FDI in Insurance
For a Better Future!

Increasing the FDI ceiling will make the Indian Insurance sector more vibrant and dynamic in the intermediate and long term. Insurance companies and other players have to gear-up and plan now to reap the future benefits, says Harsha Kapoor, Managing Partner - Avizare Solutions, Gurgaon (NCR), India.

Highly saturated markets of US and Europe pose a great risk to growth for insurance companies in these regions. Growth of insurance sector is further constrained by the economic turbulence in these countries. In order grow in these regions companies are facing challenge to innovate and improve operational efficiency.

Alternatively, insurance companies from these regions have to look for newer markets beyond their traditional geographies. Brazil, India and China offer an identifiable opportunity with low penetration rates and relatively high economic growth rates. Though the opportunity is large in emerging economies, prospective entrants face multiple challenges in terms of complexity of markets, need for extensive distribution channel, competition from existing players, lack of trained personnel, regulatory changes et al.

With a huge population of 1.3 billion and low insurance penetration, India is a relatively large market for these insurance companies. Even a subdued 5-6 per cent GDP growth in India is preferable to almost negligible growth in most of the western economies.

Though foreign insurance players have been present in India for almost more than a decade and despite the double-digit growth, the sector is yet to witness the expected vibrancy and infusion of innovative products. One of the key factors is limited inflow of investment by foreign players due to cap on foreign direct investment (FDI) of 26 per cent. To make their investments in India relevant and worthwhile, most of the foreign players are looking forward to increase their share in their respective Indian ventures. Recent proposal by government of India to hike FDI ceiling from 26 per cent to 49 per cent is the next logical and expected step.

Life premium has grown at a CAGR of over 23 per cent during last decade and, is expected to grow at 15 per cent over next decade. This is bound to fuel demand for new products, new intermediaries and additional capital. There are various factors that will drive growth in the Indian Insurance market, some of the key drivers are:

Growth Drivers

- **Rising income & growth of middle class**

  Post liberalization reforms and growth in service sector has significantly increased the purchasing power of people. The income pyramid is changing with a large number of families entering into higher income group and much more families moving into middle-income group. Currently out of over 247 million households, 75 per cent comprises the humongous middle class. This would create new pockets of fresh demand for affordable and innovative insurance products and services.

- **Societal changes and urbanization**

  It's anticipated that by 2031, 40 percent of Indian population will reside in urban centers and there would be at least 10 cities with a population more than 140 million. This rapid urbanization and fast paced economic growth has significantly altered the family structures. The concept of joint family is fast diminishing in India, especially in urban India where during the last two decades average size of family has reduced to four from six. This trend will continue further where there is negligible dependency on extended family, more and more families are going nuclear way. As such these families would be increasing looking for adequate risk cover which in turn will further drive the demand for new insurance products and services.

- **Financial Sophistication**

  India has oldest stock market in Asia and the financial services market is quite evolved and relatively stable. In the recent years consumers are getting more comfortable in doing online business and are rapidly adopting internet as a way to do financial transactions. Riding on the success of online banking and e-commerce, Insurance companies are also exploring to leverage the online platform to reach and acquire new customers. While the companies can have a low acquisition cost, the prospective customers now have an improved access to information about various insurance products and services. Such information abundance and ease to buy insurance cover online would further increase the insurance penetration in India.

In order to woo new customers and increase their share of wallet from existing customers, companies have to offer latest and innovative products and services

Implications of FDI

At the end 2011, level of FDI in Insurance is pegged at INR 68bn, with FDI in Life Insurance and General Insurance at INR 57bn and INR 11bn respectively. It is estimated that after new ceiling of 49 per cent, this will increase six fold to INR 400bn by year 2020.

Such a quantum jump in foreign direct investment would have fairly wide and far reaching implications on overall Indian economy. Insurance is the only sector where people invest money with a long term view. Therefore, growth in insurance sector would promote long term investments especially in infrastructure sector. Infrastructure has become a big bottleneck in India growth story, long term funds would go a long way in alleviating the funding issues of this sector. Moreover, multiplier effect of infrastructure upgrade can boost other sectors of the economy too.

Implication for Insurance sector

'Smart' capital moving into insurance sector would expand the market by increasing insurance sector's reach and depth. Infusion of such smart capital will aid companies to expand their network by covering new geographic areas and bringing uninsured under the net. This growth in network will also result in increase in intermediaries and agents thus generating multitude of employment opportunities across the sector.

In order to woo new customers and increase their share of wallet from existing customers, companies have to offer latest and innovative products and services. This capital would also enhance the risk-taking appetite and would promote long-tailed products in the market. Flow of foreign funds will also be accompanied by transfer of world class know how and technical expertise. These changes would further drive the competition among companies and in general make the sector more vibrant. From customer point of view, increased competition will result into wider variety of products at a better price.

On the life side, it would positively impact the new players and players that are yet building their portfolios. This capital infusion would help them to introduce new products and write more policies. Already established and existing players may not benefit much from FDI and at the same time they would have to be ready to handle more competition.

In general insurance, the sector may see advent of new companies launching new innovative and low priced products. This would also result in development of new channels, intermediaries and increased usage of web based platforms to reach new customers. Existing players would have to redefine and refine their pricing strategies to overcome the increased competition.

While the sector is going to witness increased competition and rise in underwriting of new policies, players would have to tighten their belts and prime up their risk management practices and underwriting guidelines.

Way forward

Insurance sector is set to enter into a new and vibrant phase that would be characterized with increased competition and pressure on margins. Companies need to gear up and prepare themselves for a better future. They have to:

- **Shift focus to untapped markets**

  India is an under penetrated market, there exist plenty of growth opportunities that have to be explored and tapped. Given the vastness of India and diversified choices of Indian consumers, it's almost impossible and imprudent to target the entire geography in one go. Challenge is not only to acquire customers, but also to manage and retain the distribution and channel partners given the scarcity of skilled resources. Companies have to adapt scientific approach of deploying micro-market strategy for identifying high potential and profitable markets. To get a better and granular understanding of opportunities, companies have to carefully research and analyze host of internal and external data, like their own policy issuance data, demography, consumer buying behavior, other service providers data, asset ownership and so on. Once the company is equipped with this granular information on micro markets they can identify and target most lucrative and profitable market.

For example, when a new broking company focusing on health insurance started their operation in India, they were faced with a daunting task to target most profitable customers. Soon they realized that they have to embrace an approach of targeting that is cost effective and yet yield significant results. They collected detailed information at city/district level on all health providers, demographics characteristics, infrastructure, occupational or employment characteristics and buying behavior of households. They then applied advanced analytical techniques to generate a unique city level hotspots map that gave them a detailed view to size and determine the market opportunity for their products and services. Using that hotspots map and detailed view of consumers, they were able to identify what cities to focus on and most importantly what cities or geographies to avoid. Thereafter, they designed their entire marketing and sales plan and other campaign activities to target most profitable consumers. The company was not only able to save significant cost, but they were also quick to hit the market and achieve quick success.

- **Innovate on products and services**
  Indian customers are getting more aware and are increasingly looking for customized products and services. Companies should smartly use predictive analytics to identify latent and untapped needs of the customers; and innovate on products to increase their market share.

  For example, a general insurance was long struggling to make its hold into the market and gain a respectable market share. In past they used all traditional techniques like premium discounting and mass campaign to acquire customers. However, they realized that this approach has significantly impacted their profitability, quality of risks underwritten and growing disloyal customers in their portfolio.

  Starting from scratch, company analyzed all their past policy and claims data using advanced analytics. They discovered a small but promising customer segment among small & medium enterprises that have a unique need to insure all their assets altogether. Also that segment had a limited knowledge on how to optimally manage their diversified assets. The insurance company then designed a unique product for SMEs to insure their entire assets and facilities through one policy. The company also deployed knowledge advisors and experts to help SMEs to manage their assets efficiently and effectively. This innovative product and service resulted in company acquiring and retaining a profitable customer segment.

- **Achieve operational efficiency**
  An agile and efficient operation is necessary to cater to future growth and outsmart competition. Companies should plan now to fine tune their distribution network, have a right mix of channel partners, optimize back-end operations and streamline their claims processes.

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  One of the old insurance companies offering motor insurance was faced with increasing competition from new entrants, rising operational cost and growing customer complaints related to claims. To overcome this challenge they leveraged mobile technology to streamline their claims operations and provide better service to their customers.

  They devised an approach where customers have to just send a text message to their central number informing about the accident. This was followed by series of text messages to the customer mobile, which they have to answer as yes or no. Their sophisticated rule-based backend system would then analyze the responses of customers and decide on next steps in terms of whether to send road assistance, medical help and/or a team of surveyors to ascertain the extent of claim. While this approach helped the company to reduce its operational cost, it also helped company to gain market share as consumers felt that there is a tremendous value in their offering.

- **Strengthen risk management practices**
  With growth comes the challenge of writing good and profitable business. Insurance companies have to further strengthen their risk management practices with a special focus on underwriting and operational risk.

  When a leading European insurance company took stake in an Indian insurance company, first thing they did was to review the risk management practices of the Indian company. To their surprise, they discovered several issues especially in operational risk. Though the issues were trivial, however each had a potential to blow into a major issue and could have affected foreign partner's credibility and reputation in their home geography. In order to handle the situation in time effective way, company introduced a small set of well-designed operational matrices covering their key executives and processes. These smart matrices provided the company with one view to identify and manage potential issues that may go unnoticed otherwise.

Future perfect!

Increasing the FDI ceiling will make the Indian Insurance sector more vibrant and dynamic in the intermediate and long term. Increased competition coupled with wider variety of products will result into a healthy Industry. Insurance companies and other players have to gear-up and plan now to reap the future benefits. TGA

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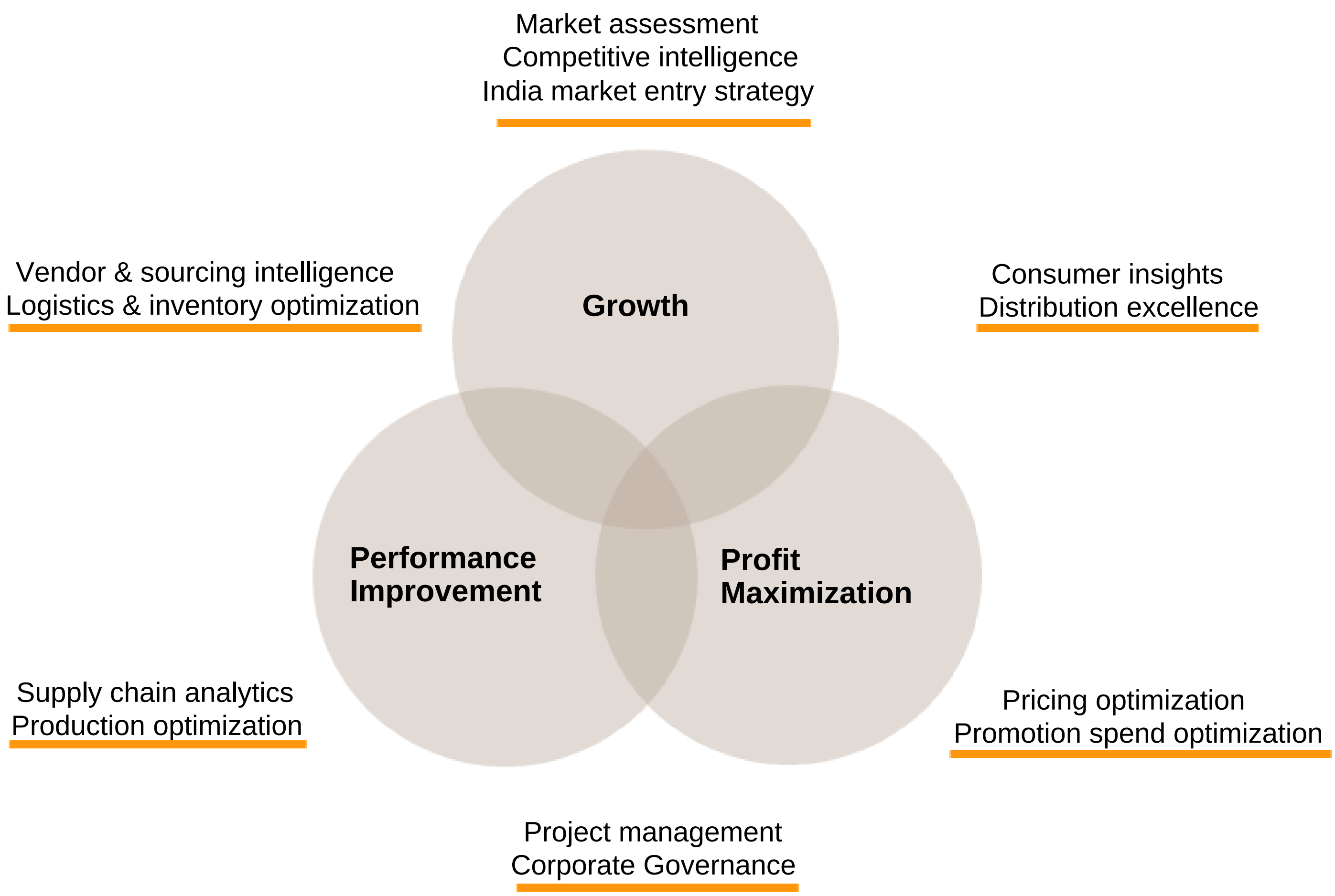

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