Driving Operational Efficiency and Effectiveness

Harry Pickett
Vice President
KPMG Management Consulting
IT Advisory Services

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Today's Session

Operations and Technology 3: Driving Operational Efficiency and Effectiveness

- Given today’s tough business climate, insurance is continuing its focus on cost management. Organizations are launching efficiency and effectiveness programs looking across all elements of their business to reduce overhead and improve profitability from their existing book of business.

- This session will:
  - Provide insight to the business climate, factors driving the current state and where we think the market is going – Will it ease or continue on the current path? Do we see convergence in the market driven by need for more economies of scale?
  - Focus on the Operations and IT domains that support the business. Both are critically important and they represent a significant line item in your company’s expense reporting.
  - Discuss the options to drive efficiency and effectiveness, how to determine the “size of prize” to build a compelling business case with an acceptable risk management profile and why governance is intrinsically important to your programs success.
Today’s Agenda

- What is Operational Efficiency and Effectiveness?
- Expense Ratio Drivers
- Cost Optimization Focus
- Our Changing Environment
- Key Success Factors
- Scope and Benefits
- Role of Operations and IT
- KPMG’s Approach to Optimization
- Key Things To Get Right – Mistakes to Avoid
- Summary
What is Operational Efficiency and Effectiveness?

Insurance companies are focusing on operational efficiency and effectiveness (E&E) programs to *improve performance and shareholder value*

- **Operational Efficiency** – *A measure comparing a company to industry leading performers in terms of the cost of their core insurance operations relative to the value of the premium and claims they generate/handle*
  
  For example: How much “bang for the buck” a company gets from its investment in its insurance operations?

- **Operational Effectiveness** – *A measure of the quality of a company’s loss/benefits/payments portfolio in terms of how well it facilitates profit maximization compared to industry leading loss portfolios*
  
  For example: How good the company’s book of business is for profitability?

  - **Effectiveness** (doing the right things) first then **efficiency** (doing the right things in a lean way)

- **Efficiency and Effectiveness Program** – *must be part of a broader strategy*
  
  E&E is not a one time initiative but an organizational mindset
What is driving higher expense ratios?

Based on our experience working with insurance companies, several factors typically drive higher expense ratios

- **M&A Impacts**
  - Heavy advertising
  - Third party underwriting fees
  - Minimal IT integration post acquisition

- **Fragmented, sub-scale operations with structural and functional silos with duplicative functions**

- **Inefficient Processes**
  - Limited shared services or disjointed automation
  - Significant time committed to non-value added activities

- **Expensive distribution channel mix (high commissions without lower loss ratio or retention)**

- **Multiple or inadequate product, channel (agent) and customer rationalization**
Cost optimization is often core to an operational efficiency and effectiveness program

Cost optimization is the method of finding and implementing alternatives to effectively deliver the highest achievable performance under given constraints, by maximizing desired factors and minimizing undesired ones

- Cost initiatives may be done as a one-off project or an ongoing process to continuously monitor spending and operational efficiency
- Cost saving opportunities can be identified top-down and bottom-up e.g. strategic level and within an individual process or department
- Efforts are scalable to the strategy, appetite and needs of the organization - opportunities can be grouped by scope and potential level of benefit as well as risk, timeline and capital investment
  - Examples include:
    - Streamline
    - Redesign
    - Transform
Our changing environment provides opportunities to improve your performance

A dynamic environment requires that a business adjust to and actively help manage the changes impacting performance

**EXPOSES ORGANIZATIONAL CHALLENGES AND OPPORTUNITIES**

- Increased need for effective governance and decision-making mechanisms
- Organizational strategy requires revised capabilities
- Companies facing retirement cliff due to aging workforce
- Internal silos create redundant capabilities across functions
- Markets, distribution channels and products must be rationalized
- Acquiring other companies to increase scale
- Lack of agile processes translates to higher costs
- Lack of transparency creates risks that must be mitigated
- Technology acquired over years requires rationalization to reduce TCO
- Delivery Model transformation: Shared service centers, Domestic/offshore outsourcing

**CHANGING ECONOMIC ENVIRONMENT**

- Financial meltdown causes shifts in priorities
- Further industry consolidation and restructuring is anticipated
- Increased regulatory compliance
- Changing tax rates
- Different paces of recovery in different regions and countries
- Consumer and corporate preferences are changing

**REQUIRING ADJUSTMENTS TO COST STRUCTURES AND SPEND MANAGEMENT**
Successful cost optimization requires a combination of three key success factors:

- **Accelerated Alignment**
- **Rigorous Diet**
- **Sustainable Lifestyle**

**Successful Cost Optimization**
These success factors are underpinned by seven key components

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<thead>
<tr>
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<th>The program objectives need to be aligned with the company strategy and fully supported by the Executive Management Committee</th>
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<td>2</td>
<td>The objectives need to be extremely explicit and consider the trade off between costs, income and potential impacts on customer service and risk</td>
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<td>The executive team needs a strong governance structure to focus and structure the cost optimization program</td>
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<td>The change journey needs to be choreographed to create employee momentum, initiative and buy in</td>
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<td>The art is to chose the highest pay back opportunities for success, to know what is achievable and how to assemble the team</td>
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<td>The establishment of a program office and key metrics to track overall progress against the business case objectives</td>
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<td>7</td>
<td>The ‘diet’ of cost reduction needs to be underpinned by a cost conscious culture to support ‘lifestyle change’ going forward</td>
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Accelerated alignment

Rigorous diet

Sustainable lifestyle
The scope of the cost optimization efforts determine the potential benefits

**Scope and Benefits**

- **Streamline**
  - Improve individual productivity
  - Identify process improvements and quick wins with a functional area
  - Enhance system to automate or improve some functionality

- **Redesign**
  - Restructure departments within the business unit, including job roles and responsibilities
  - Design end-to-end business processes and procedures
  - Upgrade or integrate current systems

- **Transform**
  - Develop target operation model (TOM) and business strategy
  - Execute an organizational transformation (strategy, process, technology, organization)
  - Realign functional areas with new TOM and business strategy
  - Implement a sound governance structure with processes and procedures to regularly monitor progress for continuous improvement
Regardless of scope, addressing costs can also lead to improvements in the customer experience and mitigate growing organizational risks.

**Reducing Operational Costs**
- Enabling business efficiencies
- Removing manual processes
- Decreasing redundant support costs
- Simplifying the environment
- Eliminating non-strategic processes and applications
- Simplifying compliance and reporting
- Decreasing infrastructure footprint

**Mitigating Business Risk**
- Managing regulatory/compliance requirements
- Improving data integrity/customer support
- Addressing the aging workforce cliff
- Consolidating data for simplified access
- Reducing risk of technology failure/extended outages
- Mitigating data security risks
- Mitigating reputational and financial risk

**Improving Customer Experience**
- Improving analytics with one view of the customer
- Facilitating faster time to market for products & services
- Aligning product design to surpass client expectations
- Leveraging channel capabilities
- Enabling customer self-service
- Driving cross sell/up-sell opportunities
- Enabling improved fraud detection
IT plays a critical role to enable a successful operations efficiency and effectiveness program

IT Governance
- IT Governance Framework
- Organization Design
- IT Due Diligence
- ITIL and Process Control Design
- IT Asset and Vendor Management

Emerging Technology
- Cloud
- Mobile Applications and Payments Infrastructure
- BYOD
- Social Media and Collaboration

Operations Transformation
- Supporting the Customer Experience
- IT Alignment and Enablement
- Business Architecture and Target Operating Models (TOM)
- Business Process Management

Strategy
- Opportunity Planning (Business Case)/IT Strategic Planning
- Business Imperatives and IT Linkage
- Application Portfolio Rationalization

Shared Services and Sourcing
- Service Delivery Strategy
- Internal/External Delivery Balance
- Defined Outcomes
- Governance and Regulatory Alignment
- Service Mgmt Performance

Enterprise Architecture
- Business and Technology Architecture Alignment
- Technology Adoption and Portfolio Management
- Solution Architecture
- EA Governance

Cyber Security & Risk Mgmt
- Identity and Access Management
- Unified IT Compliance and Security
- Business and Disaster Recovery
- Data Governance

Infrastructure Optimization
- Data Center Consolidation
- Server and Storage Virtualization
- Right Sourcing
- Organization Design & Alignment
- Talent Management
KPMG’s can assist with your operational efficiency and effectiveness program with a customized approach to meet your specific needs

- KPMG has a globally consistent methodology for delivering cost optimization solutions and support, which have been tailored for the insurance industry
- KPMG teams are multi-disciplinary to include experienced insurance industry professionals, cost optimization practitioners and specialists for the areas of specific focus: distribution, compliance, IT, HR, investments etc. - all working as an integrated team

**Globally consistent cost optimization approach**

**Multi-disciplinary team of relevant experienced professionals and specialists**

**Access to functional areas of deep specialization**

<table>
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<tr>
<th>Services &amp; Areas</th>
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<td>Real Estate</td>
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Our approach incorporates five key steps to cost optimization and continuous improvement.
Most organizations cost reduction programs fail to achieve their targets, and the gains that are achieved, appear to be short lived.

**Mistakes to Avoid**

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<tr>
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<th>Mistake</th>
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<tr>
<td>1</td>
<td>Inadequate governance processes to drive cost optimization</td>
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<td>2</td>
<td>Too much reliance on cost avoidance rather than increased cost efficiency</td>
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<td>3</td>
<td>Insufficient incentives to reward prudent cost management</td>
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<td>4</td>
<td>Too many conflicting projects</td>
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<td>5</td>
<td>Cost drivers are not clear or transparent</td>
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<td>6</td>
<td>Cost targets are too conservative</td>
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<td>7</td>
<td>Cost ownership is unclear and too narrow</td>
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<td>8</td>
<td>Cost discipline is not embedded in the culture</td>
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<td>9</td>
<td>Remaining staff is overburdened with additional workload</td>
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In addition to “Mistakes to Avoid” there are often internal “Barriers to Overcome”

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<tr>
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<th>Barriers to Overcome</th>
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<tbody>
<tr>
<td>1</td>
<td>Too many sacred cows</td>
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<tr>
<td>2</td>
<td>Defensive culture about current state</td>
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<td>3</td>
<td>Not truly understanding what the org is good at and where they need help</td>
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<td>4</td>
<td>Insufficient time in “heavy lifting” planning</td>
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<td>Not willing to put all things on the table</td>
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<td>6</td>
<td>Not taking a holistic look at the business</td>
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<td>7</td>
<td>Lack of courage and boldness</td>
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It is important to get a operational efficiency and effectiveness program off on the right foot and keep it on course

Key Things to Get Right

- **Build a compelling business case for action** linking the operational effectiveness and efficiency program scope to business priorities

- **Demonstrate executive commitment** by providing clear direction, communicating direction, quelling concerns, staying on course and demonstrating they are on board

- **Confidently manage participation** by listening and understanding concerns, issues and perceived losses and balance program and implementation with day to day priorities

- **Business and Technology alignment** with a roadmap to address people, processes and technology in business terms and focused on achieving operational results

- **Actively plan and manage partners and vendors** having clear key success factors and aggressively managing issues and risks
There are some key prerequisites required to effectively launch your operational efficiency and effectiveness program

- **Develop a productivity strategy** - *Productivity plays an important role in delivering a corporate strategy.*

- **Ensure transparency of revenue and cost drivers** - *Alignment with people’s performance measures is critical. If you grab people by their measures, their hearts and souls will follow.*

- **Develop customer value-creation targets** - *Good customer service is actually 25 percent cheaper to deliver than poor customer service. But there needs to be a political appetite at the top of the organization to recognize the benefits and institutionalize change.*
Maintaining momentum moving forward is a key to long term success

➢ **Strive for continuous improvement:**
  
  *Leading organizations keep *driving productivity improvement* through a combination of *sustained executive focus and support* for team-led change through closed-loop learning and improvement cycles.*

➢ **Build a cost conscious culture:**

  *A consistent theme of our research is if people believe ‘nothing I can do will make a difference’ or ‘if we change, I may lose my job’, then the effectiveness of any productivity strategy will be seriously challenged. People in the organization have to *believe they will be supported and recognized* if they come up with and implement ideas to reduce waste. Of all the productivity disciplines, the trust and willing engagement of staff is the most important. From our research, it is also the first to be sacrificed.*

➢ **Leverage tools and techniques:**

  *The key issue is whether the organization has built up a way of doing things which *informs and enables its people* to understand customer value, to gain insight into the state of core processes, and to identify, evaluate and deliver opportunities for improvement. This means putting relevant financial and operational information in the hands of people who can interpret and draw insight from it, in order to *drive learning and improvement cycles.*
Thank you

Harry Pickett
Vice President
KPMG Management Consulting
416-777-3571
hpickett@kpmg.ca
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