

India Life Insurance 2012:
FORTUNE FAVOURS THE BOLD

A Summary



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All factors are in place for the Indian life insurance industry to blossom into one of the fastest growing financial services markets in the world. The still nascent market is at an inflection point—rising incomes driven by economic growth are boosting demand, and increasingly sophisticated consumers with differing needs are driving some differentiated plays. For companies wanting to address this opportunity, a “me too” approach will prove insufficient. To emerge as winners, they must re-examine their strategies and commit to a few bold, breakthrough approaches. This will not only put them in pole position in the race for customers, but will also help them build sustainable and profitable businesses.

STRONG GROWTH AND PROFIT POTENTIAL FOR INDIA'S LIFE INSURERS

India's life insurance market has grown rapidly over the past six years, with new business premiums growing at over 40 per cent per year. This impressive growth has been driven by liberalisation of the sector, that enabled the entry of a host of new players with significant growth aspirations and capital commitments. These players have contributed to the sector's development by significantly enhancing product awareness, promoting consumer education and information, and creating more organised distribution channels.

But the market is still at a nascent stage in its evolution. The ratio of life insurance premium to GDP in India is currently about 4 per cent, much lower than developed market levels of 6 to 9 per cent. In several segments of the population, penetration is lower than potential. For example, in urban areas, penetration of life insurance in the mass market is about 65 per cent, and it is considerably less in the low-income unbanked segment. In rural areas, life insurance penetration in the banked segment is estimated to be about 40 per cent, while it is marginal at best in the unbanked segment.

This will change as India sees strongly accelerating household income and a more favourable demographic profile over the next two decades. According to a recent McKinsey Global Institute (MGI) study - *The Bird of Gold: The Rise of India's Consumer Market*¹, aggregate real household disposable income is expected to rise at 5.3 per cent annually—significantly more than the 3.6 per cent annual growth over the past two decades. This income growth will make India's households substantially richer and also affect income distribution. As India's per capita GDP grows, so will per capita penetration of financial services. This will accelerate insurance penetration and per capita coverage.

Our research suggests that the Indian life insurance industry could witness a rise in the insurance sector premiums to between 5.1 and 6.2 per cent of GDP in 2012, from the current 4.1 per cent. Total market premiums are likely to more than double during this period from about US \$40 billion to US \$80 - 100 billion, implying a higher annual growth in new business Annual Premium Equivalent (APE) of 19 to 23 per cent from 2007 to 2012. Such exponential growth is likely to be fuelled by the following factors:

- Greater insurance intensity per capita, as the average per capita income increases. The emergence of a larger insurable population with a greater appetite to purchase protection products is likely to drive increase in per household insurance premiums from about Rs. 1,300 to Rs. 3,000 - Rs. 4,100 by 2012.
- Broader and inclusive coverage, with the emergence of newly bankable households in significantly large numbers and considerable supply-side growth. Both these factors will augment penetration in urban and rural areas. Rural penetration is likely to increase, from about 25 per cent at present to 35 - 42 per cent in 2012, and penetration in the low-income segment in urban India will rise from 30 per cent today to 35 - 40 per cent in 2012.
- A more balanced, sustainable and annuity-based business profile as life insurance players adjust their product mix by reducing share of single premiums from about 48 per cent currently to between 35 and 40 per cent in 2012.

¹The study assumes that GDP will grow at 7.3 per cent per year for the next two decades in the base case scenario

- Adding to the growth driven by sheer economics is the demand for long-term savings and investment products—a gap met by insurance for the Indian consumer. McKinsey's proprietary consumer-oriented market research (covering both recent buyers and intended insurance purchasers across 12 cities) indicates that consumers have an unmet need for long-term savings products, and a preference for insurance vis-à-vis other investment products. Consumers rank life insurance higher than other investment options because of its ease and convenience in investing, tax benefits, and protection. Among all financial products in India, life insurance enjoys the highest popularity and demand. Contrary to the conventional directly correlated risk–return relationship, Indian consumers perceive life insurance as a low-risk and high-return investment—a perception driven by high awareness of the Life Insurance Corporation of India (LIC) and its record of delivering stable returns over the years.

Based on the above demand and supply factors, we created an economic model for the Indian life insurance industry till 2012. The model combines macroeconomic variables such as GDP growth, income distribution and savings rates with variables specific to the insurance industry such as penetration rates and share of investible surplus allocated to insurance. As evident, we have forecasted the evolution of the industry under two potential scenarios—base case and upside—varying with the potential growth in insurance penetration by income segment. Based on these forecasts, we see potential for the life insurance industry to grow strongly in volume, fulfil its economic and social role, and generate attractive profits.

MULTIPLE MARKETS EMERGING, NEEDING DISTINCT APPROACHES

As the Indian life insurance sector more than doubles from a US\$40 billion premium market to an US\$80 billion to US\$100 billion premium market, it will become more complex and layered. We anticipate new distinct consumer segments with different needs, the rising importance of significantly wider reach, and competitive dynamics such as the emergence of new business models from some competitors changing the game.

New distinct consumer segments due to dramatic demographic shifts

Rising income levels and dramatic demographic shifts will lead to the emergence of distinct consumer segments that need to be served in fundamentally different ways. Our research reveals that the following consuming classes are likely to emerge by 2012:

- **Rising affluents.** The affluent “globals” (annual household income greater than Rs. 10 lakh) will be 2.3 million households strong by 2012 and will earn almost 12 per cent of the country’s aggregate disposable income. Going forward to 2025, this segment will swell to 9.5 million households earning 22 per cent of total disposable income. This segment has a relatively low need for risk protection, being self-insured with high investment balances. Insurance is viewed primarily as an investment vehicle and an estate management tool. Primary influencers for this segment are wealth or relationship managers, rather than insurance agents, as the former also provide third-party investment products, brokerage, and other advisory services.
- **Growing middle class.** The middle class, comprising “seekers” (annual household income of Rs. 2 to 5 lakh) and “strivers” (annual household income of Rs. 5 to 10 lakh) will grow to 16 per cent of the population or 37.7 million households by 2012. In this segment, insurance is used largely for tax planning, retirement planning and savings, as well as for risk protection for the higher income professional class. While attractive, this segment is seeing intensifying competition, as most players are focusing on it to build volume.
- **Newly emerging bankable class.** At the lower end of the pyramid, the “aspirers” (annual household income of Rs. 90,000 to 2 lakh) will comprise 46 per cent of the population or 107.7 million households by 2012, representing a formidable emerging bankable class. In this segment, insurance is used for long-term savings, providing higher return at low risk, given the lack of alternative investment options. Key challenges in this segment are managing profitability due to low ticket sizes and high underwriting risk.

Larger set of urban centres and rural towns become attractive

India’s urban population will increase from 318 million to 375 million, between now and 2012 and nearly double by 2025. And it will grow beyond existing big cities, into second- and third-tier cities and small towns. Based on MGI forecasts, 26 Tier 2 cities (with population greater than 1 million) and 33 Tier 3 towns (population greater than 500,000) will account for 25 per cent of the middle class and newly bankable class in 2025. Over 5,000 Tier 4 small towns will account for as much as 40 per cent of these two classes in 2025. For those insurers hoping to take advantage of the middle class growth, entering a large number of lower tier towns is an imperative. Those wishing to target the global segment exclusively, of which 60 per cent is likely to be in the top 8 cities, can plan a limited footprint by identifying niche markets and expanding to suburbs

of mega-cities. Although these consumers will be highly accessible, players will have to reckon with intense competition that is only going to increase and extend to other segments as well.

Although incomes will grow faster in urban areas, India's rural areas will not be left behind. Rural income growth will accelerate from 2.8 per cent annually, the rate of growth of the past two decades, to 3.6 per cent over the next 20 years. By 2012, about 10.3 million rural households (with annual household income greater than Rs. 2 lakh), will control more than 22 per cent of the total rural consumption, and their numbers will swell to 43 million by 2025, controlling about half of total rural consumption.. Many of these households will, for the first time, start spending on discretionary products and services. While potential will be massive, per capita ticket sizes will be low, and rural consumers will be dispersed throughout the country. Life insurance players will need to understand their needs, design products to match them, and create distribution models to reach a highly fragmented consumer base while being cost-effective. Given regional variations, life insurers will also need to carefully choose areas they want to target.

KEY CHALLENGE: CURRENT BUSINESS MODELS TRADITIONAL AND UNDIFFERENTIATED

India's life insurance market has grown rapidly from 2001 to 2007. New business premiums have grown at the compounded annual growth rate (CAGR) of 41 per cent, and combined total premium growth has been around 28 per cent per year over this period. But while this growth is impressive, the industry is still at a nascent stage. While players are at different stages of development and market presence, their strategies and business models are largely "one-size-fits-all": low-margin single-premium policies and ULIPs have mainly driven premium growth, and the distribution models are still fairly undifferentiated. Over the next few years, life insurance players need to overcome key challenges to create a winning proposition.

Need to strengthen core product proposition

While life insurance premiums have grown over the last few years, low-margin single-premium products and potentially volatile ULIPs have accounted for most of the growth. These products have proven easier to sell, but focusing exclusively on these could impair growth and long-term profitability for India's life insurers. Single-premium policies doubled their share of overall industry new business premium (NBP) from 24 per cent in 2005 to 48 per cent in 2007. With low charge

structures, single-premium product profitability is marginal. Unit-linked policies accounted for as much as 49 per cent of NBP in 2007, a substantial increase from 9 per cent in 2004. The total non unit-linked (and hence long-term) investible asset base of the Indian life insurance industry as a percentage of GDP is only 16 per cent, against 40 to 70 per cent in developed European markets such as the United Kingdom and France. Life insurers should learn from the example of more developed markets, where, as customer awareness increased, tax advantages eroded or stock market conditions turned unfavourable, life insurance premiums moved into other, more cost-effective or better managed, investment classes. For example, in the United States, the insurance industry's market share of life and pension assets under 401(k) plans fell by 34 percentage points (from 44 to 10 per cent) between 1998 and 2004, with asset managers grabbing the bulk of assets under management.

Opportunity to professionalise the agency channel

As in many markets, the agency is the dominant sales channel for Indian life insurance, accounting for over 85 per cent of new business premiums. In India, the life insurance agency force has grown at a rapid pace, from approximately 1 million in 2000 to close to 1.9 million in 2007. Overall inactivity and attrition rates are estimated to be 50 to 55 per cent, which is significantly higher than global benchmarks of about 25 per cent. With recruitment aimed at just growing the base, productivity has suffered.

Our proprietary survey of Indian life insurance agents in eight cities indicates that agent recruitment strategies have generally failed to make appropriate selections; about 20 per cent of agents recruited fail certification and/or leave immediately after initial training, without selling a single policy. More than two-thirds of agents, part-time and full-time, have had no selling experience before becoming agents. As a result, they join as untrained resources and much of their performance depends on the training and supervision they receive on the job. While many agents, about 70 to 80 per cent, say they undergo sales and product-related training, this does not seem to translate into superior sales skills. Agents with two and three years' experience are not more productive than agents who are just one year into the job. This is because unit managers usually focus only on tenured and higher performing agents. Only 30 per cent of agents surveyed felt that their unit manager motivates them to perform better.

Furthermore, agents appear to spend their time unproductively, with two-thirds of agent time spent in non-selling activities, such as customer identification, policy issuance, after-sales service, and administration. 50 to 55 per cent of agents

are usually inactive, failing to meet minimum standards set by the company. This leaves just 25 to 30 per cent of active agents, who remain with the company for three years and sell at least one policy per month.

Scope to boost alternate channels

Of all non-agency channels, bancassurance is more acceptable to Indian customers for buying insurance than are non-bank finance companies, brokers, or direct channels such as the telephone or internet. Given the high penetration of banking products, bancassurance could be the single most important channel for insurers to rapidly acquire new customers. However, cross-sell rates in Indian banking are significantly lower than those in developed markets. In Spain, Italy and France, between 12 and 24 per cent of a bank's customers would have bought insurance through the bank. In India, this number is estimated to be less than 0.5 per cent for public-sector banks, 1 to 2 per cent for private-sector banks and 2 to 4 per cent for foreign banks. Indian bancassurance faces several challenges. Bank employees have high variance in selling skills, and banks in the public-sector typically face low operating flexibility in creating a true sales culture. Insurers usually do not invest in systematic training, a problem compounded by product complexity. In many cases, low technological capability and lack of process integration also results in poor service.

Untapped opportunity in health and pensions

Life insurance players have only just begun addressing areas beyond traditional life products. There is an untapped opportunity in health insurance and pensions, where life insurance players so far have no meaningful presence:

- **Health insurance.** Currently, only around 14 per cent of the population is covered by health insurance of any form, of which only about 15 to 20 per cent is covered through health insurance provided by insurance players. As a result, only about 1.5 to 2 per cent of total healthcare expenditure in India is covered by insurance players. Further, adjusting policy size for purchasing power parity shows that health insurance in India is about one-fifth the size of that in countries such as the United States, Germany and South Africa.
- **Pensions.** According to the Old Age Social and Income Security (OASIS report, 1999)², there will be 113 million Indians over 60 years of age by 2016 and

² Project OASIS was initiated by the Ministry of Social Justice and Empowerment, Government of India, to examine institutional mechanisms for old-age security and recommend actions for the government.

179 million by 2026. For this segment, longevity risks are on the rise—as advanced healthcare has improved life expectancy, it has also increased the risk that people will outlive their savings. Indians will have an expected lifespan of 80 years, i.e., live a full 20 non-earning years. Healthcare costs have outstripped general inflation, eroding retirees' purchasing power. Savings and investment risks are intensifying, with rising inflation or steep market declines. Barely 10 to 11 per cent of the estimated working population in India, however, is covered by formal old-age social security mechanisms.

BREAKTHROUGH APPROACHES IN FOUR AREAS

The industry is at a turning point in growth and sophistication. Intensifying competition and the growing presence of players hungry to build a meaningful presence are changing the game. The incumbent LIC has continued to hold its leadership position in terms of market share and is competing with new aggression. The two largest life insurers after LIC account for nearly 50 per cent of the non-LIC market share, while the third largest player has more than doubled its market share from 5 per cent in 2004 to 11 per cent in 2007. While their presence is still dwarfed by LIC, the largest of the private-sector players have written 1.7 to 1.8 million policies in over 550 locations across the country. Significantly, these players are entering second- and third-tier towns, and even rural areas. Meanwhile, smaller private-sector players are hungry for a larger slice of the pie, and a slew of new players intend to enter the market. Some new entrants, from industries experiencing discontinuous growth such as telecommunications or retail, have the mindset and capabilities to scale up rapidly. These players are planning to introduce new distribution and service models that could fundamentally alter buying behaviour and change the basis of competition, for example through the “shopassurance” model or leveraging a vast telecommunications franchise.

Faced with such rapidly intensifying competition, along with an evolving consumer base, we see the need for India's life insurance players to develop bold, new approaches in several key areas: differentiated strategies for core market segments; distribution excellence; operational efficiency and capturing untapped demand in health insurance and pensions.

Three core market segments require differentiated strategies

Life insurance companies have an opportunity to create targeted and tailored offerings for different segments, building a different business model and even

a different brand for each of the three core segments of the market, as described below.

“Financial advisor” to the high net worth customer. To better serve high net worth individuals, life insurers could deploy a high-quality, specialised sales force, offer comprehensive financial advice and a broad product range (including third-party products) coupled with tailored products for specific sub-segments, and set up a separate unit to serve these customers.

Tailored product and distribution model for low-income urban groups. Life insurance players could build a non-traditional, profitable business with a separate range of simple products, minimal documentation, and low-cost, highly productive affinity-group-based distribution.

Partnerships across a disaggregated value chain for the rural population. A successful model can be built for rural markets comprising a broad, bundled product suite of microinsurance, microcredit, savings, and other similar products, using partnerships and alliances for extensive consumer access and the infrastructure needed for distributed servicing.

Distribution excellence will determine success

Success for Indian insurance players will hinge on achieving excellence in distribution by raising agency productivity while simultaneously exploring new models in non-agency distribution.

Transforming the performance of the agency force would require a comprehensive program to enhance professionalism, spanning the entire agent lifecycle. This would entail initiatives such as optimising network configuration to plan the agency footfall based on the potential of each micromarket and driving individual agent performance based on market potential, rationalising agent time allocation, moving to more sophisticated sales tracking, agent support and compensation systems.

As they craft their bancassurance models, life insurance companies should ensure significantly stronger sales support, seamless integration of systems and processes between insurance company and bank partner, and simple, over-the-counter products. Finally, some Indian insurance companies may want to consider a telephone and internet-based direct model. This will require skills such as pricing and designing for risk, sophisticated process management to provide a convenient and hassle-free customer experience and straight-through processing with minimal human intervention.

Operational efficiency becomes important as scale increases

Life insurance players in more mature markets have realised significant value from aggressively pursuing operational efficiencies. We believe some of India's life insurance players have reached the scale at which operational efficiencies do matter, and that such efficiencies will increase in importance in the future. There is a substantial opportunity to enhance core profitability by redesigning products and operating processes that affect life insurance economics. Some product ideas for the Indian life insurers are increasing ticket sizes and tenures of policies, bundling high-yield additional products with high-volume, low-profit policies and adopting a design-to-cost approach in new product development.

Further, Indian life insurance companies should explore a range of tactical actions to improve persistency ratios, such as active CRM programs, incentives to agents for retention and disincentives for lapse, and well-orchestrated, centrally driven programs to promote retention. Finally, a systematic evaluation of end-to-end processes—product development, marketing and sales, underwriting, policy processing and IT—coupled with rigorous benchmarking have resulted in savings of up to 40 per cent in life insurance operations around the world.

Capturing the health and pensions opportunity profitably

In the absence of government-funded health insurance and state-sponsored pensions (excepting those for government employees), we believe there is a huge opportunity for individual player-led health insurance and pension offerings in India. While there are obstacles and risks, life insurance players could focus on the following opportunities in the largely untapped markets:

- **Selective, risk-focused play in health insurance.** The Indian health insurance market is in its infancy, with only around 2 per cent of total healthcare expenditure covered through insurance products. We expect the health insurance market to grow significantly, driven by both increased supply and demand, but some critical challenges will have to be overcome. These include poor standardisation of treatment costs across providers, a lack of data for risk management and product design, untested demand from the individual segment, and limited bargaining power of health insurance players with providers. To tap the large potential while overcoming these challenges, life insurance players should adopt an approach that balances risk with growth by focusing on careful risk pooling and appropriate pricing. Opportunities that are relatively easier to address include the mass urban affluent segment in the individual market and service sector corporations in the group market.

Life insurance players could initially focus on these segments and develop specific strategies for them.

- **Systemic reform and individual player innovation in pensions.** India will need to provide for an ageing population in the medium term with barely 11 per cent of the estimated working population in India eligible for formal old-age social security benefits. Only a few very first steps have been taken in Indian pension reform and there is a long journey ahead. India's policy-makers need to leverage learnings from other countries to improve retirement benefits to those under the pensions net, and also explore creative options to bring more people from the unorganised sector into retirement schemes. Life insurance players need not wait for government policy changes to innovate in offerings that boost penetration of pension products in the segment that voluntarily buys pension, annuity or any form of long-term retirement savings products. Here, life insurance companies need to build capabilities that position them well against asset managers and banks. They can do this by developing more innovative retirement-focused products, creating branded wrap-like solutions on an open design basis, and positioning themselves explicitly to clients as retirement-focused advisors.

IMPLICATIONS FOR INDIA'S LIFE INSURERS

We have described a range of new models, spanning the entire business system, for life insurers to capture a greater part of the rapidly growing Indian life insurance market. Some initiatives are “must-dos”, others involve an explicit choice on whether or not to strike out in a new direction. How insurers make these choices and to what extent they commit to new models, depends on their starting position and aspirations.

Multi-specialist model for large players

Large-scale players such as the incumbent LIC and the larger of the private life insurers already have a sufficiently large presence and operations in key segments and geographies. They are in a position to adopt a “multi-specialist model”, i.e., evolve into broad organisations comprising dedicated business groups, organised to serve high-potential customers and channels, with a differentiated model for each. These players are well positioned to pursue most of the new initiatives we have outlined. However, as they do so, they will need more leadership and an innovative approach to managing organisational complexity.

For instance, in developing multi-product offerings, these companies will need to ensure that low-skilled salespeople do not lose focus on the core insurance product, and that supporting platforms (for service delivery, operations, etc.) are aligned across diverse products and channels to a customer-centric front-end. They will also need to manage conflicts arising from multiple, related entities targeting the same pool of customer assets, for example, in the case of an asset management company, a wealth management unit and a life insurance company that are all part of one universal banking group.

Focused play for smaller players and new entrants

The priority for smaller companies is simpler, but more urgent. They must achieve volume and build scale rapidly because most of them are operating below optimal scale and find themselves at an increasing competitive disadvantage. If this widening gap with large-scale players is not bridged, the small players will face increasing structural barriers to growth, particularly on distribution, and fewer degrees of freedom in pricing and cost management. To combat pressure from large players, small companies will need to consider one of the following approaches:

- **Distinctive segment or channel-specialist strategy to penetrate select spaces:** Focus on one or two customer segments, adopting a tailored approach for deep penetration or build a high-quality and profitable book by becoming a channel specialist, e.g., bancassurance or direct-only player.
- **Supply-side innovator strategy to grow rapidly in the traditional model:** Develop and refine a best-in-breed approach to managing talent constraints - creating a large, readily accessible pipeline of agents, and managing attrition and productivity better than competitors, or introducing a new distribution alliance strategy to overcome bottlenecks in organic distribution growth.

Making bold choices has never been more important for life insurance companies in India. India's life insurers would do well to reflect on the old adage "*Fortuna fortes adiuvat*"—Fortuna, the Goddess of Luck, is most likely to help those who move decisively to capture the opportunities ahead.

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