to realise the business concept.

- *Software applications* are the programs used to perform the tasks required by the strategy. A large insurance company can easily reach a level of ten million lines of code, which represents 1,000 different programs, to perform the necessary tasks.

- *Base technology* consists of the hardware and the systems used to support the applications. The base technology is generic, which means that all competitors have access to similar systems in the long run. In this area the technology must be utilised efficiently, using the IT department's technical skills.

These three factors influence one another on an ongoing basis. Also, it is nearly always the case that different managers are responsible for each one. This means that there can be misunderstandings, communication problems or poor decisions. These must all be avoided.

Choice of Applications

Lets us take the example of the fund-linked life insurance policies that are now starting to appear in Sweden. When the American company E F Hutton first launched these at the end of the 70's, they had a two-year head start before their competitors were ready to offer the product to their customers. This was because E F Hutton created an application system to which its competitors did not have access. Now several Swedish insurance companies are facing similar technological and strategic challenges.

The sophisticated life insurance policies of tomorrow will be significantly more complicated than traditional life insurance products. They will require more online terminals and considerably more processing and storage capacity. Some insurance companies are currently experiencing an annual increase of 30 to 40 percent in the volumes of data they process through online terminals. Such a level of growth naturally requires powerful new central computers and an increase in primary memory capacity.

Much of the potential of the world of IT remains undiscovered. The best way of benefiting from the new base technology is not, however, to automate ingrained work methods. Instead the company's strategists should use their imagination and develop new customer values and work methods.

Planning for the Future

As we all know, it is extremely difficult to plan effectively with regard to new technological progress. But just because it is difficult, it does not mean that insurance companies can afford to ignore planning for the future. Any company that does that will be tomorrow's loser.

Consider three technologies that offer major opportunities: relational databases, expert systems and image processing systems. All can provide new competitive opportunities.

- *Relational databases* simplify the manipulation of customer data, which is far more beneficial than most of the current, product-oriented software systems. This can, for example, facilitate additional sales by giving a company's sales force access to new, more relevant information about customers' insurance profiles.

- *Expert systems* can be used simply to automate certain tasks in the fields of underwriting or claims processing, but this would be short-sighted. Expert systems will soon be able to incorporate human expertise. This will enable expansion of the insurance business beyond its existing borders. Expert systems can, for example, make it possible to assess high-risk deals that it would normally not be possible to check.

- *Image processing systems* are moving us closer to the paperless office. The function of such a system is not, however, to get rid of all paper, but instead to make it

possible to manipulate information much more quickly. Document management systems of this type are already being used by American insurance companies, where optical disks store images of a company's insurance policies. The benefit is that large volumes of data can be stored in less space than is currently the case with paper storage.

Guidance Towards Progress

It remains to be seen how a company can be guided towards a better competitive position using information technology. It is important above all that investments in technology lead to clearly measurable improvements in businesses. The most important requirement of all is that good project control is achieved. If the development project is on the right tracks and is working well, everything else will automatically fall into place.

Spend time and energy wisely. To achieve progress it is important that there is a core group of motivated and qualified employees to lead the company's technological development. The managing director, the IT manager and the managers of the departments concerned should meet on a regular basis to discuss technology and its contribution to business development. The importance of the changes should be acknowledged by management and communicated to the employees. It is not a question of having more time, but rather of using the time available efficiently.

Bring together a commercial approach and technical expertise. During a long project the experts will control around one third of the process. The rest of the process requires a broader involvement, with all of the company's employees testing the new technology, defining needs and adapting work methods. There must be skills and co-operation.

Progress does not depend on smart technical solutions that run in isolation from the rest of the company. Users and technological experts must work together to avoid the problems that always arise between them. Employees who will be working with the new technology must be involved as widely as possible, so that they learn how the new information technology works. In the same way, experts must become involved to understand the company's requirements of this technology. By getting involved throughout the whole process, users can provide the business perspective that guarantees that technical problems are not only solved in a technical way, but are also in the right way for the company.

A Thorough Understanding

- *Assign the most suitably qualified people to the project.* Use the best technical and non-technical people from all parts of the company to work on the project. It might be necessary to bring in external assistance for specific solutions to problems. It is

extremely important that the project manager has a thorough understanding of the insurance company's business strategy.

- *Develop a vision to guide the work.* After the introductory phase of a project the vision will often have to be modified so that it can guide the new strategies, systems and the base technology. The project group should first of all concentrate on why a new information system is being installed, instead of getting involved with the details. When the group members feel that they are ready to be the "guardians of the vision" and continue to formulate the vision, it gives the company both the justification and the motivation for the arduous tasks required.

- *Give the project group full authority to make decisions.* Many decisions have to be made during all phases of development, installation and use of the new information technology. These decisions have to be made quickly, as delays can contribute to failure.

  The ingrained decision-making processes often take too long, people leave before a project is finished and the management group's motivation wavers. To avoid this it is extremely important that the project group can make crucial decisions.

There are examples of Swedish insurance companies that, in terms of technology, are at the forefront of international development. Those that choose to compete on the international market can perhaps benefit from this advanced position. Those who choose instead to stay within the home market should also give careful consideration to how technology contributes to their own company's competitive strength. The challenge for all is to retain and strengthen their position. The interplay between technology and strategy will become even more important during the 90s.

This is the third and final article in the series entitled "Insurance in the 90s". The subjects covered have been skills development (12/89), distribution (1/90) and information technology (3/90).