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Don't Try This at Home

Why do insurance companies compete with software vendors?

By Marek Jakubik

In a study of insurance companies last year, Forrester Research reported that 45% of polled respondents affirmed the statement: "We tend to build internally rather than buy packaged apps." Yet, in-house software projects post a poor track record: continually over-budget, overdue, and failing to meet user needs.

Another recent study from Robert E. Nolan Company underscored this issue by showing a high degree of disparate views on the quality of service delivered by internal IT units. For example, while 62 percent of IT respondents said they were satisfied with the level of service their systems provide to their customers, only 37 percent of business respondents agreed with the same statement.

So, what's going on here? Why do insurance companies' IT units still show such a high predisposition for building their own applications? Is it because they can do it better than the vendors? In truth, no. But the prevailing belief that they can fuels the ever-popular buy-or-build debate. Three key factors contribute to the confusion.

1. The history of the P/C software industry
2. Stories of failures
3. Vendors' (mis)behavior

Am I Blue?

As in any fledging industry, the first group of P/C software vendors had difficulty offering better quality, functionality, and cost than do-it-yourself products. Furthermore, throughout the 70s, 80s, and mid-90s, the technology architecture set was very stable, in any color, as long as it was ... Blue.

Since high-level architectures were fixed and platform options limited, the required development expertise was relatively low and the skill-sets quite consistent. And, in case of any trouble, trusted helpers were only a phone call away (you guessed it: they wore matching blue suits).

Overwhelming Needs

The situation led to a broad and, on the whole, not unsuccessful deployment of myriad in-house applications. It also led to a do-it-yourself culture that took a strong hold in many IT organizations. Somewhat paradoxically, the more skilled an IT group was, the more this culture hardened, effectively shutting the doors on alternatives to in-house development.

However, what no in-house group could successfully accomplish was to manage the growing application set long-term. As the size and complexity of the application portfolio grew, companies found themselves unprepared to deal with the issues of long-term sustainability, adaptability, or price-performance. Processes by which to manage long-term platform, product line, and innovation strategies within P/C IT organizations were (and still are) either non-existent or skeletal at best. As more large players entered the technology arena, the skills and talent needed to manage all aspects of platforms, applications, and integration strategies and architectures became necessities that overwhelmed most of those organizations.

Why do 45 percent still say "we'd rather do it in-house"? One frequently quoted motive is the proliferation of stories about package failures.

Most IT managers we talk to agree with this state of affairs. So, how come a full forty-five percent still say "we'd rather do it in-house"? One frequently quoted motive is the proliferation of stories about package failures. Scary stories. Stories that send shivers down a CIO's spine.

Behind the Door

What's really behind that much-talked-about $50M dollar package implementation fiasco that got the CIO fired? It all boils down to recognizing and managing risks in three key phases of application life-cycle:

1. Product/vendor selection
2. Implementation/operation
3. Transition.

I can't resist pointing out the irony in the fact that missteps in these three areas take place in insurance companies — companies that know more than any

others about managing risks.

The first phase in which organizations goof is the selection process - a process that, at the high level, is really not that different from the underwriting process. Think of what happens in your company before a $1M commercial risk goes on the books. A well-trained, well-equipped army of experts (underwriters, loss control specialists, etc.) diligently goes through the task of risk assessment before any decisions are made. Conversely, I have seen $20M technology-product decisions made based on a fraction of such an effort. The typical reasons given for such decisions are "no time" or "no money". $20 million! No money? And for a $20 million risk, wouldn't you make time?

I could probably rest my case right here; but, unfortunately, the other phases bring examples of mistakes and misdemeanors that are just as intriguing.

During the second phase, both implementation and operations are prone to disasters due to similar factors — mainly, poor project management, over-customization, and the failure to establish a strong relationship with the vendor. This seems to be a rather trivial set of issues; yet, amazingly, many failures are caused by a plain lack of attention to such trivia.

There are two, perhaps not-so-obvious, pointers I'd like to offer here. First of all, make sure that your department acquires the rock-solid skills required to make your new application sing. That may mean hiring or using the vendor's resources. Both, growing your own or using the vendor's can work well, especially if you negotiate favorable terms with the vendor. Remember that, through buying, you already have solved the most difficult technical issues: architecture and design. Therefore, technical resources are not your key challenge anymore. Instead of worrying about those resources unduly, re-invest in a solid set of business analysis skills. The users of your new technology will love to have people with whom they can intelligently interact.

The 19th Hole

Secondly, how often does your CEO or line-of-business executive play golf with the vendor's CEO? Once a year? That should be your bare minimum. But don't stop there. Ideally, you should place yourself in a position from which you can genuinely influence the vendor's strategies. Most vendors are more than willing to listen to you. If they aim to continue making sales, they'll welcome feedback and advice from you and your peers.

The least predictable set of challenges has to do with the third phase: product transition. In other words, the product (or the vendor) is "dying" and has to be either resuscitated or replaced. The reasons may vary: a new version of software for which the vendor wants an unreasonable ransom, a dramatic shift in business strategy which the product can't handle, the vendor's bankruptcy, bad mergers, etc. There is no formula for how to manage this kind of risk. What you should do is take your time; get a ton of advice (including your legal department's); and while carefully considering your options, always engage the Executive or the company Board. Of course, in terms of risk mitigation, you should have undertaken due diligence in the selection phase: coding in escrow, change-of-control clauses, and so on. But the time for blame is later. Right now, you have to think "damage control".

That's What You Think

If you think that's an unusually high-risk scenario, think again. Disappearing code, undocumented functions, key staff departures — your in-house applications provide you with very similar excitement … daily! Architectures, designs, and code sooner or later become outdated, regardless of who delivered them. The issues of dealing with a major legacy transition are the same, whether you have in-house or packaged systems.

"Okay," you might say, "But don't we all know that vendors over-promise and under-deliver?" Yes, it's human nature, especially when controls and discipline are lacking. And there's also the ROI card. Every company wants to see a return on technology investment as quickly as possible. Does it surprise you that vendors will promise exactly that? I can only keep repeating after the Romans: *Caveat emptor*.

While many technology applications can pay off quickly, only careful, in-depth analysis will reveal how much a given project can benefit a company's bottom line, and how fast.

Yes, some will argue that certain circumstances make in-house development a preferred strategy: as in very large companies with their huge internal economies of scale. Or within the first/fast movers whose new strategies must be executed so rapidly and so frequently that only having full control over technology changes will do. Perhaps. But, only in the short-run and within the context and scope of a strategic momentum that allows companies to perform an unusual set of heroics.

Can You Compete?

In the long run, regardless of their size, culture, or capabilities, insurance companies cannot compete with professional software houses. And, even if they could, they should not. If they choose to buy, they will be rewarded through:

1. Lower risk — today's technology is a very complex beast. While building applications used to be somewhat akin to building a cottage or a family house, it is now much more analogous to building an office (with all the planning consideration of "plugging" it into the existing city/neighborhood). Leave it to the pros. They have the ability to attract the best engineering talent, the commercially driven motivation to excel, and the skills to manage technology product life-cycles.
4. Better focus — since you left the most complex technology problems to the pros, you can turn your attention to the three areas from which you can gain the affection of your users: project management, business process improvements, and data quality. Please note that in all three cases "computer geeks need not apply". Rather, you will need people with deep insurance knowledge, proven business acumen, and polished communication skills. Not a bad trade-off, if you ask me.
5. Economies of current and future trends — as with any outsourcing model, through buying you are tapping into large pools of resources and capacities. In effect, that gives you an indirect ability to exploit economic shifts and trends. To illustrate: did you know that IBM Global Services is the fifth-largest employer in India? How much of that particular labor-cost disparity trend does your company leverage? Can you do it at all? At what cost and risk?

As information technology moves towards the utility model, the argument about in-house IT's ability to provide a sustainable, competitive differentiation will be harder and harder to make. Do you know any insurance company that claims a competitive advantage because it's built the best in-house telephone?

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