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Insurance Industry in India: Structure, Performance, and Future Challenges

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Executive Summary

With the liberalization and entry of private companies in insurance, the Indian insurance sector has started showing signs of significant change. Within a short span of time, private insurance has acquired 13 per cent of the life insurance market and 14 per cent of non-life market. However, there is still a huge untapped demand for insurance. Insurance companies have a pivotal role in offering insurance products which meet the requirements of the people and, at the same time, are affordable. Some of the challenges faced by the insurance sector pertain to the demand conditions, competition in the sector, product innovations, delivery and distribution systems, use of technology, and regulation. To understand the growth and development and the future prospects of this sector, this colloquium addresses the following issues:

- What will be the demand for insurance? What types of innovative strategies of insurance education and awareness will we require to encourage the Indian consumers?
- With the changes following bank participation in insurance, will the nature of competition in this sector intensify?
- What kind of competitive and risk pressures will the insurance businesses experience? What are their implications for profitability, margins, and efficiency?
- The average size of the polices will continuously decline as the insurance companies increase the geographic coverage. As a result of this, the intermediation costs will go up. What are the implications of these on average costs?
- What will be the product market scenario?
- Has the insurance sector benefited from the knowledge base of global companies?
- To what extent have the technology gains in telecommunications, computer information, and data processing contributed to increased efficiency and productivity of insurance companies?

The following key points emerged from the responses of the panelists:

- The future in life insurance will be determined by the increase in pure protection products, a refreshing look at unit-linked plans, launch of customized plans, and improved service levels.
- The insurance sector will grow steadily rather than rapidly. While the law and regulations are in place to ensure financial strength and solvency of insurers, the regulator's challenge lies in monitoring compliance.
- The opportunity for financial services is increasing all over the world. Big domestic companies with significant market shares in the local countries will have the opportunities to commence business in other markets.
- Keeping in mind the complexities of the industry, multi-product, multi-channel, and multi-segment route needs to be followed for growth.
- The challenge of successfully implementing bancassurance lies in training the staff, integrating the insurance products, and ensuring best quality service.
- Agents in the insurance sector are critical for its success and, in order to gain competitive advantage, quality people are needed but attracting and retaining agents is a challenge.

KEY WORDS

Bancassurance

Insurance Sector

Consumer Education

Product Competition

Global Markets

INTRODUCTION

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Insurance is the backbone of a country's risk management system. Risk is an inherent part of our lives. The insurance providers offer a variety of products to businesses and individuals in order to provide protection from risk and to ensure financial security. They are also an important component in the financial intermediation chain of a country and are a source of long-term capital for infrastructure and long-term projects. Through their participation in financial markets, they also provide support in stabilizing the markets by evening out any fluctuations.

The insurance business is broadly divided into life, health, and non-life insurance. Individuals, families, and businesses face risks of premature death, depletion in income because of retirement, health risks, loss of property, risk of legal liability, etc. The insurance companies offer life insurance, pension and retirement income, property insurance, legal liability insurance, etc., to cover these risks. In addition, they offer several specialized products to meet the specific needs and requirements of businesses and individuals. Businesses also depend on these companies for various property and liability covers, employee compensation, and marine insurance.

> The availability of insurance can mitigate the impacts of risk by providing products which help organizations and individuals to minimize the consequences of risk and has a positive effect on industry growth as entrepreneurs are able to cover their risks.

Insurance does influence the growth and development of an economy in several ways. The availability of insurance can mitigate the impacts of risk by providing products which help organizations and individuals to minimize the consequences of risk and has a positive effect on industry growth as entrepreneurs are able to cover their risks. In the absence of a full range of insurance products and/or deficient products in terms of coverage and scope, the risk-taking abilities would be hampered and chances are that the economic activities would turn out to be high-risk activities. The implications of leaving various risks uncovered can be significant and the impact of losses can be devastating creating a huge burden on the governments. Therefore, a strong and competitive insurance industry is considered imperative for economic development and growth. However, the contribution of the insurance companies is also dependent on the fact that they are able to pool risks effectively. Only then would it be possible to cover these risks at an affordable and reasonable cost as the insurance provider will be able to spread the risks throughout the economy.

The insurance industry is also an integral part of the financial system. For effective functioning of the financial system, it is important that the markets are efficient by ensuring liquidity and transparency in price discovery. The role of the insurance companies as financial intermediaries is also considered significant in making these markets efficient by providing liquidity and credit. This, in turn, helps in lowering down the cost of capital and providing risk-free opportunities to all participants in the market.

Penetration of insurance critically depends on the availability of insurance products and services. Huge untapped market, proliferation of schemes, new product innovations, perception of insurable risks of Indian consumers, competitive pressures arising from integration of bank and insurance, impact of information technology, and the role of insurance industry in financial services industry are some of the forces which shape the competitive structure of the insurance industry.

The insurance companies have a pivotal role in offering insurance products which meet the requirements and expectations of the customers and, at the same time, are affordable. The future growth of this sector will depend on how effectively the insurers are able to come up with product designs suitable to our context and how effectively they are able to change the perceptions of the Indian consumers and make them aware of the insurable risks. The future growth also depends on how service-oriented insurers are going to be. On the demand side, the rise in incomes will trigger the growth of physical and financial assets. With the growth of infrastructure projects, the demand for insurance to cover the project and the risks during operations will increase. The other growth trigger is the increase in international trade. However, servicing of the large domestic market in India is a real challenge. Some of these challenges pertain to the demand conditions, competition in the sector, product innovations, delivery and distribution systems, use of technology, and regulation.

It is in this context that we posed the following lead questions to various industry leaders: What will be the demand for insurance? How does the domestic market growth of insurance look like? Are we lagging behind? Do we understand the mind of the Indian consumer? What are the perceptions of Indian consumers about the insurable risks? Do insurers find it hard to change the perceptions of the Indian consumers about insurable risks? What types of innovative strategies of insurance education and awareness are required to encourage the Indian consumers? Are Indian insurance companies geared to take up this challenge? What is the role of the Insurance Regulatory and Development Authority (IRDA)? What would be the implications of these factors for the structure and operations of life and non-life businesses? We also raised specific questions on various channels of selling focusing on the role of banks participating in insurance: Will there be a change in the way the business is done in the insurance sector? Given the present scenario, what kind of competitive and risk pressures will the insurance businesses experience? What are the adjustments required to face the competitive challenges?

> The future growth depends on how service-oriented insurers are going to be. On the demand side, the rise in incomes will trigger the growth of physical and financial assets. With the growth of infrastructure projects, the demand for insurance to cover the project and the risks during operations will increase. The other growth trigger is the increase in international trade. However, servicing of the large domestic market in India is a real challenge.

Another area of concern has been the pricing of products. This is likely to be an important determinant of growth. As the insurance companies increase the geographic coverage, the average size of polices (i.e., average premium per policy) will continuously become smaller. As a result of this, the intermediation costs will go up. To understand these, we posed questions on the product market scenario: Will the competition in future lead to product specialization (focused products) or product proliferation? Will costs be a major concern? What would be the pricing of these products? What would be the cost-containing strategies which would help the insurer to develop streamlined businesses and address intensifying competition? Will the consumer benefit from this and in what way?

In India, most of the insurance companies in the private sector have come into existence after forming joint ventures with a global partner. We raised the following questions in this context: Has the insurance sector benefited from the knowledge base of the global partners? In what way? Which innovative products offered by insurance companies have changed the face of the insurance sector? Have there been any process innovation within the insurance companies that have made the Indian insurer stronger? How much of this has come through the partner?

The health segment of the insurance sector was the first to be liberalized but has still remained less developed. We asked the panelists to respond to the following concerns: What policy changes would you propose in terms of easing the entry barriers by reducing capital requirements, reforming the private health sector by having appropriate regulations including provider payment systems and strengthening of the third-party administrators to monitor the providers? Are the complexities in this segment really unmanageable? Given these complexities of health insurance, should we have a separate insurance regulatory body to regulate health insurance? Many countries around the world have a separate health insurance regulation and a separate regulatory body.

Technology is likely to play an important role in this sector. Our questions focused on to what extent technology gains in telecommunications, computer information, and data processing have contributed to increased efficiency and productivity of insurance companies and how the new technologies have facilitated the development and servicing of the global markets.

The process of reforms initiated some years ago has some achievements to its credit. It has enhanced competition, provided a choice to the customers, triggered innovative ways and means to carry out insurance activities, improved the efficiency level of the industry, increased the coverage of insurance in terms of density and penetration, obligated the insurers to provide for the needs of social and rural sectors, and increased awareness about the necessity of insurance, to name a few. However, the achievements till date need to be built upon to further improve the efficiency of the insurance sector thereby reducing the costs and increasing the penetration particularly in rural and semi-urban areas.

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For this purpose, the following factors are critical:

- strengthening of the distribution network
- designing of products that would meet the characteristics of different segments of the population
- formulating and implementing specific strategies.

Training of all those involved in providing insurance needs to be augmented. The insurance companies still have a long way to go in establishing their image and credibility. For these, risk management skills ensuring financial stability of insurers will be important.

There are concerns that regulations and modulation play a critical role in market situations which are evolving and developing. IRDA has an important responsibility of regulating this sector. However, given the experiences, concerns are being raised whether our regulator is slow and soft. There are concerns that they are not proactive. The experience in the recent past about the 'key-man insurance' reflects this point. There is a lack of proper guidelines about the norms of reporting the performance of life insurance organizations. For example, should one-time premium be included as part of one year performance or not? This significantly distorts the comparison of performance between insurance providers. Similarly, there are issues related to bancassurance models and direct salesforce which need continuous monitoring and guidelines to evolve in these areas. Most of the insurance companies are going for unit-linked products. Should the insurance companies have in-house fund management or should it be outsourced and to whom? These are some policy questions which need to be addressed. Given the complexity of health insurance, there is a need for having a separate health insurance regulation and this needs to be addressed in a proactive manner.

INSURANCE SECTOR: CHALLENGES OF COMPETITION AND FUTURE SCENARIO

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The life insurance industry saw a growth of 10.48 per cent in terms of first year premium income and 12.83 per cent in terms of new policies sold. The size of the market for 2003-04 was Rs. 187.10 billion worth of first year premium income with 28.6 million policies. These are extremely satisfactory statistics but certainly not path- breaking; they reaffirm the belief that huge potential still remains unexploited.

Some salient features of the domestic market growth can be highlighted:

- The private insurance companies — operating from a smaller base — have achieved a staggering growth rate of 153 per cent and 101 per cent in terms of first year premium and number of policies respectively. As expected under the circumstances, the market share of LIC in respect of first year premium has fallen to 87.04 per cent from 94.34 per cent in 2002-03. The 13 per cent contribution of the private players within the third completed year of the opening up of the sector is the most significant variable that the market has thrown up in 2003-04. The fact that private banks took more than ten years to reach double figure contributions in the banking sector further accentuates the positive start made by the private insurers.

> LIC continues to remain strong in rural areas and perhaps in the middle class and the lower middle class segments while in metros and major urban centres, the private insurers have made their presence felt.

- Despite a 13 per cent first year premium contribution, the private players have only been able to garner 6 per cent of the policies. This clearly indicates that the average size per policy sold by a private insurer at Rs.11,320 is significantly higher than the corresponding figure for LIC (Rs. 4,293). The inference is obvious: LIC continues to remain strong in rural areas and perhaps in the middle class and the lower middle class segments while in metros and major urban centres, the private insurers have made their presence felt.
- Another revealing aspect of the demand progression in the market has been the unusually high content of unit-linked products in the overall performance. While exact figures of new business done under the unit-linked plans (ULIPs) may not be available, companies like Birla Sunlife and ICICI Prudential have definitely procured a big chunk of their new business premium from the ULIPs. Even the Bima Plus of LIC — a good product but languishing for the last few years on account of the lack of interest by the sales force — turned up some very good numbers in 2003-04. A total of Rs. 3.43 billion came from this plan but what was more exceptional was the fact that non-metro divisions like Lucknow and Coimbatore made major contributions proving once again that products which appeared suitable for a niche market were progressively becoming popular in the other segments. The performance of ULIPs of ICICI and Birla Sunlife in non-metro locations further underscores the point that ULIPs are here to stay and they are not a metro-confined product category any longer. This is a trend that will further emphasize itself in 2004-05 if initial responses are anything to go by.

> The new age insurance agent is trained to be an advisor to the customer instead of being a mere seller of policies. He is a suave, smart financial consultant thanks to the state-of-the-art training facilities provided by the insurers which are of international standards.

- The opening up of the sector has also seen improved efforts on educating the customer regarding his insurance needs and on fixation of insurance as a tool in his overall wealth management portfolio. The new age insurance agent is trained to be an advisor to the customer instead of being a mere seller of policies. He is a suave, smart financial consultant thanks to the state-of-the-art training facilities provided by the insurers which are of international standards. With the evolution of these advisors, insurance is being seen more as a wealth enhancer and will help insurers increase their sales in India. Further, as mentioned earlier, the success of ULIP even in mini-metros and relatively smaller markets is a reaffirmation of the fact that markets are progressing in terms of insurance awareness and education.
- A recent survey has highlighted the statistic that India is fast emerging as one amongst the youngest nations in the world. By the year 2010, we will find almost 54 per cent of our population in the 18-35 years bracket. This segment is the ideal target audience for an entire range of 'cradle to grave' insurance plans from pure protection to endowment, children's endowment and money-back plans, to whole life and pension plans. The evolving change in this key demographic variable along with the significant increase in the middle class segment of the Indian society will augur very well for the future

and would throw up enormous business opportunities for the life players.

Seventy per cent of the Indian insurance market is still dominated by money-back plans and the consumer still perceives insurance as a saving device. The new age insurers have taken it upon themselves to educate the masses on pure term insurance and its importance but it has a long way to go. Recent surveys show that consumers still favour insurance policies as a savings tool and a tax saver. What is equally interesting is that the two most prominent barriers to insurance are lack of liquidity and the fear of the consumers that their money may get locked in. This again reiterates the fact the this country still understands and favours money-back and endowment plans from the insurance catalogue. ULIPs with higher returns and greater flexibility are also on course for the contemporary demand patterns. Thus, understanding the changing perceptions of the Indian consumer and accordingly altering the product offering, marketing communication, and positioning is what is important for the insurer.

IRDA, in its role as the regulator, has undertaken the work of overlooking an orderly development and growth of the industry. It acts as the amalgam aggregating the efforts of the industry, the actuarial, and the accounting professionals and expects the industry to ensure that they have in place a rigorous system of internal controls to manage risks and comply with regulatory and legislative requirements. On the marketing front, sanctity of communication to the consumer and ensuring that reasonable policy holder expectation is built at all times is another area that the regulator focuses on. Coupled with the above, IRDA ensures that the customer is placed as the conundrum of all activity and the ultimate mark of success for the industry will lie in its ability to meet the needs of the customer effectively. Given the above backdrop, the factors that will act as differentiators in the long run will be customer orientation and service. The opening up of the sector has had positive fallouts like improved disclosure to the policy holder, both pre-sale and post-sale, and efficient claims and complaint/grievance management. These were areas that were overlooked in the pre-liberalization era but new age insurers and LIC have capacitated themselves in terms of technology as well as processes to handle these important customer service subjects which are prerequisites as we move ahead.

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Bancassurance

Bancassurance as a concept has its origins in France where this channel today is a predominant source of insurance business. SBI Life's joint venture partner, Cardiff, has the distinction of being the pioneer in this channel of distribution and our experiment of coming together will be an important milestone in the furtherance of bancassurance as a philosophy in India.

The opportunity that bancassurance throws up for the insurer has been much discussed since the opening up of the industry. Banks are also viewing this route as a value add primarily in the area of alternate income generation for the following reasons:

- Banks are in the prime function of banking and they will always remain so. However, with the shrinking margins on the business due to intense competition, banks are looking at alternate options of income generation. Today, life insurance may only be a small drop in the ocean as far as revenues for the banks are concerned but, as the contributions grow, they will start assuming more significant proportions.
- Banks are fast moving towards being viewed as a financial supermarket or a one-stop shop providing the entire gamut of financial products ranging from personal finance to life insurance to mutual funds.
- Banks generally have a service-oriented culture as against insurance companies that have an aggressive need-based selling philosophy. The rubbing-off of this selling culture on the bank will also help the bank with its own core business.
- The key challenges that are implicit to bancassurance are more people-related than anything else. Management of differences in the or-

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ganizational culture of the banks and insurance companies will be a key variable. The partners need to have a common business vision and direction towards future objectives.

The market has already seen a range of strategic alliances between banks and insurance companies based on their vision with regard to distribution reach, costs, target audience, and geographical spread. Our own experiment has so far been very heartening and we can only scale upwards from here as we will activate more of our SBI and associate bank branches in a phased fashion. Often, management of excessive success is as mighty a challenge as managing failure and our phased roll-out is a result of the knowledge that SBI brings us astounding business possibilities in bancassurance. Needless to say, bancassurance will witness some intense action in the next few years and should stabilize itself as a 30 per cent contributor to the overall pie by 2010.

A key driver of growth in a long-term business like life insurance, technological advancement will be critical to functions like data management, underwriting, fund management, actuarial efficiency, and the end-to-end service delivery process.

Competitive Challenges

As we enter our fourth year of business, the dynamics of the business has changed in good measure and though the key variables remain the same, the degree of their significance over the next four years will rise as most of the companies will be near their break-even levels. The key competitive and risk pressures that the industry would experience can be highlighted as follows:

***Multi-channel distribution footprint*:** Understanding the science of multi-distribution channel management and developing a robust field footprint will remain the most distinctive competitive challenges for the new age insurers. Managing the expectations of channel partners, viz., banks, corporate agents, brokers, and advisory force, and keeping the acquisition costs at manageable proportions at the same time will help the new players reach break-even relatively sooner. Increased rural penetration of insurance will also be a fallout of the above factors and will depend upon the spread that the distribution footprint will help the insurer achieve.

***Technological advancement*:** A key driver of growth in a long-term business like life insurance, technological advancement will be critical to functions like data management, underwriting, fund management, actuarial efficiency, and the end-to-end service delivery process. Technology will provide the cutting edge in terms of improved disclosure to the policy holder as well as the regulator in due course of time.

***Quality of manpower*:** Insurance is an intensively people-oriented business and human resources will be the undoubted differentiator like in any other retail industry. The quality of manpower attracted and retained by insurers and how their abilities and ambitions are harnessed would be the litmus test for the industry.

***Investment strategy and fund management*:** Expertise in fund management is the value proposition that any insurance company offers and the quality of asset-liability management (ALM) in a falling or stable interest rate regime will thus be a key challenge. The regulator is progressively in favour of insurance companies setting up their own investment research and dealing cells and against knowledge sharing with group asset management companies. Bonus performance on traditional plans and the net asset value (NAV) performance on ULIPs will determine the demand patterns and investment strategy will remain at the core of successful insurance business.

***Acquisition costs*:** Acquisition costs which is a sum total of technological, operational, and distribution costs, will be the key differentiating factor in the initial years. While the initial hits on the technology and process costs have already been absorbed by a majority of the new insurers, intermediary costs of distribution is a critical variable. This is where the players with a strong brand presence like SBI Life will stand to gain. SBI Life can boast of the lowest acquisition cost levels in the industry due to the lower infrastructure and set-up costs thanks to our existing bank network. Further, the intermediary costs to distribution channel partners are also lower due to the bargaining power that the strong brand possesses in life insurance.

Further, we might reach a scenario in the next four to six years when the commission levels being offered to channel partners might get stabilized or might even get bottomed out. The average commission payouts may move towards the international levels of 14-16 per cent of FPI. This will be a time-consuming change in the Indian context, given the LIC legacy that we carry, but, this revealing trend is something to watch out for as we evolve as an industry.

In the above backdrop, the risk pressure that we are likely to face will essentially be a converse of the above factors, namely:

- fragility of the systems and the operational environment
- experience, expertise, and willingness of the insurers to learn from their mistakes especially in ULIPs and group terms business
- uncontrollable or burgeoning overheads
- management of lapsation risk: A broad thumb rule is that whenever we earn a renewal income of Rs. 2 to a new income of Re.1, we are close to break-even. Thus, management of lapsation in our traditional as well as unit-linked portfolio will be a key performance differentiator.

Insurance in India was by and large governed by the remuneration charges paid out to the agents until the liberalization of the sector came about. The opening up of the sector was essentially to provide the customer with customized protection and savings solutions suited to his overall financial requirement.

Product Offerings and Market Scenario

The product market scenario has already started witnessing some revealing changes which are an indicator of what is to be expected. Product offerings can be classified into two broad categories as we move ahead:

- Customized high-end complicated products aimed at the high-end, financially-aware customer with risk appetite. Key-man insurance and ULIPs will belong to this segment.
- Simplified, OTC insurance products to cater to the middle class and lower middle class segments. These products will essentially be a combination of endowment, money-back, and pensions in varying proportion.

One other area of keen interest would be the future of ULIPs which have a very low proportion of risk cover and a very high proportion of investment and savings. Given the fact that IRDA is progressively moving towards development of insurance mainly as a protection device and the resistance from the mutual fund industry which sees insurance as a favoured industry, we might see a movement towards ULIPs with a less lop-sided proportion of risk and savings.

The postulate that the average size of policy will go down as the insurance companies increase their geographical spread is not something that can be taken as a certainty. The counter argument is that the balance in the product mix of the insurers will ensure that average premium levels per policy remain stable. Even if there is bottoming out, it will be marginal. The proportion of key-man policies, ULIPs, and high-value policies will ensure that the new age players manage their average policy sizes.

With regard to intermediary costs, the initial cost hits with regard to branch infrastructure, technology, process, channel partner management, etc., have already been incurred and the coming years will see a rationalization in cost levels.

There is a case that the acquisition cost, primarily commission, might see a downward trend across agents as well as other channels. All in all, rationalization of average costs will be a very important realm of differentiation which will translate itself into lower prices, better value propositions, and better returns.

With regard to costs, in addition to what has been highlighted above, the administration charges and fund management charges that are being collected by the insurers will progressively reduce due to economies of scale and competitive forces from insurance as well as mutual funds. The reductions in overall costs will be passed on to the customer in the form of lower administration costs, better bonuses, and lower prices.

Learning from Partners

Insurance in India was by and large governed by the remuneration charges paid out to the agents until the liberalization of the sector came about. The opening up of the sector was essentially to provide the customer with customized protection and savings solutions suited to his overall financial requirement. The value that the joint venture partners have brought in this context is huge. The foreign partners have brought in their technical and financial expertise in a range of functions such as technology and operational processes. The development of underwriting practices is again suited to the dynamics of the social practices of a nation like India. Agency management, training, and the entire end-to-end service delivery process are other areas where Indian partners have benefited a lot.

The Indian insurance companies are themselves beginning to come to terms with the dynamics of a continent like India and it would be some time before we can be a part of the global ventures. However, the experiments in India would act as a reference frame for our foreign partners as they make forays into other nations.

Going forward, we could see two kinds of polarization in the industry: (a) products that are inclined towards pure protection, and (b) return-oriented products that will progressively provide more degree of protection as the regulator is keen on increasing the percentage of risk protection in unit-linked insurance products.

Can India Become a Global Player?

With regard to the Indian insurers turning global players, I think it would be fairly premature to address this issue now. The Indian insurance companies are themselves beginning to come to terms with the dynamics of a continent like India and it would be some time before we can be a part of the global ventures. However, the experiments in India would act as a reference frame for our foreign partners as they make forays into other nations.

Health Insurance

With regard to health insurance in India, we are still passing through a phase of retarded growth which is attributable to low awareness of insurance as a concept, adverse selection of risk due to people insuring at an advanced age, and the conservative approach of insurers towards pricing due to limited availability of statistical data. Further, the inadequate development of health-related infrastructure in the country has also pegged the industry back. The industry will have to work on the education levels of the market to resolve the situation partly. Going forward, we will evolve into a scenario of an independent regulator for health insurance but that will be a function of the growth of the market and the dynamics it entails. This cannot be seen happening in the next few years.

Some key benefits of technology have been reduction in turnaround time as well as multiple interaction points with the customer through emails, facsimile, websites, and ATMs, to name a few, which have resulted in improved disclosure to policy holders.

Role of IT

What makes the life insurance industry different from the other financial services is the long-term nature of the relationship of the company with its customers, often lasting a lifetime. The leaps in technology have helped us track the relationship with the customer and also given us the information to analyse the changing needs/profile of the consumer.

Moreover, the life insurance business is highly complex with the evolving statutory regulations that IT systems must deal with. Also with the emergence of multiple channels such as bancassurance, corporate agency, and broking, the company's IT systems need to be adapted with the systems of the channel partners without compromising the information flow.

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In conclusion, the future in life insurance will be defined by the increase in pure protection products, a refreshing look at unit-linked plans with rising protection components, launch of customized plans to suit niche requirements, improved positioning and market communication by players, and last but not the least, improved service levels which will get redefined with every passing day.

NEW INITIATIVES IN THE INSURANCE SECTOR: OPPORTUNITIES AND CHALLENGES

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The insurance sector in India is nearly 150 years old. It is now in the third phase of its existence. The first phase was the long-growth phase before the two nationalizations in 1956 and 1971 of life and general insurance respectively. At that point of time, there were more than 200 life insurance companies and 108 general insurance companies. They were all private sector insurers with the exception of one state-owned general insurer. Several overseas insurers were operating in India through branches. In the second phase, the entire sector became a state monopoly. In the third phase, we now have several new private sector players competing with the large public sector insurers. Based on the current trends, it seems that, in ten years, the market will have about 35 to 40 players, equally distributed between life and general insurance sectors. Several large global insurers operate in India through joint ventures. In the short time since the market was opened up, a comprehensive set of legislative instruments has been introduced. Relatively high capital requirement combined with tight solvency norms and the long lead time for returns has kept the number of players relatively small. All the new players are promoted by corporates with financial strength and commitment supported by reputed global insurers with long standing. Stability of the market is, therefore, ensured and customers' interests in terms of security are expected to be well taken care of. Ongoing measures to implement improvements will no doubt enhance the stature of the market.

Health Insurance

Health insurance has been discussed at length in many forums. No specialist health insurer has come forward so far to establish operations in India. Therefore, life and general insurance companies are allowed to transact health insurance business. But, they are cautious in their approach primarily because of weaknesses in the infrastructure of health sector and lack of reliable data. The government and the regulator have repeatedly expressed concern on the lack of growth of health insurance business. Cross-sector initiatives are needed and these are yet to produce tangible results. The next year or two will hopefully see new initiatives and incentives to realize the potential in this sector. Demands for lower capital requirement and solvency margin have been aired during discussions. The regulator and the government are yet to consider these demands.

No specialist health insurer has come forward so far to establish operations in India. Therefore, life and general insurance companies are allowed to transact health insurance business. But, they are cautious in their approach primarily because of weaknesses in the infrastructure of health sector and lack of reliable data. The government and the regulator have repeatedly expressed concern on the lack of growth of health insurance business.

Cooperatives

Another sector yet to participate in the new paradigm in insurance is the cooperative sector. This sector too has sought special dispensations in terms of capital requirement though it is yet to carry it with conviction to the regulator. Penetration of insurance in rural areas would involve low-cost policies. The cooperative sector and the micro-credit organizations can play important roles in this regard.

Market Shares

In both the life and general insurance sectors, the new private sector insurers have made impressive gains. They hold approximately 13 per cent of the market share in life new business and a little more in general insurance. In several other Asian countries that liberalized their insurance markets, new entrants took much longer to secure even a modest share. It is, therefore, correct to say that the new private sector insurers have done remarkably well in the short period of four years.

The new entrants in the life insurance sector have done very well in terms of introducing new products, customer service standards, documentation, IT support, etc. Innovative and perhaps aggressive selling techniques too have helped a lot. For instance, competition in group insurance has been very severe. Introduction of the 'unit-linked' policies has been a significant development. This product is doing very well. LIC appears to have taken timely hold on the issues and is meeting competition very effectively in all key areas such as new products, IT, customer service, innovative distribution relationships, PR and publicity, HR, etc. It has also increased the emphasis on unit-linked policies. The share of the private sector players in the market looks set to grow slowly and stabilize at around 25 to 30 per cent.

In general insurance too, the new insurers have come out with the features displayed by the life insurers. In fact, in securing profitable corporate business, the new entrants have displayed very aggressive practices and there have even been allegations of using unhealthy methods. General insurance business is annual in nature and frequency and severity of claims are inherent in the business. Ability to settle claims quickly and resolve disputes are matters central to the sector. While the private sector insurers have rendered good service and gained the confidence of the consumer, the public sector insurers seem to have upset a vast section of the insuring public at all levels. Consequently, the new private sector insurers are able to secure significant shares in the profitable segments leaving the loss-making ones to the public sector companies. Further, the four public sector general insurance companies are not yet in a state of readiness to meet the new competition effectively. For example, the extent to which IT is used effectively is still inadequate. Response to customers is reported to be tardy. It is, therefore, likely that the market share of the public sector insurers declines more rapidly than in life insurance. It is likely to stabilize at 50 to 60 per cent.

General insurance is a complex business both in terms of its fundamentals and operating practices. A key feature of the general insurance market is its skewed structure in terms of rates and terms. More than 60 per cent of the business is controlled by a centrally administered rate structure known as the 'tariff.'

Has the Market Expanded?

As of now, significant expansion of the market through increased penetration is not in evidence. Whether the sector is growing in absolute terms or whether there is merely competition for existing business is a matter that calls for strategic discussions between the insurers and the regulator. Specific initiatives would be needed to achieve higher penetration and for moving up the ladder in comparison to other countries. It is necessary to establish measurable benchmarks that will keep track of this developmental aspect of liberalization.

Awareness

Increasing awareness is a condition precedent to penetration of insurance. Anecdotal evidence and empirical observations indicate that awareness of insurance has improved substantially. This is attributable to the effective campaign launched by IRDA and the combined impact of sustained wide-ranging publicity by all 25 insurers. Insurance has been in the spotlight at all times. This augurs well for future growth.

Common Issues

In the life insurance sector, public and private sector insurers seem to be cooperating well in matters of common interest. Their approach to issues such as benefit illustrations, representations to IRDA and government, setting up of the 'Mortality and Morbidity Information Bureau,' are examples of a mature approach to important common issues even as they compete in the field. Comparable trends are yet to be seen in the general insurance arena. Sadly, there are gaps in coordination even among the four public sector companies.

General insurance is a complex business both in terms of its fundamentals and operating practices. A key feature of the general insurance market is its skewed structure in terms of rates and terms. More than 60 per cent of the business is controlled by a centrally administered rate structure known as the 'tariff.' Innovations in these segments are difficult since policy terms as well as prices are externally determined. Competition has to be mainly on promise of good service and performance thereof. An externally administered regime of rates and terms is inconsistent with a liberalized market. IRDA has recognized this but an action plan to move towards a free market rating regime with adequate safeguards is yet to be put in place. This, when it happens, will determine the future structure of the general insurance market in India. In the public sector insurance companies, fear of runaway competition, their vulnerability in terms of observing price discipline, and the conduct of their field force and support staff are anxieties that cannot be wished away. Well-directed measures are yet to be brought about and the public sector insurers appear to be in an unenviable position. The question is whether the market should delay structural alternatives because of internal rigidities of public sector insurers and their inability to enforce internal discipline.

The general insurance sector has shown mixed performance perhaps due to the inherent nature of the business. While the private sector general insurance companies have set good standards for claims settlement, the public sector insurers are yet to show resilience in the changed environment.

Motor Tariff

The issue of tariff rates has a very important dimension in respect of motor vehicles insurance that constitutes 40 per cent of the business. Continued adverse claims experience of the statutory legal liability section of motor insurance has posed intractable issues for the companies and the regulator alike. A sizeable part of this business relates to the commercial vehicle segment that has heavy incidence of claims for several years now. Increase in insurance tariff rates is a crying need; but it is resisted by the lobby of commercial vehicles through all possible means including nation-wide strikes. The insurance industry does not have reliable data to support a case for any increase. This has provided a handle to the owners of commercial vehicles to resist increase in rates. Because of the importance of the commercial vehicles sector in the economy and their power to command attention, attempts to increase rates have produced only marginal results in the past. The new private sector general insurers are reported to be staying away from this business and the government-owned insurance companies seem to be obliged to carry the load of this portfolio at grossly inadequate tariff rates. An early solution to this difficult issue will be vital for the health and harmony of this sector. Committees have been appointed and their suggestions have been considered but solution is not yet in sight due to issues external to the sector. Delay in achieving an early solution can result in structural compulsions that may skew the balance of the sector.

Customer Service

In the short time since the market has been opened, the private sector companies have set a completely new paradigm of service in both life and general insurance sectors. All companies have come up with benchmarks for each aspect of service and also internal measurement of quality. For instance, the structure, content, and appearance of documentation are comparable to any in the world. Best practices aimed at informing the customer in a transparent manner have indeed been brought in. These are more in evidence in life insurance possibly because of the long-term nature of the business. Indian insurers in the public sector are responding slowly. Regulations have helped achieve standards of disclosure. Here again, in the life insurance sector, both LIC and the new companies seem to have set high standards in settlement of claims. The general insurance sector has shown mixed performance perhaps due to the inherent nature of the business. While the private sector general insurance companies have set good standards for claims settlement, the public sector insurers are yet to show resilience in the changed environment. This is sure to cause further dissatisfaction and consequent loss of good business. Though structural inefficiencies are stated as reasons for such a situation, the main cause seems to be a pervasive attitude problem coupled with a need for transparency in claims handling.

Intermediaries

Some of the significant requirements introduced by IRDA to promote professionalism among intermediaries relate to minimum qualifications, mandatory training, and passing an examination before a license is issued to an agent or a broker. The number of life insurance agents in the market has almost doubled to more than a million now.

There is no evidence yet to show that more agents in the new paradigm show higher level of professionalism than those before. The uglier aspects of competition have been seen in the training, examination, and consequently in the performance of the agents. Drop-out rates are still very high and productivity is quite low. Intermediaries such as agents and brokers from all parts of the country will have to play a significant role if insurance is to be spread to all segments and regions of India. The present trend does not seem to show significant improvement in the quality of the distribution force to achieve higher penetration. Insurance agency is not yet seen as a viable career in terms of income security and social acceptance. Structure of remuneration, limits imposed by law, flexibility of ownership, and transferability of agency are some of the legal rigidities that stifle the development of professionalism among intermediaries. The report submitted by a committee contains suggestions that can be considered for adoption.

Distribution is the key to development of insurance and achieving penetration. For the first time, we have licensed brokers in the market and their role will expand and develop. Increasing importance of bancassurance is a trend of significance and in due course will lead to launching of products jointly developed by the insurance and the banking sectors. Introduction of corporate agency as a distribution arm has also been a development of significance. Even as these are happening, some adverse developments attributable to misuse of the trust reposed by the regulator appear to have raised concerns. Corrective measures are being introduced as reaction to lack of compliance. The insurance industry should observe rules and regulations and avoid a situation where the regulator is obliged to introduce on-the-spot or *ad hoc* directions instead of looking for systemic solutions that have a better chance of success in strengthening the market.

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Self-regulation

In a healthy development, IRDA has made known its intention to have more self-regulating bodies for implementation of guidelines and ensuring compliance. The Life and General Insurance Councils, the Actuarial Society, the Surveyors' Association, the Brokers' Association, etc. are examples. These are trusting and mature moves. Each player in the industry has a major responsibility in making a success of this approach. Lack of self-discipline and consequent failure may result in frequent and rigorous regulatory intervention with attendant implications.

Concluding Comments

The insurance sector will grow steadily rather than rapidly. The law and regulations in place are adequate to ensure financial strength and solvency of insurers. The regulator's challenge lies in monitoring compliance to the several requirements. Delay in taking steps against erring parties would erode the credibility of regulations and customer confidence. In these four years since opening up, new insurance companies have faced the challenge of convincing an average customer that the commitments under the polices will be met by the new companies and that their stability is no less than that of the public sector companies. This depends to a great extent on the credibility of the regulations and the regulator. Early detection of problems and quick solutions are vital for maintaining the confidence of the average consumer.

In a recent study, Swiss Re mentions that India (and China) would create ample opportunities for the development of insurance backed by regulations in line with international best practices. Pension business is on the verge of a new set of government initiatives aimed at providing old-age security to vast segments of society. Developments are expected very soon.

The opening up of this sector has been a great success. There is no doubt that, in a decade, Indian insurance market will be among the front-runners in the world.

ARE INDIAN FAMILIES ADEQUATELY INSURED?

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The Indian market has a lot of potential for insurance products. Some Western markets that were considered saturated are also realizing the market potential of their middle and lower classes. In India, even the upper class may not have adequate insurance coverage. India has a population of 1 billion people consisting of approximately 160-170 million families. India's working population amounts to around .4 billion but a substantial portion of these work either as landless agricultural labourers or as casual labour with very less disposable income. The LIC issues 20 million new contracts every year and has 150 million outstanding contracts on its books. Therefore, it may be concluded that most families who need insurance have a minimum of one life insurance contract. The problem is whether the insurance is adequate or not. And this is where the potential lies. Most families in India may not have adequate insurance. In case of a calamity to the bread earner, the amount that the insurance company will pay to the family members will not be enough to enable them to maintain a standard of living (albeit lower) than what they were used to earlier.

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Challenges in Marketing Risk-cover Products

The distribution of insurance, till recently, has been through individual agents. They may have sold insurance more as investment and tax-saving products. The feature of insurance cover and its ability to retain the financial status of the family in case of the death of the bread winner may not have been emphasized. This phenomenon is also seen recently where the sales of insurance continue more for savings and tax purposes rather than for pure insurance requirements. The sales of term policies, which offer only a risk cover, form a small percentage of the total sales of all insurance companies. Agents do not push this product as the commission amounts are lower than in savings products where they are higher. There is also a typical customer requirement of getting something back on survival that leads the agent to sell a savings plan. This leads to the phenomenon of under-insurance as the customer believes that he has bought an investment plan and does not need to review his insurance needs frequently. The reality is that insurance needs change as per changes in income, life stages, and life style of each individual and these needs have to be addressed frequently. However, the customer treats insurance as an investment plan which is not revisited leading to the phenomenon of under-insurance.

Role of Intermediaries

The practice of selling insurance as an investment has perpetuated over a long period of time and is fed by an agent's obvious need to maximize his income. Agents will have to be educated that having a long-term relationship with clients will result in much more income than maximizing income in the first sale. With this recognition, agents may recommend the right investment and insurance products that suit the individual's specific needs at different stages in their lives. Building a long-term relationship is a lengthy and cumbersome process but with significant long-term benefits. Agents will first have to imbibe this behaviour and then convince their clients that what is being recommended is in their best interests. Doing this will require the tailoring of training programmes to convince agents to manage their client relationships in a manner that has the highest pay-off in the long term.

Effectiveness of Alternate Channels

Any channel that is able to achieve the above-mentioned objectives will be successful and should be a welcome addition to the insurance industry. Banks, retailers, etc. have similar advantages — walk-in customers, customers used to these establishments and willing to spend time with their employees, etc. Banks as a channel have had mixed successes in different parts of the world. Surveys have shown that different customers have different perceptions about buying insurance from banks. Some are comfortable while some are neither sure of the advice that they are getting nor are they convinced that a bank can do a good job of selling insurance. The Indian market can use the entire arsenal that can be made available to it for fulfilling its potential and making available the insurance cover that Indians require.

IRDA has done a very good job of ensuring a smooth transition from a single player market to a competitive one. It will continue to have a major role to play in the years to come in ensuring that each and every Indian citizen is approached with the right advice to cover the risk to his/her life and protect the family from adverse financial circumstances.

Appropriate Regulations

IRDA has done a very good job of ensuring a smooth transition from a single player market to a competitive one. It will continue to have a major role to play in the years to come in ensuring that each and every Indian citizen is approached with the right advice to cover the risk to his/her life and protect the family from adverse financial circumstances. India is a large and populous country with a lot of diversty. Innovative distribution channels should be encouraged and regulations should be such as to facilitate the process of provision of the right advice and the consequent sale of insurance products. Certain basic principles need to be defined and as long as these are met, insurance selling should be encouraged. Therefore, regulations governing the training and licensing of agents, the selling process, products, prices, etc. should contain generic principles which will allow insurers and their distributors certain leeway in reaching the final customer as long as the basic principles of right advice and right selling are achieved.

Growth Strategy

India is a large market and has considerable potential. Currently, the industry needs to focus on meeting the challenges of increasing penetration and achieving the right levels of protection for all Indian citizens. It will require quite a few insurers to achieve this goal. Products, processes, and procedures need to be devised and implemented by all companies that ensure that, over the long term, agents are recruited and trained to sell the right products to their customers. This will ensure the success of insurers as not only will their revenues be higher but also their costs will be lower due to higher productivity of agents, their lower turnover, and higher persistency of policies coupled with higher customer satisfaction. Putting these processes in place will require time, effort, and capital. The pay-offs will occur in the long term. The growth rate of such companies will steadily increase over time.

Meeting Cost Challenge

Increasing the distribution reach to less populated areas will increase the costs of insurers. Such costs will have to be estimated and priced into the products. Issues relating to cross-subsidization may arise. Alternatively, insurers could introduce new products for these specific market segments and price them to recover the incremental costs of their distribution. Controlling the distribution of specific products through agents has always been difficult. Another method of controlling costs by increasing productivity is to get agents to focus on particular generic products. Historically, this has been difficult to achieve and may not be in the best interests of the customer.

Indian insurers have relied a lot on their foreign partners for initiating business and developing important policies and procedures. Insurance requires special skills in actuarial and underwriting and these skills are inadequate in India.

Contribution of Global Partners

Indian insurers have relied a lot on their foreign partners for initiating business and developing important policies and procedures. Insurance requires special skills in actuarial and underwriting and these skills are inadequate in India. Expertise in these areas and recent developments in these professions have been important knowledge transfers to domestic insurers. Further, selling practices and product innovations have been easily transferred without reinventing the wheel. Developments in risk and performance management need not be learnt anew and are being implemented in much quicker time-frames than in other countries. Foreign companies have also urged their Indian partners to adopt the best practices prevalent in other areas of the world. Some of these have also been driven by legislation in the countries of the foreign partners. Going forward, domestic companies will benefit from the long-term experience of their partners in other countries and will continue to learn from them in shortening the learning curve.

Global Insurance Scenario

The opportunity for financial services is increasing all over the world. There are still quite a few countries where the penetration of banking, insurance, capital markets, etc. is quite low. There is still some potential in developed countries especially in their middle and lower segments of the population. Over time, certain companies may dominate areas such as banking and insurance and it is possible that we may have international regulators to ensure that there is adequate competition in each country or region. Big domestic companies with significant market shares in their local countries will have the opportunities to commence business in other markets. New Indian insurers may have to focus on the Indian market in the coming years and consolidate their position here before they are ready to do business elsewhere.

INTEGRATED APPROACH: KEY TO GROWTH AND DEVELOPMENT

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The evolution of the general insurance industry in India can be categorized into three phases. The first phase was characterized by unfettered market access and continued till the early 1970s. The second phase between 1975 and 2000 was the era of government-controlled oligopolies. The third phase after 2000 is of liberalization and IRDA was formed to regulate the insurance industry.

The nationalization of the insurance sector in 1973 led to the formation of four government-controlled entities with the General Insurance Corporation (GIC) as the holding company. Between them, the four public sector insurance companies set up close to 4,000 branches across the country and during the period 1973-2000, insurance premiums at the gross level increased from Rs. 2 billion to Rs. 98 billion at a CAGR of 17 per cent.

In 1999, the IRDA Act was enacted allowing entry to private sector players. At the same time, the GIC was converted into a national reinsurance company. Eight private players commenced business and, today, these players have captured close to a third of the total market.

> India is one of the most under-penetrated markets for insurance. While India's GDP is 1.5 per cent of the total world GDP, its general insurance premiums are only 0.3 per cent of global premiums. Going forward, the challenge for the industry players is to grow the category by increasing the width as well as the depth of insurance penetration.

While the three phases have their own distinctive characteristics and the category has grown in each phase, the key issue remains that India is one of the most under-penetrated markets for insurance. While India's GDP is 1.5 per cent of the total world GDP, its general insurance premiums are only 0.3 per cent of global premiums. Going forward, the challenge for the industry players is to grow the category by increasing the width as well as the depth of insurance penetration.

Market Characteristics

The market comprises of a large number of products of which predominant are those that are mandatory. Motor insurance which is statutory in nature forms close to 37 per cent of the market. Fire insurance is the next largest and forms 23 per cent. Along with fire insurance, engineering and marine are the other major corporate products and the three together contribute to 37 per cent of the market.

The tariff regulations are another characteristic of the market. Notified by an arm of IRDA, tariffs dictate the scope of the insurance cover and the price at which it can be sold. Fire insurance, engineering insurance, motor insurance, and marine hull insurance are all controlled by tariff. Tariff is essential to ensure that the new players with their smaller capitalization are able to compete effectively in the market in face of their much larger public sector competitors who have built up reserves over the years that they have been in operation. De-tariffication is a logical step in the evolution of the industry as the private sector players build their business lines and attain a balance sheet size that ensures stability. Motor Own Damage is slated to be de-tariffed in the next fiscal.

The key to market growth is through an integrated approach which includes creating awareness about insurance, enhancing reach through cost-effective distribution, and meeting customer needs through product innovation.

Product Demand

Insurance is a push product. Insurance cover is procured where it is mandated. Motor insurance that is statutory and fire insurance, which is mandated by lenders, are cases in point. A few others like marine hull, marine transit, and liability policies like public liability also fall into this category.

With the liberalization of the economy, the demand for insurance is growing. Drivers for this growth are:

- Investments in industries and infrastructure development due to:
  - increase in demand for goods and services
  - increase in exports with the globalization of the economy.
- Growth in retail consumption due to:
  - increase in per capita income
  - growth of retail financing at 35 per cent annually
  - paradigm shift in distribution with multiple channel options
  - upward mobility of the population leading to higher asset ownership.
- Increasing awareness and penetration of certain product categories such as liability insurance, health insurance, and overseas travel insurance.
- Innovative product offerings in the market such as weather insurance offering practical solutions to insurance needs.

Studies indicate that general insurance premiums grow between two and three times the growth in GDP. In the context of the Indian market, the low penetration rates indicate the potential for robust growth in this sector. It has been observed in the developed markets that as income levels rise, general insurance volumes increase at a higher than proportional rate till the market reaches saturation. Initially, the need for protecting one's health builds up leading to an increase in demand for life and health insurance. With further increase in incomes, the individual builds assets and the need to protect them drives demand for asset policies. With increasing awareness comes recognition of one's rights leading to the demand for liability insurance like professional indemnity covers for doctors, lawyers, etc. India is still at a stage where changing societal structures are encouraging people to take life and health insurance indicating the early stage of evolution of the category.

Key to Ensuring Growth

The key to market growth is through an integrated approach which includes creating awareness about insurance, enhancing reach through cost-effective distribution, and meeting customer needs through product innovation. A two-fold approach is required while adopting these drivers of growth: increase the depth of penetration in existing product-market segments and drive the width of penetration leading to market expansion by targeting new segments. Given the complexity of the industry, insurers will have to adopt a multi-product, multi-channel, and multi-segment route to the market to achieve these objectives.

Awareness creation must be in line with the creation of distribution reach to ensure that the last mile fulfilment loop is closed. The conventional distribution network comprises of physical networks of branches (direct channel) and agents tied to the insurance companies. In the future, there will be a plethora of channels allowing the customer to choose which channel he is most comfortable with. The options include agents, brokers, direct field force, telesales, bancassurance, alliances, and the internet.

With the advent of broking regulations in 2002, brokers have emerged as an important channel in the corporate segment. Worldwide, brokers control close to 80 per cent of the corporate business with the top two controlling more than half the total broking market.

Bancassurance is also gaining prominence. Nearly 60 per cent of the life insurance sold in the European countries is through this channel. Bancassurance relies upon the vast distribution reach of banks and since they are in the business of providing financial solutions, insurance ties in nicely with the product basket. The insurance companies gain through access to an established network, familiarity of channel with financial products, and access to capital. Banks gain through an enhanced product offering, fee income, and better utilization of their channels. In Europe, utilities, retailers, and affinity groups are also emerging as important alternative channels as they move into offering financial services to their loyal customer base.

On the retail front, there is a shift worldwide to virtual channels like telemarketing and the internet which offer the twin benefits of unimpeded reach for the customers and low set-up costs for the insurer. Most of these distribution channels are gaining prominence in India. As insurers seek to increase their market share and provide better service to their customers, they will increasingly explore these alternate channels of delivery to provide them with the necessary flexibility.

In addition, most customers who have taken insurance of some sort are usually under-insured in terms of the potential risks they are exposed to. This applies to individuals as well as corporates and insurers must constantly educate their customers on the need for adequate coverage. There are also a large number of underserved segments such as senior citizens, rural markets, and NRIs whose needs are still unmet. The appropriate product solution delivered through the right channels will be the key to penetrate these markets.

Insurance products can easily be copied thereby limiting differentiation at the product level. In such a scenario, competitive advantage will be gained through constant product innovation, cost effective distribution, and quality of service delivery. This will allow the insurer to differentiate the overall value proposition offered to the customer and to adopt a pricing model based on the perceived value as against discounting.

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The effective deployment of IT is a key business driver with its ability to substantially reduce operating and distribution costs while providing scalability. The strategic benefits of technology programmes such as straight through processing, enterprise application integration, and customer relationship management are well known but delivering the expected ROI on these investments is a key challenge. Success in this area will be determined by an approach where IT is seen as a business enabler and where ownership of technology projects also rests with the businesses rather than with the IT department alone.

Conclusion

The insurance sector is undergoing fundamental transformation and has an important part in the build up of the country's economic infrastructure. The insurance regulator will play a key role in laying down the ground rules and paving the way for the sector's growth and development. But the challenge clearly rests with the insurers to take the industry to its next level of evolution. In India, the ratio of assets of insurance companies to those of banks is 3 per cent while the ratio in the US is 10 per cent. This serves as another indicator of the potential that the industry must live up to.

BANCASSURANCE: EXPLOITING AN OPPORTUNITY WITH PARTNERSHIPS

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The Indian market for insurance is characterized by the geographical spread fragmented in terms of characteristics, language barriers, 248 million urban, 300 million middle class, five metros, 30 cities, 700 towns, and a large number of villages. The entry challenges of new players in the Indian insurance sector have been related to the timing of entry, the choice of joint venture partner, segments to attack, services to offer, and channels to adopt without violating the regulatory restrictions.

Traditionally, the 'agency model of selling' has been the most used and preferred channel. For an already established company, the model confers advantages like focused targeting, predictability of business flow, and ease of management. To the newcomers, this model poses its own challenges in terms of managing talents and costs. They need time to build the network of agents through recruitment, training, and incentives to enable them to contribute to the business. This means slower coverage and higher costs. The difficulty is compounded by the lack of good talent and trained direct salesforce despite lucrative compensation and incentives. This is more so in the rural areas.

Bancassurance is a format where the insurance companies offer their insurance products through the distribution channels of a bank along with a complete range of banking and investment products and services to a common customer base.

The key to unlocking the market lies in efficient coverage of services. The agency model has its own challenges as the novelty value is lost fast, natural market gets dried up quickly, and the referral market needs conviction, salesmanship, and training. The players are, therefore, required to innovate and develop new options to enter effectively and create conditions for sustaining their entry.

Bancassurance Channel as an Alternative

Bancassurance has been proposed as an attractive alternative to the traditional agency model. It has the potential to offer ready manpower, customer database, and relationship banking of the bank but it has its challenges in terms of defining partnership terms, learning, and unlearning. Bancassurance is a format where the insurance companies offer their insurance products through the distribution channels of a bank along with a complete range of banking and investment products and services to a common customer base. It purports to serve the interests of the bank in leveraging its infrastructure and the insurance company in quick entry and growth.

***Potential of the banking channel*:** Banks have played a significant role in mobilizing the savings in India and forming the backbone of the Indian financial system. They have penetrated the interiors through their branches. Over the years, the share of bank deposits in the total financial assets of households has risen to about 40 per cent. This is indicative of their immense reach to households and their savings. It is estimated that out of a total of 65,700 branches of commercial banks, each branch serves, on an average, 15,000 people. There are a total of 406 million accounts with aggregate deposits of more than Rs. 10 trillion. Rural and semi-urban bank accounts constituted close to 60 per cent in terms of number of accounts indicating the number of potential lives that could be covered by insurance with the frontal involvement of banks.

In addition to the income from the interest spread, the banks have depended on fee-based income by providing services like brokerage and commissions. Their fee-based income as a percentage of total income has been around 6 per cent. The tie-ups with insurance companies to sell the insurance products could be another source for fee-based income.

In addition to the bancassurance channel, the insurance company could also sell insurance policies through brokerage houses. IRDA stipulates a minimum requirement of Rs. 5 million for organizations to set up brokerage services. Bajaj Capital and Karvey Consultants are currently the two leading brokerage houses besides the 200 broking houses all over the country.

Harnessing the Potential

Bancassurance has already been in force in some form or the other. For example, banks have already been selling personal accident and baggage insurance directly to their credit card members as a value addition to their products. Banks have also been distributing the mortgage-linked insurance products like fire and motor vehicle insurance to their customers. Most of these have been a part of add-on with the existing services and products. They, however, are yet to use their information and database on saving habits of customers to generate the leads for insurance business.

Harnessing the potential requires that the banks develop competencies in using their database effectively. In addition to training in selling, the staff need support in analytics. They need to integrate insurance products in their portfolio of products. Given the complexity of selling the insurance products through the banks, the strategy should be to maintain the simplicity of products and meet the expectations of the customers. For example, we know that life insurance products include term and whole life, pensions and retirement as well as savings plans with risk coverage thus covering the most essential needs of the customers. In non-life basic policies, the personal accident cover, property insurance cover, etc., are being marketed. In bancassurance, given the entities involved and the training requirements, the product choice portfolio has to be kept simple and could be limited to ten products. The main objective behind this limit is to speed up the training process of the front-line sales personnel with the new products. Given the growth in the insurance sector, the banks are expected to move fast.

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To the insuring company, bancassurance gives ready access to the market but the success of this strategy hinges on keeping the product design simple and integrating the partners into the new thinking. The banking staff would require training to approach the customer with a new mind-set. The banks so far have responded to the demands from customers — for example, making a draft based on request from the customer, opening of a new account, etc.

As partners, the insurance company and the bank will have to work on certain preliminaries before entering into this channel of distribution.

The Defined Segments

Through the bancassurance partnerships, insurance companies are catering to the defined segments and are designing strategies to sell insurance to them. For example, ICICI Prudential has tied up with Lord Krishna Bank, ICICI Bank, Bank of India, Citibank, Allahabad Bank, Federal Bank, South Indian Bank, and Punjab and Maharashtra Co-operative Bank to cater to a mix of high-income urban and rural segments. The foreign banks have clients belonging to high-income groups while the domestic banks have access to middle income clients in rural, semi-urban, and urban areas.

The Experience So Far

The experience so far reflects mixed results. It is indicative of the mismatches among the partners in respect of expectations, competencies, and willingness to wait. There have also been indications of cultural compatibility issues. Two basic models — integrated and introducer — have emerged:

- ***Integrated model (also known as corporate agency model)*:** Here, the bank functions as a corporate agent for the insuring company. The entire business is taken care of by the trained and licensed staff of the bank. It is expected that the bank staff would significantly leverage client relationship as they are frequently dealing with the client.

- ***Introducer model (also known as referral model)*:** In this model, the customer has access arrangement with the bank. Specialized and trained insurance company advisers are deployed in the bank branches. The bank's role remains as that of the introducer. The insurer's role, however, ranges from being a product and service provider to an introducer. Commissions are generally negotiable. It has been observed that the conversion rate is very less and it gets exhausted soon. Database, which is a crucial factor, is managed through a tele-caller. This arrangement continues to generate the leads but has to be backed by an effective strategy to acquire customers.

Implementation Challenges

Many insurance companies have struggled in their initial stages to implement the bancassurance arrangements. Given the network of bank branches, no insuring company so far has been able to exploit the potential fully. It has been a challenging task to develop and nurture the partnerships.

Bancassurance provides the insurance company an access to a large customer base in a short time and allows it to diversify its channel risk and reduce unit costs by adding volume with fixed overheads. In turn, the insurance company provides several benefits to its partners like an access to a proven, efficient platform with no implementation risks, world-class best practices, and a full range of competitive products.

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The introduction of bancassurance requires having appropriate awareness among bank employees and ensuring that they understand its mechanism. This involves a change of mindset and developing appropriate culture at the bank level. India had very little experience in this field and there were no role models. Some companies having global experience in this field such as Aviva Insurance did not face much problem. However, there is a need to build congruence of interest between insurance selling and retail banking units. Although this would take time, yet, they would have to be successfully integrated. The lack of networking among rural and semi-urban bank branches has implications for bancassurance implementation. Complete integration of branch network involves huge investments for creating IT and communication infrastructure.

The management of the bank has to also play a critical role in ensuring that the bancassurance model works. There is a need to develop effective cross-selling strategy and for that the banks need to understand how the insurance products can be integrated into their existing product portfolio. The customer database needs to be structured properly so that it can provide adequate and relevant information which can form the basis for developing cross-selling strategies. It is important for the insurance company to understand questions such as: Are the banks cross-selling their own products? What motivates people? How strong are the unions or is the bank traditional? How far can the processes be incentivized and does it fit into the bank culture?

Many insurance companies such as ICICI Prudential and SBI Life Insurance have already established a banking network. These banks have a strong banking network of their own which they can leverage for bancassurance mode of distribution. However, this has not deterred other insurance companies such as Aviva to use bancassurance channel. Aviva had a successful bancassurance track record globally and a distribution capability well suited to the preferences of customers in the local markets.

The other key challenges in implementing the bancassurance mechanism include the following:

- It is recognized that salespeople work for incentives. So, it is essential to develop and design incentives and get the bank employees interested in the same. This also requires working with the finance department to ensure that performance is linked with the payment of incentives and developing appropriate MIS for the same.
- Interacting with the operations team and develop-

ing a CRM system through which the high networth cases can be closely monitored.

- Manpower and structure issues involve creating a single window concept and, based on this, appointing a dedicated project manager. Finding and hiring such a resource is very critical.
- Monitoring of bancassurance mechanism by holding regular meetings — weekly meetings to quarterly review meetings. These meetings are also used to educate the bank staff and the management about bancassurance using presentations and problem-solving approaches.
- Top management involvement is critical as the implementation of bancassurance mechanism involves developing and inculcating an appropriate culture in the bank. This is also important for creating an appropriate ownership about the scheme.

In order to implement the bancassurance mechanism, the banks require adequate networking among the bank branches. This, in turn, requires a substantial investment in IT to connect various branches effectively. Particularly, the branches in rural and semi-urban areas remain unconnected. Complete integration of branch network involves huge investments for creating IT and communication infrastructure.

Due to the proliferation of saving products and emerging investment opportunities in India, the bancassurance faces the challenge of selling insurance through the banking channel. The competing returns from other products such as mutual funds posed a major challenge to bancassurance. Most of the life insurance products are highly structured and have less flexibility in customizing them to the specific needs of the clients. However, unit-linked products fit this bill well and the banks can meet this challenge.

In bancassurance system, there are also co-branding issues and the partnership needed to ensure that they do not give inconsistent messages and destroy value in the process. Leveraging on both brands is challenging. The implementation of bancassurance also assumes cultural integration between the two partners.

Implementing bancassurance requires different competencies and skills. One of the important challenges in this is managing involvement of the bank staff. This is a challenging task as the banks are not approaching the customers for business but executing requests of customers. For example, the insurance companies think that target-setting is important for business growth and, for this purpose, the bank and the insurance company need to develop an effective sales management and an organization strategy; there has to be a joint ownership of targets. Banks have a lot of information and data on consumers' saving habits and these can be effectively used for lead generation. For this purpose, the partners need to develop appropriate mechanisms which ensure better use of this information.

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While implementing the bancassurance mechanism, insurance companies may also experience the difference in pace with which targets are achieved and tasks are executed. The partners may move at different pace. Capturing the market is important as the competition is high. The style of working in two cultures can be different. Incentive systems across various channels are different and these have implications for each channel. The gaps can become visible and reducing these gaps may require continuous interaction and training of bank staff.

The integrated model partnerships include a whole new range of challenges such as the challenge of scale, integration of culture, and speed. The banks experience the challenge of working with targets and developing new performance measurements. For this, the response time in deploying adequate resources is critical. Since in bancassurance the partners are going to use technology and database services, there is a concern about how systematically the relevant information on consumers interacting with banks is captured. In order to explore this channel, insurance companies are required to establish a strong leadership, work closely with the bank partner and develop this partnership, and develop innovative but simple products. Data mining and CRM approaches need to be strengthened at the bank level through appropriate use of technology.

It is observed that a customer-focused approach that fitted in with the bank culture is a critical factor in making bancassurance a success. The bancassurance sales are radically different from agency-based sales. Developing an appropriate strategy of sales management and selection, retention, and training of people involved in the bancassurance programme is also important. These are required to be strengthened to reinforce and institutionalize the bancassurance processes. The incentives and rewards play a significant role to drive the behaviour of people but this has to be developed keeping in view the bank environment and sensitivities.

MANAGING INSURANCE: MANAGING THE AGENTS

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To gain competitive advantage, the insurance companies need quality people in order to sell the product to customers. The insurance business is traditionally managed by a large number of insurance agents who work on a commission basis. Though these are not the regular employees of the organization, organizational success, however, critically depends on the effectiveness of these people. These agents are expected to promote the company philosophy of providing quality advice to customers and sell the company products. Further, in order to increase sales, the companies need to expand their business from cities to urban and suburban areas for which they need to hire and retain agents who can serve in those markets.

It is a challenge for any insurance business organization to attract qualified and capable persons to join and work with them to sell insurance in the competitive environment. Agents could enhance the possibility of success by understanding the needs of the customer and then sell insurance policy to potential customers. It requires capable people who could analyse the financial status and generate confidence among potential customers to accept the advice. However, the turnover of insurance agents has traditionally been high in this business. It is posing challenges to the insurance companies.

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Reasons for High Turnover

***Stigma*:** The low turnover of agents is owing to many factors, the most prominent among them being the stigma of being an agent in the society. During an interview, a young agent stated:

> "I have done my post-graduation in management. I earn well as an agent. However, my parents have been requesting me to get regular employment in a company. People do not want to marry their daughter to me owing to the lower status of the agents in the society. This pains my parents and me too sometimes."

***Difficult selling process*:** Agents are expected to understand the customer's needs and sell the products accordingly. This process involves high level of persuasion and a sustained effort for a long period of time. According to a senior manager in an insurance company, the sale of a product follows the 'rule of five.' According to him:

> "Out of every 625 calls, 125 suspects are identified. These suspects lead to identification of 25 prospects. The prospects are intensely pursued with a presentation and other analysis for them. These prospects lead to five hot prospects. Finally, one of those five hot prospects purchases the policy in a given month."

The above rule shows that it is an extremely time-consuming and intensive process to sell one policy. The selling process requires a certain level of analytical skill and knowledge of the different financial tools. Further, agents are required to be backed by strong information base by the office. Absence of such a back-up of the office makes it difficult to answer different questions that the customers ask the agents.

Expectation gap: The expectation gap adds to the turnover of insurance agents. To begin with, very few competent people want to become agents owing to their low social status and uncertain but potentially high income. Most of them are lured to the profession with high earning potential. However, to earn decent income, agents have to go through a learning curve that requires a lot of patience, perseverance, and persuasion in the field. During this early phase, the earnings of the agents are low despite hard work. This expectation gap leads many of them to break down in the initial period of joining the profession. Experience shows that retaining the field personnel for the first three months is a challenge. Once they stay for three months, making them stay for one year becomes easy, and, after spending three years, they continue for a lifetime.

Most of the insurance companies have not fully leveraged on the potential of part-time agents. A large chunk of prospective agents cannot devote full time to the profession due to their existing engagements. These people have a wide social network which would enable them to get good business.

Insurance agents generally do not switch jobs between the companies owing to the legal provisions but they quit the profession altogether. According to the rules, agents require 'no objection certificate' from the current employer before they could be employed by any other insurance company. Such certificates are rarely given to anyone by the companies.

Possible Ways to Attract and Retain Agents

Recruitment and selection of agents: As stated earlier, attracting and retaining of agents is one of the major challenges. To overcome this challenge, the companies need to involve local management to recruit agents among the local population. For such wide recruitment efforts, local managers could be provided support in managing applications and conducting the selection process. Further, to ensure the success of this decentralization process, it should become a part of the performance appraisal of the local management.

Traditionally, the success rate of print advertisements attracting good applicants is very low. Unusual initiatives like presentations in social functions in clubs and meetings are expected to be powerful. Live examples of a few highly successful agents could be given during the presentations. The selection of agents should include behavioural traits and analytical abilities.

Part-time agents: Most of the insurance companies have not fully leveraged on the potential of part-time agents. A large chunk of prospective agents cannot devote full time to the profession due to their existing engagements. These people have a wide social network which would enable them to get good business.

Growth and remuneration: The agents work primarily on the commission which is paid to them on the basis of annualized premium per policy. The percentage of commission varies from product to product. There is no fixed remuneration to them. The IRDA guidelines prohibit paying any compensation to agents. It makes the early career phase of the agents difficult as they generally do not get too many policies in that phase. There is a need to find ways of overcoming the early phase difficulties and revising the existing norms. More help could be extended by sales managers to agents in the early phase to make them learn ways to get business. However, socially networked agents find it relatively easy to get more policies from their networks. In reality, an average agent is able to sell one to two policies per month.

Agents could be trained to develop their competencies to get business in a continuously changing business environment. Freshly selected agents attend their first 100 hours of mandatory training as stipulated by IRDA. This training primarily consists of technical issues of insurance business. Agents could be trained on behavioural skills subsequently at different stages of their career with a company.

As agents are not the regular employees, they could not be extended traditional growth opportunities that exist for employees in a company. Agents aspire to have a regular employment and often quit the profession for want of regular jobs. To reduce the intensity of this problem, schemes could be launched to recognize the contributions in different stages of the career of an agent.

CONCLUDING REMARKS

At present, the insurance industry is in a nascent stage. With the liberalization and entry of private companies in insurance, the Indian insurance sector has started showing signs of significant change. Within a short span of time, private insurance has acquired 13 per cent of the life insurance market. However, there is still a huge untapped demand for insurance. The penetration of insurance still remains at low levels and a lot needs to be done to develop this sector.

It is against this backdrop that this colloquium discusses the issues in the development of the insurance industry during the post-liberalization period with the objective of understanding the various challenges it faces and focuses on the competition, structure, and performance of the companies in the insurance business.

S Krishnamurthy points out that the life insurance industry has shown extremely satisfactory results in terms of premium income and new policies sold but a huge potential still remains unexploited. Experience suggests that consumers still favour insurance as a saving tool for their wealth management which, in turn, puts the onus on the distribution channel to advise and educate the consumers. There is a need to change the perceptions of the Indian consumers towards pure term insurance/alternative products. The competitive and risk pressures in the industry call for multi-channel distribution footprint, technological advancement, quality of manpower, customized product offerings (for financially knowledgeable customers and OTC products for middle class and lower middle class segment), investment strategy, fund management, and acquisition cost in the initial years. The regulator is trying to play its role by amalgamating the efforts of the industry, actuaries, and accounting professionals, ensuring rigorous systems of internal controls to manage risk and complying with the regulatory and legislative requirements. There are many other problems (viz., retarded growth of health insurance, low awareness levels, adverse selection of risk, conservative approach of insurers, limited availability of data, inadequate infrastructure, and technology) that make it very difficult to assume that India is comparable at the global platform. Thus, the future of life insurance lies in increasing the pure protection products, a refreshing look at ULIP with rising protection components, and continuously improving service levels.

> The future of life insurance lies in increasing the pure protection products, a refreshing look at ULIP with rising protection components, and continuously improving service levels.

S V Mony reiterates that the insurance sector is expected to grow very fast. Stability of market is ensured through high capital requirements, tight solvency norms, and long lead time for returns and, due to this, the number of players is relatively small. Health insurance is not showing good results because insurers are cautious about the weaknesses in the health infrastructure and lack of reliable data; therefore, cross-sector initiatives are expected to produce tangible results. The cooperative sector and micro-credit organizations may help in increasing the penetration into rural areas by formulating low-cost policies and in the urban areas by improving customer service standards, documentation, IT support, etc. Expansion of the market through increased penetration calls for strategic discussions between the insurers and the regulators though the awareness has improved substantially. He argues that for rates/tariff issues, innovations are least possible until a free market rate regime with adequate safeguards is put in place by the regulatory body, IRDA, which has recognized the need to do so. In providing customer service, structural inefficiencies coupled with attitude problems and lack of transparency in claims handling are the reasons for dissatisfaction. On the part of distribution, intermediaries are made more professional by introducing requirements like minimum qualifications, mandatory training, and passing an examination before a license is issued; still there are no evidences to prove that the new age agents show a higher level of professionalism. There are many other problems associated with the agents, viz., continuously increasing drop-out rates, low productivity, income insecurity, social acceptance, regulatory limits, flexibility of ownership, and transferability of agency.

Nani Jhaveri suggests that the sale of insurance is driven more by demand side factors; even agents find it convenient to push insurance as a saving product to increase their margins. This is leading to a situation of underinsurance. Instead, agents should guide the consumers about the right product for them at the right time keeping in mind the long-term implications. Considering that different customers have different perceptions, there is a need for alternative channels of distribution, viz., walk-in customers, banks, internet, etc., and, the entire arsenal can be used to fulfil their demands. IRDA has significant challenges in ensuring the protection of the interests of the customers by regulating prices, training, products, procedures, and processes. India definitely has a considerable amount of potential if it ensures right products, right prices (by cross-subsidizing), appropriate channels of distribution, and right levels of protection for all Indian citizens. All this can be achieved by learning from the experiences and expertise of the foreign partners. This would also enable the domestic companies to continue shortening the learning curve.

Sandeep Bakhshi argues that de-tariffing the market would be logical after privatization. As the insurance products in India are push products, the drivers for growth are infrastructure development, retail consumption growth, increasing awareness and penetration of certain product categories, and innovative product offerings. The low penetration level in domestic market shows robust growth in the sector and thus an integrated approach is required to create awareness and enhance the reach through cost-effective distribution and product innovation. The growth could be possible in two ways: depth in existing product-market segments and width in new segments. Thus, multi-product, multi-channel, and multi-segment route may be followed for growth keeping in mind the complexities of the industry. The alternative distribution channels, viz., brokers, direct field force, telesales, bancassurance, alliances, and the internet with the conventional network of branches offer the customers a variety to choose from keeping in mind the maximum benefits they seek from them. The challenge lies with the insurers to take the industry to its next level of evolution.

Ramesh Bhat and M R Dixit discuss the experiences with a traditional agent-based model of insurance product distribution which is more focused, dedicated, committed, predictable, and relatively easy to manage. But, it reaches its saturation fast and has a high element of fixed cost. Banks can be potential partners in distributing insurance products through bancassurance. There can be two basic models that can operate, viz., corporate agency model and referral model. Bancassurance offers ready manpower, customer database, and relationship banking of the bank to the customers of banks making insurance a value-addition and thus in a way beneficial to both partners. However, the challenge of successfully implementing this lies in training the staff, integrating of the insurance products, and ensuring the best quality service by keeping the product design simple and seeing how well it integrates with the existing portfolio of products as insurance selling is different from direct selling. Other challenges include cultural differences, MIS issues, monitoring of the system, co-branding (leveraging on both the brands), and the difference in the pace with which targets are achieved and tasks are executed.

Bancassurance offers ready manpower, customer database, and relationship banking of the bank to the customers of banks making insurance a value-addition and thus in a way beneficial to both partners.

Sunil Maheshwari points out that the agents in the insurance sector in India are critical for the success of the organization. In order to gain competitive advantage, quality people are needed but this is a challenge. The quality of agents for the purpose lies in understanding the needs of the customer, analysing their financial status, and generating confidence among the potential customers. The turnover of insurance agents has traditionally been high in the business because of social stigma, difficult selling process, legal provisions, and expectation gap. To overcome recruitment difficulties, some suggested strategies include: recruitment at the local level, inviting those who have succeeded during the recruitment meetings and training programmes, and leveraging the full potential of part-time agents as they can operate in their closed social circles. To make the agents give their maximum, the remuneration system needs to be studied a little more in depth because they do not get fixed salary and it is very difficult for them to work full-time and survive in the initial years. Besides, they require training covering the technical and behavioural skills at different stages of their career. Also, for those agents who look for regular jobs in a company, schemes should be offered to recognize their contributions in different stages of the career.

"Hope" is the thing with feathers
That perches in the soul
And sings the tune without the words
And never stops at all,

And sweetest in the gale is heard;
And sore must be the storm
That could abash the little bird
That kept so many warm.

I've heard it in the chillest land
And on the strangest sea,
Yet never, in extremity,
It asked a crumb of me.

Emily Dickinson