CHALLENGES BEFORE INSURANCE INDUSTRY

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"Free Enterprise was born with man and shall survive as long as man survives".

— **A. D. Shroff**
1899-1965
Founder-President
Forum of Free Enterprise

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INTRODUCTION

Insurance has been under public sector for over four decades. Life insurance was nationalised in 1956 and by merging 245 Private insurance companies, Life Insurance Corporation (LIC) of India was formed. Similarly after nationalization of general insurance in 1972, General Insurance Corporation (GIC) was formed by merging 106 private insurance companies. GIC has four subsidiary companies.

When insurance industry was nationalised, it was considered a landmark and a further milestone on the way of the socialistic pattern of society that India had chosen after independence. The main objectives of the national insurance companies were to spread the message of insurance in every nook and corner of the country to improve quality of service to customers and to mobilise savings for the economic growth of the economy. It was expected that the

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* The author is a former Executive Director of Life Insurance Corporation of India. The text is based upon the keynote address delivered at a seminar on the subject as part of the late A. D. Shroff Birth Centenary Celebrations on 19th February 2000 in Mumbai under the auspices of the A. D. Shroff Memorial Trust, in association with Forum of Free Enterprise and the Indo-Japanese Association. Mr. Jha is also author of the book, "Insurance in India".

growth of the insurance business under public sector will be very fast and consumers will get insurance coverage at affordable prices.

However, the PSUs could not come up to the expectation of the customers. Policyholders' grievances started piling up against LIC and GIC. Hence Central Government appointed Malhotra Committee, headed by Mr. R. N. Malhotra, former Governor of the Reserve Bank in 1993 to review the working of the insurance industry and recommend steps to improve the working of the industry. Malhotra Committee submitted its report to the Central Government in January 1994 categorically recommending opening of the insurance sector to the private insurers — domestic and foreign — to the Indian insurance market. However it took over five years to build a consensus among the political parties on the issue of the insurance reforms.

The credit goes to the BJP-led Central Government which finally took a bold decision to open the insurance sector to the private insurers. The Insurance Regulatory and Development Authority (IRDA) Act 1999 enacted by the Central Government finally ended the monopoly of LIC and GIC over insurance business in India and has cleared the deck for entry of the private insurance in the year 2000 after getting the registration from IRDA, the regulator.

The Indian insurance industry was in the private sector during 1818 to 1955, then under public sector during 1956 to 1999 and now once again it has come under private sector in the year 2000. Hence the insurance industry has completed a full circle by now in quest of the cherished goal to provide insurance cover to every needy citizen in the country.

OBJECTIVES OF LIBERALISATION OF INSURANCE

The main objectives for opening up of the insurance sector to the private insurers as enunciated by Mr. Yaswant Sinha, Finance Minister, are :

(1) To provide better coverage to the Indian citizens.

(2) To augment the flow of long-term financial resources to finance the growth of infrastructure.

The above statement of the Finance Minister is a tacit admission that the public sector insurers have not succeeded in extending the insurance cover to all the needy people of the country due to various reasons. Hence this onerous responsibility now has been entrusted to the private insurers.

PENETRATION OF INSURANCE

LIC and GIC could not ensure very fast growth of insurance in India even in a long period extending over four decades. Hence the penetration of insurance is very low in India. The following indices as explained will indicate and support this contention.

(i) While per capita insurance premium in developed countries is very high, it is quite low in India. For instance, per capita insurance premium in India in 1999 was only \$8 while it was \$4800 for Japan, \$1000 for Korea, \$887 for Singapore, \$823 for Hong Kong, \$144 for Malaysia.

(ii) Similarly the penetration of insurance is also assessed by the ratio of the insurance premium to the Gross Domestic Product (GDP) in a country. While insurance premium as a percentage of GDP was 14% for Japan, 13% for South Africa, 12% for Korea, 9% for UK and France, it was only around 2% in India in 1999. Hence obviously the penetration of the insurance is low here.

(iii) The penetration of insurance is also assessed by a ratio of the insurance premium to the Gross Domestic Savings (GDS). While the insurance premium as a percentage of GDS was 52% for UK, 35% for other European and American countries, it was only 9% in India in 1999. Hence even this index indicates low level of penetration of insurance in India.

(iv) The share of India in World Market in terms of gross insurance premium is again very small. For instance while Japan has 31%, European Union 25%, South Africa 2.3%, Canada 1.7% share of the Global insurance premium, it is only 0.3% for India.

(v) In the sphere of Life insurance, only 25% insurable population of India estimated around 314 millions in 1999 have been able to get insurance cover. Such insurance cover in the developed countries of Europe and America has been extended to around 90 to 95% of the total population.

Hence the opening up of the insurance sector to private insurance has put a great responsibility on them to ensure a very fast growth of insurance so that India can come to the level of the developed countries of the world in the penetration of the insurance.

CHALLENGES BEFORE THE INDUSTRY

The new as well as the old insurers will have to face a number of challenges in the liberalised market.

(i) **New Insurers** — The new insurers will have to invest a minimum Rs. 100 crores as capital. The insurance business does not produce profit in the first five years. The generation of profit normally starts in the sixth year. Hence the new insurers will have to be ready for locking up the capital for 5 years without earning any profit. Besides they will face problems regarding shortage of the trained managerial cadres for insurance industry. Even the setting up of various offices and the distribution channel is a time consuming process.

Further the new insurers will have to compete with the established insurers like LIC and GIC which have created their corporate image over the years, have a big net-work of branches and agents, have a pool of experienced managers and vast financial resources. Further the life fund of the LIC will continue to be guaranteed by the government. Hence the new insurers will have to assure the policyholders about the safety of the life fund to win their confidence. The foreign insurers who will be the partners of the Indian Insurers will have expertise of the international market. It will help in establishing corporate image in the market. But foreign insurers lack experience and knowledge about Indian insurance market. That will be a handicap. The Indian insurers mostly will be from manufacturing industry and they may have some knowledge of the consumers for non-financial products. This may help in the marketing of the insurance products.

(ii) **Existing Insurers** — The existing insurers, LIC and GIC, have created a large group of dissatisfied customers due to the poor quality of service. Hence there will be shift of a large number of customers from LIC and GIC to the private insurers.

LIC may face problem of surrender of a large number of policies as they will be wooed by new insurers by offer of innovative products at lower prices. Even the corporate clients under group schemes and salary savings schemes may shift their loyalty from LIC to the private insurers.

There is a likelihood of exit of young dynamic managers from LIC to the private insurers as they will get higher package of remuneration. Further LIC has overstaffing and with the introduction of the full computerisation, a large number of the employees will be surplus. However they cannot be retrenched. Hence the operating costs of LIC will not be reduced. This will be a disadvantage in the competitive market as the new insurers will operate with lean office and high technology to reduce the operating costs.

GIC and its four subsidiary companies are going to face still more challenge. Their management expenses are very high due to surplus staff. They can't reduce their number due to service rules. Their management of claims is not upto the mark.

This will put strain on their financial resources. Further they have been depending upon the premium income of the corporate clients mainly and have not developed business in the personal line. There is a danger that GIC and its four companies will very soon lose corporate clients. Hence they are likely to be in real trouble.

Hence LIC and GIC have challenges to effect radical restructuring of the organizations so that they become more competitive, lean and may operate at low operating costs. However, the biggest challenge before LIC and GIC is the change of mindset of all employees from top to bottom so that they become more responsive to the customers and the market.

(iii) **Expectation of the consumers** — Today LIC has more than 60 products in its kitty. Even GIC has more than 180 products. But most of them are outdated as they are not suitable to the needs of the customers. Hence old as well as new insurers will have to offer innovative products to the consumers. The consumers are particularly awaiting good Pension Plans, Health Insurance, Term Insurance and Investment Products like unit-linked insurance from the life insurers. Similarly the customers expect innovative products from the general insurers for managed Healthcare, Property Insurance, Accident Insurance and other products related to the personal line of insurance.

The consumers also expect reduction in the premium of life insurance products as the mortality of the Indian life has improved three times in last 50 years. The prices of the existing life insurance products are much higher and there is scope of reduction of premium to the extent of 30% by the life insurers on the basis of improved mortality. However, it is possible only if the efficiency of the insurers improve considerably in future. Similarly there is scope of reduction of premium for fire insurance, which should be effected by the general insurers. The prices of all products of general insurance deserve reduction around 20% but it is possible only if the management expenses are reduced considerably by the existing as well as new general insurers.

Further consumers expect better yield on the life insurance policies. The existing yield on most of the life insurance policies is around 6% only, which is much lower than the yield in the market for other financial instruments. The rise in the yield is possible by more prudent management of the investment of the life fund and reduction in the management expenses.

Besides the consumers expect much improved quality of service in the liberalized market. At present policyholders are very much aggrieved by the sub-standard services of LIC and GIC particularly in the area of settlement of claims, issue of new policies, transfer of the policies and revival of policies. The new insurers will have to be more particular to meet this expectation of the consumers.

Hence the existing as well as the new insurers will have to meet all expectations of the consumer for innovative products, reduction of premium, better yield on policies and radically improved quality of service to the consumers.

(iv) **Distribution Channels** — In the liberalized insurance market there will be multidistribution channels, which will include agents, brokers, corporate intermediaries, bank branches, affinity groups and direct marketing through telesales and internet. Some channels will be cheaper than others. Hence there will be competition among the channels. The new insurers will operate with the help of the multi-distribution channels but the existing insurers may be forced to operate only with the help of Agents. Hence intense competition will grow among the old and new insurers in the market to win the consumers. This will pose a great challenge to the insurers in the liberalised insurance market.

(v) **Consumer Education** — The market very soon will be flooded by a large number of products by a fairly large number of insurers operating in the Indian market. Even with limited range of products offered by LIC and GIC, the consumers are confused in the market. Their confusion will further increase in the face of a large number of products in the market. The existing level of awareness of the consumers for insurance products is very low. It is so because only 62% of the Indian population is literate and less than 10% well-educated. Even the educated consumers are ignorant about the various products of insurance.

Hence it is necessary that the extensive plan for education of consumers should be undertaken by all the insurers. The consumer organizations and the media also can play very important role in education of the consumers. This will result in expansion of the insurance market and will also keep the needy consumers to purchase appropriate products.

(vi) **Consumer Grievance Redressal** — The insurers will have to face an acute problem of the redressal of the consumers, grievances for deficiency in products and services. IRDA has already appointed Ombudsman for looking into the grievances of the policyholders. His judgement will be binding on insurers. Further under Consumer Protection Act 1986, the consumer courts are operating at District, State and the National level. In the competitive market, awareness level of the consumers will increase and it will help consumers to fight for their legal rights for deficiency in services. Hence the number of legal cases filed by the consumers against insurers is likely to increase substantially in future. This will be a challenge to the insurers.

CHALLENGES FOR REGULATOR

Insurance Regulatory and Development Authority (IRDA) has twin roles — regulation as well as development. It is said that no game is possible without rules but too many rules spoil the game. Hence the regulator has to ensure a balance in the enactment of the regulations.

The insurance industry for its effective development needs fair competition. This has to be ensured. Further a large number of insurers with initiative, commitment and financial resources should be encouraged to enter the insurance market. The entry rules should be easy and simple so that compliance may be easier by the potential insurers.

The safety of the life fund will be a concern of the regulator. Hence a prudent solvency reserve should be enforced but at the same time it should be realistic. The regulator has to create an environment where insurers, consumers, intermediaries and other related groups can co-exist and operate for promotion of the insurance. The regulator has to give synergy to this operation.

Regulator should also put emphasis for development of certain niche markets which are in the interest of the consumers and may include pension market, health insurance market, rural insurance and insurance for weaker sections of the society.

Regulator should be perceived as an impartial authority to win confidence of all the concerned groups for achieving its objectives of regulation as well as development of Indian insurance.

FUTURE SCENARIO

The size of the existing insurance market is very large. It is also growing at the rate of 10% per year. The estimated potentiality of the Indian insurance market in terms of premium is around $80 billions (Rs. 3,44,000 crores) in 1999. Only 10% of the potentiality has been tapped by LIC and GIC and the 90% market potentiality is still fully intact.

This vast potentiality can be tapped only by a large number of insurers. To serve 100 crores of population, Indian insurance market can easily sustain about 100 insurers. Hence regulator should issue licences to a large number of insurers if the insurance market has to grow at a fast rate.

With the increase in the span of life and disintegration of the joint family system, each individual now has to arrange insurance cover for himself and for his family. Hence coverage of insurance, which is around 7% of the population in 1999, has to grow very fast. Infact all the citizens in the middle class estimated around 314 millions can afford insurance from their own financial resources. The remaining population has to be given subsidized insurance with the help of the government as well as the insurers.

The huge life fund can be utilized for financing the infrastructure industry as well as a support to other industries in the country. Hence insurance industry is likely to play a key role in changing the economic landscape of the country. However the success of the insurance industry will primarily depend upon meeting the rising expectations of the consumers who will be real kings in the liberalised insurance market in future.

"People must come to accept private enterprise not as a necessary evil, but as an affirmative good".

— Eugene Black

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