With Cost Optimization Now a Mission-Critical Priority, Insurance CIOs Must Manage Costs Beyond the Short Term

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Initiatives: Financial Services Technology Modernization and Transformation

Traditional IT and business cost optimizations are variations on themes like automation to replicate processes or to lower operating cost. Insurance CIOs looking beyond operations to other cost drivers, like loss adjustment expenses or surrenders, can leapfrog competitors, generating business value.

Overview

Key Findings

- Insurance companies have not changed their cost structures in transformative ways. Between 2009 and 2019, the median compound annual growth rate (CAGR) of revenue and the median CAGR of operating expenses tracked proportionately.

- Total business operating costs represent 14% to 21% of addressable costs that can be optimized in an insurance company. Focusing only on operating costs will not enable an insurance company to transform its cost structure.

- Optimizing reserve calculations, loss predictions and avoidable surrenders, which represent 40% to 60% of total business costs, could improve insurance companies’ competitive position.

Recommendations

Insurance CIOs responsible for driving financial services technology modernization and transformation should:

- Establish a clear line of sight between IT spending and changes in operating costs by assessing the value of IT spending using measurable key performance indicators (KPIs), such as operating expense percentage change versus IT spending percentage change. Begin by assessing your cost-efficiency using Gartner's Cost Value Matrix (CVM).

- Predict the likelihood of losses before they occur by using artificial intelligence/machine learning (AI/ML) modeling to proactively engage consumers on the value of insurance to avoid
Introduction

For the majority of CEOs across the world, 2020 will be a recession year. Even if the countries in which they operate manage to elude “technically defined” economic recession, it will still feel like a recession. More specifically, for insurance companies globally, cost management is now a mission-critical priority. This means that insurance CIOs will need to help their CFOs, who focus primarily on cost cutting, understand that optimizing business cost might actually mean increasing spending on IT.

But based on the lackluster cost-savings experience of the past five years, insurance CIOs will need help to demonstrate how additional IT spending can actually help achieve cost optimization, according to Gartner research. Gartner scanned the revenue and earnings history of 44 life and P&C insurance companies globally. Between 2009 and 2019, the median CAGR of revenue was 2.9%, while the median CAGR of operating expenses was 3.0%. This does not put these companies in a good position to thrive in an era of sustained low interest rates and declining sales. Insurance companies have essentially been treading water and have not fundamentally changed their company’s cost structure.

To move through and out of this crisis successfully, insurance companies, with the help of CIOs, must look beyond improving operational expenses to lowering other structural costs, such as avoidable property and casualty losses, reserves or avoidable surrenders. Doing this will help insurers compete on price without negatively affecting profitability, or keep prices the same and use the extra funds to create innovative products for business growth initiatives. Figure 1 is a composite summary of life and P&C insurers’ costs based on industry data Gartner collected in 2018 from the S&P Global Market Intelligence platform (see Note 1).
During an economic downturn, coupled with uncertainty and fear, it is not unusual for business executives to focus on taking rapid action to cut operational costs. While that approach might have been essential for survival at the onset of the COVID-19 pandemic, a sustained program of optimization is important for maintaining competitive parity over the long run as well. But insurance company CIOs who also help their business partners improve and avoid surrender or P&C loss, by using analytics, for example, will have a much greater impact on lowering overall costs. Some actions may be necessary to save a business, but failing to think beyond immediate concerns can create a vicious cycle of cost cutting that can degrade service and ultimately destroy desperately needed digital capability. Cost cutting can go beyond cutting fat and can start cutting into the muscle of the IT department, which could hinder recovery. And while continued focus on operating costs is a “table stakes” activity for CIOs, cost optimization affects only one area of insurance costs; for example, operations, which limits its potential to transform an insurance company’s fundamental cost structure. This nuts-and-bolts focus simply leads to parity with other incumbents. It’s akin to a business that must replace a broken window, where an expense incurred has generated absolutely no competitive edge for the business.

*Insurers haven’t been able to generate savings from their digitalization initiatives, with over half of insurance companies being classified by Gartner as “cost-inefficient,” which means that they are*
Use Gartner’s Respond, Recover, Renew Framework to Avoid Short-Term Thinking in Cost Reduction Decisions

To achieve sustainable cost management success during the COVID-19 crisis, insurance company CIOs should think of the pandemic in three phases: respond, recover, and renew (see Life and P&C Insurance CIOs: COVID-19 Cost Optimization Action Plan). To help insurance CIOs navigate the economic downturn with their CFOs and business leaders, Gartner has developed a framework based on the same three-phase approach (see Figure 2).

**Figure 2: Gartner Respond, Recover, Renew Crisis Framework**

- **Respond** — This phase is about survival. During the initial response, CIOs must meet the immediate financial needs of the crisis, while at the same time ensuring the resiliency of the company’s technology.

- **Recover** — In this phase, insurance companies are stabilizing their operations as they prepare for the “new normal.” This is where business and IT optimization occurs.

- **Renew** — This is the most strategically important phase, since the crisis will have lasting impacts on the business. Insurance companies should make structural changes to meet the new
normal and be more competitive. This is where true business model transformation will occur.

Organizations must decide quickly where and when to cut, optimize and transform. To help CIOs achieve their goals, Gartner has devised a cost management matrix based on the three-phase crisis framework (see Table 1).

Table 1: Respond, Recover, Renew Cost Management Matrix

<table>
<thead>
<tr>
<th>Respond</th>
<th>Recover</th>
<th>Renew</th>
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</thead>
<tbody>
<tr>
<td>IT Cost Cutting</td>
<td>Cost Optimization</td>
<td>Transform Cost Structure</td>
</tr>
<tr>
<td>Reactive, Short-Term, Immediate</td>
<td>Programmatic, Structured</td>
<td>Business-Value-Driven, Stakeholder Partnership</td>
</tr>
<tr>
<td>Reductions</td>
<td>Improvements</td>
<td></td>
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<td></td>
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<tr>
<td>Scope</td>
<td>Scope</td>
<td>Scope</td>
</tr>
<tr>
<td>IT budget</td>
<td>IT and business operating costs</td>
<td>Business model transformation</td>
</tr>
<tr>
<td>Catalyst</td>
<td>Catalyst</td>
<td>Catalyst</td>
</tr>
<tr>
<td>Unexpected disruption</td>
<td>Maintain parity</td>
<td>Competitive survival</td>
</tr>
<tr>
<td>Approach</td>
<td>Approach</td>
<td>Approach</td>
</tr>
<tr>
<td>Reactive</td>
<td>Planned programmatic</td>
<td>Strategic</td>
</tr>
<tr>
<td>Tactical</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Barriers</td>
<td>Barriers</td>
<td>Barriers</td>
</tr>
<tr>
<td>Appeasement/padding</td>
<td>Lack of discipline/sustainability</td>
<td>Culture/innovation</td>
</tr>
<tr>
<td>Results</td>
<td>Results</td>
<td>Results</td>
</tr>
<tr>
<td>Short term</td>
<td>Gradual change</td>
<td>Reinvention</td>
</tr>
<tr>
<td>Stop the bleeding</td>
<td>Stepping stone</td>
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</table>
Obviously, there will be some overlap in cost management activities across the response, recovery and renew phases; CIOs and their business partners will have to make interdependent decisions simultaneously to develop a coherent strategy. For example, in the case of sustained long-term, near-zero or even negative interest rates, advanced analytics in investment management will be mission-critical. Scenario planning for potentially different economic conditions is a good way to approach these decisions (see Use Gartner Reset Scenarios to Move From Survival to Renewal for

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### Risks
- **Lost capability**
- **Time and willingness to sustain**
- **Resistance — threat to status quo**

Source: Gartner (October 2020)

- **Respond: IT cost cutting** — This is a **defensive, least impactful approach**; it’s a one-time undertaking to reduce or eliminate expenses that no longer add value to the business. It is tactical in nature, and is used to keep the business operating. For example, this could include renegotiating vendor contracts, reducing workforce levels, rationalizing certain systems or reducing IT services. This works best when the business identifies a precise amount of money that must be saved by a specific date. For example, a 10% cut to all IT budgets by year-end. Keep in mind that the IT cost-cutting strategy is an **act of subtraction** and adds no value to the business.

- **Recover: Cost optimization** — In this tactical, **stepping stone/incremental improvement** approach, insurance and business IT leaders are primarily attempting to lower the cost of something that already exists, such as a specific business process, starting with quick wins and leading to more complex initiatives. For example, this could mean automating an expensive business process, such as new business onboarding, to improve productivity and efficiency.

- **Renew: Transform cost structure** — In this scenario, CIOs are **restructuring the entire cost basis** to proactively change the company’s competitive price point, or to greatly expand the firm’s profit margins. This approach goes well beyond using automation simply to optimize operating costs; for example, using analytics to predict the likelihood of surrenders before they occur, allowing the insurer to take preemptive actions to retain at-risk customers. From a technology perspective, cost transformation requires not only automation, but technologies such as AI and ML to fundamentally improve decision making and customer experience, which have a direct impact on cost. This is rethinking a business process and not simply automating the old way of doing things.
Insurance. External factors may also lead to a cyclical impact where businesses return to the respond phase as waves of COVID-19 potentially recur.

Use Gartner’s Cost Value Matrix to Determine If You Are Cost-Inefficient

Disruptive enterprise changes require insurance CIOs to make fact-based decisions regarding IT investments and the business value they deliver. Gartner developed the CVM to help IT leaders analyze and select the appropriate mix of cost optimization initiatives that focus on cost-efficiency, as well as those that yield maximum business value (see Toolkit: The Gartner Cost Value Matrix, 2018: A Framework to Measure IT Efficiency and Business Value).

The CVM is a two-by-two quadrant rating system (see Figure 3) that aims to correlate the IT spend of insurance companies to business metrics. IT costs are measured against revenue and operating expenses, while business value considers revenue per employee and income per employee (operating profit per employee).

![Gartner Cost Value Matrix](image)

Insurance CIOs can leverage the CVM to:

- Determine where their organization falls in relation to the “cost index” and “value index” axes
- Model where their organization will be in the future, given situational or dynamic adjustments to common metrics like IT spending, operating expense, income per employee and revenue per employee
Gartner research shows that about 55% of both banks and insurers are cost-inefficient and don’t achieve business value with their IT spending. CIOs of financial organizations must prioritize value optimization over simple cost cutting to achieve optimal value delivery. 4

The CVM helps insurance CIOs to better understand their current position relative to industry peers by assessing if their current mix of cost optimization initiatives will help them to achieve a higher business value than their peers. As a start, CIOs should use the Gartner CVM to create views of IT investments against measures of business performance, regularly communicating progress with the business.

Use Gartner’s Insurance Cost Management Roadmap to Start Moving From Cost Optimization to Cost Transformation

Gartner does not recommend that insurance CIOs abandon tried-and-true budget practices and operational cost optimization through automation. This is what is expected as traditionally good management. In fact, CIOs and their business partners should be driving theoretical zero-cost transaction processing, which is an essential insurance operation but is also a commodity.

Optimization initiatives, particularly in the insurance industry, typically involve automation — having a machine do what humans can, but at lower cost, or eliminating or simplifying process steps. Some examples of this include robotic process automation (RPA), optical character recognition (OCR), intelligent business process management (iBPM) systems and chatbots. These technologies could be applied to high-cost operational processes such as underwriting, new business application processes and claims management (see Tool: Banking and Insurance Use Cases to Drive Hyperautomation).

Cost transformation, however, requires going beyond process automation tasks to higher-level activities, such as predictive analysis, to drive improved decision making in complex nonstructured activities (see Digital Insurance Success Requires Leveraging Data, Analytics and Artificial Intelligence and Toolkit: Artificial Intelligence Use Cases for Insurance).

For example:

- P&C insurers should be using predictive analytics to make inroads into losses and loss adjustment expense (LAE) estimates.
- Life insurance CIOs and business leaders should use data science techniques to:
  - Reduce the cost of surrenders by improving suitability decisions before a prospect becomes a policyholder.
  - Proactively predict likely surrenders before they offer, and take preemptive actions to avoid them.
Insurance companies and their CIOs should also use technology, such as integration with digital data services, which enable life-stage monitoring to reduce surrenders by policyholders due to superfluous coverage that accumulates over time as life circumstances change.

However, technologies and business initiatives that focus primarily on the economic value of reducing losses or improving surrenders are completely different from cost optimization and automation initiatives. Cost transformation will require a heavy focus on data science and large datasets to improve predictive analytics and AI/ML to continuously improve decision-making speed and accuracy. In addition, drones and the use of sensors will become critical to dramatically reducing LAEs. Longer term, CIOs should evaluate using smart contracts that trigger activities throughout the life of a policy to engage proactively with policyholders and avoid surrenders.

Moving from cost optimization to cost transformation is not a straight line, nor is it an either-or decision or one-and-done activity. Rather, it is an ongoing set of initiatives that will span multiple years. CIOs will need to develop a portfolio of initiatives and spending in all three cost management categories shown in Figure 4.

Figure 4 and Table 2 illustrate an insurance-applicable cost management roadmap that insurance CIOs can use to start building a phased plan and timeline for moving from cost cutting to cost optimization and, finally, to cost transformation.

**Figure 4: Insurance Cost Management Roadmap**

![Insurance Cost Management Roadmap](image)

**Table 2: Insurance Cost Management Roadmap**

<table>
<thead>
<tr>
<th>Stop the Bleeding</th>
<th>Establish Parity</th>
<th>Leapfrog Competition</th>
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<tbody>
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<tr>
<td>Cost Management Focus Areas</td>
<td>Technology Focus Examples</td>
<td>Recommendation</td>
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<tr>
<td>Supply and demand management</td>
<td>Collaborative service desk tools</td>
<td>Worth with your CFO to benchmark whether your IT and business cost structures support the revenue and margin thresholds required in your target market.</td>
</tr>
<tr>
<td>IT supplier consolidation</td>
<td>DevOps infrastructure</td>
<td>Challenge existing business operating cost assumptions by conducting visioning sessions with the business to determine how technology can be used to radically change sales, services and products.</td>
</tr>
<tr>
<td>IT service reduction</td>
<td>Cloud services</td>
<td>Reduce the economic cost of surrenders, LAEs and reserve accounting by improving decision making and cost avoidance using predictive analytics, AI, and ML.</td>
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<td>Contract negotiation</td>
<td>RPA</td>
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<td>Business process management systems</td>
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<td>Natural language processing (NLP)/OCR</td>
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<td>Predictive analytics</td>
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<td>Data science</td>
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Source: Gartner (October 2020)

Evidence

1. **2020 Gartner CEO and Senior Business Executive Survey:** Gartner’s research into CEO and C-level business executive concerns, priorities and attitudes toward technology-related issues. For this annual survey, 444 responses were collected in 50 countries during 4Q19 (before COVID-19), from leaders of companies with $50 million or more and 61% with $1 billion or more in annual revenue.

2. **2009-2019 Median Revenue CAGR 2.9%, Median Opex CAGR 3.0%:** This is sourced from S&P Capital IQ platform, S&P Global Market Intelligence platform, where n = 44 for life and P&C.
insurance companies globally.

3 Composites of P&L values calculated by Gartner using U.S. insurance industry data from the S&P Global Market Intelligence platform, as well as information from secondary sources specific to the U.S. insurance industry.

4 Financial Services CIOs Should Opt for Value Optimization Instead of Simple Cost Cutting

Note 1: Life and P&C Cost Structure Example

Insurance company costs are composite examples of general areas of cost concentration in insurance companies. These are meant as examples and do not represent the actual costs of any one specific insurance company.

Recommended by the Author

Life and P&C Insurance CIOs: COVID-19 Cost Optimization Action Plan
2020 Gartner CEO Survey: The Year of Recession
Being an Early Technology Adopter in Financial Services Can Pay Off to Drive Business Value
Understanding the People Side of Digital Business: An Empirical Analysis of Digital Dexterity

Recommended For You

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カスタム・ソフトウェア開発サービスの競合状況
クラウド・コンタクトセンター・プラットフォームでMicrosoft Teamsを最大限に活用するには
AIが組み込まれたアプリケーションに関する現状・展望・注意事項

Supporting Initiatives

Financial Services Technology Modernization and Transformation