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Financial Services

# Hub and Spoke in Insurance: Aggregate and Conquer



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Yesterday's insurers operated in a markedly different world. Faced with saturating domestic markets, European insurers expanded rapidly cross border, increasing their market share by approximately 10% in just two years. Unfortunately much of this growth lacked a clear strategy and instead was primarily a land grab for collecting local businesses run as local risk-carriers with only limited group-wide integration. This model is coming to an end.

Driven both by necessity, in the face of continual pressure on margins, and opportunity given new international regulations and technological progress, today insurers' priorities have changed dramatically. Cost containment via effective cross-border operations now sits squarely at the top of their agenda.

Insurers have the opportunity to adopt business and operating models that have been common in other sectors for many years. They can restructure the value chain for efficiency and roll out business models in more homogeneous patterns across markets.

Although some players have responded to this new, competitive environment, many are still operating inefficient structures, mere sums of their constituent parts. We argue that Hub and Spoke operating models – which simultaneously enable both flexibility in organisational responsiveness and local specialisation as well as economies of scale – solve this problem.

## Hub and Spoke – what it is, how it works

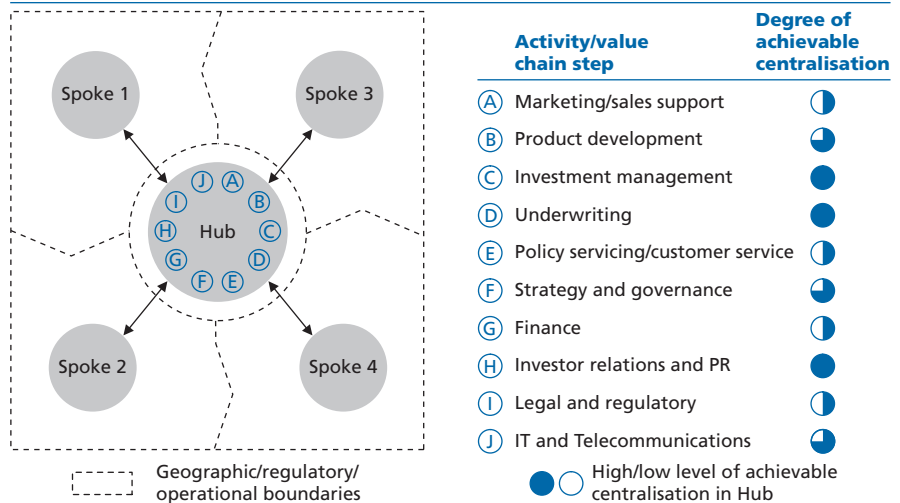
The Hub and Spoke model was first developed in the aviation industry. It rests on a single imperative: *aggregate duplicated functions*.

In its application to the insurance industry, the framework aims at centralising in a single operational centre (the Hub) all those activities that:

- Are scalable – to reduce unit costs
- Are critical value drivers – to ensure specialisation and thus the highest standards
- Can be performed cross-border

In this way, the Hub becomes a centre that provides low cost and high quality services to all other parts of the organisation (the Spokes). The Spokes, in turn, adapt the central service provision to local demand and complement the Hub's functions with activities that are “non-exportable”, for example, because of geographical, regulatory or operational constraints. Exhibit 1 illustrates this concept for insurance.

## Exhibit 1: Hub and Spoke stylised model overview



The Hub and Spoke model enables organisations to achieve two conflicting goals: organisational flexibility and economies of scale. Benefits are wide-reaching, as described below.

- **Reduced costs** – because of greater volumes processed in the Hub and minimised duplication of activities among Spokes
- **Improved service quality** – due to the greater specialisation achieved in each value chain step performed in the Hub
- **Enhanced knowledge sharing** – due to the Hub’s function of central knowledge aggregator and distributor
- **Faster innovation cycles and shortened time to market** – due to the availability of standard product and operations components created in the Hub for deployment in all markets
- **Increased strategic flexibility and enhanced synergy potential** – due to the centralised operations platform in the Hub, which facilitates new market entry and post-merger integration, making the new business “just another spoke” with no need of individual operations

In practice, implementing the Hub and Spoke model can be tricky. Our experience highlights key success factors for successful and optimal implementation:


- **Ensure the case for centralising functions is clear and balanced:**  
This ensures that the benefits from scalability and specialisation of centralised Hub functions are not outweighed by the need to adapt to local requirements in decentralised Spoke functions, and ensures local buy in from often sceptical country units. In practice, this means that the Hub and Spoke model must be implemented across homogenous businesses models or value chain steps and in similar markets

- **Align governance – assign oversight to the Hub:** For activities that involve more than one Spoke, the Hub should have formal authority and responsibility for governance. Indeed, given its central position, the Hub has the best oversight of how to coordinate and prioritise all the Spokes’ requirements
- **Ensure roles and responsibilities of Hub and Spokes are clearly outlined:** This ensures that there are neither gaps nor duplication of activities across the organisation. This can become especially tricky in transforming local independent companies into Spokes of a more centralized Hub, thus changing roles and cultures from the CEO through the whole organization

## Hub and Spoke in practice

Hub and Spoke models can be implemented to different degrees. We categorise applications into three groups, as per Exhibit 2.

**Exhibit 2: Overview of different types of Hub and Spoke models**

	Description	Example	
<b>Process</b>	Application to individual processes of an insurer	Call centre offshoring, processing, product servicing	Increasing revenue focus 
<b>Platform</b>	Application to complete segments of the insurance value chain	Asset management, IT	
<b>Business model</b>	Application to whole value chains	Bancassurance, variable annuities, direct distribution	

The above approaches differ only by degree. Yet they yield very different outcomes. For example, compared with a Hub and Spoke process, a platform can be carved out of an insurer to form a unit that provides services comparable to those provided by an independent business and can be treated as a separate profit centre. In comparison to Hub and Spokes processes and platforms, the business model approach aims at re-engineering all aspects of the value chain around the requirements of specific markets. This approach creates a dedicated and fit-for-purpose organisational structure that best caters for the peculiarities of different competitive environments.

Many of the leading insurers in Europe are designing Hub and Spoke models. As always, the more difficult job is implementing them. Once live, however, these new operating and business models may fundamentally change the rules of the insurance game.

*For more information on the Hub and Spoke model, the full report is available on our website at:*

*<http://www.oliverwyman.com/ow/insurance.htm>*



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