Reengineering and Insurance: Solving Problems, Seizing Opportunities

by Ronald E. Compton*

1. Introduction

Like many industries, the insurance and financial services sector has, in the last few years, undergone a great deal of trauma associated with insistent change. In the United States, a host of factors, from a decades-long decline in the industry's financial performance, to a rising consumer movement, to an oversaturated market, to increasingly intrusive government regulation, have forced insurance companies to reexamine nearly every aspect of their operations. In this environment, the ability to deliver value – that is, superior products and services at low cost – has become a prerequisite for survival. In response, a growing number of insurance companies, Aetna Life & Casualty Company included, have turned to reengineering – defined as the fundamental analysis and radical redesign of business processes – to achieve dramatic improvement in critical measures of performance. What exactly is reengineering? How does it work and what does it achieve? Does it have applications beyond the U.S. insurance market? I believe that the answers to those questions contain important lessons for insurance companies seeking to keep pace in a rapidly changing market.

2. Industry environment demands radical change

Although the U.S. insurance industry has been under increasing pressure for years, the rapid economic growth of the 1980s masked several long-simmering problems. Many companies did not realize the extent to which their operations were hampered by extremely high cost structures, inefficient processes, weak product lines, and inadequate methods of distribution. When the U.S. economy suffered a sharp downturn in the late 1980s, the insurance industry as a whole suffered equally sharp drops in profitability. Many insurers, both shareholder-owned and mutual companies, found their profitability further impaired by weak demand and soft pricing in the property-casualty insurance business, rapidly rising costs and demands for improved efficiency in both the life and the health care businesses, and painfully slow economic recovery across the country. The fierce battle for capital and shareholders' demands for value made the problems and pressures even more acute.

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Compounding those immediate problems was the fact that, in many ways, the fundamental dynamics of the marketplace had changed.

The consumer revolution that began 20 years ago permanently altered the U.S. marketplace. It has been intensified, in part, by America's uncertain economy. Consumers – and businesses that serve them – face serious financial pressures: sluggish income growth, lower real disposable income, higher taxes, and lingering debt burden. As a result, customers purchasing both commercial and personal insurance are more likely to base their buying decisions on price.

There is also evidence that customers do not value or approve of the way insurance companies handle their business. In poll after poll, customers say that insurance products are complicated and confusing. They have no idea what drives the price of products. And when the insurance industry's delivery mechanisms are contrasted with those of other service businesses – like banking and personal investing – many customers judge them to be inefficient, technologically unsophisticated, and painfully slow to respond to customer needs.

At the same time, industry competition has intensified, not just among insurers, but also from financial services companies, such as banks and mutual funds. It is expected that the traditional lines between investment vehicles and life insurance will continue to blur.¹

For U.S. insurers, these myriad problems can be reduced to a simple mandate: Improve profit performance by serving customers better.

3. Traditional industry with traditional methods

The insurance industry's systemic problems are rooted in its history. The industry's work flows, control mechanisms and organizational structures were created long ago, in a far simpler competitive environment, before computers were in widespread use. As a result, inefficiencies in the development and delivery of products and services have become deeply embedded.

Automation has not eliminated these inefficiencies. The insurance industry increased the use of computers for certain functions, but did so while maintaining a function-driven, fragmented structure. Instead of looking at business processes as customer product and service delivery systems, insurers automated manual functions, overlaying bureaucracy with stand-alone technology. The claim department automated its claim systems; underwriting automated underwriting systems; accounting automated accounting systems. Despite some superficial links among them, these disparate systems were not built to leverage the power of information technologies – only to speed up isolated manual processes. Over time, the insurance industry developed one of the worst productivity records in U.S. business despite being among the biggest purchasers of information technologies.²

Distribution costs are a problem as well. Many insurance products and services are sold through agents and brokers, who serve as a valuable, professional sales force and provide a strong local presence in their markets. However, depending on the relationship and the line of business, insurers and agents may often duplicate each other's functions in areas such as customer service, underwriting, claims settlement, policy renewal, even sales.

¹ See: "Reengineering: Insuring Success." *Beyond Computing*, April 1993, p. 33.

² See: Coy, Peter. "The New Realism in Office Systems." *Business Week*, June 15, 1992, p. 131.

This duplication adds no value, but drives up costs. It is important to determine who can best perform each of these functions, although the answers may vary according to location, product line or customer demands.

Inefficiency breeds high cost. It is widely acknowledged that the cost structure of the insurance business has contributed to its poor performance. Financial analysts have long complained that insurance is overcrowded, with too much capital, and too many people delivering too little value.³

Thus, insurers face a dilemma: They must improve profitability by serving customers more effectively and efficiently, and do so in an extremely difficult economic environment. A number of insurance companies, Aetna included, are achieving those goals through reengineering. They are cutting costs, reducing the time it takes to bring products to market, creating new and better links to customers, and improving their competitive positions. Current business literature is replete with their reengineering success stories.

For example, Confederation Life Insurance of Toronto, Canada, reengineered its client accounting process, reducing the number of employees performing that function from 31 to 12 and cutting the cycle time by about 70 percent. Security Life of Denver, Colorado, reengineered its process for administering new business. A process that used to take 30 days and employed 24 people in three departments is now handled in 22 days by only six people. Blue Cross/Blue Shield of Ohio reengineered the application process for customers, cutting cycle time from 21 days to 48 hours. As these examples demonstrate, reengineering can, indeed, achieve the "order-of-magnitude" improvements so needed in today's competitive environment.⁴

Reengineering is in widespread use in the U.S.; such diverse corporations as IBM, Motorola, Xerox, Ford Motor Co., Banc One Corp., Colgate-Palmolive Co., Texas Instruments and Citicorp are among those who have successfully used the process.

4. Reengineering: What it is, what it does

Dr. Michael Hammer, a business consultant and former Massachusetts Institute of Technology computer science professor, introduced the concept of reengineering in the mid-1980s. Hammer believes most business processes and structures are obsolete and must be completely reinvented.⁵

Business processes are the central concept in reengineering. A business process is defined as a collection of activities that ultimately creates something of value to the customer. Processes typically cross organizational lines and geographic locations; they constitute a self-contained series of activities that start and complete a business "event." Typically, a business has no more than four to seven major processes.

Reengineering asks basic questions: Why do it that way, or why do it at all? How would we do it if we were to start from scratch? It begins with precise, careful measurement

³ See: Stevenson, Merrill. "A Survey of American Insurance." *The Economist*, October 27, 1990, p. 7.

⁴ See: Mehler, Mark. "Reengineering: Insuring Success." *Beyond Computing*, April 1993, pp. 33-35.

⁵ See: Hammer, Michael. "Reengineering Work: Don't Automate, Obliterate." *Harvard Business Review*, July/August 1990, pp. 104-112.

of customers' needs and expectations, and helps determine how the company can best meet them. Reengineering forces companies to confront the truth that the old ways of doing business simply do not make sense in a technological age.

Dramatic improvement in performance – in measures such as cost, quality, service or speed – is the goal of reengineering. Otherwise, reengineering is not worth the tremendous upheaval it creates within the organization. Most important, reengineering engenders a dispassionate examination of a company's business practices – not from the company's view – but from the customers' view.

A critical component of reengineering is technology. Computers and telecommunications are giving companies the ability to gather, exchange and distribute information instantly, accurately and without regard to geography and time. That, in turn, allows insurers to transform their relationships with customers, agents, vendors, even competitors. There is no limit to the technologies that reengineering employs: voice, data, imaging, mobile computing, local area networking, laptop to mainframe interfaces. The benefits are many: faster production time, more efficient delivery, reduced costs, and greater customer satisfaction.⁶

5. How reengineering works

Although the fundamental concepts are the same, each company conducts its reengineering efforts in a different way. Below is a simplified description of the process of reengineering as practiced at Aetna Life & Casualty Company.

Aetna's reengineering program operates under the auspices of a small corporate reengineering department, composed of systems, communications and human resources people, formed in 1990. Establishing a separate, dedicated reengineering group has enabled Aetna to carry out multiple reengineering efforts simultaneously, implement those programs in a relatively short time span, and do so while keeping our businesses running at full speed. Working in concert with an executive sponsor from the business area being "reengineered," the corporate reengineering group manages the project, but the actual reengineering of any particular business area is conducted by the employees themselves. They have in-depth knowledge of the business under study and are in the best position to design and implement new processes that achieve dramatic breakthroughs.

6. Reengineering in action

The reengineering process itself is painstaking, time-consuming and too complex to describe in detail here. However, the central concepts are illustrated in a reengineering project now under way in Aetna's Individual Life business unit. In 1991, Aetna began selling Individual Life separately from its traditional companion lines, Personal Auto and Homeowners. Sales of Individual Life products fell sharply; the unit's viability was threatened. To succeed as a stand-alone business, Individual Life needed to drastically improve its entire operation. After stringent self-examination, Individual Life concluded that, as a high-cost provider, it simply could not achieve its financial and operational goals through its existing structure and methods. Thus, a major reengineering project began.

Reengineering starts with an internal scan that documents current work flows, an external scan that gathers information about customer needs and expectations, and a study

⁶ See: Mehler, Mark. "Reengineering: Insuring Success." *Beyond Computing*, April 1993, p. 34.

of the “best practices” of other successful companies. In Individual Life, these “environmental” scans revealed that the unit was hampered by a complex series of internal work flows fraught with bottlenecks and missed opportunities. It also revealed that customers want life insurers to provide sophisticated products, superior service from insurers and agents, and easy access to both. The goal was clear: Individual Life needed to make its work processes customer-centered, improve the efficiency and effectiveness of its distribution system, and enhance the relationships between Aetna and the agents and brokers who sell our products.

The redesigned model does all those things. It features multiple distribution channels: Aetna employees in sales centers, marketing general agents, and specialty brokers. All are supported with a single-service-delivery technology platform, highly focused market and product strategies, clearer accountability and responsibility, and electronic information flow throughout the business. The Life organization has been streamlined and flattened. An ineffective hierarchical structure is being replaced with a matrix that comprises five major business processes: underwriting and issue, customer service and communications, sales management and producer administration, research and product development, and strategy development. Old fashioned, “assembly-line” work flows have been replaced with multifunctional teams performing complete tasks, start to finish.

Since implementation began in April 1992, the Individual Life unit’s service functions have been centralized and made more accessible to customers via toll-free telephone numbers and facsimile machines. The service organization, formerly staffed by 136 people handling 500 telephone calls a week, is now staffed by 86 people handling 5,000 calls a week, with measurably improved responsiveness. Ten regional Aetna Life Sales Centers support sales activities and coordinate activities with agents. Technology tools are being used to eliminate duplication in processing, capture valuable agency management and underwriting information, and perform other time-saving, quality-enhancing functions.

Nowhere is the effect of reengineering more apparent than in the product development process. It used to take Individual Life more than a year to bring a new product to market. In contrast, in the first five months of 1993, the unit introduced three new products. Reengineering is enabling the once-threatened Individual Life unit to achieve its operational goals. Sales are sharply rising, expenses are down, and the average premium and average face amount per new policy are increasing steadily.

As this example illustrates, the process of reengineering is a major undertaking that requires time, the ability to manage dramatic change, and, often, significant investment.

7. How well does reengineering work?

From Aetna’s perspective, the answer is, “very well.” Several of our earliest reengineering projects are nearing completion, and they are already achieving lower costs, greater efficiency and better service.

Aetna’s newly reengineered property-casualty claim operation is the best example. The company used to have two separate claim operations, one for personal lines and one for commercial lines, for a total of 63 offices in all. Those two claim operations are being merged and replaced with 22 full-service claim centers that give customers 24-hour-a-day access to claim representatives. (All 22 new claim service centers will be opened by year-end

1993.) Redesigned processes and new desktop-to-mainframe computer links have enabled Aetna to cut the time to process claims and issue checks from weeks to days, while saving millions of dollars a year in expenses.

In September 1992, Hurricane Andrew put the new claim operation to the test. It performed nearly perfectly. Customers had fast, easy access to Aetna claim centers via toll-free telephone numbers. When local lines were busy, calls rolled over to claim offices in other parts of the country. Aetna claim representatives, armed with laptop computers and portable telephones, arrived on the scene to assess damage and issue checks, usually on the spot. Of 14,000 Andrew-related claims filed, there were fewer than 20 complaints, every one of which was resolved. In a post-hurricane poll, 96 percent of the 3,000 Aetna customers who returned survey cards gave our claim service an "excellent" rating.

That's just one example of what reengineering can achieve. There are others. Aetna has reduced its purchasing budget by millions of dollars a year as the result of a reengineered Company Acquisition and Payment Process (CAPP). Supported on a mainframe computer, CAPP allows authorized users to order goods and services from their desktop terminals, reducing both delivery time and the number of vendors by 90 percent. We now employ laptop computers and portable printers to enroll small-business health-plan customers at their work sites instantly, accurately and easily. Aetna Canada revitalized its life, health and financial services operations through a complete redesign that included new work flows, training for every employee, and heavy use of technology to streamline operations.

Aetna now has about a dozen reengineering projects under way. We consider reengineering to be a critical business tool that is yielding tremendous benefits.

8. Reengineering and the global market

Although the problems and opportunities in the insurance industry differ from market to market, country to country, one truth is plain: The growing interdependency of the global economy is affecting the fundamental dynamics of the insurance and financial services industry. Companies must learn to compete in light of new market realities.

While overall economic growth has slowed, changes in global economies will bring new opportunities for insurers. Worldwide insurance and financial services markets are growing; premium growth worldwide is expected to increase more than 60 percent in this decade. In Europe, even as The European Community's Single Market Initiative slowly moves toward completion, the EC already has created a far freer and more open market than previously existed. In Asia, the emerging economies in the east and southeast regions are fueling economic growth that is expected to double, or perhaps triple, over the next decade. In the Americas, the North American Free Trade Agreement could eliminate countless trade and investment barriers among the U.S., Canada and Mexico, and create a market even larger than the 12-nation European Community.⁷

To exploit these opportunities, insurance companies must be prepared to make significant changes to their operations in order to enhance their competitiveness.⁸

⁷ See: "Opportunities and Barriers." *Chief Executive*, January/February 1993, pp. 10-15.

⁸ See: Brumm, Theodore A., Jr. "Improving The Bottom Line In Troubled Times." *National Underwriter*, June 22, 1992, pp. S 18-S 19.

In mature markets, the systemic disadvantages of traditional business methods are the same as those experienced in the U.S.: saturated markets, high distribution costs, bureaucratic corporate structures, and limited product portfolios that are slow to evolve. A survey of 60 European insurance and financial services firms bears this out. Insurers who traditionally rely on exclusive agents and independent brokers are losing market share to challengers such as banks, independent sales forces and direct marketers, who sell directly to the customer, with lower distribution costs, and use technology to set new standards of customer service.⁹

In emerging markets, characterized by rapid economic growth and a growing middle class, there are different problems and different opportunities. Political and economic reforms will lead to significant growth opportunities for insurance companies that can select appropriate target markets; that is, markets where established competition is not too great, investment barriers are not too high, and sustainable competitive advantage can be achieved.¹⁰ Learning to compete in emerging markets will be difficult, however. The sheer magnitude of growth opportunity will outpace the capacity of existing business methods.

In all markets, new opportunities and new problems are being created by cross-border mergers, acquisitions, joint ventures and strategic alliances; by privatization of state-managed pension and health systems; and by the growing role of private sector insurance as a complement to government-sponsored benefit programs. In addition, consumer demand for value is spreading globally through trade, mass communications and travel. Once aroused, consumer expectations tend to rise rapidly.

In summary, reengineering can help insurance companies confront and solve a complex set of problems and obstacles to future profitability. No company operates in a static environment, no company has guaranteed revenues, no company can afford to disappoint customers. Large established companies will find they need to reengineer to just keep up with the changing demands of the marketplace. Those starting new ventures will find that the approach and methodology of reengineering can provide valuable means to create the best, most efficient, most customer-responsive company. And, every company that operates in a free market will find that there is always a new problem, a new customer, a new market, a new and better way to do things. Reengineering can be an important tool to meet those challenges.

⁹ See: "European Insurance Distribution." *United States Equity Research/Insurance*, Salomon Brothers, Inc., April 1992.

¹⁰ See: "Opportunities and Barriers." *Chief Executive*, January/February 1993, pp. 10-15.

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