



OUTSOURCING RISK AND REWARD

Evaluating the benefits and the risks associated with outsourcing products and services.



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Contents

Introduction	2
Risks of Outsourcing	3
Risks of Outsourcing Continued	4
Benefits of Outsourcing	5
Benefits of Outsourcing Continued.....	6
Insourcing	6
BinTech Partners' Position	7
Resources.....	8



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Introduction

In today's market, the pace of technological change has made being "all things to all people" an unrealistic goal. Additionally, companies consider time to market and reduction in operating expenses as key ingredients when considering expansion into new product lines. In order to achieve or maintain focus on developing and distributing new products, more companies are turning to outsourcing.

In the insurance industry, it has become paramount to the business plan for a company to consider outsourcing some or all of its non-core functions. By further understanding the risk and reward associated with these options, a company and its management team may establish its needs, weigh its options and identify the best solution based upon a clearer understanding of solutions and risk avoidance or mitigation.

This paper is intended to present several industry findings regarding outsourcing, insourcing, and the associated benefits and risks.

Risks of Outsourcing

In researching studies by Outsourcing.org, Techtarget, Deloitte, *InformationWeek*, Outsourcing Center, Thomson Reuters, Willis^[1-8], and many other outsourcing resources, we consistently found the following types of risks identified by both outsourcers and companies. We've categorized these as generally outsourcer, company or industry events or activities.

Outsourcer Controlled

- Processes (Technology and Back Office)
- Productivity
- Security and confidentiality of company's and its clients' information

Company Controlled

- Unclear service level agreements
- Unclear company objectives
- Recognizing the need for ongoing management of outsourcing

Industry Controlled

- Regulatory requirements
- Statistical requirements
- Inviability of outsourcer (downturn in industry, or merger/acquisitions)

Combined Control by Outsourcer and Company

- Cost of servicing
- Effective communication
- Flexibility for implementation and product change
- Controlling scope creep
- Building mutual trust
- Incompatibility of company and outsourcer
- Dispute resolution

Once the decision to outsource is made, the key is not only identifying the risks that are inherent to your company's project or program, but also ensuring that your company participates in the mitigation process.

In considering next steps, let's look at where risks are addressed. Outsourcing risks can be addressed basically in one of two ways: 1) Up front to identify and set risk mitigation in place, and 2) addressing the risk when an issue or problem occurs. Clearly the former is the preferred method.

Through the Outsourcing Center's "Leading Causes of Outsourcing Failures" survey in May 2004, the study found that 72% of companies and outsourcers agree that most often problems are addressed through the "governance agreement", i.e., during the ongoing outsourcer/company relationship, as regulatory or other combined control challenges occur.



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Risks of Outsourcing Continued

Techtarget, Deloitte, Outsourcing Center, and Willis^[2,3,5,7] suggest that these failures can be mitigated during the outsourcer selection process and through appropriate contract provisions by following some of these guidelines:

Selection Process

- Outsourcer has a proven track record
- Outsourcer demonstrates quality control practices
- Outsourcer will guarantee to meet specific service levels
- The company performed due diligence to validate the outsourcer's capabilities
- Outsourcer demonstrates staying power

Service Level Agreement

- Agree on system availability and up time
- Agree on back-office processing service levels
- Agree on implementation methodology
- Agree on change processes and scope control
- Set measurable and realistic expectations
- Agree on dispute resolution

Company Commitment

- Company recognizes the need to commit resources to manage the planning, execution and ongoing work with the outsourcer.⁵



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Benefits of Outsourcing

Often an outsourcer specializes in offering services to specific industries, or a niche market. When a company is able to partner with an outsourcer that has expertise in the insurance industry, the benefits, such as goal attainment, are often noted within the first six months of outsourcing.⁴

Deloitte's "Global Insurance Industry Outlook, *Issues on the horizon*, Mid-year Update:2 008," reports that:

Achieving operational excellence is critical to success for insurance companies as achieving organic growth is becoming more difficult. Inevitably, maintaining operating margins and profitability in this economic environment will increasingly depend on creating an operating model that drives down costs. To achieve this, companies will need to focus on developing enterprise-wide cost reduction programs and taking advantage of the opportunities offered by offshoring, outsourcing and emerging use of Web and IVR technologies – all the while creating new products and capabilities for serving customers in a multichannel world.

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Outsourcing is an important solution for the profitability of many carriers and brokers. Some of the benefits include:

- Avoid capital investment
- Quicker entry to market
- Focus on core
- Reduce costs
- Upgrade service capabilities
- Leverage development (system and processes)

InformationWeek reported in 2003 that, "The most frequently cited improvements included better ability to plan, higher levels of operational reliability, and more rapid implementation of new strategies and initiatives."⁴

While further risk concerns have been identified over the past few years, studies as recent as mid 2008 indicate that, with proper risk mitigation in place, companies can still achieve better ability to plan, quicker implementations, faster market expansion, and reduction in overhead and technology costs.⁷

Just as a company should understand the risk involved and ways to mitigate the risks of outsourcing, having a clear understanding of the benefits and measuring the value to your organization is not only meaningful, it's critical. Identification of the non-core activities that, while vital to your business, do not significantly differentiate you from your competitors is important for a company considering outsourcing.



Outsourcing Risk and Reward: Evaluating the benefits and the risks associated with outsourcing products and services.

Benefits of Outsourcing Continued

Functions such as information processing, accounting and policy and claim administration may drain your resources without contributing significantly to your bottom line. Due to an outsourcers' extensive experience, streamlined procedures and technology resources, they can perform these functions faster and at a lower cost.

Insourcing

Some companies determine they want to develop and support the staff, systems and organization, and thus insource its non-core functions. A company can insource out of the gate, or consider this option once the size of its new or expanded line of business grows to a point that enables support of the required infrastructure.

A company should weigh the costs and benefits of insourcing. Creating a successful and skilled internal infrastructure can be an arduous task; however, it can be accomplished through some of the following:

- Environmental scan – can you hire the talent and expertise you need for your specific products and services?
- Evaluate needs and costs associated with:
 - S ystems
 - Hiring and training ancillary resources
 - Acco unting
 - C ash management
 - Claim administration
 - Policy administration
 - Do cument packaging
 - Mailroom
- Create or modify internal processes
- Create or modify internal procedures
- Create and implement a change control plan for “take back” purposes

One of the key reasons that companies decide to bring part or all of its outsourced services back into an organization is to gain control. Other instances of insourcing occur when an outsourcer is no longer a viable entity and the company has to take back outsourced functions.

Preparing to perform outsourced services in-house can be accomplished with good planning. Just as a company is encouraged to set contract provisions for service levels and risk mitigation, specifically identifying non-core activities that your company will “take back” at a future date should be included in certain aspects of the contract as well.



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BinTech Partners' Position

BinTech Partners provides outsourcing opportunities for the insurance industry, specializing in systems and support services for personal and commercial lines products. We offer companies the resources gained from more than thirty (30) years of diverse experience in the insurance industry.

BinTech encourages our existing and potential clients to realize the best benefit of outsourcing through several methods. These include:

Define your business objectives. Start with your company's overall goals. From there, identify the specific objectives an outsourcing partner can help you meet.

Target new product areas that would complement and expand your existing lines expeditiously. Think in terms of cross-selling and logical pairings, such as Homeowners and Flood, or Auto and Homeowners.

Determine the strengths that contribute most to your company's competitive advantage. Create a clear sense of the areas in which your company excels and what sets you apart from others in the marketplace.

As an outsourcing third party administrator, we recognize that our position could be perceived as biased. However, we understand that outsourcing, while most often beneficial, is not always the best solution for every company. We have actually walked away from opportunities because we did not believe a company's goals and objectives were in-line with partnering with an outsourcer.

BinTech's management team participates in the due diligence process with our clients and, especially, potential clients. We encourage you to "kick the tires" in an effort to mitigate your risk.

- Ask for proof of experience in servicing and of the employees working with your products and services.
- Seek a partner that will provide some level of flexibility to accommodate your company's growth and changing business goals.
- Verify Best Practices are in place and seek to understand the quality control measurements that an outsourcer has in place.
- Ask for written service level agreements that stipulate effects to the contract and payment of services if not met, but more importantly, a dispute resolution process.

At BinTech, we have had success with our clients achieving a 20% overall cost savings or a 20% increase in product value... we've done that through reduction in time-to-market for new products.

We offer clear service level agreements, and provide verification of our insurance industry experience and licensing. We strive to offer flexible implementation and change methodologies, and we focus on strong quality control programs. Bottom line, our service brings the outsourcing experience with BinTech to an unsurpassed level.



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Resources

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NOTICE:

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