



The incidence of
**outsourcing,
offshoring**
and **onshoring**
on company's risk policies:
approach in the insurance sector

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**CURRENT CONTEXT OF
OUTSOURCING AND
OFFSHORING OF SERVICES**

Market globalisation, the internationalisation of companies and the economic and financial hardships currently being suffered by most firms are all factors fuelling an ongoing world trend towards outsourcing and offshoring/onshoring in industry, now spreading to all service activities.



In the broadest sense, outsourcing and offshoring/onshoring is a process whereby firms choose to contract out non strategic services to subsidiary companies or other companies, whether at home or abroad, instead of dealing with them within the firm itself, seeking such advantages as lower costs, better

adapted infrastructure and the ability of concentrating on its core activity, etc.

The following table summarises the commonest scenarios in terms of organising and placing the service, in the interests of a better understanding of the terms employed:

OFFSHORING AND OUTSOURCING		
SERVICE SITE	ORGANISATION OF THE SERVICE	
	Within the company	Outside the company
Home country	The service is carried out within in the firm and in the home country	The service is contracted out to third parties in the home country (onshoring)
Located abroad	The service is carried out by a foreign subsidiary in another country	The service is contracted out to a third party service provider in another country, either a local firm or foreign subsidiary of another multinational company
Offshoring	Intrafirm or captive offshoring	Outsourcing

A combination of service outsourcing and offshoring can generate great business opportunities and pose new challenges. The greatest challenge is the increase in competition and proper management of the positive aspects thereof in terms of growth, efficiency and quality. Service offshoring is a rapidly growing model in various economic sectors, above all using a nearshore approach, i.e., siting the service in a nearby region or country, giving companies a greater sense of security and confidence. About 60% of service offshoring currently involves this nearshoring model.

In Spain the offshoring of services is an option taken up mainly in the areas of call and contact centres and information systems. Sectors like finance (banking and insurance), telecommunications, energy, tourism firms and services are leading the way in terms of offshoring their customer attention services mainly in Latin America (mainly for reasons of cost and language) and North Africa (mainly for reasons of cost and proximity). Spanish firms have also begun to outsource services of application development and maintenance and other activities with a high administrative charge.

The main reason for embarking on an offshoring process is usually cost saving, but it is not the only one. Other factors looming ever larger are the availability of experienced professionals, labour stability, better infrastructure, the attractive business- and taxation-scenario, etc.

Offshoring in the broadest sense can be broken down into three categories depending on the distance between the site of the parent company and the site where the task is carried out:

1. Onshore or domestic offshoring inside the same country.
2. Nearshore in a nearby foreign country.
3. Offshore in a distant foreign country.

The nearshoring arrangement, with services being provided from nearby countries like Morocco, cuts down the risk and provides competitive and quality services while also cutting costs and the tax load.

The decision to go for an offshoring model is an important strategic option for any company. Its success depends on:

1. Defining clearly the desired outsourcing model, studying the process in all its phases and deciding which lend themselves to some sort of onshoring or offshoring arrangement.
2. Properly blending the capacities of nearshoring and offshoring.
3. Defining and implementing a flexible, client-oriented model, using a distributed service model comprising a front- and back-office. The front-office takes on responsibility mainly for *in situ* managing of the business of greatest added value. The back-office is the one that can be outsourced and/or offshored, since it focuses on activities that lend themselves to «industrialisation» and third-party execution, generally in lower cost production centres, albeit ensuring service quality and productivity.
4. Rounding out the model with control arrangements that ensure clear and transparent information on the state of the project/service.
5. Managing the process of cultural and methodological change in a proper way.

It is up to each individual company to convert the outsourcing and offshoring challenge into a business and growth-fuelling opportunity.

In fact, many insurance companies have already opted for this type of organisational management as part of the trend of concentrating on their core business and out-tasking the non-strategic business.



ADVANTAGES AND DISADVANTAGES OF THE OUTSOURCING AND OFFSHORING OF SERVICES

The main advantages of outsourcing and/or offshoring are the following:

1. Cost saving with cheaper labour and materials.
2. Greater efficiency and productivity by harnessing economies of scale.
3. Converting fixed costs into variable costs, increasing the company's flexibility.
4. Access to a new methodology and technology, benefiting from the service provider's experience and specialist consultancy, facilitating decision-making procedures.
5. Improving service quality with a more professional performance of the outsourced task.
6. Improving the management of human capital,

both of the staff still managing the core activity and those hired for the outsourced activity.

7. Concentrating on and optimising its main activity.
8. Greater facility of developing new business models, with a reduced need of human infrastructure and fixed materials.
9. Reduction of the necessary outlay for taking on a new activity, since the cost of carrying it out can be tied in with results, limiting the investment risk arising from failure to meet initial objectives and expectations.
10. Reduction of the time needed to launch a new activity by making it easier to set up new procedures and simpler to obtain the necessary human and material wherewithal.

Despite the success of most outsourcing and offshoring operations, we should not lose sight of the risks inherent to strategies of this type. Like any strategic transaction, outsourcing or offshoring strategies also have their downside and companies need to be aware of this before striking out down this road. They need to analyse and weigh up these risks. The main risks involved may be of various types:

1. Possible workforce friction due to any job losses in the parent firm.
2. The loss of control or know how of the outsourced or offshored activities. This risk should be mitigated by the companies retaining a sufficient level of skills within the internal organisation to ensure the service provider meets all its obligations and even change the provider if need be or return to direct running of the activities in case of outright failure.
3. The degree of dependence on the external service providers. This could be a significant risk

because overdependence might invert the relation between them, giving the provider the upper hand.

4. The company's image might be damaged by a poor service from the external providers.

5. The possibility of incurring operational risks. It should be remembered that operational risk is the risk of loss resulting from inadequate or failed internal processes and information systems, from misconduct by people or from unforeseen external events. It is a risk that is controlled mainly by means of very detailed contracts called service level agreements and which are usually covered by insurance policies.

6. Socio-cultural problems and even – at times – political problems, a risk that will be particularly to the fore in offshoring transactions in remote countries. These risks might have an impact on the company's human resources and culture.

Nonetheless, as in other sectors facing fierce competition and embroiled in the current crisis, the companies of the insurance sector have to cut their operating costs and improve their service quality to stand out from the competition and be able to focus on the constant search for new products and services. Outsourcing and offshoring certain activities can turn out to be advantageous both for the company and its clients, who are offered products and services at affordable prices.

TYPES OF SERVICES MOST OFTEN OUTSOURCED IN THE INSURANCE SECTOR

In general any process that can be proceduralised and automated is eligible for outsourcing.

A list is given below of the insurance sector tasks that are usually outsourced and/or offshored:

1. Policy and portfolio management.
2. Claims management.
3. Call and contact centres.
4. Invoicing and payment of standing orders and compensations.
5. Administration of contracts.
6. Backup functions: administrative services (management of archives, payslips, etc.) and IT services (development and maintenance of applications).



7. Product sale (by internet, telephone, etc.), especially all mass insurance such as life, health, accidents, automobile, multi-risk home insurance, etc.

According to the figures of the consultant Cap Gemini, 40% of the insurers trading in Spain have opted for outsourcing of infrastructures; 35% have opted for outsourcing of claim management and policy contracting applications; and 30% of the companies have outsourced accounts and payroll management.

But it is also true that not everything is outsourceable. Know-how should not be outsourced. Companies might turn to outsourcing in order to be able to focus on their critical business, although product design, growth strategies, positioning and marketing are key business activities that should always be kept in the hands of the insurer.

OUTSOURCING AND OFFSHORING: EXPERIENCES IN THE INSURANCE MARKET

Outsourcing and offshoring in the insurance sector began mainly in English-speaking countries. Some of the main outsourcing and offshoring stories in the insurance sector are the following:

In 2004 the insurance company **Aviva** announced the transfer of 2500 jobs in England and Canada (the services of call center, administrative and back-office) to India, with the aim of «giving the company greater

flexibility and a higher capacity». In April 2007 Richard Harvey, Aviva's CEO, said that they had about 7000 workers in India. The advantage offered by India was that most of the population speak English and the service could be managed at half the cost. This was a competitive advantage for Aviva and its clients, since they obtained better services at a lower cost. Aviva's case was an example of offshoring activities within the same company, since the Indian workers were Aviva employees. In the words of Richard Harvey: «...Outsourcing and offshoring is here to stay. The economy is now globalised and if companies do not process their data where it is cheaper and give their clients a better service they will fall back in the race ...».

The insurance broker **Willis** also transferred some of its USA and UK business, mainly claims management, to India.

The German insurance company **Allianz** set up a subsidiary in India for running IT services.

For its part, the company **Prudential PLC** transferred part of its call center to Bombay (India), scrapping 850 jobs in England. Later, in 2007, the British insurer announced its intention of outsourcing about 3000 jobs to cut costs. This measure involved transferring 1750 claims-management and client-services jobs in the United Kingdom, plus another 1250 in Bombay to a subcontracted firm, thereby closing an agreement worth 722 million pounds (about 1 billion euros). Prudential's intention was to cut costs by about 60 million pounds (83.8 million euros) by late 2010.

In October 2004 the insurance company **Royal & Sun Alliance** also announced the transfer to India of about 1100 jobs over the next two years. By means of this offshoring process it planned to cut costs by about 14 million euros. On this date it already had about one hundred workers in India.

In early 2005 the reinsurer **Swiss Re** also announced its plans to transfer part of its accounts

department to India, offshoring the accounts of its standardised civil liability contracts and other non-life lines. This switch would involve 160 job cuts in Europe (fifty in Switzerland) over the next five years.

Likewise, in early 2005, the French company **Axa** announced that it was going to transfer 700 jobs from its UK staff to India, following in the footsteps of Aviva. Later on, in September 2006, Axa France announced its intention of offshoring 1500 jobs (contact centre and admin posts) to Morocco, as part of the company's forward-looking «Ambition 2012» project. The insurance company already had employees in Morocco through its subsidiary Direct Assurance, and also in Bangalore, India. Offshoring was therefore nothing new for Axa; this was merely the first time it affected the French market.

In January 2006 the Swiss insurer **Zurich Financial Services** signed a multiannual agreement whereby an important consultant would manage part of the accounts and finance process in various countries.

In January 2007 **Aon** France was also drawing up a restructuring plan involving the closure of several offices and the transfer of dozens of jobs to Romania.

In January 2007 **AIG Europe** announced a ten-year business outsourcing agreement whereby a consultant would set up the IT platform and support the services of AIG Entrepreneur, an AIG business unit specialising in general insurance and SMEs. The aim was to «maximise the insurance company's operational efficiency and enhance its services; it will be implemented in several European countries, starting initially with France. The scheme would then be broadened to Italy, Spain and the Netherlands, among others».

Outsourcing and offshoring processes are also underway in Spain. For example, the workers of **Europ Assistance** España announced in December 2006 the transfer of a telephone attention platform to Argentina.

Also in 2006 **Groupama** España and Xerox Global Services renewed for another five year term the service contract they maintained in Spain, whereby Xerox undertook to issue the policies to the policy holders. The insurance company's clients thus receive in their homes the welcome packages, comprising the policies and various components of the acquired insurance, personalised and in full colour. Groupama has reported the advantages it has gained from outsourcing this management

All the above experiences show that outsourcing and offshoring practices have now arrived in the insurance sector and are being used by most of the sector's multinationals.

As regards the Spanish insurance sector these organisational practices have not had a very significant impact to date, other than subsidiaries falling into line with the policies laid down by the parent companies of certain multinational insurance companies. Nonetheless, in 2009 and early 2010 there is evidence that some insurance companies, insurance brokers and claims adjustment and valuation companies are giving closer



attention to the subcontracting and possible offshoring of certain services as a way of trimming costs and boosting their competitiveness. This drive is becoming increasingly important in the current downturn, where it is easier to enhance the income statement by cutting costs than by increasing sales or bringing in new clients.

Even back in October 2007, for example, the consultant Capgemini was saying that the Spanish insurance sector had a high enough maturity level for offshoring its services. A similar opinion was expressed by the consultant Everis, predicting in May 2009 that there would be an annual 8% increase in outsourceable services in the Spanish insurance sector over the coming years.

MAIN COUNTRIES FOR OUTSOURCING AND OFFSHORING SERVICES

The geography of offshoring is shifting, according to the 2009 study «Global Services Location Index (GSLI)» by the prestigious consultant AT Kearney. India and China are still the prime candidates for outsourcing; Central and Eastern Europe have slipped down the rankings while the countries of South East Asia, Middle East and North Africa have all risen.

The study, which has been conducted since 2004, analyses and classifies the 50 main countries of the world for locating outsourced activities, including IT services, contact centres and admin tasks. Each country's score is composed of a weighted combination of relative scores



on 43 parameters, which are grouped into three categories: financial attractiveness (mainly costs and taxation), people skills and availability and the business environment (technical infrastructure and governmental support).

The countries of Central and Eastern Europe, including Poland, the Czech Republic, Hungary and Slovakia, have become much less attractive to countries of Western Europe due to soaring wage-push inflation and the euro's appreciation against the dollar. At the same time the low-cost countries of South East Asia and the Middle East have risen sharply up the rankings, due mainly to the enhanced quality and availability of skilled labour. Vietnam, Egypt and Jordan thus feature for the first time among the 10 top countries.

«While cost remains a major factor in decisions about where to outsource, the quality of the labour pool is gaining importance, particularly in higher, value-added functions and where there are talent shortages at home», said Norbert Jorek, a partner with AT Kearney and managing director of the firm's Global Business Policy Council. «In response governments all over the world are investing in the human capital demanded by the offshoring industry».

The table on the next page shows the study results, ranking the top 50 countries for worldwide outsourcing:

2009 GLOBAL SERVICES LOCATION INDEX (GSLI)

(The number in brackets show the ranking in 2007 GSLI)

1. India (ranking in 2007 GSLI: 1)	26. Senegal (39)
2. China (2)	27. Argentina (23)
3. Malaysia (3)	28. Canada (35)
4. Thailand (4)	29. United Arab Emirates (20)
5. Indonesia (6)	30. Morocco (36)
6. Egypt (13)	31. United Kingdom (Tier II)* (42)
7. Philippines (8)	32. Czech Republic (16)
8. Chile (7)	33. Russia (37)
9. Jordan (14)	34. Germany (Tier II)* (40)
10. Vietnam (19)	35. Singapore (11)
11. Mexico (10)	36. Uruguay (22)
12. Brazil (5)	37. Hungary (24)
13. Bulgaria (9)	38. Poland (18)
14. United States (Tier II)* (21)	39. South Africa (31)
15. Ghana (27)	40. Slovakia (12)
16. Sri Lanka (29)	41. France (Tier II)* (48)
17. Tunisia (26)	42. Ukraine (47)
18. Estonia (15)	43. Panama (41)
19. Romania (33)	44. Turkey (49)
20. Pakistan (30)	45. Spain (43)
21. Lithuania (28)	46. New Zealand (44)
22. Latvia (17)	47. Australia (45)
23. Costa Rica (34)	48. Ireland (50)
24. Jamaica (32)	49. Israel (38)
25. Mauritania (25)	50. Portugal (46)

**(Tier II) Based on the low cost of the following localities in each country: San Antonio (USA), Belfast (UK-Ireland), Leipzig (Germany) and Marseilles (France).*

The most noteworthy aspects of the 2009 GSLI study are:

- The Middle East and North Africa (MENA) region is emerging as a hot offshoring destination due to its large, well-educated population and nearness to Europe. As well as Egypt and Jordan, ranking six and ninth respectively, Tunisia (17), United Arab Emirates (29) and Morocco (30) also figure among the favourite offshoring countries. "The Middle East and the countries of North Africa have the potential for capturing business in

the outsourcing industry on the strength of their well-trained and underemployed workforce", says Johan Gott, director of the study.

- Subsaharan Africa is also gaining strength. Ghana ranks 15, Mauritius 25, Senegal 26 and South Africa 39.
- The countries of Latin America and the Caribbean continue to capitalise on their proximity to the United States as nearshore destinations. Chile ranks highest among the countries of the region, in eighth position, on the strength of its political stability and favourable business environment.



Other high ranking countries in the region were Mexico (11), Brazil (12) and Jamaica, which leapfrogged 11 positions to number 23.

- India, China and Malaysia continue to head the ranking with a big gap on the rest, offering a perfect blend of people skills, favourable working infrastructure and low cost. India in particular has held onto top ranking in the outsourcing industry and is even fuelling industry growth elsewhere by the expansion of its companies in other countries.
- United States, represented by potential lower level «tier II» onshoring with cities like San Antonio, rose to number 14 on the list, mainly due to the benefits ensuing from the falling dollar. This country is leader in people skills, unemployment and political pressure to create jobs in this industry, in an attempt to foster employment in small inland towns. Similar trends are observable in countries like the United Kingdom, France and Germany, all of which also put in a better showing in the 2009 GSLI ranking.
- Although the worldwide financial crisis has curbed offshoring movements, offshore staff are increasing as a percentage of total jobs. This is because staff in the home country are being laid off as a result of the recession to cut costs, while offshore workers are kept on to maintain the service. On many occasions the facilities of the offshore firms, being newer, are more efficient than the local infrastructure.

These are the results of the study on a global scale. Each country will then have to weigh up such factors as its own location, language and other characteristics to choose the best offshoring option. From this outlook Spain is finding Morocco to be its ideal outsourcing and/or offshoring location since it offers the three main characteristics:

1. Cost saving due to lower salary and infrastructure costs.
2. Skilled and specialist labour.
3. Governmental support with many tax advantages and aid for training and the creation of companies.

Other factors like geographical proximity, similar time zone and ease of learning Spanish make Morocco the ideal nearshore destination for tapping into the advantages of outsourcing and/or offshoring.

HOW TO MANAGE THE RISKS INVOLVED IN OUTSOURCING SERVICES

As explained above, the reasons for taking up this option can be very varied, although the main one is usually cost saving. But we have also seen that outsourcing might entail some risks. How can we turn these risks into opportunities? The main way is by implementing the prevention policy and culture that should exist in all companies as well as in all its functions and business units. It will be hard to build up this prevention culture and function in a coherent and ongoing manner unless there is a department in charge of managing corporate risk and insurance, as an area that participates in the business strategy. This department would have to participate with the rest of the

organisation in implementing a true strategy, in the interests of controlling and minimising intrinsic and collateral outsourcing risks. This strategy will have to define, analyse and manage numerous related aspects, such as the following:

1. Define and evaluate the objectives, from the short to long term

First and foremost, the company has to define and evaluate the objectives that might prompt it to set up an outsourcing and offshoring strategy. It should therefore look at short-, medium- and long-term objectives, such as the following:

- Define the motives behind these practices and existing threats.
- Carry out the economic analysis of the company's activity and find out the weak points.
- Define the main business activities and others that might be contracted out.
- Implement schemes to enhance the quality of the services and products in terms of a better price-quality ratio within the company's business model.
- Implement flexibility-maximising actions to become more operative and reactive.
- Implement organisational schemes in accordance with the strategic objectives and the company's business plan.



2. Define the activities eligible for outsourcing and/or offshoring

The second phase would be to determine which activities can be outsourced and/or offshored. This will involve the following:

- Define and evaluate the activities that can be subcontracted and evaluate the possible future trend of the activities to be outsourced and offshored.
- Select the best service site and organisation for insourcing or outsourcing the service either in the firm itself or another one, in the home country or abroad.

Another factor to be borne in mind in terms of the insurance sector is that not all insurance activities are eligible for outsourcing. For example, it would be unthinkable to outsource and offshore completely the customer service, since this would forfeit direct communication with the final client, something that would be inconceivable in the insurance sector. Nonetheless, thought could be given to outsourcing part of the customer service, for example a contact center, to pool non-strategic information on the company-client relationship.

3. Define an action and control plan

The action plan for contracting the service out to a third party has to:

- Draw up very detailed specifications with a comprehensive explanation of the tasks, procedures and needs.
- Study the potential service-providing companies and invite bids in an objective and open tender.
- Analyse and deal with the bids received.
- Select the best service providers. The provider has to be a strategic ally for carrying out the



business, the contractual relation being based on mutual trust in the medium and long term in pursuit of the set objectives.

- Draw up the best model contracts.
- Decide on the best way of transferring the activity.
- Implement efficient monitoring and control methods.
- Appoint one or more representatives to watch out for proper collaboration and liaison between the insurance company and the service provider(s).
- Draw up and implement the necessary insurance coverage for existing risks after application of all feasible prevention measures.

Correct management of all these points will greatly favour the success of the service outsourcing and/or offshoring arrangement.

INSURANCE SOLUTIONS FOR THE RISK INVOLVED IN OUTSOURCING SERVICES

Although the main principle has to be application of the control and prevention culture in the subcontracted activities, there are certain insurance coverage arrangements that might assure success of the service outsourcing by protecting against the main risk. The main coverages of this type are:

- The company's civil liability.
- Civil liability of directors and executives.
- Political risk and exchange rate coverage.
- Break in the supply chain.
- Interruption of the business and loss of profit.
- Labour and arbitration risks.

Risk and insurance managers have to draw up and manage the best insurance coverage for safeguarding the firm from any negative consequences of service outsourcing and offshoring. An analysis therefore has to be made also of the insurance coverages to secure its liabilities. Likewise, risk managers have to look out for the solvency, quality and trustworthiness of the service-providing firms, ensuring also that the service-providing centres are strategically spread to avoid the risk of concentration and any service failure, whether due to operational risks or risks of any other nature.

In the opinion of Ricardo Lozano, General Manager of Insurance and Pension Funds, companies must have a «suitable risk management policy», carried out by «operationally independent personnel, skilled and properly trained». Proper risk management not only serves as a «measure of protection for companies» but also «gives them a competitive edge, underpinning their growth, cutting down capital costs, making it easier to undertake new business lines and, in short, contributing value».

SUMMARY AND CONCLUSIONS

Outsourcing and/or offshoring processes are now an everyday reality in most firms trading on a worldwide scale; this also holds true for the worldwide insurance sector. In the Spanish insurance industry this process is still inchoate but with a great growth potential if all the concomitant advantages are exploited and the essential risk management is coordinated by professional risk and insurance managers.

The main recommendations for the Spanish insurance sector are therefore the following:

1. Capitalise on all the advantages offered by outsourcing and/or offshoring like other countries of the English speaking world and Western Europe. As we have already analysed above, the main advantages are:

- Cost saving on the basis of cheaper labour and material infrastructure.
- Greater efficiency and productivity, achieving economies of scale.
- Converting fixed costs into variable costs, enhancing the company's flexibility.
- Access to a new methodology and technology, benefiting from the experience of the service provider, which could offer specialist advice to facilitate decision taking.
- Enhancing service quality by a more professional performance of the outsourced task.
- Improving the management of human capital, both of the staff still managing the core activity and those hired for the outsourced activity.



- Concentrating on and optimising its main activity.
- Greater facility of developing new business models with a reduced need of human infrastructure and fixed materials.
- Reduction of the necessary outlay for taking on a new activity, since the cost of carrying it out can be tied in with results, limiting the investment risk arising from failure to meet initial objectives and expectations.
- Reduction of the time needed to launch a new activity by making it easier to set up new procedures and simpler to obtain the necessary human resources and material wherewithal.

2. Benefit from the experience built up by other insurers in terms of the functions to be outsourced.

The main candidates are:

- Policy and portfolio management.
- Claims management.
- Call and contact centres.
- Invoicing and payment of standing orders and compensations.
- Administration of contracts.

- Backup functions: administrative services (management of files, payrolls, etc.) and IT services (development and maintenance of applications).

- Product sale (by internet, telephone, etc.), in particular all the mass insurance such as life, health, accidents, automobile, multi-risk home, etc.

3. Manage the inherent risks of the subcontracted activities by professional risk and insurance managers, responsible for applying the prevention policies and designing the best insurance coverage.

As we have also seen above, this involves:

- Defining and applying a complete outsourcing and/or offshoring strategy.

- Drawing up and managing the best insurance coverage arrangements.

4. Lastly, in view of the lack of experience of many companies in Spain, once the decision to outsource and/or offshore certain services has been taken, it is advisable to do so according to one of the following models:

- Onshore model (on national territory): in this model cost saving is lower but the geographical proximity makes it easier to set up the outsourced service.

- Nearshore (outside the national territory but nearby geographically): this is the outsourcing and/or offshoring model most often taken up. It represents an intermediate solution offering perhaps the best blend of potential cost saving and physical and cultural proximity, making success more likely.

Morocco is probably Spain's best offshoring option, as borne out by the study conducted by AT Kearney in 2009. ■

